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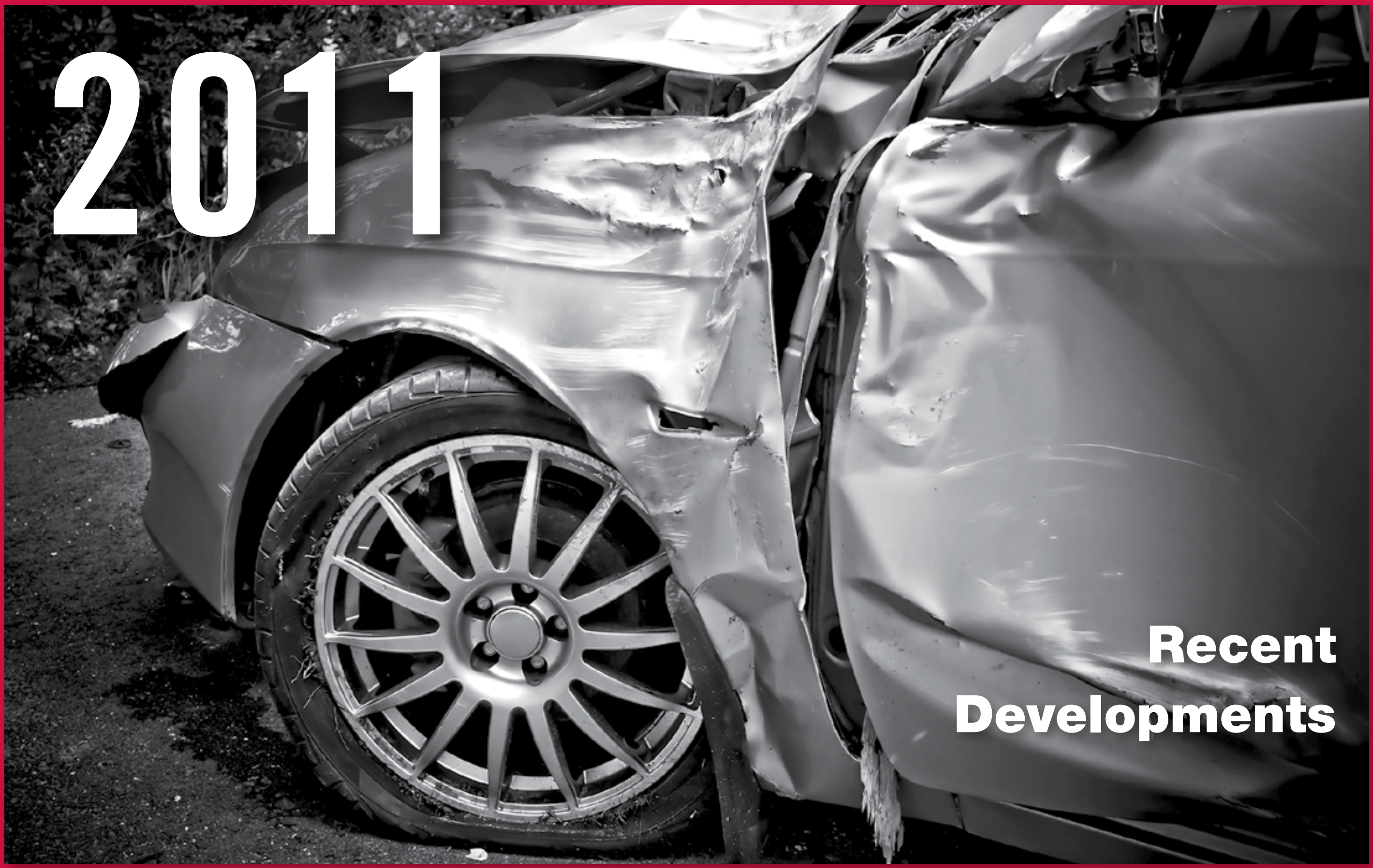

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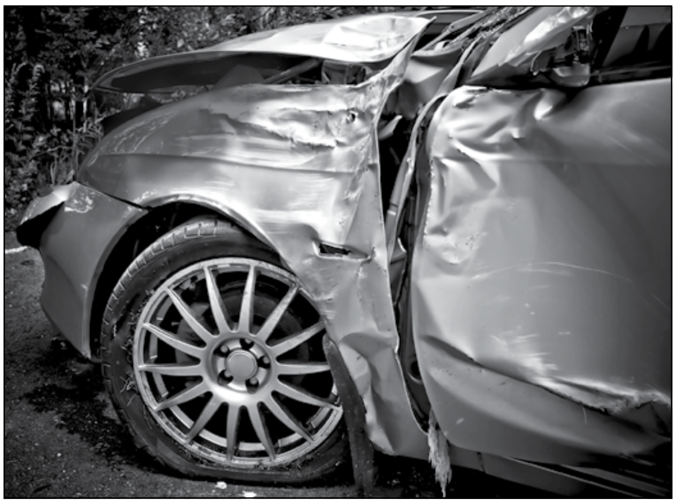

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Articles

Recent Developments

Annual Survey of TEXAS Insurance Law 2011

By Mark L. Kincaid, Suzette E. Selden, & Elizabeth von Kreisler*

I. INTRODUCTION

This year's survey covers a substantially larger number of cases, almost twice the usual number. The Texas Supreme Court decided several significant cases. The court overruled a prior decision to hold that workers compensation claimants cannot sue under the Insurance Code for unfair settlement practices.[1] In the same case, four justices also voted to overrule *Aranda*[2] and eliminate claims by workers' compensation claimants for breach of the duty of good faith and fair dealing.

The court decided another workers compensation case dealing with injuries when an employee is going to or from work, or is on a trip that is part business and part personal.[3]

The supreme court also held that the Insurance Code does not allow a cause of action for unfair discrimination for race-neutral conduct – specifically, credit scoring – that has a disparate racial impact.[4]

Revisiting the issue of appraisal, the court held that mere delay will not waive the right; the other party must show prejudice, but the court said showing prejudice is unlikely.[5]

On the liability insurance side, in a case of first impression, the supreme court held there was no coverage for liability to passengers exposed to a tubercular driver, because the injuries did not result from "use" of the bus.[6]

Two potentially significant decisions from lower courts allowed use of extrinsic evidence to decide whether the insurers had a duty to defend.[7]

A couple of other cases continued to delimit an insurer's liability for interfering with the defense or with the defense lawyer.[8]

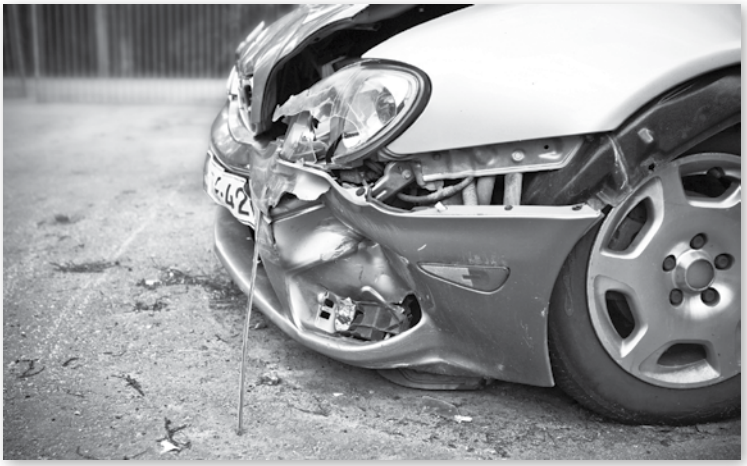
Another court upheld an insurer's agreement to "buy back" a liability policy from the defendant to eliminate coverage for a plaintiff's pending claim.[9]

This year's survey covers a substantially larger number of cases, almost twice the usual number.

II. FIRST PARTY INSURANCE POLICIES & PROVISIONS

A. Automobile

An insured was not entitled to recover under his uninsured/underinsured motorist coverage where his damages were less than the total amounts paid by the other motorist and other parties in settlement. The court found the policy language unambiguously allowed the UM insurer to take a credit for amounts



from anyone who "may" be liable, which would include all three of the settling parties. The court also held that a statute allowing the insurer to reduce its liability by the amount recoverable from the underinsured motorist's insurer did not preclude consideration of settlements from other parties because those settlements would reduce the underinsured motorist's liability as settlement credits. *Melencon v. State Farm Mut. Auto. Ins. Co.*, 343 S.W.3d 567 (Tex. App.–Houston [14th Dist.] 2011, no pet.).

A city employee was injured by a drunk driver and received worker's compensation benefits for his injuries. The employee then attempted to recover benefits under the city's UIM policy, which the city acquired for its employees. The court held that if an employee suffers work-related injuries and seeks redress from an employer that subscribes to a workers' compensation program, the only way to obtain damages is through that compensation program. The law bars the employee from forcing the employer to redress the injuries through other means. *Smith v. City of Lubbock*, No. 07-10-0466-CV, 2011 WL 4478494 (Tex. App.–Amarillo Sept. 26, 2011, no pet.).

An insured who was injured in a car accident sued the driver and his underinsured motorist insurer. The jury awarded damages that the UIM carrier would have to pay, but the appeals court reversed, holding that the plain language of Tex. Civ. Prac. & Rem. Code section 41.0105 provides that medical expenses subsequently written off by a health care provider do not constitute medical expenses actually incurred by the claimant or on his behalf where neither the claimant nor anyone acting on his behalf will ultimately be liable for pay those expenses. Therefore, because the insurer's offsets and credits subsumed the insured's collectible damages, the trial court held that the insured take nothing. *Progressive Co. Mut. Ins. Co. v. Delgado*, 335 S.W.2d 689 (Tex. App.–Amarillo 2011, pet. denied).

The Fifth Circuit held that a policy unambiguously excluded a vehicle owned by a self-insured entity from the definition of "uninsured/underinsured vehicle," so there was no coverage. Further, the court held this exclusion did not violate Texas law, because the insurance commissioner had the authority to approve policies that exclude certain motor vehicles whose operators are in fact uninsured. *McQuinnie v. Am. Home Assur. Co.*, 400 F. App'x 801 (5th Cir. 2010).

B. Homeowners

An insured's tenant sued the insurer for damages when she was injured on a riding lawn mower while mowing the lawn. The tenant was listed as an insured on the homeowner's policy. But because the policy excluded from coverage bodily injury to any insured or resident of the residence premise, the court granted the insurer's motion for summary judgment. *Rust v. Tex. Farmers Ins. Co.*, 341 S.W.3d 541 (Tex. App.–El Paso 2011, pet. denied).

After a rental home burned down, the insurer denied the claim, citing its vacancy clause, which provided that the insurer was not liable for fire perils if the building was vacant for more than sixty days before the loss. No one lived in the dwelling, but the remodeler's proposal said repairs would be completed several months before the fire occurred. The court held that there was a fact issue concerning whether the dwelling was vacant. *Columbia Lloyds Ins. Co. v. Mao*, No. 02-10-00063-CV, 2011 WL 1103814 (Tex. App.–Fort Worth Mar. 24, 2011, pet. filed) (mem. op., not designated for publication).

Insureds sued their homeowners' insurer after rain entered their roof and caused extensive damage inside the house. The insurer denied coverage. The jury found that coverage existed because the "direct force of wind or hail made an opening in [the insureds'] roof through which rain entered." The insurer appealed. Because the opening in the roof was repaired before the insurer's field adjuster could examine it, and the insureds themselves could not testify as to what caused the opening, there was no evidence that direct force of wind or hail made the opening. Consequently, there was no coverage. *Farmers Mut. Prot. Ass'n v. Rooney*, No. 11-09-00225-CV, 2011 WL 2518766 (Tex. App.–Eastland Jun. 23, 2011, no pet.) (mem. op., not designated for publication).

A homeowner whose house was damaged by a storm sued the insurer for depreciating general contractor overhead and profit and sales tax in calculating the actual cash value of the loss. The court granted the insurer's motion for summary judgment as to breach of contract and unfair insurance practices, as the insured did not show that the insurer had violated the terms of the policy. Instead, there was proof that payment was made in accordance with the policy terms. *Tolar v. Allstate Tex. Lloyd's Co.*, 772 F. Supp. 2d 825 (N.D. Tex. 2011).

C. Commercial Property

The supreme court held that a policy negotiated through Lloyds of London did not cover charges for repair vessels kept "standing by" so they could resume repairs to an offshore platform once weather permitted. *Houston Exploration Co. v. Wellington Underwriting Agencies, Ltd.*, No. 08-0890, 2011 WL 3796361, 54 Tex. Sup. Ct. J. 1683 (Tex. Aug. 26, 2011). The majority held it was proper to consider the fact that language covering standby charges included in the preprinted form contract was struck by the parties. The court held that deletions in the printed form agreement are indicative of the parties' intent. The majority further held that the language of the policy, without the deletion, did not provide coverage.[10]

Justice Johnson concurred, because he thought the policy language did not provide coverage regardless of the presence of the stricken language.

Chief Justice Jefferson, joined by two others, argued that it was improper to consider the deleted language, because it was parol evidence. Without the stricken language, the dissenters found the remaining language was sufficiently broad to cover "standby charges." The policy provided coverage for repair costs that were "necessarily incurred and duly justified" and provided coverage for vessels "when used in or about the repair." Another clause provided coverage for boats "utilise[d] … for" repairs. The dissenters reasoned that "about" was broad enough to include vessels used "in connection with" repairs. The dissenters also reasoned that the standby charges were "duly justified" and that the standby vessels were being "utilized for" the repairs, because their use was to wait on standby so that repairs could continue with haste.

In *QB Invs., L.L.C. v. Certain Underwriters at Lloyd's London*, an insured sued its insurer after one of its commercial buildings was destroyed in a fire. No. 01-10-00718-CV, 2011 WL 3359683 (Tex. App.–Houston [1st Dist.] Aug. 4, 2011, no pet.) (mem. op., not designated for publication). The insurer argued that the policy required the insured to maintain a fire alarm system and limited any obligation of the insurer to pay for fire loss if this system was not in place. It was undisputed that there was no fire alarm system at the time of the fire. The insured argued that the relevant endorsement was not listed in the binder it received and, because it had not yet received the policy with the endorsement, the endorsement was not part of the policy at the time of the fire. The court held that the terms of the endorsement had to be complied with and, therefore, found in favor of the insurer.

D. Life insurance

A life insurer brought an interpleader action to determine how life insurance proceeds should be distributed where the insured decedent had named as beneficiaries both his mother and his out-of-wedlock child. The beneficiary child died shortly after the insured. The child's mother and the insured's mother disputed which of them was entitled the child's share of the proceeds. The insured's mother argued that the child's mother was not entitled to the proceeds because the application was ambiguous in that, on one page, the insured had listed his mother on a line that said "first" and his child on a line that said "second," but another page listed both mother and child as "first beneficiaries." The court did not agree that this amounted to an ambiguity, and concluded that, taken as a whole, the designation of beneficiaries was intended to name the mother and child equally as beneficiaries. Accordingly, the child's mother could recover the proceeds on the child's behalf. *Lopez-Franco v. Hernandez*, No. 08-08-00343-CV, 2011 WL 1492002 (Tex. App.–El Paso Apr. 20, 2011, pet. denied).

When the wife and sister of an insured disputed who was entitled to the policy proceeds, a life insurer filed an interpleader. The insured had changed the beneficiary of the policy from his wife to his sister several months before his death, during a period when, apparently, he was on medication. The wife argued that the change was invalid because the insured either lacked capacity or was subject to undue influence. She submitted several affidavits in support of her position, but the court held that these affidavits were insufficient because they stated opinions, were based on assumptions, and were inconclusive about whether the insured was actually impaired at the precise time he executed the beneficiary change. As such, the evidence did no more than create a mere suspicion that the insured lacked capacity or was subject to undue influence. The change was valid, and the sister was entitled to the proceeds. *McDaniel v. Householder*, No. 11-09-00307-CV, 2011 WL 3793326 (Tex. App.–Eastland Aug. 25, 2011, no pet.) (mem. op., not designated for publication).

A life insurer filed an interpleader action asking the court to determine who was entitled to the insurance policy proceeds: a widower named as the beneficiary or a lender to whom the deceased woman had assigned the policy as collateral to secure a small business note. The widower argued that the proceeds were owed to him because he had filed bankruptcy and discharged the lender's note. The court held that the policy was never the property of the bankruptcy estate, because the lender was the assignee of the deceased's right to the policy, effectively taking her place as owner of the policy. Therefore, the lender was entitled to the proceeds of the policy. *Mass. Mut. Life Ins. Co v. Sanders*, 787 F. Supp. 2d 628 (S.D. Tex. 2011).

A life insurance beneficiary sued after the insurer denied her claim. The insurer relied on an exclusion for injuries sustained "as a result of being legally intoxicated from the use of alcohol." The insured fell at his home after an evening of drinking. The hospital listed his cause of death as a brain injury and cardiopulmonary arrest. The court determined that the exclusion applied. The insured's blood alcohol level was very high and the medical examiner's notes stated that the injury occurred because the insured "fell at home while intoxicated." The court rejected the beneficiary's argument that "legal intoxication" meant not only that the insured be intoxicated but that he be intoxicated in a legally relevant manner, such as by operating a motor vehicle in violation of the law. The court concluded that the policy did not have such a requirement, and Texas law defines "intoxicated" in more than just a criminal context. *Likens v. Hartford Life & Accident Ins. Co.*, No. H-10-155, 2011 WL 2584803 (S.D. Tex. Jun. 29, 2011).

E. Disability insurance

The Fifth Circuit held there was no disability coverage based on an ambiguous provision in a description of coverage, which could be read to allow coverage if the person suffered certain conditions *or* if the person was permanently unable to perform his usual duties and was under the supervision of a physician. The description of coverage contained a statement that if there was any conflict between the description of coverage and the master policy, then the master policy would control. The master policy made clear that disability required that the person suffer the condition *and* be permanently unable to perform activities *and* be under the supervision of a physician. *Tolbert v. Nat'l Union Fire Ins. Co.*, 657 F.3d 262 (5th Cir. 2011).

F. Health Insurance

A health plan participant sued the plan administrator for breach of contract after it refused to pay for surgeries needed to correct skin laxity following gastric bypass surgery. The participant and administrator had previously disputed earlier skin laxity surgeries and had entered into a settlement agreement by which the administrator agreed to pay for the prior surgeries and "complications" resulting therefrom. The administrator argued that it did not have to pay for the new skin laxity surgeries because they were not due to any complications resulting from the prior surgeries. In support of her position, the participant submitted an affidavit from her doctor, who stated that the surgeries were medically necessary. The court held that evidence that the surgeries were medically necessary was not evidence that they were due to "complications," which the administrator's expert had defined as things such as hematoma, wound breakdowns, and heart attack, among other things. Loose skin was not included within the definition of "complications." Therefore, the administrator was not liable. *Contreras v. Clint I.S.D.*, 347 S.W.3d 413 (Tex. App.–El Paso 2011, no pet.).

G. Worker's Compensation

The supreme court held that a worker who was in a wreck while driving from a business-related dinner to a business-provided storage unit and then home was in the "course and scope of employment" so that her injuries were covered. *Leordeanu v. Am. Prot. Ins. Co.*, 330 S.W.3d 239 (Tex. 2010). The court noted that the Workers' Compensation Act excludes two types of travel: (a) "to and from" the place of employment, unless transportation is furnished by the employer, the means of transportation are under the employer's control, or the employee is directed to proceed from one place to another; or (b) travel for the "dual purpose" of business and personal reasons, unless the travel would not have occurred without the business purpose. In this case, the worker had the business purpose of going to a storage unit to store work-related products, but also had the personal purpose of going home after a work-related dinner. The court of appeals held there was no coverage because of this "dual purpose" and that the worker would have made the trip anyway because she was going home. The supreme court disagreed, relying on the history of the statute to note that the "to and from" provisions and "dual purpose" provision had always been considered separate. Construing the statute as the court of appeals did would mean that traveling home would always be excluded, because the person would always have a personal reason.

III. FIRST PARTY THEORIES OF LIABILITY

A. Breach of Contract

An insured's failure to pay premiums for an insurance binder barred any claim for breach of contract. The court held that the binder was not ambiguous and clearly made payment of the premium a condition precedent for the insurance contact to go into effect. The court rejected the insured's argument that the policy was ambiguous and could reasonably be read to require payment of the premium for the binder only once a replacement policy was issued. *Becerra v. Ball*, No. 13-10-00361-CV, 2011 WL 3366361 (Tex. App.–Corpus Christi Aug. 4, 2011, no pet.) (mem. op., not designated for publication).

B. Unfair Insurance Practices, Deceptive Trade Practices & Unconscionable Conduct

The supreme court held that a workers' compensation claimant cannot sue for unfair settlement practices under the Texas Insurance Code. *Tex. Mut. Ins. Co. v. Ruttiger*, No. 08-0751, 2011 WL 3796353, 54 Tex. Sup. Ct. J. 1642 (Aug. 26, 2011). Ruttiger was hurt on the job. The insurer denied the claim, contending he was really hurt in a softball game. Eventually, the parties settled, agreeing that his injury was work-related. Ruttiger sued the insurance company for unfair insurance practices, deceptive trade practices, and breach of the duty of good faith and fair dealing, and won at trial.

The supreme court agreed with the insurer that the Workers' Compensation Act provides the exclusive remedy for unfair settlement practices. The court noted that in its prior decision in *Aetna Cas. & Sur. Co. v. Marshall*, 724 S.W.2d 770 (Tex. 1987), the court had rejected this very argument. But now the court concluded that the Workers' Compensation Act had changed. The majority reasoned that when *Marshall* was decided the Workers' Compensation Act provided no meaningful remedies and allowed de novo judicial review. In contrast, the Workers' Compensation Act was substantially amended after that to provide detailed procedures for handling and paying claims and for resolving any disputes that arose. The court concluded that permitting a workers' compensation claimant to also recover for unfair settlement practices under the Insurance Code would be inconsistent.

The court did, however, find no inconsistency in allowing a workers' compensation claimant to sue under the Insurance Code for misrepresentations. While such a cause of action would be allowed, in this case the court found legally insufficient evidence to support a finding of misrepresentation.

A workers' compensation claimant cannot sue for unfair settlement practices under the Texas Insurance Code.

The court also dismissed Ruttiger's DTPA claims, because they were based on the same violations as the unfair settlement practice claim under the Insurance Code.

Chief Justice Jefferson, joined by two others, dissented. The dissenters felt it was clear that the Workers' Compensation Act changes were not intended to overrule *Marshall*, so they would not hold that unfair insurance claims were precluded.

The court also addressed the common law cause of action for breach of the duty of good faith and fair dealing, which is addressed *post*.

The San Antonio Court of Appeals reaffirmed its prior holdings that DTPA claims do not survive the insured's death, so that heirs of a deceased insured could not recover on a claim that the insurer misrepresented benefits. *Tex. Farm Bureau Mut. Ins. Co. v. Rogers*, No. 04-10-00546-CV, 2011 WL 3120645 (Tex. App.–San Antonio July 27, 2011, pet. filed).

A trial court properly rendered summary judgment on claims under the DTPA against an insurer that denied a permanent disability claim based on language in the description of coverage that appeared ambiguous and potentially provided coverage. The description of coverage appeared to define permanent disability as meaning that the person suffered a listed condition *or* the person was permanently unable to perform activities and was under the supervision of a physician. However, the description of coverage said that, in the event of any conflict, the policy would control. The policy had language making clear that permanent disability required that the person have a listed condition *and* be permanently unable to perform activities. The Fifth Circuit concluded that DTPA liability for misrepresentation could not be based on a disagreement over the meaning of uncertain terms. *Tolbert v. Nat'l Union Fire Ins. Co.*, No. 09-10739, 657 F.3d 262 (5th Cir. 2011).

The *Tolbert* court noted that there could be liability under the Insurance Code for failing to state facts necessary to make other statements not misleading or making statements in a manner that would mislead a reasonably prudent person. The court noted it was not being asked to decide whether the ambiguous description, standing alone, could violate either of these provisions. Instead, the court found no violation where the ambiguous provision was accompanied by a notice that the master policy would control.

The *Tolbert* court also concluded that the plaintiff failed to state a claim for unconscionable conduct, because the conduct had to occur "at the time of the sale," and plaintiff's unconscionability claim was premised on conduct that occurred after his injury and after the inception of coverage under the policies.

On this last point, it appears the court may have erred. The court said that the plaintiff alleged that the insurer took advantage of the plaintiff's lack of knowledge to a grossly unfair degree by attempting to absolve the insurer of liability based on language in the master policy "when National Union never offered or provided any such 'Master Policy' to plaintiff prior to the filing of this lawsuit." That language seems to refer to the time of sale, which would satisfy the court's requirement.

A medical service provider sued ERISA insurers under the DTPA, seeking reimbursement for services it provided relating to insureds' surgical procedures. *Encompass Office Solutions, Inc. v. Ingenix, Inc.*, 775 F. Supp. 2d 938 (E.D. Tex. 2011). The district court held that the provider was not a consumer under the DTPA. The only relation the provider had to the policy was to seek the proceeds of the plan. The assignments the provider received from its patients did not allow it to bring DTPA claims because those types of claims generally cannot be assigned.

C. Breach of the Duty of Good Faith and Fair Dealing

The Texas Supreme Court revisited the issue of whether a worker's compensation claimant should have a right to sue for breach of the common law duty of good faith and fair dealing, as established by *Aranda v. Ins. Co. of N. Am.*, 748 S.W.2d 210 (Tex. 1988). As noted above, the court held that the changes to the Workers' Compensation Act made it inconsistent to allow an injured worker to also sue for unfair settlement practices under the Texas Insurance Code. *Tex. Mut. Ins. Co. v. Ruttiger*, No. 08-0751, 2011 WL 3796353, 54 Tex. Sup. Ct. J. 1642 (Aug. 26, 2011). Four of the justices announced that they would overrule *Aranda*, because they think the amended Workers' Compensation Act addresses the concerns that led to creation of the common law remedy. Two justices chose not to address the issue, because it had not been decided by the court of appeals in the first instance, so they favored a remand. Three justices would hold that the common law duty of good faith and fair dealing in *Aranda* should be preserved, because nothing in the legislative amendments indicated any intent for *Aranda* to be overruled.

An insurer did not violate its duty of good faith by relying on experts it hired to investigate the insured's hail claim, even though the three experts' estimates varied significantly. The court held that the insurer's reliance on the expert with the least expensive estimate did not in and of itself support a finding of bad faith. *Southland Lloyds Ins. Co. v. Cantu,* No. 04-09-00705-CV, 2011 WL 1158244 (Tex. App.–San Antonio Mar. 30, 2011).

A homeowner sued its insurer after his home was damaged by Hurricane Ike and the insurer offered minimal payment. The court dismissed the homeowner's extracontractual claims, holding that the homeowner failed to meet the pleading standards of Rule 12(b)(6) for a common law breach of duty of good faith and fair dealing. The court stated the homeowner did not provide any facts that showed the insurer's liability was reasonably clear, that his claims were covered under particular provisions of the policy, what the insurer knew at the time it denied his claims, any proposed settlements within policy limits that the insurer failed to effectuate, why and how the insurer's payments were unreasonably delayed, or where the insurer's investigation was not reasonable. *Luna v. Nationwide Prop. & Cas. Ins. Co.*, No. H-10-2918, 2011 WL 2565354 (S.D. Tex. June 27, 2011).

D. Unfair discrimination

The Texas Supreme Court held that the Insurance Code prohibits discrimination "because of" or "based on" race, but that does not provide a cause of action for practices like credit rating that are race-neutral but have a disparate impact on racial minorities. *Ojo v. Farmers Group, Inc.*, No. 10-0245, 2011 WL 2112778, 54 Tex. Sup. Ct. J. 1068 (Tex. May 27, 2011). The court compared language in the Labor Code that does give a cause of action based on disparate impact and noted such language was not used in the Insurance Code. The court also distinguished the Federal Fair Housing Act and the Civil Rights Act, both of which use language prohibiting discrimination "because of" race and nevertheless allow causes of action for disparate impact. The court held that the policy reasons behind those statutes were different. Finally, in a holding that led to a lengthy concurrence and an even longer dissent, the court held that the legislative history of the Insurance Code showed the legislature was aware of concerns about disparate impact but chose not to prohibit race-neutral use of credit scoring for insurance.

E. Negligence

An insurance agency could not be liable for professional negligence in failing to obtain liability coverage that would allow a landlord to sue its tenant for fire damage. *W. Houston Airport, Inc. v. Millennium Ins. Agency, Inc.*, 349 S.W.3d 748 (Tex. App.–Houston [14th Dist.] 2011, no pet.). The court found that in general there is no duty where there is no privity, and there was no privity between the landlord and the insurance agency. Although the tenant was required to get liability insurance naming the landlord as an additional insured, the court found that was irrelevant. The landlord's claim was as an injured third party, not as an additional insured. Finally, the court held that the foreseeability of damages to the landlord caused by a $50,000 limit on fire coverage was too remote to create a duty, considering the lack of any direct communications or relationship between the insurance agency and the landlord.

F. Prompt Payment of Claims – Physicians & Providers

A group of hospitals sued an HMO, arguing that it was liable under the prompt pay statute, now Tex. Ins. Code § 843.336-.353, for failing to timely pay claims for healthcare services provided to HMO enrollees under agreements between the hospitals and an intermediary. The hospitals had hired the intermediary to provide hospital services to the HMO enrollees and, while the HMO contracted with the intermediary, the hospitals had no contracts directly with the HMO. The court held that the plain language of the statute required contractual privity with the HMO. The hospitals could sue the intermediary under the prompt pay statute, but not the HMO. The court concluded that providers can sue through an assignment to stand in the shoes of a patient beneficiary or on their own provider contracts. Neither situation applied in this case. *Christus Health Gulf Coast v. Aetna, Inc.*, 347 S.W.3d 726 (Tex. App.–Houston [14th Dist.] 2011, pet. granted).

G. ERISA

A man who had two ERISA-governed group accident policies through his employer died in a single vehicle crash. He was intoxicated at the time of death. The claims administrator of the policies refused to pay his beneficiary the death benefit, arguing that the claim was not covered because it was not an "accident," since the deceased would have been aware of the risks of operating his vehicle while under the influence, making his death foreseeable. Neither of the policies defined the term "accident," or excluded coverage for injury when driving an automobile while intoxicated. The court held that the definition of accident should focus on what is actually expected or foreseen by the insured, not what is capable of being foreseen, looking instead to the issue of whether the insured had the subjective expectation of survival and whether that expectation was objectively reasonable from the perspective of the insured. The court found in favor of the beneficiary and ordered the administrator to pay the benefits. *Firman v. Becon Constr. Co.*, 789 F. Supp. 2d 732 (S.D. Tex. 2011).

A life insurance beneficiary sued the insurer/plan administrator under ERISA for wrongfully denying her life insurance benefits. The insurer had erroneously placed the plan participant in the wrong plan and policy and accepted premiums for over two years. After his death, the insurer informed the beneficiary that the participant was not eligible for the coverage and reimbursed the premiums paid for the policy, but denied the beneficiary's claim for life insurance benefits. The beneficiary argued that the insurer was estopped from denying coverage. The court, however, granted the insurer's motion for summary judgment. The participant did not qualify for the coverage, and any conflict in the dual role the insurer played as insurer and administrator of the plan was minimal. Equitable estoppel did not apply, according to the court, because the insurer's assurance that the participant was covered by the policy "was not reasonable because such 'statements' were contrary to the terms of the plan and policy." The beneficiary also failed to submit evidence of "extraordinary circumstances" such as bad faith or fraud. *Sanborn-Alder v. Cigna Group Ins.*, 771 F. Supp. 2d 713 (S.D. Tex. 2011).

A hospital sued an insurer for ERISA violations, breach of contract, and violations of the Texas Insurance Code, after the insurer failed to pay for services the hospital provided to the insurer's plan subscribers. The insurer moved to dismiss all of the claims for lack of standing. The court held that the hospital had standing because its pleadings stated that it had obtained an assignment of benefits and rights from the plan subscribers, making it a beneficiary of the ERISA plan. The hospital also sufficiently pled an injury-in-fact by stating that its patients were legally responsible for any charges the insurer failed to reimburse in full. The court also rejected the insurer's argument that the hospital lacked standing for failure to exhaust administrative remedies because, based on the pleadings, the insurer had withheld information required for the hospital to pursue an administrative appeal. Thus, the hospital was excused from the requirement of exhausting administrative remedies and had standing to sue. *North Cypress Med. Ctr. Operating Co. v. Cigna Healthcare*, 782 F. Supp. 2d 294 (S.D. Tex. 2011).

A medical service provider sued insurers for reimbursement for services it provided relating to insureds' surgical procedures, in *Encompass Office Solutions, Inc. v. Ingenix, Inc.*, 775 F. Supp. 2d 938 (E.D. Tex. 2011). The insurers argued that the provider lacked standing because the assignments it received from its patients did not expressly give the provider the right to bring a lawsuit. The court held that the provider had derivative standing to bring the suit, finding that the provider's assignment of the right to payment was enough to create standing.

An ERISA plan administrator refused to pay bills for services provided by a medical service provider, which was located on the second floor of a hospital. The plan covered hospital care but not services by a "skilled nursing facility." The plan administrator concluded that the provider was a skilled nursing facility rather than a hospital. The provider sued the administrator under ERISA for payment of its bills. The court determined that the provider was not a skilled nursing facility within the meaning of the plan. The plan definition included seven elements, but the administrator made no findings regarding six of those elements and so its conclusion was inconsistent with a fair reading of the plan in light of the relevant facts. Further, the administrator abused its discretion by determining that the provider was a skilled nursing facility without investigating six of the seven necessary elements. *Lifecare Mgmt. Servs., LLC v. Ins. Mgmt. Adm'rs, Inc.*, 761 F. Supp. 2d 426 (N.D. Tex. 2011).

IV. AGENTS, AGENCY, AND VICARIOUS LIABILITY

A. Individual liability of agents, adjusters, and others

After a fire occurred at an airport hangar, the lessor of the hangar sued the lessee's insurance broker for failing to obtain the proper amount of coverage required under the lease. The court held that the insurance broker for the lessee did not owe a professional duty to the lessor with whom the broker never communicated regarding insurance coverage, even though the lessor was named as an additional insured under the policy. *W. Houston Airport, Inc. v. Millennium Ins. Agency, Inc.*, 349 S.W.3d 748 (Tex. App.–Houston [14th Dist.] 2011, no pet.).

An agent did not owe any special duty to inform an insured that the policy had been cancelled. The policy was written as a direct bill, such that the agent was not involved in the invoicing, receipt, or processing of any premium payments. The insurer billed the insured directly for monthly premiums, and the insured made all premium payments directly to the insurer. There were no facts indicating that the agent owed any special duty to the insured based on custom or practice. Accordingly, the agent was entitled to summary judgment on the insured's claim of negligent failure to notify him of cancellation. *Penn-America Ins. Co. v. Zertuche*, 770 F. Supp. 2d 832 (W.D. Tex. 2011).

B. Insurer's vicarious liability for agent's conduct

After an automotive repair shop caught fire, the insured discovered that the agent had only obtained third-party liability coverage, not first-party property coverage, which the insured had requested. The court held that the insured had a duty to read and be familiar with the terms of his policy and also held that the agent was not the surplus lines insurance company's agent, because he only delivered the quote and collected the initial premium. He did not have the authority to issue the policy; therefore, the insurer was not responsible for any of his alleged misrepresentations. *Howard v. Burlington Ins. Co.*, 347 S.W.3d 783 (Tex. App.–Dallas 2011, no pet. h.).

An insurer was not vicariously liable for the conduct of an agent who defrauded an insured by taking $200,000 for an annuity, keeping $75,000 for himself and forwarding only $125,000 to the insurer. The court reasoned that the authority of the agent did not extend to the conduct in question, and the mere existence of an agency relationship was not sufficient to hold the insurer liable. *Nat'l W. Life Ins. Co. v. Newman*, No. 02-10-00133-CV, 2011 WL 4916434 (Tex. App.–Fort Worth Oct. 27, 2011, pet. denied) (mem. op., not designated for publication).

A moving truck containing an insured's personal property was stolen. The insured filed a claim with his insurer, which contacted an appraiser and replacement service to appraise the property and, at the insured's option, replace it. The insured initially wanted the appraiser to replace the stolen property and asked the insurer to pay the settlement funds directly to the appraiser, which was done. Later, the insured canceled his order with the appraiser and sought a refund from the appraiser. The refund check bounced, and the insured did not receive all of the settlement funds. The insured then sued both the insurer and the appraiser. The jury found that the appraiser had engaged in false, misleading, or deceptive acts. It also determined that the appraiser was the agent of the insurer, but, in a question conditioned upon that finding, did not find that the insurer had engaged in any false, misleading, or deceptive acts. The court of appeals affirmed the trial court's take-nothing judgment in favor of the insurer, explaining that the insured failed to meet his burden of obtaining a finding to hold the insurer liable for the appraiser's acts. While he established an agency relationship between them, he did not link this relationship to the conduct of the appraiser that the jury found false, misleading, or deceptive. *Jaster v. Shelter Mut. Ins. Co.*, No. 05-08-01441-CV, 2011WL 386856 (Tex. App.–Dallas Feb. 8, 2011, no pet.) (mem. op., not designated for publication).

C. Ratification

Evidence was insufficient to support a finding that an insurer ratified the conduct of its agent who took $200,000 from an insured and kept $75,000 for himself. Ratification requires that the insurer, although it had no knowledge of the unauthorized act of the agent, retained the benefits of the transaction after acquiring full knowledge. The court found that the insurer only received $125,000 and issued an annuity for that amount and did not have "full knowledge" of any wrongdoing by the agent. *Nat'l W. Life Ins. Co. v. Newman*, No. 02-10-00133-CV, 2011 WL 4916434 (Tex. App.–Fort Worth, Oct. 27, 2011, pet. denied) (mem. op., not designated for publication).

V. THIRD PARTY INSURANCE POLICIES & PROVISIONS

A. Commercial general liability insurance

Frito-Lay sued Adampac, a food packaging company, for contaminating its product. Adampac's insurer argued that the loss was not covered due to exclusions for damage to property in the "care, custody, or control" of the insured and for "work incorrectly performed" by the insured. The court agreed. Frito-Lay and Adampac had stipulated that the damage occurred while the product was within Adampac's exclusive possession and control. The exclusion for "work incorrectly performed" also applied, because Adampac failed to prevent the product from being adulterated, which was directly related to the repackaging job for which Adampac was hired. *Frito-Lay, Inc. v. Trinity Universal Ins. Co.*, No. 05-08-01263, 2010 WL 4705526 (Tex. App.–Dallas Nov. 22, 2010, pet. denied) (mem. op., not designated for publication).

An "absolute pollution exclusion" endorsement unambiguously excluded any duty to defend or indemnify a claim based on a worker's death from silicosis caused by prolonged inhalation of silica dust.

A masonry company was covered for damage it caused to window frames. An exclusion for damage to property upon which the insured performed its work did not apply. The insured was hired to do masonry work, not window frame work. The insured's contact with the window frames came about only as a precaution to prevent damage. *Evanston Ins. Co. v. D&L Masonry of Lubbock, Inc.*, No. 07-10-00259-CV, 2011 WL 1465776 (Tex. App.–Amarillo Apr. 18, 2011, no pet.) (mem. op., not designated for publication).

An "absolute pollution exclusion" endorsement unambiguously excluded any duty to defend or indemnify a claim based on a worker's death from silicosis caused by prolonged inhalation of silica dust. *RLI Ins. Co. v. Gonzalez*, 411 F. App'x 696 (5th Cir. 2011) (per curiam). The court found that silica dust was an "irritant" or "contaminant" under the policy endorsement. The court rejected the arguments that the policy was ambiguous if the exclusion was read this broadly, that the policy was ambiguous because another exclusion also applied and that there was an ambiguity created between the policy and the endorsement. On the last point, the court concluded that in a conflict between the policy and the endorsement, the endorsement would control.

An exclusion for "ongoing damages" did not apply to damage to a swimming pool that first occurred during the insurer's policy period, even though the insured's negligence may have happened earlier. The court held it was proper to focus on the time of the "actual physical damage," not the time of the "negligent conduct" that resulted in the damage. *Md. Cas. Co. v. Acceptance Indem. Ins. Co.*, 639 F.3d 701 (5th Cir. 2011). The court also found evidence sufficient to support the jury's answer that the "subsidence of earth" exclusion did not apply. There was evidence from which the jury could find that damage to the swimming pool was caused by structural movement, which was different and distinct from soil movement.

The "your work" exclusion precluded coverage for property damage to parts of a reactor upon which the insured performed defective work, and precluded coverage for property damage to parts of the reactor where the insured performed non-defective work, but it did not preclude coverage for damage to other parts of the reactor upon which the insured did not perform work. *Am. Home Assur. Co. v. CAT Tech, L.L.C.*, 660 F.3d 216 (5th Cir. 2011).

B. Commercial Automobile Liability Insurance

In a case of first impression, the supreme court held that a business auto policy did not cover claims by passengers infected with tuberculosis after riding on a bus driven by a diseased employee. The policy provided that covered injuries had to "result from" the "use" of the covered auto. The court concluded that the bus was merely the situs of the infection and did not have a sufficient causal nexus to the injuries. *Lancer Ins. Co. v. Garcia Holiday Tours*, 345 S.W.3d 50 (Tex. 2011).

The Fort Worth Court of Appeals, sitting en banc, held that the term "domestic employee" in an exception to an exclusion was not ambiguous and only provided coverage to persons engaged in employment incidental to their personal residents, not persons who were in the United States. *Robertson v. Home State County Mut. Ins. Co.*, 348 S.W.3d 273 (Tex. App.–Fort Worth 2011, pet. denied) (en banc). The court recognized the dictionary definitions of the term "domestic" supported both arguments; however, the court reasoned that the exception was based on provisions of the Labor Code and the Transportation Code that intended to allow liability coverage only for "domestic employees" who were engaged in employment incidental to a personal residence. To read the phrase broadly, the court concluded, would render meaningless language requiring that the "domestic employees" were "not entitled to worker's compensation benefits." In reaching its conclusion, the court declined to follow a contrary decision from the Corpus Christi Court of Appeals and instead followed several federal court decisions.

A driver was not an "insured" under his parents' liability policy, because their home was not his "primary residence." Although the driver listed his parents' home as his address on several documents and kept valuables there, the court concluded that his apartment in another town was his primary residence, because he spent most of his time there, had several months remaining on his lease, and listed that address on his bank and truck title documents. *State Farm Fire & Cas. Co. v. Lange*, No. H-09-2011, 2011 WL 149482 (S.D. Tex. Jan. 18, 2011).

C. Construction liability insurance

A commercial umbrella insurer had no duty to indemnify its insured homebuilder for amounts paid to settle with homeowners whose homes were built with defective imitation stucco siding. The builder had used the defective material on a large number of homes and then voluntarily undertook to remove that material, repair water damage, and reapply a different type of stucco. The court agreed with the insurer's argument that the builder failed to show a covered "ultimate net loss" under the policy. There had been no finding through adjudication or arbitration that the builder was legally liable. Further, the policy provided coverage for a compromised settlement, if the insurer agreed in writing, but there was no evidence that the insurer ever agreed. *Markel Am. Ins. Co. v. Lennar Corp.*, 342 S.W.3d 704 (Tex. App.–Houston [14th Dist.] 2011, pet. filed).

The *Markel* court rejected the builder's argument that the insurer could not show prejudice from the settlements without the insurer's consent. The court distinguished cases where insurers were not allowed to enforce settlement-without-consent clauses unless they could show prejudice. In this case, the court reasoned that the language defined the scope of coverage, so that the insurer did not have to show prejudice. For the same reason, the court also concluded that the insurer did not waive its right to insist on consent to any settlement. The court relied on the principle that an insured cannot assert waiver to create coverage that otherwise would not exist.

D. Excess insurance

Excess insurers had no liability where the insured settled with the primary insurer for $15 million of its $50 million limits in exchange for a release. *Citi Group, Inc. v. Fed. Ins. Co.*, 649 F.3d 367 (5th Cir. 2011). The Fifth Circuit found the excess policies unambiguously required full payment of the primary limit. The court declined to follow the rule established in *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665 (2nd Cir. 1928), which says that if an excess insurance policy ambiguously defines "exhaustion," then settlement with an underlying insurer constitutes exhaustion of the underlying policy for purposes of determining when the excess coverage attaches.

VI. DUTIES OF LIABILITY INSURERS

A. Duty to defend

The supreme court held that injured plaintiffs have no standing to sue a liability insurer for breach of its duty to defend, even though as judgment creditors they could seek judgment on the insurer's duty to indemnify. The court reasoned that the duty to defend is owed to the insured, not third party judgment creditors, so the plaintiffs had no justiciable interest in any breach of the duty to defend. *Lancer Ins. Co. v. Garcia Holiday Tours*, 345 S.W.3d 50 (Tex. 2011).

An insured who was involved in a car accident case settled at mediation for an amount he would pay personally in addition to the policy limits. The insured then sued his insurer based on complaints about how the underlying case was handled. The court held that, under these circumstances, Texas law does not recognize a cause of action by an insured against his insurer for tortious interference with the insured's relationship with his attorney arising out of the insurer's handling of the defense of a third party claim. However, the court also held in favor of the insured that a breach of contract claim can exist against an insurer for its conduct in handling the defense of a third party claim against the insured. The court also held that Texas law does not prohibit an insured from bringing valid statutory claims against an insurer. *Taylor v. Allstate Ins. Co.*, No. 01-09-00457-CV, 2011 WL 1233331 (Tex. App.–Houston [1st Dist.] Mar. 31, 2011, pet. filed).

In two potentially significant cases, courts recognized exceptions to the "eight corners" rule and allowed extrinsic evidence to determine the duty to defend.

First, the Houston Fourteenth Court of Appeals recognized a narrow exception to the "eight corners" rule and held it is proper to consider extrinsic evidence when the insurer can establish that a party seeking a defense is a stranger to the policy and could not be entitled to a defense under any set of facts. The court further held that the extrinsic evidence must go strictly to an issue of coverage without contradicting any allegation in the third party claimant's pleadings that is material to the merits of the underlying claim. *Weingarten Realty Mgmt. Co. v. Liberty Mut. Fire Ins. Co.*, 343 S.W.3d 859 (Tex. App.–Houston [14th Dist.] 2011, pet. denied).

In the *Weingarten* case, Johnson was assaulted by an unknown assailant at the store where she worked. She sued her employer, Norstand and Weingarten Realty Management Co., which she alleged was the lessor of the space. Norstand had an insurance policy with Liberty Mutual that included any lessor of premises leased to Norstand as an additional insured. The problem was that Weingarten Management was not really the lessor. Instead, a separate entity, Weingarten Investors, was the actual lessor. Liberty Mutual refused to defend Weingarten Management. After a successful defense, Weingarten Management and its own insurer sued Liberty Mutual to recoup defense costs, arguing that Liberty Mutual owed a duty to defend because Johnson named Weingarten Management as a lessor in her underlying petition.

After citing a number of cases discussing a possible exception to the eight corners rule allowing extrinsic evidence that only goes to coverage issues, the *Weingarten* court decided this was the case to recognize such an exception.

One justice dissented, because he felt the court should not recognize such an exception. Further, the dissenting Justice felt the majority had misapplied the exception recognized. In this case, the plaintiff alleged Weingarten Management was a lessor. Liberty Mutual's extrinsic evidence offered to show no coverage contradicted that allegation.

It seems the dissent has the better of the argument in this case. As the majority recognized, one benefit provided by a liability policy is a defense of allegations, even if they are false, fraudulent, and groundless. Instead of proving Weingarten Management was not a lessor to defeat *coverage*, the insurer properly should prove Weingarten Management was not a lessor to defeat *liability*. While there is some sympathy for the idea that the insurer has to defend someone who isn't "really" its insured, allowing the exception as the court has done, where the coverage facts contradict the liability facts, creates a very dangerous situation because a liability insurer may devote its resources to establishing facts to negate coverage that also would be harmful to the potentially insured party in the underlying case. The majority seems to gloss over this concern by stating that Liberty Mutual's interest in contradicting the lessor allegation was confined to disputing Weingarten Management's status as an insured.

A federal district court held that the "eight corners" rule did not apply to determine the duty to defend under an automobile liability policy.

In the second case, a federal district court held that the "eight corners" rule did not apply to determine the duty to defend under an automobile liability policy. The policy in question did not have the usual language requiring a defense "even if the allegations of the suit are groundless, false, or fraudulent." Instead, the policy said that the insurer had no duty to defend against any suit to which the insurance does not apply. Because the duty to defend was coextensive with the duty to indemnify, the court found it proper to consider evidence and determine whether the claim was covered and then determine whether there was a duty to defend. *Guideone Specialty Mut. In. Co. v. Missionary Church of Disciples of Jesus Christ,* No. 4:11-CV-009-A, 2011 WL 3805463 (N.D. Tex. Aug. 16, 2011).

In *Guideone,* the accident occurred while some church members were using a van owned by the pastor, but without his knowledge or his permission. The court found no coverage, because there was no evidence that the van was being used with the permission of the church, which was necessary to bring it within the scope of an endorsement, and there was no evidence that the van was a covered auto or that the pastor, who was an "insured," had any legal obligation to pay damages. The court concluded that summary judgment was proper on both the duty to defend and duty to indemnify, in advance of the underlying suit being resolved, because all parties, including the injured plaintiff, were before the court.

In *Taylor v. Allstate Ins. Co.*, No. 01-09-00457-CV, 2011 WL 1233331 (Tex. App.–Houston [1st Dist.] Mar. 31, 2011, pet. filed), the court considered whether and to what extent a liability insurer could be sued for its conduct in connection with the defense of a claim, or for the conduct of the defense lawyer it hired. The insured asserted various theories against the insurer based on complaints about the way the case was handled, resulting in a settlement for greater than the policy limits. The court first rejected the insured's attempt to hold the insurer vicariously liable for the defense lawyer's conduct, under the authority of *State Farm Mut. Auto Ins. Co. v. Traver*, 980 S.W.2d 625 (Tex. 1998). The court further held that the insurer could not be sued for negligence in failing to exercise ordinary care by failing to conduct an adequate investigation and failing to provide an adequate defense. The court relied on a number of prior decisions rejecting such a theory and specifically relied on the decision in *Maryland Ins. Co. v. Head Indus. Co. & Servs., Inc.*, 938 S.W.2d 27 (Tex. 1996), where the supreme court held that the exclusive common law remedies against a liability insurer are breach of contract and a claim for breaching the *Stowers* duty to settle.

Based on the same analysis, the *Taylor* court refused to recognize a claim for tortious interference with the attorney's fiduciary duties or tortious interference with the contractual relationship. The court noted that no court had recognized such theories in this context, and the *Traver* decision suggested that the insurer could not exercise enough influence to interfere with the attorney's duty of absolute loyalty. Nevertheless, the *Taylor* court did conclude that the insured potentially stated claims against the insurer for breach of contract and for violations of the DTPA and Insurance Code. Those causes of action were potentially available, and the insurer had failed to negate them.

An insurer had a duty to defend even though some of claims were excluded, because other claims might be covered. *Dallas Nat'l Ins. Co. v. Sabic Americas, Inc.*, No. 01-08-00758-CV, 2011 WL 862049 (Tex. App.–Houston [1st Dist.] Mar. 10, 2011, pet. denied).

An insurer had a duty to defend where the plaintiff sought damages, not only for damage and repair to the insured's products, but also for lost income and damages while its oil wells "were forced to stop operations while being repaired" and "other incidental and inconsequential damages." The policy covered property damage arising out of the insured's products, including loss of use but excluding damage to the insured's products and repairs to the insured's products. The pleading showed that the plaintiff's manufacturing process involved more than the insured's product, and the "other incidental and consequential damages" could reasonably be construed as referring to damages beyond those requiring repair and replacement of the insured's product itself. *Lexington Ins. Co. v. Nat'l Oilwell NOV, Inc.*, No. 01-10-00711-CV, 2011 WL 1835308 (Tex. App.–Houston [1st Dist.] May 12, 2011, no pet.).

The *Lexington* court also held that failure to notify the insurer when the insured reached its self-insured retention limit did not relieve the insurer of its duty to pay defense costs. The insured timely reported the claim, and a unilateral request in a reservation of rights letter could not create duties beyond those set forth in the policy.

A liability insurer had no duty to defend claims against a builder for a retaining wall that collapsed and caused damage to adjacent property, where the collapse occurred after the policy period. Damage to the retaining wall itself was excluded as part of the builder's work under the "your work" exclusion, and the damage to the plaintiffs' property occurred after the policy year. The court rejected the argument that coverage could be based on the negligent construction of the wall occurring during the policy period, because no damage occurred then. *VRV Dev., L.P. v. Mid-Continent Cas. Co.*, 630 F.3d 451 (5th Cir. 2011). The court then concluded that the same factual allegations that negated the duty to defend also negated the duty to indemnify.

A liability insurer had no duty to defend under "advertising injury" coverage for claims that the insured misappropriated trade secrets, including price information and other data. The court held that, even if these activities could be considered "advertising injury," they were not committed in the course of the insured's advertising of its own goods, products, or services as required by the policy. Applying Texas law, the Fifth Circuit construed "advertising" to require some sort of public dissemination, which was not alleged. *Cont'l Cas. Co. v. Consol. Graphics, Inc.*, 646 F.3d 210 (5th Cir. 2011).

An employee of an insured company injured a person while driving the company's truck, rendering the injured person a paraplegic. The company had a primary liability insurer, with $1,000,000 in coverage, and an excess insurer with $4,000,000 in coverage, both of which listed the employee as an additional insured. Both policies provided that the insurer's duty to defend or settle ended once the limit of insurance was paid. The injured party sent a *Stowers* letter that offered to release the employee from liability for $5,000,000. The offer did not include a release of the insured company. The primary insurer's limits had been tendered to the excess insurer, which accepted the offer and withdrew from further defense of the insured company. The company then sued both insurers, arguing that the insurers breached their contract with the insured by failing to provide a full defense for the company. The court granted the insurers' motions for summary judgment, holding that the insurers acted reasonably in accepting the demand, despite the fact that the insured company remained exposed. *Pride Transp. v. Cont'l Cas. Co.*, No. 4:08-CV-007-Y, 2011 WL 1197306 (N.D. Tex. Mar. 31, 2011).

An elevator technician was injured while repairing an elevator at a mall. Prior to his injuries, an inspector had cited the freight elevator for broken welds on the hatch that the technician fell through. The technician sued his employer, the mall, and the management corporation, which filed a declaratory judgment action against their insurer. The court held that the petition stated a claim within the policy's scope of coverage. However, the court found that an exclusion applied. The policy did not cover bodily injury arising out of an employee's acts or omissions, other than general supervision of work performed for the insured by the contractor. The technician alleged that his injuries were caused by the negligence of the insureds in failing to repair the elevator, but there were no allegations that the technician's injuries arose from the insured's general supervision of his work. Therefore, the insurer had no duty to defend. *Town Center Mall v. Zurich Am. Ins. Co.*, No. H-10-1913, 2011 WL 2532911 (S.D. Tex. June 24, 2011).

In a case between liability insurers regarding coverage obligations to defendants in an underlying personal injury suit, the court held that the policy did not require that there be a written contract directly between the insured and the developer to allow the developer to be an additional insured under the policy. Because the contract with the contractor agreed to make the developer an additional insured, this was enough to make the developer an additional insured. The court also held that because the original petition, combined with readily ascertainable facts going solely to the issue of coverage, presented a claim that was within coverage under the insurance policies, the insurers had a duty to defend both the contractor and developer beginning with the date of the original petition. *Millis Dev. & Constr., Inc. v. Am. First Lloyd's Ins. Co.*, No. H-10-3260, 2011 WL 3567331 (S.D. Tex. Aug. 12, 2011).

An insurer had to defend a jewelry appraiser sued for failing to exercise reasonable care in preparing a diamond ring appraisal. The intentional misrepresentation exclusion was ambiguous and did not apply to a negligent misrepresentation. *Elliott Appraisers, L.L.C. v. JM Ins. Servs., L.L.C.*, No. H-10-2231, 2011 WL 722186 (S.D. Tex. Feb. 22, 2011).

An insurer had to defend an insured in the business of providing temporary workers, whose employee died while working for a client and riding in the client's garbage truck. The policy's automobile exclusion stated that there was no coverage for bodily injury arising from use of any auto owned or operated by any "insured." The pleadings stated that the client suffered damages for which the insured was responsible and which would be covered by the policy, but made no mention of the truck or the details of how the employee died, referring only to an "accident." *Liberty Surplus Ins. Corp. v. Allied Waste Sys., Inc.*, 758 F. Supp. 2d 414 (S.D. Tex. 2010). However, the court concluded that the insurer owed no duty to indemnify, because the client was an "insured," triggering the automobile exclusion, and the client had admitted that the employee was injured in an accident involving a truck owned and/or operated by the client in which he was a passenger and that the employee was on the truck for a work-related purpose.

An insurer did not owe a duty to defend its insured for deficient construction of a tennis facility. *Ewing Constr. Co. v. Amerisure Ins. Co.*, No. C-10-256, 2011 WL 1627047 (S.D. Tex. Apr. 28, 2011). The policy's contractual liability exclusion applied because the underlying petition was for breach of contract and alleged that the insured breached various implied and express warranties all stemming from failure to construct the tennis facility properly. According to the court, the underlying suit was directly related to the insured's assumed liability with respect to its own construction work pursuant to its contract. An exception for liability that the insured would have had in the absence of the contract did not apply, because the claims sounded solely in contract. The damage alleged was to the subject matter of the contract – the tennis courts.

B. Duty to settle

A plaintiff who was hit by a drunk driver obtained an excess judgment after the insurer failed to timely accept a settlement demand. The plaintiff then got a turnover order giving him the right to assert the defendant's claims against the insurer. The court held that the demand letter was defective because it did not specifically contain an offer to release a hospital lien. The court held there was no implied offer to release liens in a *Stowers* demand and the offer to release a lien must be specifically stated to trigger the insurer's duty to settle. The court also held that the validity of the lien was irrelevant. *McDonald v. Home State County Mut. Ins. Co.*, No. 01-09-00838-CV, 2011 WL 1103116 (Tex. App.–Houston [1st Dist.] Mar. 24, 2011, pet. denied).

C. Duty to indemnify

The supreme court held it was error to decide whether an insurer had a duty to indemnify without considering extrinsic evidence. The insured had a contract to maintain vegetation at a railway crossing and was sued for failing to do so, which resulted in a fatal collision. The policy had an exclusion for "completed operations." The court held that, while the duty to defend is based on the allegations of the pleadings, the duty to indemnify is determined by the facts actually established. The court of appeals erred by not considering extrinsic evidence of whether the insured's work was completed, considering that the accident occurred in 1995 and the insured's contract extended from 1994 through 1996. *Burlington N. & Santa Fe Ry. Co. v. Nat'l Union Fire Ins. Co.*, 334 S.W.3d 217 (Tex. 2011).

A claims-made policy did not cover a claim against a county and sheriff that was similar to a prior claim for violating the plaintiff's civil rights. The later claim was not covered, because it fell within policy language providing that "interrelated acts" would be deemed made when the first such claim was made. The court concluded that the claim was made in a prior policy year when the first related claim was made. The court did not find any prior Texas or Fifth Circuit cases interpreting the term "interrelated wrongful act," but the court found the phrase had the same meaning as "related," which meant "having a logical or causal connection." The court concluded that the two claims were related and thus constituted a single claim. *Reeves County v. Houston Cas. Co.*, No. 08-09-00256-CV, 2011 WL 4062479 (Tex. App.–El Paso Sept. 14, 2011, no pet.).

An insured failed to notify the insurer of a suit pending against it for injuries sustained in an automobile accident. The injured parties notified the insurer of the suit prior to taking a default. However, the court held that the insured's failure to cooperate in the investigation, defense, and settlement of the claim supported summary judgment for the insurer. Therefore, the insurer did not have a duty to defend or indemnify. *Martinez v. ACCC Ins. Co.*, 343 S.W.3d 924, 929-30 (Tex. App.–Dallas 2011, no pet.).

An insured homebuilder sued its excess liability insurer, seeking coverage for costs incurred in repairing defective imitation stucco siding on homes it had built. *Markel Am. Ins. Co. v. Lennar Corp.*, 342 S.W.3d 704 (Tex. App.–Houston [14th Dist.] 2011, pet. filed). The homebuilder voluntarily undertook the repairs. The insurer argued that the homebuilder failed to apportion its covered losses from its uncovered losses, thereby precluding recovery, and that the homebuilder did not establish that it was "legally liable" to the homeowners as required for coverage. The court of appeals agreed with the insurer. Regarding the failure to segregate covered and uncovered losses, the court noted that the homebuilder asked the jury to state the total amount it had paid for "property damage," defining that term in a manner that would include removing and replacing the defective siding as a preventative measure (which was not covered by the policy) regardless whether there was property damage (the costs of which were covered). Because the builder did not apportion the damage between its preventative costs and its costs to repair damage, the court concluded that there was no evidence of the homebuilder's covered-loss damages.

The *Markel* court also held that the homebuilder was not "legally liable" to pay the homeowners and thus had no coverage. The policy covered damages the insured was legally liable for and which may be established "by adjudication, arbitration, or a compromise settlement to which [the insurer has] previously agreed in writing." The homebuilder argued that it was legally liable under the Residential Construction Liability Act, but the court disagreed because there was no adjudication. The settlements did not create legal liability under the policy, because the insurer had not agreed to the settlements in writing.

After finding no duty to defend under "advertising injury" coverage, in *Cont'l Cas. Co. v. Consol. Graphics, Inc.*, 646 F.3d 210 (5th Cir. 2011), the Fifth Circuit also concluded that there was no duty to indemnify. The underlying case had already been resolved, and the insured presented no evidence that its conduct occurred in the course of its own "advertising," which was required to prove coverage.

An employer argued that its insurer should indemnify it for payments made to an injured employee. The insurer had issued a group policy that provided occupational accident insurance to the employer's employees. The court held that the policy language clearly excluded either in the form of benefits, defense, or indemnity, any claims brought by employees against the insured employer. Therefore, the court concluded that the policy did not insure any casualty or general liability risks, did not require the insurer to indemnify or protect the employer from losses, and did not provide the employer with any defense relating to the employee's claims. *Ortiz v. A.N.P., Inc.*, 768 F. Supp. 2d 896 (S.D. Tex. 2011).

An insured nightclub sought coverage for a suit arising after a patron was struck in the insured's parking lot by a vehicle driven by a third party. The policy excluded coverage for bodily injury arising out of or resulting from the use of any automobile. The district court held that the policy excluded coverage for claims that arise out of incidents involving automobiles, and was not limited to vehicles driven by employees or agents of the insured. *Colony Ins. Co. v. ACREM, Inc.*, No. H-10-1137, 2011 WL 744744 (S.D. Tex. Feb. 23, 2011).

An injured worker, as an insured's assignee, sued a commercial general liability insurer for recovery under the policy for the amount of the worker's judgment against the insured for injuries the worker sustained when a pump valve on the insured's towable asphalt plant ruptured while unloading hot oil from a tanker truck. *Salcedo v. Evanston Ins. Co.*, No. EP-10-CV-363-KC, 2011 WL 2532847 (W.D. Tex. Jun. 24, 2011). The insurer argued that the judgment fell within the exclusion for damages from accidents arising from the use of an auto, since the accident happened while the oil truck was being unloaded. The worker argued that if the auto exclusion applied, then an exception to the exclusion for damages from use of mobile equipment brought the judgment back into coverage. The court concluded that the worker's injuries arose out of the unloading of the truck, which was being used for its inherent purpose of transporting and unloading hot oil. The accident also occurred in close physical proximity to the truck and was therefore within the territorial limits of the vehicle. The use of the truck had not ended when the accident occurred, since the accident happened soon after the pump first started to run. Finally, because the pumping process itself produced the worker's injuries, the use of the truck produced the worker's injuries and did not merely contribute to cause conditions that produced them. As such, the auto exclusion applied. The mobile equipment exception did not apply, however, because the asphalt plant was not "mobile equipment," which the policy defined as a self-propelled vehicle with a permanently attached pump. The asphalt plant was not a self-propelled vehicle and did not fall within the definition. Because the auto exclusion applied and the mobile equipment exception did not, the insurer had no duty to indemnify.

VII. THIRD PARTY THEORIES OF LIABILITY

A. Unfair insurance practices, and breach of the duty of good faith and fair dealing

Following Hurricane Katrina and Rita, an insured sued its insurer for coverage of damage caused by the escape of crude oil from storage tanks at the insured's facility. The insurer was defending under a reservation of rights letter, so the insured insisted on separate counsel due to the conflict of interest. However, after separate counsel was obtained, the insurer continued to have the original law firm it hired investigate certain claims and even offer settlement to one claimant, without consulting with or informing the insured. The insured argued that the settlement offer to the one claimant, which it made the insurer withdraw, resulted in a higher settlement than if the insurer had not wrongfully made the offer. The court held that Texas law does not provide a cause of action for breach of the duty of good faith and fair dealing in the context of an insurer's handling of a third-party claim. The court held that even if there was sufficient evidence to show that the insurer engaged in unfair insurance practices, the evidence was legally insufficient to show that the failure was a producing cause of the increased settlement. The court also held that even if Texas law recognized a cause of action for breach of the duty of good faith and fair dealing in the third-party claims handling context, and even if the court assumed the insurer committed an extreme act, the insurer was not liable because there was legally insufficient evidence to show that the insured suffered an injury independent of the policy claim. *Mid-Continent Cas. Co. v. Eland Energy, Inc.*, No. 3:06-CV-1576-D, 2011 WL 2417158 (N.D. Tex. June 14, 2011).

An insurer had issued a general liability policy covering an apartment building. The premiums on the policy were due monthly. One of the insured's premium checks was returned for insufficient funds, and the underwriter on the policy mailed a cancellation notice to the insured. The insured contacted the underwriter about reinstatement and was told that the policy would be reinstated if the insured sent a cashier's check by overnight mail along with a statement verifying no loss in the interim. The insured did this, but the underwriter sent another notice stating that the policy remained cancelled. The insured did not receive this second notice, but did not make any premium payments in the following two months. Later, a fire destroyed the apartment building. The insurer then filed a declaratory action that it had no duty to indemnify because the policy was cancelled for non-payment of premium, and the insurer brought counterclaims for misrepresentation, negligence, and violations of the Insurance Code and DTPA. The parties filed cross-motions for summary judgment. *Penn-America Ins. Co. v. Zertuche*, 770 F. Supp. 2d 832 (W.D. Tex. 2011).

The court found that questions of material fact existed on whether the insurer misrepresented whether the policy would be reinstated and so denied the insurer's summary judgment. The underwriter was the insurer's agent as a matter of law and could be held responsible for the underwriter's misrepresentations about reinstatement of the policy.

The court also denied the insurer's motion for summary judgment regarding whether the insured had an insurable interest in the property. The court concluded that he did, even though he was not the owner, because he had a pecuniary interest in the property. Further, there were questions of material fact regarding whether the insurer made misrepresentations regarding whether the insured had an insurable interest in the property. However, while the misrepresentation claims remained viable, the court granted the insurer's motion for summary judgment as to its duty to indemnify. The court concluded that the policy was properly cancelled in accordance with the law and the terms of the policy. Moreover, the insured did not make any attempt to pay premiums for the following two months. Because the insurer had no duty to indemnify, it did not breach the contract.

VIII. SUITS BY INSURERS

A. Subrogation

A contract requiring a waiver of subrogation rights against an insured third party company did not include employees of that company, where the waiver did not expressly refer to employees. *Reliance Ins. Co. v. Hibdon*, 333 S.W.3d 364 (Tex. App.–Houston [14th Dist.] 2011, pet. denied).

The Fifth Circuit held that one liability insurer that defended claims against a swimming pool contractor had a right of subrogation against a second liability insurer that had coverage but refused to defend. *Md. Cas. Co. v. Acceptance Indem. Ins. Co.*, 639 F.3d 701 (5th Cir. 2011). The Fifth Circuit continued to limit *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765 (Tex. 2007), which held that a liability insurer that believed it overpaid in settlement did not have a right of subrogation against another liability insurer that underpaid. The Fifth Circuit distinguished *Mid-Continent* because, in this case the second insurer violated its duty to defend the insured, which gave the insured a right of recovery to which the first insurer was subrogated.

A defendant argued that a trial court erred in recognizing an insurer as subrogee of an insured and awarding damages to the insurer in that capacity. The court of appeals, however, concluded that the insurer was a proper subrogee. The insurer sued from the outset as subrogee and asserted its right to recover in that capacity. The insurer's capacity was not challenged in the trial court. Because the defendants made no complaint in the trial court, the issue was tried by consent, and the trial court did not err in recognizing the insurer as subrogee. *Tex. Delta Mech., Inc. v. Republic Underwriter's Ins. Co.*, No. 05-09-00940-CV, 2011 WL 2572492 (Tex. App.–Dallas Jun. 30, 2011, no pet.) (mem. op., not designated for publication).

B. Allocation

Where there were two insurers for the same loss whose insurance provisions conflicted, the court concluded that it should disregard the conflicting provisions and apportion liability between both insurers on a pro rata basis. The court also held that one insurer was entitled to reimbursement from the other under a theory of contractual subrogation for the amounts it paid over its pro rata share of the defense or indemnity costs. *Millis Dev. & Constr., Inc. v. Am. First Lloyd's Ins. Co.*, No. H-10-3260, 2011 WL 3567331 (S.D. Tex. Aug. 12, 2011).

IX. DAMAGES & OTHER ELEMENTS OF RECOVERY

A. Attorney's fees

The court held that an attorney fee award by a jury of $0 in a case where the plaintiff was only awarded $100 for the cost to tow the insurer's damaged car and $0 for the car repairs, was not so against the great weight and preponderance of the evidence as to be clearly wrong or unjust. The court noted that the coverage for towing was separate from the repairs under the policy, and the plaintiff never previously submitted the towing bill to the insurer. *Crounse v. State Farm Mut. Auto. Ins. Co.*, 336 S.W.3d 717 (Tex. App.–Houston [1st Dist.] 2010, pet. denied).

A title insurer proved that property sellers committed fraud by failing to disclose an existing mechanic's and materialmen's lien for $55,000, causing the title insurer to incur damages and to have the lien removed. *Windsor Village, Ltd. v. Stewart Title Ins. Co.*, No. 10-20298, 2011 WL 61848 (Tex. App.–Houston [14th Dist.] Jan. 6, 2011, no pet.) (mem. op., not designated for publication). However, the insurer was not entitled to attorney's fees for statutory fraud, because the fraud related to real estate but did not relate to a contract that actually effected a conveyance of real estate between the parties.

B. Mental anguish

Evidence was insufficient to support an award of mental anguish damages against a home warranty provider for failing to disclose information about the condition of the house. The homeowner testified that he was angry, that living in the damaged house was difficult, that he felt he had not protected his wife, that the past few years had been a nightmare, and the couple did not entertain family in the home, were embarrassed, and there was no joy. The court concluded this testimony fell short of the high degree of mental pain and distress necessary to allow recovery for mental anguish. *Barnett v. Home of Tex.*, Nos. 14-09-01005-CV, 14-10-00197-CV, 2011 WL 665309 (Tex. App.–Houston [14th Dist.] Feb. 24, 2011, no pet.) (mem. op., not designated for publication).

C. Statutory additional damages

Sufficient evidence supported the jury's finding that the defendant homeowner warranty provider acted "knowingly" by providing minor details from an inspector's report, but omitting more important details about serious problems with the foundation. The court found that the jury reasonably could have determined that the defendant intentionally provided and emphasized certain information while omitting more important information. The trial court therefore erred in disregarding the jury's award of additional damages. *Barnett v. Home of Tex.*, Nos. 14-09-01005-CV, 14-10-00197-CV, 2011 WL 665309 (Tex. App.–Houston [14th Dist.] Feb. 24, 2011, no pet.) (mem. op., not designated for publication).

The subcontractors' insurers argued that the assignment of the contractor's claims was invalid under the anti-assignment provisions of the relevant insurance policies.

X. DEFENSES & COUNTERCLAIMS

A. Anti-assignment clause

A district court considered whether insurers' breaches of their duty to defend estopped them from asserting an anti-assignment provision in connection with their duty to indemnify. After settling a suit against it regarding deficiencies in a skilled nursing facility it had built, a contractor assigned to its insurer its claims against its subcontractors and their insurers. The contractor's insurer, as assignee, sued the subcontractors and their insurers for indemnity. The subcontractors' insurers argued that the assignment of the contractor's claims was invalid under the anti-assignment provisions of the relevant insurance policies. The contractor's insurer argued that the subcontractor's insurers were estopped to assert the anti-assignment provision by breaching their duty to defend. The district court concluded that, as a matter of law, an estoppel defense based on an insurer's alleged breach of the duty to defend the assignor cannot defeat enforcement of an anti-assignment clause in an insurance policy. The court found that Texas law favors enforcement of such clauses except when they interfere with the operation of statute, and distinguished them from "no action" clauses. *Nautilus Ins. Co. v. Conceirge Care Nursing Ctrs., Inc.*, No. H-10-2243, 2011 WL 1363815 (S.D. Tex. Apr. 8, 2011).

B. "Buyback" of insurance policy

A "buyback" agreement between an insured defendant and its insurer was upheld in *General Agents Ins. Co. of Am. v. El Naggar*, 340 S.W.3d 552 (Tex. App.–Houston [14th Dist.] 2011, no. pet. h.). A customer sued its contractor's insurer to collect on a judgment against the contractor. The underlying suit between the customer and the contractor required two trials because the first trial ended in a mistrial. Just after the mistrial, the contractor and the insurer entered into a "buy-back agreement" under which the insurer repurchased the contractor's policy, and the contractor released the insurer from any and all claims arising out of the policy. The plaintiff sought and was granted declaratory judgment that the buy-back agreement was void as against public policy, and the insurer appealed. The plaintiff argued that the agreement was void because the parties knew of the plaintiff's claims when the entered into the agreement and left the plaintiff without a remedy, and because the policy was a prerequisite to the contractor being hired. The court of appeals disagreed, however, because there was no statute requiring that the policy be in place. "Without strong public-policy reasons against enforcement," the court refused to declare the buy-back agreement as void.

C. ERISA Preemption

In *North Cypress Medical Ctr. Operating Co. v. Cigna Healthcare*, 782 F. Supp. 2d 294 (S.D. Tex. 2011), the court found that a hospital's breach of contract claim was not preempted by ERISA, because the hospital's claim was based on the insurer's breach of certain "Discount Agreements" the insurer allegedly entered into with the hospital, and thus implicated a legal duty independent of the ERISA plans. However, the hospital's claims for violations of the prompt payment statute under Texas Insurance Code sections 843.338 and 843.351 were preempted by ERISA. The statutes were explicitly directed toward health maintenance organization (entities engaged in insurance) and were remedial in nature, intending to create a deterrent against delaying reimbursement of claims, and did not affect risk allocation.

D. Late notice

In a case where a hospital was sued for medical malpractice and later settled with the injured party, the court held that the insurer was not prejudiced by late notice given to the insurer eight months after the lawsuit was filed. The hospital was self-insured up to $2 million, but gave the insurer the right to participate in the defense of any lawsuit that might implicate the insurer's coverage. The court held that depositions of nurses, where they admitted negligence, taken prior to the insurer being given notice of suit, did not prejudice the insurer because the insurer did not show how the case would have turned out differently had the insurer been able to prepare the nurses before their depositions. *E. Tex. Med. Ctr. Reg'l Healthcare Sys. v. Lexington Ins. Co.*, No. 6:04-CV-165, 2011 WL 773452 (E.D. Tex. Feb. 25, 2011).

E. Limitations

In *Citi Group, Inc. v. Federal Ins. Co.*, 649 F.3d 367 (5th Cir. 2011), the court held that limitations began to run on the date the insurer sent a letter saying that the insurer "cannot extend coverage" and "no coverage is afforded." The letter did not have to use the word "denial" to constitute a denial sufficient to trigger limitations. The insured's claim was therefore barred by the four year statute of limitations.

F. Misrepresentation or fraud by insured

Where the jury found the insured guilty of misrepresentation and voided the policy, there could be no ratification of that policy by the insurer. *Tex. Farm Bureau Mut. Ins. Co. v. Rogers*, No. 04-10-00546-CV, 2011 WL 3120645 (Tex. App.–San Antonio July 27, 2011, pet. filed).

A title insurance company met its burden of proof to show that an insured property owner committed fraud against it. In its affidavit of debts and liens, the insured failed to disclose a mechanic's and materialman's lien on the property, even though it knew of the lien because its representative had discussed it with the lienholder. In executing the affidavit, the insured had undertaken a duty to disclose the existence of the lien, and the title insurance company relied on the affidavit in issuing the policy. *Windsor Village, Ltd. v. Stewart Title Ins. Co.*, No. 14-09-00721-CV, 2011 WL 61848 (Tex. App.–Houston [14th Dist.] Jan. 6, 2011, no pet.) (mem. op., not designated for publication).

G. Res judicata & collateral estoppel

A pedestrian sued the insurer of an insured driver for damages after the insured struck the pedestrian. The court of appeals agreed that res judicata barred the pedestrian's suit against the insurer because the pedestrian had previously sued the insurer in connection with the same accident, only to have those claims disposed of by summary judgment. The fact that the pedestrian added new causes of action did not prevent res judicata from barring her second suit. *Lynch v. State Farm Mut. Auto. Ins. Co.*, No. 03-10-00477-CV, 2011 WL 2162877 (Tex. App.–Austin, Jun. 2, 2011, no pet.) (mem. op., not designated for publication).

H. Waiver of, or estoppel to assert, defenses by insurer

An insurer did not waive its right not to defend a corporate insured's owner when it defended the corporation and its owner, and then continued to represent the corporation's owner once the corporation was nonsuited prior to trial. The policy did not provide coverage for the corporation's owner and was not expanded to cover risk simply because the insurer assumed control of the defense. However, the court denied the insurer's motion for summary judgment, finding that a fact question existed as to whether the insurer was equitably estopped from declining to defend and indemnify the corporation's owner, as the attorney provided for the insurer failed to provide adequate representation, depriving the owner of the opportunity to provide a more forceful defense. *Canal Indem. Co. v. Palmview Fast Freight Transp., Inc.*, 750 F. Supp. 2d 743 (N.D. Tex. 2010).

XI. PRACTICE & PROCEDURE

A. Pre-suit Notice and Abatement

An insured homeowner sued her insurer after the insurer paid too little for damages to her roof caused by Hurricane Dolly. The insurer moved to abate the suit because the insured had not provided sufficient written notice prior to the suit and had not submitted to an examination under oath as required by the policy. The court of appeals held that the insurer was not entitled to abatement. Although the insured failed to provide notice sixty days before filing suit, more than sixty days had passed by the time the insurer moved to abate. Furthermore, the notice provided sufficiently identified the insured's causes of actions and her alleged damages. And because the insurer had previously investigated and paid the insured's claim, it could have no doubt as to her specific claim. The court also held that the insured did not need to submit to examination under oath before bringing her suit because her duties under the contract existed during the investigation of the claim, which had concluded, and these duties did not continue after disposition of the claim. Therefore, the insurer was not entitled to an abatement. *In re Cypress Tex. Lloyds*, No. 13-11-00070-CV, 2011 WL 3630515 (Tex. App.–Corpus Christi Aug. 15, 2011, orig. proc.).

B. Service of process

Service of process on an insurance company was invalid where the plaintiff attempted to serve the company's president but another person instead signed the green card. There was no evidence in the record to show that the signer was authorized to accept service. *United Servs. Auto. Ass'n v. McGuire*, No. 09-10-00256-CV, 2011 WL 2420988 (Tex. App.–Beaumont June 16, 2011, no pet.) (mem. op., not designated for publication).

C. Standing

An insured homeowner sued her insurer when it refused to pay for the loss of her home after a fire. The insurer showed that the insured had lied about her criminal record. During the suit, the insured died, but her children continued to pursue the claim. The court held DTPA claims do not survive the death of the consumer and cannot be pursued by the consumer's estate who are not themselves "consumers." Therefore, the children did not have standing to pursue the insured's DTPA cause of action. Additionally, because the jury found the insured made a material misrepresentation in her policy application, the policy was void and could not be ratified. *Tex. Farm Bureau Mut. Ins. Co. v. Rogers*, No. 04-10-00546-CV, 2011 WL 3120645 (Tex. App.–San Antonio July 27, 2011, pet. filed).

In a case where an injured party was bitten by the dog of an insured, the court held that the injured party lacked standing to sue the insured's insurance company as a third-party beneficiary of the policy between the insured and his insurance company. Because the insured's liability had not been finally determined by agreement or judgment and because the language of the "medical payments coverage" clause did not overcome the strong presumption against conferring third-party beneficiary status, the court concluded that the injured party lacked standing. The court also held that the issue of standing cannot be waived, so it rejected the injured party's argument that the insurer waived the issue of standing by failing to plead it in its answer. *Farias v. Allstate Ins. Co.*, No. 13-10-00071-CV, 2011 WL 2175220 (Tex. App.–Corpus Christi June 2, 2011, no pet.) (mem. op., not designated for publication).

D. Removal and remand – fraudulent joinder

An adjuster was not fraudulently joined as a defendant in an insured's lawsuit to defeat diversity jurisdiction. The insured's claims against the adjuster and the insurer raised common questions of fact, such as the types of damage covered by the policy and the types and amounts of damage the insured's property sustained. *Centaurus Unity, LP v. Lexington Ins. Co.*, 766 F. Supp. 2d 780 (S.D. Tex. 2011). The court held that independent adjusters can be found liable under the Texas Insurance Code. Therefore, the in-state adjusters who were parties to this case were properly joined, and because they resided in Texas, complete diversity of citizenship was absent. Therefore, the court lacked subject matter jurisdiction and remanded the case.

E. Forum Non Conveniens

A trial court did not abuse its discretion by denying a motion to dismiss based on forum non conveniens so a suit could be refiled in Florida, where the suit had been pending in Texas for almost three years, the motion to dismiss was filed within a week of trial, granting the motion would result in unnecessary delay, and witnesses would be from several jurisdictions. *In re Old Republic Nat'l Title Ins. Co.*, No. 14-10-01219-CV, 2011 WL 345676 (Tex. App.–Houston [14th Dist.] Feb. 1, 2011, orig. proc., no pet.) (mem. op., not designated for publication) (per curiam).

F. Forum selection clause

When an insurer refused to pay the full amount of an insured's claim, the insured sued the insurer in Montgomery County for fraudulent inducement, negligent misrepresentation, and violations of the Insurance Code and the DTPA. The insurer moved to dismiss the suit based on a mandatory forum selection clause in the contract, which said that Utah was the exclusive forum for claims or disputes related to "any insurance coverage issues and any payments due" under the policy. The insured argued that his claims were not related to coverage or payments under the policy because they related to pre-contractual misrepresentations that fell outside the scope of the forum selection clause. The court disagreed. The insured alleged that he did not receive the coverage represented to him and did not receive a payment he would have received if he had the coverage represented to him. The dispute thus related to coverage and payment of a policy that the insured contended the insurer induced him to enter into through fraudulent misrepresentations and, as such, fell within the scope of the forum-selection clause. *In re Prime Ins. Co.*, No. 09-11-00349-CV, 2011 WL 3505143 (Tex. App.–Beaumont

Aug. 11, 2011, orig. proc.) (mem. op., not designated for publication).

G. Arbitration

The court held in *Ranchers & Farmers Mut. Ins. Co. v. Stahlecker* that the trial court had improperly denied the appellant's motion to compel arbitration. The insurance policy included an arbitration agreement, and the court held that the insured's home damage claim related to and was intertwined with the insurance policy; therefore, the arbitration agreement applied to the claim. No. 09-11-00054-CV, 2010 WL 4354020 (Tex. App.–Beaumont Nov. 4, 2010, no pet.) (mem. op., not designated for publication).

H. Appraisal

The supreme court held that mere delay does not waive an insurer's right to demand appraisal. The delay that matters is after the parties reach an impasse. The court held that an impasse occurs when the parties have a mutual understanding that neither will negotiate further. Then, appraisal must be invoked within a reasonable time. The court further held that delay will not waive appraisal unless the insured can show prejudice. While the court

recognized prejudice was shown in arbitration cases by the other party substantially invoking the judicial process, the court stated that it was difficult to see how prejudice could ever be shown for appraisal when the policy gives both sides the same opportunity to demand appraisal. The court reasoned that when an impasse has been reached the party can avoid prejudice by demanding an appraisal itself. *In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W.3d 404 (Tex. 2011).

The court then concluded that mandamus was appropriate to enforce the insurer's right to appraisal, but mandamus would not be granted based on the trial court's failure to grant a motion to abate, and the proceedings need not be abated while the appraisal goes forward.

In a subsequent case a court of appeals declined to grant a writ of mandamus to cause the trial court to abate the suit while appraisal proceeded. *In re Liberty Mut. Group, Inc.*, No. 14-11-00310-CV, 2011 WL 2149482 (Tex. App.–Houston [14th Dist.] May 26, 2011, orig. proc., no pet.) (mem. op., not designated for publication) (per curiam); *see also In re Cypress Tex. Lloyds*, No. 14-11-00726-CV, 2011 WL 4367140 (Tex. App.–Houston [14th Dist.] Sept. 20, 2011, orig. proc.) (mem. op., not designated for publication).

Insured homeowners sued their insurer for breach of contract and bad faith after the insurer paid approximately $2,000 for hail damage that was later estimated to be $65,000. The insurer sought appraisal, but the trial court denied it. The court of appeals affirmed that the insurer had waived appraisal. A year before filing suit, the insureds wrote to the insurer requesting appraisal, but the insurer never responded. The insurer waited another sixteen months after suit was filed to invoke appraisal. Under these circumstances, the trial court correctly denied the insurer's motion for appraisal. *Southland Lloyds Ins. Co. v. Cantu*, No. 04-09-00705-CV, 2011 WL 1158244 (Tex. App.–San Antonio, Mar. 30, 2011, no pet.).

A trial court denied an insurer's motion to compel an appraisal. The insured argued that the insurer waived its rights to appraisal by denying all liability on her home damage claim. The court of appeals disagreed and conditionally granted mandamus relief to compel appraisal. Although causation was at issue, the court found that the appraisal should be determined as an initial mater to assess damages, leaving the parties to then litigate causation questions. Further, the insurer did not waive its rights to appraisal. The policy stated that no provision is waived unless the terms of the policy allow it, and the appraisal clause did not provide for a forfeiture of that right. The policy also did not require an admission of liability to invoke the appraisal clause. *In re Southern Ins. Co.*, No. 09-11-00022-CV, 2011 WL 846205 (Tex. App.–Beaumont, Mar. 10, 2011, orig. proceeding) (mem. op., not designated for publication).

The court in *Glenbrook Patiohome, Owners Ass'n v. Lexington Ins. Co.*, held that the insurer's denial of payment did not in itself waive the insurer's right to appraisal. The court went on to state that an insured cannot avoid appraisal because there might be a coverage or causation question that exceeds the scope of appraisal. Therefore, the court granted the insurer's motion to compel appraisal. No. H-10-2929, 2011 WL 666517 (S.D. Tex. Feb. 14, 2011).

A property insurer moved to compel appraisal of hurricane damage to an insured's property. The insured opposed the motion on grounds that the insurer failed to conduct a reasonable investigation of his claims and thus had not complied with the conditions precedent for appraisal. He also argued that the insurer waived its right to appraisal and that the appraisal clause was unconscionable. *Dike v. Valley Forge Ins. Co.*, No. H-11-376, 2011 WL 2517270 (S.D. Tex. Jun. 23, 2011). The district court granted the motion to compel appraisal. Compliance with the claims handling provisions of the policy and the Texas Insurance Code were not conditions precedent to exercising appraisal rights. The appraisal clause did not use conditional language, and no other policy language made the compliance with the claims handling provisions a condition precedent. The insurer did not waive its right to appraisal, regardless of the length of its delay, because the insured was not prejudiced by the delay. Finally, the appraisal clause was not unconscionable, because it was not the product of fraud, accident, or mistake.

I. Pleadings

A federal district court considered whether a pleading alleging unfair insurance practices, deceptive trade practices, prompt payment violations, and breach of the duty of good faith and fair dealing was sufficiently specific to withstand a motion to dismiss under Fed. R. Civ. P. 12(b)(6) for failure to state a claim. The court held the pleading was not sufficiently specific but allowed the plaintiff an opportunity to amend. *SHS Investment v. Nationwide Mut. Ins. Co.*, No. H-10-4004, 2011 WL 2551036 (S.D. Tex. June 27, 2011). The district court considered the recent supreme court decisions in *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009), to state that the plaintiff must allege enough facts to state a claim to relief that is plausible on its face, and a claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.

The district court noted that pleadings of Insurance Code violations and deceptive trade practices are subject to the requirements of Fed. R. Civ. P. 9(b), which requires the allegations of fraud state with particularity the circumstances constituting fraud.

The court found that the plaintiff's lengthy allegations of different violations were largely composed of legal conclusions couched as factual allegations, formulaic recitations of the elements of a cause of action, generic paraphrases of statutory language, and conclusory statements without supporting facts.

As examples of deficiencies, the court asked: Why did the insurer issue supplemental payments; how and when did the plaintiff know repairs would cost more than it was paid; what did an engineer's report and estimate state; what were plaintiff's other claim loses and their value as estimated by the insurer and by plaintiff's expert; what provision in the policy covered what particular loses; which damages did the insurer undervalue and underpay and in what amount; which elements of damages did the insurer misrepresent and where in the policy were they covered; what conduct by the insurer misrepresented what; what attempts to settle were made and why were they unfair; how was the insurer aware of its liability and what provisions in the policy made it liable; what were examples of settlement offers and how was the payment inadequate; what was the reasonable time to pay the claim; and what made the insurer's liability reasonably clear?

J. Discovery

A trial court abused its discretion by limiting an UIM insurer's deposition of the insured to only conditions that happened since the date of the prior deposition in the underlying lawsuit, which had settled. The insured failed to make any showing of undue burden, harassment, or duplication. Further, the trial court abused its discretion by ordering an advanced sanction of $100 for any question asked in violation of its protective order. *In re State Auto Prop. Cas. Ins. Co.*, 348 S.W.3d 499 (Tex. App.–Dallas 2011, orig, proc., pet. denied).

An insured's internal communications were privileged. *In re Energy XXI Gulf Coast, Inc.*, No. 01-10-00371-CV, 2010 WL 5187730 (Tex. App.–Houston [1st Dist.] Dec. 23, 2010, orig. proc.) (mem. op., not designated for publication). A suit arose between an insured's oil and gas company and its insurance broker regarding the amount of coverage the insured had for one of its wells and whether the insured had asked for an increase in coverage. After the well suffered a blowout, the broker sent an e-mail to the insured, in which the broker denied that the insured had requested an increase in coverage and confirmed that the insured had only half the coverage it thought it had. The court concluded that the insured's internal communications following the broker's email were privileged as work product because, at that point, the insured and the broker were taking directly adverse positions as to which one was at fault for failing to secure additional coverage. A reasonable person would thus conclude there was a substantial chance that litigation would ensue.

An insurer sought mandamus relief to obtain documents and depose the general partner of its insured, which had previously assigned to a tort victim its right to bring a *Stowers* action against the insurer. The insurer argued that the deposition was necessary for it to prove its *Gandy* defense and show that the underlying judgment from the suit between the insured and the tort victim was the result of a fully adversarial trial. The court of appeals denied the insurer's request for mandamus relief, finding that the insurance company had an adequate remedy on appeal. In a prior interlocutory appeal, the court of appeals had already found that the evidence raised a genuine issue of material fact regarding whether the judgment from the underlying suit was the result of a fully adversarial trial. As such, while the documents and deposition testimony sought might bolster the insurer's *Gandy* defense, it was not so vital as to justify mandamus relief. *In re Yorkshire Ins. Co.*, 337 S.W.3d 361 (Tex. App.–Amarillo 2011, orig. proc.).

K. Severance & separate trials

A trial court did not abuse its discretion by ordering severance of contract claims against an uninsured motorist carrier and extracontractual claims. *In re State Auto Property Cas. Ins. Co.*, 348 S.W.3d 499 (Tex. App.–Dallas 2011, orig. proc., pet. denied).

A court held that the insured's extracontractual claims and statutory claims for prompt payment should be severed from the breach of contract claim, after the insurer offered to settle the breach of contract claim. The insured rejected the insurer's offer. The court stated the claims must be severed to avoid prejudice to the insurer in its defense of the coverage dispute. *In re Loya Ins. Co.*, No. 01-10-01054-CV, 2011 WL 3505434 (Tex. App.–Houston [1st Dist.] Aug. 11, 2011, no pet.) (mem. op., not designated for publication).

L. Experts

A trial court did not err by allowing expert testimony from an insurance adjuster who gave his opinion that hail damage did not cause interior water damage to a motel and that the water damage was preexisting. The testimony was not speculative on its face because the adjuster testified based on his training and inspecting roofs and 28 years of experience, and supported his opinions with objective data by referring to photographic evidence regarding the condition at the motel. Further, to the extent the plaintiffs were challenging the expert's qualifications or the reliability of his testimony, the court held those objections were waived. *Patel v. Nautilus Ins. Co.*, No. 13-08-00735-CV, 2011 WL 345967 (Tex. App.–Corpus Christi Jan. 28, 2011, pet. denied) (mem. op., not designated for publication).

The court in *Dickerson v. State Farm Lloyd's, Inc.*, held that three experts were properly struck, which then left the injured party with no causation evidence. A man was killed in a car accident, and his estate brought suit against the driver and the decedent's underinsured motorist insurer. The court held that a doctor could not testify regarding accident reconstruction as it was not within his "knowledge, skill, experience, training, or education." The court also held that the injured party had not qualified the EMT as an accident reconstructionist and that the accident reconstructionist's opinions were unreliable because there were too many analytical gaps. Therefore, the court affirmed the trial court's summary judgment in favor of the alleged tortfeasor. As a result, the underinsurance issue was moot. No. 10-11-00071-CV, 2011 WL 3334964 (Tex. App.–Waco, Aug. 3, 2011, pet. filed) (mem. op., not designated for publication).

In a case involving hail damage to an insured's home, the insureds did not call the expert who had actually inspected and appraised the damage to their home, but instead called an expert who had adopted the prior expert's estimate and report. The insurer complained that the testifying expert's testimony was irrelevant and unreliable because he did not review the policy or opine on whether the damage was covered, his estimate exceeded the house's value, and he did not verify whether the items listed as damages in the report were actually damaged. The court of appeals rejected these arguments and found the testimony relevant. The expert was called to opine only on the estimated cost to repair damage caused by the hailstorm, which only required him to determine what damage was attributable to hail. It was not necessary for him to review the policy or opine whether the damage was covered. The court also concluded that the estimate was economically feasible, even though it exceeded the value of the home, because he adequately explained that the amount of work to repair a house has nothing to do with the amount of insurance available to pay for those repairs. The court further found that the expert's alleged failure to verify the items of damage went to the weight of evidence, and not its relevance or reliability. The insurer also argued that the testifying expert's testimony was irrelevant and unreliable because he merely "parroted" the prior expert's report. The court disagreed, finding that the prior expert's professional judgment was within the testifying expert's knowledge: both were experienced adjusters; the testifying expert was familiar with the software used by the prior expert to prepare his report; the manner in which the prior expert prepared the estimate was no different than the way the testifying expert would have done it; the two experts had adjusted many claims together; and the testifying expert independently inspected and verified the damage to the house as represented in the report. Accordingly, the court held that the testifying expert's testimony was relevant and reliable. *Southland Lloyds Ins. Co. v. Cantu*, No. 04-09-00705-CV, 2011 WL 1158244 (Tex. App.–San Antonio Mar. 30, 2011, no pet.).

After the insured's building was damaged during Hurricane Ike, the insurer refused to pay, asserting that the damage was normal wear and weathering. The insurer relied on its expert in maintaining its position. The court granted summary judgment in favor of the insurer on an insured's claims for bad faith, unfair settlement practices under the Texas Insurance Code, prompt payment of claims, deceptive trade practice violations, and fraud. Although reliance on expert reports does not preclude a bad faith claim if there is evidence that the reports were not objectively prepared or that the insurer's reliance was unreasonable, the court held in this case that there was nothing in the record to show that the insurer's decision to believe its own experts was unreasonable. *Lee v. Catlin Specialty Ins. Co.*, 766 F. Supp. 2d 812 (S.D. Tex. 2011).

M. Burden of proof

A court reversed and rendered judgment against a builder that recovered repair costs against its insurer, where the builder failed to segregate covered amounts from uncovered amounts. *Markel Am. Ins. Co. v. Lennar Corp.*, 342 S.W.3d 704 (Tex. App.–Houston [14th Dist.] 2011, pet. filed). The builder had voluntarily removed defective artificial stucco from a number of homes. The builder incurred costs in removing stucco to repair water damage and in removing stucco to determine whether there was water damage. The court found the former was covered but the latter was not. Because the builder failed to offer proof segregating these damages, the court held that failure to segregate covered and uncovered perils was fatal to recovery.

N. Court's charge

In *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 639 F.3d 701 (5th Cir. 2011), the court approved the following definition of "occurrence":

> "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. A deliberate act, performed negligently, is an accident if the effect is not the intended or expected result.

Id. at 706. The court found the first sentence was quoted from the insurance policy, and the second sentence came from the Texas Supreme Court's opinion in *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007). The court found the district court did not err by declining to include another sentence from *Lamar Homes* stating, "an occurrence is not an accident if circumstances confirm that the resulting damage was the natural and expected result of the insured's action, that is, was highly probable whether the insured was negligent or not." Even though this language also came from Lamar Homes, the Fifth Circuit held this was fairly close to the converse of the instruction that was already given and the insurer did not show how it would have argued the case any differently with the requested instruction.

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1 *Tex. Mut. Ins. Co. v. Ruttiger*, No. 08-0751, 2011 WL 3796353, 54 Tex. Sup. Ct. J. 1642 (Aug. 26, 2011) (overruling *Aetna Cas. & Sur. Co. v. Marshall*, 724 S.W.2d 770 (Tex. 1987)).
2 *Aranda v. Ins. Co. of N. Am.*, 748 S.W.2d 210 (Tex. 1988).
3 *Leordeanu v. Am. Prot. Ins. Co.*, 330 S.W.3d 239 (Tex. 2010).
4 *Ojo v. Farmers Group, Inc.*, No. 10-0245, 2011 WL 2112778, 54 Tex. Sup. Ct. J. 1068 (May 27, 2011).
5 *In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W.3d 404 (Tex. 2011).
6 *Lancer Ins. Co. v. Garcia Holiday Tours*, 345 S.W.3d 50 (Tex. 2011).
7 See *Weingarten Realty Mgmt. Co. v. Liberty Mut. Fire Ins. Co.*, 343 S.W.3d 859 (Tex. App.–Houston [14th Dist.] 2011, pet. denied) and *Guideone Specialty Mut. In. Co. v. Missionary Church of Disciples of Jesus Christ,* No. 4:11-CV-009-A, 2011 WL 3805463 (N.D. Tex. Aug. 16, 2011).
8 *Taylor v. Allstate Ins. Co.*, No. 01-09-00457-CV, 2011 WL 1233331 (Tex. App.–Houston [1st Dist.] Mar. 31, 2011, pet. filed); *Mid-Continent Cas. Co. v. Eland Energy, Inc.*, No. 3:06-CV-1576-D, 2011 WL 2417158 (N.D. Tex. June 14, 2011).
9 *General Agents Ins. Co. of Am. v. El Naggar*, 340 S.W.3d 552 (Tex. App.–Houston [14th Dist.] 2011, no. pet. h.).
10 The majority opinion contains a lengthy description of the negotiation process for a Lloyds of London policy, quoting from *Houston Cas. Co. v. Certain Underwriters at Lloyd's London*, 51 F. Supp. 2d 789, 791-92 (S.D. Tex. 1999).

FCRA Preemption of State Law

A GUIDE THROUGH MUDDY WATERS

By Chad M. Pinson and John B. Lawrence*

I. Introduction

This article discusses various issues with Fair Credit Reporting Act [FCRA] preemption, highlighting the most unsettled preemption issues under the statute. A review of these issues reveals a judicial need to more broadly construe and thoroughly enforce the FCRA's preemption provisions to provide for more certain outcomes by credit market participants, create more efficient interstate credit markets, and provide more credit opportunities for consumers.

It is vital that we have a national credit reporting system. Creditors need to be able to make credit decisions quickly – and often at a distance – with confidence that those decisions are grounded in correct information about the consumer.

Recognizing this, Congress in 1970 enacted the Fair Credit Reporting Act.[1] It saw a need to ensure that the credit reporting agencies, which "have assumed a vital role in assembling and evaluating consumer credit and other information on consumers . . . , exercise their grave responsibility with fairness, impartiality, and a respect for the consumer's right to privacy."[2] Although many states already possessed laws governing credit reporting, requiring the interstate entities that make up the credit reporting network to comply with fifty sets of laws was unworkable. Congress recognized a need to create "a uniform national standard," so "companies will not have to comply with a patchwork of State laws."[3]

Despite Congress's stated goal of providing clarity to the credit reporting world, the FCRA — through amendments and additions — has itself become a patchwork of at times inconsistent regulations. In its current form, it contains three principal provisions dictating when and how the

FCRA preempts state law. Section 1681t(a) is the general preemption provision, providing that the FCRA does not preempt state law except to the extent those laws are inconsistent with the FCRA.[4] The subsequent provision, section 1681t(b), lists more that twenty specific FCRA sections, declaring that no state may impose any requirement or prohibition with respect to duties arising under those sections.[5] Finally, section 1681h(e) provides that consumers may not bring certain tort claims against credit reporting agencies, furnishers of credit information, or users of that information.[6]

The state of the law interpreting these preemption provisions is confused, with some courts (relying on strained reasoning and disregarding the purpose behind the statute) giving them a far more narrow reading than others. Nationwide uniformity in interpretation is key to the functioning of the FCRA. Without it, reporting agencies and information furnishers have no clear guidance in administering the reporting system, and consumers have no clear guidance in seeking recourse against unlawful practices.

This article discusses each of the three principal FRCA preemption provisions, examining their function and the interplay between them. As is apparent from the statute and the case law, interpreting the FCRA's provisions fairly and properly results in a broad and comprehensive preemption scheme, which in turn leads to a more effective FCRA.

II. General preemption of "inconsistent" state law.

Since its enactment, the FCRA has included a general statement concerning its preemption of inconsistent state law. In its current form, that provision reads,

> [T]his title does not annul, alter, affect, or exempt any person subject to the provisions of this title from complying with the laws of any State with respect to the collection, distribution, or use of any information on consumers, or for the prevention or mitigation of identity theft, *except to the extent that those laws are inconsistent with any provisions of this title*, and then only to the extent of any inconsistency.[7]

What makes a state law "inconsistent" with the FCRA? Courts construe the term such that a state law is not inconsistent merely because it regulates a matter addressed by the FCRA.[8] Rather, FCRA section 1681t(a) preempts only those state laws "in direct conflict with federal law such that compliance with both is impossible, or the state law is an obstacle to the accomplishment of the full purposes and objectives of Congress."[9] This is in harmony with the Federal Trade Commission's interpretation of the section, which states that the "basic rule" is that "State law is preempted by the FCRA only when compliance with inconsistent State law would result in violation of the FCRA."[10]

Creditors need to be able to make credit decisions quickly – and often at a distance – with confidence that those decisions are grounded in correct information about the consumer.

Applying these principles, the Eight Circuit in *Davenport v. Farmers Ins. Group* upheld a provision in the Minnesota Insurance Fair Information Reporting Act that insurers notify customers and secure written authorization before collecting and disclosing the customers' personal information.[11] Plaintiffs alleged that the defendant-insurer violated the provision by not securing their authorization before collecting and disclosing their personal information.[12] The insurer moved to dismiss, arguing that because the FCRA allows the collection and disclosure of such information and does not require any notice or authorization, the federal law preempted the MIFIRA.[13] The district court found that the FCRA did not preempt this state statute. The Eighth Circuit agreed, noting that while the insurance company was correct that the FCRA does not expressly require insurance companies to notify consumers before collecting personal information, it also does not affirmatively prohibit them from doing so without first providing notice.[14] The state law thus was not "inconsistent with" the FCRA.[15]

Not all state laws containing more stringent requirements than the FCRA, however, are consistent with the federal scheme. In *Retail Credit Company v. Dade County*, the court held that the FCRA preempted a county ordinance requiring reporting agencies disclosing information to consumers to also disclose the source of that information.[16] The plaintiff reporting agency brought the action seeking a declaratory judgment that the ordinance was invalid. Compliance with the ordinance did not inherently require violation of the FCRA, as the FCRA provided only that the reporting agency "need not" disclose the source of the information.[17] A reporting agency would not be in violation of the FCRA for doing so. Nevertheless, the court held that the county ordinance was preempted after examining the FCRA's legislative history. Early drafts of the FCRA contained provisions requiring the disclosure of the source, but this detail was "deliberately omitted" from the final bill after Congress heard testimony that the disclosure of information sources could potentially result in the "drying up" of those sources.[18] The law thus was inconsistent with the FCRA even though it was not incompatible with the text of the FCRA.

III. Exceptions to the general preemption provision.

The FCRA underwent a substantial revision in 1996. The general provision that the FCRA does not preempt state laws except to the extent they are inconsistent with the FCRA remained, but Congress added a litany of exceptions to that general provision.[19] Now, whether they are otherwise inconsistent with the FCRA or not, "[n]o requirement or prohibition may be imposed under the laws of any state with respect to" issues related to various FCRA sections.[20]

Many of these exceptions are narrow and specific. For example, no state may impose any requirement or prohibition with respect to "the conduct required by" the FCRA's sections covering credit card number truncation, fraud alerts, consumer complaints coordination among agencies, or records disposal.[21] Similarly, states may not impose any requirement or prohibition with respect to the frequency of free annual credit disclosures.[22]

Others are written broadly, and as a result are more likely to be open to various interpretations. The nine exceptions under section 1681t(b)(1), for example, preempt all state requirements or prohibitions "with respect to any subject matter regulated under" various FCRA sections.[23] By preempting state laws concerning "the subject matter" of these sections, Congress expanded the FCRA's preemptive reach beyond the duties and procedures specifically enumerated therein. Subject matters covered by these provisions include the information contained in consumer reports, the prescreening of consumer reports, information available to identify theft victims, and the use of consumer information to make a solicitation for marketing purposes.[24] States may impose no requirement or prohibition concerning these subject matters, even if the law concerns an aspect of the subject matter that is not covered in the FCRA. Whether a state law implicates one of these "subject matters," however, may not always be clear. As is discussed in Section V.D below, courts and litigants have expended considerable energy since 1996 debating which state law claims implicate "the subject matter regulated under § 1681s-2, relating to the responsibilities of persons who furnish information to consumer reporting agencies."[25]

IV. Preemption of claims "in the nature of defamation, invasion of privacy, or negligence" against credit reporting agencies.

In what courts have described as a "quid pro quo for full disclosure," section 1681h(e) grants consumer reporting agencies qualified immunity from certain tort claims.[26] Under this provision,

> no consumer may bring any action or proceeding in the nature of defamation, invasion of privacy, or negligence with respect to the reporting of information against any consumer reporting agency, any user of information, or any person who furnishes information to a consumer reporting agency, based on information disclosed pursuant to sections 1681g, 1681h, or 1681m of this title, or based on information disclosed by a user of a consumer report to or for a consumer against whom the user has taken adverse action, based in whole or in part on the report, except as to false information furnished with malice or willful intent to injure such consumer.[27]

The FCRA thus preempts state law causes of action "in the nature of" defamation, invasion of privacy, or negligence if two prerequisites are met: (1) the information was disclosed pursuant to sections 1681g, 1681h, or 1681m; and (2) the defendant did not act with malice or willful intent.[28]

A. *Impact of the requirement that the information be disclosed pursuant to sections 1681g, 1681h, or 1681m.*

Sections 1681g, 1681h, and 1681m all govern disclosures made *to* consumers. The former two require consumer reporting agencies to disclose consumer information to a consumer at his or her request, while the latter requires users of consumer reports taking adverse action against a consumer to disclose information to that consumer.[29] Because these sections do not regulate disclosures made to third parties, plaintiffs have argued that section 1681h(e) preempts only those claims arising from communications between the defendant and the consumer.

The better reading of section 1681h(e), however, is that it should not be read so narrowly. The preemption is plainly meant to encompass some actions for defamation, as defamation is one of the three causes of action specifically listed in the provision.[30] But a cause of action for defamation *necessarily* arises out of a disclosure to a third party.[31] Thus under the narrow reading, "the provision would bar only those defamation claims that would fail as a matter of law."[32] The inclusion of defamation in section 1681h(e) would be superfluous and meaningless. To interpret the statute in such a way would violate the well-established principle of statutory construction that, "a statute ought, upon the whole, to be so constructed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant."[33] Accordingly, some courts have rejected the narrow reading entirely.[34]

Other courts have declined to hold that section 1681h(e) preempts state law claims when the disclosure is made to a third party, but effectively arrive at the same result by holding that a claim is preempted if the consumer receives a copy of the report *at any time*.[35] In *Thornton*, the plaintiff first became aware that her credit report contained the allegedly defamatory statement— that she had been "for the past four months living without benefit of matrimony with a male companion"—when her insurance agent called requesting information on the "companion."[36] Thornton requested a copy of the report, and then sued Equifax for defamation and libel.[37] The Eighth Circuit held that Thornton's receipt of her report brought her claims within the section 1681h(e)'s preemption, even though she requested the report only after being informed by a third party of the allegedly tortious statement.[38] Other courts have similarly found that "[t]he conditional privilege of section 1681h(e) applies even though the consumer first learns of the derogatory information from a third party, as long as the credit reporting agency later provides the information to the consumer pursuant to the FCRA."[39] A consumer complaining of information in a credit report is likely to at some point request and receive the report pursuant to the FCRA. Because of this, a defendant will rarely if ever be faced with a suit based solely on a disclosure made to third parties.

B. *The claim is preempted unless the defendant acted with malice or willful intent.*

Even if the consumer establishes that the information at issue was never disclosed pursuant to sections 1681g, 1681h, or 1681m, the state law claim is still preempted by the FCRA unless the defendant acted "with malice or willful intent to injure" to consumer.[40] Because "malice" is not defined in the FCRA, courts use the meaning given to the term in the context of libel litigation.[41] In that context, the Supreme Court has held that a statement is made with malice if it is made "with knowledge that it was false or with reckless disregard of whether it was false or not."[42] "Reckless disregard," in turn, is shown through evidence that the defendant "entertained actual doubt about the truth of the statement."[43]

Because malice cannot be shown except where the reporting agency actually knew a statement was false, or doubted its truthfulness, the claim is necessarily preempted if the defendant had no notice of the inaccuracy at the time the report was made.[44] In *Yeager*, the consumer brought claims for defamation, invasion of privacy, negligence, and tortious interference against TRW.[45] The dispute centered on a civil judgment that was incorrectly listed on four successive credit reports, which Yeager claimed resulted in lenders denying him credit he otherwise would have obtained.[46] Yeager did not learn of or inform TRW of the problem until after the third credit report was issued. The court granted TRW summary judgment with respect to the first three credit reports, holding that "[m]alice cannot be shown where there is no evidence which would indicate that the agency in question had notice of the inaccuracy in its report until after the report was published."[47] Because Yeager had notified TRW of the mistake prior to the issuance of the fourth report, the claims as they related to that final report were allowed to proceed.[48]

It is similarly difficult to show "willful intent," which is demonstrated by establishing that the defendant "knowingly and intentionally commit[ted] an act in conscious disregard for the rights of others."[49] The willful intent prong of the preemption test results in somewhat of a paradox within section 1681h(e). The provision purports to preempt claims "in the nature of . . . negligence . . . except as to false information furnished with . . . willful intent,"[50] but there of course can be no claim of negligence alleging willful intent. As one court explained,

> This results in a requirement that Plaintiff prove intentional or malicious negligence. This level of negligence is inherently contradictory in that negligence does not include an element of intent. In fact, "intentional negligence" is an oxymoron. There is no cause of action . . . for negligence where the offending action was taken with intent to injure.[51]

Whether or how this contradiction impacts the interpretation of the statute is unclear. Congress plainly intended to preempt all claims that do not involve malicious or intentional injury, including negligence claims.

V. Preemption of claims "in the nature of defamation, invasion of privacy, or negligence" against credit information furnishers.

On its face, section 1681h(e) applies equally to any "person who furnishes information to a consumer reporting agency" as it does to consumer reporting agencies themselves.[52] And for almost 30 years after the FCRA's enactment, it did. But in 1996, when Congress added the preemption provisions in section 1681t(b), one of those exceptions to the general rule provided that "[n]o requirement or prohibition may be imposed under the laws of any State with respect to any subject matter regulated under §1681s-2, relating to the responsibilities of persons who furnish information to consumer reporting agencies."[53] (Section 1681s-2(a) regulates the duty of a furnisher of information to provide accurate information; section 1681s-2(b) regulates the duties a furnisher of information has upon receiving notice of a dispute.)[54]

The addition of section 1681t(b)(1)(F) has resulted in a heated debate as to how to reconcile it with section 1681h(e). "Attempting to reconcile the two sections has left the district courts in disarray."[55] The inconsistency between the two is clear. Under section 1681h(e), credit information furnishers may not be found liable for state law defamation, invasion of privacy, or negligence claims "*except* as to false information furnished with malice or intent to injure."[56] But under section 1681t(b)(1)(F), credit information furnishers are not subject to *any* state law related to their role as furnishers.[57]

Fifteen years after section 1681t(b)(1)(F) was introduced, this debate is still unresolved. No circuit court has addressed the issue,[58] but the dozens of federal district courts that have tackled it have over time developed three distinct approaches: the "total preemption" approach, the "statutory" approach, and the "temporal" approach.[59] Even within some circuits, there is no consensus as to which of these disparate theories is correct.[60]

A. *The "total preemption" approach.*

The clearest of the three approaches is the "total preemption" approach, which, as its name implies, posits that with the addition of section 1681t(b)(1)(F) all state law claims against credit information furnishers that touch upon FCRA-related issues are preempted.[61] Courts adopting this approach contend that, despite the fact that Congress did not remove mention of credit information regarding furnishers in section 1681h(e), it intended for the new section 1681t(b)(1)(F) to preempt even those claims previously allowed under 1681h(e). As explained by the court that first adopted the approach,

> While Congress did not specifically provide . . . that section 1681t supersedes 1681h, it is clear from the face of section 1681t(b)(1)(F) that Congress wanted to eliminate all state causes of action "relating to the responsibilities of persons who furnish information to credit reporting agencies." Any other interpretation would fly in the face of the plain meaning of the statute.[62]

Where this approach is applied, a consumer may not bring any state law claim concerning a furnisher's FCRA obligations, "including those involving malicious and willful tortious conduct."[63]

B. *The "temporal" approach.*

The total preemption approach has been criticized by some courts, which believe it contravenes the principle that statutes should not be construed in a manner that renders any clause or word superfluous.[64] They argue that total preemption improperly ignores the fact that the words "person who furnishes information to a consumer reporting agency" remain in section 1681h(e). Nevertheless, these courts recognize that some theory is needed to reconcile sections 1681h(e) and 1681t(b)(1)(F).

The temporal approach is one such attempt to harmonize the two sections without finding total preemption. Under this approach, section 1681h(e) preempts state law claims based on the actions of a furnisher of information *before* the receiver has received notice of the inaccuracy, and section 1681t(b)(1)(F) applies *after* the furnisher receives such notice.[65]

Sections 1681s-2(a)(1)(A) and (B) govern the furnishing of information with "reasonable cause to believe that the information is inaccurate" or after notification from the consumer of an inaccuracy.[66] Section 1681s-2(b) specifically deals with duties after receiving a notice of dispute from a reporting agency.[67] Thus, courts adopting the temporal approach reason that section 1681s-2 only regulates furnishers of information after they receive notice that the furnished information may not be accurate.[68] Because section 1681t(b)(1)(F) applies only to "subject matter[s] regulated under § 1681s-2,"[69] these courts believe that section 1681h(e) still governs the preemption of claims arising prior to the furnisher receiving actual or constructive notice of inaccuracy.[70]

The end result of this approach is that state law claims against furnishers are preempted unless both (1) the actions giving rise to the claim occurred before the furnisher had notice of the inaccuracy, and (2) the claim alleges malice or willful intent to injure the consumer.[71]

C. *The "statutory" approach.*

The third approach to reconciling the two preemption provisions is the "statutory" approach, under which section 1681t(b)(1)(F) preempts only statutory state causes of action, leaving section 1681h(e) to address the preemption of common law state causes of action.[72] Courts applying this approach reason that section 1681h(e) refers to common law causes of action—"defamation, invasion of privacy, or negligence"[73]—while section 1681t(b)(1)(F) "appears to" deal only with state statutory regulations.[74] In support of the latter point, these courts note that Congress excepted two state statues from being preempted by section 1681t(b)(1)(F).[75] Thus under the statutory approach, a consumer cannot bring any state statutory claim against a credit information furnisher, but can bring a state common law claim if either malice of willful intent to injure is alleged.

D. *Conclusion: "Total preemption" is the most sensible approach.*

Of these three theories, the total preemption approach finds the most support in the FCRA, and most faithfully captures Congressional intent. The other two approaches are founded on misreadings of the FCRA, and result in preemption schemes that can only be described as illogical.

The temporal approach is based on the fallacy that section 1681s-2 only governs a furnisher's responsibilities after receiving notice of an inaccuracy. In reality, the "subject matter regulated under section 1681s-2"[76] is the "duty of furnishers of information to provide accurate information,"[77] regardless of whether the furnisher has notice of any inaccuracy.[78] Moreover, this approach leads to a "perverse"[79] and "troubling"[80] result: it gives furnishers more protection for acts committed after receiving notice of dispute than for acts committed before receiving notice.[81] If the temporal approach is correct, a consumer can bring a tort action against a furnisher who had no notice that the information was incorrect, but is prevented from bringing a tort action against a furnisher who had notice of the incorrect information, even if the furnisher acted with willful intent to injure the consumer.[82] This cannot have been the intent of Congress. As one court remarked, "[i]t seems odd . . . that Congress intended to protect furnishers of information more once they have knowledge that a consumer is disputing an item on his credit report; one would, logically, expect the opposite policy."[83]

The total preemption approach is the fairest reading of the statute, and is the most supportive of the clear Congressional intent.

The result of the statutory approach is nearly as puzzling. There is no logical reason why Congress would indiscriminately preempt all statutory claims, but allow certain common law claims. Nothing inherent to statutory claims separates them from common law claims, other than the fact that they are codified. An objective look at sections 1681h(e) and 1681t(b)(1)(F) demonstrates that Congress did not endeavor to create separate preemption rules for statutory and common law claims. Section 1681t(b)(1)(F) does not limit itself to statutory claims. The evidence cited by courts in support of the conclusion that it does so—that there are two exceptions to the provision, and they are both statutes—is superficial, and the reliance on it is misguided. Courts applying the statutory approach thus are forced to "read[] an element into section 1681t(b)(1)(F) that its text does not contain."[84] Likewise, section 1681h(e) does not limit itself to common law claims. It specifically applies to "any action or proceeding *in the nature of* defamation, invasion of privacy, or negligence."[85] There is no reason why this should not apply equally to any statutory claim that is "in the nature of" defamation, invasion of privacy, or negligence.

Indeed, the United States Supreme Court, interpreting another federal law preempting any "requirement or prohibition . . . imposed under State Law," rejected the argument that Congress intended only to trump state statues.[86] "[S]uch an analysis is at odds both with the plain words of the [Act] and with the general understanding of common-law damages actions. The phrase '[n]o requirement or prohibition' sweeps broadly and suggests no distinction between positive enactments and common law; to the contrary, those words easily encompass obligations that take the form of common-law rules."[87] The same analysis applies equally to the FCRA.

As one district court explained, the "plain language of section 1681t(b)(1)(F) clearly eliminated all state causes of action against furnishers of information."[88] The section unambiguously states that "[n]o requirement or prohibition may be imposed under the laws of any State . . . relating to the responsibilities of persons who furnish information to consumer reporting agencies."[89] Another court put it even more succinctly: "[Section 1681t(b)(1)(F)] is clear and unequivocal. It means what it says."[90] The legislative history confirms that the total preemption approach reflects Congress's intent.[91] Representatives Kennedy and Thomas explained that the 1996 amendments to section 1681t were meant to create "a uniform national standard," "so companies will not have to comply with a patchwork of State laws."[92] Allowing consumers to bring any state law claim arising out of a credit information furnisher's FCRA responsibilities would frustrate Congress's intent in creating that uniform national standard.[93] It is no surprise that within the Ninth Circuit, whose courts may have the most experience with consumer FCRA claims, this is the majority view.[94]

The temporal and statutory approaches grew out of a desire to read the FCRA in a manner that does not render superfluous the words "person who furnishes information to a consumer reporting agency" in section 1681h(e). But those alternate approaches suffer from and create even greater problems. They cut off the FCRA's nose to spite its face. "[W]hile the rule against superfluities is a helpful tool of statutory interpretation, it is not an inexorable command, and need not be followed at all costs."[95] None of the three approaches is without problem, but the total preemption approach is the fairest reading of the statute, and is the most supportive of the clear Congressional intent.

VI. Conclusion

Congress rightly intended the FCRA to serve as a comprehensive statute regulating the practice and industry of credit reporting. Over the years, numerous states have enacted legislation further regulating this conduct. These statutes, although well meaning, make it inefficient and often confusing for lenders, creditors, and credit reporting agencies to conduct business. This is especially true in an increasingly mobile and transient consumer/borrower population with more interstate creditor/consumer-lender situations. This ultimately negatively impacts consumers, borrowers, and credit applicants caught up in a credit reporting system made more inefficient by an ever-expanding web of state regulation that approaches and often subtly encroaches on the FCRA — which was intended to be comprehensive and generally preemptive. In gray areas courts would serve Congressional intent, market efficiency, and consumer interests by interpreting FCRA preemption broadly. This would eliminate confusion, provide certainty, and make credit markets more efficient and available.

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1 15 U.S.C. § 1681, et seq.
2 15 U.S.C. § 1681.
3 Kodrick v. Ferguson, 54 F. Supp. 2d 788, 794 (N.D. Ill. 1999) (quoting 140 Cong. Rec. H9810–11) (concerning the 1996 amendment to the FCRA).
4 15 U.S.C. § 1681t(a).
5 *Id.*
6 15 U.S.C. § 1681h(e).
7 15 U.S.C. § 1681t(a) (emphasis added).
8 Davenport v. Farmers Ins. Group, 378 F.3d 839, 843 (8th Cir. 2004); Cisneros v. U.D. Registry, Inc., 39 Cal. App. 4th 548, 577–78 (1995).
9 *Cisneros*, 39 Cal. App. 4th at 577.
10 16 C.F.R. § 622.
11 *Davenport*, 378 F.3d at 843.
12 *Id.* at 841.
13 *Id.*
14 *Id.* at 842.
15 *Id.* at 843.
16 393 F. Supp. 577, 581–82 (S.D. Fla. 1975).
17 *Id.* at 581.
18 *Id.* at 581–82.
19 15 U.S.C. § 1681t (a), (b).
20 15 U.S.C. § 1681t(b).
21 15 U.S.C. §§ 1681t(b)(5)(A),(B),(G),and (H).
22 15 U.S.C. § 1681t(b)(4).
23 15 U.S.C. § 1681t(b)(1). The section also lists several state laws that would be preempted by this section, but which Congress determined should be grandfathered in as they existed at the time of the section's 1996 enactment.
24 15 U.S.C. §1681t(b)(1)(A), (E), (G), and (H).
25 15 U.S.C. § 1681t(b)(1)(F).
26 Thornton v. Equifax, Inc., 619 F.2d 700, 703 (8th Cir. 1980) (citing Retail Credit Co. v. Dade County, 393 F. Supp. 577, 584 (S.D. Fla. 1975) ("It is clear that the qualified immunity provided for by Congress is meant to be a 'quid pro quo for full disclosure.'")).
27 15 U.S.C. § 1681h(e).
28 *Id.*; *see also Thornton*, 619 F.2d at 703.
29 15 U.S.C. §§ 1681g, 1681h, 1681m.
30 15 U.S.C. § 1681h(e).
31 McKeown v. Sears Roebuck & Co., 335 F. Supp. 2d 917, 942–43 (W.D. Wis. 2004) ("All defamation claims arise out of disclosures to third parties; it is a prima facie element of the claim.").
32 *Id.*
33 TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001).
34 *McKeown*, 335 F. Supp. 2d at 943; Carlson v. Trans Union, LLC, 261 F. Supp. 2d 663, 664 n.2 (N.D. Tex. 2003).
35 *Thornton*, 619 F.2d at 704; Gohman v. Equifax Information Svcs., *LLC*, 395 F. Supp. 2d 822, 829 (D. Minn. 2005); Graham v. CSC Credit Svcs., Inc., 306 F. Supp. 2d 873, 882 (D. Minn. 2004).
36 *Thornton*, 619 F.2d at 702.
37 *Id.* at 704–05.
38 *Id.* at 704.
39 Graham v. CSC Credit Svcs., Inc., 306 F. Supp. 2d 873, 882 (D. Minn. 2004); *see* Gohman v. Equifax Information Svcs., *LLC*, 395 F. Supp. 2d 822, 829 (D. Minn. 2005).
40 15 U.S.C. § 1681h(e).
41 *Thornton*, 619 F.2d at 705; Yeager v. TRW Inc., 984 F. Supp. 517, 523 (E.D. Tex. 1997); Wiggins v. Equifax Svcs., Inc., 848 F. Supp. 213, 223 (D.D.C. 1993).
42 New York Times v. Sullivan, 376 U.S. 254, 279–80 (1964), *cited in Thornton*, 619 F.2d at 705 and *Wiggins*, 848 F. Supp. at 223.
43 *Wiggins*, 848 F. Supp. at 223.
44 *See Yeager*, 984 F. Supp. at 524.
45 *Id.* at 519.
46 *Id.*
47 *Id.* at 524.
48 *Id.* at 524–25.

49 *Id.* at 523 (citing Wiggin*s*, 848 F. Supp. at 219).
50 15 U.S.C. § 1681h(e).
51 Carlson, 261 F. Supp. 2d at 665 (discussing Texas negligence law); *see* Shannon v. Equifax Information Svcs., 764 F. Supp. 2d 714, 727–28 (E.D. Penn. 2011) ("By definition, a plaintiff cannot allege willful negligence. Therefore, the only negligence action that Plaintiff can pursue if a negligence action under the FCRA.").
52 15 U.S.C. § 1681h(e).
53 15 U.S.C. § 1681t(b)(1)(F). Section 54A(a) of chapter 93 of the Massachusetts Annotated Laws and section 1785.25(a) of the California Civil code, as in effect in 1996, are excepted from this provision. 15 U.S.C. §§ 1681t(b)(1)(F)(i)–(ii).
54 Whether the FCRA preempts causes of action against information furnishers not specifically related to either of these issues is another question. The California Supreme Court recently held the FCRA did not preempt a claim that a medical provider had furnished confidential patient information to a consumer reporting agency, concluding that section 1681t(b)(1)(F) preempts state law claims only insofar as they arise out of a requirement or prohibition with respect to the specific duties regulated by section 1681s-2. Brown v. Mortensen, ___ P.3d ___, 2011 WL 2409913 (Cal. 2011).
55 Gorman v. Wolpoff & Abramson, LLP, 584 F.3d 1147, 1166 (9th Cir. 2009), *cert. denied*, 131 S. Ct. 71 (2010). In *Gorman*, the Ninth Circuit noted that the district court had applied the total preemption approach, but that "[i]n the end, we need not decide this issue." *Id.* at 1167 (9th Cir. 2009); *see also* Ross v. FDIC, 625 F.3d 808, 814 n.* (4th Cir. 2010) (commenting that "[c]ourts have taken a variety of approaches to resolving this conflict," but that its "disposition of this case on other grounds means we need not address this issue").
56 15 U.S.C. § 1681h(e) (emphasis added).
57 15 U.S.C. § 1681t(b)(1)(F).
58 Though they have recently had the opportunity. The Ninth Circuit has twice this year declined reach the issue. Johnson v. Wells Fargo Home Mortgage, Inc., 635 F.3d 401, 421 (9th Cir. 2011); Gorman v. Wolpoff & Abramson*,* LLP, 584 F.3d 1147, 1167 (9th Cir. 2009), *cert. denied*, 131 S. Ct. 71 (2010). The Tenth Circuit had its own opportunity in 2010. *See* Ross v. FDIC, 625 F.3d 808, 814 n.* (4th Cir. 2010).
59 Buraye v. Equifax, 625 F. Supp. 2d 894, 898 (C.D. Cal. 2008).
60 *See, e.g.*, *Id.* at 899 (noting that within the Ninth Circuit, courts utilize both the total preemption and statutory approaches).
61 Nelson v. Equifax Information Svcs., LLC, 522 F. Supp. 2d 1222, 1233 (C.D. Cal. 2007); *see also Buraye*, 625 F. Supp 2d at 900; Roybal v. Equifax, 405 F. Supp. 2d 1177, 1181 (E.D. Cal. 2005); Davis v. Maryland Bank, No. 00-04191, 2002 WL 32713429, at *12–*13 (N.D. Cal. 2002); Riley v. General Motors Acceptance Corp., 226 F. Supp. 2d 1316, 1324–25 (S.D. Ala. 2002).
62 Jaramilo v. Experian Information Solutions, Inc., 155 F. Supp. 2d 356, 361–62 (E.D. Pa. 2001).
63 *Buraye*, 625 F.Supp.2d at 899 (citing *Davis*, 2002 WL 32713429, at *13).
64 *See, e.g.*, Barnhill v. Bank of America, N.A., 378 F. Supp. 2d 696, 700–01 (D. S.C. 2005) (citing TRW Inc., 534 U.S. at 31).
65 Kane v. Guaranty Residential Lending, Inc., No. 04-CV-4847, 2005 WL 1153623, at *8 (E.D.N.Y.) May 16, 2005); *see also* Ryder v. Washington Mut. Bank, F.A., 371 F. Supp. 2d 152, 154–55 (D. Conn. 2005); Woltersdorf v. Pentagon Fed. Credit Union, 320 F. Supp. 2d 1222, 1226–27 (N.D. Ala. 2004); Stafford v. Cross Country Bank, 262 F. Supp. 2d 776, 785–86 (W.D. Ky. 2003); Vazquez-Garcia v. Trans-Union de Puerto Rico, 222 F. Supp. 2d 150, 161 (D. P.R. 2002); Aklagi v. NationsCredit Fin. Svcs., 196 F. Supp. 2d 1186, 1194–95 (D. Kan. 2002).
66 15 U.S.C. §§ 1681s-2(a)(1)(A)–(B).
67 15 U.S.C. § 1681s-2(b).
68 *Kane*, 2005 WL 1153623, at *8.
69 15 U.S.C. § 1681t(b)(1)(F).
70 *Kane*, 2005 WL 1153623, at *8.
71 *See Barnhill*, 378 F. Supp. 2d at 701; *Vazquez-Garcia*, 222 F. Supp. 2d at 163.
72 Meisel v. USA Shade and Fabric Structures, Inc., ___ F. Supp. 2d ___, 2011 WL 2413174, at *6 (N.D. Tex. June 14, 2011); *Barnhill*, 378 F. Supp. 2d at 703; *see also* Wolfe v. MBNA Amer. Bank, 485 F. Supp. 2d 874, 886–87 (W.D. Tenn. 2007); Gorman v. Wolpoff & Abramson, LLP, 370 F. Supp. 2d 1005, 1009–1010 (N.D. Cal. 2005); McCloud v. Homeside Lending, 309 F. Supp. 2d 1335,1341–42 (N.D. Ala. 2004); Gordon v. Greenpoint Credit, 266 F. Supp. 2d 1007, 1013 (S.D. Ia. 2003); Carlson v. Trans Union, LLC, 259 F. Supp. 2d 517, 521(N.D. Tex. 2003); Johnson v. CitiMortgage, Inc., 351 F. Supp. 2d 1368, 1375–76 (N.D. Ga. 2004)
73 15 U.S.C. § 1681h(e).
74 McCloud v. Homeside Lending, 309 F. Supp. 2d 1335, 1341 (N.D. Ala. 2004).
75 *Id.*
76 15 U.S.C. § 1681t(b)(1)(F).
77 15 U.S.C. § 1681s-2(a).
78 *Gordon*, 266 F. Supp. 2d at 1013 (holding the temporal approach to be "strained at best" because section 1681s-2 "charges furnishers of information with a duty to report accurate information regardless of whether the furnisher has notice of the dispute").
79 *Barnhill*, 378 F. Supp. 2d at 702.
80 *Johnson*, 351 F. Supp. 2d at 1374.
81 *Id.* at 1374–75; *Barnhill*, 378 F. Supp. 2d at 702.
82 *Barnhill*, 378 F. Supp. 2d at 702.
83 *Johnson*, 351 F. Supp. 2d at 1375; *see also Meisel*, 2011 WL 2413174, at *7.
84 *Kane*, 2005 WL 1153623, at *9.
85 15 U.S.C. § 1681h(e) (emphasis added).
86 Cipollone v. Liggett Group, Inc., 505 U.S. 504, 521 (1992), *cited in* Carruthers v. American Honda Fin. Corp., 717 F. Supp. 2d 1251, 1255 (N.D. Fla. 2010).
87 *Id.*
88 *Jaramilo*, 155 F. Supp. 2d at 362, *quoted in* Riley, 26 F. Supp. 2d at 1322.
89 15 U.S.C. § 1681t(b)(1)(F).
90 *Carruthers*, 717 F. Supp. 2d at 1254.
91 *Buraye*, 625 F. Supp. 2d at 900 (quoting *Davis*, 2002 WL 32713429, at *13) (adopting the total preemption approach because "the legislative history demonstrates that Congress enacted section 1681t(b(1)(F) in order to create a uniform scheme governing disclosure of credit information"); *Carruthers*, 717 F. Supp. 2d at 1256.
92 Kodrick v. Ferguson, 54 F. Supp. 2d 788, 794 (N.D. Ill. 1999) (quoting 140 Cong. Rec. H9810–11).
93 *See Buraye*, 625 F. Supp. 2d at 900 (citing *Davis*, 2002 WL 32713429, at *13).
94 *Id.* at 899 (observing that the majority of courts in the Ninth Circuit have utilized the total preemption approach, and listing cases).
95 *Carruthers*, 717 F. Supp. 2d at 1257 (collecting authorities).

Accurate Outcomes in APPRAISAL

The Importance of the Umpire's Subject Matter Expertise

by Karl A. Schulz*

Introduction

Appraisal is one of the most important current issues in Texas insurance law as a result of the Texas Supreme Court's opinion in *Universal Underwriters.*[1] The Court strongly endorsed appraisal and set forth strict conditions for its waiver.[2] Consequently, appraisal is likely to become more common, either as a result of the parties' agreement or a court order.[3] An emerging concern, therefore, is what happens next in many appraisals— a dispute over the selection of the umpire that leads to a court selecting the umpire. It is well-settled that the umpire must be fair and impartial.[4] This article traces a growing body of law that further requires subject matter expertise in the selection of the umpire.[5] Moreover, this article presents arguments that subject matter expertise will help ensure that appraisals reach the accurate outcome and, therefore, will preserve judicial resources by obviating litigation over the appraisal process and award.

The Appraisal Clause

"Today, appraisal clauses are uniformly included in most forms of property insurance policies. Virtually every property insurance policy for both homeowners and corporations contains a provision specifying appraisal as a means of resolving disputes regarding the amount of loss for a covered claim." [6] Appraisal binds the parties to have the extent or amount of loss determined in a particular way.[7] A typical appraisal clause provides:

> **Appraisal**
> If we and you disagree on the value of the property or the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser. The two appraisers will select an umpire. If they cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the value of the property and the amount of the loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed by any two will be binding.
> Each party will:
> a. Pay its chosen appraiser; and
> b. Bear the other expenses of the appraisal and umpire equally.
>
> If there is an appraisal, we still retain our right to deny the claim.[8]

Because the umpire has the power to side with one appraiser or another to make a binding award, the selection of the umpire is very important to the litigants and from the standpoint of preserving judicial resources.[9]

Most courts would likely prefer the appraisers select the umpire because that selection reflects the parties' agreement based on circumstances of the case. The appraisers' agreed selection also lightens the burden on the court and it avoids even a question of conflict of interest in the court's selection of the umpire. However, where the parties cannot agree on an umpire, either party can ask a court to make the selection.

Who Can Be An Umpire?

Although a typical appraisal clause states that the appraisers must be competent and impartial, it is often silent as to who can be an umpire.[10] In early 1900's, Texas courts emphasized the quasi-judicial role of the umpire, essentially valuing fairness and impartiality over subject matter expertise, if subject matter expertise was analyzed at all.[11] Subsequently, about one hundred years passed with very little development in appraisal jurisprudence.[12] Since Hurricanes Rita and Ike, Texas appraisal jurisprudence has developed significantly, however, the narrower question of the umpire's qualifications to oversee an appraisal has not.[13] Consequently, courts today have a great deal of freedom in selecting an umpire.

Harris and Galveston Counties both provide a list of retired judges from which current state court judges can select an umpire.[14] Federal courts in Texas are also selecting retired judges to serve as umpires.[15] Of course, a court-selected umpire need not be a retired judge, and in some cases, they are not.[16] These umpires may or may not have expertise in the specific subject matter of the appraisal.

There are some good reasons to select umpires without regard for subject matter expertise. First, a typical appraisal clause is silent as to the umpire's qualifications. If the text is silent, then there is no reason to read in a requirement for subject matter expertise. In other words, if the insurer drafting the appraisal clause wants to require certain qualifications for the umpire, it should spell that out in the text. Even if the appraisal clause states that the umpire must be "competent," competence is different than subject matter expertise. Second, umpires confront new factual situations all the time and can resolve them without subject matter expertise. For example, a retired judge likely had numerous different kinds of cases come through his courtroom, but was nevertheless able to grasp them, and could apply that same experience as an umpire. Third, requiring subject matter expertise would likely reduce the number of potential umpires, leading to repeated re-use of umpires, which could delay resolution of appraisals, lower the quality of appraisals, and inhibit the development of new umpires.

There is a growing body of law requiring subject matter expertise in order to serve as an umpire.

Despite these types of concerns, there is a growing body of law requiring subject matter expertise in order to serve as an umpire. As Judge Lee Rosenthal of the Southern District of Texas recently explained, "[b]ecause appraisal proceedings have little structure imposed by the policy, the umpire's role of assuring fairness in the process is at least as important as subject-matter expertise."[17]

The Umpire's Subject Matter Expertise Improves the Appraisal Process

In *Glenbrook Patiohome Owners Association v. Lexington Ins. Co.*, the insurance policy was silent as to who could be an umpire.[18] The parties selected appraisers but could not agree on an umpire, so they asked the court to make a selection.[19] Judge Rosenthal held:

> The role of the umpire under the policy is to receive the appraisers' statements of the value of the property and the amount of loss. If they disagree, the decision agreed to by any two of the three will be binding.
> The plaintiff submitted a list of proposed umpires. In response, the defendant urges that given the umpire's role in this case, the primary criterion for selection after impartiality should be substantive expertise in the areas of valuation and damage analysis.
> The appraisers selected by the parties have technical, substantive expertise in relevant

> areas. Although the umpire selected by this court *must be competent* to evaluate conflicting evidence and information on valuation on property damage, there is no contractual or case-law requirement for a specific license or professional certification in technical field. An umpire must combine competence in evaluating conflicting disputed evidence with expertise and experience in assuring a fair process. Because appraisal proceedings have little structure imposed by the policy, the umpire's role of assuring fairness of the process is at least as important as subject-matter expertise.[20]

Judge Rosenthal's analysis raises several important points. First, the court repeatedly emphasized that the umpire must be competent, without the appraisal clause specifically requiring competence.[21] In effect, the court took it as a given that the umpire must be competent. This is a departure from previous Texas courts that emphasized the umpire's fairness and impartiality over competence.

Judge Rosenthal subsequently enumerated what competence entails and what other qualities an umpire must have: (1) fairness, impartiality, and integrity; (2) ability to evaluate and weigh conflicting evidence, including technical evidence; (3) subject matter expertise; (4) significant subject matter experience; and (5) ability to provide service.[22] The opinion indicated that these qualities need not be formally recognized by a specific license or professional certification, however, this reasoning makes sense because in the analogous situation of expert witness qualification, a person may be qualified by knowledge, skill, experience, training, or education.[23] These five prongs should be helpful to future courts in evaluating a potential umpire's fitness for the case at hand.

The opinion also put fairness and subject matter expertise on equal footing in terms of importance.[24] The court based this holding on an observation that the policy imposes little structure on the appraisal process.[25] Lack of structure has been a source of praise and criticism of the appraisal process.[26] For example, the Texas Supreme Court observed that "[a]ppraisals require no attorneys, no lawsuits, no pleadings, no subpoenas, and no hearings."[27] The supreme court added that:

> In most cases, appraisal can be structured in a way that decides the amount of loss without deciding any liability questions. As we already noted, when an indivisible injury to property may have several causes, appraisers can assess the amount of damage and leave causation up to the courts. When divisible losses are involved, appraisers can decide the cost to repair each without deciding who must pay for it. When an insurer denies coverage, appraisers can still set the amount of loss in case the insurer turns out to be wrong. And when the parties disagree whether there has been any loss at all, nothing prevents the appraisers from finding "$0" if that is how much damage they find.[28]

The Wisconsin Supreme Court similarly held that:

> Appraisal also deserves a more deferential review because the appraisal process is a fair and efficient tool for resolving disputes. First and foremost, the process is fair to both parties. It allows each to appoint an appraiser of their own liking, with a neutral umpire as the deciding vote. Appraisals also promote finality, are time and cost-efficient, and place a difficult factual question— the replacement value of an item— into the hands of those best-equipped to answer that question. As a form of alternative dispute resolution, the appraisal process is favored and encouraged. *See generally, State v. P.G. Miron Constr. Co.*, 181 Wis.2d 1045, 1055, 512 N.W.2d 499 (1994) ("It has been the policy of this state and this court to foster arbitration as an alternative to litigation. The advantage of this process lies in the avoidance of the formalities, delay, and expense of litigation.").[29]

However:

> The lack of clear-cut appraisal rules or uniformity among jurisdictions, and sometimes even within a jurisdiction, creates serious concerns that the appraisal process does not provide procedural due process in the assessment of loss. The appraisal process calls for sound protocol. If the rules affecting outcomes are unpredictable, appraisal could deprive parties or their most basic and essential protections of due process and fundamental fairness.[30]

As the court in *Glenbrook* indicated, making the umpire's subject matter expertise equally as important as his or her fairness ensures the flexibility of the appraisal process while addressing concerns such as due process and fairness. Several other courts have elaborated on this idea. For example, in *St. Charles Parish Hosp. Dist. #1 v. United Fire and Cas. Co.,* the federal district court in Louisiana explained that:

> It is axiomatic that the third appraiser/umpire must be impartial so that his decisions are based on the merits of the disputed valuation rather than the personal influence or identity of the parties. In this tri-partite scenario, the appointed umpire occupies the position analogous to a judge because the umpire presides over two non-neutral appraisers – non-neutral on in the sense that they were named by the parties. Impartiality and absence of bias in favor of or against either party imparts confidence in the appraisal process.
>
> Beyond the requirement of impartiality, subject matter expertise and being knowledgeable about the issues in dispute are relevant to the appointment. In this regard, experience in damage analysis, estimating and/or appraisals weighs on the positive side. Individuals familiar with the practices and procedures customarily used in appraising structural damage or estimating repairs (as opposed to adjusting of claims) will promote both fairness and efficiency of the process.[31]

Similarly, the federal district court in Connecticut in *In re Travelers Indem. Co.* held that impartiality went hand-in-hand with specialized industry knowledge to ensure that the panel's decisions would be fair and based upon the merits of the dispute and not personal influence or the identity of the disputants. [32]

In sum, courts have recognized that a fair and impartial umpire with subject matter expertise is best prepared to control the appraisal and achieve the accurate outcome. In a way, this conclusion is a matter of common sense. [33] Fairness and impartiality are obviously threshold requirements to serve as an umpire. However, because losses subject to appraisal come in nearly infinite variety— from residential hurricane damage[34] to car wreck damage[35] to destruction of a vintage wine collection[36]— the umpire must also have subject matter expertise in those areas in order to knowledgeably decide the unique issues of those cases. Otherwise, the umpire may not have a sound basis for his decisions.

Umpires are Not Mediators

Umpires are not mediators and appraisal is not mediation. Umpires exercise independent judgment to side with one appraiser or the other when they submit their differences.[37] Unlike a mediator, an umpire does not govern the appraisal with the object that the parties will each compromise to reach common ground.[38] "Splitting the difference" or "splitting the baby," which might be the outcome of a mediation, is generally not a valid appraisal award.[39]

Rather than building consensus within the big picture like a mediator, the umpire keeps the focus on the disputed differences and decides on them.[40] "The office of an umpire is to decide between the two arbitrators in case they disagree. If the object of the submission was to have the concurrence of the two arbitrators chosen by the parties, then the provision for an umpire was a useless formality."[41] Appraisal also differs from mediation in that appraisal generally resolves differences between the appraisers regarding the value of the property or the amount of loss, which can involve consideration of causation issues, whereas mediation generally resolves the entire case.[42]

Courts have recognized that a fair and impartial umpire with subject matter expertise is best prepared to control the appraisal and achieve the accurate outcome.

In order to be an umpire rather than a mediator, the umpire has to decide which appraiser is correct. Making an accurate decision as to which appraiser is correct requires subject matter expertise. For example, Judge Sim Lake of the Southern District of Texas ruled on a Motion to Appoint Umpire in *American Legion Harrisburg Post No. 472 v. Westport Ins. Co.*[43] Judge Lake explained his appointment of a professional engineer as umpire in that Hurricane Ike damage case.[44]

> The plaintiff suggests a number of former state court judges who appear to be fair and might make good mediators in this type of case. But as the defendant points out, they have no apparent experience in appraising structural damage or estimating repair costs or in damage analysis. So I think the most appropriate person to appoint and the person who I will appoint is now David [Nicastro], who will be the umpire.[45]

Both mediators and umpires investigate the particular facts of a dispute. However, Judge Lake's order recognized that, unlike a mediator, the umpire must do so in order to make a knowledgeable and accurate decision on which appraiser's technical analysis is correct.

Umpires also differ from mediators in that an appraisal results in an award, which must be within the authority granted by the appraisal clause, in writing, clear, and itemized.[46] In other words, after making a knowledgeable and accurate decision on which the appraiser's technical analysis is correct, the umpire must be able to properly and adequately communicate that decision in the award. Balancing these concerns obviously requires subject matter expertise.

The implications here are important. If the umpire makes a compromise decision rather than an accurate one, he may create a bad faith case where one does not really exist. For example, an umpire may issue a compromise decision showing that the insurer failed to pay all or part of the loss. The insured could then turn around and use that failure to pay all or part of the loss as evidence of bad faith, arguing that the insurer failed to pay what a panel of independent experts decided was payable under the policy. This could be a powerful argument in a motion for summary judgment or in front of a jury. Therefore, it is imperative that the umpire reach the accurate outcome in order to avoid artificially and incorrectly providing support to bad faith liability where it otherwise does not exist.

The Umpire's Subject Matter Expertise Counters Incompetent, Partial Appraisers

As mentioned, a typical appraisal clause requires that the party select a competent and impartial appraiser.[47] Parties, however, may violate this contractual provision and select an appraiser that reliably shares their side's views.[48] At a minimum, this repeat business suggests that the appraiser will not be impartial because he has already enjoyed a stream of income from that side's law firm and he will want to continue that stream of income. At worst, the repeat business suggests that the appraiser is little more than a stooge, cloaking the law firm's arguments and tactics in the disguise of an appraisal. A related problem with selecting the same appraiser over and over again is the matter of timing. Appraisal can be a quick process, but when an appraiser is selected to work on dozens or even hundreds of cases, it is physically impossibility to visit a site, analyze information, write a report, and interact with the other appraiser and umpire in a timely fashion on all those cases. This may slow down the appraisal process and thus defeat one of its primary advantages while artificially creating an argument against appraisal that it is a slow process.

An umpire with subject matter expertise is especially important in such cases. The umpire must be able to see through incompetence and partiality, moving the appraisal along and accurately evaluating findings that may be artificially inflated or deflated. In other words, to accurately decide between partial appraisers, the umpire has to have as good or better knowledge of the subject than the partial appraisers. Otherwise, he is at their mercy.

The Umpire's Subject Matter Expertise Helps Control Costs

Texas courts have long recognized that appraisal provides a comparatively inexpensive alternative to litigation.[49] At the same time, courts are struggling with limited or dwindling resources.[50] This makes appraisal's cost-saving function even more important. Texas courts have tried to preserve the appraisal's cost-saving function by discouraging litigation regarding the scope of appraisal, waiver of appraisal, and even appraisal generally.[51] There remains, however, the potential for litigation about the qualifications of the umpire, the propriety of the umpire's award, the accuracy of the umpire's award, and a myriad of those potential issues surrounding the umpire phase of the appraisal process.[52] That litigation has the potential to be expensive and therefore defeat one of the main principles of the appraisal process.

For example, umpires' awards are sometimes challenged on the ground that the umpire exceeded his authority by deciding issues where the appraisers did not differ.[53] In other cases, the umpire's award is challenged on the ground that it was not properly valued.[54] In still other cases, the umpire's award is challenged on the ground that the umpire failed to properly consider the conclusions of a party's appraiser, or because the party felt the award was simply unjust.[55]

Texas courts have held that an appraisal award pursuant to an insurance policy is binding and enforceable unless the insured proves that the award was unauthorized or the result of fraud, accident, or mistake.[56] In other words, the appraisal award is the end result of the appraisal process, and where the award is somehow tainted, the appraisal process is wasted. That makes the award, which is the responsibility of the umpire, of paramount importance and a key point where the appraisal process can be improved.

Simply put, an umpire with subject matter expertise is better positioned to have the confidence and knowledge necessary to control the appraisal process, maintain its integrity, and decide the issues where the appraisers differ.[57] This in turn makes the appraisal process more efficient and accurate, which should obviate or reduce challenges to appraisal awards and help control costs.[58]

Conclusion

Appraisal clauses are here to stay. The focus, therefore, should be on improving the appraisal process by making the outcome more efficient and accurate. A crucial element of this improvement is the appointment of umpires with subject matter expertise. Establishing and applying standards to evaluate subject matter expertise is the next step, which will benefit insureds, insurers and judicial economy.

* Associate, Cozen O'Connor, Houston, Texas. J.D., University of Houston Law Center, 2007. Any opinions expressed in this article are not necessarily the views of Cozen O'Connor or its clients.

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1 In re Universal Underwriters, 345 S.W. 3d 404 (Tex. 2011). The Texas Supreme Court is considering two petitions for writ of mandamus concerning whether litigation should be abated during appraisal, all stemming from Footnote 5 in *Universal Underwriters* which stated that "proceedings need not be abated while the appraisal goes forward." *See* John Council, *Abate or Litigate?*, Texas Lawyer, November 7, 2011 at p. 1. Without abatement, however, a party could run up the costs of litigation during appraisal and defeat the time- and cost-saving function of appraisal. This represents a great potential for waste because "if the appraisal determine[s] that the full value was what the insurer offered, there is no breach of contract." Universal Underwriters, 45 S.W. 3d at 412; *see also Progressive Cty.* Mut. Ins. Co. v. Boyd, 177 S.W.3d 919, 921 (Tex. 2005) (holding that if there is no breach of contract, extracontractual claims do not survive). A demand for appraisal is in some ways akin to a plea to the jurisdiction. As with a plea to the jurisdiction, the appraisal should be resolved first when it is demanded, in order to avoid needless expenditures. *See* Tex. A&M Univ. Sys. v. Koseoglu, 233 S.W.3d 835, 845 (Tex. 2007).

2 *See id.*

3 *See*, *e.g.*, Dike v. Valley Forge Ins. Co., 2011 U.S. Dist. LEXIS 67175 (S.D. Tex. 2011); Butler v. Prop. & Cas. Ins. Co., 2011 U.S. Dist. LEXIS 59914 (S.D. Tex. 2011); EDM Office Servs. v. Hartford Lloyds Ins. Co., 2011 U.S. Dist. LEXIS 71209 (S.D. Tex. 2011); James v. Prop. and Cas. Ins. Co. of Hartford, 2011 U.S. Dist. LEXIS 103047 (S.D. Tex. 2011); In re Certain Underwriters at Lloyds, 2011 Tex. App. LEXIS 8151 (Tex. App.—Waco 2011, no pet.).

4 *See* 68f-168f Appleman on Insurance §3928 (stating that "An umpire selected to arbitrate a loss should be disinterested, unprejudiced, honest, and competent."); Timothy P. Law and Jillian L. Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. 291, (2006) (stating that, "At a minimum, the umpire must be fair and impartial."). An umpire's fairness and impartiality might reasonably be questioned, thereby disqualifying the umpire from selection, when the umpire has close ties to the plaintiff's or defense's bar through employment history, campaign contributions, family ties, repeated nomination for selection by one side, or otherwise. *See id.*

5 There is a great deal of modern jurisprudence and legal scholarship specifically regarding the qualifications of appraisers, or regarding the qualifications of appraisers grouped together with a discussion of qualifications of umpires, but evidently much less so specifically regarding the qualifications of umpires. *Compare* Gardner v. State Farm Lloyds, 76 S.W.3d 140, 143 (Tex. App.—Houston [1st. Dist.] 2002, no pet.) (analyzing appraisers' qualifications); Timothy P. Law & Jillian L. Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 308-18 (analyzing qualifications of appraisers and umpires together); *The Waning Wisdom of Appraisal?* Robert H. Belt, Jr., Moderator, Critical Issues for Senior Insurance Executives and In-house Counsel Jointly Sponsored by PLRB; LIRB & FDDC, Oct. 23, 2006, Chicago, Ill (same) - Paper presented at Chicago conference (same), *with* 6f-168f Appleman on Insurance §3298 – Qualifications and Appointment of Umpire (leading insurance treatise citing authorities that are generally a century or more old).

6 State Farm Lloyds v. Johnson, 290 S.W.3d 886, 888-89 (Tex. 2009).

7 In re Allstate Cnty. Mut. Ins. Co., 85 S.W.3d 193, 195 (Tex. 2002) (citing Scottish Union & Nat'l Ins. Co. v. Clancy, 8 S.W. 630, 631 (Tex. 1888)).

8 ISO Building and Personal Property Coverage Form CP 00 10 04 02.

9 *See* Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 319 ("The selection of an umpire is perhaps the most important aspect of the appraisal process.").

10 See ISO Form; Texas Homeowners Policy – Form B; *but see* Providence Lloyds Ins. Co. v. Crystal City Indep. School Dist., 877 S.W.2d 872, 874 (Tex. App.—San Antonio 1994, no pet.) (insurance policy stated that umpire must be competent and disinterested); Hartford Lloyd's Ins. Co. v. Teachworth, 898 F.2d 1058, 1059 (5th Cir. 1990) . Even for policies that do use the word "competent," that term is generally not defined, leaving courts to interpret the word on an ad hoc basis. *See*, *e.g.*, Brothers v. Generali U.S. Branch, 1997 U.S. Dist. LEXIS 14158, *9-*10 (N.D. Ga. 1997); Citizens Prop. Ins. Co. v. M.A. & F.H. Prop., 948 So.2d 1017, 1020 (Fla. Dist. Ct. App. 2007). The word "competent" is also broad and vague. A major insurance treatise analyzing umpires' qualifications generally concluded that the umpires must be competent, without really exploring what competency entails. *See* 6f-168f Appleman on Insurance §3298 – Qualifications and Appointment of Umpire. Some states have created a statutory scheme to govern the appointment of umpires. Law & Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 319.

11 *See* Delaware Underwriters v. Brock, 211 S.W. 779, 780 (Tex. 1919); Pennsylvania Fire Ins. Co. v. W.T. Waggoner Estate, 39 S.W.2d 593, 594-95 (Tex. Comm'n App. 1931, no writ); Home Ins. Co. v. Walter, 230 S.W. 723, 723-24 (Tex. Civ. App.—Dallas

1921, no writ); New York Underwriters v. Shanks, 78 S.W.2d 1026, 1028-30 (Tex. Civ. App.—Galveston 1935, no writ); Atlas Const. Co. v. Indiana Ins. Co., 309 N.E.2d 810, 816 (Ct. App. Ind. 1974, no writ); Mason v. Fire Assoc. of Philadelphia, 122 N.W. 423, 426-27 (S.D. 1909) Fowble v. Phoenix Ins. Co., 81 S.W. 485, 486 (Mo. Ct. App. 1904).

12 *Universal Underwriters*, 345 S.W. 3d at 407; *Johnson*, 290 S.W.3d at 888-89.

13 *See generally id.*; In re Slavonic Mut. Fire. Ins. Ass'n, 308 S.W.3d 556 (Tex. App.—Houston [14th Dist.] 2010, no pet.); *see also Johnson*, 290 S.W.3d at 890 (citing without comment an amicus brief that concluded "Umpires are often lawyers or mediators with no particular experience or expertise in property insurance coverage or claims.").

14 Durrett Law Firm Newsletter (on file with author).

15 *See, e.g.*, Allstate Tex. Lloyds v. Shah, 2009 U.S. Dist. LEXIS 32144, *1-*2 (E.D. Tex. 2009).

16 *See, e.g.*, *Glenbrook* order (lawyer); Judge Lake Order (engineer); *Brothers*, 1997 U.S. Dist. LEXIS at *10 (certified public accountant); Emplrs Ins. Co. v. Certain Underwriters at Lloyds of London, 2009 U.S. Dist. LEXIS 89945, *18 (W.D. Wis. 2009) (lawyer); Citrin v. Erikson, 918 F. Supp. 792, 799 (S.D.N.Y. 1996) (lawyer).

17 Glenbrook Patio Home Owners Ass'n v. Lexington Ins. Co., No. H-10-2929 (S.D. Tex. July 28, 2011) (mem. op.).

18 *Id.*

19 *Id.*

20 *Id.* (emphasis added).

21 *Id.*

22 *Id.*

23 *See* E.I. Du Pont de Nemours & Co. v. Robinson, 923 S.W.2d 549, 554 (Tex. 1995).

24 *See Glenbrook*, No. H-10-2929.

25 *Id.*

26 *See Johnson*, 290 S.W.3d at 893-894; *Universal Underwriters*, 345 S.W. 3d at 407; Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 304-308.

27 *Johnson*, 290 S.W.3d at 894.

28 *Id.*

29 Farmers Auto Ins. Ass'n v. Union Pac. Ry., 768 N.W.2d 596, 607 (Wis. 2009).

30 Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 308-09.

31 St. Charles Parish Hosp. Dist. #1 v. United Fire and Cas. Co., 2008 U.S. Dist. LEXIS 34421, *5-*6 (E.D. La. 2008).

32 In re Travelers Indem. Co., 2004 U.S. Dist. LEXIS 30074, *11 (D. Conn. 2004).

33 A clear advantage of this approach is that it will be readily understood and accepted by the average policyholder. In the popular *Dummies* series of do-it-yourself books for laymen, the author of *Insurance for Dummies* concluded that "[f]or most property valuation disputes, you don't need an elaborate group of three solemn judges. You just need a fair, unbiased, and disinterested person with excellent knowledge regarding the subject of the dispute— someone who both parties are comfortable with— to act as the umpire." Jack Hungelmann, Insurance for Dummies, 95 (2009). There is also a sports analogy applicable here. Umpires can be found in baseball, football, and tennis. Sports fans expect (or hope) the umpires are fair and impartial, but no one would expect to see a home plate umpire wearing his mask working as a chair umpire at Wimbledon.

34 *Dike*, 2011 U.S. Dist. LEXIS at *21-*22.

35 *Johnson*, 290 S.W.3d at 889.

36 Vintage Wine Policy, http://insureyourwine.com/pdf/VintageWine%20PolicyForm.pdf.

37 Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 321; *Crystal City*, 877 S.W.2d at 877; White v. State Farm Fire & Cas. Co., 2011 Mich. App. LEXIS 1419, *14 (Mich. Ct. App.).

38 *See* Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 294; Joe Brennan, *Insurance Appraisal Process - A Policyholder's Best Chance to Resolve an Insurance Claim Dispute!*, Ezine Articles, June 15, 2009, http://ezinearticles.com/?Insurance-Appraisal-Process---A-Policyholders-Best-Chance-to-Resolve-an-Insurance-Claim-Dispute!&id=2480355.

39 *See* Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 321.

40 *See Crystal City*, 877 S.W.2d at 877.

41 Twait v. Farmers Mut. Hail Ins. Co., 91 N.W.2d 575, 578 (Iowa 1958).

42 Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 298; *Johnson*, 290 S.W.3d at 893.

43 American Legion Harrisburg Post No. 472 v. Westport Ins. Co., No. 10-2770 (S.D. Tex. 2008) (order on initial conference dated April 15, 2008 on file with author).

44 *Id.*

45 *Id.*

46 Law and Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 321; *Crystal City*, 877 S.W.2d at 878; Fisch v. Transcont'l Ins. Co., 356 S.W.2d 186, 189 (Tex. Civ. App.—Houston 1962, writ ref'd n.r.e.); JM Walker LLC v. Acadia Ins. Co., 356 Fed. Appx. 744, 746 (5th Cir. 2009).

47 *See* sample appraisal clause, supra note 8.

48 *See* Law & Starinovich, *What Is It Worth? A Critical Analysis of Insurance Appraisal*, 13 Conn. Ins. L.J. at 318. Failure to comply with this contractual provision, such as by selecting the same appraiser over and over again, opens the party up to a motion to strike the appraiser or other relief.

49 Fire Ass'n of Philadelphia v. Ballard, 112 S.W.2d 532, 534 (Tex. Civ. App.—Waco 1938, no writ); *Johnson*, 290 S.W.3d at 894.

50 *The Feeblest Branch*, Economist, Oct. 1, 2011 at 31.

51 *Johnson*, 290 S.W.3d at 894; *Universal Underwriters*, 345 S.W. 3d at 412; *James*, 2011 U.S. Dist. LEXIS at *1-*2.

52 *See, e.g.*, *Crystal City*, 877 S.W.2d at 877; *JM Walker*, 356 Fed. Appx. at 746; New York Underwriters' Ins. Co. v. Shanks, 78 S.W.2d 1026, 1029 (Tex. Civ. App.—Galveston 1935, no writ); Evanston Ins. Co. v. Cogswell Props., 730 F. Supp. 2d 748, 752 (W.D. Mich. 2010).

53 *See Crystal City*, 877 S.W.2d at 876.

54 *See id*; *Cogswell*, 730 F. Supp. 2d at 752; *Atlas*, 309 N.E.2d at 814.

55 *See, e.g.,* Hozlock v. Donegal Cos., 745 A.2d 1261, 1266 (Pa. Super. Ct.. 2000); Gouin v. Northwestern Nat'l Ins. Co., 259 P. 387, 390 (Wash. 1927).

56 *See, e.g.,* Breshears v. State Farm Lloyds, 155 S.W.3d 340, 344 (Tex. App.—Corpus Christi 2004, pet. denied).

57 *See Crystal City*, 877 S.W.2d at 877; *St. Charles*, 2008 U.S. Dist. LEXIS at *5; *Travelers*, 2004 U.S. Dist. LEXIS at *9-*10.

58 *See id.*; *see also Gouin*, 259 P. at 390; Young v. Aetna Ins. Co., 64 A. 584, 586 (Me. 1906); Kuehn v. State Farm Fire & Cas. Co., 2009 U.S. Dist. LEXIS 74691, *18-*19 (S.D. Miss. 2009).

The Federal Government Takes on the Rent-to-Own Industry

by Jim Hawkins

In the summer of 2011, the U.S. House Subcommittee on Financial Institutions and Consumer Credit held a hearing about a rent-to-own bill, HR 1588, that Representative Francisco Canseco of Texas introduced along with 98 co-sponsors. Since the summer, the subcommittee approved the bill with some amendments. Now, the bill is slated to be considered by the Committee on Financial Services. I made the following statement in support of the bill, which is reproduced here with minor changes.

STATEMENT OF JIM HAWKINS
ASSISTANT PROFESSOR
UNIVERSITY OF HOUSTON LAW CENTER

"Examining Rental Purchase Agreements and the Potential Role for Federal Regulation"
U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

July 26, 2011

Chair Capito, Ranking Member Maloney, and Distinguished Members of this Subcommittee:

Thank you for inviting me to testify about the role the federal government could play in the rent-to-own industry. My name is Jim Hawkins, and I am an Assistant Professor of Law at the University of Houston Law Center, where I teach Contracts, Consumer Protection Law, and Bankruptcy. I earned my J.D. (with highest honors) from the University of Texas School of Law. Prior to my academic appointment at the University of Houston, I was a litigation associate at Fulbright and Jaworski, L.L.P. and a law clerk for the Honorable Jerry E. Smith on the Fifth Circuit Court of Appeals. In my academic research, I have spent the past five years studying and writing about alternative financial services such as rent-to-own, payday lending, and auto title lending.[1]

I believe HR 1588 offers an opportunity for federal law to help the rent-to-own market operate efficiently. First, this bill ensures that all rent-to-own customers will have clear disclosures so that they can make informed financial decisions. Second, it provides a level of certainty to rent-to-own firms so that they can operate without the fear that a rogue judicial decision or legislative act will undermine their business in a state. Finally, while providing a baseline of consumer protection for customers in every state, the bill also allows states to have laws that further restrict or even ban rental-purchase agreements.

My statement today (1) briefly introduces the rent-to-own industry, (2) describes some of the important consumer protection measures present in HR 1588, and (3) explains the relationship between HR 1588 and state law.

I. An Introduction to the Rent-to-Own Industry

Rent-to-own companies offer consumers the opportunity to acquire ownership of durable goods by making weekly or monthly rental payments. The company delivers the good to the customer's residence, and the customer decides each week or month whether to keep the good and make a payment or to return the good. Customers have no long-term obligation to keep the good, but if they complete the required payments on the contract or exercise an option to purchase the goods before the contract is up, the company gives the title to the good to the customer.

Typically, people who turn to rent-to-own have limited access to mainstream financial services, either because of low or sporadic income, or because of poor or nonexistent credit histories. The Federal Trade Commission's survey ten years ago of rent-to-own customers, however, found that 84% of these customers had a car or truck, virtually the same percentage as the general public.[2] Rent-to-own customers also have more access to credit than one might assume: 44% of customers had credit cards, compared to 88% in the general population; 64% had a checking account, compared to 87% in the general population; and 49% had a savings account, compared to 56% in the general population.[3]

In general, I believe people use rent-to-own companies to acquire goods that enhance the quality of their lives, not to obtain items necessary for their lives. A few years ago, I compiled information about the types of goods that people rent.

Table 1: Rent-to-Own Merchandise as a Percentage of Store Revenue

	Rent-A-Center[4]	Aaron's Rents[5]	Rent-Way[6]	FTC Survey[7]
Electronics	33%	33%	35%	36%
Appliances	16%	15%	16%	25%
Furniture	37%	33%	30%	36%
Computers	14%	15%	17%	2%
Other		4%		2%
Jewelry			2%	

Even goods in this table that are considered necessities for life really serve to enhance the quality of rent-to-own consumers' lives because firms provide top-quality, name-brand merchandise, in contrast to the same types of merchandise of lower quality available at second-hand stores.

The rent-to-own marketplace is occupied by two large, publicly-held companies, Rent-A-Center and Aaron Rents, and many smaller firms. The industry is competitive, as evidenced by the fact that multiple rent-to-own stores are often placed in the same location. And, because almost all rent-to-own customers have vehicles and can drive to find lower prices, all of the stores in a metropolitan area compete with each other.

Purchasing goods through rental-purchase agreements is expensive, but it is not outrageous given consumers' other options. For instance, credit cards with annual percentage rates around 20% appear to be a less expensive alternative than rent-to-own. However, if a customer with such a credit card charges $450 to purchase a television from a retailer, it will take the customer 81 months to pay off the debt if the customer makes only the minimum payment each month (assuming that payment is 2.5% of the total debt). The interest charged over those 81 months would be $364.60, bringing to total cost of the television to $814.60. Paying with a credit card would approximate the cost of acquiring the television from a rent-to-own dealer, but the consumer would take around four and a half times the length of time to pay off the debt. More disturbingly, if the consumer ran into financial problems in the middle of repaying the credit card debt, the consumer would be obligated to keep the goods and pay the debt, whereas in a rent-to-own transaction, the consumer would have the flexibility to walk away.

II. Baseline Consumer Protection Measures

HR 1588 is an important consumer protection law because it offers all rent-to-own customers a baseline of protections from unfair and misleading practices. In this section, I want to point out five of these protections and demonstrate how HR 1588 offers consumers protection that is superior to the protection provided by some existing state laws.

(1) Section 1004(b) requires some pertinent pricing information to be set off at the start of the rental purchase agreement under the title "important rental-purchase disclosures." Emphasizing this information is important for consumers who do not read every word of the contract but still need to know the basic terms of the transaction. This provision is very common in other consumer financial transactions, mirroring the Schumer box in credit card agreements, but it is absent from state rent-to-own laws.[8] Customers will benefit from having clear information about the most important terms of their agreement stated in a place where they are most likely to see it.

(2) Section 1007(9) limits the number of late fees that consumers can accumulate by forbidding rental-purchase agreements that require "the consumer to pay more than 1 late fee or charge for an unpaid or delinquent periodic payment." This provision is important because consumers may not factor in the cost of late fees when they decide to rent a good. Some current state rent-to-own laws, such as those in Georgia and Missouri, lack this protection, allowing companies to charge multiple late fees for a single delinquent payment.[9]

(3) Section 1005(a)(4) gives all consumers the right to reinstate their rental purchase agreements and to continue the process of obtaining ownership, with the time frame for reinstatement dependent on the percentage of total payments they have made. For instance, if consumers have paid 50% of the rental payments towards ownership and return the property when they stop making payments, then they have 120 days to reinstate the agreement. This right is important because some consumers might make substantial progress towards purchasing a good and then run into trouble making the final few payments. This section ensures that those customers will be able to purchase the goods if they can resume payments. Most states offer less protection to these customers who have made substantial payments towards ownership,[10] demonstrating the significance of HR 1588.

(4) Section 1007(3) prevents the situation made famous in the case *Williams v. Walker-Thomas Furniture Co.*,[11] which is taught to virtually all law students. In that case, a company made all the different goods that a consumer was acquiring from it collateral for all the different loans that the consumer had with the company. Defaulting on any one loan meant that all the goods were repossessed. Section 1007(3) forbids this practice in the rent-to-own context by prohibiting "a security interest or any other claim of a property interest in any goods, except those goods the use of which is provided by the merchant pursuant to the agreement." State rent-to-own laws, such as those in Texas, Florida, Missouri, and Georgia, for instance, do not forbid these cross-collateralization clauses,[12] leaving consumers vulnerable. In a hearing on a federal rent-to-own bill in 2001, a Representative stated that the modern rent-to-own industry was replaying the horrible facts of *Williams v. Walker-Thomas Furniture Co.* across the country.[13] HR 1588 would ensure that the practice would be illegal in every state.

(5) Finally, even the sections of HR 1588 that duplicate state laws are important because a federal rent-to-own law would be enforced by the Federal Trade Commission under section 1016(a). For example, if the FTC observed companies breaching the peace when repossessing goods, the FTC could enforce section 1007(7) to stop this conduct. While section 1007(7) is repetitive of Article 2A of the Uniform Commercial Code,[14] without HR 1588, the FTC is very unlikely to intervene to protect consumers.

III. The Relationship Between HR 1588 and State Law

Like other federal consumer protection statutes, such as the Fair Debt Collection Practices Act, HR 1588 does not prevent states from adopting laws that offer consumers greater protections than HR 1588.[15] Thus, if a state does not think HR 1588 goes far enough, it can take a wide variety of actions, from limiting the prices that rent-to-own companies can charge to banning the transaction from the state entirely.

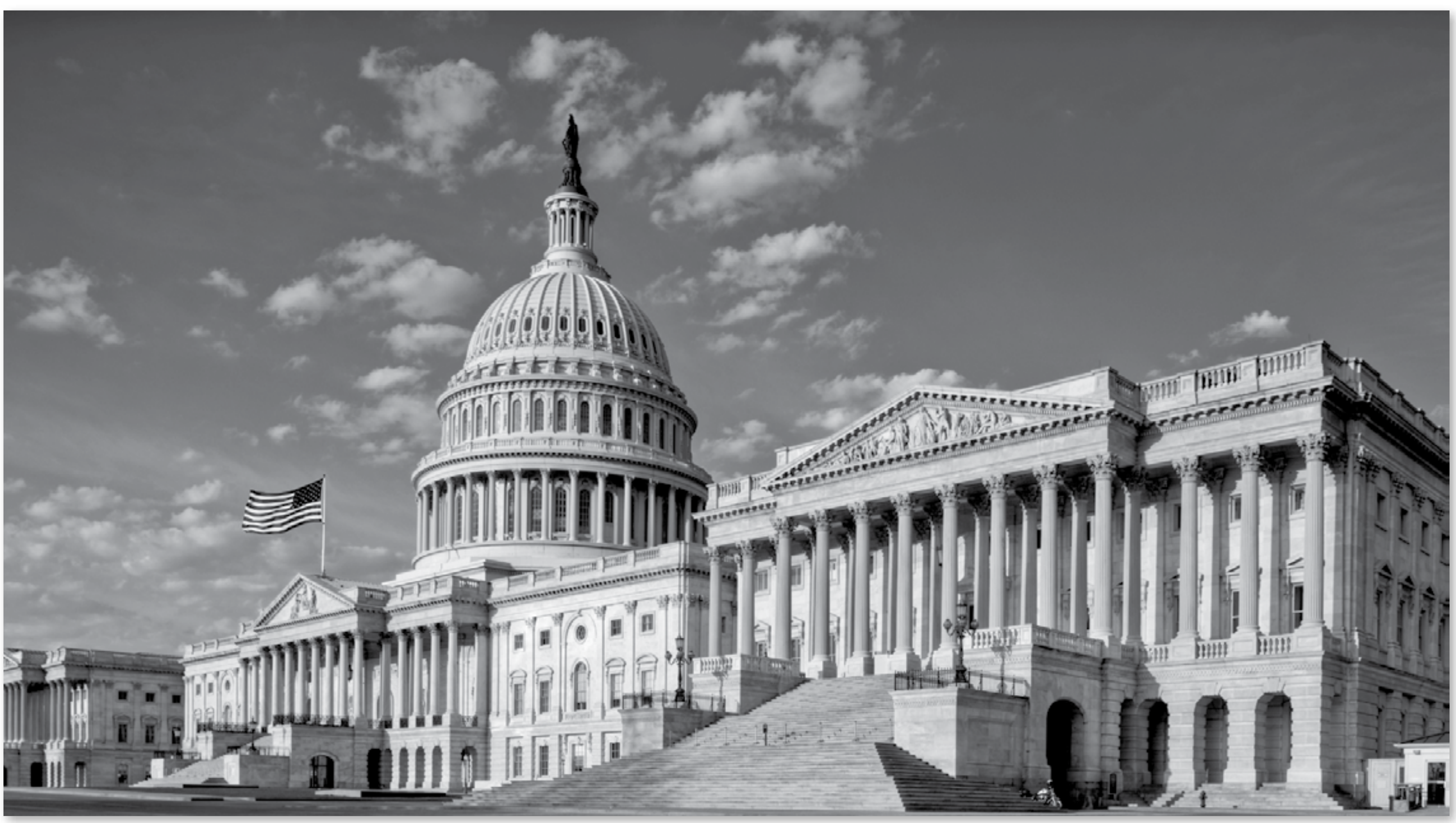
The bill does, however, restrict states in two ways. It precludes states from regulating rental-purchase agreements as credit agreements, and it prevents states from requiring companies to disclose price information as an annual percentage rate (APR). In my opinion, neither of these restrictions are adverse to consumers' interests, but they both serve a beneficial function of ensuring that rent-to-own companies will be able to operate with reasonable levels of certainty about how courts will treat rental-purchase agreements.

First, restricting states from treating rental-purchase arrangements as credit recognizes the true nature of the rent-to-own transaction. Rent-to-own is not a credit arrangement primarily because consumers are not obligated to continue renting goods for any set amount of time. The obligation to pay back the entire amount that someone has borrowed is central to the definition of credit, but it is completely absent from the rent-to-own transaction. The ability to stop paying without consequences is important because consumers literally cannot experience financial distress or be driven into bankruptcy directly because of a rent-to-own agreement. They never take on any obligations to pay for a set period, so they cannot breach that agreement.

That rental-purchase agreements are not credit arrangements is further demonstrated by the fact that rent-to-own will not be regulated by the Consumer Financial Protection Bureau under the Dodd-Frank Act. Under the Act, the Bureau regulates "financial products and services," and the most expansive category in the definition of this phrase is "extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit."[16] Under the Act, "credit" means (1) "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment" or (2) "the right granted by a person to . . . purchase property or services and defer payment for such purchase."[17] Rent-to-own agreements fall outside both of these parts of the definition. The statute does not define "debt," but debt is commonly defined as an obligation to pay money arising out of a transaction.[18] Rent to-own-agreements do not involve taking on debt because the rental agreements obligate consumers to pay for rental periods at the start of the rental period, not the end, so the consumer generally does not owe money because of the agreement.[19] Additionally, rent-to-own agreements do not involve deferring payment for a purchase because payments for renting are due before the rental period begins.

But more than arguments about the nature of the rent-to-own transaction, any legal protections that consumers obtain when states treat rent-to-own transactions as credit could still be enacted by states under HR 1588. For instance, if a state wants its usury laws to affect rental-purchase agreements, it can enact price controls on rent-to-own agreements. The only thing states cannot do is govern the transaction through a slight of hand that transforms a rental arrangement into a credit arrangement.

Second, preventing states from mandating that stores disclose annual percentage rates is a reasonable provision. APR disclosures are very difficult for most consumers to understand because people generally think in terms of actual dollar amounts, not abstract percentages. Furthermore, for many rent-to-own customers, the APR is not a relevant figure. At least 30% of customers do not ultimately purchase the goods that they have rented.[20] More to the point, some people in the industry estimate that only 2% of customers acquire ownership by paying the weekly fees through the life of the agreement. Most who acquire ownership do so by paying something less than the "total cost" under the contract by purchasing the goods part way through the agreement. For everyone except the 2% that pay the total



cost, the APR is inaccurate. If rent-to-own stores are required to disclose largely irrelevant or inaccurate information to consumers, it obscures the information that consumers really need to know.

Also, it is important to note that in the rent-to-own context, requiring APR disclosures drives most—and the biggest—rent-to-own companies from the jurisdiction, limiting or eliminating consumer choice in those states. When I gathered information in 2007, I found that in Vermont, where APR disclosures are mandated by rule, only 16 stores operate, and in Minnesota, which has an APR requirement, there are only 11 stores. It is estimated that rent-to-own companies would open somewhere between 150[21] and 300[22] more rent-to-own stores if Wisconsin changed its requirements, but currently, there are around 60 rent-to-own stores operating there. APR disclosure requirements severely limit competition and consumer choice in states that enact them.

The real effect of these two restrictions on state law is that rent-to-own firms can operate without the risk that a court will suddenly decide that a whole new body of law applies to the transaction. In 2006, this is exactly what happened in the New Jersey Supreme Court's decision in *Perez v. Rent-A-Center, Inc.*[23] The court concluded that rent-to-own products were really credit sales subject to harsher regulation, but it did so without the evidence-based, deliberative process that legislatures use to write laws. As a result, the court made several critical, erroneous empirical assumptions about the rent-to-own industry: that customers always intend to obtain ownership of rent-to-own goods,[24] that customers do not value the ability to cancel their rental-agreements,[25] and that the goods that rent-to-own stores rent are necessities for life.[26] If the state of New Jersey had to engage in the deliberative process of passing a law, it is unlikely that these same factual mistakes would be made.

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1 The views I present here are solely my own. This testimony draws heavily, sometimes verbatim, from my published articles that discuss rent-to-own, which are *Renting the Good Life*, 49 Wm. & Mary L. Rev. 2041 (2008); *Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress*, 86 Ind. L.J. 1361 (2011); *The Federal Government in the Fringe Economy*, 15 Chap. L. Rev. 23 (2011).

2 Federal Trade Commission, Survey of Rent-to-Own Customers ES-1 (2000).

3 James M. Lacko et al., *Customer Experience with Rent-to-Own Transactions*, 21 J. of Pub. Policy & Mktg. 126, 130 (2002). Economist John Caskey's research found similar results: He found that 36.7% of customers carry general use credit cards and 65.3% had some type of deposit account. John P. Caskey, Lower Income Americans, Higher Cost Financial Services 29 Table 8 (1997).

4 Rent-A-Center, Inc, Annual Report (Form 10-K), at 5-6 (Feb. 23, 2007).

5 Aaron Rents, Inc., Annual Report (Form 10-K), at 14 (Feb. 22, 2007).

6 Rent-Way, Inc., Annual Report (Form 10-K), at 3 (Dec. 29, 2005) (figures rounded to the nearest whole number).

7 Federal Trade Commission, Survey of Rent-to-Own Customers 51 (2000) (figures rounded to the nearest whole number and presented as a percentage of consumer's reported behavior).

8 Every state law I examined to see if it had a requirement like section 1004(b) lacked any rule requiring that key terms be segregated at the start of the contract. *See, for instance*, Tex. Bus. & Comm. Code §§ 92.051 – 92.053 (West 2011) (not stating any rule about how information must be presented); Montana Code Ann. § 30-19-109 (2011) (stating some information must be before the customer's signature but not set off with a specific title or at the start of the agreement); Ga. Code Ann. § 10-1-682(b) (requiring that key information be placed together in the agreement but not at the start of the agreement); Fla. Stat. § 559.9233(6) (2011) (requiring that disclosures "be stated in a clear and coherent manner" but not all at the same time or at the start of the agreement); Revised Statutes of Mo. rev. stat. § 407.662 (2011) (requiring disclosures but not specifying that the disclosures be at the front of the agreement or grouped together); Ohio Rev. Code § 1351.02 (West 2011) (requiring that disclosures "be stated in a clear and coherent manner" but not all at the same time or at the start of the agreement).

9 Ga. Code Ann. § 10-1-686.(2011); Mo. Rev. Stat. § 407.660 et seq (2011).

10 Mont. Code § 30-19-112 (2011) (giving customers 45 days to reinstate the agreement if they have paid 2/3 of the rental payments and have returned the goods); Tex. Bus. & Comm. Code § 92.053 & § 92.103 (West 2011) (giving customers who have returned goods 37 days to reinstate the agreement); Ga. Code Ann. § 10-1-686 (2011) (giving customers who pay weekly 21 days to reinstate the agreement); Mo Rev. Stat. § 407.664.1 (2011) (giving customers who pay weekly 21 days to reinstate the agreement); Ohio Rev. Code Ann. 1351.05 (2011) (giving customers who pay weekly 21 days to reinstate the agreement); Fla Stat. § 559.9235(1) (2011) (giving customers who return the goods 60 days to reinstate the agreement).

11 350 F.2d 445 (D.C. Cir. 1965).

12 Tex. Bus. & Comm. Code § 92.054 (West 2011); Fla. Stat. § 559.9234 (2011); Mo. Rev. Stat. § 407.662 (2011); Ga. Code Ann. § 10-1-684 (2011).

13 Statement of Rep. Maxine Waters, Hearing Before the Subcommittee on Financial Institutions and Consumer Credit on HR 1701—The Consumer Rental Purchase Agreement Act 4 (July 12, 2001).

14 For Texas' version of this law, *see* Tex. Bus. & Comm. Code § 2A.525(c) (West 2011).

15 *See* HR 1588 § 1018.

16 Dodd-Frank Act §1002(15)(A)(i).

17 *Id.* §1002(7).

18 *See, e.g.*, 15 U.S.C. 1692a(5) (reporting the Fair Debt Collection Practices Act's definition of debt).

19 Even cases finding that rent-to-own agreements are credit sales state that rent-to-own does not entail accumulating debt. *Miller v. Colortyme, Inc.*, 518 N.W.2d 544, 549 (Minn. 1994).

20 Federal Trade Commission, Survey of Rent-to-Own Customers ES-1 (2000).

21 Paul Gores, *Will Legislators Buy Rent-to-Own Bill?*, The Milwaukee J. Sentinel, Oct. 10, 2005.

22 Jeremy Janes, *Rent-to-Own Industry up to Old Tricks*, Wisconsin State J., Aug. 10, 2005, at A6.

23 892 A.2d 1255 (N.J. 2006).

24 *Id.* at 1258. In reality, the FTC survey found that 33% of customers did not intend to purchase the goods they rented. Federal Trade Commission, Survey of Rent-to-Own Customers ES-2 (2000).

25 892 A.2d at 1269 n.14. Another survey found that the ability to cancel a rent-to-own agreement was one of the most important reasons people chose to rent-to-own. Brian J. Zikmund-Fisher & Andrew M. Parker, *Demand for Rent-to-Own Contracts: A Behavioral Economic Explanation*, 38 J. of Econ. Behavior & Org. 199 (1999).

26 892 A.2d at 1264-65. *See* Table 1 above for evidence that rent-to-own customers do not rent necessities.

Consumer News Alert Recent Decisions

Since October 2006, the Center for Consumer Law has published the "Consumer News Alert." This short newsletter contains everything from consumer tips and scam alerts, to shopping hints and financial calculators. It also has a section just for attorneys, highlighting recent decisions. The alert is delivered by email three times a week. Below is a listing of some of the cases highlighted during the past few months. To subscribe and begin receiving your free copy of the Consumer News Alert in your mailbox, visit www.peopleslawyer.net.

UNITED STATES COURTS OF APPEAL

Cingular customers must arbitrate individual claims. The Eleventh Circuit held that in light of the Supreme Court's decision in *Concepcion*, Cingular's contract requiring arbitration and prohibiting class claims is enforceable. The court stated "we now hold that, in light of *Concepcion*, the class action waiver in the Plaintiffs' arbitration agreements is enforceable under the FAA." *Cruz v. Cingular Wireless, LLC*, 648 F.3d 1205 (11th Cir. 2011).

Amended complaint revives right to enforce arbitration clause that had been waived. The Eleventh Circuit held that a consumer fraud plaintiff's filing of an amended complaint revived a bank's right to enforce an arbitration clause containing a class action waiver. The court noted that the plaintiff's filing of the amended complaint nullified the bank's waiver of its arbitration rights. It held that "when a plaintiff files an amended pleading that unexpectedly changes the shape of the case, the case may be 'so alter[ed] . . . that the [defendant] should be relieved from its waiver.'" *Krinsk v. SunTrust Banks, Inc.*, 654 F.3d 1194 (11th Cir. 2011).

Passenger may sue airline over frequent flier program. The Ninth Circuit held that Federal aviation law does not preempt a passenger's claim against an airline for a breach of the implied covenant of good faith and fair dealing. *Ginsberg v. Northwest, Inc.*, 653 F.3d 1033 (9th Cir. 2011).

Magnuson-Moss exhaustion rule is not jurisdictional. The Ninth Circuit held that a federal court is not deprived of subject matter jurisdiction in a breach-of-warranty lawsuit by the plaintiff's failure to first engage in dispute resolution under the terms of her new car lease. The court stated, "The only question before us is whether [plaintiff's] failure to comply with the MMWA's requirement that a consumer resort to an informal dispute settlement procedure before filing a civil action deprives the court of subject matter jurisdiction. We hold that it does not." *Maronyan v. Toyota Motor Sales, U.S.A., Inc.*, 658 F.3d 1038 (9th Cir. 2011).

Debt collector may be liable for damages under both state and federal law. The Ninth Circuit held that a debt collector that sent collection letters concerning obsolete debts to 40,000 individuals could be liable in a class action for statutory damages under both federal and California law. *Gonzales v. Arrow Fin. Servs., LLC*, 660 F.3d 1055 (9th Cir. 2011).

Arbitration clause not enforceable with respect to claim under Magnuson-Moss. The Ninth Circuit held that a used car dealer could not enforce a written warranty provision that mandated pre-dispute binding arbitration if it was sued for violating the Magnuson-Moss Warranty Act. The court explained that enforcing the rule "advances the statute's purpose of protecting consumers from being forced into involuntary agreements that they cannot negotiate. In enacting the [Act], Congress sought to address the extreme inequality in bargaining power that vendors wielded over consumers by 'providing consumers with access to reasonable and effective remedies' for breaches of warranty, and by 'provid[ing] the Federal Trade Commission (FTC) with means of better protecting consumers.'" As the court noted, the Fifth and Eleventh Circuits have made contrary rulings. *Kolev v. Euromotors West/The Auto Gallery*, 658 F.3d 1024 (9th Cir. 2011).

Consumer is not limited to single recovery of statutory damages under Fair Credit Billing Act. The Ninth Circuit held that a plaintiff wasn't limited to a single recovery of statutory damages for multiple violations of the Fair Credit Billing Act. Chase Bank admittedly committed multiple violations of the Fair Credit Billing Act by misidentifying a $645 charge on the plaintiff's credit card account, failing to respond to her requests for information about it, continuing to seek payment for the charge despite her protests, and reporting the debt as delinquent to credit agencies. When the plaintiff sued, Chase argued that her damages were limited to the $1,000 statutory penalty because §1640(g) expressly limits recovery for multiple violations where the violations involved "multiple failures to disclose." But the court decided that §1640(g) did not limit the plaintiff's statutory damages. *Lyon v. Chase Bank USA, N.A.*, 656 F.3d 877 (9th Cir. 2011).

Fair Credit Reporting Act preempts state law claims. The Seventh Circuit held that the federal consumer protection law completely preempts state claims brought by a borrower who claimed that her bank falsely reported to credit agencies that she was behind on her loan payments. The plaintiff sued in state court, alleging that Bank of America told credit agencies that she was behind in payments on a loan, even though the bank knew that she wasn't. Her complaint asserted claims for willful violations of Indiana consumer protection law as well as violations of the Fair Credit Reporting Act (FCRA). The FCRA generally provides that no requirement may be imposed under the "laws" of any state with respect to the furnishers of information to consumer reporting agencies. In finding complete preemption, the court rejected the plaintiff's argument that the Act only prohibits claims brought under state statutes and not common-law causes of action, suggesting that such a conclusion was contrary to legislative-drafting manuals used by the House and the Senate. *Purcell v. Bank of Am.*, 659 F.3d 622 (7th Cir. 2011).

Car manufacturer liable for passenger's death. The Fifth Circuit held that the manufacturer of a sports utility vehicle could be liable for the death of a passenger who was ejected from her reclined seat in a rollover crash. The claim was based on a design defect in the front seat. The court noted, "To succeed on their design defect claim, the [plaintiffs] must have shown that a safer alternative—limiting the seat recline to a 45 degree angle—would have prevented or significantly reduced the risk of [their daughter's] injuries. The [plaintiffs'] expert . . . testified that seats reclined more than a 45 degree angle lead to a significantly increased risk of ejection. He further testified that ejection increases the risk of serious injury or death by six to thirteen times. The Texas statute only requires proof of a safer alternative design that 'in reasonable probability' would have reduced the claimant's injuries, which [the expert's] testimony adequately provided." *Goodner v. Hyundai Motor Co.*, 650 F.3d 1034 (5th Cir. 2011).

Home lender may recover attorneys' fees incurred in connection with a borrower's Chapter 13 bankruptcy case. The Fifth Circuit held that a lender could recover attorneys' fees pursuant to the terms of a deed of trust. The lender contended that it was entitled to its attorney fees based on language in the deed of trust providing that the "lender may do and pay for whatever is reasonable or appropriate to protect lender's interest in the property and rights under this security instrument." The court stated that, "In light of this language, it is clear that the deed of trust contemplates entitlement to attorney's fees incurred to protect Countrywide's interest in the property or rights under the deed of trust." *Velazquez v. Countrywide Home Loans Servicing, L.P. (In re Velazquez)*, 660 F.3d 893 (5th Cir. 2011).

Judgment creditor's lien on homestead unenforceable. The Fifth Circuit held that a judgment creditor did not have an enforceable lien against the proceeds of the sale of a debtor's home in excess of the $125,000 homestead exemption claimed in the debtor's bankruptcy case. The court recognized that the Bankruptcy Act exempts only $125,000 of a homestead exemption, but the court concluded that the enforceability of the plaintiff's lien was a matter of applicable Texas law. Under Texas law, a lien is unenforceable against homestead property. The court said that the "bankruptcy laws that place a cap on the value of a homestead did not convert [the plaintiff's] lien on the homestead from one that was unenforceable pre-petition to one that was enforceable as to the homestead post-petition." *Smith v. HD Smith Wholesale Drug Co. (In re McCombs)*, 659 F.3d 503 (5th Cir. 2011).

The Fifth Circuit held that a judgment creditor did not have an enforceable lien against the proceeds of the sale of a debtor's home in excess of the $125,000 homestead exemption claimed in the debtor's bankruptcy case.

Bankruptcy lawyer fined for "unreasonable reliance" on information provided by client. The Third Circuit held that a bankruptcy attorney could be sanctioned for relying on statements by its client. The court explained that "a reasonable attorney would not file a motion for relief from stay for cause without inquiring of the client whether it had any information relevant to the alleged cause, that is, the debtor's failure to make payments. Had [the lawyer] made even that most minimal of inquiries, [the bank] presumably would have provided her with the information in its files concerning the flood insurance dispute, and [the lawyer] could have included that information in her motion for relief from stay—or, perhaps, advised the client that seeking such a motion would be inappropriate under the circumstances." *In re Taylor*, 655 F.3d 274 (3d Cir. 2011).

State law determines the statute of limitations for a violation of the Telephone Consumer Protection Law. The Second Circuit held that the appropriate limitations period for a class action alleging that a business sent unsolicited fax advertisements in violation of federal consumer protection law was determined by state law. The defendant argued that the complaint was time-barred under the two-year statute of limitations provided in the Connecticut law, which specifically recognizes a cause of action for unsolicited faxes. The plaintiff countered that his lawsuit was timely because the federal "catch-all" four-year limitations period applied and his claims were tolled during the pendency of earlier proceedings in state and federal court. But the court concluded that the state limitations period governed and barred the plaintiff's lawsuit.

"[W]hile a TCPA diversity action is somewhat unusual in that the cause of action is created by federal rather than state law, that federal law authorizes TCPA claims only as 'otherwise permitted' by state law. This indicates that 'Congress intended to give states a fair measure of control over solving the problems that the TCPA addresses.' . . ." Therefore, state law determines the time period within which such actions may be brought. *Giovanniello v. ALM Media, LLC*, 660 F.3d 587 (2d Cir. 2011).

Customers can recover costs of litigating damages from data theft. The First Circuit held that a grocery chain could be liable for the "reasonably foreseeable" costs incurred by customers to mitigate the hacking of their credit and debit card numbers. *Anderson v. Hannaford Bros. Co.*, 659 F.3d 151 (1st Cir. 2011).

BANKRUPTCY APPELLATE PANELS

Bankruptcy debtor can avoid liens to stop foreclosure. The Bankruptcy Appellate Panel for the Eighth Circuit held that Chapter 7 debtors could avoid judicial liens on their homestead property in order to prevent a bank from continuing foreclosure proceedings. *White v. Commercial Bank & Trust Co. (In re White)*, 2011 Bankr. LEXIS 4307 (B.A.P. 8th Cir. Nov. 16, 2011).

A Chapter 13 debtor could "strip off" wholly unsecured liens on his principal residence. The Eighth Circuit Bankruptcy Appellate Panel ruled that a debtor may strip off junior liens on his residence, which was fully secured by a first lien. The debtor's proposed bankruptcy plan treated the claim of the senior lienholder as secured, but "stripped off" or avoided the liens of the second and third lienholders – treating their claims as wholly unsecured. The junior lienholders argued that the proposed strip off of their claims was prohibited by §1322(b)(2) of the Bankruptcy Code. The Code permits a Chapter 13 plan to "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims." But the court decided that Section 1322(b)(2)'s antimodification did not apply because the value of the debtor's principal residence is less than the claim of the senior lienholder and there is, therefore, no value securing the junior lienholders, rendering their claims unsecured under §506(a). *Fisette v. Keller (In re Fisette)*, 455 B.R. 177 (B.A.P. 8th Cir. 2011). *But see In re Quiros-Amy*, 456 B.R. 140 (Bankr. S.D. Fla. 2011).

The debtor's proposed bankruptcy plan treated the claim of the senior lienholder as secured, but "stripped off" or avoided the liens of the second and third lienholders – treating their claims as wholly unsecured.

STATE COURTS

Recording of an assignment is not necessary for foreclosure. The Arizona Supreme Court held state law did not bar the commencement of foreclosure proceedings even though an assignment of a deed of trust for the borrower's home had not been recorded. *Vasquez v. Saxon Mortg., Inc.*, 2011 Ariz. LEXIS 80 (Ariz. Nov. 18, 2011).

Car dealer forfeited right to arbitrate class claims. The California Court of Appeal held that a car dealer forfeited its right to enforce an arbitration clause in its customer agreement when it responded to a putative class action for failing to adequately disclose finance charges. *Roberts v. El Cajon Motors, Inc.*, 200 Cal. App. 4th 832 (2011).

Plaintiff cannot recover amount of undiscounted medical bills. The California Supreme Court held that a personal injury plaintiff can't recover the face amount of her medical bills when her service providers accepted lesser sums as payment. "When a tortiously injured person receives medical care for his or her injuries, the provider of that care often accepts as full payment, pursuant to a preexisting contract with the injured person's health insurer, an amount less than that stated in the provider's bill. In that circumstance, may the injured person recover from the tortfeasor, as economic damages for past medical expenses, the undiscounted sum stated in the provider's bill but never paid by or on behalf of the injured person? We hold no such recovery is allowed, for the simple reason that the injured plaintiff did not suffer any economic loss in that amount." *Howell v. Hamilton Meats & Provisions*, 52 Cal. 4th 541 (Cal. 2011), *reh'g denied*, 2011 Cal. LEXIS 11417 (Nov. 2, 2011).

A landlord can enforce a liability waiver against a tenant injured while exercising at his apartment complex's health club. A California Court of Appeals held that although landlords generally may not waive liability for their negligence, that rule does not apply in this context. The court stated, "We conclude that where a landlord chooses to enhance its offering by providing an on-site health club or exercise facility that goes well beyond bare habitability, there is no reason why the landlord may not protect itself by requiring the tenant, as a condition of use of the amenity, to execute the same waiver or release of liability that could lawfully be required by the operator of a separate, stand-alone health club or exercise facility," the court said. *Lewis Operating Corp. v. Superior Court*, 200 Cal. App. 4th 940 (2011).

Lender can be sued for "fraudulent" ARM disclosures. The California Court of Appeals held that a home lender can be sued under Truth-in-Lending, fraud and state unfair competition law based on its alleged failure to clearly disclose the negative consequences when only the scheduled monthly payments are made on an adjustable rate mortgage loan. *Boschma v. Home Loan Ctr., Inc.*, 198 Cal. App. 4th 230 (2011).

Punitive damages claim does not survive death of tortfeasor. The Supreme Court of Iowa held that a claim for punitive damage does not survive the death of the wrongdoer. "The sole question presented by this appeal is whether a right to punitive damages survives the death of the wrongdoer. On several previous occasions, we have held that punitive damages may not be recovered from the estate of a deceased tortfeasor. Upon our review, we are not persuaded that we should reconsider these precedents." *In re Estate of Vajgrt*, 801 N.W.2d 570 (Iowa 2011).

Class plaintiffs do not need to show receipt of junk faxes. The Kansas Supreme Court held that plaintiffs were not required to establish the actual receipt of unsolicited fax advertisements in order to proceed with a class action under the Telephone Consumer Protection Act. *Critchfield Physical Therapy v. Taranto Group, Inc.*, 2011 Kan. LEXIS 328 (Sept. 30, 2011).

Business cannot sue Better Business Bureau over unfavorable rating. The Missouri Court of Appeals held that a business does not have a claim against the BBB based on a "C" rating. The court stated, "Moreover, . . . the BBB's 'C' rating of Castle Rock is not sufficiently factual to be susceptible of being proved true or false. Although one may disagree with the BBB's evaluation of the underlying objective facts, the rating itself cannot be proved true or false. Therefore, the rating is protected as opinion under the First Amendment." *Castle Rock Remodeling, LLC v. Better Bus. Bureau of Greater St. Louis, Inc.*, 2011 Mo. App. LEXIS 1437 (Nov. 1, 2011).

State credit card claims are not preempted. The Montana Supreme Court held that Federal law does not preempt state tort claims against Citibank for taking steps to collect a credit card debt that the company allegedly knew to be due to unauthorized charges. *Curtis v. Citibank, S.D., N.A.*, 261 P.3d 1059 (Mont. 2011).

Pharmacist may have duty for customer-specific risk. The Nevada Supreme Court held that when a pharmacist has knowledge of a customer-specific risk with respect to a prescribed medication, he or she has a duty to exercise reasonable care in warning the customer or notifying the prescribing doctor of this risk. *Klasch v. Walgreen Co.*, 2011 Nev. LEXIS 93 (Nev. 2011).

Lender may be liable under state consumer protection act for conduct in connection with foreclosure. The New Jersey Supreme Court held that a home lender may be liable for consumer fraud law based on its alleged breach of agreements to forbear on foreclosure proceedings. "We hold that the post-foreclosure-judgment agreements in this case were both in form and substance an extension of credit to plaintiff originating from the initial loan. Fraudulent lending practices, even in a post-judgment setting, may be the basis for a Consumer Fraud Act lawsuit[,]" the court said. *Gonzalez v. Wilshire Credit Corp.*, 25 A.3d 1103 (N.J. 2011).

Car dealer's arbitration provision prohibiting class relief unenforceable. The New Jersey Appellate Division held that a new car dealer cannot enforce arbitration language waiving a customer's right to class-wide relief. The court recognized that *Concepcion* does not allow the clause to be invalidated per se on public policy ground, but found that, "the provisions before us are simply too convoluted and inconsistent to be enforced." NAACP of Camden Cnty. E. v. Foulke Mgmt. Corp., 24 A.3d 777 (N.J. Super. Ct. App. Div. 2011).

Law firm cannot sue bank over counterfeit check. New York's highest court held that a law firm couldn't sue its bank for negligently misrepresenting that a counterfeit check received from a client had cleared. The firm agreed to represent a Hong Kong company to collect debts from its North American customers. The client instructed the firm to take its $10,000 retainer from a $198,000 Citibank check purportedly from one of the client's customers. After taking its retainer, the firm was to wire the remaining balance to the client. After being told the check had "cleared," the firm wired the balance of the check to the client. The court concluded that the firm could not show reasonable reliance, explaining that the bank's employee's alleged statement that the check had cleared was "an ambiguous remark that may have been intended to mean only that the amount of the check was available (as indeed it was) in [the firm's] account. Reliance on this statement as assurance that final settlement had occurred was, under the circumstances here, unreasonable as a matter of law." *Greenberg, Trager & Herbst, LLP v. HSBC Bank USA*, 17 N.Y.3d 565 (2011).

Law firm cannot sue bank over counterfeit check. New York's highest court held that a law firm couldn't sue its bank for negligently misrepresenting that a counterfeit check received from a client had cleared.

Arbitration provision unconscionable and unenforceable. The Vermont Supreme Court held that a home inspector's arbitration clause was unenforceable. The court noted that "the contract's limitation on [the defendant's] liability creates a disingenuous arbitration remedy for the plaintiffs. Even standing alone, limiting liability to $285 irrespective of the actual damages incurred by the customer would be, at minimum, highly suspect. But under this contract's governing arbitration rules, the plaintiffs could not recover even the cost of the filing fee much less any compensatory damages. Thus, the liability limit in the contract is a complete impediment to any effective remedy for the home inspector's negligence or even intentional tort." *Glassford v. BrickKicker*, 2011 VT 118 (2011).

Automated call didn't violate Telephone Consumer Protection Act. West Virginia's highest court held that an automated call to a home didn't violate the federal TCPA because it was placed in response to a resident's Craigslist advertisement. *Mey v. Pep Boys-Manny, Moe & Jack*, 717 S.E.2d 235 (W. Va. 2011).

DECEPTIVE TRADE PRACTICES AND WARRANTIES

MAGNUSON-MOSS EXHAUSTION RULE IS NOT JURISDICTIONAL

Maronyan v. Toyota Motor Sales, U.S.A., Inc., 658 F.3d 1038 (9th Cir. 2011).

FACTS: Mariam Maronyan leased a new car from defendant, Toyota Motor Sales. The car began to have mechanical problems within the warranty period. Toyota failed to repair the problems to Maronyan's satisfaction, and she brought suit against Toyota in federal district court. Her claim alleged breach of warranty under the Magnuson–Moss Warranty Act ("MMWA"). The district court granted Toyota's motion to dismiss for lack of subject matter jurisdiction on the ground that Maronyan did not pursue her claims through the California Dispute Settlement Program (which Toyota specified in its warranty) before filing suit in civil court.

HOLDING: Reversed.

REASONING: All parties agreed that under Section 2310(a) of the MMWA, if a warrantor establishes a requirement that a dispute settlement procedure must be used before pursuing any legal remedy, then the consumer may not commence a civil action until the dispute resolution process is completed. However, the court noted that despite the mandatory language, statutorily-created exhaustion requirements ordinarily constitute affirmative defenses that may be defeated by compelling reasons for failure to exhaust. A consumer's failure to exhaust a remedy will only deprive federal courts of subject matter jurisdiction in those cases in which Congress makes plain the jurisdictional character of the exhaustion requirement. *Weinberger v. Salfi,* 422 U.S. 749, 757 (1975). Subject matter jurisdiction is rarely lost due to lack of compliance with exhaustion requirements. *See I.A.M. Nat'l Pension Fund Benefit Plan C. v. Stockton TRI Indus.*, 727 F.2d 1204, 1208 (D.C. Cir.1984) ("Only when Congress states in clear, unequivocal terms that the judiciary is barred from hearing an action until the administrative agency has come to a decision . . . has the Supreme Court held that exhaustion is a jurisdictional prerequisite.").

The court disagreed with Toyota's contention that Congress had mandated the MMWA exhaustion requirement as jurisdictional.

The court disagreed with Toyota's contention that Congress had mandated the MMWA exhaustion requirement as jurisdictional, concluding that the necessary "sweeping and direct" language required in *Weinberger* was not present. Only when Congress has used "sweeping and direct language that goes beyond a requirement that only exhausted claims be brought" should a failure to exhaust be seen as affecting jurisdiction. The Court has chastised lower courts for their "overly zealous" application of the term "jurisdictional" to what are accurately understood as claims-processing rules or elements of a plaintiff's claim. In two earlier cases, the court found that similarly-worded statutory exhaustion requirements did not deprive federal courts of subject matter jurisdiction. *Rumbles v. Hill*, 182 F.3d 1064 (9th Cir. 1999); *McBride Cotton and Cattle Corp. v. Veneman*, 290 F.3d 973, 978 (9th Cir. 2002). The court held that the generic language in the MMWA was not "sweeping and direct." Thus, the court held that § 2310(a)'s prerequisite that "the consumer may not commence a civil action . . . unless he initially resorts to [an informal dispute settlement procedure]" is merely a codification of the MMWA's exhaustion requirement and does not operate as a jurisdictional bar.

CONSUMER CREDIT

SUIT ON CREDIT CARD DEBT IS AN ACTION ON AN OPEN ACCOUNT

Capital One Bank v. Conti, 245 S.W.3d 490 (Tex. App.—San Antonio 2011).

FACTS: Capital One sued Duane Conti for failure to pay amounts owed on his credit card account. The undisputed facts showed that Conti made his last payment in June 2005 and that Capital One's petition was file-stamped on August 4, 2009. The trial court granted Conti's motion for summary judgment on the grounds that the suit was not commenced before the statute of limitations had expired.

HOLDING: Reversed.

REASONING: The court outlined the four elements of an open account as: 1) transactions between the parties; 2) creating a creditor-debtor relationship through a general course of dealing; 3) with the account still being open; and 4) with expectation of further dealing. *Eaves v. Unifund CCR Partners,* 301 S.W.3d 402, 408-409 (Tex. App.—El Paso 2009). A credit card debt is considered an open account because the terms of repayment remain subject to modification and the parties exchange credits and debits until either party settles the balance and closes the account.

If an action to collect a credit card debt is brought as an action on an open account, Section 16.004(c) of the Texas Civil Practices and Remedies Code establishes the applicable statute of limitations. Under Section 16.004, a person must bring an action on an open or stated account not later than four years after the day that the cause of action accrues. The cause of action accrues on the day that the dealings in which the parties were interested together cease. As the party moving for summary judgment, Conti had the burden to conclusively establish the date upon which the parties' dealings ceased. Proof of the date of last payment is not conclusive evidence of the date upon which the parties' dealings ceased. The court reasoned that a typical credit card agreement requires the credit card holder to make payments at regular intervals. Therefore, merely establishing the last date of payment is not sufficient to establish, as a matter of law, that the relationship between the parties also ceased on that date. The court concluded that by providing the trial court with proof of the date of his last payment and nothing else, Conti did not conclusively establish the date upon which the parties' dealings ceased and the cause of action accrued.

STATE CREDIT CARD CLAIMS ARE NOT PREEMPTED

Curtis v. Citibank, South Dakota, N.A., 261 P.3d 1059 (Mont. 2011).

FACTS: In July 2008, Meril Curtis's Citibank credit card was stolen by a houseguest who then made over $7,000 in unauthorized charges. After Curtis's discovery of the charges, Citibank instructed him to file a police report and furnish an affidavit. It then acknowledged that the charges were unauthorized and that Curtis was not personally liable for the charges. Nevertheless, Citibank referred the account to a debt collection agency, PRS.

Curtis filed suit against Citibank alleging libel, credit libel, violation of the Fair Debt Collection Practices Act ("FDCPA"), and violation of the Montana Consumer Protection Act ("MCPA"). Citibank moved for judgment on the pleadings arguing that Curtis's libel, credit libel, and MCPA claims were preempted by the Fair Credit Reporting Act ("FCRA"). The district court found that Citibank was entitled to judgment on the pleadings for these counts because the state law claims were in fact subject to federal preemption by the FCRA. Curtis appealed.
HOLDING: Reversed and remanded.
REASONING: The FCRA requires that consumer reporting agencies adopt "reasonable procedures for meeting the needs of commerce for information as to consumer credit, personnel, insurance, and other information in a manner that is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information" in accordance with the requirements of the Act. 15 U.S.C. §1681(b). In order to provide uniform enforcement, the FCRA allows exemption from state laws that are inconsistent with guidelines found within the Act. 15 U.S.C. §1681t. The court explained that in 1996, specific preemption provisions were inserted into the FCRA, including: "[n]o requirement or prohibition may be imposed under the laws of any State . . . with respect to any subject matter regulated under . . . section 1681s–2 of this title, relating to the responsibilities of persons who furnish information to consumer reporting agencies . . . ." The Act also provides guidance to financial institutions that extend credit and regularly furnish information to a "consumer reporting agency." Citibank prevailed in the lower court by arguing that in referring Curtis's account to PRS, it was simply furnishing credit information. The court disagreed.

The court found that although both parties argued about Citibank's status as a "furnisher of information" under the FCRA, the heart of the matter lay in the status of PRS as a "consumer reporting agency." The FRCA states that a "consumer reporting agency" is "any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information . . . for the purpose of furnishing consumer reports to third parties . . . ." 15 U.S.C §1681a(f). The court found that PRS is a collection agency for overdue and delinquent accounts payable. The company collected information on Curtis for the purpose of collecting an alleged debt – not for the purpose of furnishing a consumer report to an ultimate end user of credit information. Contrary to Citibank's assertions, the definition found at §1681a(f) is intended to apply to the activities of agencies such as Equifax Credit Information Services, Inc., Trans Union LLC, and Experian Information Solutions, Inc. Collection agencies such as PRS, on the other hand, are regulated by the FDCPA. No similar federal preemption provision is found within the FDCPA. As such, the court concluded that the district court erred in finding that Curtis's state law claims were preempted by the FCRA.

FAIR CREDIT BILLING ACT AUTHORIZES MULTIPLE AWARDS OF STATUTORY DAMAGES

Lyon v. Chase Bank USA, N.A., 656 F.3d 877 (9th Cir. 2011).

FACTS: Credit card holder Barbee Lyon requested information regarding a misidentified charge on his credit-card bill from Chase Bank ("Chase"). Chase failed to respond to Lyon's requests, continued to seek payment, and ultimately reported the debt as delinquent to credit agencies, despite Lyon's protest. In doing so, Chase admittedly violated multiple sections of the Fair Credit Billing Act ("FCBA") 15 U.S.C. §§1666-(j). After unsuccessfully attempting to get a direct response from Chase, Lyon and his wife filed suit, alleging claims under the FCBA and Oregon's Unlawful Debt Collection Practices Act ("UDCPA"). Chase moved to limit FCBA recovery with the argument that Lyon was precluded from recovering separate statutory penalties. The trial court granted this motion *in limine* during pretrial conference, and Chase was subsequently allowed to amend its answer to admit liability up to $1,000. The district court dismissed the UDCPA claim and limited Lyon's total recovery for the FCBA claims accordingly. Lyon appealed on the ground that the trial court erred in limiting statutory damages for Chase's multiple violations of the FCBA.
HOLDING: Reversed.
REASONING: The FCBA was enacted by Congress to regulate billing disputes, by providing a procedure for dispute identification and resolution between a cardholder and a card issuer. It requires a credit card issuer to acknowledge disputes under certain circumstances, investigate the matter, and provide a written explanation of its decision within ninety days. The creditor must send its explanation to the cardholder before attempting to collect the disputed amount, and it must notify the cardholder that he need not pay the amount in dispute until full compliance has occurred. Additionally, the FCBA prohibits a creditor from adversely reporting on the cardholder's credit rating until all requirements are met.

Pursuant to 15 U.S.C. §1640(a)(2), a creditor who fails to comply with "any requirement imposed" under the FCBA is liable for an award of statutory damages. However, §1640(g) limits a plaintiff to a single recovery for multiple violations where the violations involve "multiple failures to disclose." Chase admitted to its receipt of the billing dispute from Lyon, its lack of response or explanation of the charge, the continuation of debt collection from Lyon, and having reported the debt as delinquent to credit agencies. All these actions are in violation of the FCBA requirements. However, Chase contended that all of its FCBA violations were covered by §1640(g) and that Lyon's recovery of statutory damages was therefore limited to a single penalty. Chase argued that §1640(g) applies uniformly to any violation of the FCBA. The court disagreed. It found that §1640(g) indicates that the single recovery limitation applies to only a subset of the violations that involve" failure to disclose to any person any information required" under the covered statutes. The court reasoned that if Congress had intended uniform application of the single-recovery limitation, it would have uniformly applied the theory instead of codifying the limitations in §1640(g).

The single recovery limitation applies to only a subset of the violations that involve" failure to disclose to any person any information required" under the covered statutes.

Chase further argued that allowing separate statutory penalties for its multiple violations would lead to a flood of consumer-created claims. The court found no merit in that position. The FCBA violations supporting liability were the direct result of Chase's own conduct. They were not attributable to Lyon, who simply sought an explanation that should have been reasonably expected even without statutory requirements. The court held that Lyon's recovery of statutory damages resulting from Chases multiple violations of the FCBA were not limited toa single statutory penalty under §1640(g).

FAIR CREDIT BILLING ACT DOES NOT REQUIRE RELIANCE

Lyon v. Chase Bank USA, N.A., 656 F.3d 877 (9th Cir. 2011).

FACTS: Barbee Lyon was a credit card holder, who filed an action against Chase Bank USA, alleging violations of the Fair Credit Billing Act ("FCBA"). Lyon requested information regarding a misidentified charge on his account. Chase failed to respond, continued to seek payment, and ultimately reported the debt as delinquent to credit agencies. Chase admitted to violating sections 1666(a)-(j) of the FCBA, under which Lyon filed suit. Chase moved to exclude evidence or argument regarding Lyon's right to recover actual damages, arguing that Lyon suffered no out-of-pocket economic loss and that an award of actual damages under the FCBA requires evidence of detrimental reliance. The district court held that Lyon had to provide evidence of detrimental reliance in order to support an award of actual damages resulting from Chase's violations of the FCBA. Because Lyon had not relied on information from Chase, as Chase had provided none, the court granted the motion. Lyon appealed.

HOLDING: Reversed.

REASONING: Pursuant to 16 U.S.C. §1640(a)(1), a creditor who fails to comply with "any requirement" imposed under the FCBA is liable for "any actual damage sustained by [the plaintiff] as a result of the failure." Chase admitted that it violated the FCBA by failing to provide a written explanation in response to Lyon's billing dispute. Chase further admitted that because no explanation was provided, it also violated the FCBA by attempting to collect the disputed charge and reporting it as delinquent to credit agencies. Chase argued, however, that Lyon could not recover actual damages because Ninth Circuit precedent requires evidence of detrimental reliance for any such recovery under §1640(a)(1). It cited *Gold Country Lenders v. Smith* (*In re Smith*), 289 F.3d 1155, 1157 (9th Cir.2002). There, the court held that a bankruptcy claimant could not recover actual damages because she failed to present evidence of her detrimental reliance, without which she could not satisfy the causation element necessary to support actual damages under §1640(a)(1). However, the court distinguished *In re Smith* – as well as the out-of-circuit decisions that it followed – because it involved Truth In Lending Act ("TILA") violations, not violations of the FCBA, and differed in ways that affect the application of §1640. The court found that Chase's suggestion that all precedent related to TILA applied with equal force to the FCBA was an oversimplification of the relevant statutes, and whether "detrimental reliance" had anything to do with causation to support an award of actual damages resulting from violations of the FCBA appeared to be a question of first impression.

The court concluded that applying such a requirement to the FCBA violations admitted in this case would distort the analysis of causation and thereby contradict the purpose of §1640(a)(1). Chase did not follow the requirements of the FCBA and then undertook collection actions prohibited by the statute. The court found there was no relevant disclosure or conduct under these circumstances that Lyon could have relied upon, making Lyon's lack of detrimental reliance immaterial to a determination of whether Chase's violations resulted in actual damages. The court stated requiring evidence of detrimental reliance on an unmade explanation would bar recovery of actual damages because such evidence could never exist. Consumers cannot rely on unmade explanations, and creditors could simply avoid actual damages under the FCBA by never responding to billing disputes—the exact conduct the statute aims to prevent. The court held that evidence of detrimental reliance is not required to support an award of actual damages resulting from violations of the FCBA, reversed the magistrate judge's order denying an award of actual damages, and remanded the issue for further proceedings.

FAIR CREDIT REPORTING ACT PREEMPTS STATE LAW CLAIMS

Purcell v. Bank of America, 659 F.3d 622 (7th Cir. 2011).

FACTS: Kristen Purcell sued Bank of America, alleging that it sent reports to credit agencies stating she was behind on loan payments, even though Bank of America had information indicating that the reports were not true. Purcell brought her claims under Section 1681s-2(a) of the Fair Credit Reporting Act ("FCRA"). Purcell also sued under several state common law theories. The Bank successfully removed the case to federal district court, which dismissed Purcell's federal claim because §1681s-2(a) does not create a private right of action.

As to the state law theories, Bank of America contended that they were preempted by the FCRA. The district court rejected the Bank's interpretation of the Act, holding that the word "laws" in §1681t(b) was limited to state *statutes*. The district court reasoned that claims based on state common law were free to proceed, because §1681t(a) provides that state law claims

are not preempted, except to the extent specified by §1681t(b). The district court dismissed Purcell's common law claims without prejudice, leaving Purcell free to file her claims in state court. The Bank appealed, asserting the dismissal should have been *with* prejudice.
HOLDING: Reversed.
REASONING: The appellate court found the district court's reasoning eerily similar to that in *Swift v. Tyson*, 41 U.S. 1 (1842), where the Supreme Court interpreted the word "laws" in the Rules of Decision Act to mean only statutes. *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), famously overruled *Swift* and held that a reference to state "laws" comprises all sources of legal rules, including judicial opinions.

As in *Swift*, the district court's ruling hinged on distinguishing the words "law" from "laws." The district court felt the need to make this distinction to avoid inconsistency between §1681t(b)(1), and 15 U.S.C. §1681h(e). The appellate court reasoned that there was no basis for reading "law" to mean all laws while reading "laws" to mean only statutes, and questioned any actual legislative intent to distinguish statutory and common law. The court reasoned that §1681h(e) preempts some state claims that could arise out of reports to credit agencies, and §1681t(b)(1)(F) preempts more of these claims. An earlier statute does not defeat a later-enacted one, so there is no inconsistency between the two statutes. The Court found that §1681t(b)(1)(F) reduces the scope of state regulation without repealing any other law, which does not contradict the words of §1681h(e) due to the exceptions to §1681(b)(1)(F). All claims of willful or malicious credit reports, such as Purcell's, were preempted, and the court remanded with instructions to enter judgment for the Bank on all of Purcell's claims, state and federal alike.

DEBT COLLECTION

DEBT COLLECTOR MAY BE LIABLE FOR DAMAGES UNDER BOTH STATE AND FEDERAL LAW

Gonzales v. Arrow Financial Services, LLC, 660 F.3d 1055 (9th Cir. 2011).

FACTS: Arrow Financial Services, a collection agency, purchased the debts of 40,000 California residents. All of the debts were "obsolete" because they were more than seven years old. In 2004, Arrow attempted to collect these debts by sending identical form letters to the California residents. The letters informed each person of a past due balance owed, and offered to settle the debt for half of the outstanding amount if paid by a specified date. The letter contained three references to credit bureaus, and stated that if Arrow reported the debt, it would notify the bureaus once the settlement funds cleared. The letters also informed the recipient that failure to fulfill obligations may result in negative information being sent to credit reporting agencies.

Under the Fair Credit Reporting Act, an obsolete debt cannot be reported to a credit reporting agency.

Gonzales, who received one of these letters, sued on behalf of himself and a class constituting everyone who received a letter, claiming violations of both California's Fair Debt Collection Practices Act ("Rosenthal Act") and the federal Fair Debt Collection Practices Act ("FDCPA"). The district court granted Gonzales summary judgment on the issue of liability under the FDCPA and the Rosenthal Act. Arrow appealed, contending that permitting damages under both acts violated the FDCPA.
HOLDING: Affirmed.
REASONING: Under the Fair Credit Reporting Act, an obsolete debt cannot be reported to a credit reporting agency. 15 U.S.C. § 1681c(a)(4). Accordingly, the court found that under the "least sophisticated debtor" standard, the letters were misleading and impliedly threatened to take action that could not legally be taken — placing Arrow in violation of the FDCPA and the Rosenthal Act. Arrow argued that Gonzales was precluded from recovering statutory damages under both the FDCPA and the Rosenthal Act. The court found that that argument directly contradicted the language of both acts.

The FDCPA explicitly states that it "does not annul, alter, or affect, or exempt any person subject to the provisions of this subchapter from complying with the laws of any State . . . a State law is not inconsistent with this subchapter if the protection such law affords any consumer is greater than the protection provided by this subchapter." The court found this language, coupled with the FDCPA's express purpose to "promote consistent State action," as well as deter violations, established that Congress did not intend the FDCPA to preempt consistent state consumer protection laws. Next, the court showed that the Rosenthal Act also contemplated dual enforcement: its language states that it should be "cumulative and… in addition to any other…remedies under any other provision of law."

The court rejected Arrow's claim that as a general rule, a plaintiff may not receive multiple awards for the same item of damage. This general rule applies in contract and tort law, but is not applicable to the statutory damage provisions of both the FDCPA and the Rosenthal Act. The court noted that statutory damages under both provisions are not tied in any way to actual losses suffered by the plaintiff. Recognizing that state laws that permit recovery of additional statutory damages increase the protections given to consumers through further deterrence, the court held the Rosenthal Act's remedies are cumulative, regardless of the remedies afforded under the FDCPA simultaneously.

BANKRUPTCY

JUDGEMENT CREDITOR'S LIEN ON HOMESTEAD UNENFORCEABLE

In re McCombs, 659 F.3d 503 (5th Cir. 2011)

FACTS: Michael McCombs and his wife, Alicia Atkinson, purchased a home and an adjoining vacant lot in 2004. In March 2006, H.D. Smith obtained a judgment against McCombs in the amount of $538,016.46, and Steve Smith ("the Trustee") filed the abstract in the real property records. McCombs signed an agreement with Atkinson, stating that she would be entitled to proceeds of the sale of the house. They then executed a contract for sale with a buyer they found. In November 2006, McCombs filed for Chapter Seven bankruptcy. His wife did not join the petition. McCombs listed the homestead and vacant lot as community property and claimed a $125,000 homestead exception.

The Trustee then filed an emergency petition to sell the home only, which the court granted, and the home was sold with the Trustee and Atkinson agreeing to place the funds in escrow until the court determined how the proceeds were to be distributed. The sale netted $398,849.03 in proceeds after payment of the mortgage and other expenses. H.D. Smith filed an adversary action against McCombs, the Trustee, and Atkinson, claiming that as creditor it was entitled to excess proceeds of the sale in satisfaction of its lien. The Trustee issued a check jointly payable to McCombs and Atkinson for $125,000, the amount of the homestead exemption McCombs claimed in his petition.

The court noted the "basic federal rule" in bankruptcy is that state law governs the substance of claims, Congress having "generally left the determination of property rights in the assets of a bankrupt's estate to state law."

While the bankruptcy court was considering H.D. Smith's claim for the house proceeds, the Trustee filed an emergency motion to sell the unimproved lot. The bankruptcy court approved the sale, directing that all proceeds from the sale would become part of the excess proceeds already held in escrow. According to the Trustee, after the sale of the lot, the excess proceeds totaled $514,095.08.

The court granted summary judgment for H.D. Smith, and rejected Atkinson's claims that: (1) the property had been partitioned or gifted to her; (2) her homestead rights trumped the dollar limit; (3) she was entitled to compensation for the homestead right; and (4) failure to compensate her for her homestead right was an unconstitutional taking. The bankruptcy court found that Texas homestead law did not prevent H.D. Smith from having an enforceable lien on the excess proceeds. The court held that the lien attached to the property before the bankruptcy proceedings and became enforceable upon application of the § 522(p) $125,000 homestead exemption.

The Trustee and Atkinson filed a joint certification for direct appeal to the Fifth Circuit, and the bankruptcy court certified the case for direct appeal.

HOLDING: Reversed and remanded.

REASONING: The court noted the "basic federal rule" in bankruptcy is that state law governs the substance of claims, Congress having "generally left the determination of property rights in the assets of a bankrupt's estate to state law." Therefore, state law governs the substance of claims and a determination of H.D. Smith's rights in the excess proceeds should be decided under Texas law. In Texas, a lien is unenforceable against homestead property, and the law goes so far as to say that a judgment creditor may even be liable for slander of title for refusing to grant a partial release of its lien against homestead property under a contract to sell.

The property or proceeds from the sale of property may be subject to seizure if the property ever ceases to be the debtor's homestead. To determine homestead status the court looked to the status of H.D. Smith's lien at the time of the bankruptcy filing. McCombs's house and lot were homestead property entitled to protection under Texas law at the time McCombs filed bankruptcy. Therefore, H.D. Smith lacked an enforceable lien at that time.

The court found that the homestead cap in § 522(p) of the bankruptcy code should not make the lien enforceable, because § 522(p) is a federal statute and the court, in the absence of controlling federal interest, should defer to the state code in order to properly define a property interest. The bankruptcy laws that place a cap on the value of a homestead did not convert H.D. Smith's lien on the homestead from one that was unenforceable pre-petition to one that was enforceable as to the homestead post-petition. The purpose of § 522(p) is to limit the amount of a homestead exemption, thereby increasing the size of the bankruptcy estate available to creditors. The court could not discern any indication that the intent of § 522(p) was to make an otherwise unenforceable lien on homestead property enforceable instanter. H.D. Smith should be accorded the same priority as a creditor that it would have enjoyed had the bankruptcy not occurred.

Regardless of whether the lien attached prior to the bankruptcy proceedings, the Trustee took the property with the state-law character it had in the debtor's hands: a property with an unenforceable lien. The court additionally specified that although H.D. Smith did not have a right specifically enforceable in the excess proceeds, there was no ruling on whether H.D. Smith had an otherwise enforceable interest in the estate.

BANKRUPTCY LAWYER FINED FOR "UNREASONABLE RELIANCE" ON INFORMATION PROVIDED BY CLIENT

In re Taylor, 655 F.3d 274 (3rd Cir. 2011).

FACTS: The underlying matter in this case arose when Mr. and Ms. Niles C. and Angela J. Taylor filed for a Chapter 13 bankruptcy in September 2007. In their bankruptcy petition, they listed the bank HSBC, which held the mortgage on their house, as a creditor. To file its pleadings with the bankruptcy court, HSBC, using its computerized mortgage servicing database, retained different law firms. The firms retrieved the information from HSBC's computerized mortgage servicing database, NewTrak. HSBC used NewTrak to assign individual firms discrete assignments and provide the limited data the system deemed relevant to each assignment. The firms were selected and the instructions generated without any direct human involvement. Those firms did not have the capacity to check the data provided to them by NewTrak and were not expected to communicate with other firms that may have done related work on the matter.

The Taylors and HSBC were also involved in a payment dispute whereby HSBC took out "forced insurance" for the property and passed the cost on to the Taylors. The Taylors disagreed with the need for flood insurance and made their monthly mortgage payments excluding that amount. HSBC treated the monthly mortgage payments as partial payments. Because of the Taylors' withheld insurance payments, HSBC's records indicated that they were delinquent and HSBC retained the Udren Law Firm to seek relief from the automatic stay on debt collection activities. In the Taylors' case, NewTrak provided the Udren Firm with only the loan number, the Taylors' name and address, payment amounts, late fees, and amounts past due. It did not provide any correspondence with the Taylors concerning the flood insurance dispute. Udren Firm attorney Doyle filed a motion for relief from the stay, which never mentioned the flood insurance dispute. Doyle did nothing to verify the information in the motion besides checking it against "screen prints" of the NewTrak information.

Rule 9011 of the Federal Rules of Bankruptcy Procedure requires that parties making representations to the court certify that "the allegations and other factual contentions have evidentiary support, or if specifically so identified, are likely to have evidentiary support."

At the same time as it filed for relief from the stay, the Udren Firm served the Taylors with a set of requests for admission. The Taylors filed a response to the motion for relief from stay, denying that they had failed to make payments and attaching copies of six checks tendered to HSBC during the relevant period. Four of them had already been cashed by HSBC. The Taylors also filed an objection to HSBC's proof of claim, stating that HSBC had misstated the payment due on the mortgage and pointing out the dispute over the flood insurance. However, they did not respond to the requests for admission. Doyle filed a response to the objection to the proof of claim, which did not discuss the flood insurance issue, but stated that all the information in the proof of claim was correct.

The bankruptcy court held a hearing on both the motion for relief and the claim objection. It found that a junior associate at the Udren Firm sought to have the requests for admission admitted as evidence even though he knew they contained falsehoods. The court denied the request to enter the requests for admissions as evidence, finding that the firm had evidence that the assertions in its motion were not accurate, but that they went ahead like they never knew it. The court found the motion to be in questionable good faith and ordered the Udren Firm to obtain an accounting from HSBC of the Taylors' prepetition payments so the arrearage on the mortgage could be determined correctly. At the next hearing, the Udren Firm attorneys reported that they were unable to contact HSBC directly to verify information that the firm had already represented to be true. The court entered an order directing the Udren lawyers to appear and give testimony concerning the possibility of sanctions. The hearings took place over several days, and consisted of in-depth inquiries into the communications between HSBC and its lawyers as well as the general capabilities and limitations of a system like NewTrak.

The bankruptcy court found that Doyle had violated Rule 9011 for failing to make reasonable inquiry concerning the representations she made in the motion for relief from stay and the response to the claim objection. It required her to take three CLE credits in professional responsibility. Doyly and the other parties the court sanctioned appealed the sanctions order to the district court, which overturned the order. The United States Trustee appealed.

HOLDING: Reversed in part, affirmed in part.

RATIONALE: Rule 9011 of the Federal Rules of Bankruptcy Procedure requires that parties making representations to the court certify that "the allegations and other factual contentions have evidentiary support, or if specifically so identified, are likely to have evidentiary support." Fed. R. Bank. P. 9011(b)(3). A party must reach this conclusion based on "inquiry reasonable under the circumstances." The concern of Rule 9011 is not the truth or falsity of the representation itself, but rather whether the party making the representation reasonably believed it at the time to have evidentiary support. There need not be bad faith on the part of a party who makes a false representation. Instead, an imposition of sanctions requires only a showing of objectively unreasonable conduct.

In this case, the court focused on several statements by appellees, all of which involved false or misleading representations to the court. The appellees argued that the statements were literally true and that they should not be subject to sanctions. However, the court found that they were not actually true, but that even if they were, there was no authority permitting statements under Rule 9011 that were literally true but actually misleading. The court found that the statements, the aim of which was allow HSBC to foreclose on the Taylors' house, were either false or misleading.

The court assessed the reasonableness of the appellee's inquiry before they made their false representations. Specifically, it discussed the degree to which an attorney may reasonably rely on representations from her client. Because lawyers constantly and appropriately rely on information provided by their clients, especially when the facts are contained in a client's computerized records, it is usually reasonable for a lawyer to rely on information provided by a client, especially where that information is superficially plausible and the client provides its own records which appear to confirm the information. However, the court found that Doyle's behavior was unreasonable, both as a matter of her general practice and in ways specific to this case. The court found that an attorney must, in her independent professional judgment, make a reasonable effort to determine what facts are likely to be relevant to a particular court filing and to seek those facts from the client. She cannot simply settle for the information her client determines in advance – by means of an automated system – that she should be provided with. The court agreed with the bankruptcy court that Doyle had no relationship with the client. Instead, she worked solely with NewTrak, which no one at the firm seemed to have understood. It found that Doyle permitted HSBC to define – perilously narrowly – the information she had about the Taylors' matter. That HSBC was not providing her with adequate information through NewTrak should have been evident to Doyle from the file. She did not have any information concerning the Taylors' equity in the home, yet she made a statement before the court specifically denying that they had any.

More generally, a reasonable attorney would not file a motion for relief from stay for cause without inquiring of the client whether it had any information relevant to the alleged cause, that is, the debtor's failure to make payments. Had Doyle made even that most minimal of inquiries, HSBC presumably would have provided her with the information in its files concerning the flood insurance dispute, and Doyle could have included that information in her motion for relief from stay – or, perhaps, advised the client that seeking such a motion would be inappropriate under the circumstances.

With respect to the Taylors' case in particular, Doyle ignored clear warning signs as to the accuracy of the data that she did receive. In responding to the motion for relief from stay, the Taylors submitted documentation indicating that they had already made at least partial payments for some of the months in question. In objecting to the proof of claim, the Taylors pointed out the inaccuracy of the mortgage payment listed and explained the circumstances surrounding the flood insurance dispute. Although Doyle certainly was not obliged to accept the Taylors' claims at face value, they indisputably put her on notice that the matter was not as simple as it might have appeared from the NewTrak file. At that point, any reasonable attorney would have sought clarification and further documentation from her client, in order to correct any prior inadvertent misstatements to the court and to avoid any further errors. Instead, Doyle mechanically affirmed facts (the monthly mortgage payment) that her own prior filing ad already contradicted.

The court found that Doyle's reliance on HSBC was particularly problematic because she was not, in fact, relying directly on HSBC. Instead, she relied on a computer system run by a third-party vendor. She did not know where the data provided by NewTrak came from. She had no capacity to check the data against the original documents if any of it seemed implausible. And she effectively could not question the data with HSBC. In her relationship with HSBC, Doyle essentially abdicated her professional judgment to a black box. The court did not find that this case presented an instance of extreme complexity, nor of extraordinary deadline pressure such as would affect its analysis of reasonableness. Although the initial data the Udren Firm received was not, in itself, wildly implausible, it was facially inadequate. In short, the court concluded that Doyle's inquiry before making her representations to the bankruptcy court was unreasonable.

The attorneys, the final link in the chain of information transmission, claimed reliance on NewTrak's records, but the court disagreed that all the parties involved could insulate themselves from responsibility by the use of such a system.

The court made a point of acknowledging that the use of computerized databases can be appropriate. However, it found that the NewTrak system, as it was used in this case, permitted parties at every level of the filing process to disclaim responsibility for inaccuracies gleaned from not particularly accurate records. The attorneys, the final link in the chain of information transmission, claimed reliance on NewTrak's records, but the court disagreed that all the parties involved could insulate themselves from responsibility by the use of such a system. Instead, it held responsible the attorneys who certified to the court that the representations they made were "well-grounded in law and fact."

The court found that Rule 11 requires more than a rubber-stamping of the results of an automated process by a person who happens to be a lawyer. Where a lawyer systematically fails to take any responsibility for seeking adequate information from her client, makes representations without any factual basis because they are included in a form pleading she was trained to fill out, and ignores obvious indications that her information may be incorrect, she cannot be said to have made reasonable inquiry. Additionally, the Udren Firm itself was appropriately sanctioned because the system it put in place emphasized high-volume, high-speed processing of foreclosures to such an extent that it led to violations of Rule 9011. Therefore, the court found that the bankruptcy court did not abuse its discretion in imposing sanctions on Doyle or the Udren Firm itself. The court reversed the district court with respect to Doyle and Udren, affirming the bankruptcy court's imposition of sanctions.

ARBITRATION

ARBITRATION CLAUSE NOT ENFORCEABLE WITH RESPECT TO CLAIM UNDER MAGNUSON-MOSS

Kolev v. Euromotors, 658 F.3d 1024 (9th Cir. 2011).

FACTS: Kolev purchased a used car from Euromotors that developed serious mechanical problems within the warranty period. Euromotors refused to honor her warranty claims. Kolev filed suit against Euromotors and the manufacturer, alleging breach of implied and express warranties under the Magnuson-Moss Warranty Act ("MMWA"), as well as breach of contract and unconscionability under California law. Euromotors moved to compel arbitration, and the district court granted the motion. After the arbitrator resolved most of the claims in favor of Euromotors, the district court confirmed the arbitration award. Kolev appealed and the Ninth Circuit reviewed *de novo* the district court's order granting the petition to compel arbitration.
HOLDING: Reversed and remanded.
REASONING: On appeal, Kolev argued that the mandatory arbitration clause of the sales contract, which she signed when she purchased the car, should be barred by a provision of the MMWA disallowing mandatory pre-dispute binding arbitration of warranty claims against a dealership. The court found that although the MMWA does not specifically address the validity of pre-dispute mandatory binding arbitration, Congress expressly delegated rulemaking authority under the statute to the Federal Trade Commission ("FTC"). Pursuant to this authority, the FTC has construed the MMWA as barring pre-dispute mandatory binding arbitration provisions covering written warranty agreements, and issued a rule prohibiting judicial enforcement of such provisions with respect to consumer claims brought under the MMWA. 16 C.F.R. §703.5.

The court applied a two-step inquiry in reviewing the agency's construction of the statute. *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). It found that the FTC's construction warranted deference, pursuant to *Chevron*. First, as to whether Congress had "directly spoken to the precise question," the court found that it had not. Having found that the "statute is silent or ambiguous with respect to the specific issue," the court proceeded to the next step, an analysis of whether the interpretation by the agency was "based on a permissible construction of the statute." *Id.* The court concluded that the FTC's construction of the statute as disallowing mandatory pre-dispute binding arbitration was reasonable, for three reasons. First, the FTC sought to implement Congressional intent, which was laid out in a House Subcommittee Staff Report as ensuring "decisions of Section 110 mechanisms not be legally binding." The report further suggested that consumers should be made aware of their rights, including the right to pursue litigation. Second, the court found that the view of the MMWA as barring pre-dispute mandatory binding arbitration advanced the statute's purpose of protecting consumers from being forced into involuntary agreements that they could not negotiate. Finally, the court accorded particular deference to the FTC's construction of the statute because it represented "a longstanding, consistent interpretation of the statute."

The FTC has construed the MMWA as barring pre-dispute mandatory binding arbitration provisions covering written warranty agreements.

The court also explained why it disagreed with prior rulings on this issue by the Fifth and Eleventh Circuits. In two similar cases, those courts reached the opposite conclusion, holding that the FTC's interpretation should not be afforded *Chevron* deference. *Walton v. Rose Mobile Homes LLC*, 298 F.3d 470 (5th Cir. 2002); *Davis v. S. Energy Homes, Inc.*, 305 F.3d 1268 (11th Cir. 2002). Both courts determined the FTC's construction of the statute was unreasonable in light of the Supreme Court's decision that the 1924 Federal Arbitration Act ("FAA") tended to establish a "liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). The provision in question states that an arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §2. The court gave three reasons why it felt these holdings were incorrect.

First, the court reasoned it was unprecedented to locate Congressional intent with respect to one statute by looking to a prior, less specific statute. Therefore, any ambiguity in the MMWA could not be resolved by simply looking to the much older, broader FAA. Second, the court reiterated their previous argument that the FTC's construction of the statute was reasonable in light of the statute's language, legislative history, and underlying purpose. Finally, the court pointed out that the MMWA is different in four critical respects from every other federal statute that the Supreme Court has found does not rebut the FAA's pro-arbitration presumption, such as the Sherman Antitrust Act of 1890, the Securities Act of 1933, and the Securities Exchange Act of 1934. For example, unlike those statutes, the MMWA was actually construed by an authorized agency as barring pre-dispute mandatory binding arbitration. Also, only the MMWA contains anything from Congress regarding informal, non-judicial remedies in a way that would bar mandatory arbitration. Furthermore, the MMWA, unlike the previous statutes, explicitly preserved a customer's right to press his claims under the statute in civil court. Finally, only the MMWA provided for the protection of consumers from vendors' imposing binding, non-judicial remedies as its primary purpose.

The court held that written warranty provisions that mandate pre-dispute binding arbitration are invalid under the MMWA and that the district court therefore erred in enforcing the warranty clause by compelling mandatory arbitration of Kolev's claims. It reversed and remanded to the district court as to all breach of warranty claims.

AMENDED COMPLAINT REVIVES RIGHT TO ENFORCE ARBITRATION CLAUSE THAT HAD BEEN WAIVED

Krinsk v. Sun Trust Bank, 654 F.3d 1194 (11th Cir. 2011).

FACTS: Krinsk obtained a substantial home-equity line of credit ("HELOC") from SunTrust Bank in 2006. Almost two years later, SunTrust revoked Krinsk's line of credit, claiming that her circumstances had changed and that SunTrust did not believe she would be able to make her payments. SunTrust had earlier mailed Krinsk a letter requesting that she provide updated financial information. SunTrust mailed similar letters to many of its other Florida homeowners. Krinsk sued SunTrust in a class action, alleging the revocation was part of a state-wide scheme by the bank to restore its capital reserves. The proposed class action was limited to Florida residents over sixty-five years old.

Krinsk's agreement with SunTrust contained an arbitration clause, but SunTrust made no attempt to enforce the clause through the discovery process. The trial court granted SunTrust's motion to dismiss in part and granted Krinsk leave to amend her petition in response. The question of class certification was still under review. Krinsk amended her petition but also changed the proposed class by dropping the age requirement. In its response to the amended complaint, SunTrust raised its right to arbitration for the first time. The trial court denied SunTrust's motion to compel arbitration and stay the action, holding that the right was waived by SunTrust's willful participation in the litigation process. SunTrust appealed the ruling, on the grounds that the amended petition revived SunTrust's right to compel arbitration.

HOLDING: Vacated and remanded.

REASONING: SunTrust argued that the district court erred in concluding that the amended complaint was immaterial to whether SunTrust had waived its right to compel arbitration. It contended that even if it had waived its right to arbitrate, the amended complaint "rejuvenated" or revived its right to compel arbitration. In considering SunTrust's interlocutory appeal, the court did not comment on the district court's finding of waiver, but rather focused on SunTrust's argument that the right should be revived by the amended petition because Krinsk's amended petition increased the potential class size from "hundreds", to "thousands" or "tens of thousands." Although under the Federal Rules of Civil Procedure, an amended complaint becomes the operative pleading in the case, the filing of an amended complaint does not automatically revive all defenses or objections that the defendant may have waived in response to the initial complaint. However, the defendant will be allowed to plead anew in response to an amended complaint when it "changes the theory or scope of the case," because it would be unfair to allow the plaintiff to change the scope without granting the defendant an opportunity to respond. *Brown v. E.F. Hutton & Co.*, 610 F. Supp. 76 (S.D. Fla. 1985). Likewise, a defendant's waiver of the right to compel arbitration is not automatically nullified by the plaintiff's filing of an amended complaint. The defendant may revive its right to compel arbitration only if it is shown that the amended complaint unexpectedly changes the scope or theory of the plaintiff's claims.

The court found that although Krinsk's amended complaint merely asserted new claims based on the same operative facts as the claims in the original complaint, the amended complaint was by no means "immaterial." To so conclude flatly ignored the significance of the new class definition in the amended complaint, which greatly broadened the potential scope of the litigation by opening the door to thousands – if not tens of thousands – of new class plaintiffs not contemplated in the original class definition by discarding the old definition's limits on the class plaintiffs' age and on the bases for their HELOC suspensions, and by expanding the class period from over three months to over three years. The court concluded that SunTrust should have been allowed to rescind its waiver of its right to arbitration. SunTrust's acts in furtherance of the litigation all occurred prior to the filing of the amended complaint and thus concerned the class contemplated in the original complaint. SunTrust proceeded in court on the expectation that, if the class action were certified, it would defend itself against only the relatively small plaintiff class defined in the original complaint. SunTrust could not have foreseen that Krinsk would expand the putative class in such a broad way, and given this unforeseen alteration in the shape of the case, SunTrust, in plain fairness, should have been allowed to rescind its earlier waiver through its prompt motion to compel arbitration.

The court concluded that SunTrust's right to compel arbitration, even if waived with respect to the claims in the original complaint, was revived by Krinsk's filing of the amended complaint. It vacated the district court's order denying SunTrust's motion to compel arbitration and stay the proceedings and remanded.

MISCELLANEOUS

TELEPHONE CONSUMER PROTECTION ACT CLASS PLAINTIFFS DO NOT NEED TO SHOW RECEIPT OF JUNK FAXES

Critchfield Physical Therapy v. The Taranto Group, Inc., 263 P. 3d 767 (Kan. 2011).

FACTS: Defendant Taranto Group distributed and resold aesthetic medical devices. Taranto contracted with two outside vendors to send advertising faxes. Taranto did not own or review the databases and transmission logs used by one of the vendors. It provided the database used by the other, but did not possess or review the transmission logs. It was estimated at least 5,000 transmissions were made in violation of the Telephone Consumer Protection Act ("TCPA"). At some point the list of intended recipients was lost, and many of the plaintiffs threw away the faxes. After an individual and representative of similarly situated persons brought an action seeking damages and injunctive relief under the TCPA, Critchfield Physical Therapy filed a petition seeking to intervene as an additional class representative. Critchfield was then substituted as the sole individual plaintiff and as the representative of the proposed class. The district court issued an order certifying the proposed class, and in amended order, certified the order for interlocutory appeal. The Court of Appeals granted Taranto's application for permission to take an interlocutory appeal, and the Kansas Supreme Court granted Taranto's motion to transfer.

The TCPA is a federal response to the ever-increasing access through electronic means that advertisers have to contact consumers.

HOLDING: Affirmed.

REASONING: The TCPA is a federal response to the ever-increasing access through electronic means that advertisers have to contact consumers. It was specifically amended in 2005 to prohibit junk faxes. Taranto argued that the class should not have been certified, in part because the class lacked a common interest in that "it cannot be shown that the persons listed in the databases received the fax transmissions." Additionally, Taranto lost or destroyed the list of intended fax recipients and argued that most of the plaintiffs would not have kept the faxes they received. Taranto urged that the plaintiffs should have to prove that they actually received the faxes, and that no prior relationship existed.

The court looked to the plain language of the statute to discern the legislature's intent in creating the TCPA. The court found that the statute specifically prohibits the use of devices to "send" advertisements. The court stated that the statute creates no requirement that a transmission be received and reasoned that the legislature clearly expressed the intent to prohibit "sending" with no requirement that the plaintiff receive the fax. Although some plaintiffs may not have actually received the fax transmissions, the plaintiffs' entitlement to damages was still valid because harm may extend to intended recipients if, for instance they were so harassed that they turned off their fax machines. This was consistent with a similar interpretation was of the word "call" to include attempts to make calls. See *Lozano v. Twentieth Century Fox Film Corp.*, 702 F.Supp.2d 999, 1007 (N.D. Ill. 2010). The court concluded it was not necessary that a plaintiff demonstrate that a fax transmission was received by the plaintiff. It suffices that a plaintiff demonstrates that a fax transmission was unlawfully sent by the defendant. Furthermore, it was not a requirement for class certification that the plaintiff prove the identity of each class member or that they are entitled to damages.

STATE LAW DETERMINES THE STATUTE OF LIMITATIONS FOR A VIOLATION OF THE TELEPHONE CONSUMER PROTECTION ACT

Giovanniello v. ALM Media, LLC, 660 F.3d 587 (2nd Cir. 2011).

FACTS: In early 2004, Giovanniello reportedly received an unsolicited facsimile advertisement on his home machine in Connecticut from ALM, located in New York. More than five years after he received the fax, Giovanniello filed a class action suit against ALM Media, LLC, alleging violations of the Telephone Consumer Protection Act ("TCPA") for unsolicited fax advertisements. The TCPA prohibits use of any telephone facsimile machine to send unsolicited advertisements, and allows recovery of statutory damages in state court "if otherwise permitted" by the laws of that state. Giovanniello also invoked diversity jurisdiction to file the class action in the United States District Court for the District of Connecticut. ALM moved to dismiss the complaint due to the fact that it had been made in an untimely fashion under Connecticut law, the filing limitations of which had been incorporated by the TCPA. The district court granted ALM's dismissal motion, noting that the action was also barred by timing under the four year federal statute of limitations. However, the district court did not address whether the state or federal statute of limitations were applicable to the situation. Giovanniello appealed.

HOLDING: Affirmed.

REASONING: The court considered whether a state statute of limitations is included in "otherwise permitted" language of the TCPA, or whether the appropriate limitations period is the federal catchall limitations period. The court first recognized that although the TCPA does not expressly assign a statute of limitations for private causes of action, the "otherwise permitted" language in the statute clearly requires adherence to state laws. This reflects obvious intent from Congress that states have control over problems addressed by the TCPA. *Holster v. Gatco, Inc.*, 618 F.3d 218 (2nd Cir. 2010). The court reasoned that the purpose behind allocation of power was to prevent an evasion from jurisdictional coverage through interstate communications. Claims that are no longer permissible under a state statute of limitations cannot continue under the TCPA, regardless of the federal catchall statute of limitations. The court found that Connecticut law unquestionably applied because of Giovanniello's receipt of the facsimile in Connecticut. Additionally, this action under the TCPA is "otherwise permitted" under Connecticut law, which also recognizes a cause of action for the unlawful use of a facsimile machine to transmit unsolicited advertising material. The court concluded that because the complaint was "otherwise permitted," it must have been filed in accordance with the Connecticut state limitations period, not the federal catchall statute of limitations. Having failed to meet these requirements, Giovanniello's claim was properly dismissed.

AUTOMATED CALL IN RESPONSE TO ADVERTISEMENT DID NOT VIOLATE TELEPHONE CONSUMER PROTECTION ACT

Mey v. Pep Boys, ____ S.E.2d ____ (W. Va. 2011).

FACTS: The plaintiff's son, who lived with the plaintiff, listed a used car for sale on Craigslist.com. He provided their home telephone number for interested parties to contact him. The plaintiff subsequently received an automated recorded telephone call that indicated a cash offer would be made for the car listed if the seller went to a named website and provided information about the vehicle. It further indicated that if the seller accepted the offer, the car was to be dropped off at the nearest participating Pep Boys in exchange for a check. As a result of the call, the plaintiff filed a class action complaint seeking damages and an injunction against three defendants under the Telephone Consumer Protection Act ("TCPA"). In response to the complaint, the defendants filed a motion to dismiss. The circuit court granted the motion after it concluded that the message did not constitute an advertisement subject to enforcement under the TCPA.
HOLDING: Affirmed
REASONING: The TCPA prohibits "any telephone call to any residential telephone line using an artificial or prerecorded voice to deliver a message without the prior express consent of the called party." 47 U.S.C. § 227(b)(1)(B) (2010). There are limited exceptions, such as when calls do not include the transmission of any unsolicited advertisement. 47 U.S.C. §227(b)(2)(B) (2010). The court found "unsolicited advertisement" to be "any material advertising the commercial availability or quality of any property, goods, or services which is transmitted to any person without that person's prior or express invitation or permission in writing or otherwise."

The court found the automated call in question to not be an unsolicited advertisement. It agreed with the circuit court's reasoning that when an individual responds to a classified advertisement and conveys interest in purchasing the product offered that a response does not constitute an unsolicited advertisement. The court reasoned that the classified advertisement did not contain any limiting instructions on how a third party was to contact the plaintiff's son, and that by posting the advertisement and telephone number on the internet, he expressly invited third parties to make inquiries about the car. The court noted that the legislative history of the TCPA states that "persons who knowingly release their phone numbers have in effect given their invitation or permission to be called at the number which they have given, absent instruction to the contrary."

The plaintiff argued the automated message was not an offer to purchase the car, but rather a solicitation to entice the plaintiff into a marketing scheme intended to generate inspection and car repairs. However, the court rejected this argument and found that the telephone call was initiated for the purpose of communicating the defendants' interest in making a *bona fide* offer to engage in negotiations that might result in a *bona fide* offer for the car advertised. The fact that the defendants could have received a fee for the inspection was irrelevant. The court concluded that it would be unusual for a party responding to a classified advertisement for a used car to extend an offer without first inspecting it, and that the fee would not change the purpose of the initial call.

A telephone response to a classified advertisement is not a violation of the Act as long as the purpose of the call is to inquire about or offer to purchase the advertised product.

The court held that under the TCPA a telephone response to a classified advertisement is not a violation of the Act as long as the purpose of the call is to inquire about or offer to purchase the advertised product or service, rather than to encourage the purchase, rent, or investment in property, goods or services.

BUSINESS CANNOT SUE BETTER BUSINESS BUREAU OVER UNFAVORABLE RATING

Castle Rock Remodeling, LLC v. Better Business Bureau of Greater St. Louis, Inc. ____S.W.3d____ (Mo. Ct. App. E.D. 2011).

FACTS: Castle Rock Remodeling ("Castle Rock") filed a petition against the Better Business Bureau ("BBB") alleging defamation and tortious interference with business expectancy. Castle Rock asserted that the rating given to it by BBB states or implies that Castle Rock: (a) is a generally unreliable firm which has recently lost its accreditation with BBB; (b) has numerous complaints filed against it, and has not responded in a timely manner or has demonstrated bad faith in an effort to resolve the complaints; (c) has failed to resolve the underlying cause or causes of the pattern of complaints, and; (d) regularly engages in deceptive advertising and only changes its policies when admonished by BBB. Castle Rock claimed that BBB's "C" rating, statements regarding seventeen complaints, BBB's concerns over Castle Rock's advertising, and the expiration of Castle Rock's BBB accreditation had a negative impact on Castle Rock's business. Castle Rock also sought declaratory judgment requiring BBB to give it an "A" rating and BBB accreditation. The trial court granted BBB's motion to dismiss for failure to state a claim upon which relief can be granted.
HOLDING: Affirmed.
REASONING: Castle Rock argued that the trial court erred in granting the motion to dismiss because the petition stated a cause of action for defamation, and because BBB's representations were either statements of fact or were actionable statements of opinion which necessarily imply the existence of undisclosed defamatory facts. The court found that several of the factual statements were not defamatory when stripped of the pleaded innuendo and read in their most innocent sense. Furthermore, even if some of the factual statements were defamatory, the statements were true, and the defamation element of falsity was not met. The court concluded that the factual statements in the BBB report were either capable of non-defamatory meaning or true, and, therefore, found the statements non-actionable as a matter of law.

As to the "C" rating, assuming it was capable of a defamatory meaning, the court inquired if one or more privileges would shelter the defendant from legal action. Such privileges primarily arise from various protections offered by the First Amendment to the U.S. Constitution. They include the absolute privilege accorded statements of opinion, which even if made maliciously or insincerely, do not give rise to a libel cause of action. However, the privilege does not apply when the statement of opinion implies the existence of undisclosed defamatory facts. The test to be applied to determine if a statement is opinion is whether a reasonable factfinder could conclude that the statement implies an assertion of objective fact. The court looked to whether the "C" rating could reasonably have been interpreted as stating actual facts about Castle Rock, capable of being proven true or false. Generally, claims for defamation based upon ratings or grades fail because a rating or a grade cannot be objectively verified as true or false and thus, are opinion accorded absolute privilege.

The court relied on *Browne v. AVVO, Inc.* to determine whether BBB's statements could reasonably be interpreted as stating actual facts. 525 F. Supp. 2d 1249 (W.D. Wash. 2007). In *Browne* the court noted the defendants' website stated that the underlying data was weighted based on the defendant's subjective opinions regarding the relative importance of various attributes. Even though the defendant's rating relied on objectively verifiable data, the interpretation of that data was ultimately a subjective assessment and not objectively verifiable. That court concluded that neither the nature of the information or the language used "would lead a reasonable person to believe that the ratings are a statement of actual fact." As in Browne, BBB's rating system relies on objective and subjective components, and BBB's weighting of the objective data. The report was clear that the impression of the rating was opinion and that "BBB's rating of a business reflects the BBB's opinion about the business" and BBB's judgment. It was clear to the court that the BBB rating was based on "an evaluating process" and "subjective opinion." Thus, neither the nature of the information provided nor the language used on BBB's website would lead a reasonable person to believe that the rating was a statement of actual fact. Additionally, the "C" rating was not sufficiently factual to be susceptible of being proved true or false. Even though Castle Rock may have disagreed with the BBB's evaluations of the facts underlying the rating, the rating itself could not be proved true or false. Therefore, the rating was protected as opinion under the First Amendment, and no suit may be brought. The court concluded that none of the asserted factual statements or the rating was actionable as defamation.

That court concluded that neither the nature of the information or the language used "would lead a reasonable person to believe that the ratings are a statement of actual fact."

Castle Rock also contended that the trial court erred because its petition stated a cause of action in that BBB did not act in good faith in its dealings with and evaluation of Castle Rock. It argued that BBB's ratings should only be given a qualified or conditional privilege allowing Castle Rock to prove malice or bad faith on the part of BBB. However, the court found that a qualified privilege only applies to factual statements that are false. It exists where a plaintiff is required to prove actual malice, i.e., knowledge of the falsity or publication of false statements while having serious doubts about their truth. Because the only factual statements in Castle Rock's pleadings were either not defamatory or true and the allegation regarding the "C" rating was opinion protected by the First Amendment, the qualified privilege was not at issue and the trial court did not err in dismissing Castle Rock's libel claim.

LAW FIRM CANNOT SUE BANK OVER COUNTERFEIT CHECK

Greenberg, Trager & Herbst, LLP v. HSBC Bank USA, ____ N.E.2d ____ (N.Y. 2011).

FACTS: Law firm Greenberg, Trager & Herbst ("GTH") received a Citibank check for $197,500 from a new foreign client intended to cover the cost of its $10,000 retainer, with the excess to be wired back to the client. On September 21, 2007, GTH deposited the check into its attorney trust account at HSBC bank. The check was then sent to Citibank for processing the following business day, September 24, 2007. The routing number on the check was not one of the acceptable numbers for the Citibank branch to which the check was sent. Upon visual inspection of the check by a Citibank employee, the check was sent back with the notation "sent wrong." HSBC corrected the routing number and subsequently submitted the check to a different Citibank branch on September 26, 2007.

While the check was being processed, HSBC had provisionally credited GTH's account with the funds. Unaware of any delay, on September 27, 2007, GTH contacted HSBC to determine if the check had "cleared." Upon oral confirmation over the telephone that the check had "cleared," GTH proceeded to wire $187,500 from its account to its supposed client on September 28, 2007. Four days after the wire transfer, on October 2, 2007, Citibank notified HSBC that the check was being "dishonored" as a suspected counterfeit. HSBC notified GTH that the check had been dishonored, revoked its provisional settlement, and charged back the account in the amount of the dishonored check.

GTH sued both HSBC and Citibank. GTH brought suit against HSBC for negligence, and negligent misrepresentation — specifically for HSBC's failure to inform GTH of the check's initial return on September 25, 2007, and for informing GTH over the phone that the funds had "cleared." In addition, GTH alleged Citibank was negligent in failing to identify the check as counterfeit when it was initially presented to its processing facility on September 24, 2007.

The trial court granted summary judgment to both banks. The Appellate Division affirmed the dismissal, holding that HSBC had no duty to inform GTH of the returned check prior to it being formally dishonored on October 2, 2007, HSBC's representation that the check had "cleared" did not give rise to a negligent misrepresentation action where there was no fiduciary relationship, and GTH was in the best position to guard against the risk of a counterfeit check by knowing its client. Additionally, the court held that the personnel at Citibank were not in a position to discern whether the check was counterfeit and had no duty to inform HSBC at the time it was originally presented for examination on September 24, 2007. GTH appealed the decision to New York's highest court.

HOLDING: Affirmed.

REASONING: The court began its analysis by examining the manner in which banks process checks and the applicable legal guidelines. The court found that such transactions are governed by the Uniform Commercial Code ("UCC"), which requires a bank use ordinary care in presenting a check or sending a check for presentment, sending notice of dishonor or non-payment or returning a check, and settling a check when the collecting bank receives final settlement from the payor bank. The UCC sets a deadline of midnight on the next banking day for a collecting bank to take the above actions regarding a check from a depositor. The bank found that in this case, after GTH deposited the check at HSBC on Friday, September 21, 2007, HSBC sent the check for presentation on Monday, September 25, which was within its deadline of midnight on the next business day. Citibank returned the check as "sent wrong" within its midnight deadline on September 25, 2007. HSBC then also acted within its midnight deadline by repairing the routing number on the check and sending it to the proper bank on September 26, 2007.

Because GTH was not a customer of Citibank (the payor bank), the court concluded the only duty owed to GTH was to either pay, return, or dishonor the check in compliance with UCC 4-301 and 4-302. The court determined that summary judgment for Citibank was proper because there was no question that Citibank met its obligation by returning the check within the appropriate deadline.

Regarding GTH's first claim against HSBC, that it negligently informed GTH that the check had "cleared" and that the funds were available for transfer, the court held that liability for negligent misrepresentation of this type has only been imposed on persons who possessed something close to the level of a fiduciary relationship. *Kimmell v. Shaefer*, 89 N.Y.2d 257 (1996). GTH argued that HSBC was its agent due to their long-term relationship, in addition to UCC 4-201, which provides that before a settlement by a collecting bank becomes final, that bank is an agent of the owner of the item. The court noted that this provision does not impose a fiduciary duty on a collecting bank. The court stated that the term "agent" means that the item and any inherent risk in that item remains with the depositor and not the collecting bank. *Hanna v. First Natl. Bank of Rochester*, 87 N.Y.2d 107 (1995). HSBC disputed the existence of a fiduciary relationship. HSBC also argued that GTH had expressly waived its claims by contract. The contract between GTH and HSBC provided that GTH waived any claim against the bank arising out of representations made by the bank regarding balance information. The court found that GTH's relationship with HSBC was as a depositor and that it was insufficient to sustain a negligent misrepresentation cause of action.

There was also considerable discussion about the ambiguity and meaning of the term "cleared" in banking; with the majority dismissing the notion that "cleared" had a definite meaning on par with final settlement. The UCC allocates the risk to the depositor until final settlement. UCC 4-213. Because the court understood that "cleared" could refer simply to the availability of funds and not to final settlement, and as there was no actual final settlement, any risk would have remained with GTH. Ultimately, the court ruled GTH's reliance on the word "cleared" as an assurance of final settlement was unreasonable as a matter of law.

GTH's action for negligence alleged that HSBC owed GTH a duty to inform it when the check was initially returned as "sent wrong" on September 25, 2007. GTH argued that this should have been treated the same as being dishonored and accordingly should have resulted in a charge back of the account. A collecting bank owes a depositor a duty of ordinary care. UCC 4-202. The court agreed with HSBC that it was consistent with ordinary care for a bank to process the check in the manner they did and to consider the return as an administrative return rather than a dishonor. Because an administrative return did not trigger the same notification and charge back mechanisms in place for a dishonor, it did not create a duty for HSBC to do so. There was evidence that these actions were in accordance with standard banking practices — even if the UCC did not explicitly provide for an administrative return, it was reasonable for HSBC to consider the check as still being processed rather than dishonored. GTH failed to allege any further facts suggesting the bank acted unreasonably — accordingly, its negligence claim failed.

Finally, as to GTH's claim that it should prevail under the theory of equitable estoppel, the court noted that the doctrine of equitable estoppel only applies when an innocent party suffers from the acts of a third person, in which case the party that enabled the third person must bear the loss. The court reasoned that neither Citibank nor HSBC breached any duty owed to GTH. The court disagreed with GTH's contention that the banks were in the best position to detect the counterfeit check. Instead, it found that GTH was in the best position to guard against the risk of a counterfeit check by knowing its "client."

CUSTOMERS CAN RECOVER COST OF MITIGATING DAMAGES FROM DATA THEFT

Anderson v. Hannaford Bros. Co., 659 F.3d 151 (1st Cir. 2011).

FACTS: Hannaford Brothers is a national grocery chain whose electronic payment processing system was breached by hackers on December 7, 2007. The hackers stole up to 4.2 million credit and debit card numbers, expiration dates, and security codes, but did not steal customer names. On February 27, 2008, Visa Inc. notified Hannaford that Hannaford's system had been breached. Hannaford discovered the means of access on March 8, 2008, contained the breach on March 10 and gave notice to relevant financial institutions on March 10, some of which immediately cancelled customers' debit and credit cards. On March 17, Hannaford publicly announced the breach and resulting theft of debit and credit card numbers belonging to individuals who had made purchases at more than 270 of its stores. It also announced it had received reports of approximately 1,800 cases of fraud resulting from the theft of those numbers. Some financial institutions did not cancel customer cards, asserting that they wished to wait for evidence of unauthorized activity before taking action. Customers who requested that their cards be cancelled were required to pay fees for replacements, and some customers purchased identity theft insurance and credit monitoring services to protect themselves against possible consequences of the breach.

Twenty-six separate suits against Hannaford were consolidated into one lawsuit in the District of Maine. The consolidated complaint alleged that at least fourteen of the named plaintiffs actually had unauthorized charges charged against their accounts. Seventeen of the named plaintiffs had their cards cancelled by the bank, and two named plaintiffs requested that their issuers give them replacement cards. Plaintiffs alleged seven causes of action and sought damages for unauthorized charges and fees paid to banks for cancellation, credit insurance, and replacement card costs.

Hannaford moved to dismiss. The district court granted the motion in part, and divided the remaining plaintiffs into three categories allow the implied contract, negligence, and Main Unfair Trade Practices Act ("MUTPA") claims to proceed. For these three surviving claims, the district court concluded that dismissal depended on whether the alleged injuries were cognizable under Maine law. It determined that the first category, composed of plaintiffs who did not have fraudulent charges posted to their accounts, could not recover because their claims for emotional distress were not cognizable under Maine law. The second category, composed of a single plaintiff whose fraudulent charges had not been reimbursed, could recover for actual financial losses. The third category, composed of plaintiffs whose fraudulent charges had been reimbursed, could not recover because their alleged consequential losses were "too remote, not reasonably foreseeable, and/or speculative (and under the MUTPA, not a 'substantial injury')." In particular, the claimed overdraft fees, loss of accumulated reward points, and loss of opportunities to earn reward points were not foreseeable at the time of sale. Further, the district court determined that there was no way to value or compensate the time and effort that consumers spent to reverse or protect against losses, and that there was no allegation to justify the claim for identity theft insurance since no personally identifying information was alleged to have been stolen. The district court determined that the third category of plaintiffs could not recover.

After its ruling, the district court certified two questions to the Maine Supreme Court, the first of which was: in the absence of physical harm or economic loss or identity theft, do time and effort alone, spent in a reasonable effort to avoid or remediate reasonably foreseeable harm, constitute a cognizable injury for which damages may be recovered under Maine law of negligence and/or implied contract? The Maine Supreme Judicial Court accepted the certification and answered the first question in the negative, agreeing with the district court that time and effort alone do not constitute a cognizable harm under Maine Law. The district court entered judgment in favor of Hannaford. Plaintiffs appealed the district court's decision.

HOLDING: Affirmed in part, reversed in part.

REASONING: The court agreed with the district court that the plaintiffs' claim under MUTPA failed, but not because the plaintiffs did not allege substantial loss. The court found that the plaintiffs had adequately alleged theories of negligence and breach of implied contract, but that adequate pleading did not guarantee whether the particular types of damages alleged were recoverable under those theories. The court grouped the plaintiffs' various claims of damages into two groups: mitigation costs and opportunity loss.

Under Maine law, damage must be both reasonably foreseeable, and, even if reasonably foreseeable, of the type which Maine has not barred for policy reasons. Although reasonable foreseeability "may set tolerable limits for most types of physical harm, it provides virtually no limit on liability for nonphysical harm." In such cases, Maine courts limit recovery by considering not only reasonable foreseeability, but also relevant policy considerations such as "societal expectations regarding behavior and individual responsibility in allocating risks and costs." *Alexander v. Mitchell,* 930 A.2d 1016, 1020 (Me. 2007). Maine courts have weighed these considerations in the context of mitigation costs and determined that a plaintiff may recover for costs and harms incurred during a reasonable effort to mitigate, regardless of whether the harm is nonphysical. The court has expressly said so both in its response to the certified questions and in its decision to apply the Restatement (Second) of Torts § 919, which provides that "[o]ne whose legally protected interests have been endangered by the tortious conduct of another is entitled to recover for expenditures reasonably made or harm suffered in a reasonable effort to avert the harm threatened." To recover mitigation damages, plaintiffs need only show that the efforts to mitigate were reasonable, and that those efforts constitute a legal injury, such as actual money lost, rather than time or effort expended.

Without any Maine law on the subject other than the decision on the plaintiff's certified question, the court turned to the decisions of other courts that applied §919 of the Restatement. The court found that other courts awarded mitigation costs even when it was not certain at the time that the costs were necessary, when mitigation costs were sought but other damages were unavailable, and when mitigation costs exceeded the amount of actual damages. The Seventh Circuit held that incidental costs expended in good faith to mitigate harm are recoverable — even if the costs turn out to exceed the savings. *Toledo Peoria & W. Ry. v. Metro Waste Sys., Inc.*, 59 F.3d 637 (7th Cir. 1995) ("[a]ny other result would effectively penalize [the plaintiff] for fulfilling its obligation under Illinois law to minimize its damages"). The Fourth Circuit has noted that plaintiffs should not face "a Hobson's choice" between allowing further damage to occur or mitigating the damage at their own expense. *Toll Bros., Inc. v. Dryvit Sys., Inc.*, 432 F.3d 564, 570 (4th Cir. 2005) (a plaintiff may recover the cost of its reasonable attempts to mitigate, even if the injury is "wholly financial" in nature).

The question became whether plaintiffs' mitigation steps were reasonable. The court noted this involved a large-scale criminal operation conducted over three months and the deliberate taking of credit and debit card information by sophisticated thieves. Unlike the cases cited by Hannaford, this case did not involve inadvertently misplaced or lost data which had not been accessed or misused by third parties. The court found that there was actual misuse as well has a real risk of misuse, not merely a hypothetical risk. Additionally, there was no suggestion that there was a way to predict whose accounts would be used to ring up improper charges. By the time Hannaford acknowledged the breach, there were over 1,800 fraudulent charges, and a reasonable expectation that many more would follow. Hannaford did not notify is customers of exactly what data, or whose data, was stolen. It reasonably appeared that all Hannaford customers who used credit or debit cards during the class period were at risk of unauthorized charges. The court also reasoned that the fact that many banks or issuers issued new cards was evidence of the reasonableness of replacement of cards as mitigation. Those banks thought the cards would be subject to unauthorized use, and cancelled those cards to mitigate their own losses in what was a commercially reasonable judgment. That other financial institutions did not replace cards immediately did not make it unreasonable for cardholders to take steps to protect themselves.

The court found it was foreseeable that a customer, knowing that her credit or debit card data had been compromised and that thousands of fraudulent charges had resulted from the same security breach, would replace the card to mitigate against misuse of the card data. Similarly, it was foreseeable that a customer who had experienced unauthorized charges to her account would reasonably purchase insurance to protect against the consequences of data misuse. The court also concluded that the plaintiffs' claims for identity theft insurance and replacement card fees involved actual financial losses from credit and debit card misuse. Under Maine contract law, those losses are recoverable as mitigation damages so long as they were reasonable.

However, as to the "opportunity costs," the court found that general principles of recovery in both contract and tort, barred the plaintiffs' remaining claims. It held that the district court correctly concluded that the plaintiffs' claims for loss of reward points, loss of reward point earning opportunities, and fees for pre-authorization changes were not recoverable. Those injuries were too distant from the data breach because they were incurred as a result of third parties' unpredictable responses to the cancellation of plaintiffs' credit or debit cards. The court doubted that it was reasonably foreseeable that an issuing bank would deny a cardholder's entitlement to accumulated points when the card was merely replaced with a new one. Nor was it reasonably foreseeable that pre-authorization arrangements would involve change fees in the event of a credit or debit card replacement.

The court concluded that the mitigation damages discussed were cognizable under Maine law and reversed the district court's dismissal of the plaintiffs' negligence and implied contract claims as to those damages. The court affirmed the district court's dismissal of the remaining claims.

UCC APPLIES TO SALE AFTER JUDGMENT OF FORECLOSURE, WHEN TERMS OF JUDGMENT ARE NOT FOLLOWED

Williams v. Gillespie, 346 S.W.3d 727 (Tex. App.—Texarkana 2011).

FACTS: In 1995, Gillespie sold a bulldozer and a track hoe to Williams on credit. Williams defaulted four years later and Gillespie obtained a default judgment ("Abstracted Judgment") in the amount of approximately $76,000 for the note and fees. Gillespie obtained a writ of execution, but did not deliver it to the officer authorized to serve it. Instead, he informed Williams of its existence. Williams voluntarily relinquished the equipment to Gillespie. Gillespie testified that Williams agreed to forego a public sale by the sheriff to allow Gillespie to sell the equipment by private sale in an attempt to maximize the sales price and, thus, reduce Williams's debt as much as possible. Gillespie sold the bulldozer for $35,000 via private sale but was unable to sell the track hoe. He retained it for his own use and credited Williams with $11,500, an amount greater than any offer he had received. During the intervening years, Williams made a few intermittent payments on the debt.

Several months after the default judgment was entered, Gillespie caused an abstract judgment to be issued and filed it in the Office of the Nacogdoches County Clerk. Nine years later, he filed a second abstract judgment and a second writ of execution was entered. The second writ of execution was mailed to the Angelina County Sheriff. Gillespie then filed suit to foreclose the judgment lien on several pieces of non-exempt property owned by Williams and his wife, based on the Abstracted Judgment. Williams requested a take-nothing judgment in his second amended answer and at trial argued the default judgment had been satisfied because Chapter 9 of the Texas Business and Commerce Code ("UCC") applied to the private sale of the bulldozer and the retention of the track hoe and, because Gillespie violated various provisions of Chapter 9 there was no longer any debt owed. The trial court found that the UCC does not apply to this case and ordered that the nonexempt real property be sold at a public sale to satisfy the Abstracted Judgment. Williams appealed.

The question became whether plaintiffs' mitigation steps were reasonable.

HOLDING: Reversed.

REASONING: The court found that the Abstracted Judgment authorized an officer to seize the equipment and sell it pursuant to a public sale. There was no authorization in the judgment for the conduct of a private sale. A valid sale under a judgment occurs only when there is strict compliance with the terms of the foreclosure judgment. *Kolbo v. Blair*, 379 S.W.2d 125, 130 (Tex. Civ. App. —Corpus Christi 1964). Because Gillespie did not comply with the terms of the judgment, the sale of the bulldozer and track hoe was not a judicial foreclosure sale.

Williams contended that the trial court erred in concluding the UCC did not apply to the private sale of the bulldozer and track hoe. Because the bulldozer and track hoe were not sold pursuant to the terms of the judgment, Williams argued, the UCC must apply. The court agreed.

The judicial sale is not subject to the Code, but is conducted under other rules of law. The nonjudicial sale by the secured party is conducted under the rules of the Code. It is freely permitted and may be either public or private, the choice of remedies resting in the secured party. When Gillespie elected to sell the collateral at a private sale instead of abiding by the terms of the Abstracted Judgment, he necessarily elected to proceed under former Section 9.102 of the UCC (in effect at the time of the private sale).

The court found that Gillespie failed to provide any authority that the UCC does not apply when a judgment of foreclosure is obtained, but the terms of the judgment are not followed. It noted that the UCC version in force at the time stated that it did not supplant common law unless specifically stated. The UCC preempts the common law if the UCC and the common law conflict. Because the UCC prescribed the methods to be followed in a nonjudicial sale f collateral after default, Gillespie was obligated to follow the UCC, not pre-existing common law. The court concluded that the UCC governed the private sale of the bulldozer and the retention of the track hoe.

THE LAST WORD

Happy New Year.

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