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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

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GUILLERMO NAVA, On Behalf Of
Himself And All Others
Similarly Situated,

No. 2:08-CV-00069-FCD-KJM

Plaintiff,

v.

MEMORANDUM AND ORDER

VIRTUALBANK, LYDIAN TRUST
COMPANY, LYDIAN PRIVATE BANK,
AND DOES 1-10,

Defendants.

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This matter is before the court on defendants' VirtualBank,
Lydian Trust Company and Lydian Private Bank's ("defendants")
partial motion to dismiss the complaint of plaintiff Guillermo
Nava ("plaintiff") for failure to state a claim upon which relief
can be granted, pursuant to Federal Rule of Civil Procedure
12(b)(6). After considering the memoranda filed by the parties,

1 and for the reasons stated herein,¹ defendants' partial motion to
2 dismiss is GRANTED in part and DENIED in part.

3 **BACKGROUND**

4 On October 25, 2006, plaintiff entered into a loan agreement
5 with defendants to refinance his existing home loan. (Pl.'s
6 Compl., filed January 11, 2008, ¶ 5.) The type of loan
7 defendants sold to plaintiff is known as an adjustable-rate
8 mortgage.² (Id.) The terms of the agreement are set forth in a
9 document titled "MTA CHOICE ADJUSTABLE RATE NOTE" ("the Note").
10 (Id. at Ex. 1.)

11 The Note provided that the initial interest rate on the loan
12 would be 1.5 percent. (Id. at Ex. 1.) The Note further provided
13 that, beginning on December 1, 2006, this rate "may" change each
14 month at a calculated rate. (Id.) Actual monthly payments,
15 however, would change on a yearly basis, with the first increase
16 to take place no sooner than December 1, 2007. (Id.) The terms
17 of the loan also included a prepayment penalty. (Id. ¶ 25.)

18 Attached to the Note was a disclosure statement that
19 included a payment schedule purporting to set forth the exact
20 monthly payment obligations that would be necessary to pay off
21 all principal and interest during the term of the loan. (Id. ¶
22 121.) The payment schedule indicated that the monthly payments
23 during the first three to five years, which were based on the 1.5

24
25 ¹ Because oral argument will not be of material
26 assistance, the court orders this matter submitted on the briefs.
E.D. Cal. L.R. 78-230(h).

27 ² "A mortgage in which the lender can periodically adjust
28 the mortgage's interest rate in accordance with fluctuations in
some external market index." Black's Law Dictionary (8th ed.
2004).

1 percent "teaser" rate, were to remain the same. (Id. ¶ 20.)
2 The disclosure statement also provided that "the loan contains a
3 variable-rate feature." (Id.)

4 Although the Note states that the initial teaser interest
5 rate "may" increase beginning on December 1, 2006, plaintiff
6 alleges that defendants "immediately and significantly" increased
7 the teaser rate. (Id. ¶ 20.) Plaintiff also alleges that if a
8 borrower adheres to the payment schedule in the disclosure
9 statement after the teaser rate is increased, the loan will
10 result in negative amortization³ and loss of equity since the
11 monthly payments would be less than the amount of interest that
12 had accrued on the borrowed amount. (Id.)

13 Plaintiff alleges that he did not receive the benefit of the
14 loan rate he was initially promised and will not be able to
15 secure a new loan for up to three years because of the prepayment
16 penalty. (Id. ¶¶ 20, 25.) Accordingly, on January 11, 2008,
17 plaintiff brought this action against defendants and asserted
18 claims for 1) violation of Truth in Lending Laws ("TILA"), 15
19 U.S.C. § 1601, *et seq*; 2) violation of California's Unfair
20 Competition Laws, California Business and Professions Code §
21 17200, *et seq* ("UCL"), predicated on violations of TILA; 3)
22 violation of the UCL based on unfair or fraudulent business acts
23 or practices; 4) fraudulent omission; 5) breach of contract; 6)
24 breach of implied covenant of good faith and fair dealing; and 7)

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26

27 ³ "An increase in a loan's principal balance caused by
28 monthly payments insufficient to pay accruing interest." Black's
Law Dictionary (8th ed. 2004).

1 violation of the UCL predicated on violations of California
2 Financial Code § 22302.

3 **STANDARD**

4 On a motion to dismiss, the allegations of the complaint
5 must be accepted as true. Cruz v. Beto, 405 U.S. 319, 322
6 (1972). The court is bound to give plaintiff the benefit of
7 every reasonable inference to be drawn from the "well-pleaded"
8 allegations of the complaint. Retail Clerks Int'l Ass'n v.
9 Schermerhorn, 373 U.S. 746, 753 n.6 (1963). Thus, the plaintiff
10 need not necessarily plead a particular fact if that fact is a
11 reasonable inference from facts properly alleged. See id.

12 Nevertheless, it is inappropriate to assume that the
13 plaintiff "can prove facts which it has not alleged or that the
14 defendants have violated the . . . laws in ways that have not
15 been alleged." Associated Gen. Contractors of Calif., Inc. v.
16 Calif. State Council of Carpenters, 459 U.S. 519, 526 (1983).
17 Moreover, the court "need not assume the truth of legal
18 conclusions cast in the form of factual allegations." United
19 States ex rel. Chunie v. Ringrose, 788 F.2d 638, 643 n.2 (9th
20 Cir. 1986).

21 Ultimately, the court may not dismiss a complaint in which
22 the plaintiff has alleged "enough facts to state a claim to
23 relief that is plausible on its face." Bell Atlantic Corp. v.
24 Twombly, 127 S.Ct. 1955, 1974 (2007). Only where a plaintiff has
25 not "nudged [his or her] claims across the line from conceivable
26 to plausible," is the complaint properly dismissed. Id. "[A]
27 court may dismiss a complaint only if it is clear that no relief
28 could be granted under any set of facts that could be proved

1 consistent with the allegations." Swierkiewicz v. Sorema N.A.,
2 534 U.S. 506, 514 (2002) (quoting Hudson v. King & Spalding, 467
3 U.S. 69, 73 (1984)).

4 **ANALYSIS**

5 Defendants seek to dismiss at least some portion of each of
6 the seven claims brought by plaintiff. First, defendants contend
7 that the civil damages portion of plaintiff's claim⁴ for
8 violation of TILA should be dismissed because it is time barred.
9 Second, defendants seek to dismiss all of plaintiff's remaining
10 claims, which were all brought under state law, on the ground
11 that they are preempted by federal law. Defendants also seek to
12 dismiss plaintiff's claims for breach of contract and breach of
13 the implied covenant of good faith and fair dealing for failing
14 to state a claim upon which relief can be granted. Finally,
15 defendants seek to dismiss all claims brought against defendants
16 Lydian Trust Company and Virtual Bank.

17 **A. Violation of TILA**

18 Defendants first argues that the civil damages portion of
19 plaintiff's TILA violation claim is time barred. (Defs.' P. & A.
20 in Supp. of MTD ("MTD"), April 3, 2008, 5:23.) Plaintiff argues
21 that the statutory period has not expired based on the continuing
22 violation doctrine and equitable tolling. (Pl.'s Opp'n to MTD
23 ("Opp'n"), filed May 8, 2008, 13:23-14:20.)

24 TILA provides that a plaintiff can bring an action to
25 recover damages "within one year from the date of the occurrence
26 of the violation." 15 U.S.C. § 1640(e). The Ninth Circuit has

27 ⁴ Plaintiff also seeks to rescind the loan agreement
28 pursuant to TILA. (Pl.'s Compl. ¶ 76.)

1 expressly rejected the continuing violation theory as applied to
2 claims for damages brought under TILA, stating that the theory is
3 "unrealistically open ended" and "exposes the lender to a
4 prolonged and unforeseeable liability that Congress did not
5 intend." King v. State of California, 784 F.2d 910, 914 (9th
6 Cir. 1986).⁵

7 In King, however, the Ninth Circuit also held that equitable
8 tolling of civil damages claims brought under TILA might be
9 appropriate "in certain circumstances." Id. at 915. In King,
10 the court noted that a borrower may not have a reasonable
11 opportunity within one year to discover the fraud or
12 nondisclosures that form the basis of a TILA action. Id.
13 Moreover, the King court noted that, through TILA, Congress
14 "sought to protect consumer's choice through full disclosure and
15 to guard against the divergent and at times fraudulent practices
16 stemming from uninformed use of credit." Id. Accordingly, the
17 Ninth Circuit explained that "district courts . . . can evaluate
18 specific claims of fraudulent concealment and equitable tolling
19 to determine if the general rule would be unjust or frustrate the
20 purpose of the Act and adjust the limitations period
21 accordingly." Id.

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24 ⁵ Plaintiff attempts to circumvent King's rejection of
25 the continuing violation doctrine by citing to the Supreme
26 Court's application of the continuing violation doctrine in
27 Havens v Realty Corp. v. Coleman, 455 U.S. 363 (1982). Havens,
28 however, involved violations of the Fair Housing Act based on
"racial steering," not TILA violations based on improper
disclosures. Havens, 455 U.S. at 366. Moreover, plaintiff has
not cited to any cases adopting the continuing violation theory
for claims brought under TILA after Havens.

1 When determining whether the statute of limitations has run
2 on a motion to dismiss, a court can only grant the motion "if the
3 assertions of the complaint, read with the required liberality,
4 would not permit the plaintiff to prove that the statute was
5 tolled." Supermail Cargo, Inc. v. U.S., 68 F.3d 1204, 1206 (9th
6 Cir. 1995). The applicability of equitable tolling often depends
7 on matters outside the pleadings. Id. (citing Cervantes v. City
8 of San Diego, 5 F.3d 1273, 1276 (9th Cir. 1993)). As such, it
9 "is not generally amenable to resolution on a Rule 12(b)(6)
10 motion." Id.

11 In this case, defendants contend, and plaintiff does not
12 dispute, that the alleged TILA violations occurred no later than
13 October 25, 2006, the date plaintiff entered into the loan
14 agreement with defendants. (MTD 6:2-3.) Accordingly, since
15 plaintiff did not bring his claim until January 11, 2008, more
16 than one year has passed since the alleged TILA violation.

17 However, plaintiff has sufficiently alleged that equitable
18 tolling may apply to his TILA violation claim. Plaintiff's
19 allegations are primarily based on defendants' alleged failure to
20 clearly and conspicuously disclose various terms of the loan.
21 (Pl.'s Compl. ¶¶ 63-74.) By their nature, these allegations make
22 it plausible that defendants could not have discovered the TILA
23 violations within one year, even through the use of due
24 diligence. This situation could result in unjust enforcement of
25 the statutory period. As the Ninth Circuit directed in King,
26 further factual findings will be necessary to determine whether
27 or not equitable tolling is proper. Therefore, defendants'

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1 motion to dismiss plaintiff's claim for civil damages based on
2 violation of TILA is denied.

3 **B. UCL Claims**

4 Defendants next contend that plaintiff's UCL claims are
5 preempted by the Home Owners' Loan Act of 1933 ("HOLA").
6 Plaintiff asserts that his state law claims are exempt from
7 preemption.

8 The UCL forbids acts of unfair competition, which includes
9 "any unlawful, unfair or fraudulent business act or practice."
10 Cal. Bus. & Prof. Code § 17200. "The UCL is broad in scope,
11 embracing anything that can properly be called a business
12 practice and that at the same time is forbidden by law." People
13 ex rel. Gallegos v. Pacific Lumber Co., 158 Cal. App. 4th 950,
14 959 (2008) (internal citations omitted).

15 HOLA was enacted in 1933 in order to "restore public
16 confidence by creating a *nationwide system* of federal savings and
17 loan associations to be centrally regulated according to
18 *nationwide best practices.*" Silvas v. E*Trade Mortg. Corp., 514
19 F.3d 1001, 1004 (9th Cir. 2008) (citing Fid. Fed. Sav. & Loan
20 Ass'n v. de la Cuesta, 458 U.S. 141, 160-161 (1982)) (emphasis
21 added). Congress' intent in enacting HOLA was "to charter
22 savings associations under federal law" because, at the time,
23 "record numbers of home loans were in default and a staggering
24 number of state-chartered savings associations were insolvent."
25 Id. (citing Bank of Am. v. City and County of S.F., 309 F.3d 551,
26 559 (9th Cir. 2002)).

27 Through HOLA, Congress gave the Office of Thrift Supervision
28 ("OTS") authority to issue regulations governing thrifts. Id.;

1 12 U.S.C. § 1464. With this authority, the OTS promulgated 12
2 C.F.R. § 560.2, a preemption regulation⁶, with the purpose of
3 occupying the "*entire field* of lending regulation for federal
4 savings associations." 12 C.F.R. § 560.2(a) (emphasis added).
5 Through the preemption regulation, the OTS sought to "enhance
6 safety and soundness and to enable federal savings associations
7 to conduct their operations in accordance with best practices."
8 Id. Additionally, the regulation was intended to "give federal
9 savings associations maximum flexibility to exercise their
10 lending powers in accordance with a *uniform federal scheme of*
11 *regulation.*" Id. (emphasis added).

12 Section 560.2(b) provides a list of "illustrative examples"
13 of the types of state laws that are preempted. This includes
14 state laws purporting to impose requirements regarding:

15 "(4) The terms of credit, including amortization of loans
16 and the deferral and capitalization of interest and
17 adjustments to the interest rate, balance, payments due, or
18 term to maturity of the loan, including the circumstances
19 under which a loan may be called due and payable upon the
20 passage of time or a specified event external to the loan;

21 (5) Loan-related fees, including without limitation, initial
22 charges, late charges, prepayment penalties, servicing fees,
23 and overlit fees;

24 . . .

25 (9) Disclosure and advertising, including laws requiring
26 specific statements, information, or other content to be
27 included in credit application forms, credit solicitations,
28 billing statements, credit contracts, or other
credit-related documents and laws requiring creditors to
supply copies of credit reports to borrowers or applicants

. . ."

12 C.F.R. § 560.2(b)

⁶ Federal regulations have no less preemptive effect than federal statutes. de la Cuesta, 458 U.S. at 153.

1 Lastly, § 560.2(c) provides a list of state laws that are
2 not preempted "to the extent they only incidentally affect . . .
3 lending operations . . . or are otherwise consistent with the
4 purposes of paragraph (a) of this section." 12 C.F.R. §
5 560.2(c). These laws include contract and commercial law, real
6 property law and tort law. Id.

7 The OTS has outlined an analysis, which has been adopted by
8 the Ninth Circuit, to determine whether a specific state law is
9 preempted under § 560.2. Silvas, 514 F.3d at 1005. The first
10 inquiry of this analysis is "whether the type of law in question
11 is listed in paragraph (b)." Id.; OTS Opinion Letter at 11 (March
12 10, 1999). If the type of law in question is listed in paragraph
13 (b), "the analysis will end there; the law is preempted." Id.
14 If the law is not covered by paragraph (b), the next question is
15 whether the law affects lending. Id. If the law does affect
16 lending, there is a presumption that the law is preempted. Id.
17 "This presumption can be reversed only if the law can clearly be
18 shown to fit within the confines of paragraph (c)." Id.
19 Paragraph (c) is to be interpreted narrowly, with any doubt
20 resolved in favor of preemption. Id.

21 In Silvas, the Ninth Circuit applied this analysis and held
22 that two claims brought under the UCL challenging a lock-in fee
23 relating to a loan were preempted. Id. at 1006. The first claim
24 was brought under the false advertising section of the UCL and
25 alleged that a false statement regarding the lock-in fee was made
26 on the defendants' website and customer disclosures. Id. at
27 1003. The second claim also challenged the lock-in fee but was
28 brought under the unfair competition section of the UCL. Id.

1 The court held that, as applied, the plaintiff's UCL claims
2 implicated both § 560.2(b)(5) and § 560.2(b)(9) since a lock-in
3 fee is a loan-related fee, and because the claims were based on
4 defendants' disclosure and advertising practices. Id. at 1006.
5 Accordingly, both claims were preempted. Id.

6 In this case, three of plaintiff's seven claims are founded
7 upon alleged violations of the UCL: the first is based on
8 violations of TILA, the second is based on "unfair" or
9 "fraudulent" business acts or practices, and the third is based
10 on violations of California Financial Code § 22302. (Pl.'s
11 Compl. ¶¶ 18, 20, 28.)

12 **1. UCL claim based on unfair or fraudulent business acts**
13 **or practices.**

14 Plaintiff alleges that defendants violated the UCL through
15 the use of "unfair" or "fraudulent" business acts or practices.
16 This claim arises out of defendants' alleged failure to disclose,
17 inter alia, that negative amortization would occur and that
18 plaintiff's interest rates would increase substantially after 30
19 days. (Pl.'s Compl. ¶¶ 95, 96.)

20 Plaintiff's claim fits within § 560.2(b)(9) since the claim
21 involves whether disclosure of certain terms of credit was
22 proper. These disclosures were made in the Note itself, which is
23 both a credit contract and a credit-related document as described
24 in § 560.2(b)(9). Any decision in plaintiff's favor would place
25 substantive requirements on defendants regarding the disclosures
26 to be included in credit contracts and other credit-related
27 documents. Such substantive state law requirements would
28 directly contradict the letter and purpose of HOLA and § 560.2.

1 See Prince-Servance v. BankUnited, FSB, No. 07 C 1259, 2007 WL
2 3254432 at *5 (N.D. Ill. 2007) (stating that "hodgepodge of state
3 regulations is exactly what OTS was attempting to prevent through
4 preemption").

5 The facts in this case are analogous to the facts that were
6 before the Ninth Circuit in Silvas. In Silvas, the court held
7 that the plaintiffs' claim for unfair business practices was
8 preempted because the alleged violation was based on
9 misrepresentation of the lock-in fee in advertising and
10 disclosure documents. Silvas, 514 F.2d at 1006. In this case,
11 defendant's alleged violation is also based upon improper
12 disclosures that relate to the terms of credit in the Note. As
13 such, in both Silvas and in this case, plaintiff is attacking
14 disclosures falling within the purview of § 560.2(b)(9).
15 Therefore, as in Silvas, plaintiffs UCL claim for fraudulent or
16 unfair business practices or acts is preempted.⁷

17 Plaintiff contends that his UCL claim is not preempted
18 because it arises from a state law of "general application".
19 (Opp'n 3:16-19.) Plaintiff relies primarily upon the Central
20 District of California's opinion in Reyes v. Downey Savings and
21 Loan Ass'n, which held that a UCL claim based on unfair or
22 fraudulent business practices, founded on facts very similar to
23 the facts here, was *not* preempted by HOLA. Reyes v. Downey
24 Savings and Loan Ass'n, F.A., 541 F. Supp. 2d 1108, 1114 (C.D.
25 Cal. 2008). The court in Reyes stated that none of the types of
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27 ⁷ To the extent plaintiff claims that the terms of credit
28 themselves are unfair, such claims fit squarely within the terms
§ 560.2(b)(4). See infra, Part B.3.

1 laws listed in § 560.2(b) were implicated by the UCL claim.
2 Reyes, 541 F. Supp. 2d at 1114. The court reasoned that the §
3 560.2(b) laws "are examples of very specific laws, narrowly
4 tailored to the lending industry." Id. The court also stated
5 that the plaintiffs sought "to use the UCL to apply general
6 principles of contract law" and that "application of these
7 principles would require no affirmative action or type of
8 representation by a lending institution." Id. at 1115.

9 However, in Silvas, the Ninth Circuit did not base its
10 holding on whether the UCL was being used to apply general
11 principles of a law or whether application of the UCL would
12 require affirmative action or representation by the defendants.
13 Instead, the court in Silvas concluded that the plaintiffs' UCL
14 claims, as applied, were preempted because they were based on a
15 loan-related fee, as well as the disclosure and advertising of
16 the loan-related fee. Silvas, 514 F.2d at 1006. Accordingly,
17 this court declines to follow the rationale set forth in Reyes
18 regarding preemption of UCL claims based upon unfair or
19 fraudulent business acts or practices.⁸

20 In a similar circumstance, the Northern District of Illinois
21 determined that claims brought under Illinois' unfair competition

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23 ⁸ This court also declines to follow Mandrigues v. World
24 Savings, Inc., where the court held that UCL claims similar to
25 plaintiff's claim here were not preempted. Mandrigues v. World
26 Savings, Inc., No. C 07-04497 JF, 2008 WL 1701948, at *3 (N.D.
27 Cal. 2008). In its analysis, the court in Mandrigues never
28 discussed whether any of the types of laws listed in paragraph
(b) were implicated. Id. at *2-3. Instead, the court determined
preemption was not proper based on an analysis of paragraph (c).
Id. By doing so, the court did not apply the analysis proffered
by the Ninth Circuit in Silvas, which provides that "the first
step will be to determine whether the type of law in question is
listed in paragraph (b)." Silvas, 514 F.3d at 1005.

1 statue challenging a loan-related fee and its disclosure were
2 preempted by HOLA. Prince-Servance, 2007 WL 3254432 at *5. In
3 Prince-Servance, the plaintiff argued that § 560.2 only preempted
4 laws specifically intended to regulate lending activity of a
5 federal savings association. Id. The court disagreed, stating
6 that the plaintiff presented the issue "too broadly. Id.
7 Rather, the court held that "[i]t is clear from the language of
8 [§ 560.2] and subsequent caselaw that to the extent a generally
9 applicable law interferes with a federal savings association's
10 lending activity it is preempted." Id.

11 Based on the Ninth Circuit's ruling in Silvas and the effect
12 that application of the UCL will have on defendants' lending
13 practices, plaintiff's claim in this case for violation of the
14 UCL based on unfair or fraudulent business acts or practices is
15 preempted by HOLA. Therefore, defendant's motion to dismiss
16 plaintiff's claim for violation of the UCL for unfair or
17 fraudulent business acts or practices is GRANTED.

18 **2. UCL claim based on violation of TILA**

19 Plaintiff has also alleged a UCL violation by defendants
20 based on defendants' violation of TILA. Plaintiff's claim for
21 violation of TILA is primarily based on a failure to properly
22 disclose and represent the true interest rate of the loan and
23 that negative amortization was certain to occur, as required by
24 TILA. (Pl.'s Compl. ¶¶ 63-74.) Plaintiff's UCL claim based on
25 violation of TILA incorporates these same alleged violations.
26 (Id. ¶ 77.)

27 Similar to plaintiff's UCL claim based on unfair or
28 fraudulent business acts or practices, this claim also implicates

1 § 560.2(b)(9) since its application would purport to impose
2 requirements on the types of disclosures made by defendants.
3 Accordingly, for the same reason that plaintiff's UCL claim based
4 on unfair or fraudulent business practices is preempted by
5 federal law, plaintiff's UCL claim based on violation of TILA is
6 also preempted.

7 Moreover, plaintiff's UCL claim based on violation of TILA
8 is also preempted by federal law since its application would
9 supplement TILA by changing TILA's framework. "When federal law
10 preempts a field, it leaves 'no room for the States to supplement
11 it.'" Silvas, 514 F.3d at 1007 n.3 (citing Rice v. Santa Fe
12 Elevator Corp., 331 U.S. 218, 230 (1947)). "When an entire field
13 is preempted, a state may not add a damages remedy unavailable
14 under the federal law." Id. (citing Pub. Util. Dist. No. 1 of
15 Grays Harbor County Washington v. IDA-CORP, Inc., 379 F.2d 641,
16 648-49 (9th Cir. 2004)). Furthermore, "[a]n attempt by
17 Appellants to go outside the congressionally enacted limitation
18 period of TILA is an attempt to enforce a state regulation in an
19 area expressly preempted by federal law." Id.⁹

20 By predicating a UCL claim on a violation of TILA, plaintiff
21 is attempting to alter both the damages available under TILA and
22 the statute of limitations period for civil damages under TILA.
23 Compare 15 U.S.C. § 1640 (in class actions, damages limited to
24 \$500,000 or one percent of the net worth of the creditor; one
25 year statute of limitations for civil damages) with Cal. Bus and
26 Prof. Code §§ 17203, 17204, 17206, 17206.1, 17207, 17208

27
28 ⁹ While the Silvas court's discussion of the issue is dicta, the court, nevertheless, finds it persuasive.

1 (defendants subject to injunction, payment of restitution and
2 civil penalties; four year statute of limitations). Since
3 plaintiff is using state law to supplement TILA though his UCL
4 claim, the claim is preempted. See Reyes, 541 F. Supp. at 1115
5 (UCL claim predicated on violations of TILA preempted by federal
6 law). Therefore, defendants' motion to dismiss plaintiff's UCL
7 claim predicated on violation of TILA is GRANTED.

8 **3. UCL claim based on violation of California Financial**
9 **Code § 22302**

10 Plaintiff's final UCL claim alleges that defendant violated
11 the UCL by violating California Financial Code § 22302. As with
12 the other two UCL claims, defendant contends that this UCL claim
13 is preempted by HOLA. Plaintiff does not address this argument
14 in his opposition.

15 Section 22302 of the California Financial Code provides that
16 "[a] loan found to be unconscionable pursuant to § 1670.5 of the
17 Civil Code shall be deemed to be in violation of this division
18 and subject to the remedies specified in this division." Cal.
19 Fin. Code § 22302(b). California Civil Code § 1670.5 states that
20 if a contract is unconscionable, a court may refuse to enforce
21 the contract, may enforce the remainder of the contract without
22 the unconscionable clause, or may limit the application of any
23 unconscionable clause to avoid an unconscionable result. Cal.
24 Civ. Code. § 1670.5.¹⁰

25 /////

26
27 ¹⁰ The text of California Civil Code § 1670.5 does not
28 define "unconscionable." Instead, the legislative comments
provide examples of unconscionable agreements.

1 Plaintiff has alleged that the loan agreement he entered
2 into with defendants was unconscionable for several reasons.
3 Among these reasons was that defendants improperly disclosed
4 pertinent information regarding the terms of the loan, and that
5 the teaser rate and the prepayment penalty were each unlawful.
6 (Pl.'s Compl. ¶¶ 146-148.)

7 Section 560.2(b)(4) specifically lists adjustments to
8 interest rates as terms of credit. Furthermore, the prepayment
9 penalty in the Note is a loan-related fee under § 560.2(b)(5).
10 As such, adjudication of plaintiff's UCL claim based on violation
11 of California Financial Code § 22302 will require the court
12 determine whether at least one term of credit and a loan related
13 fee are unconscionable. Any decision in plaintiff's favor would
14 place substantive requirements on the terms of credit and loan-
15 related fees that defendants would be required to offer to
16 borrowers. As a result, this court would necessarily be imposing
17 requirements on the terms of credit and loan-related fees offered
18 by defendants. This implicates both § 560.2(b)(4) and (5). As
19 such, plaintiff's UCL claim based on a violation of California
20 Financial Code § 22302 is preempted by HOLA, and defendants'
21 motion to dismiss this claim is GRANTED.

22 **C. Fraudulent omission**

23 Defendants also seek to dismiss plaintiff's claim for
24 fraudulent omission on the ground that it is preempted by federal
25 law. (MTD 13:13.) In response, plaintiff presents his same
26 argument that the claim should not be preempted because
27 fraudulent omission is a state law of general applicability being
28 /////

1 applied to enforce the rights of contracting parties. (Opp'n
2 6:20-22.)

3 The gravamen of plaintiff's fraudulent omission claim is
4 that *pursuant to TILA*, defendants had a duty to disclose to
5 plaintiff 1) the actual interest rate being charged; 2) that
6 negative amortization would occur and that the principal balance
7 would increase; and 3) that the initial rate on the Note was
8 discounted. (Pl.'s Compl. ¶ 107.) This inevitably implicates §§
9 560.2(b)(4) and (9) since defendants' alleged fraudulent omission
10 is based on the terms of credit of the loan and disclosure of
11 such terms. It makes no difference that fraudulent omission and
12 the UCL come from different origins of law, as § 560.2 makes no
13 such distinction when addressing the types of laws that are
14 preempted.

15 Moreover, plaintiff is trying again to supplement TILA with
16 state law. Plaintiff's fraudulent omission claim is based on a
17 duty defendants are alleged to be subject to under TILA. (Pl.'s
18 Compl. ¶ 107.) By basing defendants' common law duty on TILA,
19 plaintiff is attempting to alter both the damages available under
20 TILA and the statute of limitations period for civil damages
21 under TILA. Compare 15 U.S.C. § 1640 with Cal. Civ. P. § 338
22 (three year statute of limitations on action for relief for
23 fraud; fraud claims in California do not appear to be subject to
24 statutory limits). Accordingly, for the reasons set forth above,
25 plaintiff's claim for fraudulent omission is also preempted, and
26 defendants' motion to dismiss this claim is GRANTED.

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1 **D. Breach of Contract/Breach of Implied Covenant of Good Faith**
2 **and Fair Dealing**

3 Defendants seek to dismiss plaintiff's claims for breach of
4 contract and breach of the implied covenant of good faith and
5 fair dealing on two separate grounds: first, that the claims are
6 preempted, and second, that plaintiff has failed with both claims
7 to state a claim upon which relief can be granted.

8 **1. Preemption**

9 Defendants again contend that plaintiff's state law claims
10 for breach of contract and breach of the implied covenant of good
11 faith and fair dealing are preempted by HOLA. (MTD 18:19-22.)
12 Plaintiff's again counter that each claim involves a law of
13 general application that will be applied only to enforce the
14 rights and obligations of contracting parties. (Opp'n 6:20-22.)

15 As set forth above, the types of laws in § 560.2(b) are
16 preempted to the extent that they purport to *impose requirements*
17 regarding various types of lending activities. 12 C.F.R §
18 560.2(b) (emphasis added). Plaintiff's UCL and fraudulent
19 omission claims are illustrative; an adverse ruling by this court
20 on those claims would, among other things, necessarily rule on
21 the lawfulness of the disclosures made by defendants. In
22 contrast, plaintiff's breach of contract and breach of the
23 implied covenant of good faith and fair dealing claims will not
24 potentially impose any requirements for the type of lending
25 activities described in § 560.2(b). Instead, the court will
26 determine whether parties to a contract have performed the
27 obligations they made between themselves, and have done so in
28 good faith and with fair dealing. As such, a ruling against

1 defendants will not alter their lending practices, but only their
2 practice of performing contracts. Accordingly, plaintiff's
3 breach of contract and breach of the implied covenant of good
4 faith and fair dealing claims are not the types of laws expressly
5 preempted under paragraph (b) since they do not have the effect
6 of imposing requirements on defendants' lending practices.

7 Nor are breach of contract and breach of the implied
8 covenant of good faith and fair dealing the types of state laws
9 that more than incidentally affect on the lending practices of
10 defendants under § 560.2(c). Again, defendants' lending
11 practices will not be affected whatsoever by these claims.
12 Instead, it is defendants' practices of performing contractual
13 obligations with good faith and fair dealing that might be
14 affected. Therefore, plaintiff's breach of contract claim is not
15 preempted by HOLA under § 560.2(b) or (c), and defendants' motion
16 to dismiss each claim on preemption grounds is DENIED.

17 **2. Failure to state a claim**

18 Defendants also contend that plaintiff has failed to state a
19 claim upon which relief can be granted for both his breach of
20 contract claim and breach of the implied covenant of good faith
21 and fair dealing claim. Plaintiff has alleged several ways in
22 which defendants breached the terms of the Note. Specifically,
23 plaintiff alleges that defendants 1) failed to provide a low,
24 fixed interest rate as promised; 2) failed to apply plaintiff's
25 payments to both principal and interest; and 3) promised that
26 negative amortization would occur only if plaintiff deviated from
27 the payment schedule in the disclosure statement when, in fact,
28 negative amortization was certain to occur. (Pl.'s Compl. ¶¶

1 120-124.) Plaintiff also alleges that the contract, as a whole,
2 is unconscionable. (Id. at ¶ 126.) Defendants argue that the
3 challenged conduct is permitted by the express terms of
4 plaintiff's contract and, thus, plaintiff's claims are based
5 purely on non-actionable, pre-contractual conduct. (MTD 19:7-9.)

6 In California, "[a] cause of action for breach of contract
7 requires proof of the following elements: (1) existence of the
8 contract; (2) plaintiff's performance or excuse for
9 nonperformance; (3) defendant's breach; and (4) damages to
10 plaintiff as a result of the breach." CDF Firefighters v.
11 Maldonado, 158 Cal. App. 4th 1226, 1239 (2008). "Resolution of
12 contractual claims on a motion to dismiss is proper if the terms
13 of the contract are unambiguous." Monaco v. Bear Stearns
14 Residential Mortgage Corp., -- F. Supp. 2d --, No. CV 07-05607
15 SJO (CTX), 2008 WL 867727, at *5 (C.D. Cal. 2008). "A contract
16 provision will be considered ambiguous when it is capable of two
17 or more reasonable interpretations." Id. (citing Bay Cities
18 Paving & Grading, Inc. v. Lawyers' Mut. Ins. Co., 855 P.2d 1263,
19 1271 (Cal.1993)). "[T]he language of a contract should be
20 interpreted most strongly against the party who caused the
21 uncertainty to exist." Cal. Civ. Code § 1654.

22 Additionally, "[a] breach of the implied covenant of good
23 faith and fair dealing involves something beyond breach of the
24 contractual duty itself." Careau & Co. v. Security Pacific
25 Business Credit, Inc., 222 Cal. App. 3d 1371, 1394 (1990). A
26 plaintiff must demonstrate a "conscious and deliberate act, which
27 unfairly frustrates the agreed common purposes and disappoints

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1 the reasonable expectations of the other party thereby depriving
2 that party of the benefits of the agreement." Id.

3 Viewing the allegations of the complaint in the light most
4 favorable to plaintiff, the court holds that plaintiff has
5 sufficiently alleged that the terms of the contract were
6 ambiguous. For example, paragraph 3 of the Note states that
7 plaintiff will make payments until plaintiff has paid "all the
8 *principal and interest* and any other charges described below"
9 owed under the Note. (Pl.'s Compl., Ex. 1.) Additionally,
10 paragraph 5 of the Note states that defendants will determine the
11 amount of monthly payment that would be sufficient to pay the
12 unpaid principal plaintiff owed when the monthly payments
13 changed. (Id.) These terms, when read in plaintiff's favor,
14 could support plaintiff's allegations that his monthly payments
15 were supposed to cover both the principal and interest owed on
16 the loans. It could also support plaintiff's allegations that
17 the actual likelihood of negative amortization was different than
18 reflected in the Note. Moreover, plaintiff also alleges that
19 defendant acted with "willful and wanton disregard" in performing
20 the contract, and that defendants' conduct was "malicious,
21 oppressive, and/or fraudulent." (Pl.'s Compl. ¶ 137.) As such,
22 at this stage of the litigation, plaintiff has sufficiently
23 alleged that defendants breached the terms of the Note and also
24 breached the implied covenant of good faith and fair dealing.¹¹

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27 ¹¹ The court notes that it is not finding that the terms
28 of the Note are ambiguous as a matter of law. Rather, at this
stage in the litigation, plaintiff has alleged sufficient facts
to survive a motion to dismiss.

1 Plaintiff has also alleged that defendants breached the Note
2 because the Note was unconscionable. (Pl.'s Compl. ¶ 126.) "The
3 doctrine of unconscionability has historically provided only a
4 defense to enforcement of a contract." California Grocers Assn.
5 v. Bank of Am., 22 Cal. App. 4th 205, 217 (1994). California
6 Civil Code § 1670.5, which codifies the doctrine of
7 unconscionability, "does not in itself create an affirmative
8 cause of action but merely codifies the defense of
9 unconscionability." Id. As such, plaintiff's allegation that
10 defendants breached the Note because the Note was unconscionable
11 does not create a recognized claim under California law.

12 Accordingly, defendants' motion to dismiss plaintiff's
13 breach of contract claim is GRANTED to the extent it is based on
14 unconscionability. Defendants' motion to dismiss plaintiff's
15 claims for breach of contract and breach of the implied covenant
16 of good faith and fair dealing based on all other grounds is
17 DENIED.

18 **F. Claims Against Lydian Trust Company and Virtual Bank**

19 Defendants seek to dismiss all claims alleged against
20 defendant Lydian Trust Company for failing to adequately plead
21 that Lydian Trust Company was involved in any way with the loan
22 made to plaintiff. On a motion to dismiss, courts "are not bound
23 to accept as true a legal conclusion couched as a factual
24 allegation.'" Twombly, 127 S. Ct. at 1965 (citing Papasan v.
25 Allain, 478 U.S. 265, 286 (1986)). "Conclusory allegations of
26 alter ego status will not survive a motion to dismiss."
27 Maganalles v. Hilltop Lending Corp., 505 F. Supp. 2d 594, 607
28 (N.D. Cal. 2007).

1 In this case, the Note that is the subject of this action
2 does not list Lydian Trust Company as a party to the loan.
3 (Pl.'s Compl., Ex. 1.) Rather, plaintiff has merely alleged that
4 "each of the defendants were the agent, servant, employer, joint
5 venturer, partner, division, owner, subsidiary, alias, assignee,
6 and/or alter ego of the other remaining defendants" and were
7 acting within the purpose or scope of such relationships. (Id.
8 at ¶ 12.) These allegations are conclusory and are not supported
9 by any other facts. See Maganallez, 505 F. Supp. 2d at 607. As
10 such, the complaint fails to sufficiently allege alter ego
11 liability against Lydian Trust Company, and the claims against
12 Lydian Trust Company are dismissed.

13 Defendants have also moved to dismiss all claims alleged
14 against defendant VirtualBank on the grounds that VirtualBank is
15 merely a division of Lydian Private Bank. A division of a
16 corporation is not a separate entity but is the corporation
17 itself." Maganallez, 505 F. Supp. 2d at 605. Accordingly, it is
18 incapable of being sued or indicted separately. See U.S. v. ITT
19 Blackburn Co., a Div. of ITT, 824 F.2d 628, 631 (8th Cir. 1987).

20 Plaintiff has alleged that VirtualBank is a division of
21 Lydian Private Bank. (Pl.'s Compl. ¶ 8.) The Note also states
22 that VirtualBank is a division of Lydian Private Bank. (Id. at
23 Ex. 1.) Since a division is incapable of being sued separately,
24 plaintiff has not sufficiently alleged his claims against
25 VirtualBank, and the claims alleged against VirtualBank will be
26 dismissed. See Maganallez, 505 F. Supp. at 605.

27 Plaintiff has not requested leave to amend his complaint to
28 properly allege the liability of Lydian Bank Trust and

1 VirtualBank. Nonetheless, a "district court should grant leave
2 to amend even if no request to amend the pleading was made,
3 unless it determines that the pleading could not possibly be
4 cured by the allegation of other facts." Lopez v. Smith, 203
5 F.3d 1122, 1127 (9th Cir. 2000) (citing Doe v. United States, 58
6 F.3d 494, 497 (9th Cir. 1995)). The court is unable to find that
7 the defects in alleging liability as to Lydian Bank Trust and
8 VirtualBank are incurable. Accordingly, plaintiff may amend his
9 complaint to include further allegations to properly allege his
10 claims against Lydian Bank Trust and VirtualBank.

11 **CONCLUSION**

12 For the foregoing reasons, defendants' motion to dismiss is
13 GRANTED in part and DENIED in part. Specifically:

- 14 1. Defendants' motion to dismiss plaintiff's first claim
15 for violation of TILA is DENIED;
- 16 2. Defendants' motion to dismiss plaintiff's second and
17 third claims for violation of the UCL predicated on
18 violation of TILA and unfair or fraudulent business
19 acts or practices is GRANTED without leave to amend;
- 20 3. Defendants' motion to dismiss plaintiff's fourth claim
21 for fraudulent omission is GRANTED without leave to
22 amend;
- 23 4. Defendants' motion to dismiss plaintiff's fifth claim
24 for breach of contract is GRANTED to the extent the
25 breach is based on unconscionability. As to the
26 specific terms alleged to have been breached, the
27 motion is DENIED;

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1 5. Defendants' motion to dismiss plaintiff's sixth claim
2 for breach of the implied covenant of good faith and
3 fair dealing is DENIED; and

4 6. Defendants' motion to dismiss plaintiff's seventh claim
5 for violation of TILA predicated on violation of
6 California Financial Code § 22302 is GRANTED without
7 leave to amend.

8 Additionally, all claims brought against defendants
9 VirtualBank and Lydian Trust Company are dismissed with leave to
10 amend. Plaintiff is granted fifteen (15) days from the date of
11 this order to file an amended complaint in accordance with this
12 order. Defendants are granted thirty (30) days from the date of
13 service of plaintiff's second amended complaint to file a
14 response thereto.

15 IT IS SO ORDERED.

16 DATED: July 16, 2008



FRANK C. DAMRELL, Jr.
UNITED STATES DISTRICT JUDGE