

Supreme Court Overrules Eighth Circuit on Borrower's Right to Rescind Loan Transactions

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Lenders who fail to provide proper Truth in Lending notices at the time of closing for refinancing of a mortgage on a principal residence give borrowers up to three years after the date of closing to rescind the loan by merely mailing written notice to the lender of decision to rescind the loan—the filing of a lawsuit within the three-year period is not required. The Court's ruling overrules not only the Eighth Circuit's holding to the contrary, but also similar rulings in the First, Sixth, Ninth, and Tenth Circuits that followed the Eighth Circuit.

The Case

Larry and Cheryle Jesinoski refinanced their Minnesota home loan with a loan from Countrywide Home Loans, Inc. for \$611,000.00 on February 23, 2007. Countrywide funded the loan when the Jesinoskis did not exercise their three-day right to cancel under the Truth In Lending Act ("TILA"), and the loan proceeds were used to pay an existing mortgage and other debts.

Exactly three years later, on February 23, 2010, the Jesinoskis mailed their lender a letter purporting to rescind the loan. TILA imposes a three year statute of repose on claims for rescission. See 15 U.S.C. § 1635(f). On March 12, 2010, the lender denied the request for rescission. The Jesinoskis filed suit four years and one day after consummation of the loan, alleging that they received an insufficient number of copies of the TILA notice and disclosure at the time of the closing. The District Court and the Eighth Circuit held that the Jesinoskis were required to file suit to rescind the transaction within the three-year statutory period, and that sending a notice of rescission to the lender within the three-year period is not sufficient.

The Supreme Court's Decision

The Supreme Court unanimously ruled in favor of the Jesinoskis holding that their mailing notice to the lender within the three-year period, without filing suit, is sufficient to exercise their right to rescind. Writing for the court, Justice Scalia stated that the statutory language "leaves no doubt that rescission is effected when the borrower notifies the creditor in writing of his intention to rescind. It follows that, so long as the borrower notifies within three years after the transaction is consummated, his rescission is timely." Justice Scalia stated that the statute is clear and only written notice is required to rescind within the three-year



period. The statute does not require a lawsuit to be filed within this three-year period to rescind.

What It Means For Banks

The Supreme Court did not address the question of how long a borrower has to file suit following receipt of a post-three day notice of rescission and provides no guidance as to how the parties might effectuate a rescission years following a loan closing. The language of TILA reads that if a consumer is entitled to rescission, the lender must refund any closing costs and finance charges paid by the consumer and must provide the consumer a release of the mortgage or deed of trust on the real estate securing the loan. This language is unclear whether the lender may then attempt to collect the now unsecured debt. As rescission is an equitable remedy, the lender's logical argument is that before the consumer is entitled to equitable relief, the consumer must do equity. Therefore, before the lender must release the mortgage or deed of trust, the consumer should tender to the lender the unpaid balance of the loan. The Seventh and Ninth Federal Circuit Courts of Appeal have, in fact, held that the consumer must tender to the lender the unpaid balance of the loan before the consumer is entitled to the benefits of rescission.

A lender that is already in receipt of a notice of rescission outside the three-day rescission period where no suit has been filed should consult with counsel as to whether the lender should file an action against the borrower to address the validity of the rescission claim and, if the rescission claim is valid, to condition rescission upon the borrower's return of the loan proceeds before releasing the mortgage or deed of trust.

With respect to future notices of rescission outside the three-day period, after sending its response within 20 days of receipt, as required by TILA, the lender should consider whether it is prudent to take a proactive approach by commencing an action against the borrower as described above. It is critical that lenders have a good record retention policy because defeating a rescission claim will require the lender to demonstrate compliance with TILA long after the loan closing and likely long after the loan may have been sold to a third party.

If you have questions, please contact your Lathrop Gage attorney or the attorney listed above.