

The Fourth Circuit declines to put TILA form over substance

Foley & Lardner LLP
Michael S. Lawrence

USA

December 21 2011



In the recent decision, *Watkins v. SunTrust Mortg., Inc.*, No. 10-1915, 2011 WL 6188751 (4th Cir. Dec. 14, 2011), the Fourth Circuit ruled on the specific information that a lender must provide to a borrower in order to comply with TILA's rescission notice requirement.



Author page »

The Truth in Lending Act, 15 U.S.C. § 1601 et seq. ("TILA") and the corresponding Regulation Z, 12 C.F.R. pt. 226, require that a borrower in a secured credit transaction be provided with notice of his or her right to rescind the transaction. This rescission right lasts for three days after the closing, unless the lender fails to provide the TILA mandated rescission notice, in which case, the rescission period can last for up to three years.

The appendix to Regulation Z provides several model disclosures forms that comply with TILA's rescission notice requirements. Model Form H-8, titled "Rescission Model Form (General)" is drafted to provide notice to borrowers of an original loan while Model Form H-9, titled "Refinancing with Original Creditor" is drafted to provide notice to a borrower refinancing his or her original loan with the same lender. Model Form H-9 is substantially similar to Model Form H-8 except that it includes two additional sentences specific to a refinancing transaction. First, "instead of Form H-8's disclosure that the borrower is 'entering into a transaction that will result in a security interest in your home,' Form H-9 provides that '[y]ou are entering into a new transaction to increase the amount of credit previously provided to you.'" Second, Form H-9 contains the additional sentence, "[i]f you cancel this new transaction, it will not affect any amount that you presently owe." These two additional sentences are intended to explain to a refinancing borrower that a decision to rescind their new loan will result in reinstatement of their original loan with the same lender.

The plaintiffs, a husband and wife, refinanced their original SunTrust home loan with a new loan purchased from SunTrust. At the closing, the plaintiffs were provided with a rescission notice that was substantially similar to Model Form H-8, but that lacked the additional information set forth in Model Form H-9. Eighteen months after closing on their loan refinancing, the plaintiffs, by that point facing foreclosure, notified SunTrust that they were exercising their right to rescind the loan. The plaintiffs' ground for asserting that their right to rescind continued beyond the normal three day period was that SunTrust had not satisfied its rescission notice obligation because it had provided the plaintiffs with Model form H-8 as opposed to Model Form H-9, specifically tailored for loan refinancing transactions such as theirs.

When SunTrust failed to take steps to rescind the transaction, the plaintiffs filed a lawsuit seeking

rescission under TILA. SunTrust filed a motion to dismiss pursuant to Federal Rule 12(b)(6) arguing that Model Form H-8 met TILA's rescission notice requirement because it contains all of the categories of information regarding a borrower's rescission right that TILA requires be disclosed. The district court agreed and dismissed the lawsuit holding that although a lender "would be well advised to use a Model Form H-8 in a new extension of credit and Model Form H-9 when refinancing an existing mortgage, the Court cannot conclude that a lender's use of one form in place of another, without more, is in and of itself a violation of the TILA."

On appeal, the plaintiffs argued that SunTrust's use of a form that did not contain these two additional sentences violated TILA because, in the context of a refinancing, the notice of right to rescind "must contain some advice to the borrower that a rescission will only affect the new amount financed and must also disclose that if the borrower rescinds, the borrower's obligations will revert to the preexisting loan." *Id.* at *4 (emphasis in original). In support of this contention, the plaintiffs cited a Seventh Circuit case which held a lender's notice to be deficient when they provided the borrower with both model forms. The Seventh Circuit's holding was premised on an understanding that "hypertechnicality reigns in TILA cases," and "[w]here more than one reading of a rescission form is 'plausible,' the form does not provide the borrower with a clear notice of what her right to rescind entail[s]." *Id.* at 764 (internal quotation marks omitted). The plaintiffs argued that the Fourth Circuit should adopt the Seventh Circuit's "hypertechnical" approach and find a rescission notice to be deficient if it is based on the incorrect model form.

SunTrust responded by asserting that the specific form used is not dispositive of the adequacy of a rescission notice because neither TILA's statutory provisions nor Regulation Z require that there be any additional disclosure regarding the effects of rescission in the context of a loan refinancing. SunTrust also argued that notice of the right to rescind need not be perfect and should not be used by borrowers as a "hyperthechnical loophole" to escape contractual obligations.

In affirming the district court's dismissal, the Fourth Circuit first held that TILA's disclosure requirement obligates a creditor to "clearly and conspicuously disclose . . . the [rescission] rights of the obligor under this section." *Id.* § 1635(a). Regulation Z similarly requires that the notice of rescission include "[t]he effects of rescission as described in paragraph (d) of this section," 12 C.F.R. § 226.23(b)(1)(iv). Paragraph (d) sets forth the specific consequences of rescission under TILA that must be disclosed to the borrower. In particular, an election to rescind (i) voids the transaction, including the security interest created by it; (ii) entitles the borrower to a refund of all amounts, including finance charges, paid in connection with the transaction; and (iii) requires the borrower, after the lender has carried out its obligations in rescission, to refund any money to the lender that the lender had previously provided to the borrower.

Thus, the court found that neither the statute nor Regulation Z impose additional disclosure requirements in the context of a loan refinancing. Although Model Form H-9 provides the borrower with a further explanation that their exercise of the rescission right would result in reinstatement of their original loan, the statute does not make this explanation (or the use of one model form over the other) mandatory. So long as a borrower is informed, in general terms, that choosing to rescind will return him or her to the status quo ante, that borrower has been provided with sufficient information to conclude that their previous loan would be reinstated.

The outcome of the case is significant because the Fourth Circuit has joined the majority of other circuit courts that have held that TILA compliance should be measured by the substance of a disclosure rather than its form. So long as the statutory and regulatory factors are disclosed in a

rescission notice, the lender has met its TILA obligation. Moreover, the Court expressly found that the model forms, while drafted pursuant to statute, do not impose additional legal requirements not contained in the statute or regulation. The Fourth Circuit's ruling in the Watkins case strikes a principled balance between TILA's goal of consumer protection, on one hand, and placing a reasonable limit on the informational burden that TILA imposes on the lender, on the other.

Tags USA, Banking, Litigation, Foley & Lardner LLP

If you are interested in submitting an article to Lexology, please contact Andrew Teague at ateague@lexology.com.

© Copyright 2006-2012 Globe Business Publishing Ltd | [Disclaimer](#) | [Privacy policy](#)