Florida Federal Court Dismisses Payment-Option ARM Complaint

Loan Documents Properly Disclose Terms, Including Negative Amortization

August 26, 2010

Authors

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

J. Matthew Goodin
312-443-0472
mgoodin@lockelord.com

P. Russell Perdew
312-443-1712
rperdew@lockelord.com

Over the last several years, dozens (if not hundreds) of class action complaints have been filed challenging certain mortgage loan products known as "Payment-Option ARM" loans. Payment-Option ARM loans have adjustable interest rates, and give borrowers the option of making a minimum payment that can be less than accrued interest in the first few years of a loan. If borrowers chose to make the minimum payment, unpaid interest is added to principal and negative amortization occurs, i.e. the loan balance goes up. Complaints challenging these loans generally allege that the loans were made without properly disclosing, among other things, the possibility of negative amortization.

In *Taylor, et al. v. Homecomings Financial LLC, et al.*, No. 4:09-cv-292, Dkt. No. 40 (N.D. Fla. Aug. 20, 2010), Judge Robert Hinkle dismissed plaintiffs' complaint, finding that the various documents plaintiffs received in connection with their Payment-Option ARM loans properly disclosed the terms of the loans, including the possibility of negative amortization.

Judge Hinkle began by noting that negative amortization was only a *possibility* under the terms of plaintiffs' loans. Judge Hinkle rejected plaintiffs' argument (also made in many other cases) that negative amortization was certain to occur, concluding that "the decision whether to [make payments sufficient to cover interest] rested with the plaintiff." *Taylor*, Dkt. No. 40 at p. 1.

Judge Hinkle then held that, given the structure of the loan, the lender properly disclosed the possibility, rather than certainty, of negative amortization, concluding that "a statement that negative amortization was certain to occur would not have been accurate." *Id.* at p. 15. Ultimately, Judge Hinkle concluded that the documents plaintiffs received were "chock full of disclosures" regarding how negative amortization worked, such that no reasonable person could have misunderstood the loan terms:

> Nobody could have read these documents without understanding full well the essence of the transaction: the plaintiff would have the option of making below-interest payments at the outset . . ., and eventually the plaintiff would have to pay the full principal with interest. Lower payments now mean higher payments later. And interest keeps running. It is not a difficult concept.

Id. at pp. 2, 16-17.

As Judge Hinkle noted, district courts have reached different decisions on whether similar Payment-Option ARM loans adequately described negative amortization. *Compare Carroll v. Homecomings Financial*, No. 07-3775, Docket No. 93, Slip Op. (C.D. Cal. Mar. 23, 2009) (finding that negative amortization disclosure was accurate because "plaintiffs could have elected a different payment option which would eliminate negative amortization") *with Mincey v. World Sav. Bank*, FSB, 614 F. Supp. 2d 610, 635-38 (D.S.C. 2008) (lender violated TILA by "disclosing negative amortization was a possibility when in fact it was a certainty"). No federal appellate court has addressed this issue.