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OPINION

■ PREDATORY LENDING

Stop judicial bailouts

By Daniel C. Girard Special to The National Law Journal

As a law student in the early 1980s, I remember noticing that courts would occasionally justify their decisions as furthering "public policy." Public policy was simple: Fraud is bad. Wasn't it great, I thought, that we share a common view of public policy?

Then things changed. Somewhere in the late 1980s and early 1990s, federal appellate courts started putting district court references to public policy in "sneer quotes," usually before explaining patiently that, even though the defendant's conduct might seem reprehensible, we would actually all be better off if the plaintiff lost the case. While these decisions often go to great lengths to consider the social cost of ruling for the plaintiff, they never seem to get around to tallying up the cost of ruling against the plaintiff.

Case in point: *Andrews v. Chevy Chase Bank*. The plaintiffs in *Andrews* took out a mortgage loan. The terms of the loan were not disclosed in accordance with Truth in Lending Act (TILA). Specifically, the lender made it seem that a low "teaser" rate on the loan would be fixed for five years, when the interest rate actually floated upward after the first month. The borrowers made fixed monthly payments on the loan, thinking they were paying off the loan at the teaser rate. Because their interest rate had increased after the first monthly payment, the borrowers' loan balance was increasing even as they paid off the loan at the fixed rate they thought they were promised.

The Andrewses sued under TILA, a federal law designed to protect borrowers by ensuring full disclosure of the cost of credit. The district court ruled that the lender violated TILA and the Andrewses were entitled to rescind their loan. The court certified a class of borrowers and ruled that its members were also entitled to rescind their loans. Since the borrowers all received the same loan disclosures, a finding in favor of one borrower would extend to every other borrower.

Lenders take their cue from the courts.

Not in the opinion of the 7th U.S. Circuit Court of Appeals. A divided three- judge panel ruled that Congress, when it passed TILA, did not intend to allow courts to order rescission on a class basis. The court reasoned that, since Congress chose to protect lenders by imposing a limit on damages for statutory violations under TILA, Congress would also have wanted to protect lenders by prohibiting class actions for rescission. In other words, the court's guiding assumption was that Congress didn't want anything really bad to happen to lenders under TILA.

The dissenting judge pointed out that Congress' decision to cap statutory damages could just as easily be interpreted as favoring the view that class actions for rescission are permitted under TILA. The dissent also pointed out that the court was choosing to construe an ambiguous statute in favor of the wrongdoer.

While the *Andrews* court acknowledged it was concerned with the cost of ruling in favor of the plaintiff class, it said nothing about the cost of ruling against them. Having won their case, presumably the Andrewses will refinance and move on. What about other borrowers who are still making payments on similar loans? Sooner or later they will learn that their loan balances have increased. If *Andrews* has the desired effect of limiting the lender's liability, however, these borrowers will never see their day in court, and they will eventually wind up with loan balances they cannot afford to pay. They will either struggle under the weight of their balances or default on the loans outright.

While the dissenting judge framed the issue in ethical terms, one could also take the economic approach espoused by many judges in the 7th Circuit. Perhaps it's true that the borrowers pay in the first instance, but recent events serve as a reminder that the cost of allowing predatory or fraudulent lending practices to go unchecked does not end with the borrowers.

Let's be honest with ourselves. American corporate governance is notorious for its excessive focus on short-term profits and extraordinarily generous compensation of executives. Combining lax enforcement of lending laws with an emphasis on short-term profit and lavish compensation can only encourage the kind of irresponsible lending practices that contributed to the current economic crisis. Decisions like *Andrews* send a dangerous message to lenders. Unless courts shift responsibility for unlawful lending practices back to the corporations that stand to benefit from those practices, corporate boards will have no reason to ensure that their executives refrain from risky or unethical behavior, and the excesses that led to our current predicament will recur.

Lenders take their cues from courts. If courts send lenders the message that violations of law will be tolerated, lenders will act accordingly. Although it may be too late this time around, courts can help put our economy back on a sound footing by enforcing private rights of action that exist to ensure transparency in lending and ethical business practices. NLJ

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