

## Expert Analysis

### 'You Can't Handle The Truth!' Fact, Fiction and the Servicemembers Civil Relief Act

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*Editor's note: The title refers to a famous line from the 1992 military drama "A Few Good Men."*

Over the past year and a half, several federal agencies, including the Department of Justice, Office of the Comptroller of the Currency and Federal Reserve Board, have turned their attention to promoting compliance with the Servicemembers Civil Relief Act, 50 U.S.C. app. §§ 501. Because military service often complicates service members' ability to fulfill their financial obligations or assert many of their legal rights, Congress intended the SCRA to provide protections related to financial obligations and court proceedings "to enable [servicemembers] to devote their entire energy to the defense needs of the nation."<sup>1</sup>

Recent SCRA settlements include eight-figure penalties, with six-figure compensation for a single alleged violation of the statute. In addition, these settlements have required file reviews, ongoing compliance activities and new SCRA servicing requirements. Government agencies acknowledge that the settlements include requirements that go well beyond the legal requirements of the SCRA.<sup>2</sup>

Plaintiffs' attorneys have watched SCRA settlements carefully. In recent months, we have seen an increase in SCRA-related private litigation, including several putative class action suits. By using the same legal theories as the government, these attorneys are laying the groundwork to seek substantial recoveries against creditors and mortgage servicers.

As private SCRA-based litigation increases, it is important to distinguish between actual statutory requirements and the broad-based servicing guidelines contained in settlements. Settlements are not judicial holdings and are not entitled to deference by courts reviewing allegations of SCRA-servicing errors. While they may be important touchstones for crafting SCRA compliance programs, they are not the law of the land. Given the substantial difference between the statute and these settlements — and the serious financial and reputational risks of private SCRA litigation for creditors — we think it is important for creditors and borrowers alike to refocus on the actual requirements of the SCRA.

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***Congress never intended to provide a windfall for service members or to free them from all financial obligations.***

Fiction: The SCRA exists just to protect service members.

Fact: Congress passed the SCRA to level the playing field for service members. Because active-duty service radically interrupts a service member's civilian life, Congress wanted to ensure that service members could focus predominantly on their military duties without being unduly distracted by their financial responsibilities back home.<sup>3</sup>

However, Congress never intended to provide a windfall for service members or to free them from all financial obligations. Several courts have held that the SCRA protects creditors as well as service members, and that service members cannot use the act as a sword to gain unjustified benefits during active duty.<sup>4</sup> This view is supported by statutory language protecting creditors: Section 581 prevents people from transferring property or contracts to exploit service member benefits, and Section 582 states that a certificate from the Secretary of Defense is *prima facie* evidence of an individual's military service status.

Fiction: The SCRA prevents all foreclosures against service members.

Fact: Section 533 grants service members substantial foreclosure-related protections but does not prohibit foreclosures. Under the law, if a service member obtains a home mortgage prior to entering active duty, that individual may be entitled to foreclosure protection during the period of active duty or for nine months thereafter. Congress recently amended the SCRA so that, effective Feb. 2, 2013, the foreclosure protection applies for an entire year after the end of active-duty service.

However, Congress sought to balance the protections for service members with fairness to creditors. Accordingly, Congress included several important exceptions to the SCRA's foreclosure protection:

- Active duty at origination: If a service member enters into a mortgage while on active duty, the expectation is that he or she would be able to qualify and pay for the mortgage based on active-duty military income. Accordingly, service members who enter into mortgages during active duty are not entitled to foreclosure protection.
- Court order: While the SCRA offers some protections against foreclosure, a creditor can nevertheless seek a court order permitting foreclosure even if the service member is eligible for the SCRA's protections.
- Waiver: Notwithstanding the SCRA's protections, sometimes a service member would prefer to be free from a financial burden entirely. Therefore, the SCRA permits a service member to waive any protections under the SCRA, including the foreclosure protection in Section 533.

Fiction: The SCRA's foreclosure-protection provision is a strict liability provision, and the burden is on creditors to determine whether a borrower is on active duty at foreclosure.

Fact: While some have argued that the SCRA's foreclosure protections are "strict liability," that is, a creditor is prohibited from foreclosing on a protected borrower regardless of knowledge of active duty or any steps taken to identify active-duty status, the better reading of the statutory text and legislative history is that a service member is required to inform a creditor of active-duty status.

The SCRA has never required creditors to determine if a borrower was on active duty. Indeed, when Congress first passed service member foreclosure protections during World War I and reenacted them during World War II, it would have been virtually

impossible for a creditor to determine independently if an individual borrower was on active duty. The country was fully mobilized for war, and there is no evidence that Congress intended to burden the already stretched military with responding to millions of military-status requests. Even in 2003, when Congress enacted the current language of Section 533, it recognized the severe burden that such a requirement would impose on both the military and creditors, and did not include such a requirement.

In 2005 the Department of Defense created its Defense Manpower Data Center website to enable creditors, among others, to determine if an individual is on active duty. However, this website did not exist when the foreclosure protection was enacted in 1918, 1942 and again in 2003. The creation of a website years after SCRA enactment cannot suddenly create strict liability under the law. Moreover, the U.S. Supreme Court has clearly held that, where the meaning of a statute is uncertain (as here, where there is no statutory strict liability language) it should "be construed in such a way as to avoid unnecessary hardship."<sup>5</sup>

The SCRA does not contain language requiring creditors to independently determine a borrower's military status prior to foreclosure. At least one court has interpreted the absence of such language as proof that the statute does not impose this burden on creditors.<sup>6</sup> And it would be impossible for creditors to comply with other sections of the SCRA if borrowers did not at least notify the creditor of military service.

Below are examples of situations where the DMDC website does not offer certain types of information:

- **Foreign military:** The SCRA protects not only American citizens serving in the U.S. military; it also protects American citizens serving in the military of an allied country. Determining this information is impossible through the DMDC website, which does not identify individuals serving in the armed forces of an allied nation. Moreover, allied nations do not have offices set up to handle requests for active-duty status under the SCRA.
- **Reservists:** The SCRA's protections extend to reservists not only during the period of active duty, but also from the date they receive orders to report to active duty. However, until earlier in 2012, the DMDC website would not inform a creditor if an individual was a reservist. The individual would not appear to be entitled to any SCRA protection, making it impossible to identify active-duty status. Even now, the DMDC website only identifies the date the orders were *sent to* the reservist, not the date the orders were *received by* the reservist.
- **Eviction:** Section 531 protects service members and their dependents from eviction. However, it is often the case that landlords will not have all information on all tenants in a rental property. Children, sublessees and illegal tenants rarely provide their names, Social Security numbers and dates of birth to a landlord to permit a DMDC website check. Therefore, it is impossible to determine whether these individuals are entitled to SCRA protection. Even if a landlord had such information about tenants, the landlord would not be able to determine independently whether a tenant is a dependent of a service member eligible for protections under Section 531.

Finally, the DMDC, like virtually all databases, has a known error rate. In representing creditors on SCRA matters, we have seen numerous instances where a creditor performed a DMDC search, determined that the individual was not on active duty and proceeded to foreclosure, only to learn later that the information on the DMDC website was wrong, and the individual was in fact on active duty. If the official repository

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of active-duty information is unreliable, how can the government insist that the SCRA is a strict liability statute?

Fiction: Service members are automatically entitled to the SCRA's interest rate cap.

Fact: SCRA Section 527 provides that for debts incurred prior to active-duty service, a service member's interest rate is capped at 6 percent. Furthermore, the service member can apply for this rate cap within 180 days of the end of active-duty service, and the cap will be retroactive to the date the service member first entered active duty. Finally, for home mortgage loans, the interest rate cap not only covers the period of active duty, but also one year after the end of active duty.

However, this rate-cap protection is not automatic; the SCRA requires that a service member first submit both a written request for the interest rate reduction as well as a copy of the military orders calling him or her to active duty. Indeed, without this information it would be impossible to determine the start date of an individual's active-duty period and thus apply the benefit retroactively.

Fiction: The SCRA prevents negative credit reporting during active duty.

Fact: Congress intended to remove impediments to service members seeking protection under the SCRA. Accordingly, Section 518 states that a creditor cannot file an adverse credit report against a borrower for taking advantage of the statute's protections.

However, if a service member fails to make payments while on active duty, a creditor is still entitled to report this to the credit reporting agencies. The SCRA only states that a creditor cannot penalize a borrower for seeking or receiving benefits under the SCRA. It does not prohibit the reporting of accurate credit performance information unrelated to the borrower's receipt of or request for SCRA benefits. Furthermore, the act is not intended to supplant other federal laws, and a creditor may otherwise be obligated under Section 623 of the Fair Credit Reporting Act to report a borrower's payment activity.

Fiction: SCRA protections automatically apply to a service member's spouse, children and dependents.

Fact: Most SCRA provisions do not require creditors to offer protection to service members' families. Rather, Section 538 instructs a dependent to apply to a court for SCRA protection.

Logically, this has to be the case because a creditor cannot be expected to know that a borrower's spouse or parent is a service member. A creditor often does not have enough information on the dependent (full legal name, Social Security number, date of birth) to run a search with the military. By requiring dependents to seek out SCRA protection, the law provides them with important benefits without holding creditors to an impossible standard.

Fiction: The SCRA protects everyone overseas in combat zones, including government contractors.

Fact: The SCRA explicitly states that it only covers members of the active-duty military, including members of the full-time military, National Guard and Reserves. However, the SCRA does not offer relief to civilian contractors working overseas. Not only does the statutory text exclude these individuals, but when Congress passed the SCRA in 1942, private military contractors were not a part of the American military plan.

## CONCLUSION

As private SCRA class-action litigation increases, it is vital to debunk the myths surrounding the statute. Because recent federal SCRA settlements require servicers to provide benefits exceeding those required by the act, and because federal regulators are reading some statutory provisions more broadly than is justified by the statutory text, this private litigation should serve as a wake-up call to focus on the actual requirements of the SCRA.

## NOTES

- <sup>1</sup> 50 U.S.C. app. § 502.
- <sup>2</sup> See, e.g., Press Release, Dep't of Justice, Justice Department Reaches \$12 Million Settlement to Resolve Violations of the Servicemembers Civil Relief Act by Capital One (July 26, 2012), available at <http://www.justice.gov/opa/pr/2012/July/12-ag-933.html>; Fact Sheet: Mortgage Servicing Settlement, Dep't of Hous. & Urban Dev., available at <http://portal.hud.gov/hudportal/HUD?src=/mortgageservicingsettlement/fact-sheet> (last visited Aug. 28, 2012).
- <sup>3</sup> The Judge Advocate General's Legal Center & School, U.S. Army, JA 260, Servicemembers Civil Relief Act 1-3 (March 2006) ("The act is not a panacea, however, for every legal problem of a civil nature a servicemember might face. It will not, for instance, help rescind a contract for the purchase of an automobile or a set of encyclopedias entered into after entry onto active duty. It is applicable to civil and administrative proceedings, but not to criminal proceedings. It does not excuse a servicemember from his/her obligations, but it will level the playing field so that military personnel are not disadvantaged because of their commitment to our nation.")
- <sup>4</sup> See, e.g., *Engstrom v. First Nat'l Bank of Eagle Lake*, 47 F.3d 1459, 1462 (5th Cir. 1995) ("Although the act is to be liberally construed, it is not to be used as a sword against persons with legitimate claims." (citing *Slove v. Strohm*, 236 N.E.2d 326, 328 [Ill. App. Ct. 1968]); *Walters v. Nadell*, 481 Mich. 377, 385 (2008) ("Congress enacted the SCRA as a shield to protect servicemembers from having to respond to litigation while in active service. ... Here, plaintiff is seeking to transform the SCRA into a sword to preserve his lawsuit without having timely invoked its provisions."); *George P. v. Super. Ct.*, 127 Cal. App. 4th 216, 225 (Cal. Ct. App. 2005) ("[T]he SCRA is a shield, not a sword. The goal of preventing a servicemember from being disadvantaged by his or her service to the country is not furthered by giving servicemembers an unwarranted advantage over civilian litigants."); *Lutes v. Alexander*, 421 S.E.2d 857, 864 (Va. Ct. App. 1992) ("The SSCRA is meant to act as a shield, not a sword, for servicemen.").
- <sup>5</sup> *Burnet v. Guggenheim*, 288 U.S. 280 (1933); see also *Knowlton v. Moore*, 178 U.S. 41, 77 (1900) ("[W]here a particular construction of a statute will occasion great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute"); *Wilson v. Rousseau*, 45 U.S. 646, 680 (1846) ("[A] court should hesitate before giving a construction to the clause so deeply harsh and unjust in its consequences, both as it respects the public and individual rights and interests.").
- <sup>6</sup> *Coward v. JPMorgan Chase Bank*, 2012 WL 2263359, at \*5 (E.D. Cal. June 15, 2012).



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