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TO: Clients and Friends

FROM: David F. Dulock

SUBJECT: Truth in Lending – Problems with Lock-in Agreements and Non-refundable Lock-in Fees

Recent federal cases have raised Truth in Lending disclosure issues regarding lock-in agreements with non-refundable lock-in fees on loans subject to the consumer's right of rescission under the Truth in Lending Act (15 U.S.C. §1635(b) and Regulation Z, §226.23(d)). The problem arises with the wording of the lock-in agreement and the circumstances stated by the lender under which the lock-in fee is non-refundable.

As we all are aware, if a consumer properly rescinds a loan governed by the Truth in Lending Act, the consumer is entitled to a refund of any money given to anyone in connection with the transaction, including fees and other amounts paid to the creditor and all other settlement service providers. Two recently decided cases have indicated that if the lock-in agreement or the lender's explanation of the non-refundable nature of the lock-in fee contradicts or obfuscates the right of the consumer to a refund of the fee upon rescission of the loan, then the lender has not clearly disclosed the consumer's rescission rights and subjects the lender to damages for the breach and could result in an expanded rescission period (up to three years after consummation – Reg. Z, §226.23(a)).

In *Sampanetti v. E*Trade Mortgage Corp.*, No. 02C3513 (N.D.Ill., November 5, 2002), the consumers asserted that their lock-in agreement contradicted their rescission rights under the Truth in Lending Act because the agreement allowed the lender to keep the lock-in fee if the consumers rescinded the loan before closing (i.e. refused to close the loan). The court held this was not a violation of the consumers' rescission rights because rescission rights under the Truth in Lending Act do not apply to pre-closing rescissions by the consumer. The court held that the lock-in agreement applied only to the rescission of the loan application before the loan closed and the notice of right to cancel given to the consumers applied only to a rescission after the loan closed. This holding implies that had the agreement been worded such that it applied or

reasonably appeared to the consumer to apply after closing, the lender would have violated the rescission disclosure requirements of the Truth in Lending Act and Regulation Z.

In *Jones v. E*Trade Mortgage Corporation*, 397 F.3d 810 (9th Cir. February 11, 2005), under a similar set of facts, the court came to the opposite result in construing the same form of lock-in agreement and same notice of right to cancel. The agreement clearly stated the conditions under which the fee would and would not be refunded prior to closing and was silent on the refundable nature of the fee after closing. If the decision in this case had turned solely on the wording of the lock-in agreement, the lender would have prevailed. However, prior to closing, the consumers wanted the loan repriced. The lender refused and informed the consumers that if they rescinded they would forfeit the lock-in fee. When the consumers raised the issue of rescission under Regulation Z, they were told that the lender was not subject to Regulation Z and that they would lose the lock-in fee. The consumers consummated the loan and at closing received a correct notice of right to cancel. After closing they complained to the Office of Thrift Supervision (OTC). The lender told the OTC that it was the lender's policy to refund the lock-in fee only in cases where the applicant did not qualify for the loan. The OTC communicated this lender response to the consumers. The consumers then brought suit claiming the lender failed to clearly and conspicuously disclose their rescission rights required by the Truth in Lending Act and Regulation Z ((15 U.S.C. §1635(a) and Regulation Z, §226.23(b)). The district court dismissed the claim holding that the lock-in agreement addressed only a refund of the lock-in fee before closing and, thus, was not inconsistent with the notice of right to cancel given the consumers at closing. On appeal, the Ninth Circuit court held that the consumers rescission rights were not made clear to them because of the lender's statements to the consumer and its corporate policy regarding the non-refundable nature of the lock-in fee after closing.

The purpose of this memo is to caution our clients, for loans subject to the consumer's right of rescission under the Truth in Lending Act and Regulation Z: (1) to review their lock-in agreements and delete or amend any provision that could be construed to prohibit the refund of the lock-in fee after closing, (2) to make no oral or written statement to the consumer that suggest the lock-in fee is not refundable after closing, and (3) to be mindful that the occurrence of either event could (according to the rationale of the above cases) violate the clear and conspicuous disclosure requirement of §226.23(b), Regulation Z, resulting in an expanded rescission period of up to three years and/or damages for the disclosure violation.