HPA PREEMPTS BREACH OF CONTRACT, UDAP CLAIMS 'RELATING TO' HPA'S REQUIREMENTS

The U.S. District Court for the Northern District of Illinois recently held that the federal Homeowners Protection Act, 12 U.S.C. § 4901, et seq., preempts state law UDAP and breach of contract claims, when the state law claims are based on allegations "relating to" the HPA's requirements.

A copy of the opinion is available here: **Link to Opinion.**

A borrower purchased private mortgage insurance (PMI) in connection with his mortgage loan. He received the required PMI disclosure form, notifying him that his PMI policy would automatically terminate on the date his principal balance was scheduled to reach 78 percent of the original value of the property.

The borrower later entered into a loan modification agreement. The borrower alleged that if the servicer "had properly calculated the automatic PMI termination date based on the loan modification, he would have been entitled to a new automatic termination date." He also alleged that the servicer "never notified him of a newly calculated PMI termination date or of his rights to automatic PMI termination pursuant to a newly calculated date."

The borrower asserted that the "failure to terminate the PMI or to provide him with the appropriate notifications violated the HPA." He also asserted "that the PMI disclosure form that he was provided became part of a contract between him and [the servicer], a contract that he claims [the servicer] violated by failing to terminate PMI at the proper time." In addition, the borrower asserted that, by failing to comply with the HPA, the servicer supposedly "engaged in unfair acts and practices" in alleged violation of the state UDAP statute.

As you may recall, the HPA requires that a mortgagor's PMI obligation "shall terminate . . . on the termination date" if the mortgagor is current on his payments. 12 U.S.C. § 4902(b). The "termination date" is the date on which the principal balance of the mortgage is first scheduled to reach 78 percent of the original value of the property securing the loan. Id. § 4901(18).

Following termination of PMI under the HPA, the servicer must return any unearned PMI premium no later than 45 days after termination. Id. § 4902. In addition, the Court noted that when the PMI obligation terminates under the HPA, the servicer must notify the mortgagor in writing, within 30 days of termination, that the PMI has terminated and that he no longer has PMI and owes no further

premium, payments, or other fees in connection with the PMI. Id. § 4904(a). If, however, the servicer determines that a mortgage did not meet the requirements for PMI termination, the Court noted that the servicer must provide written notice, within 30 days of the scheduled termination date, of the grounds relied on to make that determination. Id. § 4904(b).

If a mortgagor and mortgagee agree to a loan modification, "the cancellation date, termination date, or final termination shall be recalculated to reflect the modified terms and conditions of such loan." Id. § 4902(d).

The HPA also contains an express preemption clause, which provides that the HPA "shall supersede any provisions of the law of any State relating to requirements for obtaining or maintaining private mortgage insurance in connection with residential mortgage transactions, cancellation or automatic termination of such private mortgage insurance, any disclosure of information addressed by this chapter, and any other matter specifically addressed by this chapter." 12 U.S.C. § 4908(a)(1).

The HPA does not preempt "protected State laws" — i.e., laws concerning PMI requirements enacted before or within two years after the date the HPA was adopted on July 29, 1998 by a state that had PMI requirements in effect before Jan. 2, 1998 — unless they are inconsistent with the HPA. Id. § 4908(a)(2)(A), (C). A protected state law that requires earlier PMI termination or the disclosure of more information, earlier disclosure, or more frequent disclosures is not considered inconsistent with the HPA. Id. § 4908(a)(2)(B).

The borrower here did not argue that his state law claims were based on "protected State laws" under the HPA. Instead, the borrower argued that the HPA does not preempt his breach of contract or state UDAP claims because those claims supposedly did not "relate to the HPA requirements relating to private mortgage insurance."

The Court disagreed, pointing out that the borrower's state law allegations did not assert anything materially different than the borrower's HPA allegations. The Court noted that "[a]llowing the state law claims to go forward, the court concluded, would allow those claims to 'function as an alternate enforcement mechanism, echoing the enforcement provisions of the HPA, and frustrating Congress' objective of a uniform regulatory scheme.'"

The Court found that the borrower's state-law UDAP claim was "based on the same conduct as his HPA claim, and thus such claims — if allowed to proceed —

would provide Illinois plaintiffs an alternative mechanism to enforce their HPA rights, thereby frustrating Congress' goal of uniformity."

The Court also found that the borrower's "breach of contract claim in this case is based entirely on the HPA's PMI termination and disclosure requirements."

The Court noted that breach of contract claims are "usually not subject to preemption because contractual claims are generally based on self-imposed, rather than state-imposed, obligations." Although "Congress' intention to stop States from imposing their own substantive standards does not necessarily imply any intent to restrict private parties from bargaining with each other and agreeing to take on different substantive obligations themselves," the Court held that "breach of contract claims are not immune from preemption."

Thus, the Court held that "to the extent Congress' purpose in enacting the HPA was 'to remove from the states' purview the regulation of requirements concerning PMI cancellation and disclosure,' … allowing a plaintiff to enforce alleged violations of the HPA through an alternative remedial mechanism, such as a breach of contract claim, would be 'fundamentally at odds with the goal of uniformity that Congress sought to implement.'"

The borrower argued that "state law claims that do not impose additional obligations, but only add additional remedies for conduct prohibited under federal law, are not preempted." Rejecting this argument, the Court held that "all of the general preemption cases [the borrower] cites involved the assertion of independent state law claims — that is, state law claims whose success did not depend upon a finding that the federal law at issue was violated."

Here, the Court noted, the borrower's "state law claims are entirely dependent on his HPA claim." The Court held this means the state law claims were preempted under the HPA.

Accordingly, the Court granted the servicer's motion to dismiss those claims.