

Authors

Thomas J. Cunningham
312-443-1731
tcunningham@lockelord.com

Simon A. Fleischmann
312-443-0462
sfleischmann@lockelord.com

John F. Kloecker
312-443-0235
jkloecker@lockelord.com

Sally W. Mimms
312-443-0349
smimms@lockelord.com

Robert T. Mowrey
214-740-8505
rmowrey@lockelord.com

Julie Webb
312-443-0404
jwebb@lockelord.com

www.lockelord.com

This *Client Alert* is provided solely for educational and informational purposes. It is not intended to constitute legal advice or to create an attorney-client relationship. Readers should obtain legal advice specific to their enterprise and circumstances in connection with each of the topics addressed.

If you would like to be removed from our mailing list, please contact us at either unsubscribe@lockelord.com or Locke Lord Bissell & Liddell LLP, 111 South Wacker Drive, Chicago, Illinois 60606, Attention: Marketing. If we are not so advised, you will continue to receive *Client Alerts*.

Attorney Advertising

© 2010 Locke Lord Bissell & Liddell LLP

Litigation Over the Reduction of Home Equity Lines of Credit: *Hickman* and Beyond

Over the last several months, borrowers have filed a number of lawsuits challenging lenders' decisions to reduce the limits on their Home Equity Lines of Credit, or "HELOCs." In many of these actions, the borrowers seek to bring their claims on behalf of a national class of similarly situated borrowers.¹ Creditors and their assignees have uniformly moved to dismiss these complaints pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b).

Courts are just beginning to consider what is required to state a claim in these actions. This article will briefly summarize the handful of opinions considering these complaints, and discuss how the decision issued by the Honorable Amy J. St. Eve of the United States District Court for the Northern District of Illinois on January 26, 2010 adds to this developing legal landscape.

Types of Claims Asserted by Borrowers

The complaints in the recent HELOC cases typically assert causes of action for violation of the federal Truth in Lending Act, 15 U.S.C. 1601, *et seq.* ("TILA"), and state law claims for breach of contract, unjust enrichment, and violation of the forum state unfair practices act. The cases often arise when the creditor or its assignee has reduced the plaintiff's credit limit due to a significant decline in the value of the property, or due to a change in the borrower's circumstances and ability to repay the loan.

Plaintiffs generally argue that the automated valuation models or "AVMs" used by lenders in making decisions to extend or modify HELOC limits are unreliable and are not permissible under TILA. Plaintiffs may also assert in a conclusory fashion that the value of their property did not, in fact, decline significantly. In only a few cases do plaintiffs allege that they obtained a conflicting appraisal or that they have any other reason to suspect that the value of their property did not experience a significant decline.

In addition, some plaintiffs have challenged the notice given to them as insufficient under TILA,

and have argued that requiring them to pay a set annual fee during the period that their credit lines are reduced or suspended is a breach of their mortgage agreement.

While the plaintiffs in these actions seek to bring their claims on behalf of a national class, to date no motions for class certification have been filed.

The Law Governing Reductions in Home Equity Lines of Credit

TILA and its implementing regulation known as Regulation Z, which govern the administration of HELOCs, permit a creditor to reduce a borrower's credit limit where there is a significant decline in the value of the property securing the line of credit or a material change in the borrower's financial circumstances. 15 U.S.C. §§ 1647 (c)(2)(B), (C); 12 C.F.R. §§ 226.5b(f)(3) (vi)(A), (B). The Federal Reserve Board of Governors has issued binding commentary on the regulations that implement these sections of TILA. See 12 C.F.R. Part 226, Supp. I; see also *Ford Motor Co. v. Milhollin*, 444 U.S. 555, 565 (1980) (holding that "Federal Reserve Board staff opinions construing [TILA and its implementing regulations] should be dispositive" unless "demonstrably irrational").

The commentary discusses what constitutes a significant decline for purposes of the reduction of lines of credit, indicating that whether or not a decline is significant "will vary according to individual circumstances." 12 C.F.R. Part 226, Supp. I, cmt. 5b(f)(3)(vi)-6. Due to the inherent ambiguity of a rule that relies on individual circumstances, the commentary provides a safe harbor for creditors. Where a borrower's available equity in a property has declined by fifty percent, the decline is significant under the statute and the credit limit may be reduced. 12 C.F.R. Part 226, Supp. I, cmt. 5b(f)(3)(vi)-6. The fifty percent threshold is a safe harbor; Declines of fifty percent or more are significant as a matter of law. But a decline of less than fifty percent may also be significant depending on the circumstances. Many homeowners do not understand that the significant decline inquiry focuses on their *available equity* rather than the

value of the property alone. Thus, even small reductions in the value of the property may constitute significant declines under TILA if the borrower's available equity was not very large to begin with. See, e.g., *id.*

Guidelines on handling reductions in credit limits issued by the Federal Deposit Insurance Corporation expressly contemplate a creditor's use of AVMs in determining whether a significant decline in value has occurred. See FDIC FIL-58-2008, "Home Equity Lines of Credit Consumer Protection and Risk Management Considerations When Changing Credit Limits and Suggested Best Practices," 2008 WL 2552743, *3, 5 (June 26, 2008). TILA "does not require a creditor to obtain an appraisal before suspending credit privileges, although a significant decline must occur before suspension can occur." 12 C.F.R. Part 226, Supp. I, cmt. 5b(f)(3)(vi)-6.

Where a creditor decides to reduce a borrower's credit limit for any of the permissible reasons set forth under TILA, the creditor must give the borrower written notice within three business days stating the reason for the reduction. 12 C.F.R. § 226.9(c)(3). "If the creditor requires the consumer to request reinstatement of credit privileges, the notice shall also state that fact." *Id.* If the borrower requests reinstatement at any time, the creditor must "promptly investigate to determine whether the condition ... continues to exist." *Id.* TILA specifically permits creditors to collect reasonable fees for any appraisals and credit reports required before a line of credit can be reinstated. See 12 C.F.R. Part 226, Supp. I, cmt. 5(b)(f)(3)(vi)-3 and 5b(f)(3)(vi)-4.

Early Responses From the Courts

To date, only a handful of courts have ruled on motions to dismiss in these actions. Even this early on, it is clear that individual circumstances and particular factual allegations are extremely important in determining whether a plaintiff has stated a claim.

For example, in three of the seven opinions issued on motions to dismiss recent HELOC reduction cases, courts dismissed all of the plaintiffs' claims under TILA because the plaintiffs failed to adequately allege that the HELOC at issue was obtained primarily for "personal, family, or household purposes." See *Walsh v. JP Morgan Chase Bank*, No. 09-04387 RGK, Docket No. 26 at 3 (C.D. Cal. Dec. 8, 2009); *Wilder v. JP Morgan Chase Bank*, N.A., No. 09-0834 DOC, Docket No. 26 at 4 (C.D. Cal. Nov. 25, 2009); *Schulken v. Washington Mutual Bank*, No. 09-02708 JW, Docket No. 30 at 6-7 (N.D. Cal. Nov. 19, 2009).²

In *Wilder*, the court found the borrower's allegation that he had obtained a competing appraisal showing a much higher valuation for the property to be essential to the survival of his claim for breach of contract. *Wilder*, No. 09-0834 DOC, Docket No. 26 at 4-5. Similarly, the court in *Schulken* found it essential to the survival of the borrower's breach of contract claim that he alleged that he had made all payments due under the HELOC agreement and that he was not in default. *Schulken*, No. 09-02708 JW, Docket No. 30 at 8.

Courts have also dismissed separate claims for breach of the implied covenant of good faith and fair dealing as duplicative of claims for breach of contract. See *Levin v. Citibank*, N.A., No. 09-00350 MMC, Docket No. 57 at 1 (N.D. Cal. Sept. 17, 2009); *Schulken*, No. 09-02708 JW, Docket No. 30 at 9-10.

Prior to *Hickman*, most of the decisions on defendants' motions to dismiss were dismissals without prejudice and with leave to amend. See *Levin*, No. 09-00350 MMC, Docket No. 57; *Schulken*, No. 09-02708 JW, Docket No. 30; *Walsh*, No. 09-04387 RGK, Docket No. 26; *Wilder*, No. 09-0834 DOC, Docket No. 26. The court in *Falahati* dismissed the borrower's claims with prejudice, but that case involved only the ability of the lender to continue to charge an annual fee after reducing the credit limit. See *Falahati v. JP Morgan Chase Bank*,

No. 09-06012 RGK, Docket No. 16 (C.D. Cal.). *Hickman* is a significant decision because the court definitively rejected a number of the theories being advanced by plaintiffs in these cases.

The Borrower's Allegations in *Hickman*

In the complaint recently considered by Judge St. Eve, Michael Hickman alleges that defendant Wells Fargo notified him by letter that his credit limit had been reduced "due to a substantial decline in the value of the property securing the account" on October 14, 2008. *Hickman v. Well Fargo Bank N.A.*, No. 09-05090, Docket No. 1 at Ex. A (N.D. Ill.). This letter also informed Hickman that he was entitled to request reinstatement of the initial credit limit at any time, and provided a specific phone number and address for him to do so. *Id.*

Hickman called the number provided in the notice and "requested the basis for Wells Fargo's decision," but did not seek reinstatement. *Id.* at ¶ 16. On October 20, 2008, Wells Fargo sent Hickman a letter explaining that Wells Fargo had used an AVM to determine that his property – which Hickman purchased for \$750,000 – was worth only \$531,000. *Id.* at Ex. C. In its October 20, 2008 letter, Wells Fargo again provided Hickman with a specific phone number to call if he had any questions regarding the valuation or the "source utilized." *Id.*

Nearly a year later, Hickman filed a putative class action lawsuit in the Northern District of Illinois. Hickman alleges that Wells Fargo's valuation of his property was either erroneous or unreliable, and therefore Wells Fargo was not entitled to reduce his credit limit. See *id.* at ¶¶ 3, 30-33, 40, 71, 86, 101. However, Hickman does not contend that he received an appraisal of the property at any time for any alternative amount. Nor does he allege that he sought reinstatement of his initial credit limit at any time. Hickman alleges that Wells Fargo also violated TILA by requiring him to pay

upfront for a property appraisal in order to apply to have his initial credit limit reinstated. See *id.* at ¶¶ 58-59, 63-64.

Hickman also alleges that the notice sent to him by Wells Fargo violated TILA on its face because it did not contain “specific reasons” for the reduction in his credit limit. See *id.* at ¶¶ 6, 47-48, 54, 87, 94. Hickman contends that Wells Fargo’s statement that the reduction was “due to a substantial decline in value of the property securing the account” was not specific enough, and that the notice should have included additional information such as the value of the property and how that value is determined. *Id.*

Finally, Hickman alleges that his HELOC agreement does not permit Wells Fargo to charge him an annual fee after reducing his credit limit. See *id.* at ¶¶ 76-78. However, Hickman’s HELOC agreement states that the annual fee will be charged “each year my account is open, whether or not I use it” and that Hickman will “continue to be responsible for the full payment of [his] Account” even in the event of a credit line suspension or reduction. *Id.* at Ex. B, pp. 8, 11.

Based on these allegations, Hickman brought six claims for violation of TILA, two claims for breach of contract, and one claim each for violation of the Illinois Consumer Fraud Act, breach of the implied covenant of good faith and fair dealing, and “unjust enrichment/restitution.” Wells Fargo moved to dismiss the complaint in its entirety.

Judge St. Eve’s Decision in *Hickman*

In a 30-page opinion issued on January 26, 2010, Judge St. Eve granted in part and denied in part Wells Fargo’s motion to dismiss the *Hickman* complaint. See *Hickman*, No. 09-05090, Docket No. 37.

The court found that the mere allegation that Hickman did not believe the value of his property experienced a significant decline was sufficient under the federal

pleading standards to state a claim for violation of TILA based on the reduction of his HELOC limit. *Id.* at 6-8. Relying on a recent Seventh Circuit interpretation of *Iqbal* and *Twombly*, Judge St. Eve held that plaintiffs only need to give the defendant “sufficient notice of Plaintiff’s claim.” *Id.* at 7 (citing *Brooks v. Ross*, 578 F.3d 574, 580 (7th Cir. 2009)). Judge St. Eve also declined to dismiss Hickman’s claim for breach of contract based on the same allegation. The court further held that Hickman’s allegation that Wells Fargo intentionally used a faulty and unreliable AVM in reducing his HELOC limit stated a claim for unfair and deceptive business practices under the Illinois Consumer Fraud Act.

Hickman’s claims premised on the theory that the HELOC reduction notice he received was not sufficiently specific as to the reasons for the reduction were dismissed with prejudice. See *id.* at 10, 16. Judge St. Eve unequivocally held that the notice sent by Wells Fargo, informing Hickman that his credit limit was being reduced “due to a substantial decline in value of the property securing the account,” was sufficient under TILA. *Id.* at 9. The court explained that “[t]here are no requirements in TILA, Regulation Z or the Official Commentary that require Defendant to include any of the information Plaintiff cites in its Complaint.” *Id.* In addition to the TILA claim, Judge St. Eve also dismissed Hickman’s cause of action for declaratory relief based on this same legal theory. See *id.* at 15-16.

Similarly, Hickman’s claims based on Wells Fargo’s policy of requiring a borrower seeking reinstatement to pay for an appraisal of the property were dismissed with prejudice as such fees are expressly authorized by TILA. *Id.* at 11-14 (holding that “the Official Commentary reflects that the burden to pay for an appraisal may be placed on the borrower as long as the fees are bona fide and reasonable”). Judge St. Eve also dismissed this count because Hickman did not allege that he had actually requested reinstatement or been

charged any of the challenged fees. See *id.* at 12-13. In addition, Hickman’s claims for declaratory relief and violation of the Illinois Consumer Fraud Act based on this same line of argument were dismissed with prejudice. See *id.* at 15-16, 26-27.

Judge St. Eve also dismissed Hickman’s claim for breach of contract in which Hickman argued that he should not have to pay the \$75 annual fee since his credit limit was reduced. *Id.* at 19-20. Finding that “[t]he Contract expressly indicates that Plaintiff’s credit limit may be reduced during the term of the Contract, but that Plaintiff will still be responsible for all account obligations and fees,” the court dismissed this claim with prejudice. *Id.*

Judge St. Eve also found that Hickman’s claims for breach of the implied covenant of good faith and fair dealing failed as a matter of law and could not be cured by amendment. In dismissing Hickman’s claim for breach of the implied covenant with prejudice, the court found that Wells Fargo’s argument that Illinois does not recognize an independent cause of action for breach of the implied covenant “is correct.” *Id.* at 21-22 (explaining that where the plaintiff “has alleged an independent cause of action for breach of contract based on the same allegations,” the duty of good faith “does not provide [him] with an independent cause of action”). As to unjust enrichment, Judge St. Eve agreed with Wells Fargo that “a cause of action for unjust enrichment is unavailable where, as here, the parties have entered into a contract which governs the dispute.” *Id.* at 29.⁴

In sum, although Judge St. Eve allowed Hickman to proceed past the pleadings stage on his core legal theory — that his HELOC limit should not have been reduced because his property did not significantly decline in value — the court enforced the plain language of TILA and the HELOC agreement in dismissing the majority of Hickman’s claims with prejudice.

Offices

Atlanta
 Austin
 Chicago
 Dallas
 Houston
 London
 Los Angeles
 New Orleans
 New York
 Sacramento
 San Francisco
 Washington DC

Litigation Over the Reduction of Home Equity Lines of Credit: *Hickman* and Beyond (cont'd.)

The HELOC Litigation Landscape After *Hickman*

Judge St. Eve's opinion in *Hickman* deals a setback to plaintiffs asserting claims that their HELOC suspension or reduction notices were not sufficiently "specific" under TILA. The *Hickman* decision further provides HELOC lenders with authority to use against claims that they may not charge annual fees on HELOC lines that have been suspended or reduced, as well as claims that they may not charge up-front appraisal fees in connection with requests for reinstatement of HELOC limits.

In addition, the *Hickman* decision continues the trend among courts considering these issues of dismissing state law claims as dependent and duplicative, or as suffering from incurable legal defects.

Creditors and borrowers alike will be looking to see how the nine courts with motions to dismiss nearly identical actions decide these issues as the legal landscape surrounding the reduction of Home Equity Lines of Credit continues to evolve.⁵

Endnotes

- 1 These purported class actions include: *Boyden v. Harris*, N.A., No. 09-06415 (N.D. Ill.); *Falahati v. JP Morgan Chase Bank*, No. 09-06012 RGK (C.D. Cal.); *Hackett v. JP Morgan Chase Bank N.A.*, No. 09-07986 (N.D. Ill.); *Hamilton v. Wells Fargo Bank, N.A.*, No. 09-04152 CW (N.D. Cal.); *Hickman v. Wells Fargo Bank N.A.*, No. 09-05090 (N.D. Ill.); *Kimball v. Washington Mutual Bank*, No. 09-01261 MMA (S.D. Cal.); *Levin v. Citibank, N.A.*, No. 09-00350 MMC (N.D. Cal.); *Majon v. Washington Mutual Bank*, No. 09-05118 (N.D. Ill.); *Malcolm v. JP Morgan Chase Bank, N.A.*, No. 09-04496 JF (N.D. Cal.); *Ostrow v. JP Morgan Chase & Co.*, No. 09-01445 MMA (S.D. Cal.); *Schulken v. Washington Mutual Bank*, No. 09-02708 JW (N.D. Cal.); *Walsh v. Washington Mutual Bank*, No. 09-04387 RGK (C.D. Cal.); *Wilder v. JP Morgan Chase Bank, N.A.*, No. 09-00834 DOC (C.D. Cal.); *Winkler v. Citigroup, Inc.*, No. 09-01999 BTM (S.D. Cal.); *Yakas v. Chase Manhattan Bank USA, N.A.*, No. 09-02964 WHA (N.D. Cal.); *Yellin v. Wells Fargo Bank, N.A.*, No. 09-07135 PA (C.D. Cal.).
- 2 TILA applies only to loans obtained primary for consumer purposes, rather than business purposes, and plaintiffs must plead sufficient facts to demonstrate that the statute even applies to their loans as a threshold matter. See 15 U.S.C. §§ 1602(h); 12 C.F.R. § 226.2(a)(12).
- 3 Judge St. Eve did dismiss without prejudice a cause of action seeking declaratory judgment based on the same legal theory, finding that "Plaintiff has not established ... that the remedies contained in TILA would be ineffective or

inappropriate" and that "TILA presents comprehensive remedies to Plaintiff and the class." *Id.* at 15-16.

- 4 The court also dismissed the portion of *Hickman's* claim under the Illinois Consumer Fraud Act that was based upon allegedly deceptive "statements regarding the availability of credit through HELOCs" because these allegations were not pled with the particularity required for allegations of fraud pursuant to Federal Rule of Civil Procedure 9(b). *Id.* at 23-25.
- 5 Motions to dismiss are currently pending in the following nine cases: *Hamilton*, No. 09-04152 CW; *Kimball*, No. 09-01261 MMA; *Levin*, No. 09-00350 MMC; *Malcolm*, No. 09-04496 JF; *Ostrow*, No. 09-01445 MMA; *Schulken*, No. 09-02708 JW; *Walsh*, No. 09-04387 RGK; *Wilder*, No. 09-00834 DOC; *Winkler*, No. 09-01999 BTM.

About the Authors

Thomas J. Cunningham is a partner in Locke Lord's litigation department and the leader of the firm's Class Action Practice Group. He focuses his practice on the representation of banks and financial institutions in both state and federal courts. Mr. Cunningham frequently engages in consumer protection litigation and litigation involving fraud, fraudulent transfers, and bankruptcy litigation.

Simon A. Fleischmann is a partner in the Locke Lord litigation department. He concentrates his practice on the representation of banks and finance companies in complex litigation matters.

John F. Kloecker is a partner in Locke Lord's litigation department and concentrates his practice in litigation involving financial services, consumer and real estate lending practices, and the insurance and reinsurance industries.

Sally W. Mimms is an associate in the business litigation and arbitration department of Locke Lord's Chicago office and a member of the firm's Class Action Practice Group.

Robert T. Mowrey is a partner at Locke Lord. He concentrates his practice in complex business related and financial services litigation. He has nearly thirty years of extensive and active first-chair experience in jury and non-jury trials, arbitrations, mediations, and appeals.

Julie Webb is an associate in the business litigation and arbitration department of Locke Lord's Chicago office and a member of the firm's Class Action Practice Group.