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It's All about the Principal: Preserving Consumers' Right of Rescission under the Truth in Lending Act

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IT'S ALL ABOUT THE PRINCIPAL: PRESERVING CONSUMERS' RIGHT OF RESCISSION UNDER THE TRUTH IN LENDING ACT*

LEA KRIVINSKAS SHEPARD**

This Article explores a significant market-based threat to the Truth in Lending Act's ("TILA") right of rescission, a remedy that attempts to deter lender overreaching and fraud during one of the most complex financial transactions of a consumer's lifetime. The depressed housing market has substantially impaired many borrowers' ability to fulfill their responsibilities in rescission's unwinding process: restoring the lender to the status quo ante by repaying the net loan proceeds of the mortgage transaction.

When a consumer is unable to finance her tender obligation, non-bankruptcy judges' overwhelming response has been to protect the lender and deny rescission to the borrower. This Article argues that these courts, to fulfill TILA's consumer-protective function, must take a different approach. Courts should use their equitable authority under TILA to modify borrowers' repayment obligations by allowing borrowers to tender in installments, over a period of years, and at reasonable interest rates. This approach both averts foreclosures that harm borrowers, lenders, and neighborhoods and ensures that TILA's consumer-protective mandate will remain viable even in a depressed housing market.

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This Article also considers an important aspect of TILA's rescission remedy that, while tacitly acknowledged by courts and commentators, has been insufficiently explored in the academic literature. There exists an uneasy tension between the goal of TILA—informing consumers of the financial consequences of their mortgage loan transactions—and borrowers' frequent use of TILA rescission: defending their homes from foreclosure actions that the lender's disclosure violation may or may not have precipitated. The Article concludes that TILA's rescission provisions, albeit a blunt instrument in the consumer protection setting, must be vigorously enforced, particularly during periods of economic calamity, since the statute remains a singular source of borrower leverage in a legal and economic climate that remains generally inhospitable to homeowners.

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INTRODUCTION: UNDERWATER AND DROWNING

The Paxtins were in trouble. They knew it, and their creditors knew it. Two months behind on their mortgage payments and credit card bills, the couple, tired of dunning calls from debt collectors, cringed every time the phone rang, which seemed like every hour. They knew they might lose their home.

In the real estate section at the local Barnes & Noble, the couple learned about various “foreclosure defense” strategies.¹ Bankruptcy could help the couple reduce their credit card debt² but would not provide a long-term solution for their mortgage debt, which had grown out of control.³ The Truth in Lending Act (“TILA”),⁴ however,

1. See generally, e.g., RALPH R. ROBERTS & LOIS MALJAK, FORECLOSURE SELF-DEFENSE FOR DUMMIES (2008) (describing numerous defensive actions for a consumer facing foreclosure).

2. In either Chapter 7 or Chapter 13 bankruptcy, a consumer may discharge a sizeable portion of her unsecured debt. See 11 U.S.C. §§ 727(b), 1328(a) (2006); Dalie Jimenez, *The Distribution of Assets in Consumer Chapter 7 Bankruptcy Cases*, 83 AM. BANKR. L.J. 795, 805–06 (2009) (demonstrating in a study of 2,500 Chapter 7 cases filed between 2007 and 2009 that only eleven percent of all general unsecured claims received any distribution whatsoever; of these, the average median distribution was eight percent); Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 430 (1999) (demonstrating in a late 1990s sample that unsecured creditors received only 15.2% of their claims in Chapter 13 plans).

3. Consumers may modify various debts in Chapter 13 bankruptcy by reducing interest rates, extending loan terms, changing amortization schedules, and limiting secured claims to the value of the collateral. See 11 U.S.C. § 1322(b)(2) (2006). The Bankruptcy Code, however, prevents borrowers from modifying mortgage loans secured only by the debtor's principal residence. 11 U.S.C. § 1322(b)(2); Adam Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565, 571 (explaining that the bankruptcy system is generally unable to help reduce the damage from the current foreclosure crisis because of the protection it provides to most lenders who hold residential mortgage claims). Instead, borrowers must cure defaults on residential loans and pay off the loans according to their original terms; otherwise, the bankruptcy court will lift the stay on collection actions and allow the mortgagee to foreclose on the property. See 11 U.S.C. § 362(d)(1) (2006); 11 U.S.C. § 1322(b)(5); Levitin, *supra*, at 582.

might help resolve the couple's dilemma. Under TILA—an expansive federal credit price disclosure statute⁵—if their lender made a “material” error⁶ in the paperwork it provided the couple two and a half years ago when they refinanced into their thirty-year, eight percent variable interest rate loan, the couple might find a way out of the morass. If, for example, their lender misstated the annual percentage rate (“APR”)⁷ or finance charge,⁸ or failed to inform the couple of their right to back out of the loan at no cost within the first three days after closing,⁹ the Paxtins might be able to rescind—or cancel—the loan.¹⁰

4. 15 U.S.C. §§ 1601–1693r (2006).

5. See generally DEE PRIDGEN & RICHARD M. ALDERMAN, CONSUMER CREDIT AND THE LAW § 14:17, at 1022–24 (2008–2009 ed.) [hereinafter PRIDGEN & ALDERMAN, CONSUMER CREDIT] (providing an overview of the right of rescission).

6. TILA defines “material disclosures” as

the annual percentage rate, the method of determining the finance charge and the balance upon which a finance charge will be imposed, the amount of the finance charge, the amount to be financed, the total of payments, the number and amount of payments, and the due dates or periods of payments scheduled to repay the indebtedness.

15 U.S.C. § 1602(u) (2006).

7. See 15 U.S.C. § 1606 (2006). The APR provides a “unitary shopping instrument” by converting the finance charge into a percentage rate based on an annual term. Elizabeth Renuart & Diane E. Thompson, *The Truth, the Whole Truth, and Nothing but the Truth: Fulfilling the Promise of Truth in Lending*, 25 YALE J. ON REG. 181, 188 (2008).

8. TILA defines the finance charge as “the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit.” 15 U.S.C. § 1605 (2006). The finance charge includes, for example, interest, service charges, loan fees, credit report fees, and insurance charges. *Id.*

9. Under TILA, each borrower having a right to rescind must receive two copies of the notice of right to rescind, which must clearly (1) disclose that the creditor is retaining or acquiring a security interest in the consumer's principal dwelling, (2) disclose that the consumer has a right to rescind the transaction, (3) describe how the consumer can exercise the right to rescind, (4) describe the effects of rescission, and (5) provide the date the rescission period expires. 12 C.F.R. §§ 226.15(b), .23(b) (2010). The Federal Reserve Board has published model disclosure forms, including a model notice of right to rescind, to assist creditors in complying with the disclosure requirements. See, e.g., 12 C.F.R. pt. 226 app. H-8 (refinancing with a new lender); *id.* at app. H-9 (refinancing with the same creditor that issued the original loan). The requirement that each obligor receive two copies of the notice of right to rescind “is not a mere technicality,” as “[e]ffective exercise of the right to rescind obviously depends upon the delivery of one copy of the rescission form to the creditor and the retention by the obligor of the other copy.” *Stone v. Mehlberg*, 728 F. Supp. 1341, 1353 (W.D. Mich. 1989). Moreover, “each person whose home ownership interest may be compromised by a credit transaction must be informed of his or her rescission rights.” *Id.*

10. 15 U.S.C. § 1635(a) (2006).

Alternatively, if the couple had a good attorney, they might be able to reach a settlement with the lender (or the lender's assignee¹¹). If confronted with a solid TILA rescission claim, the lender, concerned about the possibility of protracted litigation, might agree to modify the couple's loan by reducing the interest rate, principal, or both. In the best-case scenario, the foreclosure action would be dismissed and the Paxtins could keep their home. The couple wasn't sure if the lender had made any errors substantial enough to trigger their rescission rights, but they had noticed that they were paying for credit insurance that they didn't remember learning about. As they dug out their mortgage paperwork from a filing cabinet, they noticed that they had received four copies of a "Notice of Right to Cancel,"¹² but the date field had been left blank.

TILA errors seemed surprisingly common, particularly during the early years of the mortgage bubble.¹³ Although mortgage companies' compliance departments are supposed to scrutinize mortgage loan documents for mistakes and omissions,¹⁴ lenders commit TILA errors more often than they violate any other consumer protection regulation.¹⁵ Some companies in the business of identifying actionable mistakes in borrowers' disclosure documents claim that major TILA or related violations might be spotted in as many as eighty percent of loans.¹⁶

11. Although this Article generally refers to those who oppose TILA rescission claims as "lenders" or "creditors," any rescission action can also be brought against assignees, 15 U.S.C. § 1641(c) (2006), even though "assignees" are not "creditors" under TILA. 12 C.F.R. § 226.2(a)(17) (2010) (a creditor must be the person "to whom the obligation is initially payable"); *see also* FDIC v. Hughes Dev. Co., 684 F. Supp. 616, 622–23 (D. Minn. 1988) (holding that when the Federal Deposit Insurance Corporation ("FDIC") purchases assets secured by mortgages on consumers' principal dwellings, the FDIC remains subject to the consumers' rescission rights); ELIZABETH RENUART & KATHLEEN KEEST, NAT'L CONSUMER LAW CTR., TRUTH IN LENDING § 2.3.5.2, at 28–30 (6th ed. 2007) ("Even when it is clear that an assignee does not meet the [TILA] definition of creditor, the assignee is liable for [TILA] violations in a number of circumstances.").

12. *See supra* note 9.

13. Telephone Interview with Pamela Simmons, Partner, Law Office of Simmons & Purdy (Feb. 9, 2010) (describing the high frequency of material disclosure errors she observed in 2004–2006).

14. *See, e.g.*, FIS REGULATORY SERVICES, FIS REGULATORY SERVICES MANUAL §§ 2.204, 2.244, 2.245 (2010), available at 2010 WL 1872958 (compliance manual used by residential lenders to help lenders fulfill state and federal regulatory requirements).

15. *See, e.g.*, Elizabeth C. Yen, *Current Truth in Lending Issues*, 53 CONSUMER FIN. L. Q. REP. 25, 26 n.12 (1999) (according to 1996 FDIC report, FDIC cited banks most often for TILA violations).

16. Gretchen Morgenson, *The Silence of the Lenders*, N.Y. TIMES, July 13, 2008, at B1 (quoting the statements of a forensic loan audit company's president that TILA, Real Estate Settlement Procedures Act ("RESPA"), and other errors were found in at least

If, however, the lender was unwilling to settle, a court would have to determine whether or not the couple was entitled to rescind. If the court identified a material error, the lender and the Paxtins would, through rescission, unwind the transaction, returning the parties to the *status quo ante*—their pre-mortgage transaction positions.¹⁷ The lender would have to return to the Paxtins their closing costs¹⁸ and two and a half years' worth of finance charges, including interest.¹⁹ In turn, the Paxtins would be required to return the present balance on the mortgage—the loan principal.²⁰ The net sum they would have to return to the lender (the current balance minus the closing costs and finance charges the lender would be forced to return)²¹—the couple's "tender obligation" or the "net loan proceeds"—would be several thousand dollars less than the principal balance on the couple's mortgage.²² Rescission is so costly for and intimidating to creditors precisely because successful rescission plaintiffs receive the equivalent of an interest-free, fee-free mortgage for the period between the loan closing and the exercise of their rescission rights.

eighty percent of mortgages recently reviewed); Lew Sichelman, *Document Review Could Save Home*, CHI. TRIB., Oct. 3, 2008, at 8 (quoting a forensic loan auditor's statement that eighty percent of recent mortgages audited had errors relating to TILA, RESPA, predatory lending, and fraud); Linda Stern, *Step Carefully When You Enter the Mortgage Market: The Problems Abound*, BOS. GLOBE, July 30, 2009, at B10 ("Almost every mortgage made during the big bubble has missing paperwork or other mistakes that violate the Truth in Lending Act."). Estimates of the frequency of actionable TILA errors, however, vary widely.

17. See 15 U.S.C. § 1635 (2006); e.g., *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418, 421 (1st Cir. 2007) ("Rescission essentially restores the *status quo ante*; the creditor terminates its security interest and returns any monies paid by the debtor in exchange for the latter's return of all disbursed funds or property interests."); *Sosa v. Fite*, 498 F.2d 114, 119 (5th Cir. 1974) ("[S]ection 1635(b) is clearly designed to restore the parties as much as possible to the *status quo ante*.").

18. For example, the lender must return all broker fees, application and commitment fees, and title search and appraisal fees. 12 C.F.R. pt. 226 supp. I (2010); 12 C.F.R. § 226.15(d)(2) cmt. 1 (2010); 12 C.F.R. § 226.23(d)(2) cmt. 1 (2010).

19. 12 C.F.R. § 226.15(d)(2); 12 C.F.R. § 226.15(d)(2) cmts. 1–2; 12 C.F.R. § 226.23(d)(2); 12 C.F.R. § 226.23(d)(2) cmts. 1–2; 12 C.F.R. pt. 226 supp. I.

20. See 12 C.F.R. § 226.15(d)(3); 12 C.F.R. § 226.23(d)(3).

21. To prevent an inefficient and "perfunctory" exchange of funds, courts routinely allow the creditor to offset the interest and fees it must return to the borrower against the loan principal the borrower must tender to the lender. See *Harris v. Tower Loan of Miss., Inc.*, 609 F.2d 120, 123 (5th Cir. 1980); *In re Piercy*, 18 B.R. 1004, 1008 (Bankr. W.D. Ky. 1982).

22. See *Stuart v. Decision One Mortg. Co. (In re Stuart)*, 367 B.R. 541, 552 n.12 (Bankr. E.D. Pa. 2007) (providing detailed description of how a successful rescission reduces the borrower's overall liability to her lender).

The only problem was that the Paxtins weren't sure how they were going to fulfill their end of the rescission bargain, or "tender"²³ the net loan proceeds to the lender. In a more normal housing market, to unwind a mortgage through rescission, the Paxtins could either finance the tender obligation by refinancing their mortgage or by selling their home, using the proceeds of either the refinancing or the sale to pay off the mortgage written by the TILA-violating lender.²⁴ If the couple successfully refinanced their mortgage, generating sufficient proceeds to pay the tender obligation, the couple could avert foreclosure and remain in their home. Even if the Paxtins were insufficiently creditworthy to refinance the loan, they could finance their tender obligation by selling the home, allowing the couple to satisfy a major debt burden and move on to a more affordable apartment or smaller home.

The Paxtins couldn't refinance their mortgage or sell their home, however, because they, like nearly a quarter of American homeowners,²⁵ were "underwater," or "upside down," on their mortgage: they owed more on their mortgage than their home—the collateral securing their mortgage loan—was worth.²⁶ In a depressed

23. In the contracts setting, the phrase "tender of performance" refers to an "obligor's demonstration of readiness, willingness, and ability to perform the obligation." BLACK'S LAW DICTIONARY 1606 (9th ed. 2009). Under this definition, a borrower seeking to rescind a loan transaction would "tender" by offering to return the net loan proceeds to the lender and, at the time of the offer, be capable of performing. *See id.* In the TILA context, however, courts use the word "tender" very loosely. Courts sometimes refer to a borrower's "tender of performance," and, at other times, courts describe "tender" as the borrower's *actual performance* of the obligation (i.e., the rescinding borrower's actual payment of the net loan proceeds to the lender). This confusion is partially attributable to courts' diverse approaches to structuring the parties' obligations in the unwinding process. *See infra* Part II.

24. RENUART & KEEST, *supra* note 11, § 6.8.2, at 465.

25. Ruth Simon & James R. Hagerty, *I in 4 Borrowers Under Water*, WALL ST. J., Nov. 24, 2009, at A1. By the end of 2010, nearly forty-two percent of Americans may be underwater. Dawn Kopecki & Theo Francis, *U.S. May Retool Loan Program for Underwater Borrowers*, BLOOMBERG (Jan. 27, 2010), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXET2r166YGU>.

26. Various terms describe the condition of a borrower, her mortgage, and the owner of the mortgage note (either the original lender or an assignee) when the borrower's mortgage exceeds her home's value. Such a borrower may be "under water," MARK M. ZANDI, FINANCIAL SHOCK: A 360° LOOK AT THE SUBPRIME MORTGAGE IMPLOSION, AND HOW TO AVOID THE NEXT FINANCIAL CRISIS 40 (2009), or "upside down," MAUREEN BURTON ET AL., AN INTRODUCTION TO FINANCIAL MARKETS AND INSTITUTIONS 326 (2d ed. 2010), on her mortgage. Or, she may have "negative equity" (the amount by which the mortgage debt exceeds the home's value) in her home. SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, FACTORS AFFECTING IMPLEMENTATION OF THE HOME AFFORDABLE MODIFICATION PROGRAM 17 (2010), available at http://www.sigtar.gov/reports/audit/2010/Factors_Affecting_Implementation

or unstable housing market, no private lender would be likely to refinance a loan with more than a 100% loan-to-value ratio,²⁷ since, in the event the borrower defaulted on the mortgage and the lender forced a sale of the home, the lender would be left with a large deficiency.²⁸ Likewise, if the couple attempted to finance their tender obligation by selling their home, they would be left short: a sale of the home in the current depressed housing market would yield far less than the couple owed on the mortgage. Thus, a sale could not generate enough proceeds to fully repay the net loan proceeds.

Things seemed bleak for the Paxtins. After the couple notified their lender that they intended to rescind the mortgage transaction, the lender initially ignored the rescission notice.²⁹ A few weeks later, it sent the couple a letter denying any TILA violations. Shortly after the parties brought the matter to court, the lender filed a motion to dismiss, claiming that, even if the lender had failed to disclose material information under TILA, thereby entitling the borrowers to rescission, continuing with the case would be futile. According to the lender, since the borrowers were underwater, they were unable to tender and, thus, unable to fulfill their end of the rescission “bargain.”

Without examining the merits of the borrowers’ claim, the court gave the Paxtins an ultimatum: unless they tendered within sixty days,

_of_the_Home_Affordable_Modification_Program.pdf. A creditor holding such a mortgage is referred to as “undersecured.” CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* § 7.32, at 772 (2d ed. 2009). Such mortgages have a loan-to-value ratio greater than 100%. See BURTON ET AL., *supra*, at 327–28.

27. The loan-to-value ratio, a key factor in lenders’ financing decisions, is calculated by dividing the outstanding principal by the current value of the property subject to the lender’s security interest. JACK P. FRIEDMAN & JACK C. HARRIS, *KEYS TO MORTGAGE FINANCING AND REFINANCING* 12 (2007).

28. DIANE THOMPSON & ELIZABETH RENUART, NAT’L CONSUMER LAW CTR., *TRUTH IN LENDING* § 6.8.2, at 293 (6th ed. Supp. 2009) (“Planning for tender may be more complicated . . . when the borrower owes more than the home is worth. This may, for example, make refinancing impossible unless the excess debt is reduced through other claims.”); CONG. OVERSIGHT PANEL, *FORECLOSURE CRISIS: WORKING TOWARD A SOLUTION* 34 (2009), available at <http://cop.senate.gov/documents/cop-030609-report.pdf>. If a borrower is underwater, a private lender is unlikely to refinance the loan because the borrower’s “repayment incentives are diminished and the homeowner may abandon the property due to the negative equity overhang.” *Id.* For example, a borrower who experiences substantial financial distress, desires to relocate to a new job in a distant location, or wants to downsize to a smaller home may conclude that the simplest course of action is to walk away from a home with significant negative equity that is impossible to sell. *Id.*

29. It is common for creditors to ignore borrowers’ rescission notices. See, e.g., *Prince v. U.S. Bank Nat’l Ass’n*, No. 08-00574-KD-N, 2009 WL 2998141, at *1 (S.D. Ala. Sept. 14, 2009).

it would dismiss their rescission claim.³⁰ Because the couple was underwater, no lender would agree to a refinancing, and a sale of the home couldn't cover the entire tender obligation. Because the couple couldn't tender, the court dismissed the action with prejudice. Out of options, the couple vacated the property. Marked by a "bank-owned" placard in the yard, the home stands dormant on a quiet street.

* * *

TILA has a laudable goal—clearly and conspicuously disclosing to consumers the cost of various credit transactions, thereby protecting consumers from unfair and deceptive acts and practices and increasing competition among banks and financial institutions.³¹ Consistent with this goal, under TILA, a consumer who has taken out a non-purchase-money mortgage³²—through a home refinancing, home equity loan, or home improvement credit sale³³—has an absolute right to rescind the loan within three business days following the loan closing.³⁴ This three-day "cooling off"³⁵ or "buyer's remorse"³⁶ period can extend to up to three years, however, if the lender omits or incorrectly discloses certain material information³⁷ in the documents the borrowers received during a non-purchase-money mortgage loan transaction.

Lenders pay dearly for these errors: as part of the unwinding process, lenders must return to borrowers all closing costs, finance charges (including interest), and all payments that the borrower has made to the lender between the loan closing and the exercise of her rescission rights. In turn, the borrower must return to the lender the original loan proceeds.

30. For a description of cases in which courts routinely dismiss inability-to-tender actions before adjudicating borrowers' rescission claims, see *infra* Part II.A.

31. 15 U.S.C. § 1601 (2006).

32. A non-purchase-money mortgage is a mortgage other than one used to finance the initial construction or acquisition of a property. *Cf.* 15 U.S.C. § 1602(w) (2006) (defining a "residential mortgage transaction"). Only non-purchase-money mortgages are eligible for rescission. *See* 15 U.S.C. § 1635(e)(1) (2006) (excepting from TILA's rescission provisions "residential mortgage transactions," or purchase-money mortgages). Congress presumably was not concerned with providing borrowers a right of rescission in the purchase-money context, since, in such cases, it would likely be apparent to the borrower that the home would be encumbered by the new mortgage.

33. *See* PRIDGEN & ALDERMAN, CONSUMER CREDIT, *supra* note 5, § 14:18, at 1024, 1026.

34. 15 U.S.C. § 1635(a).

35. PRIDGEN & ALDERMAN, CONSUMER CREDIT, *supra* note 5, § 14:17, at 1022.

36. *Semar v. Platte Valley Fed. Sav. & Loan Ass'n*, 791 F.2d 699, 701 (9th Cir. 1986).

37. *See supra* note 6.

The results of a successful rescission action can be dramatic. The net sum the borrower must return to the lender to terminate the parties' relationship can be thousands of dollars—up to three years' worth of fees and interest—less than the borrower's current mortgage obligation. Through bringing a rescission action, borrowers can routinely reduce their principal balance by ten to twenty percent, a result far more advantageous to the borrower than that achievable through any private or government-sponsored loan modification. In anticipation of protracted litigation and this costly result, lenders have been known to settle with borrowers who bring strong rescission claims.³⁸ In these settlements, lenders might agree to modify a borrower's mortgage loan by reducing the current balance by roughly the same amount the lender would have to return to the borrower in a rescission—a figure equal to the fees and interest that have accumulated since the loan closing.

Through either a completed rescission or a loan modification, the borrower, in the best case scenario, can come out ahead. A borrower previously behind on her mortgage payments might be able to avert foreclosure, remain in her home, and resume payments on a smaller mortgage loan.

TILA's rescission remedy, exercisable by borrowers on a strict liability basis,³⁹ serves a significant role in preventing lender overreaching during one of the most complex and important financial transactions in the life of a borrower. TILA rescission actions, likewise, provide one of the few sources of borrower leverage in negotiations with lenders for home mortgage modifications.⁴⁰

As illustrated by the Paxtins' story, however, TILA's rescission remedy is currently out of reach for a sizable group of consumers in certain areas of the country where home values have dropped considerably between the time the borrowers entered into these mortgage transactions with TILA-violating lenders and the point at

38. E-mail from Pamela Simmons, Partner, Law Office of Simmons & Purdy, to author (Oct. 2, 2010) (on file with author) (noting that lenders, in general, have long routinely settled valid rescission claims, but observing that, in the current legal and economic environment, lenders appear less willing to negotiate with borrowers).

39. See, e.g., *Household Fin. Realty Corp. v. McElvany* (*In re McElvany*), 98 B.R. 237, 240 (Bankr. W.D. Pa. 1989) ("It is a system of strict liability if the required disclosures are not made according to provisions of Regulation Z. It is strict liability in the sense that absolute compliance is required and even technical violations will form the basis for liability.") (citations omitted); RENUART & KEEST, *supra* note 11, § 1.4.2.3.2, at 13 ("Except where Congress has explicitly relieved lenders of liability for noncompliance, it is a strict liability statute.").

40. See *infra* Part III.C.

which the borrowers seek rescission.⁴¹ In more normal housing markets, a borrower who is eligible for rescission may be able to tender even if the value of her home is slightly less than the principal balance of her mortgage—if she is only minimally underwater,⁴² since the borrower's obligation is reduced by all origination fees and finance charges paid between the loan closing and the time of the loan's cancellation.⁴³ In the current housing market, however, while a rescinding borrower must tender only the loan principal minus all finance charges and closing costs reaped by the TILA-violating lender,⁴⁴ as a result of recent dramatic decreases in home values in certain areas of the country,⁴⁵ many borrowers' net tender obligations are still likely to exceed the value of their homes.⁴⁶ Thus, an underwater TILA plaintiff typically cannot refinance her mortgage,⁴⁷ and the sale of her home usually cannot generate sufficient proceeds to fully finance the borrower's tender obligation.

When a consumer is unable to finance her tender obligation, non-bankruptcy judges' overwhelming response is to use their equitable authority under TILA to protect the lender. Concerned that an underwater TILA plaintiff will be unable to fulfill her end of the rescission "bargain," judges frequently dismiss the plaintiff's rescission action altogether. As a result, TILA's rescission remedy, a powerful means of reducing lender overreaching, is at risk of becoming dormant and underutilized in the current depressed housing market. In the words of two practicing lawyers, TILA, at least in the rescission context, is a "statute without a remedy."⁴⁸ As a result, many lawyers in communities hardest-hit by depressed real

41. Simon & Hagerty, *supra* note 25; Kopecki & Francis, *supra* note 25.

42. See *supra* note 26 (definition of "underwater").

43. 15 U.S.C. § 1635(b) (2006). For example, if a borrower is only a few thousand dollars underwater, this "negative equity" might be canceled out by the interest and fees the lender must return to the borrower as part of the rescission process. See *id.*

44. See *id.*; 12 C.F.R. § 226.23(d) (2010).

45. According to the S&P/Case-Shiller Home Price Indices, the U.S. housing market experienced record declines beginning in 2007. See Press Release, Standard & Poor's, Nationally, Home Prices Began 2009 with Record Declines According to the S&P/Case-Shiller Home Price Indices (May 26, 2009), available at http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_Release_052619.pdf.

46. Simon & Hagerty, *supra* note 25; Kopecki & Francis, *supra* note 25.

47. See THOMPSON & RENUART, *supra* note 28, § 6.8.2, at 293.

48. Telephone Interview with Dan Mulligan, Principal, Jenkins Mulligan & Gabriel LLP (Jan. 25, 2010); Telephone Interview with Pamela Simmons, *supra* note 13.

estate prices are turning away clients with valid TILA rescission claims, regardless of the strength of the lawsuit.⁴⁹

Non-bankruptcy courts' dominant approach in inability-to-tender cases is too rigid. By requiring consumers to repay their tender obligations in full and immediately or risk dismissal of their claims, courts are, in effect, limiting rescission to a decreasing pool of privileged homeowners: those who can afford to tender from available funds or those with sufficient equity in their homes to finance their tender obligations. Given the recent widespread collapse in home values, this approach is impracticable and inequitable.

There is a better way. This Article argues that these courts, to fulfill TILA's consumer-protective function, should take a different approach. Non-bankruptcy courts, which handle the vast majority of TILA rescission actions,⁵⁰ should use their equitable authority under TILA to modify borrowers' repayment obligations by allowing borrowers to tender in installments, over a period of years, and at reasonable interest rates. There are significant benefits for all stakeholders—borrowers, lenders, and communities alike—associated with modifying repayment obligations. Considering the difficulty many government-sponsored and private-party loan modification programs have had in gaining traction to avert further degradation of the housing market,⁵¹ rescission-based modifications of repayment obligations can help mitigate the damage from the current housing crisis. This approach both reduces foreclosures that harm borrowers, lenders, and communities⁵² and ensures that TILA's consumer-

49. Telephone Interview with Dan Mulligan, *supra* note 48; Telephone Interview with Pamela Simmons, *supra* note 13.

50. Telephone Interview with David P. Leibowitz, Managing Member and Partner, Lakelaw (Jan. 29, 2010). Most TILA rescission actions appear to be brought in state court in response to foreclosure actions. *Id.* Most bankruptcy attorneys, moreover, are unfamiliar with the Truth in Lending Act and rarely bring actions under consumer statutes like TILA. *Id.*

51. See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-837, TROUBLED ASSET RELIEF PROGRAM: TREASURY ACTIONS NEEDED TO MAKE THE HOME AFFORDABLE MODIFICATION PROGRAM MORE TRANSPARENT AND ACCOUNTABLE 47 (2009); CONG. OVERSIGHT PANEL, EVALUATING PROGRESS ON TARP FORECLOSURE MITIGATION PROGRAMS 3-5 (2010), available at <http://cop.senate.gov/documents/cop-041410-report.pdf>; Peter S. Goodman, *Treasury Weighs Fixes to a Program to Fend off Foreclosures*, N.Y. TIMES, Jan. 22, 2010, at B1.

52. See CONG. OVERSIGHT PANEL, *supra* note 28, at 8-10 (describing how foreclosures impose significant stress and losses on households, communities, state and local governments, and investors). One study estimated that each foreclosure on average imposes \$60,000 in direct costs on lenders; another study estimated that one foreclosure can depress the property values of the eighty closest homes by nearly \$5,000. *Id.*

protective mandate will remain viable even in a depressed housing market.

Part I of this Article describes the origins of TILA and how courts, through the practice of conditional rescission, have used their equitable authority under TILA and Regulation Z, TILA's implementing regulation,⁵³ to protect lenders' interests. Part II describes how the depressed housing market prevents many rescission plaintiffs from restoring creditors to the *status quo ante* in full and immediately, and explores several non-bankruptcy and bankruptcy court cases in which courts have confronted inability-to-tender problems. Part III critiques courts' variegated but predominant practice of denying rescission relief—and TILA's protections—to borrowers who cannot afford to immediately tender in full. This Part suggests that these courts should instead allow borrowers to tender in installments, an approach that is more consistent with TILA's consumer-protective mandate and is crucial in preserving borrowers' leverage in a predominantly inhospitable legal and economic climate.

Whether or not disclosure-based regulations are the most effective means of protecting consumers in the marketplace is a fundamental question, but one beyond the scope of this Article. Important perspectives on this topic have been discussed elsewhere.⁵⁴ This Article, in contrast, takes a pragmatic view of how courts and regulators can currently fashion the contours of TILA's rescission remedy in a way most consistent with TILA's consumer-protective origins and functions, and to an extent that can help alleviate insidious problems in the housing market. While meaningful,

53. 12 C.F.R. § 226 (2010). In Regulation Z, the Federal Reserve Board promulgates comprehensive rules interpreting TILA. For a discussion of the history of Regulation Z and the Federal Reserve Board's interpretations, see RENUART & KEEST, *supra* note 11, § 1.4.3.1, at 13–14.

54. At the moment, consumer credit regulation is dominated by disclosure laws. Many commentators, however, have expressed doubt that disclosure-based regulation can effectively inform consumers and, accordingly, affect behavior. *See, e.g.*, Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 28, 42 (2008) (describing studies concluding that consumers misunderstand mortgage and credit card disclosures); Jonathan M. Landers & Ralph J. Rohner, *A Functional Analysis of Truth in Lending*, 26 UCLA L. REV. 711, 715 (1979) (“Behavioral scientists, public opinion research, consumer research, and our own common sense tell us the same thing: consumer behavior in a particular transaction is almost certainly not going to be affected by a [Truth in Lending] disclosure statement, notwithstanding the quality of that statement.”); Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV J. ON LEGIS. 123, 123 (2007); Jeff Sovern, *Preventing Future Economic Crises Through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers*, 71 OHIO ST. L.J. (forthcoming 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1531781.

substantive reform of the consumer protection landscape is critical, change remains elusive. This Article emphasizes that courts currently have the ability—through use of their equitable authority—to alleviate homeowner suffering and to ensure that TILA's goals are realized to the extent possible given current political and economic realities.

I. THE TRUTH IN LENDING ACT: A POWERFUL AND CONTROVERSIAL DISCLOSURE STATUTE

A. *Why Congress Passed TILA*

A product of President Lyndon Johnson's "Great Society" initiatives,⁵⁵ TILA's enactment in 1968 "marked the birth of modern consumer legislative activism."⁵⁶ Its complex disclosures and frequent use by consumers have long unnerved the credit industry,⁵⁷ and the statute remains "the most intricate and controversial mandatory disclosure law ever enacted."⁵⁸ When Congress passed TILA, the consumer protection landscape was vastly different from its current state. TILA's passage, for example, preceded a protracted period of deregulation and federal preemption of state consumer laws.⁵⁹ While the statute remains a powerful enforcement tool, the consumer-centric sentiments that saturate TILA are vestiges of a more consumer-protective and paternalistic legal and economic culture.

Congress passed TILA primarily to address ubiquitous defects in creditors' cost-of-credit disclosures.⁶⁰ Before TILA, consumers found

55. See Lyndon B. Johnson, President of the United States, Remarks at the University of Michigan (May 22, 1964), in 1 PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES: LYNDON B. JOHNSON: 1963-64, at 704-07 (discussing poverty, urban decay, the erosion of community bonds, environmental dangers, and inadequate education); ROBERT DALLEK, LYNDON B. JOHNSON: PORTRAIT OF A PRESIDENT 227-50 (2005); Peter B. Edelman, *Toward a Comprehensive Antipoverty Strategy: Getting Beyond the Silver Bullet*, 81 GEO. L.J. 1697, 1710-18 (1993).

56. RENUART & KEEST, *supra* note 11, § 1.2.1, at 4.

57. *Id.* § 1.2.1, at 4-5.

58. JOHN A. SPANOGLE ET AL., CONSUMER LAW: CASES & MATERIALS 125 (3d ed. 2007).

59. ELIZABETH RENUART & KATHLEEN E. KEEST, THE COST OF CREDIT: REGULATION, PREEMPTION, AND INDUSTRY ABUSES § 3.1.1, at 41-43 (3d ed. 2005). Interest rate deregulation, for example, arrived in the late 1970s and early 1980s, triggered by inflationary pressure that reduced lenders' profits, raising concerns that usury laws' caps on interest rates would result in decreased lending. *Id.*

60. Landers & Rohner, *supra* note 54, at 713 ("The basic premises of TIL[A] were that consumers needed certain information to make essential decisions in consumer credit transactions and that the information then available as part of the contracting process, or provided as a result of state law requirements, was inadequate.").

it difficult or impossible to comparison shop for credit, since creditors had no uniform way of calculating interest or determining what additional charges would be included in the interest rate.⁶¹ To remedy this problem, TILA requires lenders to disclose to prospective consumer borrowers specific, standardized information about open-⁶² and closed-end⁶³ credit transactions in an attempt to both (1) increase transparency and competition in the credit markets and (2) promote the “informed use of credit.”⁶⁴ TILA provides a standardized definition of two key measurements of the cost of credit: the finance charge⁶⁵ and the APR.⁶⁶

TILA’s application is broad—ranging from open-end⁶⁷ credit transactions like credit card and home equity loans to closed-end⁶⁸ transactions like car loans and mortgages. The statute applies whenever a creditor⁶⁹ offers or extends credit to a consumer⁷⁰

61. RENUART & KEEST, *supra* note 11, § 1.1.1, at 1. For example, lenders calculated interest in a variety of ways, including the add-on rate, the discount rate, and a simple interest rate, making it very difficult for a consumer to choose the cheapest form of credit. *Id.*; Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 875–76 (2003).

62. An open-end credit transaction is one in which (1) the creditor reasonably contemplates repeated transactions, (2) the creditor may impose a finance charge on an outstanding unpaid balance, and (3) the amount of credit that is extended to the consumer up to a particular limit is generally made available to the extent that the consumer repays the outstanding balance. 12 C.F.R. § 226.2(a)(20) (2010). Examples of open-end credit arrangements include credit card loans and home equity loans. *See* 12 C.F.R. §§ 226.5–.16 (2010) (disclosure regulations for open-end credit transactions). *See generally* PRIDGEN & ALDERMAN, *CONSUMER CREDIT*, *supra* note 5, § 8:2, at 503–09 (defining open-end credit).

63. Regulation Z defines “closed-end credit” negatively: as consumer credit other than open-end credit. 12 C.F.R. § 226.2(a)(10); *see* 12 C.F.R. §§ 226.17–.24 (2010) (discussing disclosure regulations for closed-end credit transactions).

64. 15 U.S.C. § 1601(a) (2006).

65. *See* 15 U.S.C. § 1605 (2006). Regulation Z describes the finance charge as “the cost of consumer credit as a dollar amount.” 12 C.F.R. § 226.4(a) (2010). It “includes charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit.” *Id.* The finance charge includes, for example, interest, service charges, loan fees, credit report fees, and insurance charges. 12 C.F.R. § 226.4(b).

66. *See* 15 U.S.C. § 1606 (2006); Renuart & Thompson, *supra* note 7, at 188.

67. *See supra* note 62.

68. *See supra* note 63.

69. Regulation Z defines a “creditor” as a person (1) “who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than 4 installments” and (2) “to whom the obligation is initially payable.” 12 C.F.R. § 226.2(a)(17) (2010). Any person who originates two or more mortgages over the course of a year or who originates one or more mortgages through a mortgage broker is considered a creditor subject to TILA’s rescission provisions. 15 U.S.C. § 1602(f) (2006); 12 C.F.R. § 226.2(a)(17). Although assignees are not “creditors” under TILA, assignees

primarily for personal, family, or household purposes,⁷¹ and when the credit is subject to a finance charge⁷² or is payable by a written agreement in more than four installments.⁷³ Congress delegated broad authority to the Federal Reserve Board to implement TILA,⁷⁴ and the Board has exercised this authority by issuing Regulation Z⁷⁵ and an Official Staff Commentary on Regulation Z.⁷⁶ The Board's interpretations of TILA and Regulation Z are given great deference by courts.⁷⁷

For certain TILA violations, a creditor is liable for actual damages, statutory damages, costs, and reasonable attorney's fees.⁷⁸ If, however, lenders commit material disclosure violations in non-purchase-money⁷⁹ home equity credit transactions, borrowers can also pursue a more dramatic remedy.⁸⁰ If, as part of the transaction, the creditor acquired or retained a non-purchase-money security interest in the consumer's principal dwelling, the consumer can rescind the transaction until midnight of the third business day following the loan closing.⁸¹ During this three-day "cooling-off" period, a consumer is "to reflect on the wisdom and desirability of the contract and on the risk of possible loss of the home."⁸² Congress believed that by imposing a "mandatory period for reflection and evaluation, consumers would be less susceptible to high-pressure or fraudulent creditor practices [that] resulted in an encumbrance on and possible

nonetheless are subject to rescission. *See* 15 U.S.C. § 1641(c) (2006); *e.g.*, *FDIC v. Hughes Dev. Co.*, 684 F. Supp. 616, 622–23 (D. Minn. 1988).

70. 12 C.F.R. § 226.2(a)(11) (defining "consumer").

71. 12 C.F.R. § 226.2(a)(12) (defining "consumer credit").

72. 12 C.F.R. § 226.4(a) (2010) (defining "finance charge").

73. 12 C.F.R. § 226.1(c)(1) (2010) (describing TILA's coverage).

74. 15 U.S.C. § 1604(a) (2006).

75. 12 C.F.R. §§ 226.1–.58 (2010).

76. 12 C.F.R. § 226; 12 C.F.R. pt. 226 supp. I (2010).

77. *See Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565 (1980) (holding that Federal Reserve Board staff opinions interpreting TILA and Regulation Z are dispositive "[u]nless demonstrably irrational").

78. *See* 15 U.S.C. § 1640 (2006).

79. For a description of non-purchase-money mortgages, see sources cited *supra* note 32.

80. *RENUART & KEEST*, *supra* note 11, § 1.1.2, at 3.

81. 15 U.S.C. § 1635(a) (2006); 12 C.F.R. § 226.23(a)(1), (3) (2006). Only non-purchase-money mortgages are eligible for rescission. *See* 15 U.S.C. § 1635(e)(1) (excepting from TILA's rescission provisions "residential mortgage transaction[s]," defined in 15 U.S.C. § 1602(w) (2006) as financing agreements arising from the "acquisition or initial construction" of a home).

82. *RALPH J. ROHNER & FRED H. MILLER, TRUTH IN LENDING* ¶ 8.01[1], at 598 (Robert A. Cook et al. eds., 2000).

loss of the homestead.”⁸³ The consumer’s three-day rescission right extends to three years⁸⁴ if the creditor fails to provide the consumer with a notice describing the rescission right or with material information about the loan, including the APR, finance charge, amount financed, total of payments, and payment schedule.⁸⁵

TILA has undergone several substantial revisions during its thirty-year history. In response to criticism from creditors that compliance with the earliest version of the statute had become too difficult, TILA was amended in 1980 in the Truth in Lending Simplification and Reform Act.⁸⁶ In 1994, in response to the predatory lending crisis,⁸⁷ Congress passed the Home Ownership and Equity Protection Act (“HOEPA”) as an amendment to TILA.⁸⁸ HOEPA established enhanced disclosure rules for “high cost” home mortgages exceeding certain price threshold triggers.⁸⁹ In 1995, in response to *Rodash v. AIB Mortgage Company*,⁹⁰ a controversial class action in which the Eleventh Circuit identified relatively minor disclosure errors as TILA violations triggering rescission,⁹¹ Congress clarified what charges needed to be incorporated in the finance charge and broadened TILA’s definition of an “accurate” finance charge.⁹² In July 2008, in response to the subprime mortgage crisis,

83. *Id.*

84. 15 U.S.C. § 1635(f).

85. *See* 15 U.S.C. § 1602(u) (2006).

86. Truth in Lending Simplification and Reform Act, Pub. L. No. 96-221, 94 Stat. 168 (1980) (codified in scattered sections of 15 U.S.C.). Based on claims that well-intentioned creditors were having difficulty complying with TILA’s technicalities, the Simplification Act reduced the number of required TILA disclosures and limited creditors’ liability to “significant” violations. *See* RENUART & KEEST, *supra* note 11, § 1.2.2, at 5–7.

87. ROBERT J. HOBBS & STEPHEN GARDNER, NAT’L CONSUMER LAW CTR., THE PRACTICE OF CONSUMER LAW: SEEKING ECONOMIC JUSTICE § 10.5.2, at 98 (2d ed. 2006).

88. *Id.*

89. Peterson, *supra* note 61, at 811 n.18. HOEPA attempted to address problems of “reverse redlining”—the targeting of individuals for “‘credit on unfair terms’ based on their income, race, or ethnicity.” *Williams v. Gelt Fin. Corp.*, 237 B.R. 590, 598–99 (E.D. Pa. 1999) (quoting S. REP. NO. 103-169, at 21 (1993), *reprinted in* 1994 U.S.C.C.A.N. 1881, 1905); Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2160 (codified at 15 U.S.C. § 5324(d) (2006)). Failure to make certain “advance-look” disclosures constitutes a failure to make “material disclosures” under TILA, which triggers a borrower’s right of rescission. RENUART & KEEST, *supra* note 11, § 9.3.10, at 696 (citing 15 U.S.C. § 1602(u) (2006); 12 C.F.R. § 226.23 n.48 (2010)).

90. 16 F.3d 1142 (11th Cir. 1994).

91. *Id.* at 1147.

92. 15 U.S.C. § 1605(a), (d), (e), (f) (2006); Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29, 109 Stat. 271 (codified as amended in scattered sections of 15 U.S.C.); Truth in Lending Class Action Relief Act of 1995, Pub. L. No. 104-12, 109 Stat.

the Federal Reserve Board added a new category of “higher-priced mortgage loans” to Regulation Z.⁹³ Lenders who issue these “higher-priced” loans are subject to heightened disclosure requirements and are required to more carefully scrutinize the borrower’s ability to repay the loan.⁹⁴

B. TILA’s Right of Rescission: A Crucial Tool in Deterring Lender Overreaching

1. Comparing TILA Rescission and Common Law Rescission

TILA’s rescission provisions shift significant leverage to consumers by enhancing the protections provided to consumers under common law causes of action and remedies,⁹⁵ the oldest and most basic forms of consumer protection.⁹⁶ For example, under the common law, a borrower seeking to rescind her mortgage loan as a result of the lender’s fraudulent misrepresentation must establish the following elements: (1) a representation, (2) its falsity, (3) its materiality, (4) the defendant’s knowledge of the representation’s falsity or ignorance of its truth (scienter), and (5) the borrower’s justifiable reliance on the representation.⁹⁷ The borrower may have to plead fraud with particularity and prove each element by clear and convincing evidence.⁹⁸

A borrower able to establish these elements must bring a common law rescission action within a short time after the transaction.⁹⁹ Traditionally, moreover, the borrower needed to take

161 (codified at 15 U.S.C. § 1640(i) (2006)). See generally Jo Carrillo & Paul Kofoed, *The Sound of Silence: The Continuing Legal Debate over Class Action Rescission Under TILA*, 6 HASTINGS BUS. L.J. 1 (2010) (discussing post-Rodash legislation and class action rescission lawsuits).

93. See 12 C.F.R. § 226.35 (2010).

94. See *id.* A higher priced mortgage loan that contains a prepayment penalty in violation of section 226.35(b)(2) is subject to TILA’s extended right of rescission. THOMPSON & RENUART, *supra* note 28, § 6.4.2.4A, at 269.

95. See *infra* Part I.B.2.

96. DEE PRIDGEN & RICHARD M. ALDERMAN, CONSUMER PROTECTION AND THE LAW § 2:1, at 16 (2008–2009 ed.).

97. W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS § 105, at 728 (5th ed. 1984). Courts, however, “list anywhere from four to nine elements of the common law fraudulent misrepresentation claim.” DAN B. DOBBS, THE LAW OF TORTS § 470, at 1345 (2000).

98. DOBBS, *supra* note 97, at 1345–46.

99. See, e.g., Warner v. Denis, 922 P.2d 1372, 1385 (Haw. Ct. App. 1997) (holding that a right of rescission must be exercised within a “reasonable time” and emphasizing that “[e]quity will not permit one party, in whose favor a right of rescission has arisen, to delay unreasonably the exercise of the right and thus speculate on the rise or fall in the value of

the first steps in restoring the lender to the *status quo ante*: the borrower had to return the loan proceeds to the lender before the court would require the lender to terminate its security interest in the borrower's home and return accrued interest and fees.¹⁰⁰

TILA substantially liberalizes these requirements. TILA rescission claims need not be pleaded with particularity.¹⁰¹ TILA violations are measured by a strict liability standard.¹⁰² Consequently, creditors will be liable even for "technical or minor" violations.¹⁰³ As under the common law,¹⁰⁴ a borrower seeking rescission under TILA need not prove that the lender's disclosure violation caused actual damage.¹⁰⁵

TILA, moreover, allows borrowers who have suffered a material disclosure violation to unwind the loan transaction up to three years following the loan closing.¹⁰⁶ It is unlikely that a borrower seeking to rescind under the common law could bring a rescission action one, two, or three years following the loan transaction, as TILA's rescission provisions permit. TILA's lengthy extended rescission period can complicate attempts to return the parties to their pre-transaction positions in cases in which the value of the property has

the land"); JAMES M. FISCHER, UNDERSTANDING REMEDIES 526 (1999) (explaining that the rescission remedy is subject to abuse because the plaintiff may seek to unwind a transaction not due to an "objective injury referable to the bargain or sale," but rather as a result of "buyer remorse").

100. See, e.g., *Williams v. Homestake Mortg. Co.*, 968 F.2d 1137, 1140 (11th Cir. 1992); *Wells Fargo Bank v. Jaaskelainen*, 407 B.R. 449, 455 (D. Mass. 2009); see also 26 SAMUEL WILLISTON, WILLISTON ON CONTRACTS § 68:24, at 284 (Richard A. Lord ed., 4th ed. 2003) ("[R]escission is not allowable . . . unless the party seeking to rescind can and does first restore or offer to restore anything of value it has received under the contract. Action must be taken within a reasonable time, and must be communicated to the other party."). In modern equitable rescission cases, however, courts need not require plaintiffs to "tender or offer restoration in [her] complaint, or show an ability to make restoration," since the court has the ability to condition relief on the plaintiff's restoration of the defendant to the *status quo ante*. 1 DAN B. DOBBS, LAW OF REMEDIES: DAMAGES—EQUITY—RESTITUTION § 4.8, at 675 (2d ed. 1993).

101. RENUART & KEEST, *supra* note 11, § 7.6.6, at 552.

102. *Smith v. Fid. Consumer Disc. Co.*, 898 F.2d 896, 898 (3d Cir. 1990) ("A creditor who fails to comply with TILA in any respect is liable to the consumer . . . regardless of the nature of the violation or the creditor's intent.") (citation and internal quotation marks omitted).

103. *Semar v. Platte Valley Fed. Sav. & Loan Ass'n*, 791 F.2d 699, 704 (9th Cir. 1986).

104. See 2 DOBBS, *supra* note 100, § 9.3(2), at 581–82.

105. See, e.g., *Griggs v. Provident Consumer Disc. Co.*, 680 F.2d 927, 932 (3d Cir.) ("The Act allows recovery even when the complainant was not deceived by misdisclosure."), *vacated on other grounds per curiam*, 459 U.S. 56 (1982); *Bilal v. Household Fin. Corp. III (In re Bilal)*, 296 B.R. 828, 833 (Bankr. D. Kan. 2003) (citing *Herrera v. First N. Sav. & Loan Ass'n*, 805 F.2d 896, 900 (10th Cir. 1986)).

106. 12 C.F.R. § 226.15(a)(3) (2010).

depreciated substantially (and the borrower therefore is unable to finance her tender obligation by selling her home or refinancing the mortgage).¹⁰⁷ This long limitations period, however, provides significant protection to consumers who detect a defect in the loan disclosures only after other related or unrelated complications with the loan arise.

In addition, TILA reverses the order of events necessary to restore the parties to the *status quo ante*. Section 1635(b) and its implementing regulation, 12 C.F.R. § 226.23(d), set forth the procedures governing rescission. Traditionally, under the common law, the borrower had to tender before the court would require the lender to terminate its security interest in the borrower's home and return all interest and closing costs.¹⁰⁸ TILA, in contrast, places the onus on the offending lender.¹⁰⁹ Under TILA, after the borrower notifies the lender or its assignee of her intent to rescind, section 1635(b) and its implementing regulation require the lender to cancel its security interest in the borrower's home.¹¹⁰ Only after the creditor complies with its obligations under the statute must the consumer return the net loan proceeds (the loan principal minus all costs and finance charges paid by the consumer over the loan term) to the creditor.¹¹¹

The rescission process set forth in the statute in many ways resembles a hostage exchange: each captor (the borrower or creditor) is reluctant to give up her hostage (the tender obligation or security interest, respectively) before the other party complies, since unrequited release risks a near-complete loss of leverage. If the borrower tenders to a creditor who refuses to release its security interest in the borrower's home, the borrower, having relinquished a large lump sum of cash and all of her bargaining power,¹¹² must resort to expensive legal process to force the lender to comply with its end of the bargain. Conversely, if the lender releases its security interest

107. See *infra* Part II.

108. See *supra* text accompanying note 100.

109. See *Palmer v. Wilson*, 502 F.2d 860, 861 (9th Cir. 1974) ("Although tender of consideration received is an equitable prerequisite to rescission, the requirement was abolished by the Truth in Lending Act.").

110. 15 U.S.C. § 1635(b) (2006); 12 C.F.R. § 226.15(d)(3).

111. 15 U.S.C. § 1635(b); 12 C.F.R. § 226.15(d)(3).

112. NAT'L CONSUMER LAW CTR., PROPOSED REVISIONS TO REGULATIONS B, E, M, Z, DD AND THE OFFICIAL STAFF COMMENTARIES 3 (2004) [hereinafter PROPOSED REVISIONS], available at http://www.nclc.org/images/pdf/banking_and_payment_systems/archive/frb_jan04.pdf.

before the borrower tenders,¹¹³ the lender is rendered a vulnerable, unsecured creditor, whose collateral is subject to attachment by lien creditors.¹¹⁴ Courts have concluded that TILA's rescission sequence imposes too substantial a burden on creditors; as a result, courts in most cases revert to the common law unwinding process, requiring the borrower to restore the lender to the *status quo ante* before the lender must cancel its security interest in the borrower's home.¹¹⁵

Rescission can have a dramatic impact on the consumer's ultimate financial obligation to the offending lender because "a valid rescission relieves the consumer of any liability for payment of finance or other charges incurred in connection with the rescinded transaction."¹¹⁶ In a normal housing market, the amount the borrower must return to the lender to cancel the loan—the consumer's tender obligation—is likely to be significantly less than the borrower's principal mortgage obligation, particularly if the borrower sought rescission toward the end of the three-year extended rescission period.¹¹⁷ When a consumer validly exercises her right of rescission, she is not responsible for any finance charges or closing costs.¹¹⁸ Thus, in effect, all cash payments the consumer made between the loan closing and the point at which the borrower exercised her rescission rights are applied to the loan principal.¹¹⁹ In contrast, the majority of the payments a non-rescinding borrower makes in the early years of a loan are applied to the interest, which continues to accrue on a slowly declining principal balance.¹²⁰

TILA's legislative history provides little guidance as to the precise reasons Congress created a rescission remedy. It is clear that Congress intended to protect homeowners from abuse by dishonest home improvement contractors who made questionable "home improvements" financed by loans secured by borrowers' homes.¹²¹

113. For a description of courts' use of the word "tender" in the Truth in Lending Act context, see *supra* note 23.

114. See *infra* text following notes 142–43.

115. See *infra* Part II.A.

116. *In re Stuart*, 367 B.R. 541, 552 n.12 (Bankr. E.D. Pa. 2007).

117. See *id.*

118. 15 U.S.C. § 1635(b) (2006); *Stuart*, 367 B.R. at 552 n.12.

119. *Stuart*, 367 B.R. at 552 n.12.

120. *Id.*

121. S. REP. NO. 96-368, at 28 (1980), reprinted in 1980 U.S.C.C.A.N. 236, 264 ("This provision was enacted to give the consumer the opportunity to reconsider any transaction which would have the serious consequence of encumbering the title to his home."); see *Zakarian v. Option One Mortg. Corp.*, 642 F. Supp. 2d 1206, 1213–14 (D. Haw. 2009) (noting that Congress created the statutory rescission right to "protect home owners from certain sharp practices of home improvement contractors . . . by creating a rescission right

Beyond this articulated concern, however, courts and the Federal Reserve Board have little information about rescission's precise origins.

In spite of significant gaps in the legislative history of rescission specifically, courts agree that, as a whole, TILA, a remedial statute, must be "liberally construed in favor of borrowers."¹²² TILA is designed to protect borrowers who, relative to lenders, are unsophisticated actors who possess less leverage in loan negotiations.¹²³ This disparity in bargaining power renders borrowers vulnerable to overreaching and fraud by lenders. Thus, consistent with the statute's overall consumer-protective purpose, Congress in TILA's rescission provisions shifts significant leverage from lenders to borrowers in setting forth a strict liability remedy that substantially liberalizes the steps needed to unwind a mortgage transaction under the common law.¹²⁴

By reordering the common law rescission sequence and forcing the lender to cancel its security interest first, TILA gives consumers extra leverage in the hostage negotiation: the borrower need not sacrifice a large sum of cash to a creditor who might drag its feet or refuse to honor its end of the bargain.¹²⁵ Likewise, by forcing the lender to act first by releasing its security interest, TILA gives the borrower some time to seek financing for her tender obligation.¹²⁶ If the borrower were required to tender while the security interest remained in place, a borrower would have difficulty funding her tender obligation by refinancing the current mortgage loan, since title to her home would be clouded.¹²⁷ Because rescission is such a "painless remedy" from the consumer's perspective and "plac[es] all burdens on the creditor," it serves as an important deterrent in urging

for home improvement loans that were secured by residential mortgages on existing dwellings").

122. *Smith v. Fid. Consumer Disc. Co.*, 898 F.2d 896, 898 (3d Cir. 1990) ("TILA, as a remedial statute which is designed to balance the scales 'thought to be weighed in favor of lenders,' is to be liberally construed in favor of borrowers." (quoting *Bizier v. Globe Fin. Servs.*, 654 F.2d 1, 3 (1st Cir. 1981))); see Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Finance Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 638 (2000).

123. RENUART & KEEST, *supra* note 11, § 1.4.2.3.1, at 12.

124. See *supra* notes 101–20 and accompanying text.

125. See PROPOSED REVISIONS, *supra* note 112, at 3.

126. See *id.*

127. See *id.*

creditors, under pain of an expensive unwinding process, to comply with TILA's disclosure requirements.¹²⁸

2. Conditional Rescission: A Reversion to the Common Law Rescission Sequence

a. Background

Although TILA allows consumers to initiate the rescission process without a court's intervention merely by sending a cancellation notice¹²⁹ to the holder of the note,¹³⁰ creditors routinely ignore the rescission notice¹³¹ or respond by denying that they have violated the statute.¹³² As a result, even though rescission under TILA is a "non-judicial" remedy, courts frequently are forced to decide whether or not the lender has committed a violation triggering a borrower's right of rescission. For the most part, by intervening in the rescission process, courts have interpreted TILA's rescission provisions in ways that have reduced consumers' leverage under the statute.¹³³

The most notable and longstanding example of this reapportionment of bargaining power is a practice known as "conditional rescission"¹³⁴ or "judicial preconditioning."¹³⁵ Although courts have ordered conditional rescission for nearly four decades,¹³⁶ the practice, due to a dramatic decline in housing values, has only recently substantially complicated matters for many borrowers in inability-to-tender cases. This section describes courts' rationale for ordering conditional rescission, illustrating that courts have not

128. See RENUART & KEEST, *supra* note 11, § 6.7.2.3, at 456 (citing *Williams v. Homestake Mortg. Co.*, 968 F.2d 1137, 1140 (11th Cir. 1992)).

129. For a description of a creditor's obligation to provide each borrower entitled to rescind with two copies of a "Notice of Right to Cancel," see *supra* note 9.

130. See 15 U.S.C. § 1635(a) (2006).

131. See, e.g., *Bookhart v. Mid-Penn Consumer Disc. Co.*, 559 F. Supp. 208, 209 (E.D. Pa. 1983); *In re Schweizer*, 354 B.R. 272, 278 (Bankr. D. Idaho 2006).

132. See, e.g., *Wells Fargo Bank v. Jaaskelainen*, 407 B.R. 449, 453 (D. Mass. 2009).

133. For a description of how courts generally deny relief to borrowers who are unable to tender in full and immediately, see *infra* Part II.A-B.

134. See, e.g., *Zakarian v. Option One Mortg. Corp.*, 642 F. Supp. 2d 1206, 1215 (D. Haw. 2009).

135. See, e.g., *Celona v. Equitable Nat'l Bank*, 98 B.R. 705, 708 (E.D. Pa. 1989). This Article uses the term "conditional rescission." Most courts, however, use neither term and generically describe this process, for example, as conditioning relief on the borrower's satisfaction of her tender obligation. See, e.g., *Ortiz v. Mortg. It, Inc.*, No. 09cv2103 WQH (AJB), 2010 WL 3220110, at *3 (S.D. Cal. Aug. 12, 2010).

136. See, e.g., *Palmer v. Wilson*, 502 F.2d 860, 862 (9th Cir. 1974) (an early conditional rescission case).

hesitated to modify the plain language of the statute for the benefit of lenders.

This Article does not critique the practice of conditional rescission itself: in most cases, conditional rescission properly protects creditors from the risk of forfeiture.¹³⁷ This Article takes a more nuanced view of the practice: because TILA is a remedial statute with a consumer-protective function,¹³⁸ courts that have ordered conditional rescission to protect lenders from forfeiture likewise must not hesitate to use their equitable authority to preserve rescission in inability-to-tender cases. As a result of courts' application of conditional rescission in inability-to-tender cases, consumers who are substantially underwater on their mortgages—a sizeable percentage of borrowers nationally—are, in effect, denied TILA's rescission-based protection, risking validation of instances of lender overreaching and fraud.

b. Courts' Rationale for Ordering Conditional Rescission

At the request of lenders defending rescission actions, courts routinely use their equitable discretion to reverse the order of events set forth in the statute,¹³⁹ effectively reinstating the common law sequence of events necessary to effectuate a rescission. Through this process of "conditional rescission," courts require the borrower to tender before the creditor invalidates its security interest in the borrower's home.¹⁴⁰ In the words of one court, conditional rescission—an equitable modification of TILA's rescission process—

137. See *infra* text accompanying notes 142–44.

138. See, e.g., *Smith v. Fid. Consumer Disc. Co.*, 898 F.2d 896, 898 (3d Cir. 1990) ("TILA, as a remedial statute which is designed to balance the scales 'thought to be weighed in favor of lenders,' is to be liberally construed in favor of borrowers." (quoting *Bizier v. Globe Fin. Servs.*, 654 F.2d 1, 3 (1st Cir. 1981))); *Drysdale & Keest*, *supra* note 122, at 638.

139. See 15 U.S.C. § 1635(b) (2006).

140. See, e.g., *Williams v. Homestake Mortg. Co.*, 968 F.2d 1137, 1142 (11th Cir. 1992); *FDIC v. Hughes Dev. Co.*, 938 F.2d 889, 890 (8th Cir. 1991); *Rudisell v. Fifth Third Bank*, 622 F.2d 243, 254 (6th Cir. 1980); *Bustamante v. First Fed. Sav. & Loan Ass'n*, 619 F.2d 360, 365 (5th Cir. 1980); *Powers v. Sims & Levin*, 542 F.2d 1216, 1221–22 (4th Cir. 1976); *LaGrone v. Johnson*, 534 F.2d 1360, 1362 (9th Cir. 1976); *Palmer*, 502 F.2d at 862. *But see*, e.g., *Celona v. Equitable Nat'l Bank (In re Celona)*, 90 B.R. 104, 115 (Bankr. E.D. Pa. 1988) (allowing the borrower to rescind even though it "relegates the Creditor's claim to unsecured, possibly uncollectible status"), *aff'd*, 98 B.R. 705; *In re Piercy*, 18 B.R. 1004, 1007–08 (Bankr. W.D. Ky. 1982) (holding that the "judicial gloss" of requiring borrowers to perform first should not be applied in cases where the borrower is filing for bankruptcy).

“ensure[s] that plaintiffs make good on their repayment obligations if rescission is awarded.”¹⁴¹

Lenders have successfully persuaded courts that following the original order of events set forth in the statute—forcing lenders to invalidate their security interests before borrowers tender—creates an undue burden on and risk to lenders.¹⁴² If, after a lender has taken steps to reflect the cancellation of its security interest in the borrower's home, a borrower defaults on her tender obligation, the lender, stripped of its secured status, must pursue the watered-down collection remedies of an unsecured creditor. To collect the outstanding debt—the borrower's tender obligation—a lender might have to ask the court to reinstate the lender's security interest. Alternatively, the lender might be required to sue the borrower and, judgment in hand, attempt to levy on the debtor's unencumbered property.

As a newly unsecured creditor, the lender would not be guaranteed a full recovery of the net loan proceeds. The newly unencumbered home might be partially or fully exempt under state homestead exemption statutes.¹⁴³ Another unsecured creditor might beat the lender in the “race of the diligent” and perfect its interest in the borrower's unencumbered, non-exempt assets before the lender does. Moreover, the debtor might seek bankruptcy protection while simultaneously exercising her rescission rights under TILA, potentially allowing the debtor to satisfy her tender obligation for pennies on the dollar.¹⁴⁴

141. *Williams v. Saxon*, No. 06-0799-WS-B, 2008 WL 45739, at *3 (S.D. Ala. Jan. 2, 2008).

142. See, e.g., *Palmer*, 502 F.2d at 862 (describing the combination of rescission and statutory damages as an “unduly harsh penalty” if “the creditor is reduced to the status of an unsecured creditor, and the debtors are judgment proof”); *Stanley v. Household Fin. Corp. III (In re Stanley)*, 315 B.R. 602, 615–16 (Bankr. D. Kan. 2004) (“The concept that a debtor is entitled to a free home or financial windfall because a creditor failed to check a box on a notice of right to rescind form is an irrational result that fails to recognize the full scope and policy behind the TILA's rescission framework.”).

143. *Dawson v. Thomas (In re Dawson)*, 411 B.R. 1, 42 (Bankr. D.D.C. 2008) (ordering conditional rescission in part because, if the lender's security interest were immediately canceled, the plaintiff would be able to avail herself of a homestead exemption, which would force the newly unsecured lender to seek repayment by levying on the debtor's unencumbered, non-exempt property). For examples of homestead exemption statutes, see TEX. CONST. art. XVI, § 51 (unlimited exemption); D.C. CODE § 15-501(a)(14) (Supp. 2010) (unlimited); OHIO REV. CODE ANN. § 2329.66(A)(1)(b) (LexisNexis Supp. 2009) (capping exemption at \$20,200 per debtor); TEX. PROP. CODE §§ 41.001-.002 (West 2000 & Supp. 2009–2010).

144. If the court classifies the debtor's tender obligation as an unsecured claim, the debtor may discharge a sizeable portion of the tender amount in either Chapter 7 or

Courts explain that their decision whether or not to change the default order set out in the statute depends on the “equities” of each case.¹⁴⁵ For example, courts appear more willing to order conditional rescission when the lender’s TILA violations are not “egregious” (e.g., when the disclosure errors do not appear intentional).¹⁴⁶ Likewise, when the borrower has engaged in some kind of reprehensible behavior (e.g., the borrower has misrepresented facts on her loan application), courts are far more willing to condition invalidation of the security interest on the borrower’s tender.¹⁴⁷

Some commentators have criticized conditional rescission as an unwarranted deviation from the plain language of a remedial, consumer-protective statute.¹⁴⁸ Arguably, a consumer who must tender before the lender cancels its security interest in her home is no better off than she would be without TILA’s protection, since TILA’s rescission provisions shift leverage to borrowers by reversing the order of the common law rescission sequence.¹⁴⁹ By forcing TILA-violating lenders to cancel their security interests first, Congress increased TILA’s deterrent role,¹⁵⁰ encouraged consumers to act as

Chapter 13 bankruptcy, through which a consumer may discharge a sizeable portion of her unsecured debt. See 11 U.S.C. §§ 727(b), 1328(a) (2006); sources cited *supra* note 2.

145. See, e.g., *Williams*, 968 F.2d at 1142 (explaining that in determining whether or not to order conditional rescission, a court “should consider traditional equitable notions, including such factors as the severity of [the lender’s] TILA violations and whether [the borrower] has the ability to repay the principal amount”); *Zakarian v. Option One Mortg. Corp.*, 642 F. Supp. 2d 1206, 1215–16 (D. Haw. 2009) (citing *Palmer*, 502 F.2d at 862) (refusing to order conditional rescission when plaintiff alleged that lender had failed to provide any required TILA disclosures).

146. See, e.g., *Kratz v. Countrywide Bank*, No. CV08-01233 DSF (OPx), 2009 WL 3063077, at *6 (C.D. Cal. Sept. 21, 2009) (“Where the alleged TILA violations are not egregious, courts not only may, but ‘should,’ condition rescission on repayment of the amounts advanced by the lender.” (quoting *LaGrone v. Johnson*, 534 F.2d 1360, 1362 (9th Cir. 1976))).

147. See, e.g., *Am. Mortg. Network, Inc. v. Shelton*, 486 F.3d 815, 819 (4th Cir. 2007) (noting that it is proper for courts to consider borrower misrepresentation since the right to rescind “‘remains an equitable doctrine subject to equitable considerations’” (quoting *Brown v. Nat’l Permanent Fed. Sav. & Loan Ass’n*, 683 F.2d 444, 447 (D.D.C. 1982))).

148. See generally Robert Murken, Comment, *Can’t Get No Satisfaction? Revising How Courts Rescind Home Equity Loans Under the Truth in Lending Act*, 77 TEMP. L. REV. 457 (2004) (arguing that conditional rescission has removed the statute’s effectiveness at preventing predatory lending); Note, *Truth-in-Lending: Judicial Modification of the Right of Rescission*, 1974 DUKE L.J. 1227 (1974) (arguing that courts should allow rescission without requiring tender).

149. *Williams*, 968 F.2d at 1140; PRIDGEN & ALDERMAN, CONSUMER CREDIT, *supra* note 5, § 14:27, at 1054.

150. *Williams*, 968 F.2d at 1140 (“[B]ecause rescission is such a painless remedy under the statute (placing all burdens on the creditor), it acts as an important enforcement tool, insuring creditor compliance with TILA’s disclosure requirements.”).

“private attorneys general”¹⁵¹ in bringing rescission actions, and gave consumers significant leverage in negotiating a possible settlement with the lender. These policy goals are undermined if consumers must tender first.

The controversy around conditional rescission itself has largely subsided, however, because Congress added a provision in the Truth in Lending Simplification and Reform Act¹⁵² sanctioning the longstanding practice.¹⁵³ In this amendment, Congress sought to clarify that “the courts, at any time during the rescission process, may impose equitable conditions to insure that the consumer meets his obligations after the creditor has performed his obligations as required under the act.”¹⁵⁴ Moreover, the Federal Reserve Board is currently considering codifying conditional rescission, requiring a borrower to tender before the creditor releases its security interest in the borrower’s home.¹⁵⁵

Although courts routinely revert to the common law rescission sequence by ordering conditional rescission, the practice has laid the groundwork for a troublesome practice in rescission cases that has deprived substantially underwater borrowers of TILA’s rescission protections: requiring consumers to tender in full immediately or within a short period of time—or else risk the dismissal of their rescission claims.

II. WHEN CONSUMERS CANNOT AFFORD TO TENDER: CHOOSING BETWEEN A RETURN TO THE *STATUS QUO ANTE* AND MEANINGFUL RESCISSION-BASED PROTECTION

Today’s depressed housing market has substantially complicated some borrowers’ attempts to seek rescission during TILA’s three-year extended rescission period. Generally, a borrower seeking to rescind either refinances her mortgage or sells her home, using the proceeds of one of these transactions to pay off the mortgage written by the offending lender.

151. *Bizier v. Globe Fin. Servs.*, 654 F.2d 1, 2 (1st Cir. 1981).

152. See *supra* note 86 and accompanying text.

153. TILA’s rescission provisions now provide that “[t]he procedures prescribed by this subsection shall apply except when otherwise ordered by a court.” Truth in Lending Simplification and Reform Act, Pub. L. No. 96-221, § 125(b), 94 Stat. 168, 175 (1980) (codified as amended at 15 U.S.C. § 1635(b) (2006)); 12 C.F.R. § 226.23(d)(4) (2010); PRIDGEN & ALDERMAN, CONSUMER CREDIT, *supra* note 5, § 14:27, at 1054–55.

154. S. REP. NO. 96-368, at 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 236, 265.

155. Regulation Z; Truth in Lending, 75 Fed. Reg. 58,539, 58,547–48 (proposed Sept. 24, 2010) (to be codified at 12 C.F.R. pt. 226).

As a result of a recent dramatic drop in home values across the country, however, an increasing number of rescission-eligible borrowers cannot afford to immediately tender. If the value of the borrower's home has decreased considerably between the time the borrower refinances her mortgage and when she seeks to rescind the transaction, neither a sale of the home nor a mortgage refinancing can generate 100% of the borrower's tender obligation. Thus, as a result of a collapse in home values and a borrower's resulting inability to finance the tender obligation, an intractable tension develops between two goals of TILA's rescission remedy: returning the parties to their pre-transaction positions (the *status quo ante*)¹⁵⁶ and providing consumers with meaningful, strict-liability-based relief through rescission when lenders commit a material disclosure error.¹⁵⁷ Although courts have the equitable authority to modify consumers' tender obligations by allowing consumers to repay the net loan proceeds in installments, most courts have treated consumers' repayment obligations in an all-or-nothing fashion: consumers are required to tender in full immediately or within a short time, or their rescission claims are eventually dismissed.

As this section explains, courts following the Ninth Circuit's holding in *Yamamoto v. Bank of New York*¹⁵⁸ generally dismiss underwater borrowers' rescission actions before adjudicating the rescission claim (i.e., determining whether or not the lender has committed a material disclosure violation, thereby entitling the borrower to rescind). Courts following *Yamamoto* reason that dismissing such claims is a logical acceleration of the outcome in cases in which courts apply conditional rescission: If a court orders conditional rescission, a lender may retain its security interest until the rescinding borrower fulfills her tender obligation. If the borrower is unable to tender, the unwinding process will be suspended, perhaps indefinitely. Given the apparent inevitable consequence of a borrower's inability to tender, *Yamamoto* courts routinely eviscerate TILA's protections by dismissing the rescission claims of borrowers

156. See, e.g., *Am. Mortg. Network, Inc. v. Shelton*, 486 F.3d 815, 820 (4th Cir. 2007); *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418, 421 (1st Cir. 2007); *Williams v. Homestake Mortg. Co.*, 968 F.2d 1137, 1142 (11th Cir. 1992); *Sosa v. Fite*, 498 F.2d 114, 119 (5th Cir. 1974).

157. *Williams v. Saxon Mortg. Co.*, No. 06-0799-WS-B, 2008 WL 45739, at *4 (S.D. Ala. Jan. 2, 2008) (describing restoring the parties to the *status quo ante* and "maintain[ing] the vitality of rescission as an enforcement tool" as the "twin aims" of TILA's rescission process (citing *Williams*, 968 F.2d at 1140, 1142)).

158. 329 F.3d 1167 (9th Cir. 2003).

who cannot afford to tender in full immediately or within a short period of time.¹⁵⁹

Courts that depart from the *Yamamoto* approach generally adjudicate underwater borrowers' rescission claims but subsequently order conditional rescission. These courts' application of conditional rescission has the net effect of denying an underwater borrower rescission-based relief, since the borrower must restore the lender to the *status quo ante* before the court will order the lender to cancel its security interest in her home and return interest and fees.

Courts' approaches in inability-to-tender cases can be grouped into three categories:

***Yamamoto* and its Progeny: Judicial Nullification of a Crucial Remedy**

A number of courts (primarily those in the Ninth Circuit) allow the lender to retain its security interest until the borrower tenders, but frequently dismiss cases at the pleading stage if (1) borrowers affirmatively acknowledge an inability to tender,¹⁶⁰ (2) the facts suggest that the borrower is unable to tender (e.g., the borrower has defaulted on her mortgage or has substantial negative equity),¹⁶¹ or (3) the borrower has merely failed to plead in her complaint that she has the ability to tender.¹⁶²

Other Circuits: Complete Adjudication, but Relief for Underwater Borrowers Remains Elusive

The majority of courts allow the lender to retain its security interest until the borrower tenders, but, unlike courts in the Ninth Circuit, generally choose not to dismiss the case at the pleading stage, even if the facts suggest that the borrower will be unable to tender.¹⁶³ Borrowers in these cases have their "day in court" (i.e., courts fully adjudicate their rescission claims), thereby increasing the likelihood that the lenders will be willing to settle the case by modifying the loans. If lenders refuse to settle, however, borrowers will be denied

159. See, e.g., *Kratz v. Countrywide Bank*, No. CV08-01233 DSF (OPx), 2009 WL 3063077, at *4-5 (C.D. Cal. Sept. 21, 2009).

160. See, e.g., *Yamamoto*, 329 F.3d at 1168.

161. See, e.g., *Carlos v. Ocwen Loan Servicing, LLC*, No. CV F 09-0260 LJO GSA, 2009 WL 1295873, at *1 (E.D. Cal. May 8, 2009).

162. See, e.g., *Rogers v. Cal State Mortg. Co.*, No. CV F 09-2107 LJO DLB, 2010 WL 144861, at *10 (E.D. Cal. Jan 11, 2010).

163. See, e.g., *Jones v. REES-MAX, LLC*, 514 F. Supp. 2d 1139, 1146 (D. Minn. 2007).

rescission relief unless and until they tender, because courts routinely order conditional rescission.¹⁶⁴

Alternative Approaches: Tendering in Installments

In limited cases in both the non-bankruptcy and bankruptcy settings, courts have been willing to allow borrowers to repay their tender obligations in installments over a period of years and at reasonable interest rates.¹⁶⁵ In these cases, the judge may or may not order conditional rescission.

The following sections describe each of these general approaches, explaining the extent to which each sustains or undercuts TILA's consumer-protective functions.

A. *Yamamoto and its Progeny: Judicial Nullification of a Crucial Remedy*

As a result of recent dramatic decreases in home values in the western United States,¹⁶⁶ courts in the Ninth Circuit have encountered the largest proportion of rescission cases in which homeowner plaintiffs are unable to immediately tender in full. This depressed housing market, combined with lower courts' widespread and expansive application of the Ninth Circuit's holding in *Yamamoto*, has largely eviscerated TILA's rescission provisions in inability-to-tender cases. This section analyzes the Ninth Circuit's holding in *Yamamoto*, describes how courts have interpreted that holding, and identifies how courts' application of *Yamamoto* harms all consumers, particularly those who are underwater.

In *Yamamoto v. Bank of New York*,¹⁶⁷ the plaintiffs sought rescission and statutory damages under TILA, claiming that their lender had failed to provide them with "Notice of Right to Cancel" forms and had inaccurately disclosed real estate appraisal fees.¹⁶⁸ In a deposition taken between the plaintiffs' motion for summary judgment and the defendants' cross-motion, the plaintiffs had

164. See, e.g., *Jobe v. Argent Mortg. Co.*, No. 3:CV-06-00697, 2009 WL 2461168, at *5, *7 (M.D. Pa. Aug. 11, 2009).

165. See, e.g., *Mayfield v. Vanguard Sav. & Loan Ass'n*, 710 F. Supp. 143, 144-45 (E.D. Pa. 1989); *Apaydin v. Citibank Fed. Sav. Bank (In re Apaydin)*, 201 B.R. 716, 718 (Bankr. E.D. Pa. 1996).

166. James R. Hagerty & Nick Timiraos, *Debtor's Dilemma: Pay the Mortgage or Walk Away*, WALL ST. J., Dec. 17, 2009, at A22 (describing how an increasing number of homeowners in Arizona, California, and Nevada, where home prices have plunged, are considering "strategically defaulting" on their mortgages).

167. 329 F.3d 1167 (9th Cir. 2003).

168. *Id.* at 1169.

testified that, even if the court granted rescission, they could not afford to tender.¹⁶⁹

On the borrowers' rescission claim, the district court gave the borrowers sixty days to tender the loan proceeds.¹⁷⁰ After the borrowers failed to tender, the district court dismissed the rescission claim without reaching the question of whether the lender had violated TILA.¹⁷¹

Agreeing with the district court, the Ninth Circuit explained that courts had long exercised their equitable authority under TILA in certain cases to condition invalidation of the security interest on the debtor's fulfillment of her tender obligation.¹⁷² According to the court, conditional rescission can take place either before or after the court determines whether or not the borrower is entitled to rescission: if the court finds that "the borrower cannot comply with [her] rescission obligations no matter what," a court can dismiss the rescission action before deciding whether the defendants committed a material disclosure error.¹⁷³

The plaintiffs in *Yamamoto* had *affirmatively acknowledged* in their depositions that, even if allowed to rescind their loan, they could not afford to tender. After giving the plaintiffs an opportunity to tender, the district court dismissed the rescission action.¹⁷⁴ In reliance on *Yamamoto*, however, recently several courts in the Ninth Circuit have gone further. These courts have dismissed rescission actions at the pleading stage if the facts merely *suggested* that the plaintiffs would be unable to tender (for example, if the plaintiffs had defaulted on the mortgage)¹⁷⁵ or if the plaintiffs had failed to allege in their complaint that they could, in fact, afford to tender (for example, by describing how they intended to finance the tender obligation).¹⁷⁶ This

169. *Id.* at 1168.

170. *Yamamoto v. Bank of New York*, No. CV-99-00360SPK, slip op. at 9 (D. Haw. Feb. 12, 2001), *aff'd*, 329 F.3d 1167. The district court dismissed the borrowers' claim for statutory damages, since the one-year statute of limitations had expired. *Id.* at 2-3.

171. *Yamamoto*, 329 F.3d at 1168.

172. *Id.* at 1171.

173. *Id.* at 1173.

174. *Id.* at 1168.

175. *See, e.g., Carlos v. Ocwen Loan Servicing, LLC*, No. CV F 09-0260 LJO GSA, 2009 WL 1295873, at *1 (E.D. Cal. May 8, 2009).

176. *See, e.g., Gonzalez v. First Franklin Loan Servs.*, No. 1:09-CV-00941 AWI-GSA, 2010 WL 144862, at *5 (E.D. Cal. Jan. 11, 2010) (granting defendant's motion to dismiss because "[p]laintiff concede[d] that she cannot allege that she has the ability to tender"); *Rogers v. Cal State Mortg. Co.*, No. CV F 09-2107 LJO DLB, 2010 WL 144861, at *10 (E.D. Cal. Jan 11, 2010) (dismissing plaintiff's rescission claim because "[t]he complaint's silence on [the plaintiffs'] tender of loan proceeds is construed as their concession of

approach is imprudent not only because it undercuts underwater borrowers' rescission-based protections, but also, as some courts have pointed out, these courts' expansion of *Yamamoto* generally violates courts' obligation under Rule 12(b)(6)¹⁷⁷ to interpret the allegations and facts in the light most favorable to the plaintiffs.¹⁷⁸

In *Carlos v. Ocwen Loan Servicing, LLC*,¹⁷⁹ for example, the plaintiffs, who sought rescission in an apparent attempt to forestall foreclosure of their California home, offered in their complaint to satisfy their tender obligation by surrendering their home or the home's fair market value.¹⁸⁰ The plaintiffs requested in the alternative (if full repayment of their tender obligation was required) that the "[d]efendants . . . accept tender on reasonable terms and over a reasonable period of time."¹⁸¹

The borrowers in *Carlos*, unlike those in *Yamamoto*, never affirmatively acknowledged that they were unable to tender. In a cryptic decision, however, the judge dismissed the borrowers' rescission action because "[t]he complaint acknowledge[d] [the borrowers'] inability to tender the loan proceeds."¹⁸² Presumably, the court inferred that a tender attempt would be futile, since (1) the borrowers had defaulted on their mortgage payments,¹⁸³ (2) the borrowers' home had collapsed in value, suggesting that a sale of the home could not fully finance their tender obligation;¹⁸⁴ and (3) in the

inability to do so"); *Logan v. ResMAE Mortg. Corp.*, No. 2:09-cv-01632-MCE-GGH, 2009 WL 5206716, at *2-3 (E.D. Cal. Dec. 24, 2009) (dismissing rescission claim where plaintiff "failed to allege any offer of tender at any stage of the proceedings" because following *Yamamoto*, courts in the Ninth Circuit "have required tender as a necessary element to proceeding with a TILA claim").

177. FED. R. CIV. P. 12(b)(6).

178. When the borrower-plaintiffs do not affirmatively acknowledge an inability to repay the net loan proceeds, courts' inference that the borrowers are unable to tender usually violates courts' responsibility under Rule 12(b)(6) to interpret the allegations and facts in the light most favorable to the plaintiffs. *See, e.g.,* *Baldain v. Am. Home Mortg. Servicing, Inc.*, No. CIV. S-09-0931 LKK/GGH, 2010 WL 56143, at *10-11 (E.D. Cal. Jan. 5, 2010) (rejecting creditor's motion to dismiss based on plaintiff's failure to allege ability to tender, but cautioning borrowers that "*Yamamoto* directs this court to require tender prior to rescission in the majority of cases, and that plaintiffs will need to meet this standard at subsequent stages").

179. No. CV F 09-0260 LJO GSA, 2009 WL 1295873 (E.D. Cal. May 8, 2009).

180. Complaint for Rescission, Damages & Jury Demand at 9, *Carlos*, 2009 WL 1295873 (No. 09-0260).

181. *Id.* at 16.

182. *Carlos*, 2009 WL 1295873, at *4.

183. *Id.* at *1.

184. *Id.* at *3.

complaint, the borrowers acknowledged an inability to tender 100% of the net loan proceeds.¹⁸⁵

Under the approach typified in *Carlos*, a borrower risks dismissal of her rescission claim not only if she acknowledges difficulty returning the net loan proceeds, but also if the facts themselves merely suggest that the plaintiff might have difficulty financing her tender obligation.

In some rescission cases, courts in the Ninth Circuit have explicitly referred to a plaintiff's ability to tender as a pleading requirement. In *Ung v. GMAC Mortgage, LLC*,¹⁸⁶ for example, the district court dismissed with prejudice the plaintiff's rescission claim when the plaintiff failed to plead her ability to tender the loan proceeds.¹⁸⁷ Although the plaintiff had indicated in the complaint that she was ready and willing to tender, she stated elsewhere that, since she was in default on the loan, she could afford only to make monthly payments under a modified loan.¹⁸⁸ Citing *Yamamoto*, the court explained that it "has the discretion to require Plaintiff to tender return of all monies received from the lender before ordering rescission; accordingly, [it] has the discretion to require Plaintiff to allege tender before proceeding."¹⁸⁹

Underwater borrowers do not fare much better in those district courts in the Ninth Circuit that reject the argument that, under *Yamamoto*, a plaintiff's ability to tender is an essential element of a TILA rescission claim. As these courts explain, because the plaintiff—once the court orders conditional rescission—is required to tender before the court will order the lender to restore the plaintiff to the *status quo ante*, borrowers' inability to tender will ultimately doom their rescission claims.¹⁹⁰ In *ING Bank v. Ahn*,¹⁹¹ for example,

185. *Id.* at *4.

186. No. EDCV 09-893-VAP (OPx), 2009 WL 2902434 (C.D. Cal. Sept. 4, 2009).

187. *Id.* at *2–3.

188. *Id.* at *2.

189. *Id.* at *3.

190. *ING Bank v. Ahn*, No. C 09-995 TEH, 2009 WL 2083965, at *2 (N.D. Cal. July 13, 2009); *Narvaes v. EMC Mortg. Corp.*, No. 07-00621 HG-LEK, 2009 WL 1227849, at *5, *9 (D. Haw. May 5, 2009) (acknowledging that "[c]ourts can grant summary judgment to a lender in a TILA action for rescission if the borrower cannot establish his ability to tender the loan proceeds," but refusing to dismiss plaintiffs' rescission claims since plaintiffs had offered in their rescission letter to defendant to tender loan proceeds and, even if plaintiffs were unable to tender, the decision to dismiss was not mandatory but within the judge's equitable discretion); *Horton v. California Credit Corp. Ret. Plan*, No. 09cv274-IEG-NLS, 2009 WL 700223, at *5 (S.D. Cal. Mar. 16, 2009); *Phleger v. Countrywide Home Loans, Inc.*, No. C 07-01686 SBA, 2009 WL 537189, at *25 (N.D. Cal. Mar. 3, 2009).

191. *Ahn*, 2009 WL 2083965, at *2.

the judge noted that *Yamamoto* did not hold that a district court was required to dismiss a case if the plaintiff failed to plead her ability to tender.¹⁹² Rather, a trial court had the discretion to dismiss the case if the court “concludes that the party seeking rescission is incapable of performance.”¹⁹³ The court explained that the plaintiffs would, however, eventually need to “demonstrate their ability to fully effectuate a rescission for the [c]ourt to enter an order of rescission.”¹⁹⁴ Nevertheless, the plaintiffs did not have to make such a showing at such an early stage of the litigation.¹⁹⁵

Yamamoto and its progeny are troubling because these cases obliterate consumers’ leverage under TILA’s rescission provisions. As interpreted by most courts, *Yamamoto* requires consumers to prove their ability to tender the net loan proceeds before the court can decide whether or not a lender has committed a TILA violation entitling the consumer to rescind. The Ninth Circuit in *Yamamoto*, in effect, “created a non-waiveable bond requirement: to get her day in court, a consumer must pay up first.”¹⁹⁶ As a result, TILA’s deterrent effect on would-be overreaching lenders is undermined.

In response to *Yamamoto*, the Federal Reserve Board added weak language to its Official Staff Commentary suggesting—but not requiring—that courts adjudicate the borrower’s rescission claim before determining how, exactly, to effectuate the rescission (e.g., deciding whether or not it will order conditional rescission).¹⁹⁷ The cases discussed in this section illustrate that most courts in the Ninth Circuit have largely ignored the Federal Reserve Board’s irresolute opinion.

Regardless of the merits of the TILA rescission claim or the severity of the lender’s alleged disclosure error, creditors in the Ninth Circuit have little incentive to negotiate a settlement—a loan modification—with a borrower who is substantially underwater.

192. *Id.*

193. *Id.*

194. *Id.*

195. *Id.*

196. See PROPOSED REVISIONS, *supra* note 112, at 4.

197. Federal Reserve System, 69 Fed. Reg. 16,769, 16,772 (Mar. 31, 2004). The Official Staff Commentary now provides: “Where the consumer’s right to rescind is contested by the creditor, a court *would normally* determine whether the consumer has a right to rescind and determine the amounts owed before establishing the procedures for the parties to tender any money or property.” 12 C.F.R. pt. 226 supp. I (2010) (emphasis added). The National Consumer Law Center’s suggestion that the Federal Reserve Board replace the phrase “would normally” with the word “must” was not adopted. See PROPOSED REVISIONS, *supra* note 112, at 4.

Because an underwater borrower is unable to tender,¹⁹⁸ under most courts' interpretation of *Yamamoto*, that borrower will not have the opportunity to prove in court that the lender has violated TILA. As predicted by the National Consumer Law Center, creditors in the Ninth Circuit routinely "contest all rescission notices and move to dismiss in the hopes that the consumer cannot tender immediately."¹⁹⁹

Yamamoto and its progeny fail to recognize that a consumer who appears *at the outset of the case* unable to tender will not necessarily remain incapable of repaying the lender. In dismissing inability-to-tender cases at the pleading stage, courts are exercising judicial euthanasia in spite of the patient's fighting chance at survival. Most significantly, a consumer who brings a TILA rescission claim may have other viable causes of action.²⁰⁰ Damages awarded under these additional claims, if the plaintiff is successful, would reduce her total obligation to the creditor.²⁰¹ In other words, the borrower's tender obligation cannot be calculated with certainty at such an early stage of the litigation.

In addition, in limited cases, borrowers whose tender obligations only slightly eclipse the value of their homes may be able to refinance their mortgage loans with community banks or nonprofit lenders.²⁰² These lenders' underwriting standards may be slightly more relaxed than those of larger banks. These opportunities, however, are few and far between.²⁰³ Nevertheless, "cutting consumers off at the knees"²⁰⁴ by dismissing potentially viable TILA rescission claims at the outset of rescission cases inequitably penalizes borrowers for what may be a temporary inability to tender.

Regardless of whether or not a plaintiff in the Ninth Circuit must demonstrate an ability to tender to survive a motion to dismiss, consumers in the western United States whose home values have

198. See THOMPSON & RENUART, *supra* note 28, § 6.8.2, at 293.

199. See PROPOSED REVISIONS, *supra* note 112, at 4; Telephone Interview with Dan Mulligan, *supra* note 48.

200. THOMPSON & RENUART, *supra* note 28, § 6.9.8.1, at 298 (advising attorneys, particularly those handling inability-to-tender cases, to "be alert to other claims to further reduce the ultimate tender amount"); 2 HOWARD J. ALPERIN & ROLAND F. CHASE, CONSUMER LAW: SALES PRACTICES AND CREDIT REGULATION § 443, at 79 (Supp. 2009) (indicating that a TILA violation may also constitute a violation of a state's unfair and deceptive acts and practices statute).

201. See THOMPSON & RENUART, *supra* note 28, § 6.9.8.1, at 298.

202. Telephone Interview with Daniel Lindsey, Supervisory Attorney, Legal Assistance Found. of Metro. Chi. (Jan. 27, 2010).

203. Specifically, only attorneys with significant community contacts (e.g., legal aid attorneys) may be able to negotiate such a financing arrangement. *Id.*

204. *Id.*

dropped dramatically and who, as a result, cannot tender in full and immediately, have little hope of seeking rescission in the non-bankruptcy setting.

B. Other Circuits: Complete Adjudication, but Relief for Underwater Borrowers Remains Elusive

1. Background

A small but growing fraction of courts outside the Ninth Circuit follow *Yamamoto*, opting to dismiss rescission claims in inability-to-tender cases before determining whether or not the lender has, in fact, committed a material disclosure violation.²⁰⁵ The majority of courts outside the Ninth Circuit, however, do not require borrowers to prove their capacity to repay the net loan proceeds before the court adjudicates their rescission claims.²⁰⁶

Nevertheless, all across the country, courts routinely order conditional rescission, requiring borrowers to restore the lender to the *status quo ante* by repaying the net loan proceeds²⁰⁷ before granting the borrower any relief under TILA. Thus, while courts not

205. See, e.g., *Am. Mortg. Network, Inc. v. Shelton*, 486 F.3d 815, 818, 821 (4th Cir. 2007) (affirming district court's summary judgment dismissal of borrower's rescission claim based on conversation between borrower and creditor in which borrower claimed he was "unable" to return the loan proceeds but attempted to negotiate a sale of house to creditor; the Fourth Circuit acknowledged, however, that the "better practice" may have been to first give the plaintiffs a "time certain" in which to tender the net loan proceeds); *Moore v. Wells Fargo Bank*, 597 F. Supp. 2d 612, 616–17 (E.D. Va. 2009) (rejecting defendant's request that court disregard plaintiff's professed ability to tender based on declining housing values when ruling on defendant's motion to dismiss and viewing facts in light most favorable to plaintiff). The *Moore* court notes, however, that subsequent "pro[of] [of plaintiff's] inability to tender" would allow court to exercise its discretion to deny rescission to plaintiff. *Id.*

206. See, e.g., *Prince v. U.S. Bank Nat'l Ass'n*, No. 08-00574-KD-N, 2009 WL 2998141, at *5 (S.D. Ala. Sept. 14, 2009) (denying creditor's "premature" motion to dismiss, which was based on "nothing more than mere speculation that the Plaintiffs are incapable of performing if rescission is ordered," and indicating that the court would "address the proper procedures for implementing the rescission" only if, after a trial on the merits, the court concluded that the borrowers were entitled to rescind the loan); *Jobe v. Argent Mortg. Co.*, No. 3:CV-06-00697, 2009 WL 2461168, at *5, *7 (M.D. Pa. Aug. 11, 2009) (concluding after a non-jury trial that the defendant had not violated TILA, but noting that even if the plaintiffs had successfully established a TILA violation, rescission would nevertheless be inappropriate because the plaintiffs had acknowledged their inability to tender in full and had defaulted on their mortgage, property tax, and property insurance obligations); *Jones v. REES-MAX, LLC*, 514 F. Supp. 2d 1139, 1146 (D. Minn. 2007) (rejecting creditor's summary judgment argument that borrowers "[were] not entitled to rescission" because they "[had] not met their burden of demonstrating that they could tender the value of the property within a reasonable period").

207. See *supra* Part I.B.2.b.

directly bound by *Yamamoto* are more likely to fully adjudicate rescission claims, a borrower's inability to tender dooms her case to failure and precludes relief for a creditor's disclosure violations. If, after the court determines that a plaintiff has a right to rescind, borrowers cannot tender in full immediately or within the timeframe prescribed by the court, lenders who have violated TILA need not return borrowers to the *status quo ante* by releasing their security interests and returning fees and finance charges.

In one respect, however, borrowers outside of the Ninth Circuit fare significantly better than their counterparts. Because courts not bound by *Yamamoto* generally reject creditors' arguments that plaintiffs must establish an ability to tender at an early stage of the litigation to salvage their claims, creditors—conscious of swelling costs and attorneys' fees—are more likely to consider settling these cases. This result is a significant improvement over the fate of borrowers' rescission cases in courts applying *Yamamoto*. *Yamamoto*'s orbit, however, continues to expand beyond the Ninth Circuit.²⁰⁸ Moreover, as the number of inability-to-tender cases grows, creditors—after evaluating the dismal loan-to-value ratio of underwater consumers' mortgages—can be increasingly confident that borrowers will ultimately be unable to tender. These creditors may be less interested in settling inability-to-tender cases. Thus, even outside the Ninth Circuit, the fate of underwater borrowers' rescission claims appears increasingly dismal.

This section examines two cases that depart from the approach adopted in *Yamamoto*. While the outcome in these cases is an improvement over those in which courts dismiss inability-to-tender cases at an immature stage in the litigation, only a more comprehensive approach—such as allowing borrowers to tender in installments—will provide the vast majority of borrowers with comprehensive protection under TILA.

2. Illustrative Cases

In *FDIC v. Hughes Development Co.*,²⁰⁹ the United States District Court in Minnesota considered cross-motions for summary judgment on a foreclosure action brought by the FDIC, the receiver of the insolvent bank that originally wrote the borrowers' mortgage.²¹⁰ The borrowers argued that they had received none of the required

208. See *supra* note 205 and accompanying text.

209. 684 F. Supp. 616 (D. Minn. 1988).

210. *Id.* at 618.

TILA disclosures, a claim the FDIC did not contest.²¹¹ The court concluded that the borrowers were entitled to rescind the loan, but ordered conditional rescission out of concern that “the [borrowers’] apparently weak financial position w[ould] prevent them from repaying the principal.”²¹² The court rejected the FDIC’s argument that the borrowers’ rescission letter was invalid without a contemporaneous tender of the loan proceeds.²¹³ Instead, the court gave the borrowers a “reasonable time” of one year to tender the loan proceeds.²¹⁴ If the plaintiffs failed to tender within one year, the FDIC could foreclose on the mortgage.²¹⁵

In *Williams v. Saxon Mortgage Co.*,²¹⁶ the borrowers sought to rescind their thirty-year, adjustable-rate mortgage with a teaser rate of 8.99% and an APR of 11.5%, alleging that the creditor had failed to disclose \$920 in various finance charges.²¹⁷ In its summary judgment motion, the creditor asked that the court order the plaintiffs to provide within thirty days “definitive evidence”²¹⁸ of their ability to tender should they prevail on their rescission claim.²¹⁹ If the plaintiffs were unable to make such a showing, the creditor argued that the court should dismiss the rescission action with prejudice.²²⁰ The creditor requested in the alternative that the court either: (1) order conditional rescission, or (2) require the parties to restore one another simultaneously to the *status quo ante*.²²¹

The court listed three reasons for rejecting the creditor’s request that the court require the plaintiffs to promptly prove their ability to restore the creditor to the *status quo ante*. First, by demanding that the plaintiffs demonstrate an ability to tender, the creditor (the summary judgment movant) was attempting to shift to the plaintiffs (the non-movants) the burden of proving the absence of any genuine issues of material fact.²²² The creditor had failed to establish that the

211. *Id.* at 625.

212. *Id.*

213. *Id.* at 620, 626.

214. *Id.* at 626.

215. *Id.*

216. No. 06-0799-WS-B, 2008 WL 45739 (S.D. Ala. Jan. 2, 2008).

217. *Id.* at *1.

218. *Id.* at *2.

219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.* at *5.

plaintiffs were incapable of tendering: its concerns, rather, were based on “inchoate, undeveloped fears.”²²³

Second, the court noted that even if it were the plaintiffs’ burden to prove their ability to tender on the defendant’s summary judgment motion, the plaintiffs had successfully demonstrated an ability to repay the net loan proceeds.²²⁴

Third, the court explained that even if the creditors had properly and successfully established the borrowers’ inability to tender, the court would not dismiss the case at that juncture.²²⁵ Specifically, the court would decline to “exercise its discretion to extinguish plaintiffs’ right of rescission altogether based on the mere possibility that plaintiffs may encounter difficulty in refinancing the [initial] loan.”²²⁶ The court declined the creditor’s invitation to rely on *Yamamoto*, which was distinguishable: in that case, “‘it [was] clear from the evidence that the borrower lack[ed] capacity to pay back what she ha[d] received.’”²²⁷ In contrast, the court observed, “no such clarity exist[ed]” in the present case.²²⁸

The court also refused to order conditional rescission at the current stage of the litigation, since to do so would be “putting the cart before the horse.”²²⁹ Relying on the Federal Reserve Board’s cautionary post-*Yamamoto* commentary, the court concluded that it was unnecessary to determine the logistics of the rescission process before: (1) the court adjudicated the borrowers’ rescission claim, and

223. *Id.* at *6.

224. The plaintiffs claimed that they were capable of financing their tender obligation by refinancing their current loan, since they were not underwater on their mortgage and the husband was employed full-time. *Id.* at *5. It is unclear, however, whether or not the borrowers were, in fact, above water. Although the borrowers submitted evidence that the home’s value was \$44,500, they relied on a three-year-old appraisal from March 2005. *Id.* From 2005 to 2008—the point at which the court ruled on the summary judgment motion—the value of Alabama homes declined substantially. However, even if the borrowers were slightly underwater, they may have been capable of fulfilling their tender obligation. To calculate the borrowers’ tender obligation, the court would have to deduct from the original principal balance of \$40,050 (1) payments made by the borrowers, (2) accrued finance charges, and (3) fees. *Id.* at *1. Provided the value of the home was equal to or greater than their tender obligation, the borrowers would have been able to finance their repayment obligation either through a refinancing or a sale.

225. *Id.* at *6.

226. *Id.*

227. *Id.* at *6 n.10 (quoting *Yamamoto v. Bank of New York*, 329 F.3d 1167, 1173 (9th Cir. 2003)). In *Yamamoto*, the borrowers had acknowledged in deposition testimony their inability to tender. *Yamamoto v. Bank of New York*, 329 F.3d 1167, 1168 (9th Cir. 2003).

228. *Williams*, 2008 WL 45739, at *6 n.10.

229. *Id.* at *7.

(2) the parties had had an opportunity to agree among themselves how to return one another to the *status quo ante*.²³⁰

The outcomes in *Hughes* and *Williams* are more consistent with TILA's consumer-protective functions than are cases that strictly apply *Yamamoto*. In cases like *Hughes* and *Williams*, a borrower's rescission claim is not doomed at the outset for what may be a plaintiff's temporary inability to tender. Many courts that depart from the approach embraced in *Yamamoto* correctly recognize how difficult it can be to accurately assess either at the motion to dismiss or summary judgment stage a plaintiff's post-adjudication capacity to tender. An underwater plaintiff may ultimately prove able to restore her creditor to the *status quo ante* by (1) relying on damages from other successful claims to reduce her overall obligation to the creditor; (2) seeking loans from friends and family to help reduce the deficiency between the tender obligation and the value of her home; or (3) attempting to refinance the loan with a community bank, whose underwriting standards might be somewhat less rigorous than those of large commercial banks. However remote these possibilities, borrowers, as *Hughes* and *Williams* implicitly recognize, deserve an opportunity to defend their rescission claims from premature dismissal—a result most consistent with TILA's consumer-protective functions and origins.

Significantly, a borrower with a strong rescission claim that a court does not dismiss prematurely is more likely to reach a settlement with her lender (most likely, a loan modification).²³¹ This result is consistent with the consumer-protective purpose of a statute with a private right of action. TILA's plain language places all burdens on the creditor; placing on the borrower the onus of proving an ability to tender, particularly before a court has the opportunity to adjudicate the borrower's rescission claim, would substantially undermine TILA's consumer-protective function. A borrower with a viable rescission claim must be afforded the opportunity (1) to have the claim adjudicated and (2) to reach a settlement with the lender based on the strength of that claim.

While these courts' reasoning highlights the logical deficiencies in *Yamamoto* and related cases, courts can do more. Allowing borrowers to tender in installments preserves TILA's rescission remedy for an increasing number of underwater homeowners.

230. *Id.*

231. See E-mail from Pamela Simmons, *supra* note 38.

C. *Alternative Approaches: Tendering in Installments*

It is crucial for courts to adjudicate homeowners' rescission claims before entertaining creditors' arguments that plaintiffs are unable to restore creditors to the *status quo ante*. Moreover, once courts determine that borrowers are entitled to rescission, courts must be willing to exercise flexibility in crafting the logistics of the rescission process. In the following cases, courts properly used their equitable discretion to allow borrowers—the intended beneficiaries of TILA's rescission provisions—to return the net loan proceeds to creditors in installment payments. These approaches are instructive to all courts adjudicating inability-to-tender cases.

1. Non-Bankruptcy Courts

In *Mayfield v. Vanguard Savings & Loan Ass'n*,²³² the plaintiffs borrowed \$14,000 in August 1986 to refinance their second mortgage (among other reasons).²³³ The loan was payable in monthly installments of \$245.88 over fifteen years at a twenty percent interest rate.²³⁴ Approximately five months later, the borrowers informed the lender that their fixed incomes made it difficult for them to pay both their first mortgage payment of \$171 and their second mortgage payment of \$245.88.²³⁵ At the lender's suggestion, the borrowers in January 1987 consolidated both mortgages into a new refinance loan of \$24,686.04, payable in monthly installments of \$477.07 at a twenty percent interest rate.²³⁶ The court concluded that the borrowers were entitled to rescind both (1) the August 1986 second mortgage refinance loan and (2) the January 1987 consolidation refinance loan, since, in each transaction, the lender failed to specify in the "Notice of Right to Cancel" when the borrowers' three-day rescission period expired and incorrectly referred to each loan as a purchase-money mortgage.²³⁷

232. 710 F. Supp. 143 (E.D. Pa. 1989).

233. *Id.* at 144–45. The borrowers received \$4,716.23 in cash proceeds from the loan. *Id.* at 144. They used additional loan proceeds to pay a water and sewer bill (\$1,428.72) and to make a payment due on their first mortgage (\$870.76). *Id.*

234. *Id.* at 145.

235. *Id.*

236. *Id.* Presumably, the borrowers' action was precipitated in part by the lender's apparent misrepresentation that the consolidation loan would reduce the borrowers' total monthly mortgage obligations. The borrowers appear to be victims of "churning." See BLACK'S LAW DICTIONARY 275–76 (9th ed. 2009).

237. *Mayfield*, 710 F. Supp. at 146.

The court refused to order conditional rescission,²³⁸ ordered the lender to cancel its security interest in the borrowers' home immediately, and allowed the plaintiffs to repay their \$16,113.62 tender obligation at \$171 per month,²³⁹ the amount of the borrowers' mortgage payment prior to the two rescinded loan refinancings.²⁴⁰ Taking a broad, reformist interpretation of TILA's objectives, the court appeared to reason that reinstating the borrowers' \$171 monthly payment was consistent with Congress's goal through rescission of restoring the parties to the *status quo ante*.

In *Shepard v. Quality Siding & Window Factory, Inc.*,²⁴¹ a home improvement loan case, the borrower entered into a credit agreement for the purchase and installation of siding on her home.²⁴² The court identified several TILA disclosure errors, including a failure to disclose the payment schedule,²⁴³ and concluded that the borrower was entitled to rescind the loan.²⁴⁴ Ordering the lender to immediately cancel its security interest in the borrower's home, the court allowed the borrower to repay to the lender the value of the aluminum siding and installation services she received, less interest and finance charges, at \$199 per month—the borrower's original monthly payment to the defendant.²⁴⁵

In *Bookhart v. Mid-Penn Consumer Discount Co.*,²⁴⁶ the court found that the lender failed to clearly disclose the fact that, when it refinanced the borrowers' prior loan, the lender acquired a new mortgage in the borrowers' home and retained its prior security interest.²⁴⁷ The court permitted the borrowers to repay \$1,376²⁴⁸ in

238. For a description of the practice of conditional rescission, see *supra* Part I.B.2.

239. The court calculated the borrower's tender obligation by tallying the funds the defendant advanced over the course of both loan transactions to (1) pay off current mortgage obligations, (2) advance some cash to the borrower, and (3) satisfy outstanding water and sewer bills; from this total, the court deducted (1) all payments made by the borrower on both loans and (2) closing costs. See *Mayfield*, 710 F. Supp. at 148–49 & nn.3–4.

240. *Id.* at 149.

241. 730 F. Supp. 1295 (D. Del. 1990).

242. *Id.* at 1296–97.

243. *Id.* at 1300–02.

244. *Id.* at 1304.

245. *Id.* at 1309.

246. 559 F. Supp. 208 (E.D. Pa. 1983).

247. *Id.* at 211.

248. The plaintiffs were required to return to the defendant the difference between the amount financed (\$3,412.20) and the total payments they had made to the lender (\$2,036). *Id.* at 212. The finance charge was cancelled by virtue of the rescission. *Id.*

monthly installments of \$15 and required the lender to cancel its security interests in the borrowers' home.²⁴⁹

The borrowers in both *Mayfield* and *Shepard* did not appear to be underwater and presumably were capable of tendering promptly and in full either through a refinancing or a sale of their homes. The courts, however, took a broad, consumer-protective view of the policies underlying rescission, concluding that, while lenders had to be made whole through the borrowers' tender obligations, borrowers could unwind the mortgage transactions slowly and affordably. These cases indicate that it is reasonable and feasible to allow rescission plaintiffs to tender in installments.

While these cases are instructive to courts considering how to structure the tender repayment process, the precise outcome in these cases should not be duplicated for an important reason: the plaintiffs in *Mayfield*, *Shepard*, and *Bookhart* were not required to pay interest on their tender installment payments.²⁵⁰ Presumably, the courts reached this result either because (1) they interpreted the TILA violations as very severe or (2) TILA provides that a borrower who exercises his or her right to rescind "is not liable for any finance or other charge."²⁵¹ Undoubtedly, for the lender to return the borrower to her pre-loan transaction position, the lender must return to the borrower all finance charges (including interest) and closing costs the borrower paid to the lender between the loan closing and the time she exercised her right of rescission.²⁵²

When, however, the court exercises its equitable discretion by allowing the borrower to return the lender to the *status quo ante* over time by making installment payments on her tender obligation, requiring the borrower to pay interest is necessary and appropriate to compensate the lender for the loss of the time-value of money (the opportunity cost suffered by the lender as a result of receiving the money over time rather than in a lump sum). A reasonable interest payment also compensates the lender for the risk of nonpayment and the possibility that inflation may cause the value of a dollar to decline before the debtor completes the repayment process.

249. *Id.* at 213.

250. The courts did not mention this fact explicitly, but subsequent interpretations of these cases are consistent with this observation. *See, e.g.,* *Bell v. Parkway Mortg., Inc. (In re Bell)* (*Bell II*), 314 B.R. 54, 61 (Bankr. E.D. Pa. 2004).

251. 15 U.S.C. § 1635(b) (2006).

252. *See id.*

Focusing, as these courts did, on an affordable installment payment plan is important to realizing the goals of TILA's rescission provisions for all borrowers—not only those who can afford to finance their tender obligations in full and immediately or within a short time. As this Article argues, imposing on offending lenders the cost of a gradual return to the *status quo ante* is a result more equitable than depriving a class of underwater borrowers the benefit of TILA's rescission-based protections.

In providing consumers with a strong private right of action in TILA's rescission provisions, Congress recognized that litigation is necessary to secure creditors' compliance with TILA's disclosure rules. If TILA's most meaningful remedies are not accessible to underwater borrowers—an increasing percentage of TILA litigants²⁵³—courts risk incentivizing lenders to engage in overreaching and misrepresentation to the extent that both increase lenders' bottom lines.

2. Bankruptcy Courts

a. The Significance of Conditional Rescission in Bankruptcy Cases

The Bankruptcy Code establishes a collective forum in which all of a consumer's debts—secured and unsecured—are categorized and satisfied either through a sale of all of the debtor's non-exempt²⁵⁴ assets (a Chapter 7 liquidation)²⁵⁵ or through the creation of a plan under which the debtor agrees to pay creditors' claims from future income over a three-year or five-year period (a Chapter 13 rehabilitation).²⁵⁶ In bankruptcy, the fate of a borrower's rescission claim in inability-to-tender cases largely depends on whether or not the judge orders conditional rescission²⁵⁷ and, therefore, whether the borrower's tender obligation will be classified as an unsecured or secured claim. This categorization is critical to lenders, since secured creditors fare much better in bankruptcy than do unsecured

253. See Telephone Interview with Pamela Simmons, *supra* note 13 (describing as a “growing problem” the number of underwater TILA litigants who are unable to tender).

254. Consistent with the Bankruptcy Code's goal of providing debtors with a “fresh start,” Chapter 7 debtors may retain certain property that they already owned at the time of bankruptcy. TABB, *supra* note 26, § 5.11, at 434 (citing 11 U.S.C. § 522(b)).

255. Liquidation bankruptcy, also known as “straight” bankruptcy, is governed by Chapter 7 of the Bankruptcy Code. *Id.* § 1.1, at 2.

256. Under Chapter 13 of the Bankruptcy Code, individuals may adjust their debts through a repayment plan of three to five years. *Id.* § 1.2, at 6.

257. See *infra* Part II.C.2.a.

creditors²⁵⁸—the “unwashed masses” of claimants consisting of credit card companies, personal creditors, and tort victims.

The majority of bankruptcy courts refuse to order conditional rescission.²⁵⁹ Instead, these courts require the lender to invalidate its security interest first, consistent with TILA’s plain language.²⁶⁰ In these cases, the lender will be treated as an unsecured creditor, and the borrower’s repayment obligation will be classified as an unsecured claim.²⁶¹ In both Chapter 7 and Chapter 13 cases, unsecured claims typically are paid out at a fraction of the face value of the debt.²⁶²

Bankruptcy courts that have adopted the majority view have reasoned that voiding the lender’s lien and treating the lender as an unsecured creditor are necessary to allow a debtor who has raised a valid rescission claim to simultaneously invoke the protections of both TILA and the Bankruptcy Code.²⁶³ These courts are reluctant to deviate from the plain language of TILA and order conditional rescission if to do so would, in effect, permit the lender to retain its favored, secured position in bankruptcy, when the lender, if the court adhered to TILA’s original rescission sequence, would otherwise be relegated to unsecured-creditor status. These courts are hesitant to upset the clear hierarchy of interests established by Congress in the Bankruptcy Code. In addition, under this view, ordering conditional rescission would require the debtor to pay the lender (who would otherwise be an unsecured creditor) in full, thereby impairing the debtor’s prospects of achieving a “fresh start” in bankruptcy.²⁶⁴

In a minority of bankruptcy decisions, however, judges routinely order conditional rescission,²⁶⁵ the dominant approach in non-

258. Whereas unsecured creditors in consumer bankruptcy cases typically receive a fraction of the face value of their claims, *see* sources cited *supra* note 2, secured creditors are entitled to be paid in full up to the value of the collateral securing their claims, TABB, *supra* note 26, § 7.27, at 735; *see* 11 U.S.C. §§ 506(a)(1), 1325(a)(5)(B)(ii) (2006).

259. RENUART & KEEST, *supra* note 11, § 6.8.4, at 468–69; *see, e.g.*, Williams v. Gelt Fin. Corp., 237 B.R. 590, 599 (E.D. Pa. 1999); *In re Bilal*, 296 B.R. 828, 840 (Bankr. D. Kan. 2003); Whitley v. Rhodes Fin. Servs. (*In re Whitley*), 177 B.R. 142, 152 (Bankr. D. Mass. 1995); *In re Piercy*, 18 B.R. 1004, 1007–08 (Bankr. W.D. Ky. 1982).

260. 15 U.S.C. § 1635(b) (2006).

261. *See* RENUART & KEEST, *supra* note 11, § 6.8.4, at 468; *e.g.*, cases cited *supra* note 259.

262. *See* sources cited *supra* note 2.

263. *See, e.g.*, *Piercy*, 18 B.R. at 1007; RENUART & KEEST, *supra* note 11, § 6.8.4, at 468–69.

264. *Piercy*, 18 B.R. at 1007–08.

265. *See, e.g.*, Quenzer v. Advanta Mortg. Corp. USA, 288 B.R. 884, 889 (D. Kan. 2003) (“Even though defendant violated TILA, automatically relegating its entire claim to

bankruptcy court settings.²⁶⁶ If a bankruptcy judge orders conditional rescission, the lender retains its security interest until the borrower fulfills its tender obligation and all other claims as part of the bankruptcy case. In these cases, the lender will be treated as a secured creditor, and the borrower's repayment obligation will be classified as a secured claim. In both Chapter 7 and Chapter 13 cases, secured creditors are paid in full up to the value of the collateral securing their claims.²⁶⁷

Like many non-bankruptcy courts, many bankruptcy courts that have ordered conditional rescission have done so to prevent debtors from enjoying a "windfall" for seemingly technical disclosure errors.²⁶⁸ Several courts, citing TILA's legislative history, have pointed out that Congress, in amending TILA to codify courts' routine practice of reverting to the common law rescission

unsecured status under these circumstances would be completely inequitable and would exact a penalty entirely disproportionate to its offense."); *Ray v. CitiFinancial, Inc.*, 228 F. Supp. 2d 664, 671 (D. Md. 2002); *Webster v. Centex Home Equity Corp.* (*In re Webster*), 300 B.R. 787, 804 (Bankr. W.D. Okla. 2003); *Wepsic v. Josephson* (*In Re Wepsic*), 231 B.R. 768, 776 (Bankr. S.D. Cal. 1998) (rejecting debtor's proposal to treat creditor's claim as unsecured and pay over the course of three or more years as contrary to rescission's purpose to return parties to *status quo ante*); *In re Apaydin*, 201 B.R. 716, 718 (Bankr. E.D. Pa. 1996) ("Even though the defendants engaged in flagrant violations of TILA, automatically relegating their entire claim to unsecured status would be an utterly disproportionate and completely inequitable penalty . . ."); *Thorp Loan & Thrift Co. v. Buckles* (*In re Buckles*), 189 B.R. 752, 766 (Bankr. D. Minn. 1995); *Lynch v. GMAC Mortg. Corp.* (*In re Lynch*), 170 B.R. 26, 30 (Bankr. D.N.H. 1994) (concluding that voiding of lien and relegating creditor to unsecured status would allow debtor to pay the creditor only a small fraction of its claim under the Chapter 13 plan, a consequence that Congress could not have contemplated). *But see Williams v. BankOne Nat'l Ass'n* (*In re Williams*), 291 B.R. 636, 655–62 (Bankr. E.D. Pa. 2003) (arguing that Congress intended to modify common law rescission practice and finding that "part of the rescission scheme which provides for the voiding of a creditor's security interest before the obligor has made payment should be applied as written unless Congress has specifically indicated that courts have the authority to modify it").

266. See *supra* Part II.B.2.

267. In Chapter 7 bankruptcy, unless the debtor redeems property subject to a security interest, 11 U.S.C. § 722 (2006), or persuades the creditor to enter into a reaffirmation agreement, 11 U.S.C. § 524(c) (2006), the trustee must return the collateral to the secured creditor, 11 U.S.C. § 725 (2006). *TABB, supra* note 26, § 7.25, at 728, § 7.32(c), at 783–86. In Chapter 13 bankruptcy, a secured creditor must receive at least the value of its secured claim (which normally is the value of its collateral). *Id.* § 1.25, at 108 (citing 11 U.S.C. § 1325(a)(5) (2006)).

268. See, e.g., *Quenzer*, 288 B.R. at 889 ("Even though the defendant violated TILA, automatically relegating its entire claim to unsecured status under these circumstances would be completely inequitable and would exact a penalty entirely disproportionate to its offense."); *In re Lynch*, 170 B.R. at 30 ("Accepting [the debtors'] position would allow chapter 13 to be utilized to provide a windfall not contemplated by the provisions of chapter 13.").

sequence,²⁶⁹ specifically contemplated that courts would order conditional rescission in the bankruptcy context.²⁷⁰ The legislative history provides that “a court might use [its] discretion [to modify TILA’s default rescission sequence] in a situation where a consumer in bankruptcy or wage earner proceedings is prohibited from returning the property.”²⁷¹

In addition, some bankruptcy courts have concluded that stripping lenders of their security interests by following TILA’s default rescission sequence allows debtors to circumvent the Bankruptcy Code’s prohibition on the modification of claims on a debtor’s principal residence.²⁷² In Chapter 13 bankruptcy, a debtor who is underwater on a television, car, or most other assets can split, or “bifurcate,” the secured lender’s claim into two portions: a secured portion represented by the fair market value of the collateral (to be paid in full), and an unsecured portion calculated by subtracting the value of the collateral from the full amount of the debt owed (to be paid at a fraction of the face value of the debt).²⁷³ Thus, an underwater debtor can satisfy a debt to its lender for less than the face value of the claim. For example, a borrower in bankruptcy who owes \$1,500 on a high-definition television worth \$900 can “strip down” the creditor’s claim to the value of the collateral—\$900. The \$900 portion of the claim must be paid in full. The deficiency of \$600 is treated as an unsecured claim, which generally is paid out to creditors at a fraction of the face value of the claim.

Congress, however, prohibits underwater homeowners from modifying residential mortgages in bankruptcy.²⁷⁴ A homeowner who owes \$250,000 on a home worth only \$200,000 must pay the lender’s

269. See *supra* notes 152–54 and accompanying text.

270. See, e.g., *Wells Fargo Ban. v. Jaaskelainen*, 407 B.R. 449, 460 (D. Mass. 2009); *Ramirez v. Household Fin. Corp. III (In re Ramirez)*, 329 B.R. 727, 742 (D. Kan. 2005); *In re Webster*, 300 B.R. 787, 802 (Bankr. W.D. Okla. 2003).

271. S. REP. NO. 96-368, at 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 236, 264–65.

272. *Jaaskelainen*, 407 B.R. at 461–62 (reversing the Massachusetts bankruptcy court’s decision that imposing conditional rescission is inappropriate in the bankruptcy context because deviating from TILA’s plain language and allowing the lender to retain its secured interest would unfairly discriminate against general unsecured creditors); *In re Ramirez*, 329 B.R. at 742 (“In this case, [by asking the court not to order conditional rescission and instead to follow TILA’s default rescission sequence,] the Ramirezes are attempting to use an equitable remedy to create a legal right to effectively strip Household’s mortgage lien, a right they are not accorded under bankruptcy law.”).

273. TABB, *supra* note 26, § 7.32, at 772; see 11 U.S.C. § 506(a)(1) (2006).

274. 11 U.S.C. § 1322(b)(2) (2006).

\$250,000 claim in full.²⁷⁵ Some courts reason that following TILA's default rescission sequence, which relegates a formerly secured mortgage lender to unsecured-creditor status, improperly circumvents the Bankruptcy Code's prohibition on the modification of residential mortgages.²⁷⁶

The following cases outline two Chapter 13 cases in which the bankruptcy judges classified the borrowers' tender obligations separately, as claims to be paid out in installments over an extended period exceeding the length of their Chapter 13 plans (which last between three and five years). These flexible approaches, like those of the *Hughes* and *Williams* courts, are instructive to courts adjudicating the rescission claims of underwater borrowers. However, where tender obligations can be satisfied more easily than outside of the bankruptcy context, encouraging underwater borrowers to file for bankruptcy is an incomplete solution. Non-bankruptcy judges have more latitude to fashion creative repayment plans than do bankruptcy judges, who are constrained by the Bankruptcy Code itself.

b. Instructive Chapter 13 Cases

In Chapter 13 bankruptcy, the debtor may satisfy the tender requirement by treating it as an unsecured claim to be repaid on a pro rata²⁷⁷ basis with other unsecured creditors through a debt readjustment plan.²⁷⁸ While the borrowers in *In re Bell*²⁷⁹ and *In re*

275. Most believe that the prohibition on the modification of residential mortgages was intended to prevent a reduction in the availability of home mortgage loans and the tightening of the conditions required to obtain a mortgage loan. *See, e.g.,* Grubbs v. Hous. First Am. Sav. Ass'n, 730 F.2d 236, 246 (1st Cir. 1984); Robert M. Zinman & Novica Petrovski, *The Home Mortgage and Chapter 13: An Essay on Unintended Consequences*, 17 AM. BANKR. INST. L. REV. 133, 136–38 (2009). *But see* Levitin, *supra* note 3, at 573 n.26 (noting that there is no conclusive evidence in the legislative history that the antimodification provision was intended to preserve mortgage credit). Recent proposals to nullify the prohibition on modifying home mortgages in bankruptcy have stalled. *See* S. Amend. 1014 to Helping Families Save Their Homes Act of 2009, S. 896, 111th Cong. (2009); Helping Families Save Their Homes Act of 2009, S. 895, 111th Cong. (2009); Helping Families Save Their Homes Act of 2009, H.R. 1106, 111th Cong. (2009).

276. *See* cases cited *supra* note 2702.

277. A creditor's claim paid on a "pro rata basis" is paid in the same proportion that the claim bears to the aggregate amount of all claims in the same "class," or category. 2 THOMAS J. SALERNO & JORDAN A. KROOP, BANKRUPTCY LITIGATION AND PRACTICE: A PRACTITIONER'S GUIDE app. 1, at 19 (Supp. 2010–2011).

278. David P. Leibowitz, *2009 Survey of Residential Mortgage Issues in Consumer Bankruptcy Cases*, in NORTON ANNUAL SURVEY OF BANKRUPTCY LAW 317, 329–32 (William L. Norton, Jr. ed., 2009).

279. *Bell v. Parkway Mortg., Inc. (In re Bell)* (*Bell I*), 309 B.R. 139 (Bankr. E.D. Pa. 2004); *Bell II*, 314 B.R. 54 (Bankr. E.D. Pa. 2004).

*Sterten*²⁸⁰ were not underwater, they, like underwater borrowers, were experiencing financial hardship, limiting their ability to immediately return their lenders to the *status quo ante*.

In *In re Bell*, the court found that the debtor was entitled to rescission because the lender failed to provide the debtor with either copy of the "Notice of Right to Cancel" at the loan closing.²⁸¹ In a later opinion, in response to the debtor's argument that she could not repay the full tender amount over the remainder of her five-year Chapter 13 plan, the court concluded that the debtor could establish a "reasonable repayment schedule" that exceeded the duration of the plan.²⁸²

In a subsequent hearing, the court ordered the borrower to repay its tender obligation of \$46,630 over fifteen years (the original loan term) at 10.8% interest, the parties' original contract rate.²⁸³ The court classified the borrower's repayment obligation as an unsecured claim but lifted the stay to enable the lender to record this obligation as a judgment in the real property records.²⁸⁴ Subsequently, the parties agreed to a settlement: a loan modification that reduced the interest rate to seven percent.²⁸⁵ In addition, the parties agreed that the lender would retain its security interest in the borrower's home during the repayment period.²⁸⁶

In *In re Sterten*, the bankruptcy court ordered conditional rescission, allowing the creditor to retain its security interest until the debtor fulfilled her tender obligation.²⁸⁷ In addition, the court allowed the debtor to repay her tender obligation over the original mortgage term of 302 months in monthly payments of \$790, a figure "at the upper end of what [the debtor] believe[d] she c[ould] afford."²⁸⁸ This monthly payment and loan term resulted in an interest rate of 6.36%.²⁸⁹

In making these determinations, the *Sterten* court recognized two competing considerations—one that favored the debtor and one that

280. *Sterten v. Option One Mortg. Corp.* (*In re Sterten*), 352 B.R. 380 (Bankr. E.D. Pa. 2006).

281. *Bell I*, 309 B.R. at 158.

282. *Bell II*, 314 B.R. at 62.

283. *Bell II*, No. 01-14420, slip op. at 2 (Bankr. E.D. Pa. Dec. 30, 2004) (order).

284. *Id.* at 3.

285. *Bell II*, No. 01-14420, slip op. at 1 (Bankr. E.D. Pa. May 31, 2005) (order confirming plan under chapter 13).

286. *Id.*

287. *In re Sterten*, 352 B.R. 380, 390 (Bankr. E.D. Pa. 2006).

288. *Id.* at 390.

289. *Id.* at 390 n.16.

avored the creditor. On the one hand, restructuring the mortgage terms to maximize the likelihood that the debtor could successfully tender in full (albeit over a “lengthy repayment period”) was crucial to preserving TILA’s consumer-protective function.²⁹⁰ At the same time, however, the lender’s disclosure violation, although a “material” error under TILA that triggered the borrower’s right of rescission, did not involve any “pervasive overreaching or irregularities.”²⁹¹ Under this view, the lender’s relatively minor disclosure error should trigger a correspondingly mild penalty.

In an attempt to reconcile these competing considerations, the bankruptcy court reached an appropriate compromise: it permitted the lender to retain its security interest pending the debtor’s fulfillment of her repayment obligation, thereby helping to ensure that the lender would be returned to the *status quo ante* (albeit over an extended period of time) and would not suffer a forfeiture (in the event of the debtor’s default).²⁹² At the same time, the court allowed the debtor to return the net loan proceeds to the lender in affordable installments over the remaining loan term.²⁹³ The court recognized that sustaining TILA as a viable enforcement tool required that the court exercise flexibility in structuring affordable repayment terms.

These two opposing factors—(1) the need to preserve consumers’ ability to rescind as a means of enforcing the statute’s objectives and (2) concerns about imposing excessive liability on creditors for de minimis violations—are present in the vast majority of TILA rescission actions. Although TILA imposes liability on creditors on a strict liability basis, it is not unreasonable for courts, in crafting an equitable remedy, to be able to consider whether or not the lender’s disclosure error was intentional or in bad faith. Nonetheless, it is crucial to preserve consumers’ access to TILA’s rescission remedy, regardless of whether these consumers are underwater or in bankruptcy, since ordinary citizens, through a private cause of action under TILA, sustain an important public policy objective: ensuring that creditors accurately and completely disclose the cost of credit. The judges in *In re Bell* and *In re Sterten* recognized that to preserve TILA’s rescission remedy—complete with its crucial deterrent functions and ability to help borrowers discern the true cost of borrowing money—courts must consider

290. *Id.* at 389.

291. *Id.* at 390.

292. *Id.*

293. *Id.*

allowing the borrower to tender in affordable installment payments. In essence, the affordability or feasibility of borrowers' obligation to return the lender to the *status quo ante* is crucial to preserving TILA's rescission remedy in a depressed housing market.

One might argue that preserving consumers' access to rescission in inability-to-tender cases can be accomplished most easily by encouraging underwater borrowers to file for Chapter 13 bankruptcy, where a court, like those in *In re Bell* and *In re Sterten*, has substantial expertise in helping the debtor structure a repayment plan,²⁹⁴ determining what interest rate to apply, and determining when a case must be dismissed based on the infeasibility²⁹⁵ of the debtor's proposed repayment schedule. Indeed, most TILA rescission plaintiffs bring rescission actions defensively in response to foreclosure actions,²⁹⁶ many of which may have been precipitated by a job loss, separation or divorce, or illness that causes additional irreparable financial strain. These plaintiffs might be good candidates for bankruptcy. In addition, it seems logical to craft the most flexible repayment options for inability-to-tender plaintiffs experiencing a degree of financial hardship that forces them to invoke the protection of the Bankruptcy Code.

While Chapter 13 bankruptcy judges should be more amenable to allowing borrowers to repay their tender obligations over installments that exceed the length of their three- to five-year plans, encouraging underwater borrowers to bring their rescission claims in bankruptcy is an incomplete solution. Although bankruptcy judges have substantial expertise in crafting repayment plans, the Bankruptcy Code itself has the potential to constrain judges' options. Allowing debtors to tender in installments, for example, is vulnerable to the argument that such an approach unlawfully circumvents Congress's prohibition on the modification of mortgages on debtors' principal residences.²⁹⁷ Moreover, particularly as the number of foreclosures increases, pushing down the prices of neighboring homes, borrowers who are underwater on their mortgages (and who therefore are unable to tender in full and immediately) may grow more distinguishable from the population of prototypical bankruptcy debtors. The inability of borrowers to tender is a problem involving issues broader than those of borrower insolvency. Homeowners'

294. See 11 U.S.C. § 1322(a)–(f) (2006).

295. See 11 U.S.C. § 1325(a)(6) (2006).

296. See *supra* note 50.

297. See, e.g., *Wells Fargo Bank v. Jaaskelainen*, 407 B.R. 449, 461–62 (D. Mass. 2009).

inability to finance their tender obligations by tapping the wealth in their homes is a more ubiquitous problem that both bankruptcy and non-bankruptcy judges should be ready and willing to address.

While bankruptcy courts have the capacity to assist underwater TILA plaintiffs with two statutory tools—TILA's rescission provisions and the Bankruptcy Code—it is crucial that non-bankruptcy judges provide borrowers with similarly broad access to rescission. Because the vast majority of bankruptcy practitioners are unfamiliar with consumer law claims and defenses under statutes like TILA,²⁹⁸ the majority of rescission claims are adjudicated by non-bankruptcy judges. Moreover, because most consumers bring rescission actions defensively in response to foreclosure actions, state court judges are likely to be the first arbiters of TILA claims. Thus, while bankruptcy judges must be open to modifying underwater borrowers' repayment obligations to sustain TILA's broader policy objectives, non-bankruptcy judges, who resolve a larger percentage of TILA rescission claims, have the capacity to advance these goals more expansively.

III. WHY INSTALLMENT PAYMENTS MAKE SENSE

This Part explores why allowing borrowers to tender in installments is superior to courts' dominant approach of denying rescission relief to borrowers who are unable to tender in full and immediately. Installment payments are consistent with the language of the statute and its consumer-protective purposes. This proposal, moreover, sustains and enhances the relatively small amount of leverage consumers possess in a largely inhospitable legal and economic climate.

A. *Weighing the Equities*

Although TILA rescission varies considerably from its common law cousin,²⁹⁹ courts have concluded that, in one respect, TILA rescission and common law rescission are coterminous: both attempt to return the parties to the *status quo ante*.

When borrowers are underwater and unable to tender either through a refinancing or a sale of the home, they are incapable of restoring the lender to its pre-mortgage loan transaction position. Although some consumer speculators gambled on real estate before

298. Telephone Interview with David P. Leibowitz, *supra* note 50.

299. See *supra* Part I.B.1.

the housing bubble burst,³⁰⁰ dramatic regional and national declines in home prices are attributable to various factors³⁰¹ for which the vast majority of borrowers bear little responsibility. In this context, imposing on lenders (those who violated TILA) or their assignees (those who purchased defective mortgages from TILA violators) the cost of a gradual return to the *status quo ante* through installment payments is preferable to depriving a significant percentage of the population of TILA's protections. Creditors have the ability to ensure not only that disclosures are accurate, but also that borrowers receive suitable mortgages that, based on a thorough inquiry into the borrowers' current income and credit history, borrowers can afford. Creditors are the least-cost avoiders of disclosure violations and the first line of defense against mortgage complications that trigger rescission actions.

While one might argue that this approach imposes too significant of a penalty on creditors, it is important to remember that Congress specifically fashioned a very strict mechanism to enforce TILA's disclosure requirements.³⁰² TILA substantially relaxes the requirements for seeking relief under the common law³⁰³ and imposes liability on lenders on a strict liability basis³⁰⁴ in order to encourage lenders to disclose the key terms of mortgage loan transactions clearly, consistently, and completely. By providing a private right of action with a severe remedy like rescission, TILA encourages consumers, serving as "private attorneys general," to police the marketplace.³⁰⁵ Allowing consumers to tender in installments is not a draconian *reformulation* of the rescission remedy; it is a more modest change necessary to *preserve* a long-standing and exacting remedy in danger of growing defunct in an idiosyncratic housing market.

One rescission provision suggests that, in certain cases, Congress was not interested in hewing too closely to a strict requirement of returning the parties to the *status quo ante* if doing so would elevate form over function and deny otherwise eligible borrowers access to

300. See Todd J. Zywicki & Joseph D. Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 3–4 (2009).

301. See generally Kurt Eggert, *The Great Collapse: How Securitization Caused the Subprime Meltdown*, 41 CONN. L. REV. 1257 (2009) (listing, inter alia, low-documentation loans, inflated house appraisals, and teaser rates as causes of the subprime meltdown).

302. See *supra* notes 102–05 and accompanying text.

303. See *supra* Part I.B.1.

304. See *supra* note 39 and accompanying text.

305. *Parker v. DeKalb Chrysler Plymouth*, 673 F.2d 1178, 1181 (11th Cir. 1982); *Ratner v. Chemical Bank New York Trust Co.*, 329 F. Supp. 270, 280 (D.C.N.Y. 1971); Murken, *supra* note 148, at 461 (citations omitted).

the rescission remedy altogether. In section 1635(b), TILA provides that "if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value."³⁰⁶ Some commentators have concluded that this provision applies to consumers' tender obligations in the home improvement credit sale context, in which a borrower enters into a contract for the purchase and installation of home improvement materials (e.g., aluminum siding).³⁰⁷ In a home improvement credit sale, the creditor does not take out a mortgage on the borrower's home. TILA nevertheless requires the contractor to provide borrowers with a "Notice of Right to Cancel," since a borrower's failure to pay all or a portion of the contract price may trigger the placement of a lien on the borrower's home.³⁰⁸ Just as in the mortgage refinancing context, a creditor's failure to completely and accurately disclose the borrower's right to cancel the transaction during the three-day "cooling-off period" can extend TILA's rescission period to up to three years.³⁰⁹

Generally, in returning her creditor to the *status quo ante*, a borrower must tender whatever specific proceeds—whether money or property—the creditor provided to the borrower under the parties' contractual relationship.³¹⁰ Thus, when a borrower in the home improvement credit sale context exercises her right to rescind, she must return to the contractor the home improvement materials she purchased. Recognizing that a strict return to the *status quo ante* would be "impracticable or inequitable" after, for example, certain materials have been affixed to the borrower's home, Congress permits such a borrower to return to the creditor the property's "reasonable value."³¹¹ Indeed, even under the common law, courts can exercise some creativity and flexibility in fashioning the mechanics of the rescission process.³¹²

306. 15 U.S.C. § 1635(b) (2006).

307. See, e.g., ROHNER & MILLER, *supra* note 82, ¶ 8.02[1][a], at 605.

308. See, e.g., Rudisell v. Fifth Third Bank, 622 F.2d 243, 251 (6th Cir. 1980) (explaining that a creditor is required to disclose the mere contingency of a mechanic's lien being placed on the home).

309. 15 U.S.C. § 1635(f).

310. See *supra* note 156 and accompanying text.

311. 15 U.S.C. § 1635(b).

312. Traditionally, under the common law, a plaintiff unable to return to the defendant precisely what she obtained in the original transaction would be denied the opportunity to rescind. Today, however, courts can fashion more creative solutions. For example, a court can allow a plaintiff attempting to rescind a purchase of property that has subsequently depreciated to restore the seller by tendering a combination of property and money. 1 DOBBS, *supra* note 100, § 4.3(6), at 614, § 4.4, at 626–27. As Dobbs has explained:

This provision might not apply in the prototypical rescindable transaction³¹³: a mortgage loan refinancing in which the creditor supplies the borrower with money—not property. This language does suggest, however, that Congress might have favored a pragmatic approach when a precise return to the *status quo ante* is either impossible or very difficult, particularly when the alternative would wholly deny TILA's protections to a class of borrowers.

Not unlike this home improvement credit sale example, requiring underwater borrowers to tender in full and immediately or risk dismissal of their rescission claims would be both “impracticable” and “inequitable.” When an innocent borrower's housing value declines unforeseeably, cleaving to a strict requirement that the borrower return her creditor immediately to the *status quo ante* undermines TILA's ability to protect a substantial percentage of American homeowners.

Courts, moreover, through conditional rescission, have been willing to use their equitable authority to protect lenders from partially or completely losing the benefit of their bargains.³¹⁴ In crafting TILA's rescission provisions, Congress reversed the sequence of events necessary to effectuate a rescission under common law.³¹⁵ Under the common law, a borrower must tender first. Until she does so, the rescission remedy is unavailable. By reversing this sequence and requiring lenders to invalidate their security interests in borrowers' homes shortly after receiving a borrower's rescission notice, Congress shifted significant leverage to consumers. By later

A rescission is an avoidance of a transaction. Rescission will normally be accompanied by restitution on both sides.

....

Restitution like other remedies must make the best of a bad situation. Adjustments that combine restitution *in specie* with restitution in money, or even combine restitution and damages, are more flexible and can be more attuned to the equities of the particular case. Legal thinking today permits judges to be attuned to forming remedies that are responsive to the case At least in some cases of wrongful conduct by the defendant, it may be that the plaintiff should be permitted to make restitution that is not *in specie* or that is not fully so.

Id.

313. See, e.g., ROHNER & MILLER, *supra* note 82, ¶ 8.01[1], at 597–98. Some practitioners, however, have cited this provision in arguments that returning the property (the home) to the creditor satisfies the tender requirement. THOMPSON & RENUART, *supra* note 28, § 6.8.2, at 294.

314. See *supra* Part I.B.2.

315. See *supra* Part I.B.1.

reinstating the common law sequence of events, courts put creditors back in the driver's seat.

This Article does not discuss in detail the propriety of conditional rescission. Those arguments have been explored elsewhere.³¹⁶ It is crucial to observe, however, that courts have "flexed their equitable muscles"³¹⁷ in retooling TILA's rescission provisions to preserve creditors' rights. Courts concluded that, without reshuffling the sequence of the steps in the rescission process, a forfeiture would occur: lenders would release their security interests in borrowers' homes, and some would be repaid only in part or, on occasion, not at all.³¹⁸

A similar forfeiture is now occurring in today's depressed housing market. If courts do not consider allowing borrowers to tender in installments, courts risk limiting TILA's extended rescission rights to a decreasing pool of privileged borrowers—those who can afford to tender from available funds or those with sufficient equity in their homes to finance their tender obligations through a refinancing or sale. This sacrifice can be averted if courts allow borrowers to tender in installments.

B. A Gradual Return to the Status Quo Ante

Allowing borrowers to tender in installments is consistent with both TILA's consumer-protective purpose and its plain language. TILA provides that creditors must tender within twenty days after receiving the borrower's rescission notice.³¹⁹ Congress imposed no such time limit for borrowers.³²⁰ In interpreting this provision, courts have concluded that borrowers, therefore, must tender within a "reasonable time."³²¹ In a depressed housing market—one in which borrowers, through no fault of their own, are unable to tender in full and immediately—allowing borrowers to tender in installments supplies the "reasonable time" necessary to prevent TILA's rescission remedy from being rendered obsolete for a significant number of borrowers.

316. See sources cited *supra* note 148.

317. Murken, *supra* note 148, at 465.

318. See, e.g., Rudisell v. Fifth Third Bank, 622 F.2d 243, 254 (6th Cir. 1980).

319. 15 U.S.C. § 1635(b) (2006).

320. See *id.*

321. See, e.g., *In re Sterten*, 352 B.R. 380, 387 (Bankr. E.D. Pa. 2006).

C. *Preserving Rescission As a Significant Source of Borrower Leverage*

Courts' willingness to circumscribe rescission—both by ordering conditional rescission and generally refusing to allow borrowers to tender in installments—may be in part attributable to persistent criticisms frequently leveled against TILA's rescission provisions.³²² This section considers these common critiques. It concludes that TILA, albeit sometimes an imprecise or indirect means of protecting consumers, must be preserved for two primary reasons. First, although, as many have argued, disclosure-based regulation is an imperfect means of protecting consumers, and TILA disclosures must be improved,³²³ rescission reinforces Congress's original intent in passing TILA: facilitating the disclosure of accurate and consistent information about the cost of credit. Second, TILA's rescission provisions promote a more subtle objective: providing consumers with a meaningful source of leverage in a predominantly inhospitable legal and economic environment.

The elements a plaintiff must establish to rescind a contract under a common law claim of fraudulent misrepresentation contrast sharply with the elements a plaintiff must establish to rescind a loan transaction under TILA.³²⁴ As a result, the link between the event giving rise to the plaintiff's right of rescission (the lender's disclosure violation) and the harm suffered by the plaintiff (her precise impetus to sue) is necessarily attenuated in some rescission cases.

Courts have observed this disconnect, and many may be more likely to order conditional rescission or reject a plaintiff's request to tender in installments for this reason. Some courts appear to perceive rescission as a draconian punishment for seemingly harmless or "technical" disclosure errors.³²⁵ An argument that TILA's rescission

322. See, e.g., Carrillo & Kofoed, *supra* note 92, at 5 (describing how creditors, in urging courts to apply conditional rescission, frequently raise protestations about "improvident consumer spending, the (mis)use of rescission to palliate economic woes caused by consumer overspending, judicial disregard for the realities of mortgage lending, and . . . the current volatility of the nation's economy").

323. See, e.g., McCoy, *supra* note 54, at 139; Renuart & Thompson, *supra* note 7, at 190 (arguing that the Federal Reserve Board should revise TILA's definition of "finance charge" to make it a more inclusive and, therefore, more accurate reflection of the cost of credit); Sovern, *supra* note 54 (suggesting that TILA's disclosure regime should be replaced with a "comprehension regime" under which lenders would be required to insure that borrowers understand their loan terms).

324. See *supra* Part I.B.1.

325. See, e.g., *King v. Long Beach Mortg. Co.*, 672 F. Supp. 2d 238, 249 (D. Mass. 2009) (explaining how the more rigorous test applied in the First Circuit is consistent with

remedy imposes excessive liability on creditors helped sway three circuits to deny members of TILA class actions access to rescission.³²⁶ Courts remain willing to order conditional rescission for “non-egregious” violations, and, presumably, courts might refuse to allow borrowers to tender in installments for the same reason.

While the disclosure violations that trigger rescission at first glance may appear inconsequential, rescission is triggered by errors in only a handful of the many categories of information that TILA requires creditors to disclose to borrowers.³²⁷ Under TILA, “material disclosures” include the APR, the method of determining the finance charge and the balance upon which a finance charge will be imposed, the amount of the finance charge, the amount to be financed, the total of payments, the number and amount of payments, and the due dates or periods of payments scheduled to repay the indebtedness.³²⁸ This information is essential to a borrower’s intelligent assessment of whether or not a particular loan is a suitable economic transaction.

Some courts, moreover, appear more hesitant to allow borrowers to seek rescission on the eve of foreclosure sales. These courts might interpret the rescission action as an opportunistic and evasive maneuver, rather than as an honest attempt to unwind a mortgage transaction entered into with incomplete or inaccurate information. Several courts, for example, have expressed that rescission is not intended to allow borrowers to reform their mortgages to obtain a “better deal” than the borrowers initially bargained for.³²⁹ Indeed, under the common law, a consumer who waits longer than a “reasonable time” after the initial transaction may be estopped from seeking rescission.³³⁰

Undoubtedly, the statute does allow some plaintiffs to sue opportunistically. Some plaintiffs who have suffered a de minimis TILA violation can bring a rescission action to escape from a bad mortgage—one with onerous terms, or one that the plaintiff simply

Congress’s 1995 amendments to TILA, which attempted to prevent creditors from facing “draconian” liability for relatively minor errors).

326. See, e.g., *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418, 427 (1st Cir. 2007) (interpreting Congress’s 1995 amendments to TILA as a “manifest intent to shield residential lenders from crushing liability”). See generally Carrillo & Kofoed, *supra* note 92 (analyzing whether consumers can seek a class-action rescission under TILA).

327. 15 U.S.C. § 1602(u) (2006); Telephone Interview with Elizabeth Renuart, Assistant Professor, Albany Law Sch. (Jan. 14, 2010).

328. See 15 U.S.C. § 1602(u).

329. See, e.g., *Am. Mortg. Network, Inc. v. Shelton*, 486 F.3d 815, 820 (4th Cir. 2007).

330. See sources cited *supra* note 99.

can no longer afford as a result of an intervening job loss, a divorce or separation, or illness.

Any statute that provides broad and meaningful consumer protection, however, will have some unintended beneficiaries. It is inappropriate to rebuke a plaintiff who has established a disclosure error for “abusing” TILA, a statute that provides borrowers, the “private attorneys general” who enforce the statute, with a strict-liability remedy. In TILA’s rescission provisions, Congress relaxed the requirements a borrower must satisfy to seek rescission for fraudulent misrepresentation under the common law.³³¹ Congress thereby necessarily and predictably deemphasized borrowers’ motivations for bringing a rescission action and simultaneously accentuated the importance of lenders’ compliance with TILA’s disclosure rules.

Moreover, the frequent “off-label” use of TILA’s rescission provisions—borrowers’ attempts to seek rescission primarily to save their homes from foreclosure³³²—must not dissuade courts from providing underwater plaintiffs full relief under TILA’s rescission provisions. This use of TILA by consumers must not be conceptualized as abuse or as indulgent opportunism, but as a legitimate attempt to alleviate financial strain in a legal environment generally lacking in substantive protections for consumers.³³³ To the extent that TILA, primarily a disclosure statute, has produced a large class of “accidental” plaintiffs who seek relief from onerous mortgage terms, legislators can consider whether a more targeted solution to consumers’ mortgage distress is appropriate. In the meantime, however, TILA’s rescission provisions should be preserved as a stop-gap measure of protection in the marketplace, which provides consumers with little substantive relief. Currently, consumers, particularly overleveraged consumers, have precious few safeguards in the marketplace. Common law remedies are insufficient to protect borrowers from lender overreaching.³³⁴ Deregulation of usury laws

331. See *supra* Part I.B.1.

332. See Telephone Interview with David P. Leibowitz, *supra* note 50.

333. Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143, 148–63 (2009).

334. See, e.g., Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 48–49 (2005) (explaining the difficulty of suing predatory lenders under a common law fraud theory).

has rendered any price for credit legal.³³⁵ The lack of an across-the-board prohibition on harmful loan terms, including prepayment penalties and teaser rates, has incentivized brokers and lenders to match consumers with unsuitable mortgage products. In bankruptcy, consumers are unable to modify mortgages on their principal residences.³³⁶ In spite of financial incentives subsidized by taxpayer dollars, servicers are frequently unable and/or unwilling to modify homeowners' mortgages.³³⁷

Lawyers representing clients in rescission actions acknowledge that TILA's rescission provisions are a blunt instrument, one providing "rough justice"³³⁸ to consumers whose mortgages may suffer from a range of defects, including material TILA disclosure errors.³³⁹ One attorney describes rescission as an "Al Capone"³⁴⁰ claim, a means of seeking justice for consumers for TILA violations committed by lenders who may be guilty of various other transgressions that may or may not be actionable.³⁴¹ A TILA rescission claim, albeit more mundane than other causes of action, is more "user-friendly"³⁴² to rescission plaintiffs.

To some, allowing borrowers to tender in installments to preserve TILA's rescission remedy and to facilitate the delivery of "rough justice" might appear unsatisfactorily imprecise. Undeniably, legislators should pursue targeted solutions to vulnerabilities in the country's consumer-protection edifice. Congress, for example, has abandoned promising long-term solutions to the housing crisis in response to powerful lobbying campaigns by the financial industry.³⁴³

335. ELIZABETH RENUART & KATHLEEN E. KEEST, NAT'L CONSUMER LAW CTR., *THE COST OF CREDIT: REGULATION, PREEMPTION, AND INDUSTRY ABUSES* § 1.1, at 1 (4th ed. 2009).

336. See sources cited *supra* note 3.

337. See, e.g., Goodman, *supra* note 51.

338. Telephone Interview with Diane Thompson, Of Counsel, Nat'l Consumer Law Ctr. (Jan. 22, 2010).

339. *Id.*

340. Telephone Interview with Daniel Lindsey, *supra* note 202. Al Capone was an infamous American gangster who was successfully prosecuted for income tax evasion. His trial and those of his top associates "made it clear to federal agents and criminals alike that people whom state governments would or could not prosecute for murder, extortion, and other serious crimes could be sent to jail by the national government for violation of the income tax laws." RON CHRISTENSON, *POLITICAL TRIALS IN HISTORY: FROM ANTIQUITY TO THE PRESENT* 56 (1991).

341. Telephone Interview with Daniel Lindsey, *supra* note 202.

342. See FISCHER, *supra* note 99, at 528.

343. See, e.g., Margaret Chadbourn, *Senate Mortgage 'Cram-Down' Bill Headed to Defeat as Banks Balk*, BLOOMBERG (Apr. 30, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aJ_sqd73P0Wk&refer=us.

Although the Dodd-Frank Act³⁴⁴ and the nascent Bureau of Consumer Financial Protection may help provide relief to consumers, meaningful improvements to laws benefitting homeowners appear elusive.

Thus, for the moment, TILA remains one of the only significant sources of consumer leverage in the loan modification setting.³⁴⁵ Significantly, allowing underwater borrowers to tender in installments—the effective equivalent of a mortgage modification—would benefit consumers, lenders, and communities alike. Borrowers frequently seek rescission in a last-ditch attempt to avoid foreclosure. If these borrowers are granted access to rescission in spite of their inability to tender in full and immediately, they are less likely to “strategically default” by walking away from their mortgages altogether. Averting foreclosures prevents familial instability, limits lenders’ financial losses, and protects communities from further degradation in home values, from dilution of their property tax base, and from the blight associated with empty homes.³⁴⁶

CONCLUSION

The right of rescission under TILA is a remedy that helps deter lender overreaching and fraud during one of the most complex financial transactions of a borrower’s lifetime. The depressed housing market, however, has substantially impaired many borrowers’ ability to fulfill their responsibilities in the unwinding process: restoring the

344. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

345. See *supra* note 51 and accompanying text.

346. See CONG. OVERSIGHT PANEL, *supra* note 28, at 34; see also Phillip Lovell & Julia Isaacs, *The Impact of the Mortgage Crisis on Children and Their Education*, FIRST FOCUS, Apr. 2008, at 1–2, available at http://www.brookings.edu/~media/Files/rc/papers/2008/04_mortgage_crisis_isaacs/04_mortgage_crisis_isaacs.pdf (“Over the next 2 years, an estimated 2 million children will be directly impacted by the mortgage crisis as their families lose their homes due to foreclosures. These children are not just losing their homes, but they also risk losing their friends, schools, and in many ways, their childhood.”); John Y. Campbell et al., *Forced Sales and House Prices*, MIT DEP’T OF ECON., 20–21 (Dec. 2009), <http://econ-www.mit.edu/files/3914> (concluding that, on average, a foreclosure reduces the value of a home by twenty-seven percent and that homes within 264 feet of a foreclosed home decline in value by one percent); *Neighborhood Stabilization Program Grants*, U.S. DEP’T OF HOUS. AND URBAN DEV., http://www.hud.gov/offices/cpd/community_development/programs/neighborhoodspg (last updated Sept. 8, 2010) (describing federal grants available to states, local governments, and nonprofit organizations to stabilize and rehabilitate foreclosure-ravaged communities).

lender to the *status quo ante* by repaying the net loan proceeds of the mortgage transaction.

Under courts' dominant approach, when borrowers are unable to tender in full and immediately or within a short time, the consumer-protective functions of rescission—and the remedy's deterrent role—are undermined. In the western United States, most courts, citing the Ninth Circuit's holding in *Yamamoto*, dismiss inability-to-tender cases at the pleading stage. If borrowers are unable to establish at the outset of the case an ability to tender, these courts, in reliance on *Yamamoto*, prematurely dispose of cases with potentially viable rescission claims. As a result, lenders defending rescission claims in courts in the Ninth Circuit routinely file motions to dismiss in the hopes that the plaintiffs will be unable to establish an ability to repay the net loan proceeds of the mortgage transaction. For this reason, practitioners in the western United States turn away borrowers who are substantially underwater on their mortgages and therefore unable to finance their tender obligations in full and immediately, regardless of the strength of their rescission claims—and the severity of the lenders' disclosure errors.

Outside of the Ninth Circuit, courts generally fully adjudicate borrowers' rescission claims, but, because courts around the country routinely order conditional rescission, borrowers outside the Ninth Circuit fare only slightly better than their counterparts. When courts order conditional rescission, they reinstate the common law sequence of events necessary to effectuate the unwinding process: borrowers must restore their lenders to the *status quo ante* by repaying the net loan proceeds before courts will require lenders to invalidate their security interests in borrowers' homes. Lenders, conscious of ballooning litigation expenses, are more likely to settle cases outside of the Ninth Circuit. Underwater borrowers with lenders who refuse to settle, however, are ultimately denied rescission relief unless and until these borrowers restore their lenders to the *status quo ante*.

There is a better way. Courts can allow underwater borrowers to restore lenders to the *status quo ante* over time—through an installment plan that resembles a mortgage modification (and under which borrowers would be required to pay a reasonable rate of interest). This approach is consistent with TILA's plain language and its consumer-protective functions and origins. Allowing borrowers to tender in installments, moreover, is essential even when borrowers bring TILA rescission actions in response to foreclosure actions that the lenders' disclosure violations may or may not have precipitated. The ability of borrowers to raise TILA claims even for "off-label"

purposes is consistent with the operation of a strict liability remedy. In addition, TILA rescission claims must remain available even to underwater borrowers, since the remedy shifts substantial leverage to consumers in a legal and economic climate lacking in meaningful substantive protections. Using TILA to facilitate a form of “rough justice” may be criticized as imprecise and overbroad. Ensuring that TILA rescission remains accessible to all borrowers in spite of vicissitudes in the housing market, however, is a crucial stop-gap measure consistent with a statute whose disclosure rules—and whose viability—depend on private enforcement by its consumer beneficiaries.