

# The Legal Intelligencer

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## Mortgage Lender, Broker Absolved for Loan Irregularities

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Nowadays, there is at least one newspaper or television account of how the residential mortgage crisis was caused by the shaky underwriting practices previously employed by our financial institutions.

In a recent decision handed down in *Morilus v. Countrywide Home Loans Inc.*, the U.S. District Court for the Eastern District of Pennsylvania recently dealt with such a convoluted transaction.

### THE CASE

In early 2005, a married couple attempted to purchase a house. Their poor credit, however, prevented them from receiving favorable mortgage terms, according to the opinion. As a result, their mortgage broker suggested that the couple find someone else they know to obtain a mortgage on their behalf and for the couple then to make the monthly payments due under the mortgage as though the couple owned the house themselves (even though they would not).

The couple eventually convinced a friend to purchase the house for them by placing the mortgage in the friend's name, the opinion said. Although the husband and wife were not signatories to the mortgage, it was understood by their mortgage broker and friend that the couple would reside at the house and make the friend's mortgage payments, the opinion said.

Only a year after the closing, the friend was forced to sell the house because of the married couple's inability to make the mortgage payments, according to the opinion.

The married couple and their friend then instituted suit against the mortgage broker and mortgage lender on the theory that they "conspired to unfairly and deceptively induce [them] to execute loan documents ... to qualify them for a loan with monthly payments they could not afford." In the complaint, the married couple and their friend alleged that the mortgage broker and mortgage lender misrepresented the friend's assets and inflated the price of the house, requiring the married couple, in essence, to enter into a second mortgage to purchase the house.

## **THE DECISION**

The district court first addressed whether the married couple even had standing to bring suit. The mortgage lender argued that the "legal interests created with the mortgage belong to the signing parties," and because the married couple were not signatories to the mortgage, they failed to raise their own rights.

The district court agreed with the married couple that they had standing because the only reason they did not sign the mortgage was as a result of the mortgage lender and mortgage broker intentionally keeping them off the mortgage, which, if proven at trial, would violate Pennsylvania's Unfair Trade Practices and Consumer Protection Law, or UTPCPL.

The district court next determined whether the lender was liable for the actions of their mortgage broker under an agency theory. The elements of an agency relationship are "the manifestation by the principal that the agent shall act for him, the agent's acceptance of the undertaking and the understanding of the parties that the principal is to be in control of the undertaking."

The mortgage lender argued that there was no evidence of a manifestation of intent for the mortgage broker to act on its behalf, nor was there ever an understanding between itself and the broker.

In response, the married couple and their friend stated that the mortgage lender had exerted such a high level of control that the mortgage broker must be an agent (and not an independent contractor).

The district court concluded that to be deemed an agent, the control "must be of such a high degree that the purported agent is deemed to have had almost no independence." In contrast, the district court believed that the married couple and their friend could only show that, should the mortgage broker conduct business with the mortgage lender, then the broker was required to abide by certain guidelines set forth by the lender.

The district court then rejected the claim of apparent agency, which rests upon whether a principal "leads persons with whom his agent deals to believe he has granted certain authority which actually exceeds the scope of the agency." The district court reasoned that the married couple and their friend were unable to show evidence of an action by the mortgage lender that would indicate the mortgage broker was its apparent agent. In particular, the district court pointed out that the mortgage broker had the ability to submit the mortgage application to any mortgage lender in the industry, not just the ultimately selected mortgage lender.

The district court next addressed the Real Estate Settlement Procedures Act, or RESPA, claim contained in the complaint. RESPA was designed to "ensure that consumers are made aware of settlement procedures and costs by imposing certain disclosure requirements, and to eliminate kickbacks and referral fees which increase the cost of the settlement process," the opinion said.

In the complaint, the married couple and their friend alleged that the mortgage lender engaged in kickbacks in the form of an undisclosed property appraisal charge. The district court dismissed the claim as barred by the statute of limitations since they were required to file the claim within one year of the alleged violation which, in this case, was the date of the closing (which they did not).

The district court next examined the UTPCPL claim. A cause of action under the UTPCPL only exists if the plaintiff can show that he "justifiably relied on the defendant's wrongful conduct or misrepresentation and that he suffered harm as a result of that reliance," the opinion said.

The district court rejected the contention of the married couple and their friend that the mortgage lender induced them to act to their detriment. The district court reiterated that the mortgage broker was not the mortgage lender's agent, and thus, without an agency relationship, the married couple and their friend had no grounds to justifiably rely upon any representation because they had not had any interaction with the mortgage lender. In short, the district court believed "[w]ithout a representation, there was no misrepresentation."

The district court then addressed the mortgage lender's attempt to move for summary judgment on its fraud and conspiracy claims against the married couple and their friend.

Under the mortgage, the house was required to be the primary residence of the signatory, the married couple's friend. The mortgage lender alleged that the friend had committed fraud by signing the mortgage with no intention of making the house her primary residence nor was it ever her primary residence.

Because there was no evidence to establish that the mortgage lender knew of the arrangement made by the married couple with their friend, the district court found that the mortgage lender was justified in relying upon the representation made in the mortgage.

Moreover, the district court recognized that the mortgage lender had indeed suffered damages as a result of the fraudulent conduct perpetuated by the married couple and their friend, reasoning that a higher interest rate would have been charged had the mortgage lender known that the married couple, not the friend obtaining the mortgage loan, would be residing in the house.

The district court, however, refused to grant summary judgment in the mortgage lender's favor with respect to its conspiracy claim against the married couple and their friend.

Civil conspiracy requires proof that "a combination of two or more persons act[ed] with a common purpose to do an unlawful act or to do a lawful act by unlawful means or for an unlawful purpose," and an overt act done to pursue this common purpose that results in actual legal damage, the opinion said. Furthermore, the plaintiff must prove malice or the intent to injure.

The district court held that the married couple and their friend were acting to advance the married couple's interest in home ownership, and not with malice or the desire to cause the mortgage lender any harm.

## **LESSONS LEARNED**

As the housing crisis has shown, the factual circumstances of cases like *Morilus* are, sadly, not that uncommon. For the past decade, some mortgage brokers would say and do whatever was necessary to close the "deal," even if it was to their clients' detriment.

The district court in *Morilus* refused to allow the married couple and their friend to shift the blame onto the mortgage broker and mortgage lender. Instead, the district court, through its ruling, essentially stated that they "made their bed, now they have to lie in it" because, even if the contours of the mortgage arrangement were originally suggested by the mortgage broker, they made the ultimate decision to proceed forward.

With more and more individuals losing their jobs, and given the depressed real estate market, *Morilus* is just the first round of this type of litigation. The victor today is the mortgage industry. •

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