

# RECENT DEVELOPMENTS

## RESPA UPDATE: HOW HOMEBUILDERS BLOCKED HUD’S RECENT EFFORT TO REFORM RESPA AND REGULATE AFFILIATED BUSINESS ARRANGEMENTS

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## INTRODUCTION

Our nation is in the midst of one of the most devastating financial crises in its history. Fueling this crisis is a housing market decimated by abusive lending practices, rapidly falling home values, alarming foreclosure rates, and diminishing consumer confidence. Appropriately, the most publicized measures considered by the federal government seek to rejuvenate home values, curb foreclosures, and aid mortgages in danger of default. But many argue that enduring change requires more-stringent regulation of the practices that facilitated our current crisis, which necessitates “a thorough review of our regulatory infrastructure, the behavior of regulators and their agencies, and the regulatory philosophy that informed their decisions.”<sup>1</sup> It was this sentiment that recently motivated the Department of Housing and Urban Development (HUD)<sup>2</sup> to revamp the Real Estate Settlement Procedures Act (RESPA),<sup>3</sup> the federal statute that governs residential real estate settlement services and closing costs.<sup>4</sup>

Congress enacted RESPA in 1974 as a response to mounting concern about the rise of settlement costs in the American land conveyancing market.<sup>5</sup> It immediately generated intense criticism and, to this day, remains a hotly contested topic among regulators, consumers, and

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1. CONG. OVERSIGHT PANEL, SPECIAL REPORT ON REGULATORY REFORM: MODERNIZING THE AMERICAN FINANCIAL REGULATORY SYSTEM; RECOMMENDATIONS FOR IMPROVING OVERSIGHT, PROTECTING CONSUMERS, AND ENSURING STABILITY 6 (2009), <http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf> [hereinafter REGULATORY REFORM].

2. The Secretary of the Department of Housing and Urban Development (HUD) is authorized to enforce the Real Estate Settlement Procedures Act (RESPA) and to prescribe rules and regulations as necessary to achieve the Act’s purposes. See 12 U.S.C. § 2617(a) (2006) (empowering the Secretary to administer RESPA); see also § 2602(6) (defining *Secretary* to mean the Secretary of HUD for purposes of RESPA).

3. Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533, 88 Stat. 1724 (1974) (codified as amended at 12 U.S.C. §§ 2601–2617 (2006)).

4. “Settlement services” are provided in connection with any real estate settlement and include title searches and examinations, document preparations, loan originations, property inspections, and services rendered by a real estate broker or attorney. See § 2602(3) (defining *settlement services* for purposes of RESPA).

5. See DEP’T OF HOUS. & URBAN DEV. & VETERANS ADMIN., 92D CONG., MORTGAGE SETTLEMENT COSTS 4 (1972) (confirming that settlement costs were unusually high in various parts of the country and revealing a complex web of referral fees, kickbacks, and commissions designed to incentivize the industry). Compare John C. Payne, *Conveyancing Practice and the Feds: Some Thoughts About RESPA*, 29 ALA. L. REV. 339, 344–50 (1978) (attributing the rise in settlement costs to a gradual transition from the relatively simple land conveyancing methods of the early twentieth century to a much more complicated and institutionalized process dominated by banks, insurance companies, savings and loan institutions, and mortgage companies), with Diana Stopello, *Federal Regulation of Home Mortgage Settlement Costs: RESPA and its Alternatives*, 63 MINN. L. REV. 367, 374 (1979) (crediting the government’s concern for rising settlement costs to its ubiquitous anxiety over mortgage interest rates).

settlement service providers.<sup>6</sup> Over the years, this unwavering public criticism has led Congress and HUD to issue numerous proposals for RESPA amendments and regulations, few of which have actually come to fruition.<sup>7</sup> But regardless of where one stands on RESPA reform most agree that RESPA is, and has always been, incomplete and in need of overhaul.<sup>8</sup> Never has this sentiment been more palpable than today.

In 2008, in the waning months of the Bush presidency, HUD answered the demand for reform.<sup>9</sup> Although the agency's Final Rule implements numerous changes to RESPA, this Recent Development focuses exclusively on one of its more controversial aspects: the definition of *required use* and its impact on the affiliated business arrangement (AfBA). This Recent Development summarizes the arguments of the National Association of Homebuilders (NAHB) and various public commenters that recently caused HUD to withdraw the new definition of required use.<sup>10</sup> Although this Recent Development demonstrates that the required use definition was a legally flawed and inappropriate solution to the problems HUD sought to remedy,<sup>11</sup> it advocates using the definition's strengths and

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6. See Charles G. Field, *RESPA In a Nutshell*, 11 REAL PROP. PROB. & TR. J. 447, 447 (1976) ("To say that RESPA's early days were stormy is to confuse a mild Spring rain with a hurricane of the Fall.").

7. See generally John C. Weicher, *Why Do We Need to Reform RESPA?*, in REGULATORY ISSUES DEBATE: POINT-COUNTERPOINT 5, 5 (2006), [http://www.realtor.org/GAPublic.nsf/files/pointcounterpoint.pdf/\\$FILE/pointcounterpoint.pdf](http://www.realtor.org/GAPublic.nsf/files/pointcounterpoint.pdf/$FILE/pointcounterpoint.pdf) (lamenting that the lack of meaningful RESPA reform measures since 1974 has resulted in an antiquated statute that is years behind a dramatically evolved real estate industry).

8. See generally Eloisa C. Rodriguez-Dod, *RESPA—Questioning Its Effectiveness*, 24 HAMLINE L. REV. 68 (2000) (assessing RESPA's efficacy in actually achieving its original goals and purposes).

9. See Real Estate Settlement Procedures Act (RESPA): Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs, 73 Fed. Reg. 68,204 (Nov. 17, 2008) (to be codified at 24 C.F.R. pts. 203 & 3500) (amending HUD regulations to provide "more timely and effective disclosures related to mortgage settlement costs for federally related mortgage loans to consumers").

10. In response to the National Association of Homebuilders's (NAHB's) lawsuit, HUD twice delayed the effective date of the required use definition. Deferred Applicability Date for the Revised Definition of "Required Use," 74 Fed. Reg. 2369, 2369-70 (Jan. 15, 2009); Further Deferred Applicability Date for the Revised Definition of "Required Use" and Solicitation of Public Comment on Withdrawal of Required Use Provision, 74 Fed. Reg. 10,172, 10,172 (Mar. 10, 2009). Ultimately, overwhelming public concern and a lawsuit brought by the NAHB forced HUD to withdraw the required use definition. See generally Withdrawal of Revised Definition of "Required Use," 74 Fed. Reg. 22,822 (May 15, 2009) (announcing the withdrawal of the required use definition).

11. See OFFICE OF POLICY DEV. & RESEARCH, U.S. DEP'T OF HOUS. & URBAN DEV., REGULATORY IMPACT ANALYSIS & INITIAL REGULATORY FLEXIBILITY ANALYSIS FR-5180-F-02: FINAL RULE TO IMPROVE THE PROCESS OF OBTAINING MORTGAGES AND REDUCE CONSUMER COSTS 3-89 (2008) [hereinafter IMPACT ANALYSIS] (advancing three arguments to support its change of the required use definition: (1) assessing the value of incentives offered by affiliated businesses inhibits effective shopping for loans and other settlement

weaknesses as a springboard for future efforts to reform RESPA and regulate AfBAs.

## I. RESPA AND THE AFFILIATED BUSINESS ARRANGEMENT

### A. *Long-standing and Widespread Usage of the Affiliated Business Arrangement*

The AfBA is neither a new phenomenon nor exclusive to the real estate settlement industry.<sup>12</sup> By regulation, Congress defined an AfBA as a business structure in which a person refers clients to a settlement service provider when such person has an affiliate relationship with the provider or an indirect or direct ownership interest in the provider of more than one percent.<sup>13</sup> For decades market professionals and service providers have entered AfBAs as a means to spread risk, gain entry into new markets, and share in the profits of cooperating service providers.<sup>14</sup> Proponents of AfBAs argue that when structured properly the arrangements stimulate competition, provide homebuyers with greater choice of settlement services, and “lower costs . . . by allowing diversified companies to streamline administrative expenses and offer consumer discounts and rebates on packages of services.”<sup>15</sup>

On the other hand, critics condemn the statutory protection of such

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services; (2) some builders may raise their prices to account for the offered incentive; and (3) as the National Association of Mortgage Brokers argues, builder incentives are inherently anticompetitive).

12. See Howell E. Jackson, *The Trilateral Dilemma in Financial Regulation*, in OVERCOMING THE SAVING SLUMP: HOW TO INCREASE THE EFFECTIVENESS OF FINANCIAL EDUCATION AND SAVING PROGRAMS 82 (Anna Maria Lusardi ed., 2008) (discussing the operation of Affiliated Business Arrangements (AfBAs) in the markets for real estate, pension plans, investment management, students loans, and insurance).

13. See 12 U.S.C. § 2602(7) (2006) (defining *affiliated business arrangement* for purposes of RESPA); see also Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J.L. BUS. & FIN. 289, 312 (2007) (referring to AfBAs as “the trilateral dilemma” and demonstrating how lenders’ payment of yield spread premiums to mortgage brokers exemplifies the AfBA structure).

14. Joseph Kolar et al., *RESPA Review: “Kicking Back” and “Doing the Splits.”* 62 BUS. LAW. 599, 603 (2007).

15. Nat’l Ass’n of Home Builders, Mortgage Lending, <http://www.nahb.org/generic.aspx?genericContentID=79479> (last visited Oct. 7, 2009); see also DONALD L. MARTIN & RICHARD E. LUDWICK, JR., AFFILIATED BUSINESS ARRANGEMENTS AND THEIR EFFECTS ON RESIDENTIAL REAL ESTATE SETTLEMENT COSTS: AN ECONOMIC ANALYSIS 7, 9–10 (2006), [http://www.respro.org/docs/CAP%20RESPRO%20Study%20\(2\).pdf](http://www.respro.org/docs/CAP%20RESPRO%20Study%20(2).pdf) (explaining that AfBAs often produce “economies of scope” that stem from “the provision of multiple services . . . that employ common resources, . . . which would not be otherwise available”).

business arrangements in a variety of markets and contexts.<sup>16</sup> Opponents cite numerous reasons why AfBAs are harmful and should not be promoted through legislation: they cause consumer confusion, increase costs to consumers, encourage price discrimination, distort competition, and unfairly burden small or independent businesses.<sup>17</sup> There is also evidence that AfBAs have recently become more prevalent, which has opponents worried that the problems described herein will soon overwhelm the entire real estate settlement industry unless the federal government acts quickly.<sup>18</sup>

### B. Section 8 of RESPA

Section 8 of RESPA is a fundamental component of the campaign to educate consumers on AfBAs and one of the statute's most litigated provisions. It generally prohibits service providers from giving or accepting "any fee, kickback, or thing of value" in exchange for referring consumers to other service providers.<sup>19</sup> Section 8, however, was not intended to eliminate the consolidation of settlement services by affiliated entities, a fact that Congress unequivocally confirmed in 1983 by codifying an AfBA exception into Section 8's anti-kickback provision.<sup>20</sup> The exemption allows affiliated businesses to benefit from referrals as long as (1) the AfBA is disclosed to the referred borrower, (2) the referred borrower *is not required to use* the affiliated business, and (3) the referring service provider does not offer or accept any kickbacks or referral fees otherwise prohibited by Section 8.<sup>21</sup> The definition of required use, therefore, is of great consequence because it dictates how and when real estate services can be bundled. Aware of this significance, HUD sought to

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16. See Conrad G. Tuohey, *Kickbacks, Rebates and Tying Arrangements in Real Estate Transactions; The Federal Real Estate Settlement Act of 1974; Antitrust and Unfair Practices*, 2 PEPP. L. REV. 309, 310, 349–50 (1975) (expressing pessimism for newly enacted RESPA's ability to regulate harmful affiliated relationships because "[t]hey wield such tremendous political and financial power that, even in those rare instances when they are scrutinized or understood, they nevertheless emerge unscathed").

17. See Withdrawal of Revised Definition of "Required Use," 74 Fed. Reg. 22,822, 22,824–26 (May 15, 2009) (to be codified at 24 C.F.R. pt. 3500) (summarizing the arguments against AfBAs and the withdrawal of the required use definition).

18. See U.S. GOV'T ACCOUNTABILITY OFFICE, ACTIONS NEEDED TO IMPROVE OVERSIGHT OF THE TITLE INDUSTRY AND BETTER PROTECT CONSUMERS 15 (2007) [hereinafter GAO REPORT] (documenting studies that indicate the use of AfBAs has been growing in recent years).

19. 12 U.S.C. § 2607(a) (2006).

20. See S. REP. NO. 93-866, at 3, 6–7 (1974); H.R. REP. NO. 98-123, at 76 (1983) (specifying that in creating the AfBA exemption, Congress did not intend to "change current law which prohibits the payment of unearned fees, kickbacks, or other things of value in return for referrals of settlement service business").

21. 12 U.S.C. § 2607(c).

clarify the phrase in 1992,<sup>22</sup> and in so doing produced the regulations that the Final Rule sought to supplant.

### *C. How the Final Rule Sought to Change RESPA's Treatment of AfBAs*

The Final Rule would have altered the definition of required use in three important ways. First, it would have expanded the applicability of the definition to “persons,” making clear that buyers *and* sellers would be eligible to receive discounts for a legitimate combination of settlement services.<sup>23</sup> Second, the definition would have included economic disincentives *and* incentives that are contingent upon the consumer’s use of a particular settlement service provider.<sup>24</sup> Third, and most importantly, the definition clarified that a *settlement service provider* could offer bona fide discounts and incentives that were tied to a person’s use of an affiliated business.<sup>25</sup> The effect of this revision would have been to disqualify homebuilders and other nonsettlement service providers from offering incentives under the AfBA exemption.<sup>26</sup> Nonetheless, in HUD’s view these changes would encourage service providers to offer, and consumers to shop for, the most cost-effective and advantageous settlement services.<sup>27</sup>

## II. THE ARGUMENTS THAT DEFEATED THE FINAL RULE

HUD’s goals of promoting comparative shopping by consumers and limiting settlement costs were unquestionably warranted and laudable. However, when faced with the NAHB’s lawsuit and significant public disapproval, the following four arguments forced HUD to withdraw its

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22. See Real Estate Settlement Procedures Act (Regulation X), 57 Fed. Reg. 49,600, 49,603 (Nov. 2, 1992) (clarifying “that *bona fide* discounts and certain packaging of settlement services which provide options are not violations of the ‘required use’ provision”).

23. See Real Estate Settlement Procedures Act (RESPA): Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs, 73 Fed. Reg. 68,204, 68,235–36 (Nov. 17, 2008) (implementing this change as a response to comments that sellers should not be precluded from receiving discounts because they are the parties who typically pay the settlement costs in real estate transactions).

24. See *id.* at 68,234 (noting HUD’s belief that economic disincentives can be as problematic as incentives in choosing settlement service providers).

25. See *id.* at 68,239–40 (allowing for such bona fide discounts provided the use of a combination of affiliated entities is optional and the lower price afforded by the combination “is not made up by higher costs elsewhere in the settlement process”).

26. See IMPACT ANALYSIS, *supra* note 11, at 3-91 (admitting that “only lenders and settlement service providers affiliated with builders of new homes could lose from the change in required use”).

27. See *id.* (claiming that the new definition does not eliminate the benefits often associated with AfBAs, but merely limits a builder’s ability to steer consumers from the least expensive services in favor of its affiliate).

required use definition on May 15, 2009.<sup>28</sup>

A. *Inadequate Evidence and an Incorrect Assumption of Consumer Confusion*

HUD claimed that the new definition would eliminate the dilemma that consumers cannot effectively shop for the cheapest settlement services and loan terms when their choices are tainted by complicated and unfavorable AfBAs.<sup>29</sup> The borrower's inability to understand the details and value of incentives, HUD argued, allows builders to capitalize on the confusion and restricts consumer choice.<sup>30</sup> However, recent consumer surveys indicate that HUD misinterpreted consumer aversions for bundled services and exaggerated consumer confusion regarding the value of nonfinancial incentives.<sup>31</sup>

HUD's entire argument about consumer confusion was speculative and predicated on the assumption of consumer ignorance.<sup>32</sup> If HUD was truly concerned about borrowers' ability to calculate the value of certain incentives, then it should have considered a rule that required their value be approximated in a disclosure document such as the Good Faith Estimate (GFE).<sup>33</sup> The fact that *some* consumers are confused about the value of

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28. See Withdrawal of Revised Definition of "Required Use," 74 Fed. Reg. 22,822 (May 15, 2009) (announcing withdrawal of the rule as well as a new rulemaking procedure).

29. IMPACT ANALYSIS, *supra* note 11, at 3-89. Despite HUD's claim that affiliated providers charge consumers higher prices than independent service providers, recent data indicates that the cost of bundled services is often the same as, and in many cases lower than, unaffiliated services. See LEXECON, INC., ECONOMIC STUDY OF TITLE/CLOSING PRICES OF AFFILIATED BUSINESSES 2 (1995) (examining 1,000 real estate transactions in seven states and finding that the prices of title-related services were the same for affiliated and unaffiliated providers); PAUL A. ANTON, ECONOMIC ISSUES RELATING TO THE TITLE INSURANCE INDUSTRY IN MINNESOTA: WOULD FURTHER REGULATION BE HELPFUL? 6-8 (1992), <http://www.savvybroker.com/AntonStudy.pdf> (reporting that prices for title-related services of affiliated providers were slightly lower than those of unaffiliated providers in the Minneapolis-St. Paul area).

30. IMPACT ANALYSIS, *supra* note 11, at 3-89.

31. See HARRIS INTERACTIVE, ONE-STOP SHOPPING CONSUMER PREFERENCES 49-50 (2008), [http://www.realtor.org/diversified\\_re\\_firms/20080501\\_one\\_stop\\_shopping](http://www.realtor.org/diversified_re_firms/20080501_one_stop_shopping) (follow "View Full Survey Findings" hyperlink) (surveying 1,446 homebuyers, of which 96% perceived that bundling makes the home-buying process easier and 93% would consider using a bundled provider); WESTON EDWARDS & ASSOCS., SIGNIFICANT CHANGES FOUND IN THE WAY HOMES ARE BOUGHT AND SOLD 41 (2003) (sampling 1,000 recent homebuyers and reporting that 68% would definitely or were "highly likely" to use a single bundled service provider if given the opportunity).

32. See IMPACT ANALYSIS, *supra* note 11, at 3-89 to -90 (relying on hypothetical situations in which HUD itself assumes a consumer would be confused).

33. The Good Faith Estimate (GFE) is a standard form required by RESPA, which must be provided by a mortgage lender or broker to a customer and includes an itemized list of fees and costs associated with a home loan. See 12 U.S.C. §§ 2603-2605(a) (2006)

incentives did not justify the sweeping prohibition of *all* builder incentives, especially when HUD did not present sufficient evidence that consumer confusion actually exists.<sup>34</sup>

On the other hand, the new definition may actually have restricted consumer choice, thus causing the exact problem that HUD tried to prevent; by prohibiting *all* incentives and discounts, even the genuine ones, consumers would lose the ability to choose those options that have previously proved beneficial. Furthermore, HUD incorrectly assumed that price is the only factor that consumers use to compare service providers.<sup>35</sup> In actuality, consumers base their choice of provider on a plethora of factors such as price, convenience, timelines, reputation, and experience.<sup>36</sup> Any assessment of AfBAs must take into account these nonmonetary benefits.

### *B. The New Required Use Would Have Harmed Consumers and Service Providers*

Contrary to HUD's projected savings, the new definition may have actually increased costs to homebuyers in two ways. First, HUD recognized that "[e]valuating the deal that [consumers] are being offered is a formidable and costly task."<sup>37</sup> Yet confusingly, the prohibition of certain bundled services would mean that consumers would have more deals, terms, and providers to compare. In many circumstances it may be more costly and burdensome for consumers to compare individual services separately—loan terms, housing prices, and settlement costs—than to compare bundles of related services.<sup>38</sup> Second, AfBAs allow providers to

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(directing the creation of and describing a standard settlement form to disclose settlement costs of all federally related mortgages); 24 C.F.R. § 3500.6(a)(1) (2004) (requiring mortgage lenders to deliver a special information booklet to anyone on whose behalf the lender prepares a federally related mortgage loan application).

34. See ANTON, *supra* note 29, at 6–7 (urging that unless proponents of further legislation can document evidence that AfBAs raise prices, downgrade service, or cause abusive practices, “more rigorous enforcement of existing laws would be the preferred remedy”).

35. See Martin & Ludwick, *supra* note 15, at 6 (explaining that the theory that AfBAs raise costs and ultimately disadvantage consumers implicitly assumes that these relationships provide “no tangible benefits that might warrant a higher price”).

36. See HARRIS INTERACTIVE, *supra* note 31, at 55 (reporting that of the many documented advantages of one-stop shopping, 73% of those surveyed identified an increased efficiency and manageability, 73% an enhanced convenience, 73% an ability to prevent “things from falling through the cracks,” and 71% a more cooperative team working to ensure completion of the transaction).

37. IMPACT ANALYSIS, *supra* note 11, at 3-90.

38. See HUD's Proposed RESPA Rule: Hearing Before the Subcomm. on Oversight & Investigations of the H. Comm. on Financial Services, 110th Cong. 285, 290 (2008)



offer discounted services that create efficiencies and in turn lower costs to consumers.<sup>39</sup> The new definition would have actually prevented service providers from enjoying the benefits of affiliated relationships, thereby stifling their ability to pass savings along to consumers.<sup>40</sup>

On the supply side, HUD recognized that the new definition of required use might harm certain entities but claimed that only a small segment of the industry would actually have been affected—only those lenders and service providers affiliated with builders of new homes.<sup>41</sup> In reaching this conclusion, HUD relied on the unsubstantiated assumption “that only large construction companies could afford to have affiliates.”<sup>42</sup> Because new homes represent a small share of total home sales and large builders construct a small percentage of these new homes, HUD claimed that any potential harm would affect a mere 5% of the market.<sup>43</sup> However, a 2006 study by the Joint Center for Housing Studies of Harvard University reported that the nation’s ten largest homebuilders represented 21% of the market for new single-family home sales, a dramatic increase from their 8% share in 1992.<sup>44</sup> With enormous growth in the number of new homes being built and the recent consolidation of the homebuilding industry, HUD likely understated the extent to which the new definition would harm homebuilders. In addition, HUD’s assessment assumed that only large builders use AfBAs, a proposition for which it provided no supporting data.<sup>45</sup> In actuality, any forecast of the detriment to homebuilders must account for the possibility that small builders also use affiliates.

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(testimony of Debra Still, CEO, Pulte Mortgage LLC) (arguing that AfBAs lead to “well-coordinated, efficient transactions,” which prevent mistakes that lead to delayed closings, minimize costs to consumers, and enhance convenience).

39. See Martin & Ludwick, *supra* note 15, at 9 (noting that “consumers may benefit from ‘one stop shopping’ which would include the greater convenience, accountability, and quality assurance of complementary settlement services”).

40. *But see* IMPACT ANALYSIS, *supra* note 11, at 3-90 (acknowledging the benefits of affiliated relationships but arguing that the new definition of required use poses even greater advantages).

41. *Id.* at 3-91.

42. *Id.*

43. *Id.*

44. See WILLIAM APGAR & KERMIT BAKER, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE EVOLVING HOME BUILDING INDUSTRY & IMPLICATIONS FOR CONSUMERS 3 (2006), [http://www.jchs.harvard.edu/publications/industrystudies/w06-2\\_evolution\\_homebuilding\\_industry/w06-2\\_evolution\\_homebuilding\\_industry.pdf](http://www.jchs.harvard.edu/publications/industrystudies/w06-2_evolution_homebuilding_industry/w06-2_evolution_homebuilding_industry.pdf) (finding also that nearly seventeen million new homes have been built in the past decade, and that 1.7 million single family homes in 2005 alone is by far the highest number ever recorded).

45. See IMPACT ANALYSIS, *supra* note 11, at 3-91 (conceding that the predicted consumer savings from the new required use definition are based solely on assumptions because “[i]ndustry data concerning the proportion of builders that have affiliated lender or settlement service providers do not exist”).

C. *The New Definition Addressed Practices Already Prohibited by RESPA*

According to HUD, some builders may compensate for the economic incentives they offer to consumers by “surreptitiously raising other charges beyond the market price,” such as interest rates, home prices, or closing costs.<sup>46</sup> Although such practices are certainly harmful and deserve regulatory attention, they are already prohibited by current RESPA provisions.<sup>47</sup> Nonetheless, HUD believed that because these practices are difficult to monitor and enforce, it would be easier to simply prohibit *all* builder discounts.<sup>48</sup> However, the fact that *some* service providers engage in practices that currently violate RESPA does not warrant a heavy-handed prohibition of all builder incentives, especially those that benefit consumers.

D. *The Final Rule Was “Arbitrary and Capricious” Under the APA*

Under the Administrative Procedure Act (APA), a reviewing court may set aside an agency action that is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”<sup>49</sup> Over the years, courts have identified numerous reasons to invalidate agency actions as arbitrary and capricious.<sup>50</sup> Accordingly, this Recent Development summarizes four reasons, advanced by the NAHB and other commenters, why the Final Rule was arbitrary and capricious.

First, the Final Rule failed to present an adequate supporting basis for its stated rationale. Although the APA’s statement of basis and purpose is by no means an onerous obligation, it does require an agency to examine the relevant data and put forth an adequate explanation of its choice that possesses some connection to the facts.<sup>51</sup> HUD’s Final Rule was so devoid

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46. *Id.* at 3-89.

47. *See id.* (“Such behavior is a violation of the current rule: discounts must be legitimate and not built into the price of the house or the cost of the loan.”).

48. *See id.* (noting the difficulties and costs of enforcement). *But see* Marsha L. Williams, *Update on RESPA*, 60 CONSUMER FIN. L.Q. REP. 138 (2006) (demonstrating significant growth in enforcement activities and settlements pertaining to sham AfBAs).

49. 5 U.S.C. § 706(2)(A) (2006).

50. *See, e.g.*, Fed. Election Comm’n v. Rose, 806 F.2d 1081, 1089 (D.C. Cir. 1986) (interpreting the arbitrary and capricious standard as “a label or conclusion applied to a rich variety of agency conduct, including sensible but legally flawed actions as well as outrageous ones”).

51. *See* Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (requiring a “rational connection between the facts and the choice made by the agency” (quoting Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962))). *But see* Pers. Watercraft Indus. Ass’n v. Dep’t of Commerce, 48 F.3d 540, 545–46 (D.C. Cir. 1995) (upholding an agency regulation even though it provided little actual authority to justify its policy choices).

of factual evidence to support its rationale for the new required use definition that it could hardly have been the product of a reasoned decisionmaking process.<sup>52</sup> The few reasons that HUD did cite were not supported by the rulemaking record and actually contradicted extensive evidence before it.<sup>53</sup>

Second, HUD provided no basis for reversing its own long-standing regulations and policies in accordance with the APA. Courts recognize that an agency's interpretation of what is in the public interest may change, and thus simply require that an agency supply a reasoned analysis when it changes course.<sup>54</sup> The new definition of required use represented a drastic shift of sixteen years of HUD's own policy, and its reliance on unsubstantiated assumptions and "flimsy anecdotal evidence" indicates that the Final Rule was not the product of "reasoned decisionmaking."<sup>55</sup>

Third, the Final Rule failed to address significant alternatives and public comments.<sup>56</sup> HUD briefly summarized some of the proposed alternatives offered before and during the comment period but altogether ignored at least two significant ones. Public commenters explained at length the current rule's benefit to builders and consumers, as well as the damaging consequences that the new definition of required use would have for the entire industry. HUD's failure to consider less-restrictive alternatives and to address public comments frustrates the purpose of notice-and-comment rulemaking under the APA and further demonstrates that the Final Rule was not the product of a reasoned decisionmaking process.<sup>57</sup>

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52. *See Nat'l Wildlife Fed'n v. Fed. Energy Regulatory Comm'n*, 801 F.2d 1505, 1512 (9th Cir. 1986) (invalidating a rule on the grounds that the agency completely ignored extensive, contrary evidence and failed to explain its rejection of viable alternatives).

53. *See supra* Part IIA-B.

54. *See Greater Boston Tel. Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) ("[I]f an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute.").

55. *Penobscot Indian Nation v. U.S. Dep't of Hous. & Urban Dev.*, 539 F. Supp. 2d 40, 52 (D.D.C. 2008) (internal quotation marks omitted).

56. Agencies need not address every conceivable alternative or comment, only significant ones. *See Pub. Citizen, Inc. v. FAA*, 988 F.2d 186, 197 (D.C. Cir. 1993) (upholding FAA's rule on the grounds that it adequately addressed those public comments that warranted review and was justified in ignoring those that merely stated "that the agency's premises or conclusions are wrong"); *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1169-70 (D.C. Cir. 1987) (describing a significant alternative as one that does not merely suggest minor improvements to the current regulatory scheme but instead represents an "altogether different methodological approach").

57. *See Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001) ("Unless the Commission answers objections that on their face seem legitimate, its decisions can hardly be classified as reasoned."); *Nehemiah Corp. of Am. v. Jackson*, 546 F. Supp. 2d 830, 847 (E.D. Cal. 2008) ("Allowing the public to submit comments to an agency that has already made its decision is no different from prohibiting comments altogether.").

Fourth, the Final Rule treated similar parties unevenly. While judicial review of agency actions is narrow in scope, agencies must regulate competitors within the same industry in a fair and evenhanded manner.<sup>58</sup> HUD claimed that the new required use definition was necessary to prevent builder practices that were unfavorable to consumers, yet it provided no evidence that the alleged detrimental conduct is exclusive to homebuilders or that this harm even exists at all. Such treatment was neither justified nor commensurate with the requirements of the APA.<sup>59</sup>

### III. LOOKING FORWARD: A WORKABLE FRAMEWORK

Any future attempt at RESPA reform must make more of an effort to comport with the APA's procedural framework. First and most importantly, HUD must introduce concrete empirical data to support any future changes to RESPA.<sup>60</sup> More specifically, HUD must demonstrate that AfBAs are harmful and that any change to the definition of required use would provide a measurable benefit to consumers.<sup>61</sup> Doing so will ensure that any reform measure is in the public interest and will be able to withstand judicial review.

Second, HUD must ensure symmetrical treatment of service providers; the overriding principle of fairness dictates that in all contexts "the government must govern with an even hand."<sup>62</sup> Singling out any one provider subjects the provision to immediate scrutiny and increases the

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58. See *United States v. Diapulse Corp.*, 748 F.2d 56, 62 (2d Cir. 1984) (conceiving the disparate treatment of similarly situated parties as contrary to law and grounds for invalidation).

59. See, e.g., *Marco Sales Co. v. FTC*, 453 F.2d 1, 7 (2d Cir. 1971) (insisting an agency may not "grant to one person the right to do that which it denies to another similarly situated").

60. See, e.g., BUREAU OF CONSUMER PROTECTION, BUREAU OF ECONOMICS & OFFICE OF POLICY PLANNING OF THE FTC, COMMENTS TO THE DEP'T OF HOUS. & URBAN DEV. ON PROPOSED AMENDMENTS TO THE REGULATIONS IMPLEMENTING THE REAL ESTATE SETTLEMENT PROCEDURES ACT 30 (2008), <http://www.ftc.gov/be/v030001.pdf> ("Absent clear evidence of probable harm from bundling related services, FTC staff believes that HUD should reconsider the proposed change because bundling can improve efficiency and save consumers money.").

61. See *Jackson*, *supra* note 12, at 110 (concluding that because the economic impact of side payments in AfBAs is equivocal and dependent on numerous factors, only careful empirical investigations will resolve these issues in the future).

62. See *Ger-Ro-Mar, Inc. v. FTC*, 518 F.2d 33, 35 (2d Cir. 1975) (prohibiting the government from giving "its blessings to [petitioner's] competitors while condemning [petitioner]"); *United States v. Undetermined Quantities of an Article of Drug Labeled as "Exachol"*, 716 F. Supp. 787, 795 (S.D.N.Y. 1989) (applying this principle to Food and Drug Administration's warning letter to a drug manufacturer and criticizing its uneven regulatory policy).

chance that the rule will be invalidated.<sup>63</sup> The Final Rule's definition of required use exemplified this detrimental lack of symmetry because it disproportionately burdened homebuilders and other nonsettlement service providers.

Third, HUD must ensure that any future changes to RESPA promote healthy competition among service providers; competition benefits consumers by keeping prices low and the quality and choice of services high.<sup>64</sup> Yet any attempt to maximize competition in the real estate market must harmonize supply-side competition and demand-side consumer protections.<sup>65</sup> In future RESPA reform efforts, HUD must demonstrate that its actions are necessary to prevent consumer harm, are tailored to minimize any anticompetitive impact, and stem from a comprehensive analysis of real estate settlement practices and market forces.

Lastly, any attempt at RESPA reform must coordinate with state laws<sup>66</sup> and align with other federal statutes that govern mortgage lending and residential real estate transactions.<sup>67</sup> Counterbalancing these statutes could simplify the home-buying process for consumers and assure that service providers are not subject to overlapping or potentially conflicting requirements.

#### CONCLUSION

In the years leading up to RESPA's enactment in 1974, dire economic

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63. See DEP'T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 81 (2008) ("Federal mortgage lending laws should ensure adequate consumer protection for *all* types of mortgage originators.") (emphasis added); REN S. ESSENE & WILLIAM APGAR, UNDERSTANDING MORTGAGE MARKET BEHAVIOR: CREATING GOOD MORTGAGE OPTIONS FOR ALL AMERICANS, at vi (2007) ("Regulators need to create clear guidance and fair rules of the game that are applied equally across the marketplace.").

64. See FTC, COMPETITION COUNTS: HOW CONSUMERS WIN WHEN BUSINESSES COMPETE 2 (2008), <http://www.ftc.gov/bc/edu/pubs/consumer/general/zgen01.pdf> (underscoring the importance of competition as what "makes our economy work" by providing consumers with choices in price, selection, and service).

65. See ORG. FOR ECON. CO-OPERATION & DEV., GLOBAL FORUM ON COMPETITION: THE INTERFACE BETWEEN COMPETITION AND CONSUMER POLICIES 230 (2008) (warning that failure to examine or the devaluation of these interwoven forces could produce a law that excludes low-cost service providers without actually preventing consumer harm or providing any countervailing benefits).

66. See GAO REPORT, *supra* note 18, at 48–49 (cautioning that without greater coordination among the various state regulators, many RESPA violations will "go undiscovered and uncorrected").

67. This is not only a generally prudent practice but also a requirement of the Administrative Procedure Act. See, e.g., *Zabel v. Tabb*, 430 F.2d 199, 209 (5th Cir. 1970) (requiring agencies to heed other relevant statutory policies when executing their own statutory responsibilities).

conditions and an imminent housing crisis had the government frantically trying to stave off a recession. In the face of overwhelming political and public pressure to act, Congress passed RESPA to address problems that it believed were contributing to the crisis, namely rising settlement costs and abusive settlement practices. Two years after its enactment, one of its many critics wrote that RESPA was actually “the result of an instinctive need to get something done, anything done, that would bear the stamp of political good faith without too greatly endangering a going system.”<sup>68</sup>

More than thirty years later, a battered housing market again calls for prompt action. Although the multidimensional nature of the current crisis demands expansive legislation across a wide variety of markets, RESPA reform could be a significant component of any effort to restore transparency, competition, and consumer confidence to the housing industry. However, HUD cannot act rashly without taking the time to ensure that any new regulations are grounded in well-documented, concrete evidence and not in dramatized stories and speculation.<sup>69</sup>

In withdrawing the required use definition, HUD claims to have embraced its opportunity “to reconsider all of the issues involved in the application of the required use concept and to better craft requirements and limitations that address the valid concerns raised in the preceding rulemaking.”<sup>70</sup> In so doing, HUD should consider this Recent Development’s recommendations, which will allow it to modernize RESPA while ensuring that AfBAs operate in a manner that provides consumers and service providers with the greatest benefit.

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68. Payne, *supra* note 5, at 364.

69. Cf. REGULATORY REFORM, *supra* note 1, at 21 (underscoring the critical role government will play in restoring the nation’s economy, “not in replacing financial markets or overwhelming them with rules, but in bolstering financial markets through judicious regulation” premised on “principles of sound risk management, transparency, and fairness”).

70. Withdrawal of Revised Definition of “Required Use,” 74 Fed. Reg. 22,822, 22,826 (May 15, 2009).