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Borrower Sues his Bank for Agreeing to Lend him Money – and Wins

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Ralph Elliott, faced with mounting debt resulting from the loss of his job and the divorce from his fourth wife, was unable to make his mortgage payments to the First Federal Community Bank of Bucyrus (the "Bank"). What he did next was rather unusual – *he sued the Bank for agreeing to grant him the loan.* On July 8, 2020, a unanimous three-judge panel of the United States Court of Appeals for the Sixth Circuit found for Elliott and determined that the Bank must pay him damages for making a loan that the Bank knew, or should have known, he could not repay.

Background

This case, *Elliott v. First Federal Community Bank of Bucyrus*[1], is one of just a few reported cases addressing a key provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act – the so-called "ability-to-repay" requirement. This provision requires a creditor making a residential mortgage loan to make a "reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan…" The provision, which was added to the Truth in Lending Act ("TILA"), was further implemented by changes to federal Regulation Z. The "ability-to-repay" requirement was created in response to what was viewed as a major cause of the 2008 financial crisis – lenders making mortgage loans to people who could not afford to pay the loans back.

Facts of the Case

Elliott applied for a $315,000 mortgage loan from the Bank. His application listed various sources of income, including spousal support and rental income. With respect to the spousal support, the Bank relied on representations from Elliott and his then-wife that they were going to enter into a separation agreement requiring the payment of spousal support to Elliott. However, the separation agreement had not actually been reviewed by the Bank (it had not even been executed at that time, although it was shortly thereafter). For the rental income, the Bank reviewed Elliott's tax returns showing rental income received in the past, but never checked to see if he was actually receiving the amount of rental income he claimed he was at the time he filed his mortgage application (the rent Elliott was actually receiving was less than what he listed). The Bank also never reviewed the lease.

Elliott's loan application was denied at first, but on reconsideration the application was approved by the Bank and the loan was made. Not long after, he stopped making his mortgage payments and sued the Bank.

Elliott claimed that the Bank violated TILA and Regulation Z by making the mortgage loan to him without a reasonable and good-faith determination that he had a reasonable ability to repay the loan and for failing to verify his stated income with documentation. He pointed to the fact that the Bank never verified and documented whether he was in fact entitled to spousal support and was receiving the amount of rental income he was claiming. This was technically true, but the Bank argued that Elliott ultimately did enter into a spousal support agreement entitling him to monthly payments, and that he also was in fact receiving rental income (albeit in a lower amount than he represented). Nevertheless, the court found that the Bank was required to verify and document these sources of income using reasonably reliable third-party records, and the failure to do so violated TILA and Regulation Z.

The court noted that although "the Bank's arguments are sympathetic, they do not change the fact that technical violations of TILA generally result in liability." The lower court will now determine the amount of damages the Bank must pay Elliott. The appellate court did allow the Bank's foreclosure action against Elliott to proceed, but indicated that the damages for the TILA violation can be used to offset the amount Elliott is ultimately liable for in the foreclosure.

The *Elliott* case was decided by the U.S. Court of Appeals for the Sixth Circuit, which covers Ohio (where this case originated) and several neighboring states. There have been no significant appellate cases addressing the "ability-to-repay" rule in the Second Circuit (which includes New York) or the Third Circuit (which includes New Jersey), so it is unclear how those courts will view this issue.

Further Information

If you have any questions regarding this case or the "ability-to-repay" rule, please feel free to contact Joseph D. Simon at (516) 357-3710 or via email at **jsimon@cullenllp.com**, Kevin Patterson at (516) 296-9196 or via email at **kpatterson@cullenllp.com**, Elizabeth A. Murphy at (516) 296-9154, or via email at **emurphy@cullenllp.com**, or Mandy Xu at (516) 357-3850 or via email at **mxu@cullenllp.com**.

Please note that this is a general overview of the issues addressed and does not constitute legal advice.

Footnote

[1] *Elliott v. First Fed. Cmty. Bank of Bucyrus*, No. 19-3690, 2020 WL 3839865 (6th Cir. July 8, 2020).

Practices

- Regulatory and Compliance

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