



IN THE CIRCUIT COURT OF JACKSON COUNTY, MISSOURI  
AT INDEPENDENCE

<p><b>FILED</b> By Judicial Administrative Assistant Division 28</p> <p>JUL 10 2006</p> <p>Circuit Court Of Jackson County Mo. By <u>Charissa Nelson</u></p>
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David C. McLean, et al.,

Plaintiffs,

vs.

First Horizon Home Loan Association  
(f.k.a. McGuire Mortgage Company),

Defendant.

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) Case Number: 00CV228530  
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) Division 28  
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**SPECIAL MASTER'S REPORT ON  
DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT ON  
ALL LOANS MADE AFTER DECEMBER 31, 1998**

In accordance with the Order Appointing Special Master, I issue my report on Defendant's Motion for Partial Summary Judgment on All Loans Made After December 31, 1998. Before drafting this report, I have considered the following:

- Defendant's Suggestions in Support
- Defendant's Amended Suggestions in Support
- Defendant's correspondence dated June 5 and June 12, 2006
- Plaintiffs' Response
- Plaintiffs' Supplemental Response
- Plaintiffs' correspondence. dated June 9, 2006

I have also studied the exhibits submitted by counsel. In addition, I have researched and reviewed the applicable law. On May 30, 2006, I heard oral argument on this matter.

**OVERVIEW**

The Representative Plaintiffs in this class action have sued McGuire Mortgage Company, now known as First Horizon Home Loan Association, under the Missouri Second Mortgage Loan Act (MSMLA). The Defendant now moves for

partial summary judgment as to all loans made after December 31, 1998. The Special Master has previously filed a report on pre-emption generally and also filed a report on the lawfulness of loan rates. The Court sustained the Special Master's Report for Partial Summary Judgment on the first preemptory motion as to discount fees alone. In the Special Master's Report on lawfulness, the Court sustained the Special Master's Report to the effect that the Defendant did not establish what the loan rates in Kansas were and, therefore, was not entitled to Summary Judgment as to the lawfulness of loan rates.

Under Supreme Court Rule 74.04, judgment is appropriate when no genuine dispute exists about the material facts.

#### MATERIAL FACTS

The material facts are generally as stated on pages 6 and 7 of Defendant's Brief, marked as Exhibit A and incorporated herein by reference.

First Tennessee Bank National Associates (First Tennessee) is a national bank with its principal place of business in Memphis, Tennessee. Defendant alleges that First Horizon Home Loan Corporation is a subsidiary of First Tennessee after December 31, 1998 and, therefore, subject to the National Banking Act after that date.

Before and after December 31, 1998, Defendant charged origination fees, underwriting fees, processing fees discount fees and flood certification fees. Defendant also charged, as closing costs, tax service fees, broker fees, record assignment fees, express mail fees, title charges, document preparation fees, credit reporting fees and appraisal fees on various loans made to members of this class action.

Defendant says that all the charges and closing costs are pre-empted by the National Bank Act subsequent to December 31, 1998.

Plaintiffs admit that discount fees and flood certification fees are interest and are, therefore, pre-empted by the National Bank Act. Plaintiffs deny that the remaining fees and charges are interest and, therefore, are illegal under the Missouri Second Mortgage Act.

#### ARGUMENT

Defendant argues first that MSMLA does not apply to the loan when the interest rate was lawful under any other law of either a federal or state and therefore the rates of this case are lawful. Secondly, Defendant argues that in addition to the loan discount fees, underwriting, processing and origination fees are interest under the National Bank Act. Thirdly, the National Bank Act grants national banks and their operating subsidiaries the power to charge, as closing costs, its customers' incidental non-interest fees which any bank may do in its discretion and unfettered by any state law restrictions.

Defendant through the Supplemental Affidavit of Clyde A. Billings established that First Horizon is an operating subsidiary of First Tennessee from and after December 31, 1998. Defendant further argues that origination, underwriting, and processing fees are interest under the National Bank Act and therefore are not subject to MSMLA primarily because of the indemnity provisions in the sales agreement with respect to any losses a subsequent holder suffers in connection with the loans for many different reasons.

With respect to Defendant's first argument, Defendant claims that under the Tennessee Industrial Loan and Thrift Companies Act (ILTCAA) governing loans

made by industrial thrift companies interest can be provided at the rate of 24 per annum for loans over \$100.00 and commencing May 17, 1999 the Credit Card Banks Act (CCBA) provides a rate of twenty-one percent per year.

Defendant states that there are no loans made to class members after May 17, 1999 when the interest rate exceeded twenty-one percent.

Defendant further argues that both the ILTCA and the CCBA apply and, that the interest rates after December 31, 1998 were lawful.

Defendant further argues that the National Bank Act pre-empts Plaintiffs' claim for charges on loans made after December 31, 1998.

Under *Phipps v. FDIC*, 417 F 3<sup>rd</sup> 1006, 1012-13 (8<sup>th</sup> Cir 2005) and *Smiley v. Citibank NA*, 517 US 735, 745-46 (1996) and 12 CFR Section 7.4001(a) the term interest should be considered to include any payment compensating the prospective creditor for an extension of credit, or making available a line of credit or any default or breach by a borrower of a condition upon which credit was extended. Defendant argues that loan origination fees, underwriting fee, application fee, processing fee, discount fees and late fees all fall within that definition.

Defendant finally argues that closing costs charged by a National Bank are not subject to State Regulations. Among the National Banks power under the OCC Regulation is the power to charge customers non-interest charges and fees. (12 CFR Section 7.4002(c)) and that the courts have deferred to the OCC Regulation in ruling certain fees are pre-empted. See *Bank of America, NA v. City and County of San Francisco*, 319 F 2d 551 (9<sup>th</sup> Cir 2002) and other cases on page 17 of Defendant's brief.

Defendant also argues that even if it retained, directly or indirectly closing costs, they still constitute interest under the NBA. See Smiley, 517 US at 741-42 discussions 12 CFR Section 7.4001(a).

Defendant in its correspondence dated June 5, 2006 states that the NBA adopts a most favored lender rule allowing First Horizon to use the highest interest rate applicable to any type of lender and that the 1996 version at CFR Paragraph 73 at 10 no longer applies. (The competing type of lender) Even so, the Defendant argues that ILCA is not prohibited from making home loan mortgages. Further, the CCSBA applicability is broad and goes further credit card loans.

Defendant in its June 12, 2006 correspondence further confirms its belief that competition is not a determination or applicable to the exportation of rates at issue. The limitation was deleted and does not apply to post-1998 loans. The Defendant also relies on an opinion of the Attorney General of the State of Tennessee to the effect that rate exportation allows a federal institution at the highest rate permitted under existing Tennessee law.

Finally, Defendant argues that 12 CFR Section 7.4001 and 7.4002 should not be disregarded simply because the OCC did not include language as is found in 12 CFR Section 7.4002(b) (2).

#### COUNTER ARGUMENT

Plaintiffs assert that Defendant has not satisfied its burden of proving the asserted fact that First Horizon is an operating subsidiary of First Tennessee from 1999 through 2002. Defendant has not put forth any evidence that origination, underwriting, and or processing fees charged after December 31, 1998 constitute a mere return of investment. By charging, contracting for and/or receiving

origination, underwriting, processing and other non-interest fees, the Defendant violated Section 408.233.1 RSMo.

Further in its legal argument, Plaintiff states that Defendant has not shown that the interest rates that it exported from Tennessee were lawful rates for all the post-1998 loans at issue nor that its interpretation of Section 408.232.4 RSMo., the MSMLA exemption provision, is constitutionally sound. Defendant has not shown that the National Bank Act (NBA) pre-empts the claims of Missouri borrowers who obtained these loans after December 31, 1998 even if the NBA governs those loans.

A. With respect to Defendant's not being an operating subsidiary of First Tennessee as of January 1, 1999, Plaintiffs' do not accept the conclusionary statements of Clyde Billings as set forth in his second of two affidavits that First Horizon was not required to submit any new application to the OCC at that time for approval of McGuire to be an operating subsidiary of First Tennessee.

B. With respect to interest rates, First Horizon has not shown that the rate of interest it charged for all post-1998 loans was lawful as a matter of law and, therefore, were exempted from the MSMLA pursuant to NBA Section 85 and 408.232.4 RSMo.

The maximum effective rates generally according to Section 47-14-103 of the statutes of Tennessee are

- (1) For all transactions in which the effective rate of interest for particular categories of creditors, lenders or transactions, the rate so fixed.
- (2) For all written contracts....and not subject to subdivision (1), the applicable formula rate.

Under Tennessee law, the maximum effective rate that a state bank or lender can charge for home loans is an amount equal to two (2) percentage points above the most recent weighted average yield of the accepted offers of the Federal National Mortgage Association's current free market system auction for commitments to purchase conventional home mortgages (FNMA Auction) as determined by Section 47-15-103 of the Tennessee Code Section 47-15-102(a). During the period from January 1, 1999 to December 2002, the home loan rate ranged from 9.05% to 9.12%. Not less than 516 of the 2072 post-1998 loans appear to have terms greater than 181 months (15 years) and are home loans as defined under Tennessee law. (Ex A, Paragraph 2 of Plaintiffs' Brief) Defendant has not shown that the interest rate for any post-1998 loan was no greater than the Tennessee home loan rate and less than the federal discount rate on commercial paper as specified in NBA Section 85, (AE Subparagraph 2-10) the Court cannot grant summary judgment as to these loans.

Plaintiffs argue that the same is true of the 1500 or so post-1998 loans that apparently have a term no greater than 181 months. The maximum effective rate that a Tennessee bank or lender would have to compete is the applicable formula rate Tennessee Code Section 47-14-103(2). During the period of time in question the formula rate ranged from 11.756 in January 1999 to 8.25% in December of 2002.

Plaintiffs argue that Defendant's attempt to rely on the extraordinary high interest rates allowed under the Tennessee Credit Card Banks Act Section 45-2-1901 et. seq. (CCBA) and the Tennessee Industrial Loan and Thrift Companies Act Tennessee Code Sections 45-5-1-1-1, et. seq. (ILTCA). Neither of these rates is

applicable for purposes of NBA Section 85. The interest rate under CCBA applies to extensions of credit made to a credit card account. The ILTCA rate does not apply to home loans. Tennessee Code Section 45-5-302(2) (ILTCA). Nor does ILTCA apply to the state or national bank Tennessee Code Section 45-5-302(2). Under 12 CFR Section 7.7310 a national bank may charge interest at the maximum rate permitted by state law to any competing state chartered bank or licensed lending institution.

C. Plaintiffs state that First Horizon's attempt to exempt the post-1998 loans from MSMLA violates Article 3, Section 44 of the Missouri Constitution. The Court of appeals in Adkison expressly did not decide whether the Defendant's construction would violate the Missouri Constitution Article 3, Section 44 (see page 15 of Plaintiffs' Brief). Defendant's construction would result in foreign competition to significantly undermine Missouri banks' incentive too make competitive second mortgage loans.

D. National Bank Act sections 85 and 86 do not pre-empt state law claims that are not disputed interest. *Doe v. Northwest Bank Minnesota NA*, 107 F 3<sup>rd</sup> 1297. *Video Trax Inc. v. National Bank NA*, 33 F Supp 2d 1041, 1048 (SD Fla 1998), bank overdraft fee is not interest. *Smith v. Beneficial National Bank*, 971 F Supp 513, 517 (MD Ala 1997) reconciling varied judicial opinions that have addressed the issue of complete preemption under Section 85 and 86 of the NBA.

- (1) Not every fee charged by a Lender making a real estate loan is interest under federal law. There are numerous non-interest real estate loan fees. *Smiley v Citibank (SD) NA* 517 US 735 (1996). Only those fees compensating a creditor for an extension of credit

or any default or breach by a borrower of a condition upon which credit was extended actually qualify as interest.

(2) Origination, processing and underwriting fees at issue are all non-interest charges. These charges are settlement service charges.

Wombold v Associates Financial Services 104 P 3<sup>rd</sup> 1080 1088-89.

(3) RESPA, the Real Estate Settlement Procedures Act defines loan origination fees as encompassing loan processing and underwriting and the handling and closing or settlement of such loans.

(4) Underwriting fees are also non-interest charges. Underwriting is the process of evaluation of a loan prospect to ensure they have the financial capacity to repay the loan. This is a fee paid for the settlement services the lender provides. See Wombold 104 P 3<sup>rd</sup> 1088-90.

(5) Processing fees are also non-interest charges. A processing fee covers the administrative costs of processing the loan fee. See Wombold 104 P 3<sup>rd</sup> at 1088-89.

Citibank v. Smiley, 517 US at 741-42 states that charges assessed for something other than merely making the loans are non-interest charges.

Phipps is contrary to Smiley. Phipps is an over generalization of the OCC definition in 12 CFR Section 7.4001 (a). The Court in Phipps concluded that origination fees are interest.

E. The NBA does not pre-empt post-1998 claims based on the unlawful assessment of non-interest fees. CFR Section 34.4 applicability of State law sets forth the specific pre-empt as applied to national bank.

1. amount of a loan
2. schedule of re-payment
3. terms
4. aggregate amount which may be loans upon security of real estate
5. covenants and restrictions that must be contained in a lease to qualify the leasehold acceptable security for a real estate loan

Plaintiffs further state that 12 CFR 34.4 (2002) contains an express preemption clause and states further that when you have expressed preemption non-covered subjects are not pre-empted.

Plaintiffs further state that the OCC did not intend to pre-empt section 408.231 RSMo.

Plaintiffs further argue that the Defendant has not offered any opinion letters from the OCC that the OCC reasonably construed the NBA as authorizing a bank charge any non-interest fees at 408.231 RSMo.

Lastly, Plaintiffs state that whether or not a particular charge is interest does not depend upon the identity of the payor but on the purpose for which the charge is being made.

In its supplemental response, Plaintiffs point out that 12 CFR Section 2.2.8 is a perfect example of Congress's making known its intent to allow a particular type of fee regardless of state law. There is a conspicuous absence of any similar regulation addressing the other fees at issue in this case.

#### DISCUSSION

Plaintiffs claim that Defendant has not shown as a matter of law that First Horizon is an operating subsidiary of a National Bank. This matter was decided in this case by Special Master's first preemption report to the effect that First Tennessee Bank National Association acquired McGuire Mortgage by stock purchase on December 31, 1998 and as a result McGuire Mortgage was merged into First Tennessee Mortgage Companies a wholly owned subsidiary of First Tennessee Bank. When the Court approved this report this fact became the law of the case and cannot be challenged again.

As was stated in the Special Master's Report on lawfulness of loan rates, the MSMLA does not apply to any loan on which the rate of interest is lawful without regard to the rates of interest in Section 408.2.231 of MSMLA. In other words, lawfulness is determined by the usury rate for residential real estate loans. A second real estate mortgage borrower who is charged a non-usurious interest rate has no cause of action under MSMLA.

First Horizon has not shown, as a matter of law that Tennessee Industrial Loan and Thrift Company Act or the Tennessee Credit Card Act is an applicable rate for the purpose of the NBA Section 85. Consequently, Defendant's motion for summary judgment on its claim that the interest rates charged were lawful must fail.

As stated in the first Special Master's Report on preemption, the starting presumption is that Congress has not intended to pre-empt state law. *Black v. Financial Freedom Senior Funding Corporation* 112 Cal Reporter Second 445, 452 (Cal App. 2001). To establish federal preemption, Defendant has the burden of proving that Congress is clear in manifest intent.

The National Bank Act and regulations of the OCC and the case law specifically pre-empt any state law claims with respect to interest and incidental closing costs charged by national banks and their subsidiaries. Origination charges are interest under 12 USC Section 85. This charge includes origination fees, processing fees and underwriting fees. *Phipps v. FDIC* 417 Federal 3<sup>rd</sup> 1006, 1012 (8<sup>th</sup> Cir. 2005), 12 USC Section 85 and 12 CFR 7.4001. *Adkison v. First Plus Bank* 143 SW 3<sup>rd</sup> 29 ( Mo App2004), *Avila v. Community Bank* 143 SW 3<sup>rd</sup> 1 (Mo. App. WD 2004) 1. The remaining closing costs listed in Plaintiffs' amended petition constitute incidental closing costs specifically prohibited by 12 USC Section 85.

In addition, Plaintiffs' claim that exempting post 1998 loans from MSMLA would violate Article 3, Section 44 of the Missouri Constitution must also fail. The preemption of interest rates will overrule any conflict with the Missouri Constitution. *Black v. Financial Funding Corporation* 92 Cal Rptr. 4<sup>th</sup> 917 (Ct. App. 2001)

Accordingly, the Special Master finds that all of the fees and closing costs subsequent to December 31, 1998 as set forth in Plaintiffs' Third Amended Petition are pre-empted.

#### RECOMMENDATION

The Special Master respectfully recommends that the Court Overrule Defendant's motion for summary judgment on the grounds that the rates were lawful under MSMLA and sustain Defendant's Motion for Partial Summary Judgment on all loans made after December 31, 1998 on the grounds of preemption..

2/9/06  
Date

William F. Mauer  
The Honorable William F. Mauer  
Special Master

On 7/9, 2006, this Special Master's Report was submitted to

**The Honorable Vernon E. Scoville, III**  
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CERTIFICATE OF SERVICE

The undersigned does hereby certify that on July 11, 2006, a true and correct copy of the above was:

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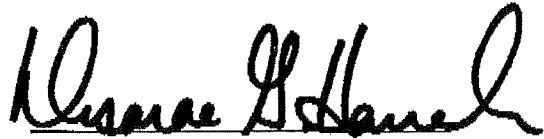
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