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 8

9 UNITED STATES DISTRICT COURT
 10 NORTHERN DISTRICT OF CALIFORNIA
 11

12 ARMANDO PLASCENCIA and MELANIA
 PLASCENCIA, individually and on behalf of all
 13 others similarly situated,

14 Plaintiffs,

15 vs.

16 LENDING 1st MORTGAGE; LENDING
 1st MORTGAGE, LLC; EMC MORTGAGE
 17 CORPORATION; and DOES 1 through 10
 inclusive,

18 Defendants.
 19

Case No.: C-07-04485-CW

**EMC MORTGAGE CORPORATION'S
 NOTICE OF MOTION AND MOTION TO
 DISMISS FOR FAILURE TO STATE A
 CLAIM UPON WHICH RELIEF CAN BE
 GRANTED; MEMORANDUM OF POINTS
 AND AUTHORITIES IN SUPPORT
 THEREOF [Fed R. Civ. P., Rule 12(b)(6)];
 [PROPOSED] ORDER**

Date: September 25, 2008
 Time: 2:00 p.m.
 Courtroom: 2
 Judge: Hon. Claudia Wilken

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **I. INTRODUCTION**

3 In their third amended complaint, plaintiffs Armando and Melania Plascencia have added a
4 new party to their attack on Option ARM loans, defendant EMC Mortgage Corporation. EMC is
5 the purported assignee of plaintiffs’ loan. Although plaintiffs indiscriminately refer to EMC as one
6 of the “defendants,” the gravamen of plaintiffs’ complaint has nothing to do with EMC. As the
7 Court is aware, plaintiffs allege, on their own behalf and on behalf of a putative class, that they
8 were misled into obtaining their Option ARM loan and that the loan’s terms were not adequately
9 disclosed at origination.

10 As a mere assignee, EMC did not originate the allegedly offensive loan, solicit plaintiffs to
11 obtain it through supposedly deceptive means, or provide the purportedly inadequate disclosures.
12 If plaintiffs have a grievance about the origination of their loan, then, it is not with EMC. And,
13 plaintiffs point to no other conduct of EMC post-assignment that would support any viable claim.
14 EMC therefore moves to dismiss plaintiffs’ third amended complaint and each of its purported
15 causes of action pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure.

16 The first cause of action for violation of the federal Truth-in-Lending Act (“TILA”),
17 15 U.S.C. § 1601 *et seq.*, should be dismissed because plaintiffs cannot recover any relief under
18 that statute. Only two forms of relief are available: rescission and damages. Plaintiffs cannot
19 rescind their loan under 15 U.S.C. § 1635 because they have paid their loan in full through a
20 refinance. Therefore, there is nothing left to rescind. *King v. State of California*, 784 F.2d 910,
21 913 (9th Cir. 1986). Plaintiffs cannot recover actual or statutory damages under TILA because
22 they filed suit more than a year after consummation of their loan and because they do not allege
23 facts sufficient to toll TILA’s one-year limitations period. 15 U.S.C. § 1640(e).

24 The second and fourth causes of action for unlawful, unfair, and fraudulent acts in violation
25 of the California Unfair Competition Law, Cal. Bus. & Prof. Code § 17200 *et seq.*, should be
26 dismissed because the UCL does not recognize vicarious liability. Just like their TILA claim,
27 plaintiffs’ claims for violation of the UCL are predicated on supposedly inadequate disclosures and
28 misleading representations made at origination. It is settled, however, that a defendant is only

1 liable for a UCL violation if it “personally participates” in the allegedly wrongful act. *Emery v.*
2 *Visa International Service Association*, 95 Cal.App.4th 952, 960 (2002). Because EMC is the
3 purported assignee, it could not and did not participate in the alleged wrongful act—the origination
4 of plaintiffs’ loan. Therefore, plaintiffs have no claim for violation of the UCL against EMC.

5 Moreover, plaintiffs’ UCL claim for unlawful practices (second cause of action) fails for
6 the additional reason that it is preempted by TILA. This claim is based solely on the defendants’
7 alleged noncompliance with TILA. Yet, plaintiffs seek to take advantage of the UCL’s more
8 favorable statute of limitations, and to recover additional remedies not allowed by TILA. Plaintiffs
9 cannot use the UCL to seek relief that is foreclosed by TILA, which preempts “inconsistent” state
10 laws. 15 U.S.C. § 1610(a).

11 For this same reason, plaintiffs’ third cause of action for fraudulent omissions should also
12 be dismissed. Again, plaintiffs challenge the same alleged omissions as they do in their TILA
13 claim, but try to avail themselves of the state law claim’s longer statute of limitations and more
14 expansive remedies. This is directly inconsistent with TILA—and impermissible. Further, to the
15 extent that plaintiffs claim that EMC had a duty to disclose separate from TILA, the claim fails
16 because EMC did not originate the loan. EMC thus had no opportunity, much less a duty, to
17 disclose anything.

18 Plaintiffs’ fifth cause of action for breach of contract should be dismissed because
19 plaintiffs’ promissory note refutes their assertion that EMC breached any contractual duty by
20 “failing to apply any portion of [plaintiffs’] monthly payments toward their principal loan
21 balances.” Third Amended Complaint (“TAC”), ¶ 155. The note clearly provides that payments
22 may be less than the amount of interest accruing each month and that, if so, “the Note Holder will
23 subtract the amount of my monthly payment from the amount of the interest portion and will add
24 the difference to my unpaid Principal.” *Id.*, Ex. 1, ¶ 5(c). That is just what plaintiffs say EMC did.
25 Because the note expressly permits that conduct, it cannot be a breach of the contract.

26 Plaintiffs’ sixth cause of action for breach of the implied covenant of good faith should be
27 dismissed for a similar reason. The note expressly permits EMC to engage in the conduct that
28 plaintiffs claim breached the implied covenant—raising the interest rate monthly, even if the new

1 interest rate results in interest charges exceeding the required monthly payment. The covenant of
2 good faith cannot be read to prohibit a party from doing that which the agreement expressly
3 permits.¹

4 In short, plaintiffs have no grievance with EMC. EMC did not originate their loan or give
5 them the TILA disclosures they challenge. And plaintiffs' note expressly authorizes EMC to apply
6 plaintiffs' payments in the manner alleged to be wrongful. Accordingly, the Court should dismiss
7 plaintiffs' third amended complaint as to EMC without leave to amend.

8 II. STATEMENT OF FACTS

9 On a motion to dismiss, the Court accepts as true the facts properly pleaded in the
10 complaint, but not conclusions of law. *Alperin v. Vatican Bank*, 410 F.3d 532, 541 (9th Cir. 2005);
11 *In re Verifone Secs. Litig.*, 11 F.3d 865, 868 (9th Cir. 1993). A plaintiff must plead sufficient facts
12 "to provide the 'grounds' of his 'entitle[ment] to relief,' [which] requires more than labels and
13 conclusions, and [for which] a formulaic recitation of the elements of a cause of action will not
14 do." *Bell Atlantic Co. v. Twombly*, ___ U.S. ___, 127 S.Ct. 1955, 1964-65 (2007) (citations
15 omitted). Documents attached to pleadings as exhibits are deemed part of the complaint and may
16 be considered by the Court in deciding the motion. Fed. R. Civ. P., Rule 10(c); *Durning v. First*
17 *Boston Corp.*, 815 F.2d 1265, 1267 (9th Cir. 1987). Also, "it is proper for the district court to 'take
18 judicial notice of matters of public record outside the pleadings' and consider them for purposes of
19 the motion to dismiss." *Mir v. Little Co. of Mary Hosp.*, 844 F.2d 646, 649 (9th Cir. 1988); *accord*
20 *Kourtis v. Cameron*, 419 F.3d 989, 994 n. 2 (9th Cir. 2005).

21 In keeping with these rules, and without conceding for any other purpose the truth of
22 plaintiffs' allegations, EMC sets forth the facts pertinent to this motion.

23 A. The Underlying Facts

24 On May 16, 2006, plaintiffs refinanced the loan on their San Leandro, California home,
25 obtaining an option ARM loan from defendant Lending 1st Mortgage.² TAC, ¶¶ 2, 3, Ex. 1;
26

27 _____
28 ¹ *Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.*, 2 Cal.4th 342,
374-75, 6 Cal.Rptr.2d 467 (1992).

1 Request for Judicial Notice (“RJN”), Ex. A. Plaintiffs are informed and believe that Lending 1st, at
2 some unspecified time, sold plaintiffs’ loan to EMC.³ *Id.* at ¶¶ 6, 19.

3 Plaintiffs’ promissory note is labeled an “**ADJUSTABLE RATE NOTE,**” in boldface
4 capital letters at the very top of the first page. TAC, Ex. 1, p. 1; emphasis in original. Just below
5 that label, also in boldface capital letters, the note avers:

6 **THIS NOTE ALLOWS MONTHLY RATE CHANGES AND**
7 **ANNUAL PAYMENT CHANGES. THIS NOTE MAY**
8 **REQUIRE UNPAID INTEREST TO BE ADDED TO LOAN**
9 **PRINCIPAL AND REQUIRE ME TO PAY ADDITIONAL**
10 **INTEREST ON THE UNPAID INTEREST (NEGATIVE**
11 **AMORTIZATION).**

12 TAC, Ex. 1, p. 1; emphasis in original.

13 Plaintiffs’ loan had a low initial interest rate, which adjusted to the full indexed rate when
14 the first payment was due, and then readjusted monthly thereafter according to changes in the
15 index. TAC, ¶¶ 24, 32(a); Ex. 1, ¶¶ 2, 4.

16 Plaintiffs’ loan also featured low minimum monthly payments, at least during the first three
17 to five years of the loan. TAC, ¶¶ 24, 32(b). In the initial year, minimum monthly payments were
18 set at an amount which would fully amortize the loan if the low initial interest rate remained
19 applicable during the loan’s entire term. *Id.*, ¶ 32(c). Thereafter, the required monthly payment
20 amount changed annually to the amount needed to fully amortize the loan if at the prior month’s
21 interest rate. *Id.* at Ex. 1, ¶ 5(A).

22 During the first five years, however, the minimum payment amount could not be increased
23 by more than 7.5% each year. TAC, Ex. 1 § 5(B); TAC, ¶ 32(d). After five years, or if loan
24 principal ever equaled 115% of the amount originally borrowed, the minimum payment amount
25 would be readjusted without regard to this cap. *Id.*, Ex. 1, §§ 5(D), (E).

26 ² Plaintiffs name both Lending 1st Mortgage and Lending 1st Mortgage, LLC as defendants.
27 TAC, ¶¶ 3, 4. Apparently, Lending 1st Mortgage LLC was formerly known as Lending
28 1st Mortgage.

³ EMC disputes this allegation. Nevertheless, EMC will treat this allegation as true, as it
must for purposes of this motion.

1 Under their promissory note, plaintiffs could choose to pay more than the minimum
2 payment each month. The note lists three increased payment options: interest only payment (the
3 amount of interest accrued each month so as to avoid negative amortization), fully amortized
4 payment (the amount needed to repay the loan in full by its maturity date), or a 15-year amortized
5 payment (the amount needed to repay the loan within 15 years of the initial payment). TAC, Ex. 1,
6 ¶ 5(F).

7 A rider to plaintiffs' deed of trust provided for a prepayment penalty if plaintiffs prepaid
8 more than 20% of their loan in any of the first three years of its term. TAC, ¶ 32(e); Ex. 1, pp. 8-9,
9 ["Prepayment Rider."]

10 Plaintiffs' TILA Disclosure Statement ("TILDS") revealed that the loan had a variable rate
11 feature, that the loan's annual percentage rate was 7.680%,⁴ and that there might be a prepayment
12 penalty if the plaintiffs repaid the loan early. FAC, Ex. 1, p. 7.

13 In May 2007, plaintiffs refinanced their home again, obtaining a new first mortgage from
14 Cameron Financial Group, Inc. dba 1st Choice Mortgage. RJN, Ex. B. As a result, plaintiffs
15 repaid, in full, the option ARM loan that Lending 1st had made to them in May 2006, and the deed
16 of trust securing that loan was reconveyed. RJN, Ex. C.

17 **B. The Complaint's Claims**

18 Plaintiffs claim that they and other similarly situated borrowers were led to believe that the
19 low initial interest rate on their option ARM loan was fixed for three to five years and that if they
20 made payments based on that rate there would be no negative amortization on their loans, but that
21 their payments would be applied to loan principal as well as interest. TAC, ¶ 26. In fact, the
22 interest rate readjusted to the full indexed rate shortly after the loan was made. When it did so,
23 interest accrued at a rate exceeding the required monthly payments, guaranteeing negative amortize-
24 tion, and application of monthly payments solely to interest, not loan principal. *Id.*, ¶¶ 29, 30.

25
26 ⁴ Because the initial interest rate was lower than the fully indexed rate, the TILA disclosure
27 was required to state an annual percentage rate that "reflect[ed] a composite annual percentage rate
28 pt. 226, Supp. I, §17(c)(1) ¶¶8, 10.

1 Plaintiffs say they were prevented from refinancing out of these disadvantageous loans by the loans'
2 prepayment penalty provisions and by plaintiffs' loss of equity due to negative amortization. *Id.*,
3 ¶¶ 30, 32(e) 174.

4 Based on these allegations, plaintiffs assert the same six causes of action against EMC and
5 1st Lending, who are jointly referred to throughout the complaint as the "defendants."

6 The first cause of action alleges four violations of TILA: 1) failure to clearly disclose the
7 actual interest rate (TAC, ¶¶ 57-65); 2) failure to disclose that the payment schedules are not based
8 on the annual percentage rate in the TILA Disclosure Statement (*id.*, ¶¶ 66-78); 3) failure to
9 disclose negative amortization (*id.*, ¶¶ 79-86); and 4) failure to clearly disclose that the initial
10 interest rate was discounted (*id.*, ¶¶ 87-95). Plaintiffs seek actual and statutory damages, attorneys'
11 fees, and rescission of their loans. *Id.*, ¶ 96.

12 The second and fourth causes of action are based on California's UCL. The second alleges
13 that the defendants committed unlawful business practices by violating TILA in the manner just
14 described. TAC, ¶¶ 102-03. The fourth alleges that the defendants' practices were unfair and
15 deceptive because they misled borrowers about the terms of their loans in the ways discussed
16 above. *Id.*, ¶¶ 129-30.

17 The third cause of action is for fraudulent omissions. It contends that the defendants had a
18 duty to disclose the actual interest rate being charged on the note, that negative amortization would
19 occur, and that the initial interest rate was discounted. TAC, ¶¶ 110-11.

20 The fifth cause of action is for breach of contract (TAC, ¶¶ 147-159), and the sixth cause of
21 action, which is based on the same set of allegations, is for breach of the implied covenant of good
22 faith. *Id.*, ¶¶ 160-75. Plaintiffs allege that the defendants indicated to plaintiffs that their monthly
23 payments would be applied to payment of both principal and interest, but that the defendants
24 breached this promise by never applying any of the payments to principal. *Id.*, ¶¶ 151-52, 154-55,
25 163-64. Plaintiffs also allege that the defendants charged more interest than agreed by readjusting
26 the interest rate shortly after loan origination rather than keeping the rate constant for three to five
27 years, as they anticipated. *Id.*, ¶¶ 149, 162, 168.

28

1 **III. PLAINTIFFS STATE NO CLAIM FOR RELIEF UNDER TILA**

2 “TILA provides borrowers only two remedies for disclosure violations: (1) rescission, *see*
3 15 U.S.C. § 1635 and (2) damages. *See* 15 U.S.C. § 1640.” *Eubanks v. Liberty Mortg. Banking*
4 *Ltd.*, 976 F.Supp. 171, 174 (E.D. N.Y. 1997). Plaintiffs seek both rescission and damages, but they
5 are entitled to neither.⁵

6 **A. Plaintiffs Refinanced and So Cannot Rescind**

7 Again, plaintiffs refinanced in May 2007, obtaining a new first mortgage in the amount of
8 \$450,000. RJN, Ex. B. The deed of trust securing the loan originated by 1st Lending has been
9 reconveyed. RJN, Ex. A and C.

10 “The loan of [May 2006] cannot be rescinded, because there is nothing to rescind.
11 [Plaintiffs] refinanced that loan in [May 2007], and the deed of trust underlying the [May 2006]
12 loan has been superseded.” *King*, 784 F.2d at 913.⁶

13 **B. Plaintiffs Sued Too Late to Recover Damages**

14 “[A]n action for damages under TILA must be brought within one year from the alleged
15 violation. *See* 15 U.S.C. §1640(e).” *Eubanks*, 976 F.Supp. at 174; *accord: King*, 784 F.2d at 913.

16 “[T]he limitations period in Section 1640(e) runs from the date of consummation of the
17 transaction” *King*, 784 F.2d at 915. For TILA purposes, “consummation” occurs when “a
18 consumer becomes contractually obligated on a credit transaction.” 12 C.F.R. § 226.2(a)(13).

19 Plaintiffs’ loan was “consummated” in May 2006. TAC, ¶ 2; Ex. 1; RJN, Ex. A. This
20 action was not filed until August 29, 2007 (see Docket no. 1), more than a year later, and thus too
21 late to recover damages under section 1640(e).

22 _____
23 ⁵ Again, plaintiffs’ TILA claim against EMC is based on their allegation that EMC is the
24 assignee of their loan. TILA strictly limits assignee liability to those violations that are “apparent
on the face” of the TILA disclosure statement. 15 U.S.C. § 1641(e)(1)(A).

25 ⁶ Although several other courts have recently disagreed with *King* on this point, *Handy v.*
26 *Anchor Mortg. Corp.*, 464 F.3d 760 (7th Cir. 2006); *Barrett v. J.P. Morgan Chase Bank, N.A.*, 445
27 F.3d 874 (6th Cir. 2006); *Pacific Shore Funding v. Lozo*, 138 Cal.App.4th 1342, 42 Cal.Rptr.3d
28 283 (2006), this Court remains bound by *King*, a Ninth Circuit decision that has not been over-
ruled, superseded by a Supreme Court opinion, or abrogated by legislative change. *Zuniga v.*
United Can Co., 812 F.2d 443, 450 (9th Cir. 1987) (“District courts are, of course, bound by the
law of their own circuit, and ‘are not to resolve splits between circuits no matter how egregiously
in error they may feel their own circuit to be.’”).

1 TILA's one-year limitations period is subject to equitable tolling "in appropriate
2 circumstances." *King*, 784 F.2d at 915. However, to claim the benefit of such tolling, a plaintiff
3 must allege circumstances showing that he or she could not have discovered the facts underlying
4 the claim through the exercise of reasonable diligence or that extraordinary circumstances beyond
5 his or her control made it impossible to file the claim on time. *Huynh v. Chase Manhattan Bank*,
6 465 F.3d 992, 1004 (9th Cir. 2006).⁷

7 Plaintiffs allege no such facts and could not do so even if granted leave to amend. Plaintiffs
8 could easily have discovered the facts underlying their claims by reviewing their loan documents
9 and TILDS before or after closing. "[N]othing prevented [plaintiffs] from comparing the loan
10 contract, [defendants'] initial disclosures, and TILA's statutory and regulatory requirements."
11 *Hubbard v. Fidelity Fed. Bank*, 91 F.3d 75, 79 (9th Cir. 1996) (fn. omitted).⁸ Plaintiffs do not and
12 cannot claim that they were otherwise prevented from suing in a timely manner. *See Huynh*,
13 465 F.3d at 1004.

14 Equitable estoppel, also known as fraudulent concealment, is another possible basis for
15 tolling a statute of limitations. *Guerrero v. Gates*, 442 F.3d 697, 706 (9th Cir. 2006). But, to
16 invoke that doctrine, plaintiffs would have to plead with particularity (and later prove) facts
17 showing (a) active misconduct by EMC "above and beyond the wrongdoing upon which plaintiff's
18 claim is [based], to prevent the plaintiff from suing in time," (b) plaintiffs' actual and reasonable
19 reliance on defendants' misconduct in failing to timely file suit, and (c) plaintiffs' lack of actual or
20 constructive knowledge of the facts constituting their claim despite their due diligence.⁹

21 Plaintiffs allege no such facts and cannot do truthfully do so. EMC did nothing after being
22 assigned plaintiffs' loan to conceal from them the facts on which they base their TILA claim.

23 _____
24 ⁷ See also *Cada v. Baxter Healthcare Corp.*, 920 F.2d 446, 451 (7th Cir.1991) (Equitable
25 tolling "permits a plaintiff to avoid the bar of the statute of limitations if despite all due diligence
he is unable to obtain vital information bearing on the existence of his claim.")

26 ⁸ See also *Anderson v. Wells Fargo Home Mortg., Inc.*, 259 F.Supp.2d 1143, 1148-49
27 (W.D. Wash. 2003) (no equitable tolling of TILA claim); *Bryant v. Mortgage Capital Resource
Corp.*, 197 F.Supp.2d 1357, 1367-68 (N.D. Ga. 2002) (same).

28 ⁹ *Guerrero*, 442 F.3d at 706-07; *Pincay v. Andrews*, 238 F.3d 1106, 1110 (9th Cir. 2001);
Grimmett v. Brown, 75 F.3d 506, 514 (9th Cir. 1996).

1 Affirmative misconduct is required; “[a] failure to ‘own up’ [to prior misconduct] does not
2 constitute *active concealment*.” *Grimmett*, 75 F.3d at 515. Moreover, a defendant’s mere silence
3 cannot sustain a claim of fraudulent concealment unless the defendant owed the plaintiff a fiduciary
4 duty of disclosure. *Thorman v. American Seafoods Co.*, 421 F.3d 1090, 1096 (9th Cir. 2005).¹⁰ A
5 lender owes no fiduciary duty to a borrower.¹¹ Accordingly, EMC’s “ ‘silence or passive conduct
6 does not constitute fraudulent concealment.’ ” *Thorman*, 421 F.3d at 1095 (citations omitted).

7 Moreover, plaintiffs do not and cannot show that they relied on EMC or lacked constructive
8 knowledge of their claims. A decade ago, the First Circuit held that no fraudulent concealment or
9 equitable tolling could be raised to toll TILA’s one-year limitations period in a case where the
10 plaintiff alleged similar TILA claims arising from the allegedly non- or mis-disclosure of the
11 negative amortization feature of an option ARM loan. *Salois v. Dime Sav. Bank*, 128 F.3d 20, 25-
12 26 (1st Cir. 1997).

13 The First Circuit’s reasoning is equally applicable here:

14 Regardless whether negative amortization was inevitable with [the
15 challenged loans], the documents contained all of the information
16 necessary to determine the interaction of [defendant’s] formula with
17 prevailing interest rates. It was attorney consultation, rather than
18 newly-discovered information that prompted plaintiffs’ lawsuit. ...
19 As the district court observed, “The loan documents notified
20 plaintiffs of the possibility of negative amortization, when it would
21 apply, and how it would work,” so that even “[i]f [defendant] had
22 misrepresented the nature of the loans, the loan documents plaintiffs
23 signed would have put them on notice of the fraud.

24 *Id.* at 26 (citation omitted).

25 In short, plaintiffs’ claim for damages under TILA is time-barred by §1640(e)’s one-year
26 limitations period. Plaintiffs cannot obtain rescission under TILA because they refinanced their
27 home again in June 2007. Therefore, plaintiffs’ first cause of action should be dismissed for failure
28 to state a claim on which any relief may be granted to them. *Eubanks*, 976 F.Supp. at 174.

¹⁰ See also *Conmar Corp. v. Mitsui & Co. (U.S.A.)*, 858 F.2d 499, 505 (9th Cir. 1988).

¹¹ *Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 882-83 (9th Cir. 2007)
(applying Nevada law); *Nymark v. Heart Fed. Savings & Loan Assn.*, 231 Cal.App.3d 1089, 1093
n. 1, 283 Cal.Rptr. 53 (1991) (“The relationship between a lending institution and its borrower-
client is not fiduciary in nature.”).

1 **IV. PLAINTIFFS STATE NO CLAIM FOR VIOLATION OF THE UCL**

2 Plaintiffs’ second and fourth causes of action allege violations of California’s UCL. The
3 second cause of action is based on allegedly unlawful acts, whereas the fourth cause of action is
4 based on allegedly unfair and fraudulent acts. TAC, ¶¶ 97-108, 125-146. Both causes of action
5 fail because the UCL does not recognize vicarious liability. Therefore, EMC cannot be liable as a
6 mere assignee of plaintiffs’ loan. The second cause of action (for unlawful practices) fails for the
7 additional reason that it is preempted by TILA.

8 **A. EMC Cannot Be Vicariously Liable Under the UCL**

9 Just like their TILA claim, plaintiffs’ UCL claims are predicated on the allegation that there
10 was something wrongful—namely, unlawful, unfair, or fraudulent—with the disclosures they
11 received and representations that were made when their loan was originated. TAC, ¶¶ 102, 129-
12 136. So their UCL claims against EMC are, like their TILA claim against EMC, based on EMC’s
13 purported status as an assignee.

14 But it is settled that “the concept of vicarious liability has no application to actions brought
15 under the unfair business practices act.” *People v. Toomey*, 157 Cal.App.3d 1, 14 (1984); see also
16 *Emery*, 95 Cal.App.4th at 960. “A defendant’s liability must be based on his personal
17 ‘participation in the unlawful practices’ and ‘unbridled control’ over the practices that are found to
18 violate section 17200 or section 17500.” *Emery*, 95 Cal.App.4th at 960 [citations omitted]; *accord*:
19 *Perfect 10, Inc. v. Visa Intern. Service Ass’n*, 494 F.3d 788, 808-09 (9th Cir. 2007).

20 The California Court of Appeal’s decision in *Emery*, 95 Cal.App.4th 952, is instructive.
21 There, the plaintiff brought an action under the UCL challenging as unlawful and unfair certain
22 solicitations mailed to California residents regarding foreign lotteries. Visa was “not involved in
23 the preparation or distribution of the solicitations.” *Id.* at 956-57. Rather, the solicitations were
24 prepared and distributed by certain merchants who were authorized to use the Visa payment
25 system. These merchants displayed the Visa logo on their solicitations to inform consumers that
26 they could purchase lottery tickets with their Visa credit cards. *Id.* at 957-59. The plaintiff argued
27 that Visa was liable under various agency theories or an aiding and abetting theory. The court
28 decisively rejected all these arguments, holding that because “Visa itself played no part in

1 preparing or sending any ‘statement that might be construed as untrue or misleading under the
2 unfair business practices statutes,’ it could not be liable for a UCL violation. *Id.* at 964.

3 The Court should do the same here. The acts plaintiffs challenge all occurred at or before
4 the origination of the loan, which EMC had no role in. Plaintiffs allege they failed to receive
5 disclosures that complied with TILA when they obtained their loan from 1st Lending. TAC, ¶ 102.
6 They allege that they were solicited to obtain a “deceptively advised financial product,” and that
7 the terms of the loan were misrepresented to them during the “loan application process.” *Id.* at
8 ¶¶ 129-131. But EMC could not and did not “personally participate” in such allegedly wrongful
9 practices because it did not originate the loan. Rather, EMC was allegedly assigned the loan after
10 origination. *Id.* at ¶¶ 6, 19. Because “[EMC] itself played no part in preparing” any disclosure
11 statement required by TILA, or in the origination process at all, it cannot be liable for the UCL
12 violations plaintiffs assert here. See *Emery*, 95 Cal.App.4th at 964.

13 For this reason, the Court should dismiss both plaintiffs’ second and fourth causes of action
14 without leave to amend.

15 **B. TILA Preempts Plaintiffs’ Second Cause of Action for Unlawful Practices**

16 Plaintiffs’ second cause of action should be dismissed for an independent reason. Again, the
17 second cause of action purports to allege an unlawful practice under the UCL. TAC, ¶¶ 97-108.
18 This claim is based solely on EMC’s alleged violation of TILA and its implementing regulations. *Id.*

19 An action under the UCL “to redress an unlawful business practice ‘borrows’ violations of
20 other laws and treats these violations, when committed pursuant to business activity, as unlawful
21 practices independently actionable under [the UCL] and subject to the distinct remedies provided
22 thereunder.” *Farmers Ins. Exchange v. Superior Court*, 2 Cal.4th 377, 383 (1992); accord: *Kasky*
23 *v. Nike, Inc.*, 27 Cal.4th 939, 949, 119 Cal.Rptr.2d 296 (2002).

24 The “distinct remedies” available under the UCL are limited to restitution and injunctive
25 relief. Cal. Bus. & Prof. Code § 17203; *Madrid v. Perot Systems Corp.*, 130 Cal.App.4th 440, 452
26 (2005). Any action under the UCL must be commenced within four years after the cause of action
27 accrues. Cal. Bus. & Prof. Code § 17208. This four-year statute of limitations, not the limitations
28

1 period applicable to the predicate law being “borrowed,” governs all UCL actions. *Cortez v.*
2 *Purolator Air Filtration Prod. Co.*, 23 Cal.4th 163, 178-79 (2000).

3 Thus, if allowed to pursue their second cause of action, plaintiffs would, in effect, be
4 permitted to recover additional remedies that Congress did not allow for TILA violations and to do
5 so in a suit filed beyond TILA’s limitations period.

6 In both of these respects—additional remedies and longer limitations period—the UCL is
7 “inconsistent” with TILA. TILA’s remedies and limitations period are not mere “floors” upon
8 which states are free to erect an additional scaffolding of more generous remedies and harsher
9 sanctions. Instead, particularly in enacting the Truth in Lending Simplification and Reform Act of
10 1980, Congress carefully limited and tailored the relief that private plaintiffs could obtain for TILA
11 violations, balancing the need for private enforcement of the act against the equally pressing
12 concern that creditors not be over-penalized.¹²

13 TILA expressly preempts state laws that are “inconsistent” with the provisions of TILA, to
14 the extent of the inconsistency. 15 U.S.C. §1610(a)(1). This provision has been held to preempt a
15 state’s assignee liability statute to the extent it imposed liability on assignees for assignors’ TILA
16 violations in situations where the assignee would not be liable under TILA’s own assignee liability
17 provision. *Alexiou v. Brad Benson Mitsubishi*, 127 F.Supp.2d 557, 561, 564-65 (D. N.J. 2000).

18 The *Alexiou* court’s reasoning is instructive:

19 The language of § 1641(a) clearly indicates that in order for an
20 assignee of a loan to be held liable for disclosure violations, the
21 violation alleged by the plaintiff must be apparent on the face of the
22 disclosure statement. The question therefore becomes whether the
New Jersey Holder Rule is “inconsistent” with § 1641(a) since it
does not require that the alleged violations be apparent on the face of
the disclosure statement for assignee liability to attach.

* * *

23 ... [I]n light of the congressional intent behind the 1980
24 Amendments to make creditor compliance with consumer loan laws
easier, the Court finds that the New Jersey Holder Rule puts an
25 additional, unwarranted burden on creditors which goes against the

26 ¹² See S. Rep. 96-73, at 7, 17-18 (Apr. 24, 1979); reprinted in 1980 U.S.C.C.A. N. 280, 285,
27 295-96: “This Bill would narrow a creditor’s civil liability for statutory penalties to only those
28 disclosure[s] which are of central importance in understanding a credit transaction’s cost or terms.
... This is a significant reduction from the current scope of liability.” The 1980 act also plugged a
hole in TILA’s limit on a creditor’s liability in class actions and clarified the creditor’s bona fide
error defense.

1 purpose of the 1980 Amendments to the TILA. Section 1641(a) of
2 the TILA provides one clear standard, namely that an assignee may
3 be held liable for the violations of an assignor only when those
4 violations are “apparent on the face of the disclosure statement.”
5 § 1641(a). Because the New Jersey Rule puts this additional burden
6 on creditors (including assignees), the state law is contrary to the
7 intent of Congress in enacting the TILA and its amendments, and
8 “stands as an obstacle to the accomplishment and execution of the
9 full purposes and objectives of Congress.”

* * *

6 Moreover, if the conflicting state laws were not preempted, a
7 creditor/assignee who conducts business on a national level would be
8 compelled to research the laws of all of the states to ensure that it is
9 abiding by each and every law promulgated by the states. These
burdens are substantial and cumbersome to creditors and contradict
the goal behind the TILA and its 1980 Amendments.

9 *Id.*¹³

10 In the same way, the UCL’s additional remedies and longer statute of limitations are
11 inconsistent with the limited remedies and one-year limitations provision Congress enacted as part
12 of TILA. By imposing liability where none would exist under TILA and by imposing greater
13 liability than the limited remedies Congress so carefully tailored in 1980, the UCL is just as
14 inconsistent with TILA as the New Jersey Holder Rule at issue in *Alexiou*. Therefore, as in
15 *Alexiou*, the state law cannot stand. The UCL is preempted by 15 U.S.C. § 1610(a)(1) insofar as it
16 might otherwise allow additional remedies or longer periods for suing based on the “unlawful
17 practice” of violating TILA.

18 As plaintiffs’ second cause of action seeks to use the UCL for that precise purpose, it relies
19 on a preempted statute and, hence, fails to state a claim on which relief may be granted.

20 **V. PLAINTIFFS HAVE NO CLAIM FOR FRAUDULENT OMISSIONS**

21 Plaintiffs’ third cause of action for fraudulent concealment is essentially a rehashing of their
22 TILA claim. It should be dismissed for two reasons. First, to the extent plaintiffs directly invoke
23 TILA to support this claim, it is preempted by federal law. As explained above, plaintiffs cannot
24 give a TILA-based claim a state law name just to take advantage of additional damages and a
25 longer statute of limitations. Second, to the extent plaintiffs allege EMC had a separate common
26

27 ¹³ See also *Silvas v. E*Trade Mortg. Corp.*, 421 F.Supp.2d 1315, 1320 (S.D. Cal. 2006)
28 (additional UCL remedies and longer statute of limitations are inconsistent with TILA and
preempted as applied to a federal savings bank).

1 law duty to disclose, their claim fails because EMC did not originate their loan. Therefore, EMC
2 had no duty to disclose anything and could not have omitted anything, fraudulently or otherwise.

3 “[T]o establish fraud through nondisclosure or concealment of facts, it is necessary to show
4 the defendant ‘was under a legal duty to disclose them.’”¹⁴ *OCM Principal Opportunities Fund,*
5 *L.P. v. CIBC World Markets Corp.*, 157 Cal.App.4th 835, 846 (2007). Plaintiffs contend that the
6 “defendants” failed to disclose three of the four facts on which their TILA claim is based: 1) the
7 actual interest rate being charged on the note; 2) that negative amortization would occur; and 3)
8 that their initial interest rate was discounted. TAC, ¶¶ 110, 111. They allege that the defendants’
9 duty to disclose these facts stems not only from TILA, but also because the “defendants” made
10 “partial representations of material facts when Defendants had exclusive knowledge of material
11 facts that negative amortization would occur.” *Id.* Neither of these allegations could support any
12 duty of EMC to disclose anything, and plaintiffs’ fraudulent omissions claim therefore fails as a
13 matter of a law.

14 As a threshold matter, plaintiffs’ conclusory references to the purported omissions of the
15 “defendants” are insufficient under Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b)
16 provides that a plaintiff “must state with particularity the circumstances constituting the fraud.”
17 Fed. R. Civ. P., Rule 9(b). This requires a plaintiff to “state the time, place and specific content of
18 the false representations as well as the identities of the parties to the misrepresentation.”
19 *Miscellaneous Service Workers Drivers & Helpers, Teamsters Local # 427 v. Philco-Ford*
20 *Corporation, WDL Division*, 661 F.2d 776, 782 (9th Cir. 1981.) When there are multiple parties, a
21 plaintiff must identify the specific role of each defendant allegedly involved in the fraud. *Swartz v.*
22 *KPMG LLP*, 476 F.3d 756, 765 (9th Cir. 2007).

23
24
25 ¹⁴ “[T]he elements of an action for fraud and deceit based on concealment are: (1) the
26 defendant must have concealed or suppressed a material fact, (2) the defendant must have been
27 under a duty to disclose the fact to the plaintiff, (3) the defendant must have intentionally
28 concealed or suppressed the fact with the intent to defraud the plaintiff, (4) the plaintiff must have
been unaware of the fact and would not have acted as he did if he had known of the concealed or
suppressed fact, and (5) as a result of the concealment or suppression of the fact, the plaintiff must
have sustained damage.” *Marketing West, Inc. v. Sanyo Fisher (USA) Corp.*, 6 Cal.App.4th 603,
612-613 (1992).

1 Plaintiffs run afoul of these rules here. TAC, ¶¶ 117-124. They allege that the
2 “defendants” had exclusive knowledge of facts that they failed to disclose to the plaintiffs. TAC,
3 ¶ 117. And, they claim that the “defendants” made partial representations of material facts while
4 concealing other qualifying facts. TAC, ¶ 111. But these conclusions have no factual context.
5 Plaintiffs do not allege when and where these representations were made. Nor do they identify
6 what individuals made the representations, or on which “defendants” behalf they might have been
7 acting. This is nowhere near the heightened standard of pleading required by Rule 9(b).

8 Putting aside this lack of specificity, and construing plaintiffs’ references to “defendants”
9 liberally, plaintiffs still fail to plead any facts that would give rise to a duty to disclose in EMC.

10 To the extent plaintiffs seek to incorporate purported TILA violations, their fraudulent
11 omissions claim is preempted for the same reason that their UCL claim for unlawful acts is
12 preempted. Through their fraudulent omissions claim, plaintiffs again attempt to avail themselves
13 of different remedies and a more favorable statute of limitations, both of which are directly
14 “inconsistent” with TILA. Plaintiffs’ fraudulent omissions claim is inconsistent with TILA in at
15 least two respects, either of which is sufficient to preempt this portion of their claim.

16 First, as discussed above, an action for damages under TILA must be brought within one
17 year of the alleged violation. 15 U.S.C. § 1640(e); *King*, 784 F.2d at 913. A fraudulent
18 concealment claim, by contrast, need only be brought within three years after discovery of the
19 claim. Cal. Code Civ. Proc. § 338(d). Because plaintiffs are entitled to neither rescission nor
20 damages under TILA, they apparently seek “to remedy [alleged] TILA violations for which the
21 statute of limitations has already run.” *Silvas*, 421 F.Supp.2d at 1320. To allow plaintiffs to pursue
22 their time-barred TILA claim under the guise of a fraudulent omissions claim would directly
23 contradict the narrow limitations period Congress established for TILA violations. Accordingly,
24 this aspect of plaintiffs’ fraudulent omissions claim is preempted by TILA. See *id.*

25 Second, punitive damages are not recoverable for TILA violations. See 15 U.S.C. § 1640(a);
26 *In re Ameriquest Mortg. Co. Mortg. Lending Practices Litig.*, 2007 WL 1832113 at *2 (N.D. Ill.
27 2007); *Bond v. Fleet Bank (RI), N.A.*, 2002 WL 373475 at *3 (D. R.I. 2002). By contrast, punitive
28 damages are available for fraud claims (Cal. Civ. Code § 3294(a)), and plaintiffs seek to recover

1 them here for the alleged failure to comply with TILA. TAC, ¶¶ 123-24; Prayer, ¶ E. Once again,
2 this additional remedy is directly inconsistent with the limited remedies afforded plaintiffs by TILA.
3 Congress has prescribed what relief is available for plaintiffs seeking to redress TILA violations.
4 Plaintiffs cannot circumvent these rules simply because they choose to call their cause of action
5 another name. As such, plaintiffs’ fraudulent omissions claim is preempted for this reason, too. See
6 *Silvas*, 421 F.Supp.2d at 1319-20.

7 To the extent plaintiffs’ fraudulent omissions claim is based on a separate common law
8 duty to disclose, there are no facts alleged supporting such a duty. Absent a fiduciary
9 relationship,¹⁵ a duty to disclose only arises when “(1) the defendant makes representations but
10 does not disclose facts which materially qualify the facts disclosed, or which render his disclosure
11 likely to mislead; (2) the facts are known or accessible only to defendant, and defendant knows
12 they are not known to or reasonably discoverable by the plaintiff; (3) the defendant actively
13 conceals discovery from the plaintiff.” *Warner Constr. Corp. v. City of Los Angeles*, 2 Cal.3d 285,
14 294 (1970). Each of these three circumstances “presupposes the existence of some [sic] relation-
15 ship between the plaintiff and defendant in which a duty to disclose can arise.” *LiMandri v.*
16 *Judkins*, 52 Cal.App.4th 326, 337 (1997). “As a matter of common sense, such a relationship can
17 only come into being as a result of some sort of *transaction* between the parties.” *Id*; emphasis in
18 original. None of these three circumstances are present here.

19 Simply, there was no “transaction” between EMC and plaintiffs that would have given
20 EMC the opportunity, much less a duty, to provide plaintiffs with the disclosures they complain
21 about. Plaintiffs allege that purportedly inadequate disclosures were given at their loan’s
22 origination. TAC, ¶¶ 111-124. But again, EMC did not originate plaintiffs’ loan; it was just
23 allegedly assigned it at some later time. TAC, ¶¶ 6, 19. Therefore, EMC could not and did not
24 make any representations which would have engendered a duty to disclose other facts qualifying
25 those representations. Nor could EMC have actively concealed any facts from plaintiffs at
26 origination, or have had exclusive knowledge of facts that plaintiffs were unaware of at that time.

27 _____
28 ¹⁵ Again, a lender owes no fiduciary duty to a borrower. *Giles*, 494 F.3d at 882-83 (9th Cir. 2007) (applying Nevada law); *Nymark*, 231 Cal.App.3d at 1093, n. 1.

1 In fact, EMC had no knowledge of plaintiffs—and no knowledge of the circumstances of their
2 loan’s origination—until after it was assigned their loan.

3 And plaintiffs fail to plead any facts that would obligate EMC to disclose anything after it
4 was assigned their loan. They point to no specific contact, communication, or correspondence with
5 EMC after assignment. Again, they do not allege that EMC made any representations to them, let
6 alone that it also selectively omitted certain material facts. Nor do they allege that EMC failed to
7 disclose certain facts that it knew plaintiffs were unaware of. Nor do they allege that EMC actively
8 concealed certain facts from plaintiffs.

9 Even if they had made such allegations, plaintiffs’ fraud claim would still fail as to EMC
10 because they fail to allege they took any action in reliance on EMC’s concealment. Of course,
11 actual reliance is an essential element in any action based on fraud. See e.g., *Mirkin v. Wasserman*,
12 5 Cal.4th 1082, 1088 (1993). But plaintiffs fail to allege that they relied on anyone’s
13 representations after the loan was assigned to EMC. In fact, plaintiffs allege only a single act of
14 reliance: “had the information been [sic] disclosed, Plaintiffs and each Class member would have
15 not entered into the loans.” TAC, ¶¶ 45, 121.

16 This allegation undermines plaintiffs’ entire fraudulent omissions claim against EMC.
17 Again, EMC had nothing to do with plaintiffs before their loan was assigned to EMC and, as such,
18 could not have concealed or fraudulently omitted to tell them facts before they entered into the
19 loan. Plaintiffs do not allege that they took any action or refrained from taking any action after the
20 loan was assigned to EMC based on any continued non-disclosure. To the contrary, plaintiffs
21 allege that they could not have taken any action in reliance because they were locked into their
22 loans and could not refinance because of the loan’s prepayment penalty. TAC, ¶¶ 30, 32(e), 174.
23 Without an allegation of actual reliance on EMC’s representations, plaintiffs have no claim for
24 fraudulent omissions.

25 For all of these reasons, plaintiffs’ third cause of action for fraudulent omissions should be
26 dismissed.

27
28

1 **VI. THE FIFTH AND SIXTH CLAIMS SHOULD BE DISMISSED**

2 The fifth cause of action for breach of contract and sixth cause of action for breach of the
3 implied covenant of good faith and fair dealing are based on the same basic allegations and should
4 be dismissed for the same reason: plaintiffs’ promissory note’s express words refute plaintiffs’
5 allegations about the terms of their option ARM loan agreement.

6 **A. Basic Principles Of Contract Interpretation Under California Law**

7 “The goal of contractual interpretation is to determine and give effect to the mutual
8 intention of the parties.”¹⁶ “That intent is to be inferred, if possible, solely from the written
9 provisions of the contract.”¹⁷

10 “When a dispute arises over the meaning of contract language, the first question to be
11 decided is whether the language is ‘reasonably susceptible’ to the interpretation urged by the party.
12 If it is not, the case is over.”¹⁸

13 A contract’s words “must be construed in the context of that instrument as a whole.”¹⁹ A
14 court interprets a contract’s terms “ ‘in context’, and give[s] effect ‘to every part’ of the [contract]
15 with ‘each clause helping to interpret the other.’ ”²⁰ If possible, “the court should give effect to
16 every provision of the contract.”²¹

17 If they conflict, a contract’s specific provision will control over its general language.²² If
18 particular words in a contract are inconsistent with its nature, or with the main intention of the
19

20 ¹⁶ *Safeco Ins. Co. v. Robert S.*, 26 Cal.4th 758, 763, 110 Cal.Rptr.2d 844 (2001).

21 ¹⁷ *Pardee Constr. Co. v. Ins. Co. of the West*, 77 Cal.App.4th 1340, 1352, 92 Cal.Rptr.2d
22 443 (2000); Cal. Civ. Code, §1639.

23 ¹⁸ *Oceanside 84, Ltd. v. Fidelity Federal Bank*, 56 Cal.App.4th 1441, 1448, 66 Cal.Rptr.2d
24 487 (1997) (citation and internal quotation marks omitted).

25 ¹⁹ *Palmer v. Truck Ins. Exchange*, 21 Cal.4th 1109, 1118, 90 Cal.Rptr.2d 647 (1999).

26 ²⁰ *Id.*, 21 Cal.4th at 1115.

27 ²¹ *National City Police Officers’ Ass’n v. City of National City*, 87 Cal.App.4th 1274, 1279,
28 105 Cal.Rptr.2d 237 (2001).

²² *Continental Cas. Co. v. Phoenix Constr. Co.*, 46 Cal.2d 423, 431, 296 P.2d 801 (1956);
Cal. Code Civ. Proc., §1859.

1 parties, they are to be rejected.²³ “Repugnancy in a contract must be reconciled, if possible, by
2 such an interpretation as will give some effect to the repugnant clauses, subordinate to the general
3 intent and purpose of the whole contract.” Cal. Civ. Code, §1652.

4 “When a contract is reduced to writing, the intention of the parties is ascertained from the
5 writing alone” Cal. Civ. Code, §1639. The writing “supersedes all the negotiations or
6 stipulations concerning its matter which preceded or accompanied the execution of the
7 instrument.”²⁴ In construing a contract, the Court’s duty is “simply to ascertain and declare what is
8 in terms or in substance contained therein, not to insert what has been omitted or omit what has
9 been inserted; and where there are several provisions or particulars, such construction is, if
10 possible, to be adopted as will give effect to all.” Cal. Code Civ. Proc., § 1858.

11 **B. Defendants Did Not Promise To Apply A Portion Of Each Payment To**
12 **Principal**

13 The fifth and sixth claims are based, in part, on the allegation that “defendants” agreed that
14 plaintiffs’ “monthly payment obligations will be applied to payment of both principal and interest
15 owed on the loan.” TAC, ¶ 163. EMC and Lending 1st breached this promise, plaintiffs aver, by
16 not applying any of their payments to principal when the interest accruing on their loans each
17 month exceeded plaintiffs’ monthly payments. *Id.*, ¶¶ 152, 154, 165, 166.

18 Apparently, plaintiffs base this assertion on four sentences in §3(A) and (B) of their note.
19 The first sentence says “I will pay principal and interest by making a payment every month.” The
20 remaining three sentences more particularly describe this obligation, stating the amount of the
21 “initial monthly payments,” dates when payments must be made (first of each month beginning on
22 a specified date), and the obligation’s end point (when the loan is fully repaid).

23 None of these four sentences supports plaintiffs’ allegation that the parties agreed each
24 monthly payment would be applied to principal as well as interest. None of the sentences
25 addresses the subject of payment application. None purports to impose any obligation on the Note

26 _____
27 ²³ Cal. Civ. Code, §1653; *see also* Cal. Civ. Code, §1650 (“Particular clauses of a contract
are subordinate to its general intent.”); Cal. Code Civ. Proc., §1859.

28 ²⁴ Cal. Civ. Code, §1625; *see also* Cal. Code Civ. Proc., §1856(a).

1 Holder. Rather, the first states, and the latter three describe, *plaintiffs'* obligation to make monthly
2 payments.

3 Other provisions of the promissory note address payment application specifically. The note
4 provides that “[e]ach monthly payment will be applied ...to interest before Principal.” TAC, Ex. 1,
5 p. 1, § 3(A). Implicitly, if a payment is applied to interest first and unpaid interest exceeds the
6 payment amount, none of the payment will be left to apply to loan principal.

7 The notes do not leave the matter to implication, however. Instead, they state expressly:
8 “For each month that my monthly payment is less than the interest owed, the Note Holder will
9 subtract the amount of my monthly payment from the amount of the interest portion and will add
10 the difference to my unpaid Principal.” TAC, Ex. 1, p. 3, § 5(C). “If the Minimum Payment is not
11 sufficient to cover the amount of interest due then any accrued but unpaid interest will be added to
12 Principal and will accrue interest at the rate then in effect. This practice is known as negative
13 amortization.”²⁵ *Id.*, p. 3, ¶ 5(A).)

14 The just-quoted provisions deal specifically with payment application and even more
15 specifically with application of payments which are less than the monthly accrued interest. They
16 refute any notion that the Note Holder must apply any of the monthly payment to loan principal in
17 that circumstance. Instead, they state clearly that in that situation, all of the monthly payment is
18 applied to accrued interest, and the remainder of the accrued interest is added to loan principal.

19 If there were any inconsistency between these specific payment application provisions and
20 the sentence plaintiffs rely on—“I will pay principal and interest by making a payment every
21 month”—the specific payment application provisions would prevail over the general statement just
22 quoted. But, of course, there is no inconsistency. The borrower’s promise to pay is entirely
23 separate from the Note Holder’s obligation to apply those payments in a particular manner.
24 Plaintiffs’ sentence addresses their payment obligation. It is harmonized with the note’s other
25 above-quoted provisions that address payment application.

26 _____
27 ²⁵ This provision and § 5(C) of the note refute the complaint’s allegations that defendants
28 represented that there would be no negative amortization if plaintiffs made monthly payments in
the amounts defendants prescribed and that if defendants did as promised, plaintiffs’ payments
would have been sufficient to pay both principal and interest. See TAC, ¶¶ 151, 152, 152, 163-65.

1 In short, when all its provisions are considered, each in the context of the other, the note's
2 meaning is unambiguous. Payments are applied first to interest. Only the remainder, if there is
3 any, is applied to principal. Contrary to plaintiffs' allegations, the note is not reasonably
4 susceptible to an interpretation imposing any obligation on the Note Holder to apply any of the
5 payment to loan principal when the payment has been fully exhausted by paying interest first.

6 **C. Defendants Did Not Promise To Keep The Interest Rate Constant**

7 The fifth and sixth claims also allege that "defendants" agreed the loan "would have a fixed
8 interest rate equal to a low promised interest rate for a period of three (3) to five (5) years." TAC,
9 ¶162. Plaintiffs claim that EMC and Lending 1st breached this supposed promise by raising the
10 interest rate shortly after loan origination. *Id.*, ¶¶ 154, 165, 168.

11 The promissory note states otherwise. After setting the loan's initial 1% interest rate,
12 Section 2 immediately cautions: "The interest rate I will pay may change in accordance with
13 Section 4 of this Note." TAC, Ex. 1, p. 1, § 2. Section 4(A) quashes any notion that the interest
14 rate will remain unchanged for three to five years. Instead, it says: "The interest rate I will pay
15 will change on the 1st day of [month, year], and the adjustable interest rate I will pay may change
16 on that day every month thereafter." *Id.*, p. 2, § 4(A).

17 The just-quoted sentence could hardly be clearer. In plain English, it says exactly when the
18 interest rate will change: Not three to five years hence, but on the first of a specified month, and
19 the first day of each month thereafter.

20 Plaintiffs try to surmount this obvious flaw in their claim by averring that they were led to
21 believe this language did not mean what it says because the payment schedule section of the TILA
22 disclosure statement is "based on that [i.e., the initial] low 1% to 3% interest rate." TAC, ¶¶ 149,
23 24, 26. According to plaintiffs, the payment schedule shows payments "exactly equal to the
24 amount required to pay off the loan if, indeed, the interest rate actually charged on the loan was the
25 [initial] low interest rate promised." *Id.*, ¶ 119.

26 One look at the payment schedules discloses the fallacy of this allegation. *See* TAC, Ex. 1,
27 p. 7. In fact, the payment schedule shows payments increasing every year through the fifth year of
28

1 the loan—on the first payment change date and each change date thereafter—in accordance with
2 § 5(A) and (E) of the note. *Id.*; see TAC, Ex. 1, pp. 2-3, § 5(A), (E).)

3 Only an increase in the interest rate could cause the payment amount to increase as shown
4 on the payment schedule. Hence, on its face, the TILA disclosure statement reveals that the parties
5 must have contemplated an increase in the interest rate well before the loan’s third year. Thus, the
6 TILA disclosure statement, like the note, refutes plaintiffs’ assertion that their interest rate was not
7 to change for three to five years.

8 **D. The Fifth And Sixth Claims Are Not Legally Viable**

9 As just shown, the promissory notes’ express provisions refute the key allegations of the
10 fifth and sixth causes of action. The note expressly provides that (a) payments will be applied to
11 interest before principal—and not to principal at all if the payment does not exceed the amount of
12 accrued but unpaid interest, and (b) the interest rate will change on the first payment date and the
13 first day of each later month. These provisions prevail over the complaint’s contrary allegations.

14 “Where a plaintiff’s cause of action arises out of a contract which is attached to the
15 complaint as an exhibit, and such attachment shows unambiguously on its face that the relief
16 prayed for is not merited, dismissal is both justified and appropriate.” *Palda v. v. General*
17 *Dynamics Corp.*, 47 F.3d 872, 876 (7th Cir. 1995). Simply, “the exhibit trumps the allegations.”
18 *Thompson v. Illinois Department of Professional Regulations*, 300 F.3d 750, 754 (7th Cir. 2002);
19 [emphasis in original; citations omitted]. The promissory note attached to the complaint in this
20 case shows unambiguously that plaintiffs are not entitled to relief on their breach of contract claim.
21 Accordingly, their fifth cause of action should be dismissed as to EMC.

22 The sixth cause of action should meet the same fate. The implied covenant of good faith
23 cannot supply what is lacking here; namely, an obligation on the Note Holder’s part to apply part
24 of every payment to principal or to refrain from changing the interest rate for the first three to five
25 years. As just shown, the promissory note expressly provides to the contrary.

26 The implied covenant “ ‘cannot impose substantive duties or limits on the contracting
27 parties beyond those incorporated in the specific terms of their agreement.’ ” *Agosta v. Astor*, 120
28 Cal.App.4th 596, 607, 15 Cal.Rptr.3d 565 (2004), citing *Guz v. Bechtel National, Inc.*, 24 Cal.4th

1 317, 349-50, 100 Cal.Rptr.2d 352 (2000). Nor can the implied covenant be read to prohibit a party
2 from doing that which the agreement expressly permits. *Carma Developers (Cal.), Inc.*, 2 Cal.4th
3 at 374-75

4 Because the promissory note expressly provides that payments are to be applied first to
5 interest, and only whatever remains to principal, the implied covenant cannot impose on the Note
6 Holder any obligation to apply a portion of every payment to principal. Nor can the implied
7 covenant be read to forbid the Note Holder from changing the interest rate on the first payment
8 date and each following month, as the note expressly permits.

9 Plaintiffs' assertions that the "defendants" "represented" various facts contrary to the note's
10 express terms (e.g., TAC, ¶¶ 151, 162, 163) do not assist plaintiffs. The alleged representations are
11 directly contrary to the promissory note's clear, express terms and so fall under the parole evidence
12 rule, which "bars consideration of extrinsic evidence of prior or contemporaneous negotiations or
13 agreements at variance with the written agreement." *Casa Herrera, Inc. v. Beydown*, 32 Cal.4th
14 336, 344, 9 Cal.Rptr.3d 97 (2004).

15 Not even a promissory fraud claim may be "premised on prior or contemporaneous
16 statements at variance with the terms of a written integrated agreement," (*Case Herrera, Inc.*,
17 *surpa*, 32 Cal.4th at 346), much less a claim for breach of the implied covenant. Thus, the sixth
18 cause of action fails to state a claim on which relief may be granted and, hence, should be
19 dismissed as to EMC.

20 **VII. CONCLUSION**

21 For the reasons stated above, the Court should dismiss the plaintiffs' third amended
22 complaint and each of its so-called causes of action against EMC without leave to amend.

23 DATED: August 14, 2008

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By: /s/ Erik Kemp
Erik Kemp

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