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Did the Banking Regulators Cite Hundreds of Violations in Error?

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Perhaps no provision of the Equal Credit Opportunity Act of 1974 ("ECOA") has been as contentious as that relating to spousal guarantees. To a prudent lender, a policy requiring the signature of a spouse or co-owner of property being pledged as collateral has always made good business sense. However, to the federal bank regulators charged with enforcing ECOA, the implementation of such a policy has been viewed as a violation of law. Hundreds, if not thousands, of violations under ECOA may have been cited over this very issue.

On March 22, 2016, the U.S. Supreme Court handed down its first opinion since the passing of the late Justice Antonin Scalia. In *Hawkins v. Community Bank of Raymore*, an evenly divided Court upheld an Eighth Circuit decision that dismissed a lawsuit filed by Valerie Hawkins and Janice Patterson ("Petitioners") against the Community Bank of Raymore ("Bank") for unlawful discrimination concerning "spousal guaranties." In doing so, the Court let stand a finding that a guarantor was not a person protected under ECOA and, therefore, had no right to file a claim against a bank for discrimination based on gender and marital status through a demand that she guarantee a loan with her husband.

Background

The ECOA, as implemented by Regulation B, applies to all creditors and makes it

unlawful for any creditor to discriminate against any "applicant" with respect to any aspect of a credit transaction on the basis of race, color, religion, national origin, age, gender or marital status. The ECOA defines an "applicant" as any person who directly requests or who has received an extension of credit from a creditor. Simply put, only an "applicant" can bring a cause of action under the ECOA.

Prior to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Federal Reserve Board ("FRB") was charged with enforcement and rulemaking authority for the ECOA. With the implementation of the Dodd-Frank Act, that authority now generally resides with the Consumer Financial Protection Bureau ("CFPB"). In 1985, the FRB substantively changed the definition of an "applicant" for credit to include, among other things, "guarantors." Rooted in the prevention of gender discrimination, the purpose of this change was to prevent creditors from requiring the signature of an applicant's spouse if the applicant otherwise qualified under the bank's standards of creditworthiness.

Hawkins v. Community Bank of Raymore

In 2002, Petitioners' husbands formed PHC Development, LLC ("PHC") in connection with real estate development. In extending over $2 million in credit, the Bank requested Petitioners' husbands, as PHC's sole owners, to sign personal guarantees. In addition, and at issue, was that the Bank also asked Petitioners to sign personal guarantees. In 2012, PHC refused to make required loan payments. Subsequently, Petitioners brought suit, claiming that they had been required to provide guaranties solely due to their status as spouses and that such spousal guaranties were void and unenforceable under the ECOA. The issue raised was whether the Court should apply the FRB definition of an "applicant" – i.e., to include a guarantor.

In deciding issues such as these, federal courts typically give great deference to administrative agencies in interpreting and formulating regulations pertaining to their statutory mandates ("*Chevron* framework"). Under the *Chevron* framework, the federal court first asks whether the intent of Congress is clear as to the precise question at issue. Only if the federal court concludes that the statute is silent or ambiguous with respect to the specific issue presented will the federal court then proceed to the second step of the *Chevron* framework, which requires the federal court to consider whether the agency's reading fills a gap or defines a term in a reasonable way in light of congressional intent.

The district court granted the Bank's motion for summary judgment reasoning that Petitioners, as guarantors, were not "applicants" under the unambiguous plain meaning of the word as defined in the ECOA. The Eighth Circuit affirmed the district court's ruling. In handing down its decision, the Eighth Circuit did not follow the Sixth Circuit's decision in *RL BB Acquisition LLC v. Bridgemill Commons Del. Grp. LLC*, which found that the term "applicant" was ambiguous and that the FRB interpretation of that word could reasonably include guarantors. With the Supreme Court granting review, banks around the country anticipated clarity, only for that anticipation to be left unfulfilled with the passing of Justice Scalia. In its 4-4 decision, the Supreme Court upheld the Eighth Circuit ruling. However, lacking a majority vote, the Supreme Court decision does not decide the issue on a national

level. The Circuits remain split, and the law remains in flux.

Seventh Circuit Refuses to Embrace the Mundane

This is not the first time the federal courts have addressed spousal guarantees. Prior to Hawkins and RL BB Acquisition, the Seventh Circuit (IL, IN and WI) had the opportunity to weigh in on this issue in *Moran Foods, Inc. v. Mid-Atlantic Market Development Company, LLC*. In *Moran Foods*, the Seventh Circuit did not ultimately address the issue as to whether the FRB was permitted to substantively change the definition of “applicant.” Rather, the Seventh Circuit held that regardless of the definition of an "applicant," a bank's request for a signed spousal guaranty is clearly not discriminatory where the basis for the request is of sound commercial practice. The court reasoned that spouses often are unaware of the precise allocation of property between them, and the mere possibility of comingled ownership interests, in property to be secured, is enough to request a spousal guaranty. So even if a guarantor was an “applicant” under ECOA, the Seventh Circuit reasoned, the customary intermingled finances of spouses justified a creditor's decision to require a spousal guarantee and did not therefore constitute a violation of ECOA.

Conclusion

As the decision of the Supreme Court failed to obtain a majority vote, there is no uniform answer to whether a policy that requires a spousal guarantee violates ECOA. As the law stands today, a spousal guarantee policy is lawful in the Eighth Circuit (MN, MO, IA, etc.) and probably the Seventh (IL, WI and IN), but not in the Sixth (MI, OH, KY and TN). Further, the Ninth (CA, WA, NV, etc.) and Third Circuits (PA, NJ and DE) have not squarely addressed this issue. Noting this wide disparity in the law, a bank would be wise to review its policy based on the states in which it does business.