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Mortgage Banking & Consumer Credit Alert

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Looking Back to the Future: "Presumptively Unfair" Mortgage Loans in the Case of Commonwealth of Massachusetts v. Fremont Investment & Loan, et al.

On February 25, 2008, a Superior Court judge in Massachusetts issued a preliminary injunction barring Fremont Investment & Loan ("Fremont") from foreclosing – without prior consent of the Attorney General and/or the Court – certain sub-prime loans that it originated between 2004 and 2007. These loans have characteristics that were once standard and permissible in the industry, but are now presumptively unfair under Massachusetts' consumer protection statute.[1] According to the Court, "Fremont, having helped borrowers get into this mess, now must take reasonable steps to help them get out of it."

The four characteristics that render the Fremont loans presumptively unfair are: (1) the loans are ARMs with an introductory period of three years or less; (2) the loans have an introductory or "teaser" rate 3 percent lower than the fully indexed rate; (3) the borrowers have a debt-to-income ratio that would have exceed 50 percent if the lender had measured the debt by the fully indexed rate, not the teaser rate; and (4) the LTV is 100 percent, or the loans carry a substantial prepayment penalty, or the prepayment penalty extends beyond the introductory period.

By issuing the injunction, the Court, first, extended the reach of the Massachusetts consumer protection statute ("Chapter 93A") to cover the Fremont loans, which were not considered unfair under Chapter 93A when they were originated and which do not otherwise fall within the Massachusetts Predatory Home Loan Practices Act enacted by the legislature in 2004, and second, the Court applied this new judge-made law retroactively. According to the Court, at the time legislation was passed governing high-cost loans, the legislature "did not imagine that lenders would issue loans with this degree of risk unless they were high-cost loans." In the absence of a legislative enactment covering the Fremont loans, the Court stepped into the perceived void existing and created as a result of the slump in home prices.

While the ruling only covers certain loans originated and serviced by Fremont in Massachusetts, it raises a number of legal issues and concerns for mortgage lenders, namely that it may arguably violate a lender's due process rights by retroactively applying a new legal standard not enacted by the legislature, and it potentially impairs a lender's rights under the contract clause of the U.S. Constitution. Thus, the effect of the Fremont Order, and its finding that loans with certain characteristics are "presumptively structurally unfair" under Chapter 93A, could have far reaching effects on, not only other lenders seeking to foreclose on sub-prime loans in Massachusetts, but also on how other courts, states' attorneys general, and other federal and state lending regulators across the country view the "fairness" of similar sub-prime mortgage loans.

Setting the Stage

On March 7, 2007, the Federal Deposit Insurance Corporation ("FDIC") required Fremont, an FDIC insured bank, to cease and desist from certain sub-prime lending practices. Among several other practices prohibited by the agreed-upon March 7, 2007 Cease and Desist Order was to forbid Fremont from "marketing and extending adjustable rate mortgage products to sub-prime borrowers in an unsafe and unsound manner that greatly increases the risk that borrowers will default on the loans or otherwise cause losses to the [b]ank."[2]

On July 10, 2007, on the heels of the FDIC Cease and Desist Order, Fremont and the Massachusetts Attorney General ("Attorney General") reached agreement on a procedure to be followed in connection with loans owned or serviced by Fremont. Pursuant to that agreement with Fremont, the Attorney General required Fremont to provide it with 90 days' advanced notice before Fremont commenced any foreclosure proceeding. If the Attorney General objected to the proposed foreclosure proceeding, the agreement prohibited Fremont from initiating the foreclosure. Pursuant to that agreement, Fremont sent the Attorney General the required documentation on properties it sought to foreclose upon. On October 4, 2007, the Attorney General objected to each of the foreclosures, with the exception of those loans that were not owner-occupied and where the loan servicer was not able to make contact with the borrower.[3] That same day, however, the Attorney General brought its civil enforcement action against Fremont. Fremont subsequently exercised its right to terminate the agreement with the Attorney General.[4]

Chapter 93A

Chapter 93A, like most other state unfair and deceptive acts or practices statutes ("UDAP"), provides that any person who engages in the conduct of any trade or commerce and who suffers any loss of money or property, real or personal, as a result of an unfair or deceptive act or practice may bring an individual or a class action for damages and equitable relief.[5] Monetary damages for a violation of Chapter 93A may include double or triple damages, attorneys' fees and costs. Significantly, the statute does not cap available damages. Additionally, as was the case here, Chapter 93A permits the Attorney General to bring an enforcement action and to seek preliminary and permanent injunctive relief against parties to restrain unfair and deceptive acts or practices.[6] The Attorney General may also seek civil penalties of up to $5,000 per violation, in addition to costs and attorneys' fees.[7]

In 1992, the Attorney General, acting under authority provided by Chapter 93A to define unfair acts or practices, promulgated regulations relating to mortgage lenders and mortgage brokers.[8] In late 2007, the Attorney General issued additional regulations further defining the types of mortgage lending acts and practices that would be considered unfair or deceptive under the Act, including among other prohibitions: (a) making a mortgage loan unless the broker or lender, based on information known at the time the loan is made, "reasonably believes" that the consumer will be able to repay the loan, and (b) processing or making loans without verifying income documentation (unless certain express requirements are satisfied). According to the Attorney General, these newly promulgated regulations, like the regulations issued in 1992, "are not intended to be all inclusive as to the types of activities prohibited by" Chapter 93A.[9] "Acts or practices not specifically prohibited by [the regulations] are not necessarily consistent with Chapter 93A or otherwise deemed legitimate by the absence of regulation…."[10] It is undisputed, however, that the newly promulgated regulations apply only to loans for which applications were received after January 2, 2008, and do not apply retroactively.

The "Foreseeable" Path to "Presumptively Unfair" Loans?

Against this regulatory backdrop, on October 4, 2007, the Attorney General filed a complaint against Fremont and its parent company alleging unfair and deceptive loan origination and sales conduct in connection with Fremont's past lending practices in the sub-prime market.[11] Based on the allegations that certain of the loans offered by Fremont were "structurally unfair" in violation of Chapter 93A, the Attorney General moved for a preliminary injunction, seeking to prohibit Fremont from initiating or advancing any foreclosure on residential mortgage loans in Massachusetts without the express consent – in writing – of the Attorney General's Office.[12]

As viewed by the Court, the central question to be decided in connection with the decision to grant

injunctive relief was whether the Attorney General was likely to prevail in proving that these Fremont loans were "structurally unfair" so that the issuance of such loans was an unfair act or practice in violation of Section 2 of Chapter 93A. The Court answered the question, "yes."

In its Findings of Fact, the Court determined that at least half of Fremont's loans were sub-prime and shared certain characteristics that rendered them at high risk of default:

- virtually all the mortgage loans had a low fixed introductory interest rate ("teaser rate") that remained for two or three years, then adjusted to a variable rate based on the market rate of interest (commonly referred to as "2/28" or "3/37" adjustable rate mortgages);
- many loans carried the potential for so-called "payment shock," which may occur when the introductory rate is considerably lower than the eventual adjusted rate, so that the amount of the mortgage interest would substantially increase once the adjusted rate takes hold;
- borrowers were approved for loans with a debt-to-income ratio less than or equal to 50% in determining whether the borrower qualified for the loan;
- borrowers were qualified for ARM loans based solely on the initial introductory rate and not the "fully indexed rate," a rate at which those borrowers would not have otherwise qualified and have been able to pay;
- loans were made with little or no down payment with a loan-to-value ratio equal to or approaching 100 percent of the collateral's value (including "piggy-back" loan arrangements); and
- some loans had significant prepayment penalties for early prepayment of the loan note and/or prepayment penalties that extended beyond the introductory interest rate adjustment.[13]

Notably, the Court acknowledged that there was no law or industry or regulatory standard that prohibited making loans with the characteristics possessed by the Fremont loans at the time they were made. In particular, the Court recognized that there was no "federal or Massachusetts statute or regulation applicable to all mortgage loans that prohibited these practices from occurring together – that is, there was no Massachusetts statute or regulation that expressly declared that a bank could not issue a 2/28 ARM, stated income loan with a loan-to-value ratio of 100 percent and a prepayment penalty for the early payoff of that loan (through sale or refinancing) to a borrower with a debt-to-income ratio exceeding 60 percent."[14] Simply put, there was no "indication from the record that it was unusual for sub-prime lenders to engage in any or all of these practices."[15] At the same time, there was no evidence before the Court that Fremont or its representatives (mortgage brokers) made false representations to borrowers regarding the terms of their loans.

The Court looked to the "spirit" of other predatory lending statutes applicable to high-cost loans and non-binding guidance issued by federal agencies that monitor lending practices to reach the conclusion that certain sub-prime loans should now be considered presumptively unfair because of the level of risk they presented for default and foreclosure.[16] The Court turned first to the 2004 Massachusetts Predatory Home Loan Practices Act (the "Act"), which expanded the protections afforded borrowers under the state's anti-predatory regulations for certain high-cost mortgage loans. That Act prohibits a lender from making a high-cost home mortgage unless the lender reasonably believes that at the time the loan is consummated that one or more of the borrowers will be able to make the scheduled payments to repay the home loan, based upon consideration of the borrower's current and expected income, current and expected obligations, employment status, and other financial sources other than the borrower's equity in the collateral property.[17] The Act also prohibits inclusion of prepayment penalties for these high-cost mortgage loans.[18]

The Attorney General did not allege or seek to prove that any of the Fremont loans were governed by the Act, which regulates the making of high-cost loans, and the Court acknowledged that the Fremont loans were not covered by the statute. The Court nonetheless found that the legislature could not have "imagined" at the time of enactment of the high-cost loan statute, the nature of the risk posed by sub-prime loans. From there, the Court determined that the standard imposed by the legislature on high-cost loans should carry over to certain sub-prime loans, that is, that it is unfair to issue a mortgage loan when the lender reasonably believed that the borrower could not meet the scheduled payments.

As a matter of public policy, the Court stated that it "is both imprudent and unfair to approve mortgage loans that the borrowers cannot reasonably be expected to repay if housing prices were to fall."[19] The Court observed that the "benefit to consumers from sub-prime mortgages was that [borrowers with low credit scores] were able to obtain mortgages they would not otherwise have been eligible to obtain."[20] However, because sub-prime loans often carried a low introductory rate that could substantially increase after two to three years, borrowers were "doomed to default and foreclosure,"[21] according to the Court, because they could not refinance their mortgages when home values fell. "Just because we as a society failed earlier to recognize that (many sub-prime loans) were generally unfair does not mean that we should ignore their tragic consequences and fail now to recognize that unfairness."[22]

Thus, even though the legislature had not included non-high-cost loans in prior lending practices enactments, the Court nonetheless concluded that even for loans that do not fall within the umbrella of the high-cost statute, the loans will nonetheless violate Massachusetts law if "the lender should reasonably have recognized … that after the introductory period, the borrower would not be able to meet the scheduled payments … and the loan was doomed to foreclosure unless the fair market value of the property increased."[23] "Given fluctuations in the housing market and the inherent uncertainties as to how that market will fluctuate over time," the Court found it "unfair for a lender to issue a home mortgage loan secured by the borrower's principal dwelling that the lender reasonably expects will fall into default once the introductory period ends unless the fair market value of the home has increased at the close of the introductory period."[24]

A Shifting Burden: A New Standard Is Born

The Court imposed an atypical burden-shifting structure (similar to the structure employed in discrimination actions) that is neither contemplated by Chapter 93A nor employed in prior Chapter 93A case law. The Court held that a loan is "presumptively unfair" if it possesses the following four characteristics:

(1) the loan is an adjustable rate mortgage with an introductory period of three years or less;

(2) the loan has an introductory or "teaser" interest rate that is at least three percent lower than the fully indexed rate;[25]

(3) the borrower has a debt-to-income ratio[26] that would have exceeded 50 percent if Fremont had measured the debt by the debt due under the fully indexed rate (instead of measuring the debt due under the introductory teaser rate); <u>and</u>

(4) the loan-to-value ratio is 100 percent, the loan carries a substantial prepayment penalty, or the prepayment penalty lasts beyond the introductory period.[27]

Once this prima facie case is offered, the loan will be considered "presumptively unfair" and the burden of proof shifts to the lender – meaning that the lender must produce sufficient evidence that a reasonable fact finder could conclude that the loan was not actually unfair. Providing little further guidance, the Court then vaguely indicates that a lender could meet its burden by showing that the borrower had other assets that "realistically could have enabled the borrower to meet the scheduled payments and avoid foreclosure, or other reasonable means of obtaining refinancing even if the fair market price of the mortgaged home had fallen."[28]

The Court circles back and concludes that the "presumption would not change the burden of proving a Chapter 93A violation; the burden of proving that the loan was unfair remains with the plaintiff."[29] It is not clear, however, what evidence a plaintiff/borrower would be required to offer, if any, to prove that the loan was unfair once the presumption applies.

The Injunction

The Court determined that the Attorney General is likely to prevail in proving that many of the loans issued by Fremont secured by a borrower's primary residence had the four required characteristics, and thus were not only presumptively unfair, but actually unfair. The Court enjoined Fremont from foreclosing on any of the subject properties without first notifying the Attorney General of its intention to foreclose and requiring participation in a lengthy notice and objection process, and potentially further Court involvement on a loan-by-loan basis.

Thus, the Court issued what it deemed a "carefully measured preliminary injunction"[30] but which actually imposes broad oversight and review of all Fremont loans subject to foreclosure. The injunction requires Fremont to provide the Attorney General with notice of all foreclosures it intends to initiate or advance and allow the Attorney General an opportunity to object to the proposed foreclosures. For loans that do not possess the four characteristics described above (i.e. not presumptively unfair), loans that are not secured by the borrower's principal dwelling, or properties that are vacant or uninhabitable, Fremont must still give 30 days' advance written notice of the foreclosure so that the Attorney General has an opportunity to object to the foreclosure. If, however, a Fremont loan has the four characteristics described above (and is now considered "presumptively unfair"), and the borrower occupies the property as his or her principal dwelling, Fremont must provide advance written notice 45 days before the foreclosure identifying the reasons why the proposed foreclosure is reasonable under the circumstances. If the Attorney General objects to the foreclosure, the parties have 15 days to attempt to resolve their differences. If the differences are not resolved, Fremont may proceed with the foreclosure only with the prior approval of the Court (or a special master).[31]

In considering whether to allow the foreclosure, the Court will consider, among other factors, whether the loan is presumptively unfair and whether Fremont has taken reasonable steps to "work out" the loan with the borrower to avoid foreclosure. The Court noted that even where a mortgage loan is found to be presumptively unfair, borrowers are not relieved of their monthly mortgage obligations. The preliminary injunction will not also reach to those borrowers who can afford to repay the loan, but rather, only those borrowers who cannot afford to repay the loan and face the risk of foreclosure.[32]

Legal and Practical Implications

This decision raises a number of legal issues and concerns.

First, arguably, the due process clause of the Fourteenth Amendment to the U.S. Constitution should prohibit Massachusetts from retroactively imposing a new lending standard on Fremont. The Court's Order begs the question as to whether one can look retrospectively through the prism of a declining economy and waning house prices to determine that conduct is unfair, when at the time of that conduct, it did not appear unfair or otherwise unlawful under governing legal requirements.

The Court attempts to justify looking in the rear-view mirror by contending that Fremont "had more than fair warning of the dangers posed by loans bearing the four characteristics" by referencing non-binding federal agency lending guidelines on sub-prime lending and high LTV loans. However, past debate over proposed lending guidance by multiple federal agency authorities, including differing opinions as to what conduct may be unfair, is not likely to put a party on notice of the ultimate conduct to be regulated and eventually deemed unfair.[33] At the same time, it is worth noting that, until recently, neither the federal government nor the Attorney General promulgated regulations to specifically address the types of loans at issue. Likewise, neither the federal agencies (which the Court recognized contributed to the current sub-prime crisis by a prior failure to monitor) nor the Attorney General sought to enforce what she seems to suggest was already unfair and deceptive under Chapter 93A.

In essence, the Attorney General seeks to penalize Fremont (and potentially any other originator) for an alleged failure to comply with a previously unknown interpretation of the state UDAP statute. A law that "either forbids or requires the doing of an act in terms so vague that persons of common intelligence must necessarily guess at its meaning and differ as to its application, violates that first essential of due process of law."[34] Due process demands that before a state can enforce a law depriving a person of property, the state must provide reasonable notice of what the law prohibits.[35] As the U.S. Supreme Court has cautioned, an ill-defined rule "impermissibly delegates basic policy matters to policemen, judges, and juries for resolution on an ad hoc and subjective basis, with the attendant dangers of arbitrary and discriminatory applications."[36] While Chapter 93A has always sought to regulate unfair or deceptive conduct, the due process principle of fair notice and the prohibition against retroactive enforcement should apply to the government's attempt to enforce a novel interpretation of an existing statute.[37]

Second, in the Fremont Order, the Court takes an activist approach by standing in the shoes of the legislature and (a) adopting a new standard of unfairness applicable to sub-prime loans based on what

the legislature might "imagine" that standard should be, and (b) creating a burden-shifting evidentiary presumption to be applied to these sub-prime loans that is not articulated in Chapter 93A. The Court's reliance on the Massachusetts Predatory Home Loan Practices Act and the "spirit" of the Act, which, according to the Court, makes it unfair to make a loan where the lender reasonably believes that the borrower could not make scheduled payments, as justification to set a new "unfairness" standard for all home mortgage loans, appears misplaced and heralds problems associated with judicial legislating. For example, while the Court blames Fremont for not heeding the warnings set forth in federal agency lending guidelines on sub-prime loans dating back to 1999, the Court lets the state legislature off the hook for not recognizing those same warnings in 2004, when it passed and enacted the Act making it applicable to only certain kinds of high-cost mortgages, and not the mortgages at issue in the Fremont case. While few would dispute the Court's statement that the mortgage market has changed, lenders may take issue with the notion that they should have foreseen, when other government bodies and regulatory authorities did not, that the concept that "unfair" mortgage lending would eventually include the existence of certain and commonly used loan products that would only be unfair when coupled with an economic downturn and an overall reduction in home values.

Added to the complexity of attempting to determine "what would the Legislature do" with respect to the types of loans it would legislate to be "unfair" is whether the Court, as opposed to the legislature, can impose the burden-shifting evidentiary presumption instituted for the first time in the Fremont case. That topic is likely better suited to a different client alert; needless to say, it will likely receive significant attention in future Chapter 93A jurisprudence.

Third, the Fremont decision potentially raises impairment of contract issues. While the Order states that it is not releasing borrowers from their obligation to repay their mortgage debt, the interpretation of Chapter 93A by the Court has the potential effect of altering that contractual obligation if the note holder cannot exercise its security interest in the property, the only practical means of paying the debt. The Contracts Clause, Article I, § 10 of the U.S. Constitution, prevents states from passing any statute that will alleviate the commitment of one party to a contract or that interferes with the enforcement of the contract. Although the legislature may modify or alter the remedy for enforcement of a contract, it cannot impair the contract's obligations, deny the contract holder's remedies under the contract or "so circumscribe the existing remedy with conditions and restrictions as seriously to impair the value of the right."[38] And although the legislature has some limited power to alter or modify contracts, the Court's interpretation of Chapter 93A as set forth in the Fremont decision may be unconstitutional to the extent that application of Chapter 93A to the Fremont loans unreasonably impairs Fremont's contractual rights under its notes and mortgages in violation of Fremont's due process rights.

Finally, it is not clear what the ultimate remedy and solution may be for borrowers with Fremont loans that the Court deems presumptively unfair. As part of the elaborate preliminary injunction process, if Fremont and the Attorney General cannot resolve their differences as to whether any loan should proceed to foreclosure, the Court plans to step in and examine whether the loan is "presumptively unfair," whether Fremont has taken reasonable steps to workout the loan and avoid foreclosure, and whether there is an alternative to foreclosure. While the Court states that borrowers (even with presumptively unfair loans) are not simply released from their obligation to repay their loans, the tough question will be, what will occur if the Court determines that the loan is presumptively unfair and a loan work out is not achieved? If the option of foreclosure is no longer available to the lender, what incentive does a borrower have to work out the loan? What will, or better yet, what *can* the Court do in such a situation? The injunction presents these problems and offers no solutions. One thing is clear, however. The notice and objection framework and potential Court involvement will be expensive and will likely be a tremendous drain on the resources of the Attorney General, Fremont, and the Court.

Looking Forward

It is still too early to tell what impact the Fremont Order will have in Massachusetts and elsewhere. With respect to other lenders that made similar loans in Massachusetts and in other states, it is foreseeable that plaintiff borrowers may bring individual actions, and likely putative class actions, seeking to apply this broad ruling – that is, advancing arguments that loans containing similar characteristics should

be considered structurally unfair and be tagged with the presumption of unfairness. As referenced above, Chapter 93A, like other state UDAP statutes, provides for up to triple damages for each violation of the statute, and does not provide a cap on liability, even for class actions. It is also foreseeable that plaintiff borrowers, whether individually, or on behalf of a class of similarly situated borrowers, will also seek injunctive relief against other lenders in Massachusetts similar to the injunction granted to the Attorney General, which would certainly have an impact on the foreclosure process and would likely require further court involvement. At the same time, given the success of the Attorney General in obtaining injunctive relief against Fremont, it is possible that additional enforcement actions based on similar loan criteria and the newly minted "structurally unfairness" concept will be brought against other lenders, both in Massachusetts and in other jurisdictions.

It is also unclear what impact the Fremont decision will have on non-originating note holders, assignees, and third party loan servicers. Massachusetts Chapter 93A does not provide for assignee liability, thus it is unlikely that the Order will extend to non-Fremont entities or third party servicers. Indeed, the Attorney General abandoned a draft assignee liability provision from its newly promulgated anti-predatory lending regulations. At the same time, the holder-in-due-course doctrine should continue to apply and protect subsequent holders of "presumptively unfair" mortgages, even in the wake of the Fremont Order. That doctrine provides that a holder in due course[39] is subject to only a limited number of defenses in its right to enforce a negotiable instrument, such as a mortgage.[40]

In sum, while the Fremont preliminary injunction applies only to Fremont, it is likely to have a broader reach in Massachusetts and beyond in light of the fact that loans of the type now presumed to be "structurally unfair" under Massachusetts law were made by numerous lenders throughout Massachusetts and the country. To be sure, future events will be guided by whether Fremont appeals the decision, and if appealed, how appellate courts will view the issue.

Endnotes

1 Massachusetts Unfair and Deceptive Act and Practices Statute, Mass. Gen. Laws ch. 93A, § 2.

2 For additional information on the FDIC's cease and desist agreement with Fremont, see "Un"-derhanded Enforcement: Lender Ordered to Comply With Proposed Guidance, Mortgage Banking and Consumer Credit Alert by Laurence E. Platt and Kristie D. Kully, March 2007, at http://www.klgates.com/newsstand/Detail.aspx?publication=3669.

3 2008 WL 517279, at *2 (Mass. Super. Ct. Feb. 26, 2008) ("Fremont").

4 Id. at *3.

5 Mass. Gen. Laws ch. 93A, § 9.

6 Mass. Gen. Laws ch. 93A, § 4.

7 Fremont, 2008 WL 517279, at *1.

8 See generally, 940 C.M.R. 8.00, et seq.

9 940 C.M.R. 8.02.

10 Id.

11 The Attorney General's enforcement action against Fremont seeks, among other things, civil penalties, restitution, and other damages arising from Fremont's allegedly unfair and deceptive loan origination practices in Massachusetts.

12 Fremont, 2008 WL 517279, at *1.

13 Id. at *4-5.

14 Id. at *9.

15 Id.

16 Id. at *9.

17 The Court also noted that the Act provides a presumption that the borrower has the ability to repay if the borrower's debt-to-loan ratio was 50 percent or less. Id. at *9 (citing 209 C.M.R. 32.34(c)).

18 Fremont, 2008 WL 517279, at *9. For a detailed analysis of the Massachusetts Predatory Home Loan Practices Act see Massachusetts Effectively Outlaws High Cost Home Mortgage Loans and Imposes Suitability Standards on all Home Mortgage Loans, K&L Alert, Mortgage Banking Commentary, August 2004, at http://www.klgates.com/files/Publication/cb8b106a-c5a2-4a01-a571-8c3086cb42e5/Presentation/PublicationAttachment/b7261c7e-4dc8-4d27-85df-86528df17705/MBC0804.pdf.

19 Fremont, 2008 WL 517279, at *13.

20 Id. at *5.

21 Id. at *5.

22 Id. at *13.

23 Id. at *10.

24 Id. at *10.

25 The fully indexed rate is defined as the index rate at origination plus the margin added after the introductory period expires, regardless of any rate caps.

26 The "debt-to-income ratio" is the ratio between the borrower's monthly debt payments (including the monthly mortgage payment) and the borrower's monthly income.

27 Fremont, 2008 WL 517279, at *10.

28 Id. at *11.

29 Id. at *11.

30 Id. at *14.

31 Id. at *16-17.

32 Id. at *14.

33 For example, when policy statements concerning a statute or rule are unclear or when the statute or rule has been subject to differing agency opinions, a "regulated party is not 'on notice' of the agency's ultimate interpretation of the regulations, and may not be punished." General Electric Co. v. U.S. E.P.A., 53 F.3d 1324, 1333-34 (D.C. Cir. 1995) (emphases added) (that different divisions of the enforcing agency disagreed about the scope of the rule at issue constitutes evidence that party could not have received fair notice of interpretation advanced during fine proceeding); Upton v. S.E.C., 75 F.3d 92, 97-98 (2d Cir. 1996) (rejecting the SEC's assertion that a consent order reached with one broker-dealer could put another broker-dealer "on notice" of the SEC's new interpretation of the rule at issue); Beaver Plant Operations, Inc. v. Herman, 223 F.3d 25, 30 (1st Cir. 2000) (past inconsistent agency interpretations constitute evidence that plant operator could not have received fair notice of interpretation advanced by agency during penalty proceeding).

34 Roberts v. United States Jaycees, 468 U.S. 609, 629 (1984) (quoting Connally v. General Construction Co., 269 U.S. 385, 391 (1926)).

35 Grayned v. City of Rockford, 408 U.S. 104, 108 (1972); United States v. Hoechst Celanese Corp., 128 F.3d 216, 224 (4th Cir. 1997) ("[d]ue process requires that a party must receive fair notice before being deprived of property") (citing Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950)). Moreover, the due process principle of fair notice applies as much to the imposition of civil penalties as it does to the imposition of criminal sanctions. Hoechst Celanese, 128 F.3d at 224; Upton v. Securities and Exchange Commission, 75 F.3d 92, 98 (2d Cir. 1996).

36 Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1982).

37 See, e.g., Beaver Plant Operations, Inc. v. Herman, 223 F.3d 25, 31-32 (1st Cir. 2000) (vacating civil penalty where OSHA adopted interpretation of rule at issue after time of alleged violation; no retroactive punishment permitted); United States v. Chrysler Corp., 158 F.3d 1350, 1354-55 (D.C. Cir. 1998) (reversing NHTSA order as violating due process clause where NHTSA failed to provide fair notice of interpretation of rule at time of alleged noncompliance); Hoechst Celanese, 128 F.3d at 224-27 (due process clause precluded imposition of civil penalty for alleged violation of regulation prior to time EPA directly contacted plant owner regarding EPA's new interpretation of regulation); United States v. Apex, 132 F.3d 1287, 1291 (9th Cir. 1997) (exercising the rule of lenity where defendant had inadequate notice of agency's interpretation of the rule used to support conviction); General Electric Co. v. EPA, 53 F.3d 1324, 1328-29 (D.C. Cir. 1995) (use of a citation proceeding "as the initial means for announcing a particular interpretation" deemed insufficient notice).

38 Richmond Mortgage & Loan Corporation v. Wachovia Bank & Trust Co., 300 U.S. 124, 128 (1937).

39 A "holder in due course" is a holder of a negotiable instrument where: (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument (a) for value, (b) in good faith, (c) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (d) without notice that the instrument contains an unauthorized signature or has been altered, (e) without notice of any possessory claim to the instrument, and (f) without notice that any party has a defense or claim in recoupment. See Mass. Gen. L. ch. 106 § 3-302.

40 Mass. Gen. L. ch. 106 § 3-305.

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