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Massachusetts Court Rules that Mortgage Lender Must Halt Foreclosure Activity

Certain Subprime Mortgage Loans Presumed to be “Structurally Unfair” to Consumers

On February 25, 2008, Judge Ralph Gants of the Suffolk Superior Court (Massachusetts) issued a preliminary injunction against Fremont Investment & Loan in connection with foreclosure actions undertaken by Fremont with respect to certain residential mortgage loans in Massachusetts.¹ The court’s ruling prohibits Fremont from “initiating or advancing any foreclosure on any residential mortgage loan in Massachusetts without the written consent of the Attorney General’s office.”² As a state court ruling, the impact of the injunction is limited to loans serviced by Fremont in the Commonwealth of Massachusetts.

The Massachusetts Attorney General’s office initiated this action against Fremont in October 2007, alleging that Fremont’s residential mortgage lending activities constituted “unfair and deceptive acts or practices” in violation of a Massachusetts consumer protection statute.³ Relying on broad equitable concepts, the court described those types of mortgage loans that fall within the scope of the injunction. “[T]his Court finds that it is within the penumbra of that concept of unfairness

that any mortgage loan secured by the borrower’s principal dwelling should be presumed to be structurally unfair if the loan possesses the [following] four characteristics:

- The loan is an ARM with an introductory period of three years or less;
- The loan has an introductory or “teaser” rate for the initial period that is at least 3 percent lower than the fully indexed rate;
- The borrower has a debt-to-income ratio that would have exceeded 50 percent if the lender’s underwriters had measured the debt, not by the debt due under the teaser rate, but by the debt due under the fully indexed rate; and
- The loan-to-value ratio is 100 percent or the loan carries a substantial prepayment penalty or a prepayment penalty that extends beyond the introductory period.”⁴

In addressing the fact that at the time of origination there was no federal or Massachusetts state law that prohibited mortgage loans with these characteristics, the court reasoned that “as the mortgage market changes, so, too, must the understanding of what lending conduct is unfair.”⁵ The court explained that the

¹ Commonwealth v. Fremont Inv. & Loan and Fremont Gen. Corp., No. 07-4373-BLS1 (Mass. Super. Ct. Feb. 25, 2008) (findings of fact and conclusions of law for order granting preliminary injunction).

² *Id.* at 1.

³ MASS. GEN. LAWS ch. 93A, § 2 (2007).

⁴ *Fremont*, No. 07-4373-BLS1 at 20.

⁵ *Id.* at 22.

Attorney General had not sought, and the court did not provide, a determination that the Fremont loans are in violation of a separate Massachusetts predatory home lending statute.⁶ That law, which specifically relates to residential mortgage loans, includes a statutory presumption that a borrower is able to repay the mortgage loan if a borrower's debt-to-income ratio, based on the initial interest rate, is 50 percent or less.⁷ This statutory presumption contrasts with the court's formulation of debt-to-income ratio, which is based on the fully indexed, or non-"teaser," interest rate.

The court further noted that the effect of its presumption of unfairness is to "shift the burden of production to the lender to demonstrate that the loan was not actually unfair."⁸ The court offered several ways in which the lender may satisfy this burden, including the presence of other assets of the borrower to assist in repayment or other reasonable means of refinancing the mortgage loan.

⁶ *Id.* at 16.

⁷ MASS. GEN. LAWS ch. 183C, § 4 (2007).

⁸ *Fremont*, No. 07-4373-BLS1 at 20.

Notably, the court specifically declined to include "stated income" documentation as a characteristic of those mortgage loans subject to the presumption of unfairness. The court reasoned that stated income loans "become more prone to foreclosure only if the applicant (or the broker with the acquiescence or ignorance of the applicant) falsely inflates his income or assets."⁹

The court's ruling extends only to residential mortgage loans in Massachusetts for which Fremont acts as servicer. The Attorney General's office has not indicated whether similar injunctions will be sought against other mortgage loan servicers. However, the court noted that the actions of Fremont were not unusual in the subprime mortgage industry.¹⁰ The court's ruling is a preliminary injunction, reaching a conclusion only that the Attorney General is likely to prevail at trial in proving that the mortgage loans originated by Fremont are "not merely presumptively unfair but actually unfair"¹¹ under the statute. A trial date has not been announced.

⁹ *Id.* at 21.

¹⁰ *Id.* at 15.

¹¹ *Id.* at 26.

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