UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

MICHAEL PEMBERTON and SANDRA COLLINS PEMBERTON, *individually and on behalf of others similarly situated,*

Plaintiffs,

v.

NATIONSTAR MORTGAGE, LLC, *a Federal Savings Bank,*

Defendant.

Case No. 14-CV-01024-BAS-MSB

ORDER:

(1) PRELIMINARILY APPROVING CLASS ACTION SETTLEMENT;

(2) CONDITIONALLY APPROVING PROPOSED SETTLEMENT CLASS; AND

(3) SETTING HEARING OF FINAL APPROVAL OF SETTLEMENT

Plaintiffs obtained an adjustable rate mortgage ("ARM") loan that permitted them to defer payment of accrued interest. The loan provided that unpaid accrued interest would be added back to their unpaid principal balance. How that unpaid accrued interest added back to the principal balance ("negative amortization") should be treated for purposes of IRS deductions is the subject of this lawsuit. Plaintiffs argue that, even though it is added back to principal, the negative amortization is still interest that should have been reported on IRS Form 1098.

I. PROPOSED SETTLEMENT

The proposed settlement agreement (ECF No. 130-2 ("Settlement" or "Settlement Agreement")) applies to class members ("Class" or "Class Members") defined as "All persons who, according to Nationstar's reasonably available computerized computer records, had or have Option ARM loans serviced by Nationstar and made payments to Nationstar in any tax year from 2010 – 2018." (Plaintiff's Motion for Preliminary Approval of Class Action Settlement, ECF No. 130 ("Motion") at 14.)

Plaintiffs and Defendant (collectively, the "Parties") agree that the Class shall be provisionally certified, and that, subject to the Court's approval, the law offices of David J. Vendler and Michael R. Brown, APC, will be appointed as Class Counsel. (*Id*. at 2.) Michael Pemberton and Sandra Collins Pemberton will be appointed Class Representatives. (*Id*.)

"Class Members may submit Claim Forms with documentation sufficient to establish that the Class Member paid more in taxes than was owed, for one or more tax years between 2010 and 2018." (Settlement Agreement § 2.01(a).) "Nationstar will conduct an investigation of each claim submitted to verify from its records whether or not Class Members' Form 1098 included deferred interest." (*Id.* § 2.01(b).) For tax years 2016, 2017 and 2018, if Nationstar determines the amount reported on Form 1098 does not include deferred interest "and documentation provided by the Class Member establishes that the Class Member paid more in taxes than was owed based on the failure to include deferred interest in the Form 1098, Nationstar will issue an amended IRS Form 1098" including the negative amortization not previously reported to the IRS. (*Id.* § 2.02.) For tax years 2010 through 2015, where Nationstar determines that the amount reported on Form 1098 did not include deferred interest "and the documentation provided by the Class Member establishes that the Class Member paid more in taxes than was owed based

on the failure to include deferred interest in the Form 1098, Nationstar will issue the Class Member a payment of $50." (*Id.* § 2.04.)

Independent of the Class compensation, Class Counsel will seek attorneys' fees not to exceed $700,000, which Nationstar will not oppose. (Settlement Agreement § 4.02.) Additionally, the Class Representatives will seek an incentive award of $20,000, which Nationstar agrees not to oppose. (Settlement Agreement § 4.03.) Nationstar shall pay the costs of notice to the Class, as well as any attorneys' fees and incentive award ordered by the Court. (Settlement Agreement § 3.09.) The Settlement Agreement is not contingent on the Court's granting attorneys' fees or a Class incentive award. (Settlement Agreement § 4.04.)

II. ANALYSIS

A. Class Certification (for Settlement Purposes Only).

Here, the Parties seek to certify a class for settlement purposes only. Federal Rule of Civil Procedure 23(a) provides that a class may be certified "only if (1) the class is so numerous that joinder of members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a). In addition to meeting the 23(a) requirements, a class action must fall into one of the categories laid out in Rule 23(b). Fed. R. Civ. P. 23(b). The Parties seek to certify the class under Rule 23(b)(3). (Motion at 19.) Both 23(a) and 23(b) are satisfied in this case.

1. Fed. R. Civ. P. 23(a)

a. Numerosity

The numerosity requirement is generally satisfied when the class contains 40 or more members, a threshold far exceeded in this case. *Consolidated Rail Corp. v. Town of Hyde Park*, 47 F.3d 473, 483 (2d Cir. 1995); *Celano v. Marriott Int'l, Inc.*, 242 F.R.D. 544, 549 (N.D. Cal. 2007). Nationstar issued 46,695 Option ARM loans

and the Settlement Class is estimated to be 64,183. (Motion at 19.) That number is on its face large enough that individual joinder of all class members would be impracticable. Fed. R. Civ. P. 23(a)(1) is therefore satisfied.

b. Commonality

The commonality requirement requires that there be "questions of law or fact common to the class." Fed. R. Civ. P. 23(a)(2). Here, the claims against Nationstar arise from Nationstar's failure to include repayments of capitalized interest on borrowers' Form 1098. The legal questions include whether this capitalized interest should have been included on the Form 1098 and, if so, whether Nationstar should have issued corrected Forms. Because Class Members here have the same or similar allegations, there are common questions of law and fact and Fed. R. Civ. P. 23(a)(2) is satisfied.

c. Typicality

In general, the claims of the representative parties "need not be substantially identical" to those of all absent class members and need only be "reasonably co-extensive" in order to qualify as typical. *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1020 (9th Cir. 1998), *overruled on other grounds by Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338 (2011). Here, the Named Plaintiffs claim that Nationstar failed to properly report capitalized interest on their Forms 1098. These claims are identical or nearly identical to those of the other Class Members. Fed. R. Civ. P. 23(a)(3) is therefore satisfied.

d. Adequacy of Representation

For the class representative to adequately and fairly protect the interests of the class, two criteria must be satisfied. "First, the named representatives must appear able to prosecute the action vigorously through qualified counsel, and second, the representatives must not have antagonistic or conflicting interests with the unnamed members of the class." *Lerwill v. Inflight Motion Pictures, Inc.*, 582 F.2d 507, 512 (9th Cir. 1978). Here, the Named Plaintiffs have vigorously pursued the action thus

far and appear capable of continuing to do so. Counsel appear qualified, competent, and experienced in class action lawsuits. (*See* Declaration of David J. Vender, ECF No. 130-1 ("Vendler Dec.") at ¶¶ 2-20; Declaration of Michael R. Brown, ECF No. 130-7 ("Brown Dec.") at ¶¶ 3-8.) Named Plaintiffs also have no antagonistic or conflicting interests with the Class Members. Rule 23(a)(4) thus appears to be satisfied.

2. Fed. R. Civ. P. 23(b)

The Parties seek to maintain their class action under Fed. R. Civ. P. 23(b)(3). (Motion at 19.) Under Rule 23(b)(3), "Plaintiffs must also demonstrate that a class action is 'superior to other available methods for fairly and efficiently adjudicating the controversy.'" *Otsuka v. Polo Ralph Lauren Corp.*, 251 F.R.D. 439, 448 (N.D. Cal. 2008) (citing Fed. R. Civ. P. 23(b)(3)). "Where classwide litigation of common issues will reduce litigation costs and promote greater efficiency, a class action may be superior to other methods of litigation," and it is superior "if no realistic alternative exists." *Valentino v. Carter-Wallace, Inc.*, 97 F.3d 1227, 1234–35 (9th Cir. 1996).

In this case, the alternative to a class action would be to have the individual Class Members, which amount to over 64,000 individuals, file separate lawsuits. That would be both impractical and inefficient. Such individual litigation would consume judicial resources, impose additional burdens and expenses on the litigants, and present a risk of inconsistent rulings. Thus, the Court finds class action is superior to other methods for fairly and efficiently adjudicating this controversy.

B. <u>Fairness, Reasonableness, and Adequacy of the Proposed Settlement</u>.

The Ninth Circuit maintains a "strong judicial policy" that favors the settlement of class actions. *Class Plaintiffs v. City of Seattle*, 955 F.3d 1268, 1276 (9th Cir. 1992). However, according to Federal Rule of Civil Procedure 23(e)(2), "the court may approve [a settlement that would bind class members] only after a hearing and on finding that [the settlement] is fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2).

In determining whether the proposed settlement is fair, reasonable, and adequate, "a district court must consider a number of factors, including: the strength of plaintiffs' case; the risk, expense, complexity, and likely duration of further litigation; the amount offered in settlement; the extent of discovery completed, and the stage of proceedings; the experience and views of counsel; the presence of a governmental participant; and the reaction of the class members to the proposed settlement." *Staton v. Boeing Co.*, 327 F.3d 938, 959 (9th Cir. 2003). The Court considers the first four of these factors below.

1. Strength of Plaintiff's Case, and Risk of Further Litigation

The procedural history of this case is lengthy. On February 5, 2015, the Court granted Defendant's Motion to Dismiss with respect to the claim for violation of 26 U.S.C. §6050H and stayed the remainder of the case based on the primary jurisdiction doctrine. (ECF No. 17.) The Court ordered Plaintiffs to initiate proceedings before the IRS. After several years of inaction from the IRS, Plaintiffs requested the stay be lifted. (ECF Nos. 18, 26.)

On March 2, 2017, the Court lifted the stay (ECF No. 39), but raised the question of whether Plaintiffs had Article III standing in light of the Ninth Circuit's decision in *Smith v. Bank of America, N.A.*, 679 Fed. Appx. 549 (9th Cir. 2017). After briefing, where Plaintiffs conceded that their original complaint did not meet the standing requirements established by the Ninth Circuit, the Court dismissed the case with leave to amend. (ECF No. 42.) Plaintiffs filed a First Amended Complaint. (ECF No. 43.)

Nationstar moved again to dismiss for lack of subject matter jurisdiction. The Court ultimately denied Nationstar's motion to dismiss for lack of jurisdiction (ECF No. 53) but dismissed with prejudice Plaintiffs' claims for breach of contract (Count 1), breach of the implied covenant of good faith and fair dealing (Count 2), UCL claims under the "unlawful" and "fraudulent" prongs (Count 4) and fraud (Count 7). (ECF No. 70.) The Court allowed Plaintiffs' claim for negligence (Count 8) and a

UCL claim under the "unfair" prong (Count 4) to go forward and allowed Plaintiffs to amend the declaratory relief claim. (*Id.*)

During the discovery that proceeded after Plaintiffs had filed a Second Amended Complaint on July 18, 2018 (ECF No. 76), Plaintiffs learned that Nationstar's ordinary practice was to allocate and report payments of capitalized interest on Form 1098 "in exactly the manner Plaintiffs had contended was correct." (Motion at 2.) However, because the prior servicer of Plaintiffs' particular loan did not separately track capitalized interest, Plaintiffs' capitalized interest was never entered into Nationstar's system, and Nationstar made no effort to determine if Plaintiffs' ARM loan included a capitalized interest balance when it assumed Plaintiffs' loan. (*Id.*) As a result, and notwithstanding its normal interest-reporting policy, Nationstar did not include Plaintiffs' payments of capitalized interest on the Forms 1098 it issued to them. (*Id.*)

"Discovery also revealed that, in 2016, after this lawsuit was filed, and as a direct result of it, Nationstar undertook steps to bring Nationstar's 1098 interest reporting, as well as the interest reporting for other loans that had been transferred to it for servicing in line with" what Plaintiffs claim is the proper reporting practice. (Motion at 4-5.) "This 'fix' by Nationstar effectuated the fundamental relief that Plaintiffs were seeking to achieve when they initially filed their lawsuit, i.e. forcing Nationstar to report class members' capitalized interest payments on Forms 1098." (Motion at 5.)

However, Nationstar was unable to identify all loans that included deferred interest that were not tracked by the previous servicer, nor did this "fix" help borrowers who were no longer being serviced by Nationstar. Plaintiffs sought to amend the complaint to add these new theories of recovery, but the Court denied the motion. (ECF No. 114.) Hence, this Settlement attempts to resolve the only remaining issues in the case.

The Parties discussed settlement with two separate neutrals, the Honorable Ronald M. Sabraw (Ret.) and Magistrate Judge Michael Berg. (Motion at 20.) Plaintiffs have been concerned throughout the case that the statute of limitations imposed by 26 U.S.C. §6511(a) is three years. Thus, as time elapses, Class Members' ability to file amended tax returns and obtain the relief they seek declines. Furthermore, Plaintiffs were aware that there was a risk, given the Court's rulings to date, of losing the case at or before trial. Given the remaining claims in the case, and the fact that Plaintiffs have largely achieved the relief they were seeking on behalf of the Class, the current posture of the case supports the Settlement Agreement.

2. Consideration Offered

With respect to tax years 2016, 2017, and 2018, Plaintiffs have received exactly the relief the were seeking on behalf of the Class—the ability to force Nationstar to deliver amended Forms 1098. However, for tax years 2010 through 2015, Class Members have lost the ability to file amended tax returns. Therefore, the Settlement Agreement provides for monetary compensation of $50.00.

Although Plaintiffs and Class Members may have been entitled to greater compensation if Plaintiff's allegations were proven true, this does not mean that the settlement is inadequate. *Linney v. Cellular Alaska P'ship*, 151 F.3d 1234, 1242 (9th Cir. 1998). "[The] very essence of a settlement is a compromise, 'a yielding of absolutes and an abandoning of highest hopes.'" *Officers for Justice v. Civil Ser. Comm'n of the City & Cty. of San Francisco*, 688 F.2d 615, 624 (9th Cir. 1982).

Ultimately, at the time of Final Approval, it would be useful to the Court for the Parties to outline what monetary relief they believe Class Members could possibly have obtained had they been successful after trial and how the Parties came up with the $50.00 figure. However, for purposes of a preliminary approval, the Court concludes that relief offered in the Settlement Agreement is sufficient for approval.

3. Extent of Discovery Completed and Stage of Proceedings

"[S]ettlement approval that takes place prior to formal class certification requires a higher standard of fairness." *Hanlon v. Chrysler Corp.*, 150 F.3d at 1026. However, this case has been pending for five years. It has resulted in extensive motion practice and significant discovery. (Motion at 20.)

Furthermore, the proceedings are otherwise at an advanced stage. The Parties met with two separate neutral mediators. All "settlement negotiations were hard fought and involved many contested issues, including liability, damages and whether the Plaintiffs even had standing to bring this action." (Motion at 20.) Proceedings have progressed far enough that the Parties are agreeing to this settlement with "eyes wide open" and a full awareness of what they are doing. The Court therefore concludes that this factor favors approval.

4. Experience and Views of Counsel

As laid out in their Declarations, Class Counsel are experienced in class action lawsuits, having led or participated in numerous class action lawsuits, including those involving the financial services industry and similar complex tax reporting issues. (Vendler Dec. ¶¶ 2-20; Brown Dec. ¶¶ 3-8.) Class Counsel declare that, considering the risks including previous rulings from the Court and the likelihood that this case was headed for the Court of Appeals, the Settlement is "fair and reasonable as to the Class." (Vendler Dec. ¶ 42; Brown Dec. ¶ 24.)

Generally, "[t]he recommendations of plaintiffs' counsel should be given a presumption of reasonableness." *Boyd v. Bechtel Corp.*, 485 F. Supp. 610, 622 (N.D. Cal. 1979); *cf. Stull v. Baker*, 410 F. Supp. 1326, 1332 (S.D. N.Y. 1976) (the court should consider the recommendation of counsel, and weight it according to counsel's caliber and experience). Here, due especially to the experience and knowledge of Class Counsel, their recommendations are presumed to be reasonable, and this factor accordingly favors approval.

C. Fairness Hearing and Required Notice to Parties.

1. Notice Requirements

Under Rule 23(c)(2)(B), "the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." Fed. R. Civ. P. 23(c)(2)(B). The Rule directs:

> The notice must clearly and concisely state in plain, easily understood language: (i) the nature of the action; (ii) the definition of the class certified; (iii) the class claims, issues, or defenses; (iv) that a class member may enter an appearance through an attorney if the member so desires; (v) that the court will exclude from the class any member who requests exclusion; (vi) the time and manner for requesting exclusion; and (vii) the binding effect of a class judgment on members under Rule 23(c)(3).

Fed. R. Civ. P. 23(c)(2)(B). "[T]he mechanics of the notice process are left to the discretion of the court subject only to the broad 'reasonableness' standards imposed by due process." *Grunin v. Int'l House of Pancakes*, 513 F.2d 114, 120 (8th Cir. 1975).

The proposed settlement agreement anticipates that the Parties will retain the services of a third-party administrator who will serve notice on the class members. (Settlement, §§ 3.02, 3.03.) Written notice will be sent to all class members by using addresses in Nationstar's database and cross-checking these addresses by conducting a National Change of Address Search. (Settlement § 3.03(a) and (b).) Class Members will be informed of their right to opt-out and retain their individual claims, as well as to object to the fairness of the settlement. The Settlement Administrator will also create an Internet website with settlement information and a toll-free number for Class Members to call with questions related to the Settlement. (Settlement Agreement §§ 3.04, 3.05.)

The Court has reviewed the proposed Notice as well as the notice procedures and finds that they satisfy the requirements of Rule 23(c)(2)(b).

2. Fairness Hearing

Fed. R. Civ. P. 23(e)(2), requires that "[i]f the proposal would bind class members, the court may approve it only after a hearing and on finding that it is fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2). "The purpose of a fairness hearing is to provide the court with sufficient evidence for it to make an informed decision relating to the fairness of the proposed settlement." *UAW v. General Motors Corp.*, 235 F.R.D. 383, 386 (E.D. Mich. 2006). A fairness hearing need not have all the procedures and protections of a full trial; it is a forum for intervenors to voice their objections and for the fairness of the settlement to be determined, and a court is within its discretion to limit the hearing as necessary to meet those objectives. *UAW*, 235 F.R.D. at 386; *Tenn. Ass'n of Health Maint. Org., Inc. v. Grier*, 262 F.3d 559, 567 (6th Cir. 2001).

Here, in their Settlement Agreement, the Parties agree to a framework for Class Members who either wish to opt-out or to object to the proposed Settlement. (Settlement §§ 3.06, 3.08.) Although the Settlement Agreement calls for the Court to limit the time for and method of objections, it is reasonable and in keeping with the purpose of a fairness hearing to do so, and reasonably preserves objectors rights to be heard.

III. CONCLUSION & ORDER

In light of the foregoing, the Court **GRANTS** the Parties' joint motion for preliminary approval of the class action Settlement and hereby **ORDERS** the following:

1. Pursuant to Rule 23 of the Federal Rules of Civil Procedure, the Court hereby conditionally certifies a class for settlement purposes only.
2. The class shall consist of "All persons who, according to Nationstar's reasonably available computerized computer records, had or have Option ARM loans serviced by Nationstar and made payments to Nationstar in any tax year from 2010 – 2018."

3. The Court hereby appoints Michael Pemberton and Sandra Collins Pemberton as Class Representatives.

4. The Court hereby appoints the Law Office of David J. Vendler and Michael R. Brown, APC, as Class Counsel to represent the Class.

5. The Court hereby preliminarily approves the Settlement Agreement and the terms and conditions of Settlement set forth therein, subject to further consideration at a Final Approval Hearing.

6. The Court will hold a Final Approval Hearing on January 13, 2020, at 11:00 a.m., in the Courtroom of the Honorable Cynthia Bashant, United States District Court for the Southern District of California, Courtroom 4B (4th Floor – Edward J. Schwartz United States Courthouse), 221 West Broadway, San Diego, CA 92101, for the following purposes:

   a. Finally determining whether the Class meets all applicable requirements of Rule 23 of the Federal Rules of Civil Procedure and whether the Class should be certified for the purposes of effectuating the Settlement;

   b. Finally determining whether the proposed Settlement of the case on the terms and conditions provided for in the Settlement Agreement is fair, reasonable, and adequate and should be approved and ordered by the Court; and

   c. Ruling upon such other matters as the Court may deem just and appropriate.

7. Before the Fairness Hearing, Defendants shall file with the Clerk of the Court proof of their compliance with the notice provisions of the Class Action Fairness Act of 2005 ("CAFA"), 28 U.S.C. § 1715.

8. In compliance with Fed. R. Civ. P. 23(b)(3), the Class Members will be permitted to exclude themselves from the class.

9. Briefs for the Final Approval Hearing must be filed with the Clerk of the Court no later than 28 days prior to the final approval hearing.

10. The Court may adjourn the Final Approval Hearing and later reconvene such hearing without further notice to the Class Members.

11. Class Members who desire to object to the fairness of the settlement must file written objections with the Clerk of this Court 14 days before the Final Approval Hearing.

12. Class Members must provide a copy of the written objections to the Class Counsel and to counsel for the Defendant Nationstar at the following addresses:

Class Counsel:

Law Office of David J. Vendler
2700 South Oak Knoll Avenue
San Marino, California 91108

Michael R. Brown, APC
2030 Main Street, Suite 550
Irvine, California 92614

Counsel for Defendant Nationstar Mortgage LLC:

Erik Wayne Kemp
John B. Sullivan
Adam Vukovic
Mary Kate Kamka
Severson & Werson, APC
One Embarcadero Center, Suite 2600
San Francisco, California 94111

13. All objections must include the objector's full name, address, and telephone number, along with a statement of the reasons for his or her objection, whether or not he or she intends to appear at the fairness hearing, and, if the objector intends to appear, whether he or she will appear on his or her own behalf or through counsel.

14. All objections must be filed with the Clerk and served on the Parties' counsel no later than the Objection Deadline. Objections that do not

contain all required information or that are received after the Objection Deadline will not be considered at the Final Approval Hearing.

15. Any Class Member who does not file a valid and timely objection to the settlement shall be barred from seeking review of the settlement by appeal or otherwise.

16. Any response by the Plaintiffs to the objections of Class Members must be filed with the Clerk of the Court no later than seven days after the objection deadline.

17. Class Counsel shall file with the Clerk of this Court their application for attorney's fees, costs, and expenses no later than 4 weeks before the final approval hearing, sufficiently in advance of the expiration of the objection period that any Class Member will have sufficient information to decide whether to object and, if applicable, to make an informed objection.

18. The Parties are ordered to carry out the Settlement Agreement in the manner provided in the Settlement Agreement.

IT IS SO ORDERED.

DATED: October 9, 2019

Cynthia Bashant

Hon. Cynthia Bashant
United States District Judge