Regulation B: Who can Invoke its Protections?

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The U.S. Supreme Court, after hearing arguments earlier this month in *Hawkins v. Community Bank of Raymore*, will decide whether guarantors of defaulted loans, who are the spouses of a borrower's principals, are entitled to pursue the protections of the Equal Credit Opportunity Act (ECOA).

The ECOA prohibits a creditor from discriminating against an applicant for credit based on his or her marital status or from requiring a spousal guaranty or co-signor if an applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested (except in certain defined circumstances).

The Facts

Pertinent facts of the *Hawkins* case are as follows. Community Bank of Raymore (Bank) made loans totaling more than $2M to PHC Development, LLC (Borrower) to finance the development of a residential subdivision. Valerie Hawkins and Janice Patterson (Spouse Guarantors), whose respective husbands jointly owned and controlled the Borrower, each executed several guaranties of the loans. When the Borrower failed to make the payments due under the loan documents, the Bank declared the loans in default, accelerated the loans and demanded payment from the Borrower and from the guarantors.

The Spouse Guarantors sued the Bank seeking damages and a declaration that their personal guaranties were void and unenforceable. They claimed that the Bank had only required their guaranties of the loans made to the Borrower because the Spouse Guarantors were married to the principals of the Borrower, and that they were discriminated against based on their marital status in violation of the ECOA. The district court granted the Bank's motion for summary judgment holding that a guarantor is not protected from discrimination based on marital status under the ECOA and the U.S. Court of Appeals for the Eighth Circuit affirmed.

The Rulings

In other words, the District Court and Eighth Circuit ruled that the Spouse Guarantors did not have standing, as guarantors, to bring an action under the ECOA. The decision hinged on whether the word "applicant" includes a guarantor. Under the ECOA, only an "applicant" has a cause of action against a creditor. The text of the ECOA defines an "applicant" as "any person who applies to a creditor directly for an extension, renewal, or continuation of credit, or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit." Under the ECOA, the Federal Reserve Board is responsible for drafting regulations to implement the ECOA, which is implemented by the Federal Reserve Board's Regulation B. Regulation B expands the ECOA's definition of an "applicant" to specifically include guarantors, sureties, endorsers and similar parties. The district court and Eighth Circuit held that the Spouse Guarantors, as guarantors, did not qualify as "applicants" under ECOA despite Regulation B's interpretation that the term "applicant" does include guarantors.

Questions for the Supreme Court

The question the Supreme Court is considering in *Hawkins v. Community Bank of Raymore* is whether guarantors of loans are "applicants" who have standing to bring an action under the ECOA, and whether the Federal Reserve Board had the authority under the ECOA to expand the definition of "applicant" to include guarantors.

If the Supreme Court finds that guarantors are not "applicants" for purposes of gaining the protections of the ECOA, these Spouse Guarantors, and spousal guarantors generally, will not be permitted to bring an action to invalidate their guaranties based on a claim of discrimination based on marital status. If the Supreme Court finds that guarantors are "applicants" for purposes of gaining the protections of the ECOA, the Bank will have to defend against the claims that it violated the ECOA by requiring guaranties of the loans from the Spouse Guarantors.

The Supreme Court's decision will not affect the prohibitions against a creditor discriminating against an applicant based on his or her marital status or requiring a spousal guaranty or co-signor if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested (except in specific circumstances). Lenders will still need to comply with Regulation B and exercise caution when requiring a spousal guarantee. There are situations in which a creditor may require or accept a spousal guaranty, but lenders will still need to make sure that they are doing so in strict compliance with the ECOA and properly document the circumstances under which a spousal guaranty of a loan is obtained.

We will continue to monitor this issue and provide updates of further developments. Please contact Meredith A. Bieber (215.864.6292; bieberm@whiteandwilliams.com) or any other member of our Finance Group for further assistance.