

United States District Court
for the Southern District of Georgia
Augusta Division

FILED
U.S. DIST. COURT
BRUNSWICK DIV.

2003 FEB -5 P 3:45

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SS. ST. OF GA.

DAVID BARNES and AMY S. SYKES, on behalf of themselves and all other persons similarly situated,

Plaintiffs,

v.

REPUBLIC MORTGAGE INSURANCE COMPANY,

Defendant.

CIVIL ACTION

NO. CV199-240

AND

JANET G. PATTON, MATTICE and CHERYL BRASHEAR, and CHRISTOPHER and LISA MILLER, on behalf of themselves and all others similarly situated,

Plaintiffs,

v.

TRIAD GUARANTY INSURANCE CORPORATION,

Defendants.

CIVIL ACTION

NO. CV100-132 ✓

ATTEST: A TRUE COPY

Certified to 2/5/2003

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Deputy Clerk

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O R D E R

Motions to certify a class are presently before the Court in both of the above-styled putative class actions. Although these are two distinct cases, the Court finds that similar issues of law and fact decide the question of whether these cases are appropriate for class treatment and, accordingly, the cases are consolidated for purposes of this order. For the reasons set forth below, Plaintiffs' motions will be **DENIED**.

FACTS

Plaintiffs are mortgage borrowers who purchased mortgage insurance from Defendants. Mortgage insurance protects lenders from default and is generally required when the amount borrowed exceeds 80% of the mortgaged property's value. Although the borrower pays for the insurance, the lender chooses the insurance provider. Because the borrower must pay for whatever product the lender chooses, prices in the industry are not set by a competitive market and are relatively uniform.

Defendants contend that they market themselves to lenders by providing quality service and entering into mutually beneficial structured agreements with lenders involving a variety of financial products and services. Like most if not

all mortgage insurers, for example, Defendants offer "captive reinsurance" to mortgage lenders, who assume part of Defendants' insurance risk in return for premium payments. By offering reinsurance to lenders, Defendants establish continuing relationships with those lenders and provide the lenders, who share Defendants' risk, with an incentive to refer better-quality loans to Defendants for mortgage insurance.

Plaintiffs contend that some of these transactions between Defendants and lenders, notably contract underwriting, captive reinsurance, and pool insurance, violate the "anti-kickback" provisions of Section 8(a) of the Real Estate Settlement Procedures ("RESPA"). See 12 U.S.C. § 2607(a). Specifically, Plaintiffs allege that Defendants offer these products and services at a loss in exchange for referral of lucrative mortgage insurance business. They seek to certify a class consisting of individuals who purchased mortgage insurance from Defendants while one or more of these challenged agreements were in effect between Defendants and Plaintiffs' lenders. During the period of time at issue here, Defendants each had contract underwriting, captive reinsurance, and pool insurance agreements with hundreds of lenders.

DISCUSSION

I. RULE 23 CLASS ACTIONS

Fed. R. Civ. P. 23 establishes the standards that must be met before a case can proceed as a class action in federal court. A plaintiff in a putative class action must show, as an initial matter, that

(1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

Fed.R.Civ.P. 23(a). After establishing that the putative class meets each of the requirements in Rule 23(a), the plaintiff must also show that the class fits within one of the categories in Rule 23(b). Here, the parties agree that if this case is suitable for class certification, it will be under Rule 23(b)(3), under which a class may be certified if, and only if,

the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and...a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

Fed. R. Civ. P. 23(b)(3). The decision whether to certify a class is within the Court's discretion and is reversible only for abuse of that discretion. Jaffree v. Wallace, 705 F.2d

1526, 1536 (11th Cir. 1983). The Court will consider the evidentiary submissions of the parties but will not decide the merits of the cases. In re Theragenics Corp. Sec. Litig., 205 F.R.D. 687, 694 (N.D.Ga. 2002).

Defendants essentially present three arguments against class treatment in this case. First, they contend that the class representatives are neither typical nor adequate representatives of their putative class. Second, they argue that individual issues predominate over issues common to all class members. Finally, they argue that Plaintiffs' equitable tolling claims raise additional individual issues that further undermine Plaintiffs' case for class treatment. Because the Court finds that issues requiring individual treatment do predominate over common issues in both cases, the Court need not and will not reach the question whether Plaintiffs are adequate or typical representatives of the classes that they purport to represent.

II. PREDOMINANCE

Defendants direct the Court's attention to the "bleak history" of class certification attempts in RESPA cases involving "yield spread premium" payments. See Taylor v.

Flagstar Bank, FSB, 181 F.R.D. 509, 512-13 (M.D.Ala. 1998) (citing cases from various jurisdictions). The yield spread premium cases cited by Defendants involved transactions that were substantially different from the structured transactions at issue in this case, and Plaintiffs seek to distinguish them. However, the Court finds that the underlying rationale of those cases applies here with equal force.

Yield spread premium payments are cash bounties paid by lenders to brokers who write loans at a rate that is above the "par" rate for the loan. Culpepper v. Inland Mortgage Corp., 132 F.3d 692, 692 (11th Cir. 1998). The premium amount varies from transaction to transaction based on a table published with the daily rate schedules issued to the lender by the broker. Id. The Eleventh Circuit, deferring to a Department of Housing and Urban Development ("HUD") statement of policy, has held that the standard for liability under RESPA in yield spread premium cases is "whether compensable services were provided by the broker and whether the total amount of broker compensation was reasonable in the light of the circumstances of each loan." Heimmermann v. First Union Mortgage Corp., 305 F.3d 1257, 1264 (11th Cir. 2002); Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy

1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees under Section 8(b), 66 Fed.Reg. 53,052 (Oct. 18, 2001) ("2001 SOP").

This rule appears to mandate a predominantly individualized inquiry into the facts surrounding each separate loan transaction, despite the fact that the premium payments are tied directly to the interest rate of the loan and do not reflect the quality of service or the amount of work performed by the broker. HUD's primary rationale for supporting individualized treatment in yield spread premium cases is its belief that these premium payments are usually justified by the fact that they allow brokers to offer loans at higher interest rates to borrowers who are unable to pay up-front settlement costs at the time of settlement. 2001 SOP at 53053 to 53054. The premium payment from the lender reimburses the broker for absorbing the cost of settlement, and the borrower then repays the lender over the lifetime of the loan. Id. A broader understanding of the purpose of these premiums and their value to the borrower allows us to see them as legitimate transactions and not, in most if not all instances, simply an incentive for brokers to refer loans to a given lender.

Here, the agreements at issue purport to be separate business transactions between the mortgage insurer and the lender, and the Court need not consider whether they are of value to the borrower. However, the relevant test is still whether the value received - in this case, by the insurer - bears a reasonable relationship to the value of the services or investment opportunities provided. See 24 C.F.R. § 3500.14(g)(2) (establishing market value test for RESPA cases involving a purported exchange of goods or services for business referrals). Here, again, the central question is how we are to measure value.

Plaintiffs contend that they will be able to demonstrate at trial that none of the challenged agreements provided value to the lender that was reasonably related to the actual market value of the services or financial products. Defendants, on the other hand, contend that they can justify any disparity between the agreements as offered and their putative market value in an arms-length transaction with a third party to the mortgage insurance relationship. They argue that each agreement brought added value above and beyond its market value, because the challenged structures allow Defendants to develop long-term relationships with lenders and thus provide a continuing

opportunity for Defendants to market themselves to those lenders. They also contend that sharing risk with lenders creates an incentive for those lenders to refer better quality loans to Defendants. Whatever the merit of these explanations, they are not susceptible to evaluation based on generalizations about the abstract value of the structured transactions in a market unpolluted by kickbacks, because they purport to offer legitimate reasons why Defendants might offer products and services at reduced rates to lenders and give preferential treatment to those lenders capable of producing the largest volume of quality loans.

An additional difficulty for Plaintiffs lies in establishing which individual loans are part of the allegedly "tainted" volume of referrals. In order to recover treble damages under RESPA, Plaintiffs must show that they paid for a "settlement service involved in the violation." 12 U.S.C. § 2607(d)(2). In the yield spread premium cases, it was at least clear which loans were involved, because the purported kickback payments were made on a loan-by-loan basis. Here, the finder of fact would have to decide, with regard to each individual lender, which loans were referred pursuant to an agreement or

understanding for business referrals between Defendants and the lender.

As Plaintiffs point out, the Court has held that the phrase "involved in the violation" does not require proof of a direct link between the actual service provided and the referred loan. Plaintiffs need not show, for example, that the insurer underwrote each class member's individual loan pursuant to a contract underwriting agreement. (CV100-132 Order of October 10, 2002, at 6). They must, however, show that their loans were part of a volume of business referred in exchange for a thing of value. 24 C.F.R. § 3500.14(e). This question is not trivial and does not lend itself to simple solutions. Determining whether a given agreement is evidence of a violation of RESPA requires the finder of fact to look at the agreement in the context of an ongoing relationship between an insurer and a lender.

Suppose, for example, that a lender had a history of referring 30% of its mortgage insurance business to a given insurer. After entering into a reinsurance agreement with that insurer, the lender begins sending 60% of its business. Leaving aside the question of whether it is legitimate to say that the favorable terms of the agreement are proof that the entire

volume of subsequent business was referred in exchange, it is, at the very least, evident that such a 100% increase in volume is more likely to appear to be the product of an unwritten agreement to refer business than an increase of 50%, or 5%, or for that matter, a slight decrease in referrals.

Another example of the difficulty here is suggested by Plaintiffs, David Barnes and Amy Sykes, who argue that David Barnes can be considered typical of his purported class because,

[a]lthough [a captive insurance agreement between his lender and his insurer] was executed after Barnes' loan was made, there is no evidence as to how long the negotiations for the agreement preceeded the effective date or whether those negotiations affected referrals made before the agreement became effective.

(Pls.' Resp. Def.'s Opp'n to Class Treatment at 6). If it is possible to argue that individual loans were part of a volume of business "tainted" by the scheme even if they were referred by the lender before the structured transaction went into effect, then it should also be possible to argue that the kickback scheme ended at some time while the contractual agreement was still in force. For example, a given lender might cease regularly to avail itself of contract underwriting at a rate agreed to by the mortgage insurer. Even if the contract agreement were still in force, the finder of fact might be less inclined to view any subsequent referrals as having been made

pursuant to a continuing agreement to refer business, given that Defendants were no longer providing services to the lender.

Plaintiffs' case rests on the assumption that any of the lenders who participated in the challenged contractual relationships must, by virtue of their participation alone, have entered into a parallel, unspoken agreement to refer business to Defendants in exchange. But the Court sees no reason to assume that this was true in every instance, even if it was presumptively true in many instances. The fact that an agreement to provide a product or service is in place does not, in and of itself, establish that the lender's motive for referring business to Defendants is tied to that agreement as a quid pro quo.

Under RESPA, Plaintiffs are free to sue their mortgage insurer, their lender, or both. Pedraza v. United Guaranty Corporation, 114 F.Supp.2d 1347, 1354-58 (S.D.Ga 2000). What they cannot do is ignore the fact that violations of RESPA's anti-kickback provisions arise from an agreement or understanding between two parties. The proof offered by Plaintiffs might show that Defendants engaged in a purposeful pattern or practice of RESPA violation. It would not, however, constitute proof of liability as to individual class members.

See Rutstein v. Avis Rent-A-Car Systems, Inc., 211 F.3d 1228 (11th Cir. 2000) (finding predominance of individual issues where significant particularized questions governed liability and only common issue was whether car rental agency had a policy or practice of discriminating against Jewish customers).

III. EQUITABLE TOLLING

The Plaintiffs' equitable tolling claim is similarly flawed. Plaintiffs contend that Defendants intentionally disguised these alleged kickback schemes as legitimate business transactions in order to facilitate non-disclosure by their lenders, who Plaintiffs contend had an affirmative duty under RESPA and HUD regulations to disclose transactions that affect the cost of settlement services. They further allege that Defendants misrepresented the true nature of these transactions to the state regulatory authorities. Not only would they base liability on a presumption that the parties to these agreements must have had a tacit agreement to violate RESPA, they also would toll the statute of limitations by raising an additional presumption that the parties acted in concert to conceal the violation.

In Pedraza, the Court held that Plaintiffs seeking equitable tolling under RESPA's anti-kickback provisions in a mortgage insurance case must establish a link between Defendants' conduct and the fraudulent conduct of their lenders. Pedraza at 1358. Plaintiffs seek to fulfill their obligation under Pedraza by claiming that the structures themselves were designed in tacit conspiracy with the lenders to facilitate fraudulent HUD disclosures. However, proof of their claim in the context of a class action would ultimately depend on the same assumption rejected above, that offer and acceptance of these challenged agreements suffices to demonstrate a concerted effort to violate the law, in this case by fraudulently concealing a predicate violation of RESPA.

Plaintiffs, seeking precedent for the proposition that fraudulent conduct under RESPA can be proven on a class basis, would analogize this case to Weil v. Long Island Sav. Bank, FSB, 200 F.R.D. 164 (E.D.N.Y. 2001). However, Weil was a suit against a lender by borrowers who contended that their lender defrauded them regarding the lender's relationship with a law firm that was paying kickbacks to the lender in return for referral of closing business. The case involved one lender and one settlement service provider, and the alleged misstatements


were contained in standard form documents. This case, on the other hand, is not against the lender, the party with a duty to disclose. Moreover, it involves hundreds if not thousands of different relationships among lenders, borrowers, and insurers.

Plaintiffs' proposed proof of their equitable tolling claims is tantamount to saying that the purported violations were a "self-concealing" wrong, a violation that is intentionally misleading by design. This Court explicitly rejected that conclusion in Pedraza, because to do otherwise would be to impose the lenders' duty of disclosure on Defendants, something that RESPA does not contemplate. See Pedraza at 1357 ("In any event, the Court disagrees with Plaintiff's characterization of Defendant's conduct as a self-concealing wrong."). Because RESPA and HUD impose the duty to disclose on lenders, equitable tolling in a case against a mortgage insurer would require proof of specific instances of conduct linking the insurer to fraudulent conduct on the part of a lender. Needless to say, that would introduce additional individualized inquiries into a case that is already overburdened with them.

CONCLUSION

For the reasons set forth above, Plaintiffs' motions to certify a class will be and hereby are **DENIED** in both of the above-styled cases.

SO ORDERED, this 5th day of February, 2003.



JUDGE, UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA

UNITED STATES DISTRICT COURT
Southern District of Georgia

Case Number: 1:00-cv-00132
Date Served: February 5, 2003
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