State of New Jersey

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Governor

OFFICE OF THE ATTORNEY GENERAL
DEPARTMENT OF LAW AND PUBLIC SAFETY
DIVISION OF LAW

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November 20, 2003

H. Robert Tillman, Director
Division of Banking
Department of Banking & Insurance
P.O. Box 40
Trenton, New Jersey 08625

Reni Erdos, Director
Division of Consumer Affairs
Department of Law & Public Safety
124 Halsey Street
Newark, New Jersey 07102

Re: 03-0188 -- Home Ownership Security Act of 2002

Dear Directors Tillman and Erdos:

You have asked whether the interpretation of the Home Ownership Security Act of 2002 ("the Act") detailed in Regulatory Bulletins issued by the Department of Banking and Insurance("the Department") as guidance to the mortgage lending industry would be accorded deference by a court of law. The New Jersey Home Ownership Security Act of 2002, N.J.S.A. 46:10B-22 et seq. ("the Act"), was passed by the Legislature on May 1, 2003, to be effective November 27, 2003. The Act is a remedial statute which attempts to address and curb abuses in the residential mortgage lending business. At the same time, a number of changes were made in consultation with, and at the direction of, leaders in the credit rating industry, to ensure that all non-high cost loans covered by the Act will continue to be rated by the leading credit rating services. As guidance to the industry, the Department has issued two Bulletins indicating how it interprets and intends to enforce provisions of the Act. You have asked this office to review these Bulletins and have specifically asked us to review a number of the questions set forth therein. For the following reasons you are advised that the Department's interpretation of the Act is a reasonable one, not inconsistent with either the legislative intent or language

of the Act. The Department's interpretation is, therefore, entitled to great weight and a court would accord deference to its interpretation of the Act since it is the agency charged with the Act's enforcement. We will deal with several of these issues raised separately below.

The Weight Accorded the Department's Construction of the Act

It is a well settled principle that a court, in reviewing agency action interpreting a statute it is charged with enforcing, will not substitute its judgment for that of the agency's. See Chevron U.S.A. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 104 S. Ct. 2778, 2782, 81 L. Ed.2d 694(1984); Kaspar v. Board of Trustees, TPAF, 164 N.J. 564, 581 (2000). As the U.S. Supreme Court said in Chevron, supra, "[C]onsiderable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer." Chevron, supra, 467 U.S. at 844; See also In re Pub. Ser. Elec. & Gas Co., 167 N.J. 377 (2001) (considerable weight given construction of statute by agency charged with enforcement); Smith v. Director, Div. of Taxation, 108 N.J. 19 (1987) (substantial deference given to interpretation by agency charged with enforcing act).

In In re Pub. Ser. Elec. & Gas Co., supra, our Supreme Court reaffirmed the long established principle that a "grant of authority to an administrative agency is to be liberally construed to enable the agency to accomplish the Legislature's goals" 167 N.J. at 384. The Court went on to indicate that it would defer to the agency's interpretation provided it is was not plainly arbitrary or unreasonable. Ibid. See also Merin v. Maglaki, 126 N.J. 430, 437 (1992). As the Court said in Kaspar, supra:

[W]hen the Legislature has not addressed the precise question of statutory meaning, the reviewing court

> may not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

> To uphold an agency's construction of a statute that is silent or ambiguous with respect to the question at issue, a reviewing court need not conclude that the agency construction was the only one it permissibly could have adopted, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.

[Kaspar v. Board of Trustees, supra, 164 N.J. at 581 citing 2 Am. Jur. 2d Admin. Law §525 (1994)]

The Department is the agency primarily charged with enforcement of the Act. The Act provides the Department with the authority to enforce violations thereof. N.J.S.A. 46:10B-28. Specifically, the Department has authority to conduct examinations and investigations, issue subpoenas and orders to enforce provisions of the Act with respect to persons licensed or subject to the provisions of the Licensed Lenders Act, N.J.S.A. 17:11C-1 et seq. See N.J.S.A. 46:10B-28a. The Department also may examine records of persons originating or brokering loans and may impose civil penalties for violations of the Act. Finally, the Department, through the Director of Banking, is charged with developing and implementing a program to inform the public about predatory practices and to protect the public from such practices. Accordingly, as the agency charged with the Act's enforcement, the Department's interpretations of the Act as contained in the Regulatory Bulletins would be accorded considerable weight by a court of law and would not be overturned absent a showing that the interpretation is arbitrary or unreasonable. The issues raised herein will now be addressed in the context of whether the Department's interpretation is unreasonable or arbitrary.

Limitations on Damages[*]
Addresses Bulletin 1 - Questions 1 thru 7 and 9
Addresses Bulletin 2 - Questions 18a, b, c, 19 and 23

Bulletin 1, Question 1

Your concern regarding limitations on damages relates to assignee liability provided under N.J.S.A. 46:10B-27. Specifically you first ask whether the Bulletin's assertion that the cap on the damages against an assignee applies when a borrower chooses to seek damages under the CFA as authorized by the Act, N.J.S.A. 46:10B-29a, is a reasonable one entitled to deference by the courts. In short, the Department's interpretation that the liability cap in the Act does apply in actions by borrowers against assignees, even if the action for a violation of the Act is brought by a borrower under the CFA, is a reasonable one entitled to such deference.

It is apparent from a review of the Act's provisions that the Legislature intended to provide enhanced safeguards to borrowers as protection against unfair lending practices. Concomitant with this purpose, the Legislature also sought to ensure that legitimate sources of funding for mortgage lending would remain available given the change in the holder in due course doctrine in the context of mortgage lending. Thus, the Legislature struck a balance in, on the one hand, providing for assignee liability but on the other, limiting and conditioning such liability in actions brought by borrowers. See N.J.S.A. 46:10B-27c and Statement to Floor Amendments to A75 (Third Reprint), March 13, 2003 (changes were made in consultation with credit rating services to ensure that non-high cost loans covered by the bill will continue to be rated by credit rating services). This balance must be considered when determining whether the Legislature intended that the assignee liability provisions of the Act would apply when a borrower chooses to bring action pursuant to the CFA for violations under the Act.[**]

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[a] All questions related to assignee liability will be addressed under this topic.

[b] Of course, if a borrower were to seek redress against an assignee for violations of the CFA, which violations were

In construing statutes, it is axiomatic that courts will look to a statute's plain language to ascertain legislative purpose and intent. See McCann v. Clerk of City of Jersey City, 167 N.J. 311, 320 (2001). The paramount objective of a court in determining the meaning of a statute is to "effectuate the legislative intent in light of the language used and the objects sought to be achieved." Ibid. (quoting State v. Hoffman, 149 N.J. 564, 568 (1997)). In so doing, the court's task is to harmonize the individual sections and read the entire statute in a way most consistent with the overall legislative intent. New Jersey Dep't of Law & Pub. Safety v. Bigham, 119 N.J. 646, 657 (1990).

Here, the plain language of the assignee liability provision of the Act, N.J.S.A. 46:10B-27, clearly indicates that the provisions will apply notwithstanding any other law to the contrary. See N.J.S.A. 46:10B-27c. Thus, whether a borrower brings an action pursuant to the Act or the CFA as provided by N.J.S.A. 46:10B-29a, the assignee liability provisions of the Act would be applicable. This interpretation effectuates the remedial purpose of the Act by providing a borrower with the benefit of recovery not only against the originating lenders but also against assignees or subsequent holders of such lenders, while not imposing such stringent damages that investment in New Jersey loans would be adversely impacted. Indeed, such liability can be characterized as an incentive against engaging in abusive lending, either directly or indirectly. We also note that the assignee liability provision is an exception to the general rule regarding holders in due course. As noted above, this language was added to ensure that non-high cost loans covered under the Act would continue to be rated. The evident intent was, therefore, that this limitation would apply not only to actions under -27a and -27c but also "where applicable" in connection with actions by borrowers against an assignee under the Consumer Fraud Act. Since the Department's interpretation is one that reconciles the different aims of the Act and is not unreasonable, a court would defer to the Department's interpretation of the Act. Accordingly the assignee liability provisions of the Act would apply, whether the borrower brings action under the CFA or the Act.

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outside the scope of the Act, then there would be no such limitation on liability as provided for under the Act.

Bulletin 2, question 23

You next ask whether the assignee liability provisions of N.J.S.A. 46:10B-27 apply even when a borrower pursues claims for compensatory or punitive damages. In its Bulletin the Department has stated that the limits and conditions on assignee liability in N.J.S.A. 46:10B-27 apply and that a borrower may not circumvent those limits by seeking separate compensatory or punitive damages from an assignee.

As indicated above, the Department's view that the assignee liability provisions of the Act are applicable no matter what type of damages are sought by a borrower under the Act is a reasonable interpretation. The provisions of the Act are clear that the assignee liability provisions apply, notwithstanding any other law to the contrary. Accordingly, if action is brought pursuant to the Act, a court would give great weight to the Department's view that a borrower's recovery against an assignee is limited to the damages set forth at N.J.S.A. 46:10B-27.

Bulletin 1, Question 9

You next ask whether an entity exercising "due diligence" to prevent it from purchasing or taking assignment of any high-cost home loan pursuant to N.J.S.A. 46:10B-27b(3), must review 100% of loans being purchased in order to gain the safe harbor thereunder. The Department has concluded in its Bulletin that such review is not required.

N.J.S.A. 46:10B-27b(3) does not specifically mandate a review of 100% of the loans being purchased. Rather the statute requires only that a person exercise reasonable due diligence. The Act establishes elements that presumptively constitute such diligence, none of which require a review of 100% of the loans purchased. As a guide, the Department looked at a recent advisory to national banks and their operating subsidiaries by the Office of the Comptroller of Currency ("OCC"), in which it described recommended practices for reducing the risk of purchasing predatory loans.

The OCC recommended that banks conduct quality control review of loan documentation at the onset of the third-party relationship, or after a particular risk has been identified, to ensure the transactions comply with the bank's policies and legal requirements. See OCC Advisory Letter, AL 2003-3 (Feb. 21, 2003). In so doing, the OCC noted that "such file sampling should be adequate to ensure that loans are being underwritten consistently with the bank's policies." Id. at p.9. It is reasonable for the Department to conclude that similar file sampling should be sufficient to satisfy the reasonable due diligence standard, and a court would give great weight to that interpretation.

Bulletin 1, Question 2

The Department next asks whether a borrower can recover damages under both N.J.S.A. 46:10B-27a and -27c from one assignee in connection with the same loan transaction. The Department has concluded that, as a practical matter, in most instances such recovery would not occur, but that in certain limited situations recovery may be had under both sections since they provide distinct remedies for different types of claims.

N.J.S.A. 46:10B-27a provides:
Notwithstanding any other law to the contrary, if a home loan was made, arranged, or assigned by a person selling either a manufactured home, or home improvements to the dwelling of a borrower, or was made by or through a creditor to whom the borrower was referred by such seller, the borrower may assert all affirmative claims and any defenses that the borrower may have against the seller or home improvement contractor limited to amounts required to reduce or extinguish the borrower's liability under the home loan, plus the total amount paid by the borrower in connection with the transaction, plus amounts required to recover costs, including reasonable attorney's fees against the creditor, any assignee or holder, in any capacity.

Thus, under section 27a, a borrower may assert claims against an assignee that could be asserted against the original seller of the manufactured home or home improvements where the seller made, arranged or assigned the home loan or the loan was made by or through a creditor to whom the borrower was referred by the seller. Such claims are often for the home improvement

contractor's wrongdoing, usually related to fraud or poor workmanship.

N.J.S.A. 46:10B-27c, on the other hand, permits a borrower to assert claims against an assignee which could be asserted against the original creditor. Normally such violations concern flipping or high-cost loan provisions.

In the situation where the seller of a manufactured home or home improvement acts in two capacities, both as seller and also as original creditor, the borrower could have separate claims against the assignee pursuant to both N.J.S.A. 46:10B-27a and -27c. It is noted that under N.J.S.A. 46:10B-27a, a borrower could receive the damages available under subsection c plus the total amount paid by the borrower in connection with the transaction.

Bulletin 1, Question 3
Bulletin 2, Question 19

This leads to your next question which is what is included in the phrase "total amount paid by the borrower in connection with the transaction" under N.J.S.A. 46:10B-27a.

The term "total amount paid by the borrower in connection with the transaction" is not defined in the Act. However, that language was added by floor amendment and was designed to ensure that non-high cost loans made in this State will continue to be rated by credit rating agencies and was intended as part of an explicit limitation on damages against assignees. In addressing this question and others, infra, the Department has looked to the FTC Holder Rule, 16 C.F.R. §433 et seq., which is a generally applicable rule in consumer transactions that is recognized industry-wide. The FTC Holder Rule impacts those individuals and entities regulated by the Department who engage in the sale or lease of goods and services to consumers, see, e.g., Retail Installment Sales Act, N.J.S.A. 17:16C-1 et seq. Thus, it is reasonable to look to the FTC Holder Rule for guidance.

The rule requires notice that any holder of a consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods and services,

and that recovery by the debtor shall not exceed amounts paid by the debtor. 16 C.F.R. §433.2. The rule has been interpreted as permitting the consumer to assert a right not to pay all or part of the outstanding balance under the contract but the consumer will not be entitled to receive a recovery which exceeds the amounts of money the consumer has paid in. See FTC Staff Guidelines on Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 41 Fed. Reg. 20022 (May 14, 1976).

Although the Department advises that it is still studying this issue, it is reasonable to construe the phrase "total amounts paid by the borrower in connection with the transaction" to include the principal and interest paid by the borrower but not to exceed the amount the borrower has paid in the transaction, including, in certain circumstances, points and fees. Moreover, as indicated above, this standard is generally recognized in the industry and has been applied to the types of transactions in questions here.

You also ask whether it is reasonable to construe the phrase "in connection with the transaction" in N.J.S.A. 45:10B-27a as referring to the credit transaction.

It is reasonable to construe the phrase "in connection with the transaction" as referring to the credit transaction, given that the credit transaction which involves the financing of home improvements or the sale of manufactured homes is the transaction regulated pursuant to N.J.S.A. 46:10B-27a. In addition, where the seller is the original creditor, all payments to the seller by the buyer are included in the calculation of amounts paid in connection with the transaction. In this context, such payments may include down payments, deposits, periodic payments, late fees and other payments to the seller.

Bulletin 2, Question 18a

You next ask whether DoBI can rely on the FTC Holder Rule in the context of determining the definition of seller under N.J.S.A. 46:10B-27a. As previously indicated, supra, it is reasonable to generally rely on the Rule given its standards are applicable to the type of transactions at issue here.

Moreover, it is reasonable to base the definition of the word seller under the Act on generally accepted industry-wide standards. Under the FTC Holder Rule a seller is defined as "a person who, in the ordinary course of business, sells or leases goods or services to consumers." 16 C.F.R. §433.1(j). Further, this definition is consistent with the definition of retail seller under the Retail Installment Sales Act. See N.J.S.A. 17:16C-1(C).

Bulletin 1, Question 4
Bulletin 2, Question 20

You next ask whether the Department's interpretation is reasonable that cash-out refinancing transactions and junior lien mortgage loans are not subject to the assignee liability provisions for home improvement and manufactured housing loans when there is no seller of the home improvement or manufactured home sufficiently involved as required by N.J.S.A. 46:10B-27a.

It is clear from the provisions of the Act that if the seller of the home improvement or manufactured home is not the original creditor, and does not refer the borrower to the creditor or otherwise have the requisite involvement, then there is no assignee liability under the Act, since the statutory predicates for such liability are not present. Ibid. The Department's interpretation is reasonable and would be accorded great weight by a court.

You also ask whether the Department's interpretation is reasonable that a loan in a pool in which the borrower receives cash does not constitute a home improvement loan subject to the assignee liability provisions of N.J.S.A. 46:10B-27a.

As indicated above, by the clear terms of the Act, a cash-out refinancing transactions, i.e., transactions in which a borrower receives cash, is not a home improvement loan subject to the assignee liability provisions of N.J.S.A. 46:10B-27a. To be applicable, the loan must be made or arranged by the home improvement contractor or the loan must be made or arranged by a creditor to whom the borrower was referred by the home improvement contractor for purposes of buying home improvements or manufactured housing. Accordingly, the Department's

interpretation is a reasonable one and would be accorded deference by the courts.

Bulletin 1, Question 5
Bulletin 2, Question 18b

You next ask if the Department's determination of how much involvement the home improvement contractor or manufactured home seller must have in arranging the home loan for assignee liability to be applicable is reasonable. You advise that while the Act does not explicitly address this issue, the Act, in this regard, was based on the FTC Holder Rule, supra, since the Rule provides a generally applicable standard in this context which is recognized throughout the industry.

Guidelines to the rule provide that the circumstances in which a home improvement contractor will be determined to have "referred" a borrower to a lender will include those situations where the seller, in the ordinary course of business, is sending buyers to a particular loan outlet or outlets, for credit which is to be used in the sellers' establishment. See, e.g., FTC Staff Guidelines to Trade Regulators Rule Concerning Preservation of Consumers' Claims and Defenses, supra. In such circumstances, it is reasonable to conclude that the seller is effectively arranging credit for his customers and is therefore sufficiently involved that the assignee liability provisions of N.J.S.A. 46:10B-27a would be applicable. The Department's interpretation is, therefore, a reasonable one.

Bulletin 2, Question 18c

The Department next asks whether the Department's view that the amount of damages which may be imposed against an assignee who purchases home improvement or manufactured home loans pursuant to N.J.S.A. 46:10B-27a is capped in a manner similar to that in the FTC Holder Rule, supra, is reasonable.

The Act clearly sets forth the limitation on the amount of damages available to a borrower under N.J.S.A. 46:10B-27a against an assignee. Such damages are limited to amounts required to reduce or extinguish the borrower's liability under the home loan, plus the total amount paid by the borrower in connection with the transaction, plus amounts required to cover

costs, including reasonable attorney's fees. Ibid. The Department's view is, therefore, reasonable.

Bulletin 1, Question 6

You next ask whether the Department's position on how an assignee would be able to determine whether a loan is a home improvement or manufactured home loan which was made, arranged or assigned by a seller, or made by a lender who was referred to the borrower by the seller in the ordinary course of business is reasonable.

The Department states in its bulletin that assignees and purchasers have mechanisms available to ensure that loans being purchased or assigned comply with federal and state law. Assignees should be able to identify loans covered by N.J.S.A. 46:10B-27a since such loans must include notices provided by state or federal law. With regard to the required notices, under the Home Repair Financing Act, N.J.S.A. 17:16C-64.2 no home repair contract shall require the execution of a note unless such note is identified thereon as a "Consumer Note." Under the FTC Holder Rule, supra, it is an unfair and deceptive trade practice for a seller to take or receive a consumer credit contract, i.e., home loan under the Act, see N.J.S.A. 46:10B-27a, which fails to include a notice regarding assignee liability. See 16 C.F.R. §433.2(a). In addition, regulations under the Consumer Fraud Act require that any note executed in conjunction with a home repair contract must include the notices required by state or federal law concerning the preservation of the buyer's claims and defenses. See N.J.A.C. 13:45A-16.2(a)(13)(ii). Assignees and purchasers should, therefore, be able to identify covered loans in almost all situations. In the situation where the seller or creditor fails to include such notices, the assignee could still be liable. See Associates Home Equity Services, Inc. v. Beatrice Troup, 343 N.J. Super. 254, 276 (App. Div. 2001) (when loan arranged by and in concert with home improvement contractor, lender can not circumvent the consequences of the Holder Rule due to failure to include the required notice). However, the Department notes that there are mechanisms such as targeted inquiries prior to purchase, representations and warranties that can be employed to ensure that loans comply with legal requirements. Accordingly, it is

clear that the Department's view is a reasonable one entitled to deference.

Bulletin 1, Question 7

Your next question is whether the Department's position that borrowers can assert class action claims under N.J.S.A. 46:10B-27a in connection with home improvement or manufactured home loans against creditors, assignees or holders is reasonable. It is.

Section 27a does not expand or restrict the ability of a borrower to raise class action claims. Thus, there is nothing in the Act to preclude a class action suit to the extent a borrower can satisfy other requirements for class certification. The Department notes, correctly, that the damages available to each borrower in such situation will be capped as provided in N.J.S.A. 46:10B-27a.

Flipping
Bulletin 1, Question 10

Under the topic of flipping, you ask whether the "flipping" restriction (also know as the "reasonable tangible net benefit" requirement) set forth at N.J.S.A. 46:10B-25b applies to all home loans.

Under the clear terms of the Act, the flipping provisions apply only when two requirements are satisfied. First the new loan must be a covered home loan as defined by the Act, and second the refinance must occur within 60 months of the consumation of the existing home loan. It should also be noted, however, that the Act does not create a presumption that any home loan which is not a covered home loan or high-cost home loan and any refinancing outside 60 months is not unconscionable or does not constitute an unlawful practice under the CFA. Ibid.

Authority of the Department's Regulatory Bulletins
Bulletin 2, Question 22

Under the last topic, you ask how effective or binding the regulatory Bulletins are, especially where the Act does not provide DoBI with authority to promulgate regulations.

As set forth, supra, as the agency charged with enforcing the Act, the Department's interpretation thereof would be accorded considerable deference.

In Christensen v. Harris County, 529 U.S. 576, 120 S. Ct. 1655, 146 L. Ed. 2d 621 (2000), the U.S. Supreme Court clarified the distinction between the level of deference to be accorded formal agency regulations and informal agency interpretations. In so doing, the Court held agency interpretative guidelines are "...entitled to respect under Skidmore v. Swift, 323 U.S. 134, 65 S. Ct. 161, 89 L. Ed. 124 (1994), but only to the extent that they have the power to persuade." Christensen v. Harris, 529 U.S. at 588.

As to the persuasiveness of agency interpretative guidelines, Skidmore v. Swift, supra, set forth the appropriate standard, explaining:

[R]ulings, interpretations and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority do constitute a body of experience and informed judgment, to which courts and Litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon thoroughness evident in the consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."

Skidmore v. Swift, 323 U.S. at 140. In applying the Skidmore test, the Court has noted that agency interpretations issued contemporaneous with a statute are entitled to greater deference. See e.g., Public Citizens v. Department of Justice, 491 U.S. 440, 463 n.12, 109 S. Ct. 2558, 105 L. Ed. 2d 377 (1989).

Although signed into law in May 2003, the Act is not effective until November 27. As such, the Department's Regulatory Bulletins are being issued contemporaneously with the Act's implementation and therefore, entitled to greater deference. Clearly, the bulletins are thorough and consistent with the Act and reasonably construe provisions therein. Thus, as the agency who will enforce the Act, the Department's

Bulletins, issued contemporaneously with the Act's implementation, should be accorded deference as an expression of the view of the Act's administering agency.

For all the above reasons, you are advised that the Department's Bulletins 1 and 2 reasonably interpret the provisions of the Act and such interpretation would be accorded deference by a reviewing court.

Sincerely yours,

PETER C. HARVEY
ATTORNEY GENERAL OF NEW JERSEY

By:
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