

## [Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—W.D. Wash.: Complaint over Zillow’s CFPB troubles failed to identify RESPA violations, \(Oct. 3, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

The district court in Seattle dismissed a shareholder complaint taking issue with statements Zillow officers allegedly made—or omitted to make—about a Consumer Financial Protection Bureau inquiry into potential RESPA violations. When Zillow disclosed the investigation in August 2017, shares fell about 15 percent. Because the fraud complaint failed to plead a RESPA violation, its allegations as to falsity and scienter failed, but loss causation could become plausible after amendment (*In re Zillow Group, Inc. Securities Litigation*, October 2, 2018, Coughenour, J.).

**Co-marketing program.** The CFPB matter concerns a co-marketing program that Zillow created in 2013. The program allows mortgage lenders to pay some of a real estate agent’s advertising costs directly to Zillow in exchange for appearing on the agent’s listings and receiving about 40 percent of their leads. RESPA prohibits giving or accepting any kickback or other referral fee where a federally related mortgage loan is involved, but a safe harbor provision permits payment for goods or services actually furnished or performed. The CFPB subpoenaed Zillow in April 2015, and Zillow revealed the demand the following month. In August, Zillow disclosed that the CFPB had concluded its investigation and intended to pursue a civil action if Zillow would not settle.

One of the claims advanced by the purported class-action plaintiffs depended on underlying RESPA violations because the plaintiffs challenged statements regarding Zillow’s compliance with the law. The court found that the plaintiffs’ theory that the co-marketing program was *per se* illegal lacked a basis in fact or law: the complaint did not allege with particularity that co-marketing agents were actually providing unlawful referrals to lenders, and any such referrals would fall within the safe harbor. The court also rejected the plaintiffs’ theory that the co-marketing program violated RESPA by allowing lenders to pay more than fair market value for advertising services.

The complaint also failed to plead with particularity any false statements or omissions on the part of Zillow management. On an investor conference call in November 2015, an analyst asked, "And is the RESPA or CFPB kind of investigations into this—is this something that should be a concern? Or something that you think is not really an issue?" The CFO responded that co-marketing was a small part of Zillow’s business and that "we work diligently to comply with all of the rules put forth by government agencies and of course, we monitor the CFPB and the things they are saying and doing to make sure that we remain in compliance and to make sure that we understand how their activities relate to our business." This statement was not misleading, the court reasoned, because it was neither an affirmative statement nor an omission suggesting Zillow was not under regulatory scrutiny.

The court was no more persuaded by allegations that Zillow failed to disclose changes to the co-marketing program. Although the complaint’s reliance on a confidential witness satisfied the PSLRA pleading requirements, the complaint did not contain particularized factual allegations demonstrating that the co-marketing program was altered to remedy RESPA violations. As the court had already found, the complaint failed to plead underlying RESPA violations.

Because it failed to adequately allege falsity, the complaint also failed to evince a strong inference of scienter. The allegations, taken individually, failed and, as a whole, they supported a compelling contrary inference:

that the defendants believed the co-marketing program did *not* violate RESPA. While the allegations of loss causation were also insufficient, loss causation does not need to be pleaded with particularity, and the court allowed leave to amend in the event the plaintiffs can successfully plead a materially misleading statement.

The case is [No. C17-1387-JCC](#).

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Companies: Zillow Group, Inc.

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