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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

Richmond Division

EVELYN ANDERSON, et al.,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	Civil Action No.
	)	87-0236-R
FEDERAL NATIONAL MORTGAGE ASSOCIATION, et al.,	)	
	)	
	)	
Defendants.	)	

MEMORANDUM IN SUPPORT OF MOTION TO DISMISS

May 11, 1987

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3. Plaintiffs Have Failed To State A Cause Of Action Against Investors Under Either § 23 or § 24. 37

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Plaintiffs purport to represent a class of Virginia residents who borrowed money from Landbank and whose loans were later allegedly purchased from Landbank by the Federal National Mortgage Association (FNMA), Perpetual Savings Bank, FSB (Perpetual), Home Unity Savings and Loan Association (Home Unity), Yankee Bank for Finance and Savings, FSB (Yankee Bank), ComFed Savings Bank, formerly Heritage Savings and Loan Association (ComFed), First Federal Savings and Loan Association of South Carolina (First Federal of South Carolina) and First Federal Savings and Loan Association of Seminole (First Federal of Seminole), collectively referred to as Investors, and Southeast Mortgage Corporation. Plaintiffs seek to maintain the action against a class of defendant financial institutions that purchased loans from Landbank, said to be represented by six of the eight named defendants. Plaintiffs seek equitable, monetary, declaratory and injunctive relief.

Pursuant to Rule 12 of the Federal Rules of Civil Procedure, a Complaint may be dismissed for failure to state a claim where it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief. Conley v. Gibson, 355 U.S. 41 (1957). Considering only the allegations of the Complaint for purposes of this Motion, Investors have moved to dismiss the Complaint because the plaintiffs have stated no claim against Investors.[1/]

Plaintiffs' first, second and third causes of action allege that Landbank committed mail and securities frauds and that the Investors, who were the victims of the fraud, aided and abetted the fraud by failing to discover that they were being defrauded. This is said to be a violation of RICO.

1/ The Complaint is also replete with deficiencies that this Court need not reach if the Motion to Dismiss is granted. Therefore, this Memorandum will not discuss the unsuitability of this Complaint for class action treatment, either as a plaintiff class or defendant class, the lack of standing of the plaintiffs to sue each of the Investors or the misjoinder of parties and causes of action in the Complaint.

the ninth and tenth causes of action, plaintiffs contend the loans violated the Virginia Consumer Protection Act. Defendants urge this Court not to exercise pendent jurisdiction over the far-reaching issues raised by those claims. Even if the Court were to consider the causes of action, they fail to state claims against the Investors. With respect to the alleged violations of Virginia Money and Interest statute, a comparison of the facts alleged and the statutory language reveals no violation of Virginia law. Also, the transactions at issue in this Complaint are not subject to the Virginia Consumer Protection Act. Therefore, those claims should be dismissed.

I. Plaintiffs' RICO Counts Fail To State Claims Against Investors

Plaintiffs' first, second and third causes of action allege that Landbank committed mail and securities frauds and that the Investors violated the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1961, et seq., by aiding and abetting these purported frauds because they were negligent in failing to discover that they themselves had been defrauded by Landbank. Plaintiffs claim that had the Investors not breached fiduciary duties they owed to their stockholders, members and depositors "to conduct their business in a prudent and responsible fashion", "the entire Landbank scheme would have collapsed." Simply stated, plaintiffs allege that Investors aided and abetted a scheme to defraud themselves.

Plaintiffs have alleged no facts demonstrating that any Investor had the requisite intent or degree of participation in the alleged scheme of Landbank to be a proper RICO defendant. Plaintiffs' RICO claims are each fatally flawed in so many ways that only one conclusion can be drawn: the plaintiffs have sued the wrong persons. Plaintiffs readily admit in their Complaint that Landbank devised the scheme to defraud, and did defraud, Investors. Complaint, ¶ H-148. Yet, despite their admission that

The speciousness of plaintiffs' first cause of action is displayed by plaintiffs' inability to allege that Investors had the requisite scienter and degree of participation to aid and abet mail fraud. A person may be liable under 18 U.S.C. § 1962(a) only if it participated in the pattern of racketeering activity as a principal within the meaning of 18 U.S.C. § 2. 18 U.S.C. § 2 does provide that one who aids or abets an offense against the United States is punishable as a principal. However, plaintiffs must plead with particularity that a defendant consciously assisted the commission of the specific crime in some active way to state a claim of aiding and abetting liability. Laterza v. American Broadcasting Co., Inc., 581 F. Supp. 408 (S.D.N.Y. 1984).

Rule 9(b) of the Federal Rules of Civil Procedure requires that "in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." The purposes of the pleading requirements of Rule 9(b) are: (1) to ensure that allegations are specific enough to inform defendants of the charges aginst them and enable them to prepare an effective response and defense (2)

(Continued From Previous Page)

Court for the Eastern District of Virginia, attached as Exhibit A (the Norfolk Action). On November 6, 1986, Investors filed a Memorandum in Opposition to Motion for Preliminary Injunction, attached as Exhibit B. The Memorandum informed plaintiffs that their Amended Complaint utterly failed to allege any activities engaged in by Investors that constituted indictable mail or wire fraud. RICO only prohibits racketeering activity composed of criminally indictable acts. Sheftelman v. Jones, 605 F. Supp. 549, 554 (N.D.Ga. 1984) reconsideration den. 636 F.Supp. 263. Thus, plaintiffs' Amended Complaint failed to allege any violation of RICO by the Investors.

Having been educated by Investors' Memorandum, plaintiffs have filed the Complaint now before the Court. Lacking any facts on which to base its claims against Investors, plaintiffs nevertheless attempt to circumvent the requirements of RICO by merely adding to their original allegations that Investors, by allegedly acting imprudently and allowing themselves to be defrauded by Landbank, aided and abetted Landbank's mail and securities fraud.

Even though Rule 9 permits scienter to be averred generally,[3/] plaintiffs were still unable to allege that each, or any, Investor shared in Landbank's criminal intent to defraud. In fact, plaintiffs admit that Landbank sold loans "to investors by means of false or fraudulent pretenses, representations and promises, in violation of 18 U.S.C. § 1341." Complaint, ¶ H-148. The gravamen of plaintiff's first cause of action is that Investors did not know, but in plaintiff's opinion should have known, of Landbank's fraud. This falls far short of alleging that Investors were aware of Landbank's criminal intent and the unlawful nature of its acts.

Further, plaintiffs do not allege that Investors participated in the alleged fraudulent scheme of Landbank. As discussed above, plaintiffs admit that Landbank defrauded Investors into acquiring interests in the loans originated by Landbank. Thus, Investors could not have shared in Landbank's criminal intent. The sole support of plaintiffs' RICO allegations against Investors in the first cause of action is that, "upon information and belief", plaintiffs knowingly and/or recklessly violated their fiduciary duties to their stockholders, members and depositors. Complaint, ¶ I-4. According to plaintiffs, this breach of fiduciary duties, and concomitant failure to discover the fraud and return the loans, "was a condition precedent for Landbank to continue its illegal and fraudulent operations and to continue to obtain money by false or fraudulent pretenses." Complaint, ¶ I-14. Plaintiffs have alleged that Investors aided and abetted a scheme to defraud themselves. No cause of action, much less a RICO cause of action, can be based on such a legal and factual impossibility.

Plaintiffs' inability to plead that Investors shared the criminal intent of Landbank or actively participated in its scheme results in a complaint that is similar

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3/ Of course, this can only be done within the strictures of Rule 11 of the Federal Rules of Civil Procedure.

fraud, and have not alleged any fraud committed by Investors with sufficient particularity to satisfy Rule 9(b).

B. Plaintiffs Lack Standing To Bring A RICO Claim Based On Predicate Acts of Securities Fraud

Plaintiffs' second cause of action alleges that Investors aided and abetted Landbank's fraudulent sale of securities by purchasing unregistered securities without inquiring or investigating whether a registration statement had been filed. The Court need not even address the issue whether Investors aided and abetted any securities fraud in order to dismiss this claim. Plaintiffs lack standing to bring a RICO claim based on predicate acts of fraud in the sale of securities, since they were neither purchasers nor sellers, and thus did not suffer a cognizable injury from the alleged predicate acts of securities fraud.

In International Data Bank, Ltd. v. Zepkin, 812 F.2d 149 (4th Cir. 1987), the United States Court of Appeals for the Fourth Circuit held that only purchasers and sellers of securities have standing to bring RICO claims based on predicate acts of securities fraud. Although International Data involved Rule 10b-5 securities violations, the Court stated that this standing rule "pertain[s] not just to Rule 10b-5, but to all [RICO] securities fraud actions." International Data, at 153. The Court reasoned that:

> [S]ecurities litigation presents "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." [Blue Chip Stamps], 421 U.S. at 739. That danger is increased, not diminished, by the presence of a treble damages provision in . . . the RICO statute. The larger potential recovery under RICO enhances the "settlement value" and "nuisance" potential of a securities fraud action — both dangers to which the Blue Chip Stamps Court adverted. 421 U.S. at 740-43. This circuit has been especially sensitive to the disruption of business activity by lawsuits designed to poison the atmosphere with accusations of fraud, and thereby "exploit meritless claims for their settlement value. . . ."

Plaintiffs' RICO claim based on mail fraud is similarly speculative with respect to causation. Plaintiffs argue that they were injured by the failure of the Investors to discover Landbank's fraud. Once again, however, Plaintiffs, if injured at all, were injured in receiving the loan from Landbank, which would have occurred prior to the alleged purchase of the loan by the investor. Thus, the Complaint fails to allege any cognizable injury by the plaintiffs as a result of any alleged violation of RICO by the Investors.

D. Plaintiffs Fail To Allege Substantive Securities Fraud Violations By Investors

Even if plaintiffs had standing to bring a RICO claim based on predicate acts of securities fraud, the second cause of action still could not survive. Plaintiffs allege, "on information and belief," that Landbank devised some nebulous and unspecified scheme to sell unregistered securities in violation of 15 U.S.C. § 77e(a) and § 77q. Plaintiffs further allege that Investors aided and abetted Landbank's securities fraud by buying these unregistered securities despite some unspecified duty to determine whether a registration statement had been filed by Landbank. Plaintiffs' second cause of action, based almost entirely on undisclosed "information and belief," fails to provide any facts of Landbank's purported fraudulent scheme or Investors' alleged participiation in this scheme, and fails to satisfy the requirement of Rule 9(b) that fraud be pleaded with particularity.

Fraud in the sale of securities may constitue a predicate act under RICO. Not every securities violation involves fraud, so not every securities violation is a potential predicate act. Fraudulent conduct is not required to violate § 77(e). Plaintiffs merely claim that Landbank devised a scheme to sell unregistered securities, but fail to allege with any particularity the circumstances making that purported scheme

through the use or medium of any prospectuses or otherwise any security, unless a registration statement has been filed," this section is only intended to make it unlawful for dealers to offer to purchase securities before a registration statement is filed.

> Section 5 [§ 77e] of the Securities Act prohibits both offers to sell and offers to buy a security before a registration statement is filed. Section 2(3) [§§ 77e(c)] of the Act, however, exempts preliminary negotiations or agreements between the issuer or other person on whose behalf the distribution is to be made and any underwriter or among underwriters. Thus, negotiation of the financing can proceed during this period but neither the issuer nor the underwriter may offer the security either to investors or to dealers and dealers are prohibited from offering to buy the securities during this period.[5/] Consequently, not only may no steps be taken to form a selling group, but also dealers may not seek inclusion in the selling group prior to the filing.

S.E.C. Release No. 33-4697, 29 F.R. 7317, 17 C.F.R. 231.4697, CCH Federal Securities Law Reporter, ¶ 3258.[6/] (Emphasis added).

As pointed out in G. A. Thompson & Co., Inc. v. Partridge, 636 F.2d at 945, 962 (5th Cir. 1981), the Securities Act of 1933 was designed to protect buyers, giving them the right to recission or damages due to a failure by the seller to file a registration statement. The Court in G. A. Thompson was confronted with what it characterized as a "unique" and "unsupported" theory that non-dealer buyers could violate 15 U.S.C.

5/ The reason for this provision was stated in the House Report on the Bill as originally enacted, as follows:

> ". . . Otherwise, the underwriter . . . could accept them in the order of their priority and thus bring pressure upon dealers who wish to avail themselves of a particular security offering, to rush their orders to buy without adequate consideration of the security being offered." H. R. Report No. 85, 73rd Cong., No. 1st Sess. (1933), p. 11.

6/ See also, 1954 U.S. Code Cong. & Ad. News, 2973, 2997, concerning the 1954 amendment which revised § 77e to its current form. "The words 'or offer to buy' are removed to the new Section 5(c) [§ 77e (c)] to serve their present purpose of preventing dealers from being committed to underwriters or the issuer without being informed. Thus, under the Bill it will not be lawful for dealers to offer to buy prior to the filing date." (Emphasis added)

International Data Bank (IDB) sued former IDB owners Zepkin and Grossman for fraudulent statements contained in the stock prospectus they issued for their firm. Id. at 150-51. The Court stated that IDB properly alleged Zepkin and Grossman committed two acts of racketeering in the course of soliciting funds for the company. Id. at 151. Ruling first that IDB did not have standing to bring a RICO action based on fraud in the sale of securities. since it was neither a buyer or a seller, the Court went on to consider whether IDB properly alleged a pattern of racketeering activity. Because the element of continuity was lacking, the Court also dismissed the action because a pattern was not alleged. Id. at 154-55.

The Court, relying on the decision of the Supreme Court of the United States in Sedima, S.P.R.L. v. Imrex Co., Inc. 473 U.S. 479, 105 S.Ct. 3275 (1985) stated that a pattern of racketeering activity requires at least two related predicate acts that are part of a continuous criminal endeavor. International Data, at 150-51. The Court held that the single, limited fraudulent scheme involving the misleading prospectus was not sufficient to satisfy the continuity requirement. Id. The Court also did not find a pattern in the fact that the single allegedly misleading prospectus reached ten investors. Id.

> To allow a "pattern of racketeering" to flow from a single, limited scheme such as this one would undermine Congress's intent that RICO serve as a weapon against ongoing unlawful activities whose scope and persistence pose a special threat to social well-being. The present case does not involve a "pattern of racketeering," but ordinary claims of fraud best left to "the state common law of frauds" and to "well-established federal remedial provisions." Sedima, 105 S.Ct. at 3293 (Marshall, J., dissenting).

International Data, at 155.

activity in the interstate lending and other banking activies [sic] as part of their on going daily operations.

Complaint, ¶ I-22, I-47.

Because plaintiffs fail to allege that Investors invested proceeds of racketeering activity in any entities but themselves, the first and second causes of action must be dismissed.

G. Plaintiffs' Third Cause Of Action Is Deficient Because It Alleges No Facts Demonstrating That Investors Conducted Or Participated In The Conduct Of Landbank's Affairs Through A Pattern Of Racketeering Activity

Plaintiffs' third cause of action, alleging that Investors violated 18 U.S.C. § 1962(c), is merely their "if all else fails" count. Plaintiffs allege that, for purposes of this count, Landbank was the enterprise, and that the Investors "were associated with the Landbank enterprise." Complaint, ¶ I-51. Plaintiffs then make the conclusory allegation that Investors "have directly and indirectly participated in the conduct of the Landbank enterprise's affairs through a pattern of racketeering activity." Complaint, I-53. Presumably, plaintiffs rely on the allegations contained in the first and second causes of action to try to establish the pattern of racketeering activity needed for their § 1962(c) count. As discussed earlier, in the first two counts plaintiffs failed to plead the alleged fraud with sufficient particularity, failed to plead substantive securities, mail and wire fraud violations committed by Investors, lacked standing to raise predicate acts of securities fraud, failed to allege any injury caused by Investors and failed to establish a pattern of racketeering activity in which any Investor participated. Since the third cause of action relies on the facts alleged in the first two to establish an alleged pattern, it also fails to state a claim for these reasons.

Also, in Bennett v. Berg, 710 F.2d 1361 (8th Cir. 1983), cert. denied, 464 U.S. 1008 (1983), the court held that the claim was deficient for failing to allege the requisite degree of participation in, or conduct of, the affairs of an enterprise by each defendant. In Berg, residents of a retirement community brought a RICO action alleging that defendants participated in a pattern of racketeering in an attempt to defraud the plaintiff residents. In dismissing the RICO count the court noted that "[a] defendant's participation must be in the conduct of the affairs of a RICO enterprise, which ordinarily will require some participation in the operation or management of the enterprise itself." 710 F.2d at 1364.

The United States Court of Appeals for the Fourth Circuit has adopted the "operation or management of enterprise" standard in United States v. Mandel, 591 F.2d 1347 (4th Cir. 1979). Governor Mandel of Maryland was alleged to have defrauded the public through an attempt to misrepresent facts to the General Assembly regarding the operations of certain racetracks. In addressing the issue of whether Mandel "participated" in the conduct of the affairs of the enterprise, the Court of Appeals for the Fourth Circuit adopted the district court's holding that the "conduct or participate" language in § 1962(c) requires "some involvement in the operation or management of the business . . . ." 591 F.2d at 1375. The Court of Appeals for the Fourth Circuit has also made it clear that the words "promoted," "improved," "advanced" and "benefitted" are not synonymous with "conducted" and "used" in § 1962(c). United States v. Webster, 669 F.2d 185, 186 (4th Cir. 1982) cert. denied, 456 U.S. 935 (1982). No involvement by Investors in the operation or management of Landbank has, or can be, alleged, and the third cause of action therefore fails to state a claim against Investors.

Wachtel v. West, 476 F.2d 1062,1065-66 (6th Cir. 1973), cert. denied, 414 U.S. 874 (1973); King v. State of California, 784 F.2d 910, 915 (9th Cir. 1986) (rejecting "continuing violation" theory). The regulations promulgated pursuant to § 1604 ("Regulation Z"), at 12 C.F.R. 226.17(b), provide that in connection with loans of the type at issue in this litigation, disclosure should be made before "consummation" of the transaction, "consummation" being defined in 12 C.F.R. 226.2(a)(13) to be "the time that a consumer becomes contractually obligated on a credit transaction." It is therefore clear that the claims of plaintiffs Anderson (loan executed August 10, 1982), Westerman (loan executed October 23, 1982), Williams (loan executed November 14, 1983), Cofflin (loan executed May 25, 1983), Hayslett (loan executed September 17, 1983) and Hodge (loan executed June 22, 1983), Complaint ¶¶ H-1, H-2, H-4, H-5, H-9 and H-10, under § 1640 are time barred by virtue of § 1640(e).

Moreover, § 1641(a) provides that any truth in lending liability of Investors as voluntary assignees of the Landbank loans at issue in this litigation will be limited to the violations of TILA "apparent on the face of the disclosure statement." Plaintiffs do not allege that the purported TILA violations of which they complain were apparent on the face of the disclosure statements involved in this case in either of the respects specified in § 1641(a)[9/] or in any respect. Further, whether Landbank's charges for appraisals and private mortgage insurance were excessive cannot be determined from the face of the disclosure statements themselves, nor could Investors determine from the face of these disclosure statements whether the amount financed included

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9/ Section 1641(a) provides that "a violation apparent on the face of the disclosure statement includes, but is not limited to (1) a disclosure which can be determined to be incomplete or inaccurate from the face of the disclosure statement or other documents assigned, or (2) a disclosure which does not use the terms required to be used by this title."

complaint in the United States Bankruptcy Court for Eastern District of Virginia on July 16, 1986, in which the claim for declaratory relief under § 1635 now contained in the present complaint was made for the first time. However, even if it is assumed for purposes of argument only that the filing of this amended complaint could serve to toll the period of limitation prescribed in § 1635(f), see, Bull v. United States, 295 U.S. 247, 258-61(1935), this argument cannot withstand analysis. Plaintiffs Hayslett and Hodge were not named as parties in the amended bankruptcy complaint, and their TILA actions therefore were not filed until March 6, 1987 when the complaint currently before this Court was filed. The claims of plaintiffs Anderson, Westerman and Cofflin, who were named as parties in the amended bankruptcy complaint, were barred by § 1635(f) even as of July 16, 1986, when the amended bankruptcy complaint was filed because the latest of their loan transactions was consummated on May 25, 1983.

Only plaintiff Williams, whose loan was consummated on November 14, 1983 and who was a named party in the July, 1986 amended complaint, is therefore in any position to attempt to avail herself of any tolling of the limitation period prescribed in § 1635(f) arguably occasioned by the filing of the July, 1986 amended complaint. The alleged TILA violation with respect to her loan consisted of including "excess" charges out of an appraisal fee of $200 in the amount financed rather than in the finance charge. Complaint, ¶ H-4. However, the regulations contained in 12 C.F.R. 226.4(c)(7)(iii) provide that bona fide and reasonable (not actual) fees for appraisals are specifically to be excluded from the finance charge if the transaction involved is secured by real estate. This Court should therefore find that as a matter of law the alleged failure to include the "excess" over and above a reasonable appraisal fee in the finance charge rather than in the amount financed, when the total fee involved was

America v. Gibbs, 383 U.S. 715, 726 (1966). Even if the federal claims remained, however, this Court should decline to exercise pendent jurisdiction for two reasons. First, the presence of difficult and unresolved questions of state law weighs heavily against the exercise of pendent jurisdiction. Second, jurisdiction is rarely exercised over state claims and issues pendent to TILA claims.

1. Difficult And Unresolved Questions Of State Law Mandate Dismissal Of Counts V Through X.

As previously noted, plaintiffs' Complaint is substantially identical to the Amended Complaint which plaintiffs filed in the Norfolk Action. The Norfolk action was dismissed without prejudice pursuant to the District Court's decision to abstain from hearing the case under 28 U.S.C. § 1335(c)(1). That statute permits abstention when it is "in the interest of comity with State courts or respect for State law." The district court based its decision to abstain on the following facts:

> In this case, plaintiffs raise substantial state law claims. . . . These claims require determination of complex issues of Virginia's mortgage and lending law, as well as interpretations of its usury statutes and its Consumer Protection Act. This Court's determination would have pervasive effects on a broad area of business that has been traditionally at the heart of state legislative power. For example, plaintiffs' first cause of action [which corresponds to Count V of the present Complaint] requires a ruling as to what degree points charged in connection with a loan must be stated in the note. Determination of this question would affect lending practices throughout Virginia. The Court's ruling would involve the recording of notes, mortgages, and deeds of trust all over the state — to the very westernmost tip of the Commonwealth.
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> Although the fact that a state law claim is asserted is not by itself reason to abstain, In Re All American of Ashburn, Inc., 47 [sic; 49] Bankr. 926 (Bankr. N.D. Ga. 1985), this Court finds that abstention is proper where, as here, numerous state claims are alleged, each requiring resolution of unsettled state law issues. See, In Re Dart & Bogue Co., 52 Bankr. 594 (Bankr. D. Conn. 1985). That is particularly true where the claimant urges an expecially expansive theory of state law. In this case, plaintiffs maintain that the defendants' loans violated the Virginia

unsettled or contrary to the law of other states, the district court declined to exercise jurisdiction:

> The second Gibbs factor — a surer-footed reading of state law in state court — is determinative in this case.

625 F. Supp. at 889 (emphasis added).

Similarly, in Chandler v. Riverview Leasing, Inc., 602 F. Supp. 157 (E.D. Pa. 1984), Chandler sued in state court for violations of TILA and on state law claims. Riverview removed to federal court. The court determined to remand the state law claims to state court:

> In light of plaintiff's uncontested assertion of the novelty of the state law claims, the Court concludes it would be preferable for the state courts to address these issues. The interests of all parties will be best served by having the state courts first decide these state issues of first impression.

602 F. Supp. at 158; see also, Fuller v. Hurley, 559 F. Supp. 313, 322 (W.D. Va. 1983) (had "state law not been clear on this issue" of the constitutionality of Virginia attachment statute, court would have declined to exercise pendent jurisdiction); National Market Reports, Inc. v. Brown, 443 F. Supp. 1301, 1306 (S.D. W.Va. 1978) (pendent state law claims based on West Virginia constitution dismissed because state constitution "should be construed in first instance by the most qualified interpreter, the highest court of the State"). Because plaintiffs' expansive claims raise difficult questions of state law, pendent jurisdiction should not be exercised.

2. This Court Should Not Exercise Jurisdiction Over Claims Pendent To TILA Claims

Jurisdiction rarely should be exercised with respect to claims pendent to Truth-in-Lending Act (TILA) claims.[10/] Noting the increasing number of TILA claims filed in

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10/ Counts V through X arise out of a nucleus of operative facts common only to plaintiffs' TILA claims. These claims do not append to plaintiffs' RICO claims for two

(Continued)

> Plaintiffs who wish to bring all their claims in a single forum may take advantage of the provision for concurrent jurisdiction in 15 U.S.C. § 1640(e) by pursuing those claims in state court.

395 F. Supp. at 864; see also, Price v. Franklin Inv. Co., Inc., 574 F.2d 594, 607 n. 29 (D.C. Cir. 1978) (automobile purchaser sued lender for violations of TILA, appending state law claims of usury and loan sharking; district court's refusal to exercise pendent jurisdiction affirmed, in part because "district courts should take particular care 'not . . to permit [TILA] to be used simply as a means to obtain a federal forum for ordinary debtor-creditor controversies between citizens of the same state or not involving the jurisdictional amount . . . '" citing Hughes v. Ford Motor Credit Co., 360 F.Supp. 15, 19 (E.D. Ark. 1973), and Solevo); Jordan v. Montgomery Ward & Co., 317 F.Supp. 948, 950 (D. Minn. 1970), aff'd in part, rev'd in part on other grounds, 442 F.2d 78 (8th Cir. 1971), cert. denied 404 U.S. 870 (1971) (where TILA and usury claims involved different issues and usury issues were then before state courts, pendent juridiction not exercised).

The Solevo court, pointing to the absence of special circumstances and the presence of difficult questions of state usury law, declined to exercise jurisdiction. 395 F.Supp. at 864. Here there are no special circumstances, and difficult questions of state law abound. It follows that Counts V through X should be dismissed.

In sum, as the Norfolk District Court pointed out, plaintiffs' usury and consumer protection claims require "resolution of unsettled state law issues" and urge "an especially expansive theory of state law." Order of November 14, 1986, p. 6. Further, plaintiffs' claims are appended to their TILA claims, and courts generally have eschewed the exercise of jurisdiction pendent to TILA claims. On "considerations of comity and the desirability of having a reliable and final determination of the state claim by state courts having more familiarity with the controlling principles and the

§ 24, pertaining to subordinate mortgage loans, by seeking to enforce loan obligations with respect to which purportedly excessive charges for appraisals and private mortgage insurance were made. Complaint, ¶ I-58 and I-60. Plaintiffs seek to have the subordinate mortgage loans declared unenforceable under § 47 of the statute and to enjoin Investors under § 46 of the statute from collecting the loans or foreclosing upon the real estate collateral securing them. Complaint, p. 67(c)(i)(ii); (d)(i)-(ii). With respect to the first mortgage loans covered by § 37, Plaintiffs seek a declaration that these loans are usurious, an injunction against collection and foreclosure, reformation of the loan contracts and an award of "twice the total of interst paid." Complaint, p. 68 (e)(i)-(iv); (f)(i)-(iii).

The questions presented for the Court's resolution may be summarized as follows: (1) does a failure to include points in the interest rate stated in the note constitute a violation of §§16 and 37? (2) Do Plaintiffs state a proper cause of action under §§ 23 and 24 against Investors when the allegedly excessive fees for appraisals and private mortgage insurance were collected by Landbank? (3) Are the remedies sought by Plaintiffs under the Money and Interest statute available to them on the facts alleged in the Complaint? As a review of the Money and Interest statute and the cases construing it will demonstrate, each of the foregoing questions must be answered in the negative.

1. The Relevant Statutes

The loans made by Landbank to Plaintiffs were secured by either first or subordinate mortgages on residential real estate and are thus subject to either § 16 or § 37. Section 37, which pertains to first mortgage loans, states that loans subject to its provisions "may be lawfully enforced as agreed in the obligation of indebtedness or in an

closing the loan," and that "such fees and charges shall not be considered in determining whether a contract for a loan or forbearance of money or other things is illegal within the meaning of this title." Section 24 provides that "any lender making a loan secured by a subordinate mortgage may require a borrower to pay... the actual cost of title examination, title insurance, mortgage guaranty insurance, recording fees, surveys, attorneys' fees, and appraisal fees," and that "no other charges of any kind shall be imposed on or be payable by the borrower either to the lender or to any other party in connection with such loan..." Neither § 23 nor § 24 states that the charging of excessive fees for the services enumerated in the sections is usurious, nor does either section provide a remedy for its violation. See, Myers v. Williams, 85 Va. 621, 629 (1889).

The remedies available under the Money and Interest statute are set forth in §§ 45, 46, and 47. Section 45, the language of which looks back to equity practice in Virginia during the 19th century, does not provide for an affirmative remedy but rather allows a defendant in a suit brought on a purportedly usurious obligation to raise usury as a defense and, if the defense is successful, limits the plaintiff to recovery of principal only. Section 45 is premised on the notion that an usurious loan is for illegal consideration (i.e. interest) rather than being null and void. See, Lynchburg National Bank v. Scott Brothers, 91 Va. 652, 654 (1895).

Section 46 is based upon the same premise as § 45 and allows a borrower to bring suit within two years "from the time the usurious transaction occurred" to recover twice the amount of usurious interest paid. This section also allows a borrower to seek an injunction if property securing an allegedly usurious loan is in danger of being foreclosed upon by the lender. It must be emphasized that § 46 applies only to interest actually paid by a borrower which is in excess of what is permitted by the

that an "interest disclosure" under TILA is made. If this disclosure is made, the loan may be enforced at the "stated" interest rate. Plaintiffs do not allege that the truth in lending disclosures with respect to the loans placed in issue by the Complaint are inadequate because the points charged in connection with these loans are not included in them.

Resolution of Plaintiffs' claims is therefore controlled by the decision of the United States Court of Appeals for the Fourth Circuit in Smith v. Anderson, 801 F.2d 661 (4th Cir. 1986), in which the court concluded that § 16(E)[13/] exempts long term loans it covers from regulation of the interest rate charged and that "appropriate federal disclosure satisfies the requirements of Virginia law." Id. at 664. Indeed, in discussing § 17 of the Money and Interest statute, which requires financial institutions to quote the cost of consumer credit in terms of an annual percentage rate, the court specifically stated that there is no requirement under this section that an annual percentage rate be stated on the face of a note. Because, as the court noted, a truth in lending disclosure statement is an "integral part of the transaction and is recognized as such by state law," Id., it is clear that § 16 does not require that an annual percentage rate — i.e. an interest rate including points — be stated in the note so long as appropriate disclosure is made on the truth in lending statement.

Although the court did not have occasion to discuss § 37 in Smith, that section, as is evident from the discussion above, contains language identical to that in § 16 and the result should therefore be the same under it as under § 16. Moreover, § 37 specifies that "a loan may be enforced as agreed in the obligation of indebtedness or in an agreement signed by the borrower...." The Complaint contains no allegation that

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13/ The provisions of § 16(F), discussed above, are identical to those of § 16(E).

However, Plaintiffs admit that these charges have already been paid to Landbank, the lender, see, Complaint, ¶ E-7(c) and (d), and the only connection of Investors with these purportedly improper charges arises from the fact that Investors now hold the loans in connection with which they were assessed. If a violation of either § 23 or § 24 had occurred, the proper defendant would be Landbank, the "lender" to which both sections refer. The excessive charges which these sections proscribe, if made at all in this case, were made by Landbank, not Investors, and neither section forbids the holding of loans in connection with which allegedly improper charges have already been made and collected by the original lender. Moreover, neither section provides any kind of remedy for its violation, and indeed § 23 explicitly states that the proscribed charges "shall not be considered in determining whether a contract for a loan or forbearance of money... is illegal within the meaning of this title."[14/]

Moreover, Investors, by purchasing the loans from Landbank in the secondary mortgage market became holders in due course of the obligations of Plaintiffs, as the Complaint, ¶¶F-3(a), H-17, H-19, indicates: a holder in due course is defined by Va. Code § 8.3-302 as one who takes an instrument for value in good faith and without notice of defenses to its enforcement. Va. Code § 8.3-302(1) and (4). Because the Money and Interest statute does not provide that a violation of either § 23 or § 24 has the effect of rendering the transaction in which the violation occurred a nullity, and because Investors did not deal with Plaintiffs, no cause of action under either § 23 or §24 can be stated against Investors as holders in due course of Plaintiffs' loans. See, Va. Code § 8.305(2)(b), and page 39, infra.

14/ If §§ 23 and 24 are read in pari materia with § 26, the proper remedy for a violation of these sections would be a refunding of the improper charges, without otherwise affecting the validity of the obligation. Such an interpretation squares with § 23's injunction that the charges it proscribes are not to be considered in determining whether usury occurred.

Furthermore, the Complaint, ¶¶ F-3(a), H-17, H-19, and page 38, supra, indicates that Investors, far from being agents of Landbank, became holders in due course of the notes of Plaintiffs, by allegedly purchasing the Landbank loans in the secondary mortgage market. If Investors are holders in due course, the remedy provided by § 46 will also not be available to Plaintiffs in this action. While a holder in due course will arguably be subject to the "null and void" penalty set forth in § 47, Va. Code § 8.3-305(2)(b) and Official Comment 6; Scott, supra., at 654-55, holder in due course status will cut off application of the remedy delineated in § 46 because the premise of § 46 is not that the purportedly usurious contract is void, but rather that it is deemed to be for an illegal consideration. Scott, supra.; Moore v. Potomac Savings Bank, 160 Va. 597 (1933). Indeed, as the court in Moore remarked,

> The holder of a negotiable instrument for which he has paid valuable consideration before maturity is not bound at his peril to be on the alert for circumstances which might possibly excite the suspicion of wary vigilance; he does not owe to the party who puts the paper afloat the duty of active inquiry in order to avert the imputation of bad faith. The rights of the holder are to be determined by the simple test of honesty and good faith, and not by a speculative issue as to his diligence or negligence. The holder's rights cannot be defeated without proof of actual notice of the defect in title or bad faith on his part evidenced by circumstances. Though he may have been negligent in taking the paper, and omitted precautions which a prudent man would have taken, nevertheless, unless he acted mala fide, his title, according to settled doctrine, will prevail.'

Id. at 608.

The remedies afforded by §§ 46 and 47 are not available to Plaintiffs because the transactions of which they complain and the defendants whom they seek to hold liable are not appropriate subjects against which to deploy the remedies provided by the Money and Interest statute. The charges and points assessed in connection with the Landbank loans held by Investors were fully disclosed to Plaintiffs in the truth in

These transactions also are specifically excluded by § 59.1-199 of the Act. Smith v. U.S. Credit Corp., 626 F. Supp. 102, 103 (E.D. Va. 1985), aff'd sub nom. Smith v. Anderson, 801 F.2d 661 (4th Cir. 1986). The U.S. Credit court held, fatally to Plaintiffs' claims, that the Act does not apply to "consumer real estate transactions . . . covered by the Federal Consumer Protection Act. . . . 15 U.S.C. § 1603." 626 F. Supp. at 103.

Moreover, § 59.1-199 (D) excludes "Banks, savings and loan associations, credit unions, small loan companies, public service corporations and insurance companies supervised by the State Corporation Commission or a comparable federal regulating body." Except for the Federal National Mortgage Association, which plaintiffs admit is a "federally chartered corporation, established for the purpose of providing liquidity to the home-financing market," Complaint, ¶ D-3, all Investors are savings and loan institutions governed either by the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, or a comparable regulating body. See also Complaint, ¶¶ D-4 through 10-10. Hence, no Investor can be subject to the Act.

Because neither Investors nor the transactions of which Plaintiffs complain are subject to the Act, Counts IX and X of Plaintiffs' Complaint must be dismissed.

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from the coverage of the Virginia Consumer Protection Act of "those aspects of a consumer transaction which are regulated by the Federal Consumer Protection Act, 15 U.S.C. § 1601 et. seq.," Va. Code § 59.1-199(c), extended to aspects of a transaction not regulated by the federal act. The applicability of the Act to transactions such as those at issue here was not raised or decided in Glasby. The language of § 59.1-198( ) clearly excludes the transaction which Plaintiffs entered into with Landbank.

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