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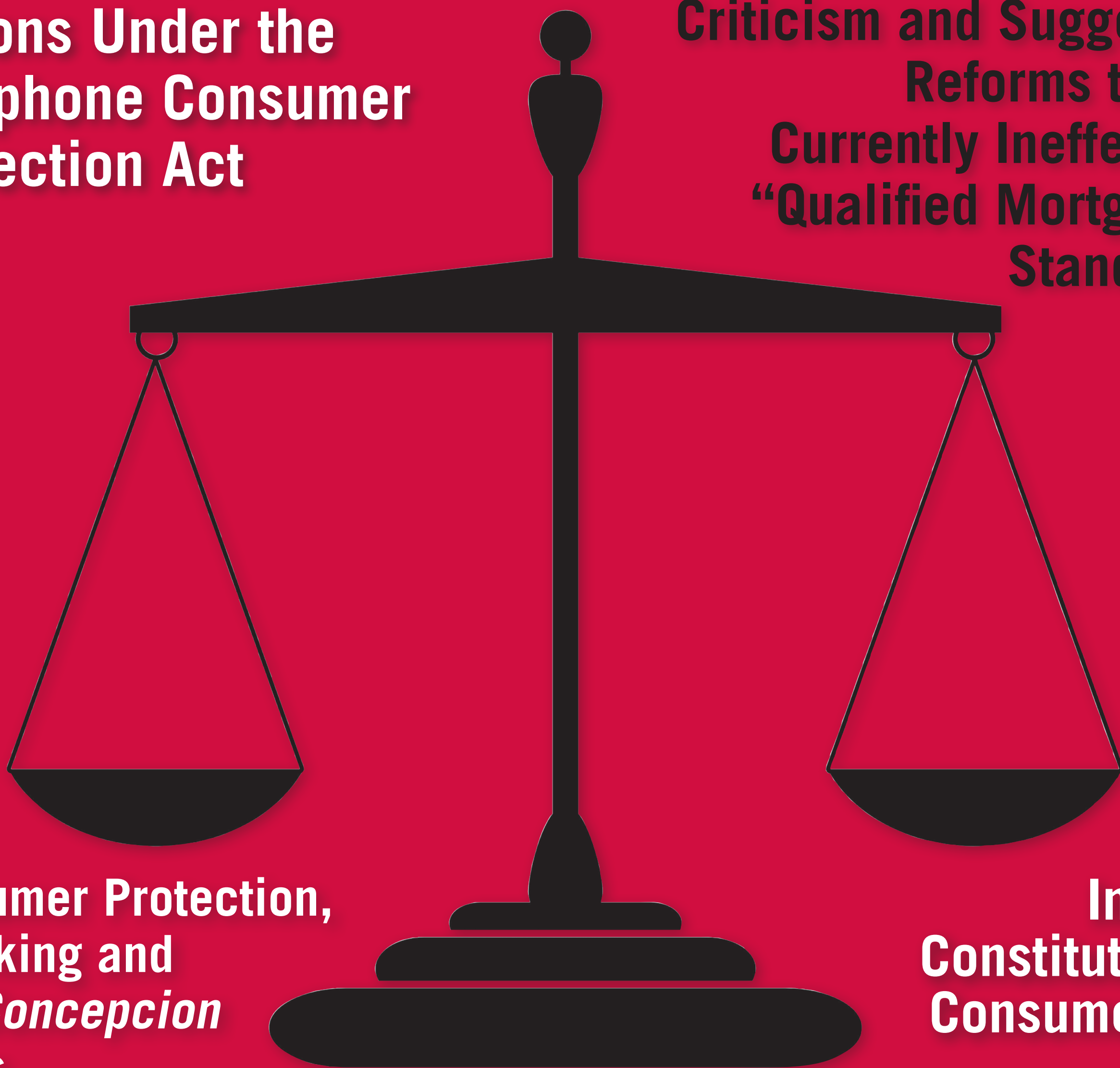
# Journal of Consumer & Commercial Law

OFFICIAL PUBLICATION OF THE CONSUMER & COMMERCIAL LAW SECTION OF THE STATE BAR OF TEXAS

## Certification of Class Actions Under the Telephone Consumer Protection Act

## Criticism and Suggested Reforms to the Currently Ineffective "Qualified Mortgage" Standards



## Consumer Protection, Hijacking and The *Concepcion* Cases

## India's Constitutional Consumerism

## Notario Fraud and a Private Right of Action Under the Texas DTPA

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# Journal of Consumer & Commercial Law

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## Articles


**Certification of Class Actions Under the Telephone Consumer Protection Act and the Prohibition Against "Fail-Safe" Classes**
**By Scott J. Hyman and Eric J. Troutman** 2

**Consumer Protection, Hijacking and The *Concepcion* Cases**
**By Brandy G. Robinson** 7

**Too "Qualified" or Not "Qualified" Enough? Criticism and Suggested Reforms to the Currently Ineffective "Qualified Mortgage" Standards**
**By Amanda Brett Ethridge** 17

**Protecting the Vulnerable Among Us Notario Fraud and a Private Right of Action Under the Texas DTPA**
**By Lauren A. Fisher Flores** 28

**Interface Between India's Constitutional Consumerism and the Consumer Protection Act of 1986**
**By Naman Jain and G. Datta Prasad** 32

**Consumer News Alert-Recent Decisions** 35


## Recent Developments


**Deceptive Trade Practices Act** 41

**Consumer Credit** 41

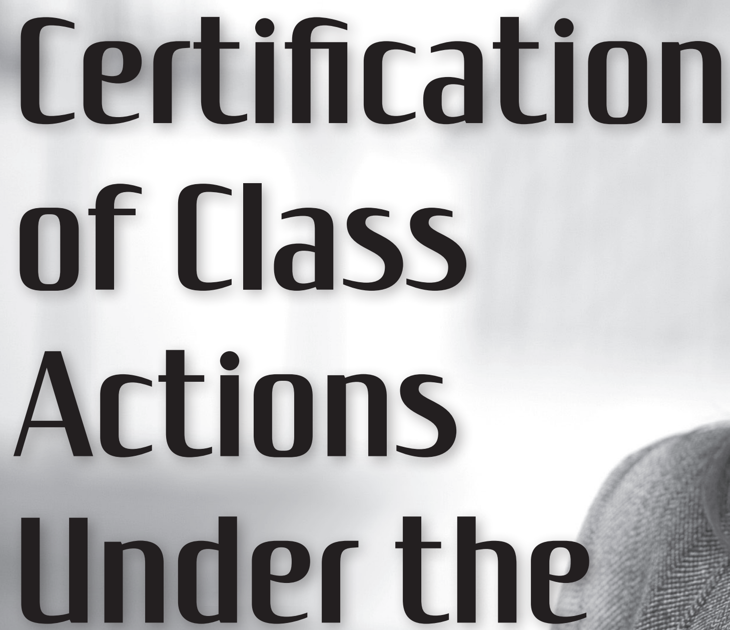
**Debt Collection** 42

**Arbitration** 45

**Bankruptcy** 50

**Miscellaneous** 51

**The Last Word** 56



# Certification of Class Actions Under the Telephone Consumer Protection Act and the Prohibition Against "Fail-Safe" Classes*

**By Scott J. Hyman** and Eric J. Troutman*****

## *I. Introduction*

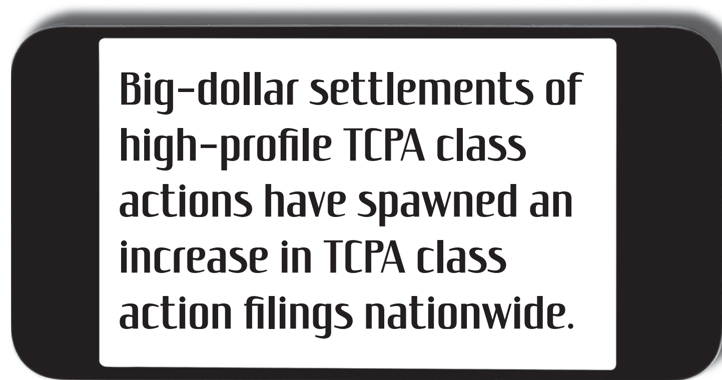
It seems simple enough: a plaintiff defines a putative class under the Telephone Consumer Protection Act (TCPA)[1] to include individuals who received autodialed calls/texts on their cellular telephones, but who had not given prior express consent.[2] So, what's the problem with this class definition?[3] The problem is that a putative class-member in a TCPA class action does not become a member of the class until they establish liability on the merits; i.e., that they did not give "prior express consent" under the TCPA. Such a recursive[4] class definition, requiring the merits of each class member's claim to be evaluated in order to determine class membership, has been called a "fail-safe" class. This class definition creates a "heads I win, tails you lose" situation where class members either receive a favorable judgment or are defined out of the class.[5]

Although Federal Rule of Civil Procedure (FRCP) Rule 23 does not explicitly mention "fail-safe" classes,[6] FRCP Rule 23's requirement that common questions pre-dominate is the flip-side of the same coin.

Courts should not hesitate to strictly construe and deny class certification of broad, recursive "fail safe" TCPA classes. The only inquiries then become whether a recursive "fail-safe" class can be amended and/or re-defined after the pleading stage.[7]

## II. Issues Related to Class Certification of TCPA Class Actions under a Traditional Application of the Express Terms of FRCP Rule 23

Big-dollar settlements of high-profile TCPA class actions[8] have spawned an increase in TCPA class action filings nationwide.[9] Contested TCPA classes, however, remain notoriously difficult to certify.[10] True, some courts have certified TCPA classes. But, the number of procedural and substantive theories upon which courts have denied certification of class actions are limited only by varying criteria permitted by Federal Rules of Civil Procedure (FRCP) Rule 23.[11] Some courts have evaluated the issue of prior express consent under a "predominance" analysis, finding that common issues do not predominate[12] unless the telephone numbers called originated from a single source and there is a definitive means of determining that consent was lacking regarding all numbers from that source.[13]




Other courts have applied a "typicality" analysis, particularly in "wrong-number" or "wrong-called-party" situations.[14] Still others have found the class action device not to be "superior" to other available methods for fairly and efficiently resolving the dispute in question.[15]

## III. The Prohibition Against "Fail-Safe" Classes

A class action plaintiff must demonstrate the existence of an "aggrieved class."[16] Accordingly, FRCP Rule 23 and due process require that plaintiffs propose a class that is definite and ascertainable based on objective criteria that do not require a merits-based analysis.[17] Courts properly look below the surface of a class definition to determine whether the actual process of ascertaining class membership will require determination of the merits of every class member's claim.[18]

Such merits-inquiring class definitions are called "fail-safe" classes. At its most basic, a "fail-safe" class is one loosely defined as "all individuals wrongfully denied something by the defendant"— a definition that creates a "heads I win, tails you lose" situation where class members either receive a favorable judgment or are defined out of the class.[19]

Although the term is not used, the federal Manual for Complex Litigation confirms that "fail-safe" classes should be avoided to "avoid subjective standards…or terms that depend on resolution of the merits."[20] The United States Courts of Appeals for the Sixth and Seventh Circuits have held that "fail-safe" classes cannot be certified.[21]

The United States Court of Appeals for the Fifth Circuit, however, has allowed a recursive, "fail-safe" class to be certified.[22] While the United States Court of Appeals for the Ninth Circuit has shown hostility to fail-safe classes in an unpublished decision,[23] it also has rejected a challenge that a class definition was circular.[24] Nevertheless, most California district courts and state courts[25] refuse to certify "fail-safe" classes.[26]

## IV. "Fail-Safe" TCPA Classes

### A. FRCP Rule 23's Implied Prohibition Against "Fail-Safe" Classes Applies Even When All Other Textual FRCP Rule 23 Requirements are Met, Although Leave to Amend May Be Granted

Only a handful of TCPA class actions or class definitions have been evaluated through the "fail-safe" prism. The prohibition against "fail-safe" class action definitions is an independent ground to deny class certification of TCPA class actions, even if the class definition otherwise meets all of FRCP Rule 23's other explicit requirements.[27]

For example, in *Zarichny v. Complete Payment Recovery Services, Inc.*,[28] Judge Dalzell struck an FDCPA/TCPA class at the pleadings stage because it was an impermissible "fail-safe" class. Judge Dalzell found that the "fail-safe" analysis should be done before the analysis of the four requirements of Rule 23(a)–"numerosity" of class members; "commonality" to the class of questions of fact or law; "typicality"; and adequacy of the class representative. Judge Dalzell found that "ascertainability" does not appear in the text of Rule 23, but the ascertainability inquiry in a TCPA case itself triggers the "fail-safe" analysis. A putative TCPA class comprised of those people who received autodialed telephone calls without the recipient's "prior express consent" cannot be ascertained "without the sort of extensive fact-finding that class actions should avoid." Accordingly, Judge Dalzell struck the TCPA Plaintiff's class allegations from her lawsuit.

In *Taylor v. Universal Auto Group I, Inc.*,[29] Judge Strombom addressed certification of a "fail-safe" TCPA class at the class certification stage. Judge Strombom conducted an in-depth legal and factual analysis of the textual pre-requisites for certifying a TCPA class under FRCP Rule 23, and found most of the textual requirements met. Judge Strombom then held, however, that a TCPA class defined as those TCPA putative class members who did not give "prior express consent" to be autodialed on their cellular telephones was an impermissible

"fail-safe" class and, therefore, class certification should be denied. Judge Strombom found that a "fail-safe" class definition provided an independent basis to deny certification, explaining: "This Court, however, is persuaded that inclusion of the "without prior consent" language in the national classes definition makes it a "fail-safe" class, as clearly the issue of consent is central to determining defendant's liability."[30] Judge Strombom granted the plaintiff leave to amend the class to try to avoid the fail-safe class problem.

In *Sauter v. CVS Pharmacy, Inc.,*[31] Judge Graham found a prohibited "fail-safe" class when plaintiff defined the class as, "all persons within the United States who received a non-emergency telephone call from CVS to a cellular telephone through the use of an automatic telephone dialing system or an artificial or prerecorded voice and who did not provide prior express consent for such calls." Judge Graham extensively analyzed prior TCPA jurisprudence applying or refusing to apply the "fail- safe doctrine," and concluded that the prohibition against "fail-safe" classes was consistent with FRCP Rule 23's requirements. Accordingly, Judge Graham granted the defendant's motion to strike the class-action allegations from the complaint, but granted the plaintiff leave to amend to try to cure the "fail-safe" problem with the class definition.

In *Lindsay Transmission, LLC v. Office Depot, Inc.,*[32] Judge Jackson struck a class action definition as constituting a "fail-safe" class applying an analysis largely similar to the "predominance" inquiry. She explained that "[d]etermining class membership will require the kind of individualized determinations, the absence of prior consent and the absence of a prior business relationship, precluded by Rule 23."[33]

**B. Fail-Safe Classes at the Pleadings Stage and Discretion to Modify or Allow Modification of "Fail-Safe" Class Definitions**

Most courts believe they retain the discretion to modify a "fail-safe" class definition, or to require the plaintiff to do so, as long as the re-defined class does not become over or under-inclusive in other ways.[34] Some courts have hesitated to address the "fail-safe" nature of a TCPA class definition at the pleadings stage – the proposed class might be redefined to avoid ascertainability or other "fail-safe" problems at a later stage. For example, in *Olney v. Job.com, Inc.*,[35] Judge O'Neill refused to strike class allegations, even though he concluded that the class definition purported to define a "fail-safe" class:

> It is true that Plaintiff's original proposed class is a "fail safe" class. Because the TCPA prohibits calls to cellular telephones using ATDSs unless prior express consent has been given, defining the class to include anyone who received such a call without prior express consent means that only those potential members who would prevail on this liability issue would be members of the class. However, in the Ninth Circuit, it is not necessary to deny certification (or in this case strike class allegations) simply because the initially proposed class is a "fail-safe" class.[36]

Other courts have hesitated to address the "fail-safe" nature of a TCPA class action at the pleadings stage when the court similarly perceived appellate hostility to striking class actions at the pleadings stage[37] or when the court was skeptical that the class definition is a "fail-safe" class.[38]

**V. Conclusion**

Although FRCP Rule 23 does not explicitly prohibit certification of "fail-safe" classes, it certainly implies it. Class actions filed under the TCPA create particular problems of certification due to the "fail-safe" nature of the typical class definition of individuals who were autodialed on their cellular telephones without their consent. Courts should not hesitate to find such definitions recursive or circular – even at the pleadings stage. Although leave to amend might be granted to allow a Plaintiff to attempt to cure the problems inherent with a "fail-safe" TCPA class definition, courts should not hesitate to strike or to deny certification to TCPA classes that remain inherently recursive and cannot cure their "fail-safe" defects.

Although FRCP Rule 23 does not explicitly prohibit certification of "fail-safe" classes, it certainly implies it.

* *Reprinted with permission from 68* Consumer Finance Law Quarterly Report *326 (2014).*

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1 "No person or entity may initiate any telephone call (other than a call made for emergency purposes or made with the prior express consent of the called party) using an automatic telephone dialing system…(iii) to any telephone number assigned to a paging service, cellular telephone service, specialized mobile radio service, or other radio common carrier service, or any service for which the called party is charged for the call." 47 CFR § 64.1200(a)(1).

2 Most district courts have held that "prior express consent" is an affirmative defense that need not be pleaded by the plaintiff.

*See, e.g.*, Bates v. I.C. Sys., 2009 WL 3459740, *2 (W.D.N.Y. Oct. 19, 2009) (citing In the Matter of Rules & Regulations Implementing the Tel. Consumer Prot. Act of 1991, 23 F.C.C.R. 559, 564-65 (Jan. 4, 2008).) The FCC's ruling, however, provides that a dialer has the burden of proof only if "a question arises as to whether express consent was provided…." 23 F.C.C.R. 559, 564 - 65. That is, a caller seemingly must first put consent at issue before the burden of production shifts to the caller. The Court of Appeals for the Ninth Circuit accordingly held that a TCPA Plaintiff must plead an absence of prior express consent. Meyer v. Portfolio Recovery Assocs., LLC, 707 F.3d 1036, 1043 (9th Cir. 2012). *See also:* Steinhoff v. Star Tribune Media Co., LLC, 2014 WL 1207804 (D. Minn. 2014); Fields v. Mobile Messengers America, Inc., 2013 WL 6073426, *3 (N.D. Cal. 2013).

[3] Whether a "non-consent" class can be certified under the TCPA is one of the myriad of procedural problems created by TCPA, including legal disputes on even the most basic issues of the TCPA, such as standing, jurisdiction, or even what elements must be pleaded to state a claim. See, e.g., Eric J. Troutman, Scott J. Hyman & Divya S. Gupta, *Staying TCPA Cases under the Primary Jurisdiction Doctrine,* 68 Consumer Finance Law Quarterly Report 312 (2014). The TCPA's substantive reach is no more settled, with legal disputes on the most basic questions such as what an autodialer (ATDS) is, whether human interaction with technology disqualifies it as an ATDS, what constitutes prior express consent to receive autodialed calls, and whether a consumer can revoke express consent and, if so, whether it can be done orally. *Id.*

[4] "Recursion" is a term used in mathematics and logic when the application of a function to its own values generates an infinite sequence of values. See, generally, https://en.wikipedia.org/wiki/Recursion.

[5] *See generally,* Comment, *The Fail-Safe Class as an Independent Bar to Class Certification*, 81 Fordham L. Rev. 2769 (2013); see also Zarichny v. Complete Payment Recovery Services, Inc., 80 F. Supp.3d 610, (E.D. Pa. 2015) (TCPA class definition was a "fail-safe" class that required "determination on the merits before members are identified, creating what the Supreme Court called "one-way intervention").

[6] Rodman v. Safeway, Inc., 2014 WL 988992 (N.D. Cal. 2014) ("But this concept does not appear in the text of Rule 23").

[7] Warnick v. DISH Network LLC, 2014 WL 6680407 *4 (D. Colo.
2014) ("…Plaintiff has not shown why I should not convert the denial without prejudice of the Motion for Class Certification to a denial with prejudice.").

[8] *E.g.:* Malta v. The Federal Home Loan Mortg. Corp., 2013 WL 444619 (S.D. Cal. 2013); Arthur v. Sallie Mae, Inc., 2012 WL 4075238 (W.D. Wash. 2012); Agne v. Papa John's Int'l, Inc., 286 F.R.D. 559 (W.D. Wash. 2012).

[9] http://dev.webrecon.com/debt-collection-litigation-cfpb-com- plaint-statistics-october-2014/.

[10] *See generally,* Eric J. Troutman & Scott J. Hyman, *The Telephone Consumer Protection Act*, in DEBT COLLECTION IN CALIFORNIA §§ 2B.35-38 (CEB 2014).

[11] *See, e.g.*, Gene & Gene LLC v. Biopay, LLC, 541 F3d 318 (5thCir 2008).

[12] *See, e.g.*: Connelly v. Hilton Grand Vacations Co., LLC, 294 F.R.D. 574, (S.D. Cal. 2013) ("It is likely that each individual received a different amount of information regarding how his cell phone number would be used and there is at least a non-trivial possibility that some class members expressed consent in a manner that was colored by these evaluated individually, rather than on a class wide basis."); Kristensen v. Credit Payment Services, 2014 WL 1256035 (D. Nev. 2014) ("Kristensen's burden at the class certification phase is to 'advance a viable theory employing generalized proof to establish liability with respect to the class involved.'"); Chapman v. First Index, Inc., 2014 WL 840565 (N.D. Ill. 2014) (Denying certification where Plaintiff did not demonstrate "objective criteria by which class membership could be readily ascertained or a common method of proof by which lack of consent could be established on a class-wide basis."); Gannon v Network Tel. Servs., Inc., 2013 WL 2450199 (C.D. Cal. 2013) (individualized consent inquiries predominated in texting case); O'Connor v Diversified Consultants, Inc., 2013 WL 2319342, *4 (E.D. Mo. 2013) (denying certification because of unique evidentiary issues that will need to be resolved on individual-case basis).

[13] *See, e.g.*, Manno v Healthcare Revenue Recovery Group, LLC, 289 F.R.D. 674, 684 (S.D. Fla. 2013) (certifying class when individuals identified as putative class members during discovery on numerosity issue had no communications with defendant before alleged offending calls, so could not have expressly consented to be called); Targin Sign Sys., Inc. v Preferred Chiropractic Ctr., Ltd., 679 F.Supp.2d 894, 896 (N.D. Ill. 2010) ("Nor is there a whisper about those targets, or any of them, being people who, or institutions that, had consented" to the defendant's faxing them). One district court viewed a "split" of authority on TCPA class certification. See St. Louis Heart Center, Inc. v. Vein Centers For Excellence, Inc., 2013 WL 6498245 (E.D. Mo. 2013).

[14] *See, e.g.*, Buonomo v. Optimum Outcomes, Inc., 301 F.R.D. 292, 297 (N.D. Ill. 2014) ("Wrong number" class Plaintiff cannot represent class including debtor class members.); Labou v. Cellco Partnership, 2014 WL 824225 (E.D. Cal. 2014) (Preemptively decertifying class where non-customer attempted to represent claims of broader class including non-consenting customers.)

[15] Compare The Savanna Group, Inc. v. Trynex, Inc. 2013 WL 66181, * 16 (N.D. Ill. 2013). (Low recovery makes individual plaintiffs unlikely to pursue their claims in separate actions; class treatment "superior") with Smith v. Microsoft Corp.,297 F.R.D. 464, (S.D. Cal. 2014) (Denying certification in TCPA case for lack of superiority.)

[16] McLaughlin on Class Actions, Prerequisites To Class Certification, § 2.2 (2014).

[17] *See generally,* Rubenstein, *Rule 23(a) Prerequisites for Class Certification: Implicit Requirements – Definiteness,* in NEWBERG ON CLASS ACTIONS, § 3.6 (2014).

[18] *Id.*

[19] *See generally,* Comment, *The Fail-Safe Class as an Independent Bar to Class Certification*, 81 Fordham L. Rev. 2769 (2013); HERR, Annotated Manual For Complex Litigation, § 2.222 (2014).

[20] Herr, Annotated Manual For Complex Litigation, § 21.222 pp. 270 (Fed. Jud. Ctr. 2004). The Manual cites Forman v. Data Transfer, Inc., 164 F.R.D. 400, 403 (E.D. Pa. 1995), which was a "fail safe" TCPA class although it did not use that term. *Id.*, § 21.222 fn 827. In *Forman*, Judge Giles denied certification of a TCPA blast-fax class because the putative class was defined "the purported class as 'all residents and businesses who have received unsolicited facsimile advertisements' requires addressing the central issue of liability" and "[d]etermining a membership in the class would essentially require a mini-hearing on the merits of each case". *See also* Herr, Annotated Manual for Complex Litigation, § 2.222 (2014).

[21] *See, e.g.*, Young v. Nationwide Mut. Ins. Co., 693 F.3d 532, 538 (6th Cir. 2012); Randleman v. Fid. Nat'l Title Ins. Co., 646 F.3d 347, 352 (6th Cir. 2011); Adashunas v. Negley, 626 F.2d 600, 604 (7th Cir. 1980).

[22] *See*, In re Rodriguez, 695 F.3d 360, 370 (5th Cir. 2012); Mullen v. Treasure Chest Casino, 186 F.3d 620, 624 n.1 (5th Cir. 1999); Forbush v. J.C. Penney Co., 994 F.2d 1101, 1105 (5th Cir. 1993), *abrogated on other grounds* by Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011).

[23] Kamar v. RadioShack Corp., 375 Fed. Appx. 734, 736 (9th Cir.2010) (unpublished) ("Fail-safe" classes are unascertainable because the class definition would allow putative class members to avoid the effects of res judicata if they do not succeed on the merits of their claim, such that putative members either win or are not part of the class).

[24] *See* Vizcaino v. U.S. Dist. Court for W. Dist. of Wash., 173 F.3d 713, 722 (9th Cir. 1999), *amended*, 184 F.3d 1070 (9th Cir. 1999).

[25] Only two unpublished California state appellate decisions have addressed the prohibition against "fail-safe" class actions as such and by name: Canez v. King Van & Storage, Inc., 2010 WL 4948441 * 5 (Cal. App. 2 Dist. 2010); and Sony Electronics Inc. v. Superior Court, 145 Cal.App.4th 1086, 1095 (2006). Although not labeling such classes as "fail-safe" class actions, California Courts do hold that "It is error to certify a class if that class is defined in terms of ultimate liability questions." *See*, Hicks v. Kaufman & Broad Home Corp. 89 Cal.App.4th 908 (2001); Ghazaryan v. Diva Limousine, LTD., 169 Cal.App.4th 1524, 1531 (2008).

[26] *See, e.g.*, Kirchner v. Shred-it USA Inc., 2014 WL 6685210 n.3 (E.D. Cal. 2014); Brown v. Hain Celestial Group, Inc., 2014 WL 6483216 (N.D. Cal. 2014) ("If Hain loses, we won't." This is impermissible. It amounts to a "fail-safe" class in which membership will be determined by the Court's prior determination of Hain's liability."); Syed v. M-I LLC, 2014 WL 5426862 n. 4 (E.D. Cal. 2014) ("[A] 'fail-safe' class is one that includes only those who are entitled to relief [and] allow[s] putative class members to seek a remedy but not be bound by an adverse judgment-either those class members win or, by virtue of losing, they are not in the class and are not bound."); Gray v. County of Riverside, 2014 WL 5304915 (C.D. Cal. 2014) (A class is "fail safe" if the definition of the class shields the class members from adverse judgment); Trosper v. Styker Corporation, 2014 WL 4145448 (N.D. Cal. 2014) (The Ninth Circuit has held that "[t]he fail-safe appellation is simply a way of labeling the obvious problems that exist when the class itself is defined in a way that precludes membership unless the liability of the defendant is established); In re ConAgra Foods, Inc., ___ F.R.D. ___2014 WL 4104405 (C.D. Cal. 2014); Ubaldi v. SLM Corporation, 2014 WL 1266783 (N.D. Cal. 2014); Ortiz v. CVS Caremark Corporation, 2013 WL 6236743 (N.D. Cal. 2014); Roth v. CHA Hollywood Medical Center, L.P., 2013 WL 5775129 (C.D. Cal. 2014) October 25, 2013); Olney v. Job.com, Inc., 2013 WL 5476813 (E.D. Cal., 2014) (TCPA case); Gormley v. Nike Inc., 2013 WL 322538 (N.D. Cal. 2014); In re AutoZone Wage and Hour Employment Practices Litig., 289 F.R.D. 526, 545 - 46 (N.D. Cal. 2012); Connelly v. Hilton Grant Vacations Co., LLC, 2012 WL 2129364 (S.D. Cal. 2014) (TCPA case); Kas v. Mercedes-Benz USA, LLC, 2011 WL 5248299 (C.D. Cal., 2011); Thomasson v. GC Services Limited Partnership, 275 F.R.D. 309 (S.D. Cal., 2011); Schaffer v. Litton Loan Servicing, LP, 2009 WL 9436302 (C.D. Cal. 2009); Velasquez v. HSBC Finance Corp., 2009 WL 112919 (N.D. Cal. 2009); Brazil v. Dell Inc., 585 F.Supp.2d 1158 (N.D. Cal. 2008); Heffelfinger v. Electronic Data Systems Corp., 2008 WL 8128621 (C.D. Cal. 2008); Dodd-Owens v. Kyphon, Inc., 2007 WL 420191 (N.D. Cal. 2007).

[27] *See generally*, Comment, *The Fail-Safe Class as an Independent Bar to Class Certification*, 81 Fordham L. Rev. 2769 (2013).

[28] 80 F. Supp.3d 610, (E.D. Pa. 2014).

[29] 2014 WL 6654270 (W.D. Wash. 2014).

[30] Some courts, instead, have decided the issue through a predominance analysis, even though the class definition "treads close" to a fail-safe class. *See, e.g.*, Balschmiter v. TD Auto Finance LLC, 2014 WL 6611008 * 21 fn. 19 (E.D. Wis. 2014).

[31] 2014 WL 1814076 (S.D. Ohio 2014).

[32] 2013 WL 275568 (E.D. Mo. 2014).

[33] *See also,* Levitt v. Fax.com, 2007 WL 3169078 at *5 n. 5 (D. Md. 2007) (decertifying a fail-safe TCPA class); Booth v. Appstack, Inc., 2015 WL 1466247 (W.D. Wash. 2015); Salam v. Lifewatch, Inc., 2014 WL 49608947 (N.D. Ill. 2014); G.M. Sign, Inc. v. Franklin Bank, SSB, No. 06 C 949, 2007 WL 4365359, at *3 (N.D. Ill. 2007) (rejecting TCPA class where "the proposed class definition improperly includes a component of a lack of defense, namely proof of express permission or invitation prior to the receipt of the fax advertisement."); Kennard v. Electronic Data Syst. Corp., 1998 WL 34336245(Tex. Dist. Ct. 1998) (proposed TCPA class failed because "it requires the Court to determine whether a person gave prior express invitation or permission to receive the challenged fax and/or whether each potential class member had an existing business relationship with EDS.").

[34] *See generally* McLaughlin on Class Actions, Prerequisites To Class Certification § 2.2 at n. 28 (2014) (citing authorities).

[35] *See* Olney v. Job.com, Inc., 2013 WL 5476813 (E.D. Cal. 2013).

[36] *Id.*, at *11, citing In re AutoZone, Inc., Wage & Hour Employment Practices Litig., 289 F.R.D. 526, 546 (N.D. Cal. 2012).

[37] Connelly v. Hilton Grant Vacations Co., LLC, 2012 WL 2129364 (S.D. Cal. 2014); Haghayeghi v. Guess ?, Inc., 2015 WL 1345302 (S.D. Cal. 2015) ("The class, as currently defined is suspect as it requires a finding that Defendant sent unauthorized text messages to determine who is a class member; however, the Court finds it more appropriate to address the issue in a motion for class certification.").

[38] Wolfkiel v. Intersections Insurance Services Inc., 303 F.R.D. 287, 294, (N.D. Ill. 2014).

# Consumer Protection, Hijacking and The *Concepcion* Cases

**By Brandy G. Robinson***

## I. INTRODUCTION

In *AT&T Mobility LLC v. Concepcion*[1] ("*Concepcion*"), a 2011 decision that remains controversial to this day, the U.S. Supreme Court held that traditional state-level unconscionability defenses to class-arbitration waivers in consumer adhesion contracts were wholly preempted under the auspices of the Federal Arbitration Act ("FAA"). The decision leaves consumers with substantially less opportunity to have their legal complaints heard in a court of law.

Nevertheless, in *Concepcion's* wake, courts and agencies throughout the country have continued to devise numerous means of challenging the legality of arbitration clauses. This article looks at some of these post-*Concepcion* holdings and examines their viability in the mid- to long-term, in light of a United States Supreme Court that appears strongly inclined to bolster its support for the FAA—even in instances where doing so preempts other federal laws in the process.

## II. *CONCEPCION* AND POST *CONCEPCION* CASES

The impetus that ultimately led to the *Concepcion* holding was *Discover Bank v. Superior Court*, a 2005 case before the Supreme Court of California.[2] In *Discover Bank*, the plaintiff, Christopher Boehr—a Discover credit card holder residing in California—challenged the legality of a clause in the bank's card-application paperwork forbidding customers from engaging in any form of class-wide arbitration against Discover.[3] Boehr filed a complaint in California court claiming that Discover had been engaging in deceptive trade practices by misrepresenting their payment deadlines to consumers.[4] Discover moved to compel arbitration, as stipulated in Boehr's original card agreement, and the trial court initially granted their motion. However, after the plaintiff's motion for reconsideration and a pro-plaintiff ruling in a largely identical case, *Szetela v. Discover Bank*, the court reversed itself and concluded that allowing such waivers would be unconscionable under California law.[5] Further, the court concluded that the FAA, which makes arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," did not preempt either California law in this regard or the court's right to rule in Boehr's favor.[6] The state's Second Court of Appeal reversed the trial court's holding, but the California Supreme Court reversed and remanded the appellate decision, reinstating the trial court verdict.[7]

In its opinion, the supreme court established what subsequently became known as the "Discover Bank rule."[8] The "rule" invalidated class-action waivers on unconscionability grounds when the waiver existed in a "take it or leave it" consumer adhesion contract; the amount of money being disputed was inconsequential; and "the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money."[9] While the rule was widely cited in hundreds of cases over the course of five years, the U.S. Supreme Court effectively reversed it in *Concepcion*.

The basic case circumstances in *Concepcion* were similar to those in *Discover Bank*: both involved challenges to class-arbitration prohibitions in consumer adhesion contracts. Unfortunately for the plaintiffs (the Concepcions), they elected to adjudicate their case in federal court instead of state court, despite the fact that they resided in California.[10] That decision may have been fatal to their case, thanks in large part to hostility among the U.S. Supreme Court's conservative bloc to state-level FAA challenges. Not only did the Court deny the Concepcions any relief, Justice Antonin Scalia—who authored the *Concepcion* opinion—seized the opportunity provided to entirely abrogate the California Supreme Court's *Discover Bank* holding. The holding stated that, absent any specific congressional mandate, general public policy reasons were insufficient grounds for superseding the FAA and its 90 years of historical precedent.

Justice Scalia's opinion took particular umbrage with state-level courts trying to wiggle around the mandates of federal law, providing their own interpretations of FAA clauses and manipulating the Act as they saw fit. The Court explicitly stated that "the point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute."[11]

The *Concepcion* case clearly divided the court, given both the length of Justice Stephen Breyer's dissent, as well as Justice Scalia's apparent need to rebut Justice Breyer's rebuttal.[12] Despite the apparent incongruity with his argument, Justice Scalia found nothing in the FAA's legislative history suggesting an intention on Congress's part to include class arbitration under the Act's auspices.[13] Nonetheless, he concluded that the U.S. Supreme Court's own case history had firmly established a "national policy favoring arbitration," including class-wide arbitration.[14]

However, this contention presents some analytical holes in need of filling. For instance, Justice Scalia's analysis fails to account for the likelihood of bias in instances where a defendant is granted the exclusive right—per a contract's stipulated terms—to select an arbitrator. Justice Scalia also disregarded the reality that consumers rarely have any role in the drafting of such clauses.

*Concepcion* has created some confusion as to whether a plaintiff can invalidate an arbitration waiver clause, and if so, under what conditions. Because of this confusion, attorneys have tested *Concepcion*'s limits, questioning: (1) whether procedural and substantive unconscionability defenses are sufficient to overcome *Concepcion*; (2) whether class arbitration waiver clauses would be enforceable if the plaintiff would, as a practical matter, be prohibited from asserting his or her federal statutory rights; (3) whether *Concepcion* would apply where the parties would be required to participate in class arbitration under state law; or (4) whether *Concepcion* applies when actions lie in state court.

### 1. *Coneff v. AT&T Corporation*

In *Coneff v. AT&T Corp.*,[15] plaintiffs argued that *Concepcion* was distinguishable, but these arguments were not persuasive to overcome the *Concepcion* ruling and effect.[16] The Plaintiffs argued: (1) large arbitration costs associated with individual arbitration would prevent effective vindication of federal rights in the arbitral forum; (2) cases such as *Mitsubishi*[17] and *Green Tree*[18] are in conflict with the *Concepcion* ruling and implied exceptions should apply; and (3) Washington law[19] was different from the California law as addressed in the *Discover Bank* case, which *Concepcion* overruled and rejected.

> **In *Italian Colors Restaurant*, the Supreme Court rejected this cost argument and stated individual proceedings were adequate in vindicating federal statutory rights.**

The Ninth Circuit, however, noted that *Concepcion* had rejected similar arguments. Specifically, the Supreme Court in *Concepcion* reasoned small amounts in controversy would not necessarily increase arbitration costs and interfere with the plaintiff's vindication of rights and that FAA favored a liberal policy in enforcing private arbitration agreements.[20] The court reversed the district court decision, ruling against the plaintiffs, to conform with and follow the decision in *Concepcion*. The court noted the U.S. Supreme Court was clear yet broad in stating that the FAA trumped state law and such private agreements are enforceable.[21]

Post-*Concepcion* cases have reinforced the decision in *Concepcion,* emphasizing that class arbitration is not favored. For example, in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*[22], where an arbitrator exceeded his powers authorizing class arbitration contrary to the FAA or when not agreed by the parties. Further case law may provide hope for consumers and show what *Concepcion* has left open such as whether an agreement upon the parties to arbitrate via class arbitration.

### 2. *American Express, Co., et.al. v. Italian Colors Restaurant*

In *American Express, Co., et.al. v. Italian Colors Restaurant,*[23] the plaintiff argued its right of "effective vindication" would be precluded if *Concepcion*'s rule was applied. The plaintiff asserted that the high costs of an individual arbitration would, as a practical matter, preclude the plaintiff from enforcing its statutory

rights. This argument, however, did not get very far.

In *Italian Colors Restaurant*, the Supreme Court rejected this cost argument and stated individual proceedings were adequate in vindicating federal statutory rights, as class actions were not the only practical way for the plaintiffs to vindicate federal statutory rights.[24]

In support of this contention, Justice Scalia explained that there is no mention of class action under the Sherman and Clayton Acts. Moreover, he emphasized a class action was noteven contemplated at the time of the laws' enactment. Justice Scalia, however, seemingly overlooks that anti-trust allegations are serious in nature and afforded special attention under the law.

Fortunately, the dissenting opinion got it right. In essence, the dissenting opinion suggests the broad decisions in *Concepcion* and *American Express, Co., et.al. v. Italian Colors Restaurant* shield companies from illegal activity and behavior[25], which is contrary to the FAA's intent. Essentially, the dissenting opinion forecasted a major issue *Concepcion* would not fix.

Since *Concepcion*, courts have changed several rulings to accommodate the shift in policy and practice per *Concepcion*'s broad understanding. This means reversing original consumer protection rulings that found class waivers were unconscionable and unenforceable.[26]

### 3. California cases: *Samaniego v. Empire Today, LLC* and *Ajamian v. CantorCO2e, L.P.*

In 2012, two California courts refused to apply *Concepcion*:[27] *Samaniego v. Empire Today, LLC*[28] and *Ajamian v. CantorCO2e, L.P.*[29] These cases have not been overruled, and while called into question, remain good law on several points. The primary differences between these cases and *Concepcion* and *Italian Colors* are: (1) the cases involved employment contracts and (2) the arbitration clauses were both procedurally and substantively unconscionable under California law.

*Samaniego v. Empire Today, LLC* looked at the *Discover Bank* rule as a categorical rule overruled by *Concepcion,* but allowing for a narrow exception of contractual defenses such as procedural and substantive unconscionability issues. This meets the intent and spirit of the FAA and state law, disallowing contracts that are one-sided, unfair or fraudulent.[30] *Samaniego* looked at the theory the weaker party to an adhesion contract can avoid enforcement of a choice-of-law provision where enforcement of such would result in substantial injustices.

It is important to note that in *Ajamian*, the court, reasoned that both procedural and substantive unconscionability needed to be present.[31] The court used a sliding scale between excessive procedural and substantive unconscionability to compensate for weaker unconscionability in the two-part test. The court went back and forth on this issue but eventually found the agreement procedurally and substantively unconscionable, thus unenforceable. This is an indication procedural and substantive unconscionability defenses (at least under California law) could be viable options in overcoming *Concepcion*'s ruling upholding class arbitration waiver clauses.[32]

### 4. NLRB Case: *D.R. Horton, Inc. and Michael Cuda*

In a 2012 employment law case, *D.R. Horton, Inc. and Michael Cuda*,[33] the National Labor Relations Board (NLRB) narrowly held that "employers may not compel employees to waive their NLRA right to collectively pursue litigation of employment claims in *all* forums, arbitral and judicial."[34] The Board took care to note the *Horton* case differed from *Concepcion* for several reasons, and the *Concepcion* ruling did not apply. For example, the NLRB historically recognizes employees' ability to join to pursue workplace grievances via litigation and even arbitration. The board cited numerous case precedent and other federal statutes such as the Federal Arbitration Act and the Norris-LaGuardia Act.

In fact, the Board noted that not too long after the passage of the National Labor Relations Act (and even the Norris-LaGuardia Act), the board held "the filing of a Fair Labor Standards Act suit by three employees was protected concerted activity, see *Spandsco Oil & Royalty Co.*, 42 NLRB 942, 948–949 (1942), as was an employee's circulation of a petition among coworkers, designating him as their agent to seek back wages under the FLSA, see *Salt River Valley Water Users Association*, 99 NLRB 849, 853–854 (1952), enforced. 206 F.2d 325 (9th Cir. 1953)."[35]

Second, the NLRB's decision further emphasized that the issue was one of conflict between two federal laws (or an individual's federal rights), whereas *Concepcion* involved state law preempted by federal law. [However, *American Express, Co., et.al. v. Italian Colors Restaurant* closes off this line of thinking; the court in *American Express, Co.* would not allow such a distinction between laws, as the court ruled the FAA controls unless there is a congressional mandate to suggest otherwise. This leaves procedural and contractual defenses as the only viable defenses available in overcoming class arbitration waiver clauses.]

Third, the NLRB's decision found a sharp contrast between the *Concepcion* ruling and the *Horton* case by highlighting that agreements between employees and employers were at stake, which is far limited and narrower than the *Concepcion* decision. In particular, *Concepcion*'s argument involved the claim that a class-action waiver in an arbitration clause of any contract of adhesion in the State of California was unconscionable, potentially affecting tens of thousands of claimants. In *Horton*, this was not the case.

Finally, the Board recognized the parties agreed to arbitrate, but stated the case is not permitting Horton to authorize class arbitrations or class actions. Rather, the Board emphasized an employer could not prohibit such as a condition of employment, "so long as the employer leaves open a judicial forum for class and collective claims, employees' NLRA rights are preserved without requiring the availability of class wide arbitration. Employers remain free to insist that *arbitral* proceedings be conducted on an individual basis."[36]

The Board's decision in *Horton,* however, was short lived. Just a year later, the Fifth Circuit reversed the decision, holding, "we disagree and conclude that the Board's decision did not give proper weight to the Federal Arbitration Act.[37]

### 5. *Recent case law*

Arguably, there may be room for interpretation as the *Concepcion* ruling may not apply to certain types of cases and the agreement of the parties may give significant weight to a non-*Concepcion* ruling and effect. In a recent wave of cases, state courts found ways around *Concepcion*.

#### a. *Cases where courts found arbitration clauses unconscionable*

In cases, such as *Flemma v. Halliburton Energy Services, Inc.*[38], and *Chavarria v. Ralph's Grocery Company*[39], the courts found the arbitration agreements unconscionable.

*Flemma* involved an employee action against the employer, Halliburton Energy Services, Inc., alleging wrongful termination. The court reasoned, "enforcing the Texas agreement would violate New Mexico public policy because, under New Mexico law, the agreement is unconscionable."[40] The court also found the agreement unfairly one-sided and the parties did not form a valid agreement under New Mexico law.

In *Chavarria*, another employee action against an employer (but a putative class action), alleging wage and hour violations

under California law, the court denied an employer's motion to compel arbitration of the plaintiff's individual claim. The court found the arbitration policy both procedurally and substantively unconscionable. The court explained, "where . . . the employee is facing an employer with 'overwhelming bargaining power' who 'drafted the contract and presented it to [the employer] on a take-it-or-leave-it basis,' the clause is procedurally unconscionable."[41] Further, the court stated several terms rendered the arbitration policy substantively unconscionable.[42]

**b. *Cases where the FAA did not preempt state law***

In *Harris v. Bingham McCutchen, LLP*[43], an employee action against a law firm for housing and public policy violations, the state court further found the FAA does not preempt Massachusetts's law requiring "clear and specific reference" to statutory discrimination claims. Therefore, an arbitration clause that did not "clearly and specifically" refer to statutory discrimination claims as required by Massachusetts law cannot be enforced on those statutory discrimination claims. The court's reasoning was that a choice-of-law clause is interpreted to incorporate the chosen state's law governing the enforcement of arbitration agreements.[44] The court also recognized and distinguished that *Concepcion* determined the FAA preempted California law that class-action waivers in "commercial adhesion contracts were unconscionable as stated in *Discover Bank*."[45]

In *Mendez v. Mid-Wilshire Health Care Center*[46], another employee action, the court held that arbitration agreements in collective bargaining agreements (or CBAs) did not apply to an employee's FEHA claims. The court ruled on a similar basis in *Harris v. Bingham McCutchen, LLP*. The court reasoned a waiver of an employee's right to employment discrimination claims heard in a judicial forum must be "clear and unmistakable" and a court will not infer such an intent to waive unless "explicitly stated."[47]

**c. *Cases where courts found several contractual provisions unconscionable and not severable***

There have been cases where courts held several provisions unconscionable and found severability impossible without destroying the nature of the intended agreement. For example, *Gandee v. LDL Freedom Enterprises, Inc.*[48] and *Brown v. MHN Government Services, Inc.*[49]

In *Gandee v. LDL Freedom Enterprises, Inc.*, a borrower, Gandee, brought a putative class action against a lender, LDL Freedom Enterprises, Inc., alleging violations of the state Debt Adjustment Act and the Consumer Protection Act. Gandee challenged several provisions in LDL Freedom Enterprises, Inc.'s agreement including the venue clause, fee-shifting provision, and statute of limitations provision on the grounds of unconscionability. The court found that Gandee was correct and met the burden in showing the arbitration would be prohibitive and the provisions unconscionable; the challenged provisions were substantively unconscionable under Washington law.

> ***Concepcion* and *Italian Colors Restaurant* don't leave much for consumer attorneys attempting to overcome a class arbitration waiver.**

The court reasoned that *Concepcion*, as applied to the case, is consistent with Washington law and not in conflict. "In Washington, either substantive or procedural unconscionability is sufficient to void a contract."[50] The court's rationale was simple. LDL Freedom Enterprises, Inc. drafted the contract, so naturally the venue would be one advantageous to the drafter. Further, the only party to benefit from the fee-shifting provision (or loser pays provision) would be, again, LDL Freedom Enterprises, Inc., which is contrary to the law's intent and subsequently "chills Gandee's ability to bring suit under the CPA."[51] The statute of limitations provision was also unfair, as the provision shortened the state law 4-year period to 30 days.

*Brown v. MHN Government Services, Inc.*[52] was another Washington case that found a similar result. However, this was not a consumer protection case but an employment-related case. In *Brown v. MHN Government Services, Inc.*, employees, on behalf of themselves and a proposed class, brought an action alleging state law wage claims. Like in *Gandee v. LDL Freedom Enterprises, Inc.*, the court held several provisions, including the arbitration agreement, forum selection provision, statute of limitation provisions, and the fee-shifting provision, unconscionable.[53] The court, unlike in *Gandee v. LDL Freedom Enterprises, Inc.*, also held the arbitrator selection provision was substantively unconscionable.

The court in *Brown v. MHN Government Services, Inc.* saw several provisions as unfair, one-sided, and not severable. However, the court found the arbitration agreement procedurally unconscionable, even though the arbitration agreement lacked procedural oppression unlike in other cases where procedural oppression was present. The court reasoned the arbitration agreement still contained "procedural surprise due to its lack of clarity regarding which set of AAA rules would govern the arbitration."[54]

MHN changed its position several times on which set of AAA rules applied, creating ambiguity in the arbitration agreement.[55] This ruling suggests arbitration must be explicitly clear and that "procedural unconscionability can be present where rules are referenced in an arbitration agreement but not attached."[56]

## III. AFTER *CONCEPCION*, WHAT'S LEFT TO ADMIRE?

*Concepcion* and *Italian Colors Restaurant* don't leave much for consumer attorneys attempting to overcoming a class arbitration waiver, whether the consumer's claims involved statutory of common law violations. But the opinions do leave a small door open, for some questions.

The first issue involves what kinds of cases qualify for class arbitration or class actions under the FAA, if at all. Second, whether an agreement can allow plaintiffs to waive certain issues for individual arbitration and allow plaintiffs to pursue other issues via class claims and class actions via a judicial forum. Finally, the procedural issues that arise from such matters would be another concern, as it is unclear whether a procedural attack would overrule a class arbitration waiver.

**1. *Congressional Mandated Areas*[57]**

Congressional mandated areas could offer limited exceptions in bypassing *Concepcion*'s applicability. For instance, arguably, *Concepcion* does not apply in employment related cases, as evidenced from the NLRB administrative agency ruling in *D.R. Horton* and in the series of California cases, *Samaniego v. Empire Today, LLC* and *Ajamian v. CantorCO2e, L.P.*

In addition, the U.S. Supreme Court has been reluctant to apply *Concepcion* to general international cases. It is important to note there are limited exceptions or instances where the FAA binds international matters. By acknowledging Chapters 2 and 3 of the FAA apply to international arbitration, courts allow limited instances in forcing international parties to arbitrate; these instances include complex matters or where congress provides otherwise.

With the McCarran-Ferguson Act of 1945 enacted years after the FAA, arguably, the FAA neither indicates nor includes the insurance sector within its authority, thus having a 'reverse preemption' effect.[58] In essence, even though the FAA is liber-

ally constructed and construed, the FAA does not preempt state insurance laws.

Recently, in *Scott v. Louisville Bedding Co.*[59], a Kentucky court ruled in favor of a policyholder and held that the FAA did not preempt the state law limiting such arbitration clauses in insurance matters. Another recent case, *Washington Department of Transportation v. James River Insurance Company*[60], accentuated similar reasoning and ruled the FAA did not preempt the state insurance law. Still, this is not the consensus when a matter relates to an international party. Indeed, courts have held that state laws cannot trump treaties or conventions.

Cases such as *ESAB Group v. Zurich Insurance*[61] and *Safety National Casualty Corporation v. Certain Underwriters at Lloyd's, London*[62] emphasized once a foreign party is involved in a matter, then the New York Convention[63] applies. These arguments go to the heart of the Convention, which is to allow an objective means and device for resolution of international disputes or disputes involving international parties. As such, a state law superseding the Convention would cause doubt as to the state and nation as a genuine interest in upholding customary international law and relations. As for now, courts are in conflict as to where the Federal Arbitration Act of 1925, the McCarran-Ferguson Act of 1945 and the New York Convention stand.

### 2. *Negotiation*

The parties may agree to arbitrate and even allow for class arbitration or class litigation methods before or after agreeing to an arbitration agreement.[64] While not surprising, most companys probably would not agree to class arbitration or litigation methods; but it is not difficult to believe a company would agree if the costs would be too burdensome to bear and negative brand reputation would result. Clearly, such a decision or agreement to allow class arbitration would favor the company's financial interests if doing so would equate to lower costs and brand protection. As such, the plaintiffs may be able to use such situations as a bargaining tool.

Consider that *Concepcion*-like clauses have the potential to hide unethical or bad industry practices. Arguably, this would hinder public awareness and exposure of any wrongdoing of a company, as individual arbitration would not yield the same impact as class arbitration or class litigation. There is an increased likelihood of the depletion of the plaintiff's resources. Furthermore, the plaintiffs would not be properly spreading the costs among themselves, and plaintiffs may not receive the benefits of such.

Further, the *Concepcion* ruling has left open the possibility that parties can agree to either arbitrate or litigate on certain issues, while waiving the right to either arbitrate or litigate on other issues, not in violation under federal law (similarly stated under the *Horton* ruling). Essentially, could claimants agree to forego certain claims in arbitration and leave other claims open for litigation? The verdict is unknown.

### 3. *Procedural Attacks & Contractual Defenses*

*Concepcion* has also left open whether procedural defenses, such as substantive and procedural unconscionability, along with traditional contractual defenses, are able to overcome arbitration waiver provisions. *Concepcion* did not directly speak on this issue[65], yet, after *Concepcion*, many court rulings began reversing decisions on the sole fact the FAA preempted any court decision that ruled agreements prohibiting class arbitration or class actions unconscionable and unenforceable. However, very few court rulings or the parties involved focused on the procedural limitations of *Concepcion*.

As mentioned earlier, cases such as *Samaniego v. Empire Today, LLC* and *Ajamian v. CantorCO2e, L.P.* give consumers hope that not all agreements will be treated the same and that the weaker party can prevail in challenging the unfairness and unequal agreement. In those series of cases and thereafter, the weaker parties alleged procedural and substantive unconscionability defenses. Recent cases show that fee-shifting, choice-of-law, statute of limitations or arbitration selection clauses that are unfairly one-sided may be unconscionable. Consequently, if there are several unconscionable provisions, then these provisions may be impossible to sever without changing the entire intent and context of the whole agreement.

## IV. POTENTIAL ABUSES OF POST-*CONCEPCION* RULINGS

### 1. *Companies 10, Consumers 0*

The *Concepcion* court assumed the consumer could find adequate representation and/or could advocate for one's self, especially on complex legal issues. This is not so. Essentially, *Concepcion*'s impact equates to leaving consumers out in the cold, leaving the possibility that consumers and others will not be able to get representation on legal issues. As the dissenting opinion stated in *Concepcion*, very few attorneys would take cases that do not involve a large dollar amount. Thus, this will create a definite and immediate imbalance.

Moreover, even if an attorney takes the plaintiff's case, there are few options in succeeding in bypassing *Concepcion*. This is because not every state's law will specifically allow for setting aside an agreement based on procedural and/or substantive unconscionability issues. Additionally, the same may be true for a state's law that does not provide for similar "clear and unmistakable" or "clear and specific reference" standards as in *Mendez v. Mid-Wilshire Health Care Center* and *Harris v. Bingham McCutchen, LLP*.

### 2. *Loss of Economy*

While not specifically declared, the national practice or view on litigation is that litigation is a minor yet significant part of the economy. With litigation consisting of 2% to 3% of the Gross Domestic Product[66], arguably, litigation will be slowing down soon. Where litigation is complex or specialized, the nation can see billions of dollars placed into this area of litigation. For example, healthcare and international issues often dominate litigation and arbitration practices.

Class actions or other similar actions also contribute to this GDP outlook. So, what does the elimination of the class action mean for the national economy? How would the *Concepcion* ruling affect the national economy disallowing class arbitration and related matters?

Despite *Concepcion*, public policy still supports early and non-court resolution of legal matters, because these methods take up less resources, time and energy. As such, putting aside the uninspiring ruling in *Concepcion*, lower courts and jurisdictions have been encouraged and even mandated in some jurisdictions via state law to resolve disputes early and through non-court resolution methods.

As discussed above, the U.S. Supreme court has not rationalized this issue in any way other than favoring the pro-defendant view disfavoring class arbitration. Unfortunately, courts continue to tussle over whether plaintiffs can pursue class actions or class arbitration. Yet, public opinion would support alternative dispute resolution (ADR) for class actions, because this would ease court congestion and resources. Additionally, any method of ADR helps in balancing the interests of pro-plaintiff and pro-defendant stance in such litigation matters.

### 3. *Bad Consumer Practices and Potential Abuses*

There is no concrete indication yet of the negative consequences of *Concepcion*. Nevertheless, one could foresee and even anticipate industry practices shifting in a company's favor that negatively affects the consumer base.

#### a. *Evading Detection & Liability*

One example would be class waivers in agreements. This has become commonplace and can be used as a method in evading detection of federal monitoring mechanisms in certain industries such as securities and consumer protection. This equals a lack of notice provided to the public of certain negative or unscrupulous business practices that the public and federal government need to know.

With class arbitration, there is a possibility of either flagging or correcting bad industry practices if the public or federal government is aware of such practices. Without the consumer's ability to join into class arbitrations, the industry, public and federal government cannot effectively ascertain, forecast or gauge whether certain trends or practices affect a particular industry or business. Arguably, class actions and related matters show patterns and practices that would trigger the right attention by the proper entities and public to correct and remedy those negative patterns and practices.

#### b. *Consumer Imbalance & Industry Influence*

If the class waiver is neither specific nor interpreted in a different manner, another issue may arise where plaintiff attorneys may not form class matters but combine a smaller number of plaintiffs together.[67] This would overwhelm courts. This also would affect defendants and industries alike, resulting in several large awards to plaintiffs versus one collective award to correct industry practice or business practice.

A *Concepcion* clause might yield favorable results for the defendant and very low or no results for the plaintiff, since the arbitrator would mostly be chosen by the defendant. This also would mean the majority of the arbitrator's business would be dependent upon the defendant and/or the defendant's industry.[68] There is a very unlikely arbitrators would find it favorable to rule in favor of the plaintiff with the possibility of losing business. The question of arbitrator fairness and neutrality would come into play.[69]

With one plaintiff involved in an arbitration process (and most likely without attorney guidance), a plaintiff may neither understand nor know the arbitrator's obligations and the plaintiff's rights; so, error is possible. While appealing an arbitrator's decision may be a likely result, the likelihood that a plaintiff will know and understand this option (even after being provided notice) is low. An appeal may mean wasted time and effort on the plaintiff's part or the arbitration as a whole, and the one-sided agreement may appear to be an extortionate tactic, since the plaintiff may feel either discouraged, overwhelmed or lacking in knowledge and not pursue the appeal. The plaintiff has no choice but to accept the arbitrator's decision.[70]

Moreover, the time between the arbitrator's decision and the appeal may create other issues, such as the defendant's act of evading responsibility and payment of additional damages. In sum, the defendant will get away with significant liability and other violations under the law.

#### c. *Bargaining Power Issues*

The bargaining power is obviously unequal. The plaintiff does not draft the agreement. This would also mean the plaintiff chooses neither the rules nor the arbitrator. This would also raise doubt as to the good faith of the defendant or arbitrator. Possible questionable interests might indicate the exploitation of the plaintiff's vulnerability and lack of resources, knowledge and attorney representation for the plaintiffs. This further displaces the plaintiff's interests and the arbitrator's questionable interests may derail an otherwise successful arbitration.

The drafting of such clauses may be so proliferating that the clauses become abusive. There has been no specific limitation to such waivers, other than the procedural challenges left open from the *Concepcion* ruling. Therefore, *Concepcion* makes such waivers standard and bargained for in certain industries.

*Concepcion* prevents the advocacy and litigation of legitimate consumer concerns plaguing an entire business or industry, which is one of the basic, underlined First Amendment principles, which would be class matters. Consequently, companies have the authority to waive an individual's right to assembly and pursue lawful remedy under the law.

#### d. *Heightened Consumer Scrutiny*

Cases such as *Concepcion* and *AmEx* deemphasize the importance of public policy and create a heightened scrutiny for plaintiffs to overcome the class waiver clause. Essentially, the burden has shifted from the defendant to the plaintiff. The presumption is that class waivers are valid and enforceable, if there is no evidence of procedural error or issue. In fact, most plaintiffs would not be able to prove this procedural error, if the plaintiff's right to assemble and corroborate on evidentiary issues is inhibited.

An unexpected benefit from *Concepcion* is the consumer industry's opportunity to influence the arbitration practice. *Concepcion* keeps the decision-making authority and interpretation of the contractual obligations in the hand of the arbitrator and parties in many ways. Consumer advocates and the consumer industry as a whole may see opportunities to negotiate for better and balanced terms, particularly in the post-agreement phase.

### 4. *Post-Concepcion: Reversals and Errors*

Since *Concepcion*, several courts have reversed lower court decisions to accommodate *Concepcion*. Often, there is little guidance as to what is acceptable under *Concepcion*. This leaves the consumer, legal and arbitral communities to guess whether certain class arbitration waivers are fully enforceable. Therefore, errors are possible in court rulings because of this lack of *Concepcion*'s understanding and its hold on the arbitral community. Notably, error in some court reversals may have occurred due to *Concepcion*'s lack of guidance.

For example, in, *Wolf v. Nissan Motor Acceptance Corporation*,[71] a service member, Mathew Wolf, brought a class action under federal law, Servicemembers Civil Relief Act (SCRA). Wolf, deployed overseas, used a federal law (SCRA) allowing him to return a leased vehicle. The service member asked for the advance payments made under the financing agreement but the company refused to do. Even though the law looked favorable upon Wolf's case and federal law, the court reversed, stating that it had to follow *Concepcion* as it is binding.

It is unclear whether the court in *Wolf* fully understood *Concepcion*'s ruling and reach. The problem in *Wolf* was the lack of clear congressional language within the SCRA allowing for class arbitration or class litigation, despite the law being one providing for special relief. Out of fairness, later cases helped in clarifying that cases involving federal laws and rights and procedural defenses might change a potential *Concepcion*-like result and impact.[72]

*Wolf*'s reversal was, arguably, in error. In closer review, *Wolf* involved a federal law, a congressionally mandated law providing for special relief, arguably outside the FAA. This law came in effect decades after the FAA and specially for bypassing issues like *Concepcion*. The entire intent and spirit of the SCRA arguably sets aside an exception to the FAA, as Wolf's arguments go to the heart of the SCRA, a congressional mandated law.

Additionally, Wolf was pursuing his statutory remedies and rights, seeking to enjoin Nissan from unfair business practices and for the return of his advanced payments. Arbitration (individual

or class arbitration) forecloses the possibility of allowing Wolf to pursue those remedies in a traditional judicial route.

Finally, Wolf is not alone in his legal journey. T decision in *Wolf* also affects an entire class of people with similarly woes as Wolf. Ultimately, by disallowing a class action or class arbitration, *Wolf* prejudices a protected class of individuals under the SCRA. No service member would have the time, effort or ability to pursue an individual claim for relief. As such, class action or class arbitration would be the most effective and feasible method as envisioned under the SCRA.

*Wolf* is one case, arguably, in error. However, this case calls into question how many other cases have been reversed in error per *Concepcion*, based on the sole fact that the FAA preempted any court decision that ruled agreements prohibiting class arbitration or class actions unconscionable and unenforceable.

## V. RECOMMENDATIONS: SOLUTIONS TO *CONCEPCION*

Trends suggest that business practices might change. A possible benefit of this change is that businesses and the consumer industry may see a balancing of the equities in consumer agreements. If this were to happen, it could help resolve the problem of class action waivers by providing consumers with sufficient bargaining power at the time of contracting. In reality, however, this is unlikely, and here are some additional possible solutions to the problems cretaed by *Concepcion.*These alternatives include: (1) renegotiation for class arbitration and/or allow arbitrator to interpret the contractual language on whether class arbitration is possible; (2) filing a motion to compel class arbitration and/or requesting injunctive relief and declaratory relief to determine the clause or agreement's applicability; (3) court-developed alternatives; and (4) congressional intervention in creating statutory law making situations like *Concepcion* unconscionable and not favored under current law.

Congressional intervention is a final alternative and may offer the best solution for consumers.

### 1. *Renegotiation*

Renegotiation may be an option for some consumers. Although companies may not see any benefit in renegotiating, every situation is not be the same. As a result, a company may see some benefit in renegotiating and allowing class arbitration if the costs are reduced or lessened. Moreover, the company may avoid losing brand reputation and standing by agreeing to the renegotiation, which could prevent individual claims going before a court to determine the validity of an agreement (exposing certain practices to the world).

Where the opportunity for renegotiation arises, with the help of his or her attorney, the plaintiff's bargaining power could shift for the better. Renegotiation for the allowance of varied ADR methods for different matters and looking to state law and public policy are other approaches. This approach recognizes there are other methods in resolving conflicts that are invaluable to industries seeking to minimize the financial liability owed to the plaintiffs and others.

It is unreasonable to assume most companies will negotiate a new and fair agreement for many consumer and transactions. It is reasonable, however, for a consumer to try the renegotiating approach, as the consumer would lose nothing. This could help in equalizing bargaining power.

### 2. *Court Intervention Tools: Motions to Compel, Injunctive Relief and Declaratory Relief*

There may be reluctance in certain fields to allow class matter practice due to other mechanisms and tools that alert the public and government of these practices, such as whistleblower laws. However, courts and society cannot rely upon whistleblower actions as definitive methods in policing these areas and suspect practices for we have seen instances where business can silence the voice of the whistleblower. In some cases, class action lawsuits may be the only way in which to bring about change and attention to certain issues.

By tradition, defendants in *Concepcion*-like cases request the court to compel individual arbitration. However, nothing prohibits the plaintiff from requesting a similar action, i.e., compelling class arbitration.[73] Consumers diligent in getting the matter properly handled can institute actions such as motions to compel class arbitration and a demand for class arbitration and injunctive and declaratory relief via asserting contractual defenses and other applicable theories under the law. Bringing such an action based on contractual defenses like procedural and substantive unconscionability can get the court's attention in considering whether the court should review the issues and whether the arbitration provision is fair, equal and bargained for.

### 3. *Court-Developed Alternatives*

Courts can use a self-developed alternative to bypass the *Concepcion* ruling or theory altogether, which some courts have done in avoiding the unfair results from *Concepcion*. This essentially involves public policy considerations. When a plaintiff brings anti-class arbitration and litigation clauses to the court's attention and there is some reason to believe that the legal claims or practices are a part of an industry standard that is not acceptable or damaging, there must be a higher level of scrutiny placed on the drafter.

Questions in this court-developed alternative could touch upon: (1) foreseeability (2) incidence (3) intent (4) effects (5) commonality (6) finality (7) conflicts and (8) public policy.[74] These factors are consistent regardless if the court's decision will approve or deny the class arbitration. Economy and public policy are the primary concerns for any alternative.

### 4. *Congressional Intervention*

Congressional intervention is a final alternative and may offer the best solution for consumers. Legislatively, there have been congressional responses to address inequities and imbalances created by certain laws or court rulings. Examples would include the congressional response to *Banco Nacional De Cuba v. Sabbatino*[75] and a line of expropriation cases at that time. In *Banco Nacional De Cuba v. Sabbatino*, the U.S. Supreme Court held that the expropriation did not violate international law, as there was a presumption of the validity under the Act of State Doctrine. Congress, however, responded enacting laws removing this presumption via the Second Hickenlooper Amendment[76] (or known as the Sabbatino Amendment).

It seems unlikely, however, that Congress will enact a general prohibition on consumer arbitration. This is not to say it has not had numerous opportunities. As in years past, the Arbitration Fairness Act, prohibiting forced arbitration in consumer contracts, has been introduced in both the House[77] and the Senate.[78] And, just as in years past, there is little likelihood of passage.

At the federal level, the most likely source of reform from oppressive forced arbitration clauses is action by the newly created Consumer Financial Protection Bureau [CFPB]. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, enacted in response to the financial crisis of 2007-10, created the CFPB.[79] Section 1028(a) of the Act instructs the CFPB to study "the use of agreements providing for arbitration of any future dis-

pute . . . in connection with the offering or providing of consumer financial products or services," and to provide a report to Congress on the same topic. Congress has given the CFPB the authority to limit or prohibit the use of forced arbitration in consumer financial contracts, based on the results of its study.

The CFPB issued its report in March of 2015.[80] To the surprise of few consumer advocates, the Report indicated that arbitration agreements restrict consumers' relief for disputes with financial service providers by precluding lawsuits and limiting class actions. The report found that, in the consumer finance markets studied, very few consumers individually seek relief through arbitration and the courts, while millions of consumers obtain relief each year through class action settlements.[81] It is hoped that in light of the findings of the Report, the CFPB will take steps to eliminate forced arbitration in consumer financial transactions.[82] Of course, any action taken by the CFPB is limited to consumer financial transactions.

## VI. CONCLUSION

*Concepcion* and its progeny create a chilling effect on attorneys representing individuals injured from certain suspect business practices, because adequate attention and relief through a class is nearly impossible. In many instances, the only way these practices are economically and efficiently redressed is through the class action route.

Consumers play a valuable role in policing the fairness and ethics of certain business practices and laws. *Concepcion* essentially allows businesses to avoid liability and (even if unintentional and not foreseeable) hide questionable business practices, which could be detrimental and devastating to individual consumers as well as our economy.

Time will tell if *Concepcion* has an impact in one industry or another. Until then, the consumer population must use the tools available to them, which generally will not include judicial class actions or class arbitration. What *Concepcion* offers is an unexpected opportunity for consumers and the arbitration industry to reevaluate the various relationships with businesses.

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1 AT&T Mobility, LLC v. Concepcion, 563 U.S. 333, 31 S.Ct. 1740 (2011).
2 Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).
3 *Id*. at 1103.
4 *Id*.
5 Szetela v. Discover Bank, 118 Cal. Rptr. 2d 862 (2002).
6 *Id*.; *see also* 9 U.S.C. § 2.
7 *Discover Bank*, 113 P.3d at 1100.
8 *Id*. at 1109-1111.
9 *Id*.
10 *Concepcion*, 131 S. Ct. at 1742.
11 *Id*. at 1749.
12 *See Id*. at 1762, n. 5.
13 *Id*.
14 *Id*. at 1749.
15 Coneff v. AT&T Corp., 673 F.3d 1155 (9th Cir. 2012). *See also* Sanchez v. Valencia Holding Co., LLC, 353 P.3d 741 (Cal. 2015).
16 *Id*.
17 Mitsubishi Motors Corporation v. Soler Chrysler-Plymouth, Inc 473 U.S. 614 (1985).
18 Green Tree Financial Corp. v. Randolph, 531 U.S. 79 (2001).
19 *Id*. Plaintiffs argued Washington law would rule such waivers unconscionable and unenforceable.
20 It is interesting to note plaintiffs also raised procedural unconscionability arguments, which is a valid defense to contract formation. The issue was there were questions as to what law control (Missouri or Washington). The court also noted that some states required both procedural and substantive unconscionability issues to be present in order to effective object and make one's burden in the invalidity of such agreements. Here, Washington's law was unsettled as to whether both procedural and substantive unconscionability issues must be present in a contract dispute. *Concepcion* also leaves open this question, thus never thoroughly addressing and examining this area.
21 *See also,* American Express Co., et. al. v. Italian Colors Restaurant, 133 S.Ct. 2304. The court closes off the possibility that asserting federal law rights, post-*Concepcion*, would protect consumers facing a *Concepcion*-like clause. This was not the case in *American Express* as federal law violations were alleged and the court still held *Concepcion* applied.
22 Stolt-Nielsen v. AnimalFeeds Int'l Corp., 559 U.S. 662 (2010).
23 *American Express, Co*. 133 S.Ct. 2304.
24 It is interesting to note that in the *American Express* line of cases, the Second Circuit consistently held its ground in stating that the *Concepcion* ruling did not apply in the *American Express Merchants' Litigation*. Its sole reasoning rested upon Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985), where the U.S. Supreme Court held that parties may agree to arbitrate on certain issues rather than litigate those issues "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum."
25 Before American Express, Co., et.al. v. Italian Colors Restaurant, the legal community believed federal violations and laws such as anti-trust implications would fall outside *Concepcion*'s reach. However, it did not. In fact, *Concepcion*'s ruling had the opposite effect. The dissenting opinion in American Express Co., et.al. v. Italian Colors Restaurant, No. 12-133, Slip Op. at 15, highlights: "As a result, Amex's contract will succeed in depriving Italian Colors of any effective opportunity to challenge monopolistic conduct allegedly in violation of the Sherman Act. The FAA, the majority says, so requires. Do not be fooled. Only the Court so requires; the FAA was never meant to produce this outcome. The FAA conceived of arbitration as a "method of resolving disputes"—a way of using tailored and streamlined procedures to facilitate redress of injuries. *Rodriguez de Quijas*, 490 U. S., at 481 (emphasis added). In the hands of today's majority, arbitration threatens to become more nearly the opposite—a mechanism easily made to block the vindication of meritorious federal claims and insulate wrongdoers from liability. The Court thus undermines the FAA no less than it does the Sherman Act and other federal statutes providing rights of action. I respectfully dissent."
26 *See, e.g.,* Coneff v. AT&T Corp., 673 F.3d 1155 (9th Cir. 2012)
27 While these two cases are not the only cases rejecting *Concepcion*'s broad ruling, these are significant as it yields from the same state interpreting similar contractual issues. In fact, *Figueroa v. THI of New Mexico at Casa Arena Blanca LLC*, 306 P.3d 480 (N.M. App. 2012), the New Mexico Court of Appeals found the unconscionability analysis of an arbitration agreement was not preempted by the FAA and the arbitration agreement at hand was unreasonably and unfairly one-sided, therefore, making it unenforceable. Figueroa reasoned, "if state law governs issues concerning the validity, revocability, and enforceability of contracts generally, that law's application to arbitration agreements is not preempted by the FAA." *Id*. at 484. The court also recognized

the New Mexico Supreme Court invalidated arbitration agreements that were unfairly and unreasonably one-sided in favor of the drafter in *Cordova*, 2009-NMSC-021, ¶ 4, 146 N.M. 256, 208 P.3d 901.

[28] Samaniego v. Empire Today LLC, 140 Cal. Rptr. 3d 492 (Cal. Ct. App. 1st Dist. 2012), review denied (July 11, 2012).

[29] Ajamian v. CantorCO2E, L.*P.,* 137 Cal. Rptr. 3d 773 (Cal. Ct. App. 1st Dist. 2012).

[30] *Samaniego*, 140 Cal. Rptr. 3d at 502. "Concepcion addresses whether the FAA preempts the Discover Bank rule. (131 S.Ct. at p. 1746.) The United States Supreme Court held that it does, because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." (Id. at p. 1748.) But at the same time as the Court repudiated the categorical rule in Discover Bank, it explicitly reaffirmed that the FAA "permits agreements to arbitrate to be invalidated by 'generally applicable contract defenses, such as fraud, duress, or unconscionability,' [although] not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue." (*Id*. at p. 1746, 30 Cal.Rptr.3d 76, 113 P.3d 1100; 9 U.S.C. § 2; see Mission Viejo Emergency Medical Associates v. Beta Healthcare Group (2011) 197 Cal.App.4th 1146, 1158, fn. 4, 128 Cal. Rptr.3d 330.) In short, arbitration agreements remain subject, post- Concepcion, to the unconscionability analysis employed by the trial court in this case."

[31] *Ajamian*, 137 Cal. Rptr. 3d at 796. "Where there is no other indication of oppression or surprise, the degree of procedural unconscionability of an adhesion agreement is low, and the agreement will be enforceable unless the degree of substantive unconscionability is high. …" In *Figueroa*, the court highlighted "if there is a combination of both procedural and substantive unconscionability, there is no absolute requirement under New Mexico law that both must be present to the same degree or that they both be present at all. See *Figueroa*, 306 P.3d 480 at 489. This signifies that state law may control and will definitely vary in unconscionability defenses.

[32] Other distinctions are clear and may help to shed light on additional issues. In both cases, the courts found California law was applicable and a lack of "clear and unmistakable evidence" the parties intended to delegate authority to the arbitrator rather than the court in deciding issues such as unconscionability. See *Ajamian*, 137 Cal. Rptr. 3d 773 (Cal. Ct. App. 1st Dist. 2012).

[33] D. R. Horton, Inc. and Michael Cuda. Case 12–CA–25764 (January 3, 2012, Decision and Order); note that D.R. Horton, Inc. has appealed this decision to the Fifth Circuit. *See note 37* infra.

[34] *Id.* at 12.

[35] *Id.* at 2.

[36] *Id.* at 12.

[37] D.R. Horton, Inc. v. National Labor Relations Board, 737 F3d 344 (5th Cir. 2013).

[38] Flemma v. Halliburton Energy Services, Inc., 303 P.3d 814 (N.M. 2013).

[39] Chavarria v. Ralphs Grocery Company, 2013 WL 5779332 (C.A.9 (Cal.))

[40] *Flemma*, 303 P.3d at 820.

[41] *Chavarria*, 2013 WL 5779332 at 4.

[42] *Id.* at 5.

[43] Harris v. Bingham McCutchen LLP., 214 Cal. App. 4th 1399 (2013).

[44] *Id.* at 1407.

[45] *Id.*

[46] Mendez v. Mid-Wilshire Health Care Center, 163 Cal. Rptr. 3d 80 (2013).

[47] *Id.* at 86.

[48] Gandee v. LDL Freedom Enterprises, 176 Wash. 2d 598 (2013).

[49] Brown v. MHN Government Services, Inc., 178 Wash. 2d 258 (2013).

[50] *Gandee* , 176 Wash. 2d at 603.

[51] *Gandee*, 176 Wash. 2d at 606.

[52] *Brown*, 178 Wash. 2d 258 (2013).

[53] It is important to distinguish this case from *Gandee*, as the court in *Brown.* held that the arbitration agreement was procedurally unconscionable under California law.

[54] *Brown*, 178 Wash. 2d at 267.

[55] *Id.* at 268.

[56] *Id.* at 268.

[57] It is important to note that *Concepcion* does not affect public enforcement litigation. Such parties may bing claims on behalf of a large group of people. History, tradition and legislation recognize this in areas of employment litigation and consumer protection.

[58] *See* Mutual Reinsurance Bureau v. Great Plains Mutual Reinsurance Company, 969 F. 2d 931 (10th Cir. 1992)

[59] Scott v. Louisville Bedding Co., 404 S.W.3d 870 (Ky. App. 2013).

[60] State of Wash. Dep't. of Transp. V. James River Ins. Co., 292 P.3d 118 (Wash. 2013).

[61] ESAB Grp., Inc. v. Zurich Ins., 685 F.3d 376 (4th Cir. 2012).

[62] Safety Nat'l. Cas. Corp. v. Certain Underwriters at Lloyds, London, 587 F.3d 714, 720 (5th Cir. 2009) (*en banc*).

[63] Formally known as the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. See 9 U.S.C. §§ 201-208. In 1990, this Convention saw an addition of a third chapter: the Inter-American Convention on International Commercial Arbitration of 1975 (or the Panama Convention). See also 9 U.S.C. §§ 301-307.

[64] Section 2 of the FAA provides that both pre-dispute agreements and post-dispute agreements fall within its scope. Therefore, such agreements are "valid, irrevocable and enforceable" subject to a defense under contract law or in equity. 9 U.S.C. §2 (2000).

[65] The *Concepcion* ruling hinted to this and the plaintiffs in *Coneff* and other cases even made intelligent arguments there were procedural unconscionability issues presented. Clearly, this possibly may create a state law issue of sorts. However, few courts have been effectively able to articulate this issue opposite the *Concepcion* ruling.

[66] Tillinghast-Towers Perrin, Tort Cost Trends: An International Perspective (1995).

[67] This is the case with a recent 2011 class action certification ruling in Walmart v. Dukes, 131 S.Ct. 2541 (2011), an employment discrimination suit. The court disallowed the class certification in its current form, as the class was too broad. Attorneys for the consumers could not pursue a class action in any form, forcing the attorneys to pursue smaller numbers of consumer claims at a time.

[68] Symeon Symeonides, *Choice of Law in the American Courts in 2011: Twenty-Fifth Annual Survey,* The American Journal of Comparative Law, Volume LX, Number 2 (2012)

[69] *Id*. Symeonides provides two excellent examples on this issue. (1) "an arbitrator with an arbitral organization decided nineteen cases in favor of a particular credit card business and then one in favor of the consumer; this was the last referral that the organization made to the arbitrator" (2) "In 2009, the National Arbitration Forum (NAF), a private arbitration provider focusing on consumer debt cases, withdrew from that market after being used in two lawsuits: (a) one by San Francisco's city attorney, charging

that NAF was running an 'arbitration mill' favoring credit card companies and that "of 18,075 credit card cases heard over several years, consumers won thirty times" and (b) another suit by Minnesota's attorney general, charging that NAF shared a common owner with one of the country's largest debt collection agencies."

70 *Id.*

71 Wolf v. Nissan Motor Acceptance Corp., 2011 WL 2490939 (D.N.J. June 22, 2011).

72 This case denotes that denying service members under federal law asserting their federal right to proper relief and remedy would equate to consumers having a similar fate. What this means for creditor rights is that creditors can legally discriminate and create policies, practices and agreements that contradict public policy.

73 For consumers who ban together and the attorneys that represent them, motion practice would be an interesting solution to *Concepcion*, as companies may be faced with additional liability, expenses and exposure of certain practices some companies may not want visible or on record. This is especially interesting if the plaintiffs win on their motions. Attorney fees, damages, injunctive and/or declaratory relief, and/or eventual class arbitration could be the reality the defendant faces.

74 *Foreseeability*: Whether certain legal claims or practices complained of were foreseeable?
*Incidence*: Whether or not certain practices incidental and limited in scope as to not frequently occur?
*Intent*: Whether or not the practices are intentional or unintentional?
*Effects*: Whether or not the practice substantially impacts an entire industry, commerce or consumer confidence?
*Commonality*: Whether or not there is commonality among other claimants?
*Finality*: Whether or not there is finality via individual resolution or class resolution methods?
*Conflicts*: Whether or not there are any conflicts that could impede upon the parties' interests or destroy the harmony in a potential class matter?
*Public Policy*: Whether or not there are clear and acceptable public policy considerations that supersede the clause?

75 Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964). In the series of these expropriation cases, Cuba nationalized its sugar industry and seized all the assets of U.S.-owned sugar products. It is important to note, during that time, there was major political and international conflict involving Cuba's actions.

76 22 U.S.C. § 2370

77 Arbitration Fairness Act of 2015, H.R. 2087, 114th Cong. (2015).

78 Arbitration Fairness Act of 2015, S. 1133, 114th Cong. (2015).

79 *See* 12 U.S.C. § 5511 (Dodd-Frank Act § 1021) ("The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.").

80 CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS, PURSUANT TO DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 1028(A) (2015), http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

81 A summary of the Report may be found at, http://files.consumerfinance.gov/f/201503_cfpb_factsheet_arbitration-study.pdf.

82 Those opposed to consumer arbitration have already taken steps to prevent the CFPB from prohibiting forced arbitration in consumer arbitration. Congressmen Steve Womack (AR-3) and Tom Graves (GA-14) have written an amendment to an appropriations bill that would require the CFPB begin all over again with its studies before taking any action, http://op.bna.com/bar.nsf/id/jbar-9xlp9s/$File/amend.pdf

# Too "Qualified" or Not "Qualified" Enough?

## Criticism and Suggested Reforms to the Currently Ineffective "Qualified Mortgage" Standards

By Amanda Brett Ethridge*

## I. Introduction

The Mortgage Reform and Anti-Predatory Lending Act of 2010[1], is one of the latest regulations enacted by the Consumer Finance Protection Bureau ("CFPB"), as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] ("the Dodd-Frank Act").[3] The Mortgage Reform and Anti-Predatory Lending Act ("the Act") also functions as Title XIV of the Dodd-Frank Act, and the Act became effective on January 10, 2014.[4] This highly influential mortgage underwriting rule significantly updated existing provisions of the Truth In Lending Act[5] ("TILA") and principally requires residential mortgage lenders to thoroughly determine through vigorous verification that prospective borrowers have the financial ability to repay their home loans.[6]

The general topic of this article is past and present predatory lending practices by financial institutions in the residential mortgage context. More specifically, it will address the sub-topic of mortgage safety and soundness standards under the recently imposed "qualified mortgage" regime of the new regulatory environment created by the Mortgage Reform and Anti-Predatory Lending Act of 2010. As related to the general topic and sub-topic, the article will set forth and analytically develop the theme that in its current state, the Act's "qualified mortgage" standards will likely provide ineffective results, rather than fulfilling its intended purpose of accurately assessing the creditworthiness and financial "ability to repay" of applicant consumer borrowers.

The Mortgage Reform and Anti-Predatory Lending Act  was passed in response to growing concern that bold action needed to be taken to combat system-wide predatory lending practices and protect consumer borrowers nationwide, with the hope of stimulating and reviving the entire United States economy and financial markets.[7] Excessive predatory lending in residential mortgage loan transactions, along with gross oversight and regulatory failure, served as the root of the Global Financial Crisis, which ultimately caused and contributed to the Great Recession.[8] Counteracting these negative consequences of the predatory lending of the past is crucially important because the United States mortgage market has roughly $9.9 trillion in mortgage loans outstanding, making it the largest single consumer market for consumer financial products and services.[9] When the securitized housing mortgage market imploded in 2008, the rest of the economy collapsed along with it because of its overwhelming size and influence.[10]

The Mortgage Reform and Anti-Predatory Lending Act specifies the requirements for and defines the term "qualified mortgage."[11] Lenders prefer to have their residential mortgage loans deemed "qualified" because it serves to protect them in the future in the event that a consumer borrower should default and attempt to sue the lender for rescission under TILA due to alleged predatory lending practices.[12] Also, lenders desire to extend "qualified mortgages" because they can repackage them through securitization and sell them for higher prices than non-qualified mortgages because "qualified mortgages" are a safer investment associated with less risk, which makes them more valuable.[13] While the Act was an important, good faith first attempt by the CFPB to fulfill its duty assigned by the Dodd-Frank Act of battling predatory lending tactics, the Act has many loopholes and inconsistencies. The Act does impose more significant requirements for lenders to comply with than existed in the critical years leading up to the Global Financial Crisis, but the Act is inadequate in its current form to sufficiently guard consumer borrowers against some residential lenders that seek to conceal their predatory behavior under the guise of a "qualified mortgage."[14] Many provisions that seem strict at first glance need only be complied with for the first few years of a home loan.[15] After the initial years, a lender is free to impose excessive interest rates or raise the consumer borrower's monthly payment to an unsustainable level, which would likely lead the borrower into default and inevitably foreclosure.[16]

Although there is still considerable room for improvement, the CFPB's recent statutory standards and regulations on lending in secured residential credit transactions have reached levels of specificity never before seen in federal lending regulation.[17] However, the criticism should mostly outweigh the admiration, in large part because the Act contains significant gaps in coverage and is not as groundbreaking as one might originally think.[18] This is partly due to the fact that after being burned by the financial meltdown that took place starting in 2008 because of their prior predatory lending behavior, lenders naturally altered their practices and procedures to become more conservative and less risky, even before the Act was finalized, let alone made official.[19] The "qualified mortgage" standard is a step in the right direction by the CFPB, but as it currently stands, it needs meaningful revision to accomplish its underlying purpose.

**The Mortgage Reform and Anti-Predatory Lending Act of 2010[1], is one of the latest regulations enacted by the Consumer Finance Protection Bureau.**

Part II of this article sets the stage with a historical background and development of the egregious predatory lending that occurred in the residential mortgage industry in the context of the Global Financial Crisis. Part III examines the Dodd-Frank Act in relation to residential mortgage loans and predatory lending, while Part IV critiques provisions of the substantive "qualified mortgage" standards of the Mortgage Reform and Anti-Predatory Lending Act of 2010. Finally, Part V provides the author's conclusion that the current CFPB "qualified mortgage" standards are inadequate to completely satisfy the Act's underlying purpose, and offers recommendations and reforms to the existing regulations.

## II. The History of Predatory Residential Mortgage Loans in the Global Financial Crisis

The Global Financial Crisis was a systemic crisis that affected the entire world, the first of its kind in the United States since the 1930's.[20] Entire segments of the credit and lending markets all over the world ceased to function for longer than one month.[21] The Global Financial Crisis ultimately unraveled in 2008, and its devastating consequences altered the course of the financial markets, the securities and derivatives markets, and especially the economic futures of its survivors all around the world forever.[22] The Global Financial Crisis was fundamentally the product of the increasing aggregate effect of poorly made decisions and unwise business strategies.[23] Some of the key origins of the failure included "excessive borrowing, excessive lending, and excessive investment incentivized by a series of significant economic and regulatory factors."[24]

### A. Securitization

In addition to the excessive borrowing and excessive lending to mass numbers of unworthy debtors, securitization was another key factor affecting predatory lending in the Global Financial Crisis.[25] Securitization is a "transaction structure in which loans (such as loans secured by residential real estate – i.e., mortgages) are pooled together ("repackaged") as collateral underlying

the issuance of securities, predominantly debt securities."[26] "Pooling" works by helping to achieve a greater level of diversity for any particular investor's portfolio of assets when the risks of each loan collected and put into the pool are uncorrelated.[27] These pooled groups of mortgages were used to back securities called collateralized debt obligations ("CDOs")."[28] Basically, these mortgage-backed securities were combined in special purpose vehicles[29] ("SPVs") that were divided into slices or "tranches" based on the level of their exposure to default.[30] The predatory borrowing and lending tied into securitization based on the underlying fact that the securitization affected all kinds of asset classes, but it most directly occurred in the market for subprime residential mortgages in the United States, where it produced and led to overwhelmingly destructive systemic results.[31] "Systemic risk" is defined as: "the risk that an event will trigger a loss of economic value or confidence in, and attendant increases in uncertainty about, a substantial portion of the financial system that is serious enough to quite probably have significant adverse effects on the real economy."[32]

**B. Subprime Mortgages**

These "subprime mortgages" were associated with higher interest rates than a prime rate and were extended in extremely large quantities to low-income borrowers, associated with higher risk, who sought to purchase residential property to become a homeowner, often for the first time.[33] The borrowers were deemed "subprime" due largely in part to their exceedingly poor credit and below average credit histories.[34] Correspondingly, a "subprime mortgage" is defined as a loan to a borrower of either questionable, undetermined, or unsatisfactory credit quality.[35]

Subprime mortgages were residential mortgages either guaranteed, issued, and/or purchased by the Federal National Mortgage Association ("FNMA" also known as "Fannie Mae") and the Federal Home Loan Mortgage Corporation ("FHLMC" also known as "Freddie Mac"), which essentially function as government-created secondary markets for commercial banks and other mortgage lending institutions of many variations to sell residential mortgages.[36] Leading up to the financial credit crisis of 2008, Fannie Mae and Freddie Mac purchased, packaged, securitized, and resold residential mortgages in the form of mortgage-backed securities with a federal guarantee that the principal and interest payments would be repaid to investors, therefore, earning a profit on the difference between the price of the mortgage-backed securities and their original cost of funding.[37] At the heart of the issue here is the fact that FNMA and FHLMC predatorily decreased their underwriting and due-diligence standards for qualifying mortgages and mortgage-backed securities.[38] But the blame was not on these agencies alone.[39] After the dust settled, the Federal Housing Finance Agency ("FHFA"), the conservator of FNMA and FHLMC, sued seventeen of the country's largest banks to recoup $196 billion that Fannie Mae and Freddie Mac had spent purchasing mortgage-backed securities from these large banks.[40]

Subprime mortgage-backed securities, with their relatively simple securitization and sale processes, were not the only problematic structured finance tool responsible for the Global Financial Crisis.[41] Increasingly, financial engineers continued to develop complex financial investment structures known as structured investment vehicles ("SIVs") and conduits, collateralized loan obligations ("CLOs"), synthetic securitizations, CDO squared ("CDO$^2$"), and synthetic CDOs.[42] These structured finance tools were made possible through the use and technology of off-balance sheet accounting structure, capital markets funding, over-the-counter derivatives, and credit-default swaps ("CDSs").[43] A "CDS" is:

> [A] bilateral derivative transaction, which may be seen as a type of protection against default of a synthetic loan. In essence the seller of a CDS agrees to pay the buyer if a credit event occurs, typically some sort of default by an unrelated borrower. The buyer of the CDS agrees to pay the seller a stream of payments roughly equivalent to the payments that would be made by the identified but unrelated borrower. As such, the seller of the CDS receives a stream of payments which mimic a loan.[44]

Another way to look at a CDS is that it is a form of debt insurance.[45] The entire financial derivatives investing market, especially with the mass amounts of the pooled and securitized residential mortgage-backed securities distributed, became an alphabet soup of confusion to potential investors.

**C. The Bubble Finally Pops**

Near the end of 2006, the culmination of the financially engineered mortgage-backed securities was gearing up to become the perfect economic storm.[46] At this time, the United States, along with several other Western hemisphere countries, was enjoying the many benefits of high real estate prices that turned out to be unsustainable over the long term.[47] It was a time period of unparalleled low and stable inflation rates.[48] Some economists and other experts on the Great Recession[49] have even classified the Global Financial Crisis as "an accident waiting to happen."[50] During this period, there were uncharacteristically low risk spreads for most classes of assets, the volatility of the market was unusually low and stable as well, [51] and the United States housing real estate prices were steadily increasing, creating an unyielding, widespread belief that home prices would likely continue to appreciate forever without limit and would undoubtedly never depreciate in value.[52]

It seems as if the major banks that were selling the pooled mortgage-backed securities chose to take advantage of this conjecture and decided they could afford to become extraordinarily leveraged. These decisions were deemed reasonable at the time because even if some unworthy borrowers would almost certainly default on their home mortgages, there would always be more "homeowners" to take out additional residential home loans in pursuit of the American dream. The bank could continue making money on the interest by perpetuating this cycle. This scene set the perfect stage for a strong period of growth and prosperity, cultivated by complacency, ignoring many of the warning signs, and dangerous risk-taking.[53] The heads of the national banks reassured themselves that their strategy would produce positive results overall because the individual property markets in America would rise and fall independently of each other, but that proved to be entirely untrue.[54] Instead, beginning in 2006, the United States began to suffer a nationwide housing price slump.[55]

When the national financial system finally caught up with the compounding of the numerous poor decisions, industry-wide complacency, and unsustainable amount of leverage that banks were attempting to carry in a domino effect catastrophe, the stock market crashed, and the residential housing market bubble inevitably popped.[56] For a bank to be highly leveraged[57], it means that the bank is employing the use of credit to enhance its speculative capacity, or that it is using borrowed capital for an investment, while expecting and betting that the amount of profits made on the underlying investment is greater than the amount of interest payable on the borrowed capital.[58] If the opposite ends up being true, meaning that the profits (or losses) made on the underlying investment is less than the amount of interest payable on the borrowed capital, the bank is in trouble and has probably attempted to sustain a level of leverage beyond its means.[59] This

extremely unfortunate underwater situation was agonizingly real for millions of "homeowners."[60] The investment banking institutions could have eased the epic downfall of the market, or quite possibly prevented it altogether, if they had lowered their maximum loan-to-value ("LTV") ratio by requiring a higher percentage down payment from consumer borrowers when they were applying for a mortgage.[61] The regulators also could have required that the banks set aside more capital for a rainy day emergency fund and maintain greater percentages of fractional reserves.[62] But neither did.

This triggered a downward spiral and led to record high numbers of unemployment and the loss of many hard-working Americans' life savings, which they intended to rely on for support during their retirement years.[63] It is safe to say that the worldwide credit crisis of 2008 produced long-lasting consequences for the future of global and international finance and permanently reshaped the world of investing.[64] Another key factor surrounding the Global Financial Crisis was that the industry leaders in asset investment ratings firms misclassified the subprime mortgage-backed securities and other structured financial derivatives as being much "safer" and less risky than they actually were.[65] It is often assumed that at least part of the misclassification was due to ignorance and part was due to failure to adequately monitor.[66] The ratings agencies have been widely criticized for slow reaction to deteriorating credit risks, rapid reappraisals, and an asymmetric view of credit improvements and declines.[67]

**D. Oversight Failure By the Ratings Agencies**

Investors purchased these mortgage-backed securities and other CDOs that they associated with less risk because they trusted in the fact that they had "AAA" credit ratings assigned by the most dependable credit ratings agencies with the longest-standing historical accuracy and the best reputations.[68] Standard and Poor "AAA," meaning "prime" and having an "extremely strong capacity to meet financial commitments" is the highest credit rating an asset, security, or option can receive from this agency.[69] "BBB-" designates the lowest possible rating that is still considered "investment grade" by market participants.[70] Any class of assets that does not meet the standard to be considered "investment grade" is instead referred to as "junk."[71] Also, it is important to note that any rating from "AA" to "CCC" may be modified in rating slightly up or slightly down with the addition of a plus (+) or (-) sign displayed within the major rating categories.[72] However, Standard and Poor reminds potential investors that their credit ratings are not indicators of investment merit.[73] "Ratings are not buy, sell, or hold recommendations or a measure of asset value."[74] They are not intended to recommend the suitability of an investment because it depends on the individual investor's portfolio and desired risk premium.[75] The central ratings agencies involved in this disaster were Moody's and Standard and Poor.[76]

Many of the executives at the credit ratings agencies felt compelled and obligated to provide a positive and confident assessment of these creatively engineered financial derivatives.

These credit ratings agencies, commonly known as Moody's and S&P, were paid directly by the banks that created and financially engineered the mortgage-backed securities in question.[77] Therefore, many of the executives at the credit ratings agencies felt compelled and obligated to provide a positive and confident assessment of these creatively engineered financial derivatives because the banks were essentially their customers.[78] These agencies rated the mortgage-backed securities and other structured finance tools as prime or "AAA," which is the same rating as many bonds and investments issued by the United States Treasury or state and local municipal bonds that are thought of as being completely risk free, when in reality the mortgage-backed securities could have been more accurately rated as very risky and "subprime" or "junk."[79] The prime ratings gave investors a very false sense of security when spending significant portions of their savings on these securities that ended up being not only extremely risky but entirely worthless.[80] Investors even went so far as to seek out these "prime" mortgage-backed securities because of the higher than average returns that they were associated with.[81] Investors probably should have known that this arrangement was too good to be true when they were receiving higher than average returns with supposedly less risk. But the possibility of substantially higher profits trumped reason.

Following the unraveling of the many aspects of the interconnected financial markets and the stock market crash, many Americans were left with their retirement accounts and mutual fund accounts virtually depleted, creating widespread panic.[82] After every crash of the United States economy, slowly but surely the market eventually recovers, but some of the ones hit hardest in this particular recession were the elderly who did not have the years necessary to wait for their financial holdings to recover.[83] Because of the panic multiplying exponentially each day, many elderly Americans pulled their money out of their investments in an attempt to hoard cash as the stock market was still on its way down, which is a grave common mistake of casual investors.[84] This drove the stock market further and further down in value as trust in the system rapidly declined and nearly disintegrated.[85]

**E. Major Financial Institution Failures**

In March 2008, the first major casualty of the economic meltdown was Bear Stearns, the fifth largest United States investment bank and "the one with the least diversified business and the greatest direct involvement in debt capital markets."[86] Its fundamental problem centered on severe but disguised liquidity issues, even though Bear Stearns appeared to be fully liquid because it was actually well capitalized.[87] On March 14, 1998, the Federal Reserve Bank of New York provided emergency funding to Bear Stearns through the intermediary of J.P. Morgan.[88] The bailout was not enough to prevent Bear Stearns from preparing to file for bankruptcy on March 17, 2008.[89] However, on March, 16, 2008, J.P. Morgan agreed to buy out Bear Stearns for

parts.[90] Later on October 25, 2013, J.P. Morgan was ordered to pay $5.1 billion to settle allegations of misleading FNMA and FHLMC about the quality of the residential mortgage derivatives that it sold the housing agencies during the upward slope of the national real estate boom.[91] Bear Stearns' failure was previously unprecedented for an investment bank of such great magnitude.[92] Once the bank's clients began to lose faith, counterparties, other clients, and the entire industry of lenders refused to participate in transactions with Bear Stearns in any capacity, and this avoidance ensured the downward spiral of Bearn Stearns and sealed its fate.[93] After trust, "the ultimate glue of all financial systems," in the once world-renown investment bank dissolved, it was deemed poisonous, and "nobody trusted anybody, so nobody would lend."[94]

The next casualty in the lineup of the Great Recession was Lehman Brothers, the fourth largest United States investment bank.[95] On September 15, 2008, Lehman Brothers filed for Chapter 11 bankruptcy protection, "with $680 billion in assets, $650 billion in liabilities, and over 100,000 creditors around the world."[96] The Lehman Brothers bankruptcy constituted the largest and most complex bankruptcy that the United States and the modern business world have ever seen.[97] The downfall of Lehman Brothers would later come to be regarded as "the straw that broke that camel's back" and ultimately led to the record-breaking stock market plummet and subsequent systemic credit crisis.[98] It is widely believed that declining to bail out Lehman Brothers and allowing the investment bank to be disassembled in bankruptcy proceedings was the federal regulators' "most dramatic error."[99] Many economists opine that the decision by the United States government to forgo bailing out Lehman Brothers and allowing it to fail in an attempt to avoid meddlesome government intervention, ironically ended up resulting in more government intervention, rather than less.[100] During the same week, Bank of America acquired and purchased the remaining assets of Merrill Lynch, which was formerly the third largest United States investment bank.[101] Uncertainty and insecurity were on the rise rapidly because after this historic collapse, the market participants contemplated for the first time, "if Lehman [Brothers] failed, [then] anyone could fail."[102] The prior common perception that some of these financial giants were "too big to fail," was now simply a remnant of the prosperous past.[103]

Lastly, what should have been another epic casualty of the Global Financial Crisis was American International Group ("AIG").[104] At the time of the Great Recession, AIG was the largest insurance company in the world with over $1 trillion in global assets.[105] AIG's predominant form of business consisted of writing and selling credit default swaps on corporate and residential mortgage debt.[106] During the course of ordinary business, at any given time AIG's equity was only a fraction, around one-fifth, of its potential liability, measured in the full notional amount.[107] Therefore, when residential "homeowners" began defaulting on their mortgages, the mortgage-backed securities entered default, and AIG could not pay the notional amount, also known as par value, that was now due to the credit default swap holders.[108] It was soon obvious that if the United States Treasury allowed AIG to fail, it would trigger systemic catastrophic results, causing other institutions around the globe to fail as well, due to their intimate relationships and interconnectedness.[109] Trying to face reality, AIG clumsily and possibly illegally asked the Federal Reserve for a massive loan needed in order to survive[110] On September 16, 2008, the United States Treasury guaranteed a two year $85 billion loan from the Federal Reserve, which protected AIG's creditors and counterparties.[111] This resulted in a 79.9 percent equity stake for the Federal Government in AIG.[112] The implications of the Global Financial Crisis are still being felt deeply, and without the government intervention and fiscal stimulus, there likely would have been a massive global depression, rather than a recession.[113] It is unclear whether the Great Recession is entirely over, but it is imperative that regulators, bankers, and investors learn from the mistakes of the past in the hope of a better financial tomorrow.

**III. The Dodd-Frank Wall Street Reform and Consumer Protection Act**

**A. The Dodd-Frank Act and Predatory Lending**

The purpose of enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act")[114] was to provide some accountability for the Global Financial Crisis and the loss of eight million jobs.[115] The Dodd-Frank Act is the most comprehensive financial reform since the 1930's.[116] It was the supposed solution[117] by Chris Dodd, a former Connecticut senator, and Barney Frank, a former Massachusetts representative,[118] to a plethora of past regulatory failings and oversights,[119] or a "sweeping legislative package designed to prevent another spectacular financial collapse."[120] The Dodd-Frank Act is often viewed as a bailout bill, meant to salvage the remnants of the devastated United States financial industry.[121] Unfortunately, the current status of the Dodd-Frank Act today remains uncertain, with many vital sections still unfinished or unimplemented.[122] Since the effective date of January 10, 2014, however, the Dodd-Frank Act speaks to predatory lending in the residential mortgage setting.[123]

The Dodd-Frank Act is the most comprehensive financial reform since the 1930's.

Predatory lending occurs when "money lenders use unfair, deceptive, or fraudulent practices to entice borrowers," usually the consumer borrowers most in need of cash, into taking out a loan from them, regardless of the purpose of the loan.[124] Dodd-Frank triggered a major shift in accountability and deviated from traditional credit principles by obliging lenders to attempt to determine whether the borrower has the ability to repay the loan.[125] This shift assumes that consumers are unable to understand the complexities of the loan process, cannot be trusted to provide reliable application information, and are incapable of acting in their best own interests.[126] Looking at the Global Financial Crisis from this perspective completely blames the downfall of the residential mortgage market on lenders and financial institutions that "preyed" on the " victim" consumers.[127] In addition, the "ability to repay" requirement allows consumer borrowers to sue their lender if it later becomes evident that the lender overestimated their

financial ability to fulfill the obligations of their home loan.[128]

However, from the lender's perspective, there is only so much that can be done to verify financial fitness.[129] For example, if a consumer has a steady income during the initial years of the repayment schedule but then loses his job or becomes subject to extraordinary medical bills pertaining to an accident, the consumer could quickly default on his mortgage.[130] This is one reason why the Dodd-Frank Act offers a "safe harbor" for lenders to protect them from potential liability if they exercise due diligence in the application review process.[131] If the lender satisfies all the requirements of approving a "qualified mortgage" to the borrower, the requirements of which are discussed further in Part VI, the lender is protected from consumer recourse.[132] This "hastily crafted" regulation greatly oversteps the appropriate remedy because it inhibits the freedom of borrowers and lenders to agree to a considerable amount of mortgage options, and it will lead to an increase in mortgage rescission litigation and less credit availability for borrowers seeking a residential home loan.[133]

The central rule within the Mortgage Reform and Anti-Predatory Lending Act implements sections 1411 and 1412 of the Dodd-Frank Act, which mandate that lenders "must make a reasonable and good faith determination based on verified and documented information that the consumer has a reasonable ability to repay the loan according to its terms."[134] This means that the lender must actually verify the consumer loan applicant's income and previously existing debt obligations, rather than merely relying on the applicant to be honest and forthcoming about his financial status.[135] This rule imposed on lenders applies quite broadly in "any consumer credit transaction secured by a dwelling."[136] In general, prior to the adoption of the Act, lenders could partake in loose underwriting practices that quickly approved consumer borrowers that had an obvious lack of an ability to repay.[137] While this "reasonable and good faith determination" regulation imposes a greater burden on the lender than before, it benefits the lender as well by preventing the lender from imprudently approving a loan applicant that will furnish the lender with an undesirably risky mortgage that will be difficult to securitize and sell and will cause problems in the future through a likely inevitable consumer borrower default.[138]

**B. The Creation and Role of the CFPB**

The Consumer Finance Protection Bureau was created[139] as part of the original framework of Dodd-Frank for regulating and monitoring systemic risk and its harmful effects.[140] The CFPB was established as an inner segment of the Federal Reserve System, and it is considered by some to be one of the most powerful federal agencies ever created.[141] The CFPB regulates all financial activity related to consumer products and services without meaningful checks on its authority from Congress or the President.[142] One of the CFPB's most recent regulations, the Mortgage Reform and Anti-Predatory Lending Act ("the Act"), took effect on January 10, 2014, and it is the central piece of the CFPB's new mortgage scheme.[143]

The intent behind the role and formation of the CFPB was to protect ordinary consumers from deceptions and schemes by Wall Street investment banks and other financial institutions involving mortgages, credit cards, securities, and any other related product.[144] The CFPB is the federal agency responsible for enforcing TILA[145], which allows consumers to pursue rescission of their home mortgage against the lender under certain circumstances.[146] This view of the CFPB presumes that many large financial institutions and investment banks are like predators, preying on and devouring the helpless, innocent, victimized consumers.[147]

The intent behind the role and formation of the CFPB was to protect ordinary consumers from deceptions and schemes by Wall Street investment banks and other financial institutions.

**IV. The Mortgage Reform and Anti-Predatory Lending Act**

**A. Residential Mortgage Safety and Soundness**

Maintaining safety and soundness in the financial sense signifies that a consumer withdraws precisely the same quantity and quality of what he previously deposited with a financial institution.[148] Economic safety and soundness is often assessed with a "CAMELS" rating.[149] "CAMELS" is an acronym that stands for "capital adequacy, asset quality, management capability, earnings quantity and quality, the adequacy of liquidity, and sensitivity to market risk."[150] Safety and soundness of financial institutions is also frequently evaluated by the "5 C's of Credit: Character, Capacity, Collateral, Capital, and Conditions."[151]

Surprisingly, safety and soundness in the mortgage context is not a new concept.[152] As far back as 2001, safe and sound banking practices required lenders to ascertain that there was adequate evidence that a consumer borrower possessed sufficient resources and the financial ability to make all required payments on home loan obligations before the lender granted the loan.[153] The factors that banks were already supposed to consider within the mortgage application process were: the interest rate on the loan, the credit score of the applicant borrower, the current liquidity of the lender overall, the price of the dwelling to be secured by the loan, the current foreign exchange rate, the particular transaction in general, compliance with existing applicable regulations, strategic risks, reputational risks, and the effect of approval on the particular lender as a whole.[154] However, these existing requirements failed to prevent the mortgage market meltdown in 2008 because both consumers and lenders are naturally greedy.[155] Some unscrupulous lenders anticipated that they could continue to capitalize on this business plan through the large commissions associated with approving loans to low and mid-income borrowers who did not have the financial fitness necessary to repay their loan obligations, and then selling and repackaging residential mortgages into mortgage backed securities.[156] Regarding the events surrounding the complete overleveraging of the financial markets that led up to the Great Recession, prudent underwriting and the denial of unworthy applicant borrowers by residential mortgage lenders could very well have kept the mortgage markets safe and sound.

**B. "Qualified Mortgage" Standards**

The Dodd-Frank Act linked predatory lending with the idea of mortgage safety and soundness for the first time, connected by the system-wide abuse that took place in underwriting housing loans and the unsustainable practices that provided almost effortless access to credit.[157] More narrowly, the Mortgage Reform and Anti-Predatory Lending Act ("the Act"), sets forth strict criteria of how a lender can achieve "qualified mortgage"[158] status on a loan secured by a dwelling.[159] The general foundation of the newly implemented regulation indicates that no creditor is permitted to make "a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the con-

sumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance, and assessments."[160] Before 2010, this requirement that is now universal, applied only to certain high-cost and high-risk mortgages.[161]

Furthermore, a "qualified mortgage" designates that the regular periodic payments for the loan may not include an increase in the principal balance, known as negative amortization, or allow the consumer debtor to defer repayment of the principal through means of an interest only loan.[162] Additionally, the loan payments shall not contain a "balloon payment," which is a scheduled payment that is more than twice as large as the average of the previous payments.[163] To satisfy the "qualified mortgage" test, creditors must also intensely and diligently verify that the evidence of consumer income and financial resources relied upon to qualify for the obligation is reliable and property documented.[164] For mortgages with fixed interest rates, the underwriting process merely must be based on a payment schedule that fully amortizes the loan over the loan term and adequately takes in to account all the applicable taxes, insurance, and assessments that pertain to the loan.[165] For mortgages with adjustable interest rates, the underwriting process must be based on the maximum rate allowed under the loan during the first five years, including a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments.[166] Any residential mortgage loans meeting the definition of a "qualified mortgage" must comply with any and all CFPB regulations and guidelines about total monthly debt to monthly income.[167] Specifically, the CFPB passed a regulation that mandates that at the time of consummation of the loan a consumer borrower's overall monthly debt to income ratio cannot exceed 43 percent, in order for a lender to achieve "qualified mortgage" protection.[168] This includes debt completely unrelated to residential real estate.[169] Moreover, a "qualified mortgage" cannot have total points and fees payable that exceed three percent of the total amount of the loan or have a term that exceeds a maximum of thirty years.[170] Lastly, the regulation provides that a reverse mortgage can achieve "qualified mortgage" status as long as it fulfills all of the same requirements.[171] These elements in combination are supposed to sufficiently inhibit creditor financial institutions from engaging in predatory lending.[172] However, in their current state these rules may work to inefficiently approve some financially unstable consumers and deny many creditworthy consumers.

### C. Criticism of the "Qualified Mortgage" Requirements

The Mortgage Reform and Anti-Predatory Lending Act ("the Act") contains many inconsistencies and significant gaps in coverage. As it stands, the Act is inadequate to sufficiently guard consumer borrowers against some lenders attempting to hide their predatory behavior behind a "qualified mortgage."[173] For example, many provisions that seem strict at first glance need only be complied with for the first five years of the home loan.[174] After the initial five years, the lender is free to impose excessive interest rates or raise the borrower's monthly payment to an unreasonable level, which would likely lead the borrower into default and inevitably foreclosure.[175] It is essential that this part of the statute become more comprehensive, so the Act should be reformed to mandate that any requirements imposed during the initial years of the residential mortgage be enforced throughout the entire term of the loan. This alteration would properly and meaningfully expand the accountability of the lender to the full length of the loan period.

Correspondingly, the Act is not ideal for lenders either. The Act imposes an undue burden on lenders because in addition to their existing responsibilities and obligations, they must now worry about exceptionally precise and minute procedures, covering activities from communications with borrowers to general business practices, etc.[176] This overstepping of regulatory boundaries impairs both lender and borrower freedom of choice, confuses consumer protection with consumer control, and fosters an unhealthy dependence on government intervention, which impairs the positive effects of the free market on the economy. In total, bare minimum compliance with the Dodd-Frank Act could cost financial institutions about $50 billion annually, or 12 percent of overall operating expenses.[177] Plus, this incredibly sizable amount of money does not include the litigation fees that lenders will undoubtedly incur in connection with the borrower right to sue under the "ability to repay" requirement.[178] Even if a lender prevails in court through a finding of due diligence in pursuing a good faith verification that the borrower had a reasonable "ability to repay," the lender will be left to pay the litigation costs suffered through defense.[179] Rather than being able to offer residential mortgages to the largest amount of qualified consumers, lenders will be too busy spending their limited funds on trainings for upper level management and employees to comply with the new regulations.[180] To combat these severe compliance costs, the CFPB should conduct an extensive review of the existing rules in light of their cost versus their benefit to eliminate any provision with a price that outweighs its worth. This will prevent unnecessary compliance measures that do not provide substantial value.

Further, the Act is over inclusive, unnecessarily restricting certain financing options across the board that a lender could previously choose to offer, such as balloon payments.[181] The formerly accepted various financing options were designed to fit the needs of a myriad of borrowers.[182] Of course, some borrowers cannot handle the risk or responsibility that comes with a mortgage loan with a balloon payment. However, some borrowers can. Balloon payments and other irregular residential mortgage plans should be approved on a limited basis as "qualified mortgages" if they satisfy the remainder of the obligations and as long as the specific borrower in question has a reasonable "ability to repay" the irregular mortgage structure. On the other hand, the Act is also under inclusive, in the sense that it will allow some non-creditworthy borrowers to slip through the cracks to approval, if they merely satisfy arbitrary requirements, such as the 43 percent maximum debt to income ratio.[183]

History, time, and statistics have demonstrated that a maximum debt to income ratio is not the best predictor of loan repayment performance.[184] It is an inefficient tool to use in distinguishing whether a borrower is creditworthy.[185] One of the main reasons this is true is because "income" is difficult to analyze. For example, a young adult with a residential mortgage, a trust fund, and zero income would fail the "qualified mortgage" test, along with a retiree with a residential mortgage, a large bank account of life savings, and zero income. These applicant borrowers would be excluded from the benefits and protection of having a mortgage deemed "qualified," even though they may be quite creditworthy.

Instead of the current maximum debt to income ratio, the misguided, but extremely necessary "qualified mortgage" standard should require creditor lenders to focus on loan to value ratio and/or credit score, along with applicant income, economic climate, etc. Imposing a maximum loan to value ratio and/or a minimum credit score would vastly increase the efficiency of the Act, and it would better predict the likelihood that the consumer borrower has reasonable "ability to pay" and would fulfill the obligations under the residential loan. However, neither criterion could be looked at in a vacuum. They each must be considered in relation to each other and any other pertinent application information.

In order to obtain an official credit score, a consumer must have borrowed money in the past. If a particular consumer

has never gone into debt because he has always had enough wealth to pay for items in cash, this should not make the consumer less creditworthy or undeserving of the protections associated with a "qualified mortgage." To remedy this potentially unclear characteristic, the loan to value ratio and the credit score of the applicant borrower should be evaluated on a sliding scale. If an applicant is willing to offer a large down payment, for example 70 percent, has verified stable income or funds to repay, but has no credit history or credit score, it should be apparent that this borrower is still creditworthy. Likewise, if an applicant has an outstanding credit score, has verified stable income or funds to repay, but can only offer a 12 percent down payment, this borrower is likely still creditworthy as well. Although a firm tightening up of the loan underwriting process is arguably warranted, imposing arbitrary rigid regulations, without regard to the applicant's criteria as a whole is unjustified.

As it stands, there are significant problems and inconsistencies inherent in the Mortgage Reform and Anti-Predatory Lending Act. Nonetheless, it is a step in the right direction because unfortunately, it is not economically possible for everyone who desires to own a home to do so. To fully recover from the predatory lending practices, system-wide fraud, and loose residential mortgage underwriting that led up to the Global Financial Crisis, these recommendations should be implemented into the Act, which would benefit both lenders and borrowers ultimately.

**V. Conclusion and Recommendations**

For all of these reasons, the current CFPB "qualified mortgage" standards under the Mortgage Reform and Anti-Predatory Lending Act, as a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, are inadequate to effectively satisfy the intended purpose or underlying objectives of the regulation. For the Act to accomplish its desired goals, substantial reforms must be adopted. First, the CFPB should amend the Act to require that all "qualified mortgage" beneficial borrower protection provisions required for the initial years of the residential mortgage loan be applicable to all years of the loan term, not merely the first five years. This obligation would protect consumers in general, by precluding lenders from raising the interest rate or the monthly payment on mortgages to unsustainable levels that the consumer borrowers cannot afford. Similarly, this requirement would help to reduce the number of defaults and foreclosures because of inability to repay, and it would rightfully hold residential lenders accountable for the credit that they extend to consumers.

Moreover, the CFPB should conduct an exhaustive review of the existing "qualified mortgage" standards in regards to analyzing their cost versus their benefit. This will eliminate unnecessary compliance measures that do not provide substantial value. As the Dodd-Frank Act currently stands, even bare minimum compliance would impose an undue burden on lenders through the exceptionally meticulous procedures. In litigation costs alone, residential mortgage lenders will incur significant expenses defending suits associated with alleged "ability to repay" violations, even if the lender complied with making the requisite good faith verification. These costs will likely be passed on to the consumer in the form of additional fees. To ease the heavy burden of these compliance costs, the CFPB should reevaluate the new standards in relation to their realized benefits.

In addition, irregular mortgage structures should not be completely excluded from the realm of "qualified mortgages" in all circumstances. These irregular loan repayment schedules should be available as "qualified mortgages" on a very limited basis, but only if all other "ability to repay" requirements are met. Many consumers cannot maintain the discipline and postponed responsibility that often comes with a mortgage with a large balloon payment at the end of the loan term, but some consumers can. The existing "qualified mortgage" standards under the Act will inhibit the positive effects of the free market on the financial system and will impair lender and borrower freedom of choice in extending and obtaining residential mortgages. This dangerously confuses consumer control with consumer protection. The Act is both overinclusive and underinclusive because it not only unnecessarily restricts certain mortgage financing options categorically but also can improperly approve particular noncreditworthy borrowers if they satisfy arbitrary requirements.

Lastly, rather than requiring a maximum debt to income ratio, it should be mandatory for lenders to evaluate the creditworthiness of applicant consumers through the analysis of a maximum loan to value ratio and a minimum credit score, on a sliding scale of importance. This would decrease the chance that the borrower would default on the mortgage. Loan to value ratio and consumer credit rating have been proven to be significantly better indicators of future loan repayment performance by history and statistics. Focusing on loan to value ratio and credit score and factoring in these numbers along with income, market conditions, etc., will drastically improve the efficiency of the Act in approving creditworthy applicants and denying noncreditworthy applicants.

In conclusion, the CFPB has already made meaningful strides towards demanding that lenders comply with strict residential loan underwriting criteria, but there is still much room for reform and improvement. Consumer protection in general requires protection that is tailored to meet the needs of a variety of differently situated consumers. Currently, the Mortgage Reform and Anti-Predatory Lending Act is both overinclusive in some ways and underinclusive in others. By applying the reforms, improvements, and recommendations suggested herein, the Act will become more efficient and more effective.

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# Protecting the Vulnerable Among Us

By Lauren A. Fisher Flores*

## INTRODUCTION

The Salazar family fled Venezuela after Hugo Chavez came into power.[1] When they arrived in Texas, they sought assistance at Cristo Vive ("Christ Lives") Christian Social Services.[2] Jorge Sanchez, the Director at Cristo Vive, told the Salazars that they did not qualify for asylum.[3] The problem was that Cristo Vive was not a law office, and Mr. Sanchez was not an attorney.[4] Mr. Sanchez's bad advice meant that the Salazars missed the one-year deadline to file for the protections of political asylum.[5]

Mr. Sanchez was a notary public taking advantage of the common misunderstanding between "notary public" and the similar Spanish term "notario publico."[6] Unlike notary publics in the United States who witness the signing of documents, in Latin America, a notario publico is a highly skilled attorney with a special government license.[7] Some unscrupulous notaries capitalize on the confusion and take advantage of immigrant families in Texas.[8] According to one study, one out of five Latino immigrants reported receiving legal services from a notario or "immigration consultant."[9] Perhaps even more disturbing, many of the immigrants surveyed were completely unclear whether the legal help they received came from an attorney or a non-attorney.[10] Because they fail to receive adequate representation, victims of unauthorized immigration service providers lose money, time, and original documents.[11] However, unlike in other kinds of consumer fraud, immigrant consumers can also lose their opportunity to legalize their immigration status.[12] As a result of these unauthorized immigration services, immigrants have faced deportation and even jail.[13] Since 2002, the Consumer Protection Division of the Texas Office of the Attorney General has used state consumer protection laws to shut down more than 75 unauthorized legal service providers.[14] As often is the case, public enforcement of consumer protection laws has left these laws under enforced.[15]

> Mr. Sanchez was a notary public taking advantage of the common misunderstanding between "notary public" and the similar Spanish term "notario publico."

This paper explores a recent case from Travis County that lays the groundwork for individual consumers to pursue a private right of action.[16] It uses this case to argue that private attorneys can complement the Attorney General's actions and help curb the problem by filing suit under the Texas Deceptive Trade Practices Act (DTPA). After laying out the foundational provisions of the DTPA, the paper describes the recent Travis County case, showing how the case is an invitation for private attorneys to enter this arena and protect consumers.

## TEXAS DECEPTIVE TRADE PRACTICES ACT

First enacted in 1973, the DTPA provides consumer protections, and makes unlawful false, misleading, and deceptive acts in trade and commerce.[17] To maintain an action under the DTPA, a consumer must "seek or acquire" by "purchase or lease" any "goods or services" "for use."[18] The DTPA broadly interprets the term "consumer," and does not require privity of contract between the parties.[19] The DTPA allows for four separate but cumulative causes of action: the laundry list; unconscionability; breach of warranty; and Chapter 541 of the Insurance Code.[20] A wronged consumer is entitled to economic damages, court costs, and attorney fees.[21] Economic damages include monetary losses like cost of repair or replacement and lost wages.[22] The DTPA is a no-fault statute, so the consumer does not have to prove the business intended to deceive the consumer or intended to violate the law.[23] However, if consumers can show the business acted knowingly, he or she may recover up to three times economic damages and damages for mental aguish. If the consumers shows the defendant acted intentionally, he or she may collect up to three times the amount of economic damages and mental anguish damages.[24]

Many of the other specific consumer protection laws in Texas also contain language in the statute to make a violation of that law a cause of action under the DTPA. These are known as "tie-in statutes." A violation of a tie-in statute is actionable under the individual statute and is also separately actionable as a violation of the DTPA. One of these tie-in statutes is § 406.017, Representation as Attorney.[25] This statute specifically prohibits notary publics from stating or implying that they are attorneys.[26] The statute also prohibits notaries from receiving compensation for preparing immigration documents.[27] Further, the statute prohibits use of the term "notario publico" in advertisements, and lays out specific guidelines for advertising in a different language.[28] Unlike the economic damages for a general cause of action under the DTPA, damages for a violation of a DTPA tie-in statute are actual damages.[29] Actual damages include all damages recoverable at common-law including mental anguish damages.[30] If a consumer brings a DTPA tie-in statute claim and can prove the party acted knowingly, the consumer can recover up to three times the amount of actual damages.[31]

Under the DTPA, and action may be brought by either the state or an individual.[32] In addition to public enforcement by the Texas Attorney General, the DTPA also allows for a private right of action.[33] To give rise to a private right of action under the "laundry list," the wrongdoing must fit within the list of 27 acts or practices the DTPA specifically defines to be false, misleading, or deceptive.[34] The Texas Attorney General has successfully used the DTPA to close a number of unlawful immigration service providers.[35] Unlike an individual consumer, the Attorney General can file suit for any false, misleading, or deceptive act and does not have to fit the action into one of the prohibited acts in the laundry list. In a recent case in Travis County, Texas, the Attorney General chose to assert a cause of action under the laundry list.[36] As a result, Texas practitioners now have a how-to guide for filing a private cause of action against unlawful immigration services under the DTPA.

## STATE OF TEXAS V. JUST FOR PEOPLE

In *State of Texas v. Just for People, Inc.*, the court paved the way for a private right of action against unlawful immigration service providers by listing the violations of the DTPA that may arise under the laundry list.[37] The defendant, "Just for People," was a non-profit corporation advertising immigration services for a fee in Spanish language media.[38] Just for People told its customers that it could help them obtain their legal permanent residency or work permit.[39] However, none of the employees at Just for People were attorneys or otherwise accredited to provide immigration services.[40] Just for People even had an active duty military officer wear his military uniform at the office and lead customers to believe that the officer was working in an "official, governmental capacity."[41] One customer reported he paid over $10,000 for his family to get work visas. However, no one in his family ever received a visa or work permit.[42] Instead, when clients complained, Just for People threatened them with deportation.[43] In total, Just for People collected approximately $195,325.00 from consumers.[44]

In its Final Judgment and Permanent Injunction, the Travis County court held that Just for People and its directors had violated the DTPA.[45] The court's order provided a broad definition of immigration services that included preparing documents.[46] The court found that Just for People's actions constituted trade and that orders and injunctions were in the public interest.[47] The court held that Just for People violated numerous provisions of the laundry list.[48] The court held that Just For People violated subsections 17.46(b)(2) and (3) by "causing confusion or misunderstanding as to the source, sponsorship, approval or certification of Defendant's services and causing confusion or misunderstanding as to Defendant's affiliation, connection or association with or certification by another."[49] The court further found Just for People liable under subsection 17.46(b)(5) for misrepresenting its services "sponsorship, approval, characteristics, ingredients, uses, benefits or quantities."[50] The court also found Just for People violated subsections 17.46(b)(12) for making representations that an agreement conferred rights that it did not, and 17.46(b)(24) for failing to disclose facts "in order to induce a consumer to enter into a transaction."[51] The court ordered Just for People to pay $480,000.00 in civil penalties, $234,796.00 in attorney's fees, $11,007.81 in court costs, and $195,325.00 in restitution.[52] The court also made clear that the Attorney General's suit did not prevent an individual consumer's private right of action under the DTPA.[53]

## PRIVATE CAUSE OF ACTION FOR IMMIGRANT CONSUMERS

The cases pursued by the Attorney General have already laid the groundwork for a private causes of action, and private causes of action may even be superior to public actions. The same findings that made the Attorney General successful in its cause of action could also assist individual victims in a private cause of action. The Attorney General charges create a foundation for arguing several of the laundry list factors, including § 17.46(b)(2), (3), (5), (12), and (24).[54] The Attorney General's Office alone, however, cannot keep up with these unscrupulous businesses.[55] A private cause of action could supplement government efforts and be less intimidating for immigrants.

Not only are private causes of action against fraudulent notaries possible, they are likely superior to public actions. A private cause of action may be more effective because immigrants often do not know their rights, and are hesitant to come forward and work with government agencies, particularly if they fear being deported.[56] Furthermore, unlike the government that is constrained by lack of resources, private attorneys have incentives to pursue the action because they can recover attorneys' fees.

Immigrants have the right to sue under the DTPA but currently are not using this powerful tool. Practitioners can and should pursue a private cause of action. Attorneys can recover attorney fees, and clients can receive damages, as well as punitive damages up to three times their loss, upon a showing the defendant acted knowingly or intentionally.[57] By using the Representation as an Attorney tie-in statute, clients can collect actual damages including mental anguish damages, and punitive damages by a finding the defendant acted knowingly. This financial punishment would serve as a disincentive for businesses seeking to take advantage of this vulnerable population.

## CONCLUSION

Immigrant victims of legal service fraud could present a challenge as clients, even in a private cause of action. They are a vulnerable population, often scared to come forward, and unsure of which legal protections apply to them.[58] Their tenuous legal status also may be challenging for representation.[59] If they have been victims of notario fraud, they also may have a pending deportation order, or they may already have been deported.[60] Once a victim is deported, the likelihood they will be able to file a private right of action diminishes greatly.[61] Groups like the American Bar Association, however, are working to provide education and resources and build awareness of the issue.[62] The private bar can and should play a role in the fight by encouraging clients to pursue a private right of action. Families like the Salazars need the advice and support of the legal community. Had the Salazars filed a private right of action, they may have been able to recoup treble damages and attorney's fees, while also providing additional deterrence to unscrupulous immigrant service providers. A private right of action under the DTPA may just be the tool needed to protect this vulnerable population.[63]

** University of Houston Law Center graduate, May 2015. This article won second place in the 2015 writing competition sponsored by the Consumer and Commercial Law Section of the Texas Bar.*

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1 Jeremy Schwartz, *Some Immigrants Seeking Austin Firm's Help See Hope Turn to Despair*, Austin Am. Statesman (Aug. 24, 2011, 9:07 AM), http://www.statesman.com/news/news/local/some-immigrants-seeking-austin-firms-help-see-ho-1/nRb2b/

2 *Id.*

3 *Id.*

4 Agreed Final Judgment and Permanent Injunction, State of Texas v. Cristo Vive, Christian Soc. Servs. In c., No. D-1-GV-12-001092 (53rd Dist. Ct., Travis County, Tex. Aug. 30, 2013), *available at https://www.texasattorneygeneral.gov/newspubs/releases/2013/AFJPI.pdf*

5 Schwartz, *supra* note 1.

6 *See* Anne E. Langford, *What's in A Name: Notarios in the United States and the Exploitation of A Vulnerable Latino Immigrant Population*, 7 Harv. Latino L. Rev. 115, 116 (2004).

7 Pedro A. Malavet, *Counsel for the Situation: The Latin Notary, A Historical and Comparative Model*, 19 Hastings Int'l & Comp. L. Rev. 389, 403 (1996).

8 Patrick George, *Lawsuit: Austin Business Fleeced Immigrants*, Austin Am. Statesman (July 26, 2012, 5:29 AM), http://www.statesman.com/news/news/local/lawsuit-austin-business-fleeced-immigrants/nRqPC/

9 Robert L. Bach, *Building Community Among Diversity: Legal Services for Impoverished Immigrants*, 27 U. Mich. J.L. Reform 639, 652 (1994).

10 *Id.*

11 Monica Schurtman & Monique C. Lillard, *Remedial and Preventive Responses to the Unauthorized Practice of Immigration Law*, 20 Tex. Hisp. J. L. & Pol'y 47, 56 (2014)(explaining "[h]arm typically falls into one or more, and sometimes all, of the following categories: (1) removal-- often to countries with which immigrants no longer have ties or where they have experienced or risk serious physical harm; (2) loss of documents needed to establish eligibility for an immigration benefit; (3) bars to regularizing immigration status; (4) long-term or even permanent separation of families; (5) financial damage caused by paying for useless or harmful procedures, including payment for applications that are never filed; (6) loss of employment; and (7) long-term detention. Harm can also be physical, as in the case of an asylum applicant who is tortured or killed if deported to her country of origin") (internal citations omitted).

12 *Id.*

13 Vianey Alderate, *Phony Lawyers Calling Themselves Notarios Continue to Scam Unsuspecting Immigrants*, Borderzine: Reporting Across Fronteras (March 21, 2014), http://borderzine.com/2014/03/phony-lawyers-calling-themselves-notarios-continue-to-scam-unsuspecting-immigrants/;%20Langford%20supra%20note%206%20at%20123

14 Bryan Cohen, *Texas AG Obtains Judgment Against Legal Services Provider,* Legal Newsline Legal J. (April 29, 2013, 12:07 PM), http://legalnewsline.com/news/241189-texas-ag-obtains-judgment-against-legal-services-provider

15 *See, e.g.*, Kathleen S. Morris, *Expanding Local Enforcement of State and Federal Consumer Protection Laws*, 40 Fordham Urb. L. J. 1903, 1924-25 (2014). ("The nation's consumer protection regime is broken. The problem is not a lack of good law: federal and state legislatures have enacted far-reaching consumer protection statutes, most notably the expansive Federal Trade Commission Act (the FTC Act or the Act) and its state statutory counterparts (the little Acts). The problem is that due to insufficient funding and staffing, industry capture, or some combination of both, these potentially powerful bodies of consumer protection law are woefully under-enforced.").

16 Final Judgment and Permanent Injunction as to Defendant Just for People, Inc., State of Texas v. Just for People, Inc., No. D-1-GV-12-000990 (98th Dist. Ct., Travis County, Tex. April 22, 2013), *available at* https://www.texasattorneygeneral.gov/newspubs/releases/2013/042513_final_judgment_Just_for_people_inc.pdf

17 Tex. Bus. & Com. Code Ann. § 17.46(a) (West 2013).

18 28A Tex. Prac., Texas Consumer Law Ch. 1.

19 Richard M. Alderman, The Lawyer's Guide to the Texas DTPA Section § 2.03 (LexisNexis 12th ed. 2010, with Supp. 2015).

20 *See e.g.* 28A Texas. Pracatice., Texas Consumer Law Ch. 1.

21 *See* Tex. Bus. & Com. § 17.50.

22 "Basically, this provision limits a consumer to 'money damages.' Therefore, 'soft damages,' such as pain and suffering and mental anguish, recoverable as actual damages, are clearly not within the definition of economic damages." Richard M. Alderman, The Lawyer's Guide to the Texas DTPA Section § 9.04 (LexisNexis 12th ed., with Supp. 2015).

23 *See id.* § 17.50(h); Richard M. Alderman, Know Your Rights: Answers to Texans' Everyday Legal Questions 145 (8th ed. 2010).

24 *Id.*

25 "Failure to comply with this section is, in addition to a violation of any other applicable law of this state, a deceptive trade practice actionable under Chapter 17, Business & Commerce Code." Tex. Gov't Code Ann. § 406.017 (f) (West).

26 Tex. Gov't Code Ann. § 406.017 (a) (West).

27 *Id.*

[28] *Id.*; Tex. Gov't Code Ann. § 406.017 (b) (West).

[29] "Notwithstanding any other provision of this subchapter, if a claimant is granted the right to bring a cause of action under this subchapter by another law, the claimant is not limited to recovery of economic damages only, but may recover any actual damages incurred by the claimant, without regard to whether the conduct of the defendant was committed intentionally." Tex. Bus. & Com. § 17.50(h).

[30] Richard M. Alderman, The Lawyer's Guide to the Texas DTPA Section § 9.02 (LexisNexis 12th ed., with Supp. 2015).

[31] *Id*.

[32] Richard M. Alderman, The Lawyer's Guide to the Texas DTPA Section § 2.03 (LexisNexis 12th ed. 2010, with Supp. 2015).

[33] Tex. Prac., *supra* note 18.

[34] Tex. Bus. & Com. § 17.46(d).

[35] *See* Cohen, *supra* note 14.

[36] Tex. Bus. & Com. § 17.46(a); *See* Final Judgment, *supra* note 16. The Attorney General charged "(2) causing confusion or misunderstanding as to the source, sponsorship, approval or certification of goods or services, (3) causing confusion or misunderstanding as to affiliation, connection or association with, or certification by another, (5) representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits or quantities which they do not have or that a person has a sponsorship, approval, status, affiliation or connection which he does not have, (12) representing that an agreement confers or involves rights, remedies, obligations which it does not have or involve, or which are prohibited by law, and (24) failing to disclose information concerning goods or services which was known at the time of the transaction if such failure to disclose such information was intended to induce the consumer into a transaction into which the consumer would not have entered had the information been disclosed." *Id.*

[37] *Id.* at 3-4.

[38] *Id*. at 2.

[39] Plaintiff's Original Petition at 8, State of Texas v. Just for People, Inc., No. D-1-GV-12-000990 (98th Dist. Ct., Travis County, Tex. April 22, 2013) *available at https://www.texasattorneygeneral.gov/newspubs/releases/2012/%20072412plaintiffs_petition.pdf*

[40] *Id.*

[41] *Id*.

[42] News Release *Attorney General Abbott Charges Austin Group with Providing Unauthorized Legal Services* TexasAttorneyGeneral.gov (July 25, 2012), https://www.texasattorneygeneral.gov/oagnews/release.php?id=4099

[43] Plaintiff's Original Petition, *supra* note 39, at 8. Plaintiff's alleged, "Instead of helping these consumers, Defendants take their money, sometimes a substantial amount of money, provide no assistance, and threaten the consumers with deportation if they complain." *Id.*

[44] Final Judgment, *supra* note 16, at 3.

[45] *Id*. at 1.

[46] [P]roviding or offering assistance for a fee to individuals with immigration issues including preparing documents to be presented to any United States immigration agency for purposes of obtaining permanent or temporary legal status to remain in the United States, advising any person whether or not to file a petition, application, or other form to obtain a benefit under United States immigration laws, and offering to represent an individual before the board of Immigration Appeals or any other governmental agency or unit that could grant a benefit to the individual under United States immigration laws. *Id. at 3.*

[47] *Id*. at 4.

[48] *Id* at 4; Tex. Bus. & Com. § 17.46.

[49] Final Judgment, *supra* note 16, at 4.

[50] *Id.* (internal citations omitted).

[51] *Id.*

[52] *Id*. at 8.

[53] *Id*. at 2.

[54] Tex. Bus. & Com. § 17.46; *See* State of Texas v. Paneque, 2013 WL 2638411.

[55] *See* Alderate, *supra* note 13.

[56] *See* Plaintiff's Original Petition, *supra* note 29, at 8.

[57] *See* Tex. Bus. & Com. § 17.50.

[58] *See* Joseph M. Gietl, *Like Lambs to the Slaughter: How Unregulated Immigration Practitioners Harm Immigrants*, 19 Pub. Int. L. Rep. 66 (2013); Bach, *supra* note 9.

[59] *Id.*

[60] *See* Schurtman & Lillard, *supra* note 11.

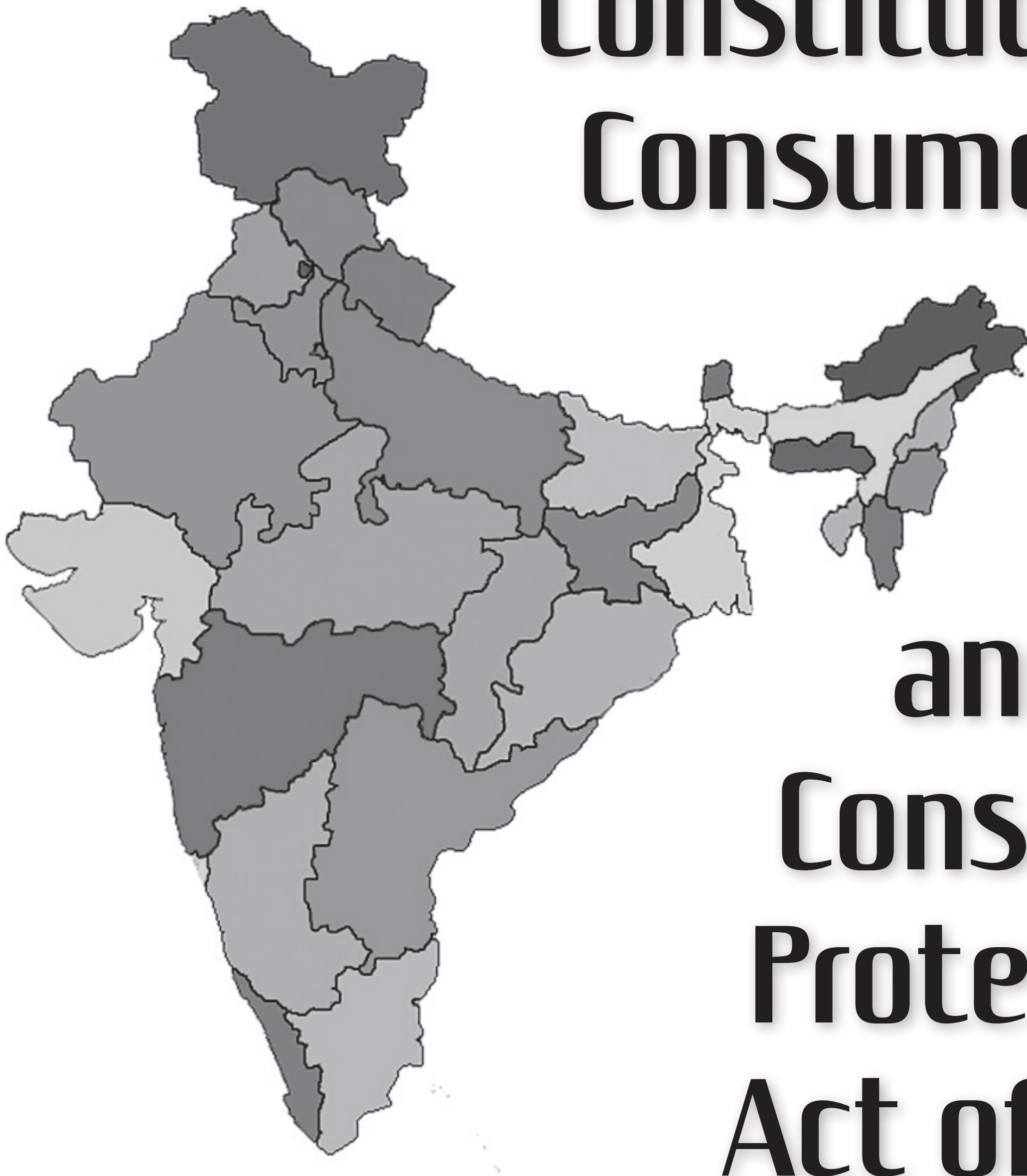
[61] *See, e.g. id.*

[62] American Bar Association's Commission on Immigration Projects and Initiative, *Fight Notario Fraud*, http://www.americanbar.org/groups/public_services/immigration/projects_initiatives/fightnotariofraud.html

[63] As this article was being edited, the Texas Legislature amended the Deceptive Trade Practices Act to make it a false and misleading act or practice to misrepresent in a foreign language that a person is an attorney. The new provision, subsection 17.46(b)(28) reads as follows:

> (28) using the translation into a foreign language of a title or other word, including "attorney," "lawyer," "licensed," "notary," and "notary public," in any written or electronic material, including an advertisement, a business card, a letterhead, stationery, a website, or an online video, in reference to a person who is not an attorney in order to imply that the person is authorized to practice law in the United States.

# Interface Between India's Constitutional Consumerism



# and the Consumer Protection Act of 1986

By Naman Jain* and G. Datta Prasad**

## 1. Introduction

The law of consumer protection jurisprudence in the Indian context is inclined to be brought, by and large, under the ambit of the law of contracts. Thus, a consumer under the Consumer Protection Act, 1986 (hereinafter referred as COPRA) has to advance consideration for the goods and services he/she seeks to acquire.[1] However, the COPRA fails to recognize the constitutional contract between the state and its citizens.

A constitutional contract is not an unfamiliar concept in the Constitution. For example, articles 17 and 23 of the Constitution recognize the concept of constitutional crime. The Constitution binds the state to provide goods and services to a certain class of citizens by way of its own schemes and legislation in order to uphold the constitutional values of the preamble and make fundamental rights available to all. This concept of consumerism under the authority of the state can be termed as constitutional consumerism. It recognizes a class of citizens towards whom the State owes a duty to provide goods and services, entitling every citizen to a minimal life of dignity, and ensuring social, economic and political order.[2]

Therefore, it is for such goods and services that the Constitution does not require any form of consideration from the person receiving them. The Consumer Protection Act fails to recognize these consumers resulting in a lack of accountability from the State towards these consumers. This article discusses the damages consequently caused, and questions whether the Act needs to be changed to be in harmony with the constitutional values embedded in the Constitution.

> **The Consumer Protection Act is in contrast with the constitutional value of human dignity, which is the foundation for the specified categories of persons receiving goods and services.**

## 2. Constitutional Consumerism

The question arises as to who these consumers are? Is the constitution bound to provide them goods and services? They are mainly all citizens who fall in the constitutional category of "undeserved want."[3] The Constitution further defines them as citizens forced by economic necessity to work in fields unsuited to their age or strength;[4] for example, young children who are liable to abuse.[5] There also is a special category of citizens to whom the State is bound to provide goods and services for their educational and economic interests— "weaker sections," especially "scheduled castes"[6] and the "scheduled tribes." The state is bound by the Constitution to provide these citizens with minimal goods and services as they cannot enjoy their fundamental rights if such goods and services are not ensured to them. This constitutional duty of the State to ensure such basic goods and services to such citizens, who otherwise cannot afford it themselves, has been upheld to be a fundamental right by the Supreme Court in *Francis Coralie Mullin v. Administrator, U.T. Delhi*.[7]

The Union and State Governments have, to this effect, either launched a multitude of schemes through executive orders such as Beti Bachao, Beti Padhao, Sukarna Samridhi Accounts for the minor girls, Integrated Child Development Scheme, or enacted specific legislations such as the National Food Security Act or the Mahatma Gandhi National Rural Employment Act. Owing to the fact that these schemes provide goods and services to a specified class of citizens and claim a paramount share of the public funds expenditure that is approved by the Parliament, all such specified citizens are consumers of the goods and services provided by the State.[8]

## 3. Consumer Protection Act and the Constitution

Unlike the Constitution, the Consumer Protection Act fails to recognize such citizens. As noted above, the Consumer Protection Act generally adopts the parlance of the law of contracts. In other words, citizens are not recognized if they are not covered by the words "contract" and "consideration" under Section 2(d) of the Act – the definition of consumer. The Act, thereby, fails to consider the following possibilities:

(a) There is an implied contract between the Government and such specified categories of persons; and

(b) A contract of this order does not require consideration from its citizens.

The COPRA is in contrast to the constitutional value of human dignity, which is the foundation for the specified categories of persons receiving goods and services. Thus, it is quintessential for the COPRA to embrace the supreme constitutional value of human dignity – the very foundation of the right to goods and services.

This leads to the question of under which rubric a contract would be classified. The Fundamental Rights Chapter of the Constitution derives its meaning from the values enshrined in the Preamble and enunciated in the Directive Principles of State Policy. If executive orders or legislation are not based upon the Preamble and the Directive Principles, the Fundamental Rights Chapter loses its meaning.[9] Therefore, there is a need to recognize a special species of contracts called the constitutional contracts (as discussed above) between the state and its specified citizens who have the right to receive such goods and services. This is the only method to hold the state and its executive or its agencies and officials accountable for the goods and services supplied by them to constitutional categories of citizens as part of their constitutional duty.[10]

## 4. Consequences

The Consumer Protection Act, by failing to recognize consumers, as well as Parliament's failure to apply the Directive Principles while legislating the Act and its mandatory duty to do so under u/Art 37,[11] has caused a lack of accountability from the executive to these categories of citizens. The mismanagement and corruption in the use of the public funds approved by Parliament for these constitutionally designated citizens, under executive schemes[12] or specific legislation is well documented by several agencies and the Comptroller & Auditor General of India, a constitutional position under Article 148 of the Constitution.[13]

The absence of constitutionally designated contracts ensuring goods and services to constitutional categories of citizens, results in their inability to receive the benefit of the provisions relating to unfair trade practices[14] and the false supply of goods and services[15] under the COPRA. Its undisputable significance can be evidenced through the plethora of media reports on the child victims under the Mid-Day Meal Scheme and the kind of primary education being provided under the umbrella of the fundamental right to primary education. The absence of a judicially managed legal aid throughout the country under the National Legal Services Act,[16] extinguishes the constitutional values of justice and equality for such consumers.

A consumer under the Consumer Protection Act can have access to the nearest District Forum and can easily file a complaint in the manner mentioned under Section 12 of the Act, thereby avoiding the complex and expensive procedure of a writ petition or a civil suit. This is important because most of these

constitutionally designated categories of citizens – who are in dire poverty – may not be in a position to exhaust remedies offered by the ordinary courts as opposed to the Consumer Forums (or, District Forums in specific). This is particularly relevant considering the failure of successive Governments to effectively implement the directive of principles. The principle became the Fundamental Right to free and compulsory primary education under Article 21-A. It ensures minimal receipt of any of the benefits of the Supreme Court's judgment permitting letters or post cards to be addressed to it for the violation of Fundamental Rights. A World Bank study[17] shows that Public Interest or Social Action Litigation has not benefited the poor and the oppressed constitutional classes of citizens. On an average 0.4% or 260 out of sixty thousand cases are Public Interest Litigation (PIL), which are generally not initiated by letters or handwritten petitions sent to the Supreme Court, and indicates that inclusion of such constitutional contracts and such constitutionally designated citizens becomes all the more pertinent. It is essential to recognize such beneficiaries as constitutional consumers under the Consumer Protection Act, because denying the access to consumer forums to such consumers defeats the *ubi jus ibi remedium* maxim of law – the right to a remedy for a wrong.

This situation can be legally corrected by either amending the COPRA to recognize such a constitutional contract, or by enacting a separate consumer law for constitutional consumers.

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[1] Section 2(d), of the Consumer Protection Act, 1986, "'Consumer' means any person who—

(i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or

(ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who 'hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person but does not include a person who avails of such services for any commercial purposes."

[2] Article 37, The Constitution of India, 1950.
[3] Article 41, The Constitution of India, 1950.
[4] Article 39(e), The Constitution of India, 1950.
[5] *Id.*
[6] This is now subject to the creamy layer being excluded in terms of the Supreme Court judgment in Indra Sawhney v. Union of India, AIR 2000 SC 498.
[7] AIR 1981 SC 746.
[8] On the expanding role of the welfare state, see R.D. Shetty v. International Airport Authority, (1979) 3 SCC 489 Para 11 & Mathew J. in Sukhdev Singh v. Bhagat Ram Sardar Singh Raghuwanshi (1975) 1 SCC 421 at 448 Para 78.
[9] Articles 73 &162, The Constitution of India, 1950
[10] M.C. Mehta v. Union of India, 1998 (9) SCC 589, Fundamental duties must be read as creating rights in citizens under Article 21.
[11] Article 37 states inter alia that 'it shall be the duty of the State to apply the Directive Principles in making laws'.
[12] Articles 73 &162, The Constitution of India, 1950
[13] Report No. 22 of 2012-13, Union Govt., Ministry of Women & Child Development; Performance Audit of Integrated Child Development Services Scheme; Report No. 6 of 2013, Union Govt. Ministry of Rural Development; Performance Audit of Mahatma Gandhi National Rural Employment Guarantee Scheme.
[14] Section 2(r), Consumer Protection Act, 1986.
[15] Section 2(oo), Consumer Protection Act, 1986.
[16] Article 39–A, The Constitution of India, 1950.
[17] Gaurin Varun, *Public Interest Litigation in India: Overreaching or Underachieving?* World Bank, Policy Research Working Papers 5109, 8 (November 2009), available at http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5109, last accessed 25th January 2015.

# Consumer News Alert Recent Decisions

Since 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 discussed 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 SUPREME COURT**

*The Supreme Court rules that the EEOC's conciliation efforts are subject to judicial review in claims of unlawful discrimination against an employer.* The EEOC filed suit against Mach Mining, LLC on the basis of sex discrimination as to the company's hiring practices. After deciding that reasonable cause existed, the EEOC sent a letter to Mach Mining inviting the employer to participate in an informal conciliation proceeding with the plaintiff to attempt to rectify the charge. Later, the EEOC sent a second letter to Mach Mining, stating it had determined that conciliation efforts had been unsuccessful. The EEOC then filed suit in federal court. In response, Mach Mining argued, pursuant to Title VII of the Civil Rights Act of 1964, that the EEOC had failed to conciliate in good faith prior to filing suit. The EEOC moved for summary judgment on that issue, contending that the sufficiency of its conciliation efforts were not subject to judicial review. The trial court agreed with Mach Mining to the extent that the EEOC's conciliation efforts were, in fact, subject to judicial review, but the Seventh Circuit reversed and found that the EEOC's conciliation efforts were not subject to judicial review. The Supreme Court reversed the Seventh Circuit's decision, holding that although the EEOC maintains wide discretion with respect to the informal means by which conciliation efforts are achieved, the courts are authorized to employ judicial review of the EEOC's conciliation efforts in cases involving a charge of unlawful discrimination. *Mach Mining, LLC v. E.E.O.C.*, 135 S. Ct. 1645 (April 29, 2015). https://supreme.justia.com/cases/federal/us/575/13-1019/

*Debtor who converts from a Chapter 13 to a Chapter 7 is entitled to return of post petition wages not distributed by the Chapter 13 trustee.* The United States Supreme Court held that absent a bad-faith conversion, 11 U.S.C. 348(f) limits a converted Chapter 7 estate to property belonging to the debtor "as of the date" of the original Chapter 13 filing. By excluding post-petition wages from the converted Chapter 7 estate, the statute removes those earnings from the pool of assets to be liquidated and distributed to creditors. Allowing a terminated Chapter 13 trustee to disburse those earnings to the same creditors would be incompatible with that statutory design. When a case is converted, the Chapter 13 trustee is stripped of authority to distribute "payment[s] in accordance with the plan." *Harris v. Viegelahn*, 135 S. Ct. 1829 (May 18, 2015). https://supreme.justia.com/cases/federal/us/575/14-400/

*The Supreme Court has held that the Employee Retirement Income Security Act's (ERISA) six-year statute of limitations does not bar an action against the managers of a 401K despite the fact that the decision to invest in the funds which was the subject of the suit was made more than six years before the filing of the suit.* The suit by former and current employees of Edison International alleged that the fund managers breached their fiduciary duties by placing em-

ployee 401k funds in "retail" mutual funds which had higher fees than the lower priced "institutional" funds that were available to the managers. Because the suit had been filed more than six years after the selection of the funds, the district court dismissed the case as barred y ERISA's six year statute of limitations, and the Ninth Circuit affirmed that dismissal. Reversing that decision, the Supreme Court noted that the fiduciary duty at issue in the ERISA context derived from the common law of trusts, and that the common law of trusts imposed a continuing duty to monitor and remove imprudent investments. Because of this continuing duty, the court ruled that dismissal of the action based merely upon the date of the initial selection of the funds was erroneous. *Tibble v. Edison Int'l*, 135 S. Ct. 1823 (May 18, 2015) https://supreme.justia.com/cases/federal/us/575/13-550/

*Bankruptcy court may not award fees to professionals for defending fee applications.* The United States Supreme Court held that Section 330(a)(1) of the Bankruptcy Code does not permit bankruptcy courts to award fees to section 327(a) professionals for defending fee applications. The American Rule provides the basic point of reference for attorney's fees: Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise. Congress did not depart from the American Rule in section 330(a)(1) for fee-defense litigation. The phrase "reasonable compensation for services rendered" necessarily implies "loyal and disinterested service in the interest of" a client, Time spent litigating a fee application against the bankruptcy estate's administrator cannot be fairly described as "labor performed for"—let alone "disinterested service to"—that administrator. Requiring bankruptcy attorneys to bear the costs of their fee-defense litigation under section 330(a)(1) creates no disincentive to bankruptcy practice. *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (June 15, 2015). https://supreme.justia.com/cases/federal/us/576/14-103/

## U.S. Supreme Court affirms the use of "disparate impact" analysis to find violations of the Fair Housing Act.

*The U.S. Supreme Court affirms the use of "disparate impact" analysis to find violations of the Fair Housing Act ("FHA").* Disparate impact analysis does not require proof of an intent to discriminate, but allows statistical proof that an action results in a disparate impact on a protected group to prove a violation of the law. The State of Texas and private parties had argued that the use of "disparate impact" analysis was illegal because it may require housing authorities to use race as a basis for making decisions in housing subsidies. The Supreme Court held that the FHA as amended by congress clearly contemplated and allowed disparate impact analysis. *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (June 25, 2015). http://www.supremecourt.gov/opinions/14pdf/13-1371_m64o.pdf

**FEDERAL CIRCUIT COURTS**

*Cases should be stayed, not dismissed, during arbitration.* The Second Circuit held that a court should stay a case when it grants a motion to dismiss. The court noted that when the case is dismissed the matter is immediately appealable as a final order. The court recognized the administrative advantages of a rule permitting dismissal, but held that the Federal Arbitration Act, 9 U.S.C. § 1 et seq. ("FAA"), requires a stay of proceedings when all claims are referred to arbitration and a stay is requested. *Katz v. Cellco P'ship,* 794 F.3d 341 (2d Cir. July 28, 2015). http://law.justia.com/cases/federal/appellate-courts/ca2/14-138/14-138-2015-07-28.html

*Demanding fees in a foreclosure complaint in a way contrary to the underlying agreement is actionable under the FDCPA.* The Third Circuit held that an attorney who in a foreclosure complaint attempted to collect fees for services not yet performed violated the Fair Debt Collection Practices Act. *Kaymark v. Bank of Am., N.A.*, 783 F.3d 168 (3d Cir. April 7, 2015). http://law.justia.com/cases/federal/appellate-courts/ca3/14-1816/14-1816-2015-04-07.html

*Debt collector has the burden to prove a third party communication fits within an exception provided by the FDCPA.* The Third Circuit considered a case of first impression: who has the burden to prove a challenged communication fits, or does not fit, with the exception of the Act. The court stated:

> Under the Fair Debt Collection Practices Act … a debt collector is liable to a consumer for contacting third parties in pursuit of that consumer's debt unless the communication falls under a statutory exception. One of those exceptions covers communication with a third party "for the purpose of acquiring location information about the consumer" but, even then, prohibits more than one such contact "unless the debt collector reasonably believes that the earlier response of such person is erroneous or incomplete and that such person now has correct or complete location information." 15 U.S.C. § 1692b…. We conclude that the debt collector bears that burden.

*Evankavitch v. Green Tree Servicing, LLC*, 793 F.3d 355 (3d Cir. July 13, 2015). http://law.justia.com/cases/federal/appellate-courts/ca3/14-1114/14-1114-2015-07-13.html

*Minor changes in telemarketing language do not defeat class certification.* The Third Circuit held that a district court was wrong in refusing to certify a class. The district court recognized the plaintiff's theory of a sham enterprise, but focused on the fact that different sales pitches were used and different products were pitched. The Third Circuit vacated, reasoning that the district court did not adequately consider evidence of the structure of each of the alleged fraudulent schemes and related FTC investigations. "If absolute conformity of conduct and harm were required for class certification, unscrupulous businesses could victimize consumers with impunity merely by tweaking the language in a telemarketing script or directing some (or all) of the telemarketers not to use a script at all but to simply orally convey a general theme designed to get access to personal information such as account numbers." *Reyes v. Netdeposit, LLC*, 2015 WL 5131287 (3d Cir. Sept. 2, 2015). http://law.justia.com/cases/federal/appellate-courts/ca3/14-1228/14-1228-2015-09-02.html

*Falsity requires all reasonable experts agree.* The Fourth Circuit held that "to state a false advertising claim on a theory that representations have been proven to be false, plaintiffs must allege that all reasonable experts in the field agree that the representations

are false." "When litigants concede that some reasonable and duly qualified scientific experts agree with a scientific proposition, they cannot also argue that the proposition is 'literally false.'" *In re GNC Corp.*, 789 F.3d 505 (4th Cir. June 19, 2015). http://www.ca4.uscourts.gov/Opinions/Published/141724.P.pdf

*Texas Debt Collection Act award of $75,000 for mental anguish and $156,775 for attorney's fees is affirmed.* The Fifth Circuit reviewed the scope and liability provisions of the TDCA, and held that any person, not just debtors, who has sustained actual damages from a Texas Debt Collection Act violation has standing to sue. The court also found that the term "actual damages" includes mental anguish, and significantly that the economic loss rule does not bar TDCA violations. *McCaig v. Wells Fargo Bank (Texas), N.A.*, 788 F.3d 463 (5th Cir. June 10, 2015). http://www.ca5.uscourts.gov/opinions/pub/14/14-40114-CV0.pdf

*Rule 68 offer to individual plaintiff does not moot class action.* Plaintiff filed suit seeking statutory damages for alleged violations of the Electronic Funds Transfer Act (EFTA), 15 U.S.C. § 1693, et seq., after he was charged $2.95 for an ATM withdrawal but was not given notice or informed of the fee. At issue was whether a Federal Rule of Civil Procedure 68 offer mooted plaintiff's individual claim and the class action claims. Finding the reasoning of the Ninth and Eleventh Circuits persuasive, the Fifth Circuit held that an unaccepted offer of judgment to a named plaintiff in a class action "is a legal nullity, with no operative effect." Nothing in Rule 68 alters that basic principle. Accordingly, given that plaintiff's individual claim was not mooted by the unaccepted offer in this case, neither were the class claims. *Hooks v. Landmark Indus., Inc.*, 2015 WL 4760253 (5th Cir. Aug. 12, 2015). http://law.justia.com/cases/federal/appellate-courts/ca5/14-20496/14-20496-2015-08-12.html

## No advertisement, no Telephone Consumer Protection Act liability.

*No advertisement, no Telephone Consumer Protection Act liability.* The Sixth Circuit considered whether a fax from Medco, titled "Formulary Notification," was an advertisement. The fax stated that "The health plans of many of your patients have adopted" Medco's formulary and asked the receiver to "consider prescribing plan-preferred drugs" to "help lower medication costs for patients." -Under the Commission's analysis, if the primary purpose of the fax at issue is informational rather than promotional, the TCPA does not apply. The court began with the TCPA's definition of "advertisement" at Section 227(a)(5) as "any material advertising the commercial availability or quality of any property, goods, or services." The court noted that the Federal Communication Commissions interpretation of this provision is that if the primary purpose of the fax at issue is informational rather than promotional, the TCPA does not apply. "That aptly describes the faxes here," the court said. "They contain only information—parts of the formulary—and do not seek to promote products or services to make a profit." *Sandusky Wellness Ctr., LLC v. Medco Health Solutions, Inc.*, 788 F.3d 218 (6th Cir. June 3, 2015). http://law.justia.com/cases/federal/appellate-courts/ca6/14-4201/14-4201-2015-06-03.html

*Telephone Consumer Protection Act imposes direct liability on business.* The Sixth Circuit held that a plaintiff's standing in a junk fax case doesn't depend on whether it printed out a fax that was sent to it. The court recognized that receiving an unsolicited fax injures people in ways other than the waste of paper and ink, and held that Congress could appropriately allow people to sue over faxes they never printed. The court also held that under the TCPA someone who has a fax advertisement for his or her business sent by a contractor or other third party is directly liable as a principal if the fax violates the TCPA. *Imhoff Inv., L.L.C. v. Alfoccino, Inc.*, 792 F.3d 627 (6th Cir. July 7, 2015). http://law.justia.com/cases/federal/appellate-courts/ca6/14-1704/14-1704-2015-07-07.html

*Providing a creditor with a cell phone number is "prior express consent" under the Telephone Consumer Protection Act ("TCPA").* When the plaintiff obtained a mortgage, he used a home number. Subsequently, he discontinued his home phone service, and notified the lender that his cell phone was his new contact number. Ultimately the plaintiff fell behind on his mortgage, and the cell number was used by the mortgage company in collection efforts. The Sixth Circuit affirmed the district court's finding that the provision of the cell phone number to the mortgage company was "prior express consent" under the TCPA such that the mortgage company's use of the cell phone number was not in violation of the TCPA. *Hill v. Homeward Residential, Inc.*, 2015 WL 4978464 (6th Cir. Aug. 21, 2015). http://caselaw.findlaw.com/us-6th-circuit/1711496.html

*Is arbitration a "darling of federal policy"?* Writing for the Seventh Circuit, Judge Richard Posner enforced an arbitration clause, while questioning the often stated position that arbitration should be the favored method of dispute resolution or arbitration. "And it's not clear why, so far as eliciting the meaning of a given arbitration clause is concerned, such a clause should be distinguished from any other clause in a contract." Judge Posner also hits the nail on the head when he questions why the defendant even wants arbitration, when it would easily prevail in court. "But doubtless it wants arbitration because the arbitration clause disallows class action arbitration. If the Andermanns' claims have to be arbitrated all by themselves, they probably won't be brought at all, because the Andermanns if they prevail will be entitled only to modest statutory damages." *Andermann v. Sprint Spectrum L.P.*, 785 F.3d 1157 (7th Cir. May 11, 2015). http://law.justia.com/cases/federal/appellate-courts/ca7/14-3478/14-3478-2015-05-11.html

*Class satisfied Rule 23's ascertainability requirement.* The district court certified a plaintiff class of individuals "who purchased Instaflex within the applicable statute of limitations of the respective Class States for personal use until the date notice is disseminated," under Rule 23(a) and (b)(3). The Seventh Circuit rejected defendant's argument that Rule 23(b)(3) implies a heightened ascertainability requirement, noting an implicit requirement under Rule 23 that a class must be defined clearly and that membership be defined by objective criteria rather than by, for example, a class member's state of mind. In addressing this requirement, courts have sometimes used the term "ascertainability." Class definitions fail this requirement when they were too vague or subjective, or when class membership was defined in terms of success on the merits (fail-safe classes). This class satisfied "ascertainability" *Mullins v. Direct*

*Digital, LLC,* 795 F.3d 654 (7th Cir. July 28, 2015). http://law.justia.com/cases/federal/appellate-courts/ca7/15-1776/15-1776-2015-07-28.html

*Filing a proof of claim on a time-barred debt is not, alone, a prohibited debt collection practice under the federal Fair Debt Collection Practices Act (FDCPA).* The United States Bankruptcy Appellate Panel for the Eighth Circuit held that since the inclusion of a debt in a bankruptcy petition is essentially an invitation to the creditor to file a proof of claim, the mere filing of such a proof of claim, even for a time barred but otherwise valid debt, is not a violation of the FDCPA. The Eighth Circuit declined to follow the Eleventh Circuit's recent decision in *Crawford v. LVNV Funding LLC,* 758 F.3d 1254 (11th Cir. 2014) which reached a contrary conclusion. *In re Gatewood,* 533 B.R. 905 (B.A.P. 8th Cir. July 10, 2015). http://law.justia.com/cases/federal/appellate-courts/ca8/15-6008/15-6008-2015-07-10.html

*Truth in Lending requires a security interest in a primary residence.* The Eleventh Circuit affirmed a grant of summary judgment in favor of the defendant, alleged to have failed to make proper disclosures. The court concluded that defendant did not take the requisite interest in plaintiffs' primary residence to trigger the TILA protections on which plaintiffs rely. *Lankhorst v. Indep. Sav. Plan Co.*, 787 F.3d 1100 (11th Cir. May 28, 2015). http://law.justia.com/cases/federal/appellate-courts/ca11/14-11449/14-11449-2015-05-29.html

*Communication directed to attorney may violate FDCPA.* The Eleventh Circuit Court of Appeals potentially expanded the scope of actionable conduct under the Fair Debt Collection Practices Act ("FDCPA") to include communications directed to a debtor's attorney. While the court held that it may be a high bar to establish a violation, litigation related activities are not exempted from coverage under the FDCPA. *Miljkovic v. Shafritz & Dinkin, P.A.*, 791 F.3d 1291 (11th Cir. June 30, 2015). http://media.ca11.uscourts.gov/opinions/pub/files/201413715.pdf

*To be a debt collector under the Fair Debt Collection Practices Act, the entity must meet a statutory test.* Capital One purchased the account in question as part of a portfolio of credit card accounts from HSBC. The plaintiff argued, in keeping with the majority rule, that Capital One fell within the definition of "debt collector" under § 1692a(6)(F)(iii) because the subject debt was in default at the time it was acquired by Capital One. The Eleventh Circuit disagreed, stating that before a defendant can be brought within the scope of the FDCPA, it must satisfy one of the two "substantive requirements" of the "debt collector" definition: either having a principal purpose of debt collection or regularly collecting debts owed or due another. *Davidson v. Capital One Bank (USA), N.A.*, 2015 WL 4994733 (11th Cir. Aug. 21, 2015). http://media.ca11.uscourts.gov/opinions/pub/files/201414200.pdf

**FEDERAL DISTRICT COURTS**

*The United States District Court for the Northern District of California dismissed a proposed class action which alleged that LinkedIn was a Consumer Reporting Agency ("CSA") under the Fair Credit Reporting Act ("FCRA"), and that LinkedIn violated the law with an online feature for businesses to check applicants' references on the site without the applicants' knowledge.* The Plaintiffs unsuccessfully argued that the site's "Reference Search" feature produced "Consumer Reports" ("CR") under the law. The class representatives used LinkedIn to apply for jobs, alleging that they were denied employment opportunities after the potential employers connected with them on LinkedIn, and that LinkedIn's provision of the "Reference Search" function to prospective employers violated the FCRA. The Court rejected this argument for multiple reasons, including the fact that the LinkedIn feature is excluded from the FCRA definition of "Consumer Report" because the applicants voluntarily provide the information with the intention of LinkedIn publishing it. The Court also held that because LinkedIn is not a CSA which gathers CR to sell to 3rd parties for a fee, it could not create a CR. *Sweet v. LinkedIn Corp.*, No. 5:14-CV-04531-PSG, 2015 WL 1744254, (N.D. Cal. Apr. 14, 2015). https://docs.justia.com/cases/federal/districtcourts/california/candce/5:2014cv04531/281365/33

**Uber arbitration agreement held unenforceable.**

*Uber arbitration agreement held unenforceable.* The U.S. District Court for the Northern District of California held that both the 2013 and 2014 versions of Uber's contracts with its drivers were both procedurally and substantively unconscionable, and, therefore, unenforceable as a matter of California law. The court found that although plaintiff validly assented to the terms of the contract, the arbitration provisions were procedurally unconscionable because the opt-out clause was "inconspicuous and incredibly onerous to comply with." The court also found the provision was substantively unconscionable because it is "permeated with substantively unconscionable terms:" it waives plaintiffs' right to bring certain claims in any forum, it has an impermissible fee-shifting clause, a carve-out that "permits Uber to litigate the claims most valuable to it in court . . . while requiring its drivers to arbitrate those claims . . . they are most likely to bring against Uber," and a provision that gives Uber authority to modify contract terms unilaterally and at any time. *Mohamed v. Uber Technologies, Inc.*, No. C-14-5200 EMC, 2015 WL 3749716 (N.D. Cal. June 9, 2015). http://www.employmentlawblog.info/images/uber%20decision.pdf

*The U.S. District Court for the Eastern District of Louisiana has dismissed a potential class action against eBay alleging that the company was responsible for increasing its users' risk of identity theft following a data breach in 2014.* The court ruled the plaintiff lacked standing under Article III of the Constitution to pursue the claims because the alleged injury was too speculative to meet the "certainly impending" standard established by the Supreme Court in Clapper vs. Amnesty International USA. *Green v. eBay Inc.*, No. CIV.A. 14-1688, 2015 WL 2066531 (E.D. La. May 4, 2015). http://law.justia.com/cases/federal/district-courts/louisiana/laedce/2:2014cv01688/162697/38/

*U.S. District Court finds "sign-in-wrap" arbitration agreement invalid and unenforceable.* A court for the Eastern District of New York defined a new category of online agreement called the "sign-in-wrap" where text indicates that acceptance of the "terms of use" is required to continue, but the user never actually has to click a box accepting the terms of use as in most "clickwrap" agreements. The court held that such a "sign-in-wrap" agreement was

an insufficient basis upon which to compel arbitration. *Berkson v. Gogo LLC*, No. 14-CV-1199, 2015 WL 1600755 (E.D.N.Y. Apr. 9, 2015). https://www.truthinadvertising.org/wp-content/uploads/2015/04/Berkson-v-Gogo-memo-and-order.pdf

*Clickwrap did not constitute assent.* A Tennessee federal judge denied the motion for partial summary judgment as to a breach of contract claim because there was evidence that the plaintiff did not actually assent to the "clickwrap agreement" requiring acceptance of new contract terms on defendant's website. Despite defendant's evidence that the plaintiff's online account had accepted a 2009 change in contract terms with a clickwrap acceptance, the court held that a factual dispute existed because the plaintiff alleged that he did not access the website or authorize an agent to do so. *Jim Schumacher, LLC v. Spireon, Inc.*, No. 3:12-CV-625, 2015 WL 3949349 (E.D. Tenn. June 29, 2015). http://law.justia.com/cases/federal/districtcourts/tennessee/tnedce/3:2012cv00625/66200/76/

**STATE COURTS**

*California Supreme Court upholds class action waiver in arbitration clause.* The California Supreme Court rejected arguments that a class-action ban in an arbitration clause, together with a few other provisions that were unfavorable to a consumer, rendered the arbitration clause unconscionable. The opinion emphasized that an arbitration clause, like any other contract, may be challenged on unconscionability grounds, and that the unconscionability standard must be "the same for arbitration and non-arbitration agreements." The Court recognized that under *Concepcion* a class action waiver cannot itself be held unconscionable. The other provisions at issue in the clause, however, did not render it so unfair as to be unconscionable. *Sanchez v. Valencia Holding Co., LLC*, 353 P.3d 741 (Cal. Aug. 3, 2015). http://law.justia.com/cases/california/supreme-court/2015/s199119.html

**The right to challenge an arbitration award on grounds set forth in the Federal Arbitration Act cannot be waived by contract.**

*The right to challenge an arbitration award on grounds set forth in the Federal Arbitration Act cannot be waived by contract.* A Georgia appellate court has held that a contract restricting the challenging of an award impinges on the Georgia Arbitration Code (which is analogous to the Federal Act) and is unenforceable. Thus, the losing party in the arbitration can pursue an action in court to vacate or modify the award pursuant to state and federal arbitration law. *Atlanta Flooring Design Centers, Inc. v. R.G. Williams Const., Inc.*, 773 S.E.2d 868 (Ga. Ct. App. July 16, 2015) https://scholar.google.com/scholar_case?case=18353269951745897592&q=Atlanta+Flooring+Design+Centers,+Inc.+v.+R.G.+Williams+Construction,+Inc.,&hl=en&as_sdt=6,44&as_vis=1

*Arbitration agreement unconscionable and unenforceable.* The Hawaiian Supreme Court in an aggressive decision applied its state contract law to conclude that the condo owners did not agree to a developer's arbitration agreement, but held that even if they did, the agreement was unconscionable because it prohibited both discovery and punitive damages. Under state law, the court found that the fact that the arbitration clause was not in the sales contract, but in a separate "auxiliary document," there was no clear intent to arbitrate. The court also found that the inability of the condo owners to do discovery deprived them of an adequate alternative forum, and that the preclusion of punitive damages was "substantively unconscionable" in a contract of adhesion. *Narayan v. Ritz-Carlton Dev. Co.*, 350 P.3d 995 (Haw. June 3, 2015). http://law.justia.com/cases/hawaii/supreme-court/2015/scwc-12-0000819.html

*Iowa Supreme Court affirms summary judgment against casino patron who claimed she won a large "bonus" award.* Patron won 185 credits, or $1.85, while playing a penny slot machine at a Casino. At the same time, a message appeared on the screen stating, "Bonus Award - $41797550.16." The game rules, which were available when the player started to play, did not provide for any kind of bonus. They also included the statement "MALFUNCTION VOIDS ALL PAYS AND PLAYS." Patron filed suit asserting breach of contract, estoppel, and consumer fraud. The court affirmed the lower court summary judgment in favor of defendant on all three counts. *McKee v. Isle of Capri Casinos, Inc.*, 864 N.W.2d 518 (Iowa April 24, 2015). http://law.justia.com/cases/iowa/supreme-court/2015/140802.html

*Slip and fall in Hospital is not a health care liability claim.* The Texas Supreme Court reversed a trial and appellate court ruling that dismissed the plaintiff's claim for failure to comply with the Texas Medical Liability Act. The supreme court held the Act did not apply because the plaintiff's claim was based on safety standards and had nothing to do with the providing of health care. *Ross v. St. Luke's Episcopal Hosp.*, 462 S.W.3d 496 (Tex. May 1, 2015). http://law.justia.com/cases/texas/supreme-court/2015/13-0439.html

*Exemplary damages cap is not an affirmative defense.* The Texas Supreme Court held that: (i) the exemplary damages cap, Tex. Civ. Prac. & Rem. Code § 41.008(b), is not a matter "constituting an avoidance or affirmative defense" and need not be affirmatively pleaded because it applies automatically when invoked and does not require proof of additional facts, and (ii) because Petitioner timely asserted the cap in her motion for new trial, the exemplary damages must be capped at $200,000. *Zorrilla v. Aypco Constr. II, LLC*, No. 14-0067, 2015 WL 3641299 (Tex. June 12, 2015). http://law.justia.com/cases/texas/supreme-court/2015/14-0067.html

*Demand letter from EPA constitutes a "suit."* The Texas Supreme Court held that a demand letter from the EPA to a potentially responsible party ("PRP") under CERCLA and administrative proceedings under CERCLA constitute a "suit" that triggers an insurer's obligations under a CGL policy. *McGinnes Indus. Maint. Corp. v. Phoenix Ins. Co.*, No. 14-0465, 2015 WL 4080146 (Tex. June 26, 2015). http://law.justia.com/cases/texas/supreme-court/2015/14-0465-0.html

## Arbitration provision that excepted any fee claims by attorney from its scope but require client arbitrate all claims, was not substantively unconscionable.

*Arbitration provision that excepted any fee claims by attorney from its scope but require client arbitrate all claims, was not substantively unconscionable.* The Texas Supreme Court reversed a lower court ruling that an arbitration clause was substantively one-sided, unconscionable and unenforceable. The supreme court noted, "In sum, although the provision was one-sided in the sense that it excepted any fee claims by Royston, Razor from its scope, excepting that one type of dispute does not make the agreement so grossly one-sided so as to be unconscionable." *Royston, Rayzor, Vickery, & Williams, LLP v. Lopez*, No. 13-1026, 2015 WL 3976101 (Tex. June 26, 2015). http://law.justia.com/cases/texas/supreme-court/2015/14-0109.html

## DECEPTIVE TRADE PRACTICES AND WARRANTIES

### DTPA UNCONSCIONABILITY IS AN OBJECTIVE STANDARD

### WORKERS COMPENSATION STATUTE PREEMPTS DTPA.

Vause v. Liberty Ins. Corp., 456 S.W.3d 222 (Tex. App.—San Antonio 2014).
http://caselaw.findlaw.com/tx-court-of-appeals/1685261.html

**FACTS:** Appellant Kathryne Vause ("Vause") injured herself while working at a restaurant. The restaurant's workers' compensation insurer, Appellees Liberty Insurance Corporation and Justin A. Smith ("Liberty Insurance"), investigated and subsequently denied Vause's claim. Vause alleged that Liberty Insurance violated provisions of the insurance code and the DTPA. The trial court granted Liberty Insurance's motion for summary judgment. Vause appealed.
**HOLDING:** Affirmed.
**REASONING:** Vause argued that Liberty Insurance, as both insurer and insurer's underwriter, engaged in unconscionable trade practices by failing to adequately investigate her claim and by improperly refusing and/or delaying payment of benefits. In assessing the unconscionability of Liberty Insurance's allegations under the DTPA the court of appeals noted that an the DTPA employs an objective standard, whereby intent or knowledge of wrongdoing on the part of the alleged offending party, is irrelevant. The court of appeals rejected Vause's DTPA claims in their entirety by holding that the workers' compensation statute under the insurance code was Vause's exclusive remedy, thereby precluding recovery under the DTPA.

## CONSUMER CREDIT

### TRUTH IN LENDING REQUIRES A SECURITY INTEREST IN A PRIMARY RESIDENCE

Lankhorst v. Indep. Sav. Plan Co., 787 F.3d 1100 (11th Cir. 2015).
https://scholar.google.com/scholar_case?case=6899192452061903203&hl=en&as_sdt=6&as_vis=1&oi=scholarr

**FACTS:** Plaintiffs, ("The Lankhorsts"), moved to Orange Park, Florida in 2010. After moving into their new home, they began receiving calls from WET, Inc. ("WET") soliciting the sale of a water treatment system. The Lankhorsts agreed to purchase the treatment system and indicated on the Purchase Agreement that they intended to seek financing for the purchase. The WET salesman told the Lankhorsts that they would qualify for a low interest rate. Following the installation of the treatment system, Defendant, Independent Savings Plan Company, ("ISPC") delivered the Credit Agreement, at which time, Lankhorst discovered that the interest rate was 17.99%.

**The circuit court found that the provision in question added nothing that a judgment in the state of Florida would not already provide, and was not a security interest.**

The Lankhorsts filed suit alleging that ISPC violated the Truth in Lending Act by failing to disclose examples of minimum payments and the maximum repayment period for this "extension of credit which is secured by the consumer's principal dwelling." The district court granted summary judgment in favor of ISPC, finding that the Credit Agreement did not convey a security interest in the Plaintiffs' residence violating the Truth in Lending Act. The Lankhorsts appealed.
**HOLDING:** Affirmed
**REASONING:** Subsections 15 U.S.C. § 1635 & 1637a, the Truth in Lending Act, apply to a security interest in a primary residence. The Eleventh Circuit found that the judgment against the debtor, as opposed to the Credit Agreement or the UCC, gave rise to the potential lien against the home. Florida state law converts any judgment to a lien against real property independent of any contract. The Eleventh Circuit also found that the provision in question added nothing that a judgment in the state of Florida would not already provide, and was not a security interest.

### LOAN AGREEMENT THAT OBLIGATED BORROWER TO PAY FEES OF ATTORNEY HIRED TO COLLECT DID NOT COVER FEES INCURRED DEFENDING CLAIMS BY BORROWER

Clark v. Missouri Lottery Comm'n, ____ S.W.3d ____ (Mo. Ct. App. 2015).
http://law.justia.com/cases/missouri/court-of-appeals/2015/wd78060.html

**FACTS:** Gary Michael Clark, ("Clark"), won the Missouri Lottery, with a payout of $50,000.00 per year for the rest of his life, with a minimum payout of thirty years. Clark executed an agreement to deposit lottery payments in an account at Community Bank in order to secure a loan from the same bank. Clark brought a declaratory judgment action against the Missouri Lottery Commission and Community Bank of El Dorado Springs ("the Commission") to declare the agreement void and unenforceable. Clark argued that the state lottery prohibited the assignment of his lottery prizes by the Commission. Thus, the assignment of his lottery payments to secure

two loans from Community Bank was invalid.

The circuit court granted summary judgment against Clark and in favor of the Commission. Clark appealed.

**HOLDING:** Affirmed.

**REASONING:** The appellate court stated that Community Bank failed to establish that it was entitled to attorney's fees under the terms of the loan agreement. The loan agreement had a provision that stated Clark agreed to pay the fees incurred by Community Bank if the bank hired an attorney to collect on the notes.

The appellate court found that this case was not a collection case brought by Community Bank, but rather a declaratory judgment action created by Clark to determine the validity of the assignment of his lottery winnings and the loan agreement created therefrom. The court further determined that Community Bank's motion for attorney's fees was lacking an adequate explanation as to how the facts and circumstances of the current case entitled them to attorney's fees under the provision of the loan agreement.

## DEBT COLLECTION

### FILLING A PROOF OF CLAIM ON A TIME-BARRED DEBT IS NOT, STANDING ALONE, A PROHIBITED DEBT COLLECTION PRACTICE UNDER THE FEDERAL FAIR DEBT COLLECTION PRACTICES ACT

Gatewood v. CP Medical, LLC____F3d.____(8th Cir. 2015).
http://law.justia.com/cases/federal/appellate-courts/ca8/15-6008/15-6008-2015-07-10.html

**FACTS:** Mr. and Mrs. Gatewood ("the Gatewoods") filed a Chapter 13 bankruptcy petition. CP Medical's agent timely filed a proof of claim. The court confirmed the Chapter 13 plan, proposing monthly payments and a pro rata distribution to unsecured creditors. The Gatewoods subsequently fell behind on their plan payments and converted the case to a Chapter 7.

**The bankruptcy court and court officers protect debtors from abusive collection practices.**

After confirmation, but during the pendency of the Chapter 13 case, the Gatewoods filed an adversary proceeding against CP Medical for monetary damages caused by a violation of the Fair Debt Collection Practices Act ("FDCPA"). The Gatewoods asserted that by filing a claim on a debt that is time-barred, CP Medical engaged in "false, deceptive, misleading, unfair and unconscionable" debt collection practice in contravention of the FDCPA.

The bankruptcy court granted CP Medical's motion for summary judgment. The Gatewoods appealed.

**HOLDING:** Affirmed.

**REASONING:** The Eighth Circuit reasoned that filing an accurate proof of claim containing all the required information, including the timing of the debt, standing alone, is not a prohibited debt collection practice. The court reasoned there is no need to protect debtors who are already under the protection of the bankruptcy court, and there is no need to supplement the remedies afforded. The bankruptcy court and court officers protect debtors from abusive collection practices, and the Bankruptcy Code provides adequate remedies for potential creditor misconduct. The court refused to insert judicially created remedies into Congress's carefully calibrated bankruptcy scheme, thus tilting the balance of right and obligations between debtors and creditors.

### DEBT COLLECTOR DOES NOT HAVE AN OBLIGATION UNDER THE FDCPA TO INFORM CONSUMER OF TAX CONSEQUENCES

Altman v. J.C. Christensen & Assocs., 786 F.3d 191 (2d Cir. N.Y. 2015).
http://law.justia.com/cases/federal/appellate-courts/ca2/14-2240/14-2240-2015-05-14.html

**FACTS:** Defendant**,** Christensen & Associates ("Christensen") was hired to collect debts owed by Plaintiff, Issac Altman, ("Altman") on his credit card bills. Christensen offered to settle Altman's debts for a lesser amount than his total balance. Altman alleged that Christensen violated the FDCPA by not warning Altman that his tax liability may increase from cancellation of debt income. The trial court ruled that Christensen did not owe a duty to Altman to inform him of possible tax consequences. Altman appealed.

**HOLDING:** Affirmed.

**REASONING:** The appellate court held that Christensen was not deceptive by his failure to disclose tax consequences, because the letter expressly stated that the savings were based on the "outstanding account balance" and not on tax liability. The appellate court reasoned that the scope of the FDCPA was to protect debtors from abusive debt collection practices, and requiring a debt collector to disclose potential tax consequences is outside the scope of the FDCPA.

### TEXAS BREACH OF CONTRACT CLAIM IS NOT PREEMPTED BY THE FEDERAL HOME OWNER'S LOAN ACT

### TEXAS NEGLIGENT MISREPRESENTATION CLAIM IS PREEMPTED BY THE HOLA

### TEXAS DEBT COLLECTION ACT CLAIM IS NOT PREEMPTED BY THE HOLA

Barzelis v. Flagstar Bank, F.S.B., 784 F.3d 971, 973 (5th Cir. 2015).
http://www.gpo.gov/fdsys/granule/USCOURTS-ca5-14-10782/USCOURTS-ca5-14-10782-0

**FACTS**: Stacy Barzelis ("Mortgagor") brought action in Texas state trial court against Flagstar Bank ("Lender") for wrongful

foreclosure, breach of contract, negligent misrepresentation, violation of the Texas Debt Collections Act ("TDCA") and violation of the Real Estate Settlement and Procedures Act ("RESPA").

The trial court removed the case to federal court. The federal district court dismissed the state law claims and granted summary judgment on the RESPA claim. Mortgagor appealed the dismissal of the case claiming it was preempted by the Home Owner's Loan Act ("HOLA") of 1933.

**HOLDING**: Affirmed in part and reversed in part.

**REASONING**: The court examined the substance of the HOLA and determined that the Mortgagor's breach of contract claim was not preempted. Initially the court found that Section 51.002(d) was preempted, however, the claim was reversed because it did not address the alleged breaches of the actual security instrument.

The court determined that the Mortgagor's negligent misrepresentation claim was, however, preempted by HOLA. The court noted that the Mortgagor had asserted that in mailed notices the Lender had negligently misrepresented the status of her loan and foreclosure sale. The court held her claim was based on misstatements in disclosures contained in credit related documents and, therefore, preempted under the HOLA.

Finally, the court found the TDCA claim was not preempted by the HOLA because the essential purpose of the TDCA is to limit coercive and abusive behavior by all those seeking to collect debts. This is not something that burdens lending in the same way, as for example, a specific mandate on interest rates. Thus, the TDCA is not preempted by the HOLA.

**UNDER THE FAIR DEBT COLLECTION PRACTICES ACT PLAINTIFF NEED NOT PROVE KNOWLEDGE OR INTENT TO ESTABLISH LIABILITY**

**FDCPA PLAINTIFF NEED NOT SHOW ACTUAL DAMAGES**

Wise v. Zwicker & Assocs., 780 F.3d 710 (6th Cir. 2015).
http://www.leagle.com/decision/In%20FCO%2020150312143.xml/WISE%20v.%20ZWICKER%20&%20ASSOCS.,%20P.C.

**FACTS:** Plaintiff, Dawson Wise ("Wise"), defaulted on a credit card account held with American Express. American Express retained Defendant, Zwicker & Associates, P.C. (Zwicker), to collect the debt. Two attorneys for Zwicker contacted Wise and demanded payment on the debt, as well as attorney's fees for their collection activities. Wise filed suit against Zwicker, claiming the demands for attorney's fees violated the FDCPA. Zwicker filed for summary judgment, which the court granted. Wise appealed.

**The risk of penalties under the FDCPA is placed solely on the debt collector engaged in an activity that is not entirely lawful.**

**HOLDING:** Affirmed in part, reversed in part.

**REASONING:** The court concluded that "[u]nder the FDCPA, a plaintiff does not need to prove knowledge or intent to establish liability, nor must he show actual damages." The risk of penalties under the FDCPA is placed solely on the debt collector engaged in an activity that is not entirely lawful, thus relieving consumers from exposure to "unlawful debt collector behavior without a possibility for relief." As a result, "if a debt collector seeks fees to which it is not entitled," they have committed a FDCPA violation on its face regardless of whether or not there was a court issued statement prohibiting the collection of the fees.

The court also noted that the FDCPA authorizes an award of statutory damages or equitable relief, without a requirement the consumer prove any actual damages.

**DEBT COLLECTOR HAS BURDEN TO PROVE A THIRD PARTY COMMUNICATION FITS WITHIN AN EXCEPTION PROVIDED BY THE FDCPA**

Evankavitch v. Green Tree Servicing, LLC, ____ F.3d____(3rd Cir. 2015).
http://www2.ca3.uscourts.gov/opinarch/141114p.pdf

**FACTS:** Evankavitch, defaulted on a mortgage that was later assigned to Green Tree Servicing LLC, ("Green Tree"). After failing to reach Evankavitch personally, Green Tree made numerous unsuccessful phone calls to Evankavitch's daughter and neighbors asking them to tell Evankavitch to contact Green Tree regarding the mortgage.

**The Third Circuit court noted that as a general rule, the FDCPA forbids a "debt collector from contacting third parties in its attempts to collect a consumer's debt."**

Once Evankavitch learned of Green Tree's communications with her daughter and neighbors, she filed suit against Green Tree, claiming that Green Tree violated the FDCPA by impermissibly contacting third parties in its debt collection efforts. The district court entered judgment in Evankavitch's favor for $1,000. Green Tree appealed.

**HOLDING:** Affirmed.

**REASONING:** The Third Circuit court noted that as a general rule, the FDCPA forbids a "debt collector from contacting third parties in its attempts to collect a consumer's debt." An exception to this rule exists when the communications are made "for the purpose of acquiring location information about the consumer." However, a debt collector may not contact a third party regarding location information more than once "unless the debt collector reasonably believes that the earlier response of such [third party] is erroneous or incomplete and that such [third party] now has correct or complete location information."

The court indicated five factors in determining whether the consumer or the debt collector has the burden of proving/disproving the applicability of the third party exception to the general FDCPA rule. Those factors include: (1) whether a defense is a statutory exception, (2) whether the statutory scheme indicates which party has the burden, (3) whether a plaintiff will be unduly prejudiced by the assertion of a defense, (4) which party has control of the information necessary for proving/disproving the defense, and (5) policy considerations. After

reviewing these factors, the court concluded that the debt collector exception to third party communication is an affirmative defense that must be proved by the debt collector for the exception to the general FDCPA rule to apply.

**ANY PERSON, NOT JUST A DEBTOR, WHO HAS SUSTAINED ACTUAL DAMAGES FROM A TEXAS DEBT COLLECTION ACT VIOLATION HAS STANDING TO SUE**

**ACTUAL DAMAGES INCLUDE MENTAL ANGUISH**

**ECONOMIC LOSS RULE DOES NOT BAR TDCA VIOLATIONS**

McCaig v. Wells Fargo Bank (Texas), 788 F.3d 463 (5th Cir. 2015).
http://www.ca5.uscourts.gov/opinions%5Cpub%5C14/14-40114-CV0.pdf

**FACTS:** Plaintiffs, David and Marilyn McCaig ("the McCaigs") took over Allie McCaig's mortgage payments after her death. The loan soon fell into default and the McCaigs entered into settlement and forbearance agreements with the mortgage holder, Defendant, Wells Fargo Bank ("Wells Fargo"). The agreements provided that Wells Fargo would not foreclose on the property so long as the McCaigs followed the payment plan set forth in the agreement. The McCaigs adhered to the plan, but Wells Fargo initiated the foreclosure process and the dispatch of multiple erroneous notices of default. The McCaigs filed suit.

**The court held that a violator of the TCDA should not be shielded from liability under the economic loss rule simply because there are existing contracts between the parties.**

The district court found that Wells Fargo breached its agreements with the McCaigs violating the TDCA. The McCaigs were awarded $75,000 each for mental anguish damages and $156,775 in attorney's fees, in addition to other forms of monetary relief. Wells Fargo appealed.
**HOLDING:** Affirmed in part, vacated and remanded in part.
**REASONING:** In determining whether the McCaigs had standing to sue, the circuit court first looked to the statutory scheme of Texas Financial Code § 392.403. The Fifth Circuit concluded that the statute "provides for remedies for 'any person' adversely affected by prohibited conduct, not just parties to the consumer transaction." *Monroe v. Frank,* 936 S.W.2d 654, 660 (Tex. App. 1996). The McCaigs lack of an interest in the property and the fact that they were not parties or obligors to the mortgage did not matter to the court's standing analysis.

The court then asserted that the *Bentley* case stands for the proposition that "mental anguish is a form of 'actual damages'," thus, qualifying the McCaigs as an appropriate party to bring suit against Wells Fargo. *Bentley v. Bunton*, 94 S.W.3d 561, 604 (Tex. 2002).

The court continued to evaluate whether the economic loss rule barred the McCaig's claims. The economic loss rule generally prevents recovery for mistakes that solely involve a breach of contract. The first step in the economic loss analysis is to look to see if there is an independent duty based in tort for the McCaigs claims. That duty may be based on a breach of contract so long as the duty is "independent of the contractual undertaking and the harm suffered is not merely the economic loss of a contractual benefit." In that type of situation, the economic loss rule will not bar recovery.

The court held that a violator of the TCDA should not be shielded from liability under the economic loss rule simply because there are existing contracts between the parties. Even though Wells Fargo's mistakes constituted a contractual breach of its agreements with the McCaigs, Wells Fargo was still liable for violating the TDCA because it breached the TDCA's independent statutory duty.

**DEMANDING FEES IN FORECLOSURE COMPLAINT IN A WAY CONTRARY TO THE UNDERLYING AGREEMENT IS ACTIONABLE UNDER THE FDCPA**

Kaymark v. Bank of Am., N.A., 783 F.3d 168 (3d Cir. 2015).
http://law.justia.com/cases/federal/appellate-courts/ca3/14-1816/14-1816-2015-04-07.html

**FACTS:** Appellant, Kaymark, defaulted on a mortgage held by, Appellee, Bank of America, N.A. ("BOA"). On behalf of BOA, Appellee, Udren Law Offices, P.C. ("Udren") initiated foreclosure proceedings against Kaymark in state court. The terms of the mortgage allowed the lender to charge the borrower fees for services preformed and expenses incurred in connection with the borrowers default. The foreclosure complaint filed in the foreclosure proceedings listed not-yet-incurred fees as due and owing.

Kaymark filed suit, alleging BOA violated the FDCPA by attempting to collect fees for legal services not-yet-preformed. The district court granted BOA's motion to dismiss, concluding neither the mortgage contract nor state or federal law prohibit the inclusion of not-yet-incurred fees. Kaymark appealed.
**HOLDING:** Affirmed in part, reversed in part.
**REASONING:** The Fifth Circuit first determined whether BOA used a false, deceptive, or misleading representation to collect a debt. The court found that the most natural reading of the mortgage contract was that BOA was not authorized to collect fees for not-yet-performed legal services and expenses. Because Kaymark agreed to pay attorneys' fees and other expenses that were actually incurred with the default, not fees that might occur, the foreclosure complaint form, which included these not-yet-incurred fees was actionable under the FDCPA.

The court also refused to find that a communication could be uniquely exempted from the FDCPA because it is a formal pleading or, in particular, a complaint. In the instant case, the foreclosure action met the broad definition of debt collection under the FDCPA because the complaint was directed at Kaymark in an attempt to collect on his debt, thereby actionable under the FDCPA.

**TO BE A DEBT COLLECTOR UNDER THE FAIR DEBT COLLECTION PRACTICES ACT, ENTITY MUST MEET STATUTORY TEST**

Davidson v. Capital One Bank, ____F.3d____ (11th Cir. 2015).

**FACTS:** HSBC Bank Nevada, N.A. ("HSBC") filed suit against Keith Davidson ("Davidson") to collect on a credit card account. The parties entered into a settlement agreement, whereby Davidson agreed to pay $500 to HSBC Bank Nevada, N.A. ("HSBC") to dismiss its collection action. Davidson defaulted on the payments and the loan was later acquired by Capital One Bank (USA), N.A. ("Capital One"). Capital One filed suit against Davidson to collect on the same credit card account alleging the account was delinquent $1,149.96. Davidson responded by filing a class action suit claiming that Capital One's activities violated the FDCPA.

Capital One moved to dismiss Davidson's action for failure to allege that Capital One was a "debt collector" for the purposes of the FDCPA. The district court dismissed the action, stating that whether the account was in default at the time it was acquired had no bearing on whether Capital One satisfied the statutory definition of a "debt collector," but they did not meet the definition of debt collector under the FDCPA. Davidson appealed.

**HOLDING:** Affirmed.

**REASONING:** The court began with the definition of "debt collector" under § 1692a(6) of the FDCPA. The Act defines "debt collector" to mean: (1) "any person who uses any instrumentality of interstate commerce or the mail in any business the principal purpose of which is the collection of any debts," or (2) any person "who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another." The court defined a "creditor" as "any person to the extent that he receives an assignment or transfer of debt in default solely for the purpose of facilitating collection of such debt for another." Davidson argued based on the exclusion under the FDCPA, that if the debt was in default at the time it was acquired, the entity is a "debt collector", but if the debt was not in default at the time it was acquired, the entity is a "creditor."

The court rejected Davidson's argument stating where a person does not fall within any of the six statutory exclusions under the FDCPA, he is not deemed a "debt collector," and the statutory definition of "debt collector" applies without regard to the default status of the underlying debt. Davidson failed to plausibly allege that Capital One was a "debt collector" under the FDCPA and the "principal purpose" of Capital One's business was debt collection. Therefore, Captial One was not subject to liability under the FDCPA.

## ARBITRATION

**IS ARBITRATION A "DARLING OF FEDERAL POLICY?"**

Andermann v. Sprint Spectrum L.P, 785 F.3d 1157 (7th Cir. 2015).
http://media.ca7.uscourts.gov/cgi-bin/rssExec.pl?Submit=Display&Path=Y2015/D05-11/C:14-3478:J:Posner:aut:T:fnOp:N:1549408:S:0

**FACTS:** Plaintiffs, ("the Andermanns"), obtained mobile phone service from U.S. Cellular in 2000 under a renewable two-year contract that was last renewed in 2012. The contract contained a arbitration clause providing that all disputes arising out of the contract would be resolved by binding arbitration and that the arbitration agreement would survive termination of the agreement. The contract also provided that U.S. Cellular could assign the agreement without notifying the Andermanns. In May 2013, U.S. Cellular assigned the contract to Defendant, ("Sprint") without notice to the Andermanns. Sprint sent the Andermanns a letter informing them of the sale and that their mobile phone service agreement would be terminated on January 31, 2014 due to the incompatibility of Sprint's network with the Andermanns' phones. Sprint followed the letter with six calls.

The Andermanns brought suit in federal district court alleging that these calls contained unsolicited advertisements in violation of the Telephone Consumer Protection Act ("TCPA"). Sprint responded by asking the court for an order to arbitrate based on the contract and the presumption in favor of arbitration. The district court denied Sprint's motion to compel arbitration. Sprint appealed.

**HOLDING:** Reversed and Remanded.

**REASONING:** The district court ruled for the Andermanns on the grounds that the dispute arose after the contract was terminated, thus, the dispute regarding the legality of the calls could not have arisen out of the contract. The Seventh Circuit, ruled that Sprint was entitled to arbitrate, finding that the service agreement allowed the assignment leading to the incompatibility of the Andermann's phones and the ultimate reason for the disputed calls. The court reasoned that the calls were necessary in Sprint's efforts to retain the Andermanns as customers, thus the Andermanns were required to arbitrate because the dispute clearly arose from the assignment clause within the agreement.

**It's not clear that arbitration, which can be expensive because of the high fees charged by some arbitrators and which fails to create precedents to guide the resolution of future disputes, should be preferred to litigation.**

In his discussion of arbitration, Judge Posner discussed the presumption that arbitration is the favored method of dispute resolution. He stated:

> Sprint gilds the lily, however, in telling us that arbitration is a darling of federal policy, that there is a presump-

tion in favor of it, that ambiguities in an arbitration clause should be resolved in favor of arbitration, and on and on in this vein. It's true that such language (minus the "darling") appears in numerous cases. E.g., *Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24–25 (1983); Kiefer Specialty Flooring, Inc. v. Tarkett, Inc.,* 174 F.3d 907, 909 (7th Cir. 1999). But the purpose of that language is to make clear, as had seemed necessary because of judges' historical hostility to arbitration, that arbitration was no longer to be disfavored—especially in labor cases, see, e.g., *Granite Rock Co. v. International Brotherhood of Teamsters,* 561 U.S. 287, 298– 99 (2010), where arbitration is now thought a superior meth- od of dispute resolution to litigation.

The Federal Arbitration Act is inapplicable to labor disputes, however, and merely makes clauses providing for the arbitration of disputes arising out of transactions involving interstate or foreign commerce, as the dispute in this case is conceded to arise, enforceable in federal and state courts. 9 U.S.C. §§ 1, 2. The issue is then one of interpreting the clause to see whether it covers the dispute. It's not clear that arbitration, which can be expensive because of the high fees charged by some arbitrators and which fails to create precedents to guide the resolution of future disputes, should be preferred to litigation. And it's not clear why, so far as eliciting the meaning of a given arbitration clause is concerned, such a clause should be distinguished from any other clause in a contract.

**COURT FINDS WAIVER OF ARBITRATION BASED ON SEVENTEEN MONTHS AND MORE THAN 1,300 ATTORNEY HOURS**

Oregel v. PacPizza, LLC, ____F.3d____ (Cal. Ct. App. 2015).
http://www.consumerfinancelitigation.com/uploads/file/Oregel%20v%20PacPizza%20A141947.PDF

**FACTS:** Plaintiff, Julio Oregel ("Oregel"), was a former employee of Defendant, PacPizza, LLC ("PacPizza"). Oregel brought a class action suit against PacPizza alleging they failed to reimburse delivery drivers for necessary expenses in violation of Labor Code § 2802 and California's unfair competition law. Following seventeen months of litigation, extensive discovery request and more than 1,300 working hours attorneys spent related to Oregel's motion for class certification, PacPizza filed a petition to compel arbitration.

The district court denied PacPizza's petition to compel arbitration, concluding that they had waived their right to arbitrate Oregel's claims. PacPizza appealed.

**HOLDING:** Affirmed.

**REASONING:** The court disagreed as to the applicability of the futility rule to this case, and identified three reasons why PacPizza had waived their right to arbitrate. First, PacPizza waited to file their petition for arbitration until after Oregel filed his motion for class certification, taking the opportunity to examine the motion and supporting evidence. Only then did they strategically file their petition for arbitration, rather then failing to file due to the futility.

Secondly, PacPizza acted inconsistently with their right to arbitrate by actively participating in the seventeen-month long litigation process while maintaining their silence on arbitration. They failed to plead arbitration as an affirmative defense, demanded a jury trial, paid jury fees, attended two case management cases and actively participated in the extensive discovery related to Oregel's class claims. The court stated these actions would lead any plaintiff to believe that he or she had to fully prepare for a full trial, thereby supporting a claim of waiver.

Third, PacPizza waived its right to arbitrate by causing an unreasonable and unjustified seventeen-month delay. PacPizza created substantial prejudice for Oregel by causing him to incur substantial expenses of over 1,300 hours and $19,990 in costs associated with his class certification motion.

**CALIFORNIA SUPREME COURT UPHOLDS CLASS ACTION WAIVER IN ARBITRATION CLAUSE**

Sanchez v. Valencia Holding Company, LLC 353 P.3d 741 (Cal. 2015).
http://appellatecases.courtinfo.ca.gov/search/case/mainCaseScreen.cfm?dist=0&doc_id=2001577&doc_no=S199119

**FACTS:** Plaintiff-Respondent, Gil Sanchez ("Sanchez"), an automobile purchaser, entered into an automobile sales contract with Defendant-Appellant, Valencia Holding Company, LLC ("Valencia"). The contract contained an arbitration agreement with a provision waiving the right to class action litigation or arbitration, and a provision stating that if the class waiver was deemed unenforceable, the entire agreement shall be unenforceable. Sanchez filed a class action lawsuit and alleged Valencia violated the Consumer Legal Remedies Act ("CLRA") by making false representations about the condition of the vehicle. Sanchez argued that a class action was appropriate despite the inclusion of a class action waiver in the arbitration clause.

**"We hold that *Concepcion* requires enforcement of the class waiver but does not limit the unconscionability rules applicable to other provisions of the arbitration agreement."**

The trial court held that both the class action waiver and the entire agreement were unenforceable on the ground that the CLRA expressly provided for class action proceedings and declared this to be an unwaivable right. Subsequently, in *Concepcion,* the United States Supreme Court held that the Federal Arbitration Act ("FAA") barred absolute class waivers in consumer arbitration agreements and preempted state law to the contrary. The Supreme Court noted, however, that "the FAA does not preempt generally applicable contract defenses, such as fraud, duress, or unconscionability." The court of appeals declined to decide whether the class action waiver was at issue and held that the arbitration appeal provision and the arbitration agreement as a whole were unconscionably one-sided. The California Supreme Court granted review.

**HOLDING:** Reversed and remanded.

**REASONING:** The court first stated that class arbitration waivers in consumer contracts are unconscionable when they are found in

a setting in which disputes between the contracting parties predictably involve small amounts of damages and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out individually of small sums of money. The court noted that the unconscionability standard is the same for arbitration and non-arbitration agreements.

The court noted that under *Concepcion* the CLRA's anti-waiver provision was preempted insofar as it barred class waivers in arbitration agreements covered by the FAA. The court explained that a state rule invalidating class waivers interferes with arbitration's fundamental attributes of speed and efficiency and disfavors arbitration as a practical matter and must be preempted by the FAA. "We hold that *Concepcion* requires enforcement of the class waiver but does not limit the unconscionability rules applicable to other provisions of the arbitration agreement."

**ARBITRATION AGREEMENT IS AMBIGUOUS AND UNENFORCEABLE**

Narayan v. Ritz-Carlton Dev. Co., Inc., 350 P.3d 995 (Haw. 2015).
https://scholar.google.com/scholar_case?case=11694822164135602215&hl=en&as_sdt=6&as_vis=1&oi=scholarr

**FACTS:** Plaintiffs, Krishna Narayan et al. ("Homeowners"), purchased ten condominium units that were developed and managed by Defendants, the Ritz-Carlton Development Company and the Ritz-Carlton Management Company ("Respondents"). The developer defaulted on its loans and Marriot pulled its Ritz-Carlton branding and operating funds, leaving the Homeowners with the responsibility of covering the multi-million dollar shortfall.

The Homeowners sued the Respondents for breach of fiduciary duty, access to books and records and injunctive/declaratory relief. Respondents filed a motion to compel arbitration based on the arbitration provision in the condominium declaration. The circuit court denied the Respondents' motion and the Respondents appealed. The intermediate court of appeals held that that the parties had entered a valid agreement to arbitrate and that the dispute fell within the scope of the agreement. The Homeowners appealed.

**HOLDING:** Vacated and remanded.

**REASONING:** The Homeowners argued that they had not agreed to arbitration terms "buried" in the condominium declaration, and that the terms of their purchase agreements created ambiguity regarding their assent to arbitrate. The Court accepted that argument by holding that the purported agreement to arbitrate was unenforceable because it was ambiguous when taken together with the terms of the purchase agreements and the public report.

The supreme court noted that in order to prove the existence of an enforceable agreement to arbitrate, the agreement must be unambiguous as to the intent to submit disputes or controversies to arbitration. The court identified two circumstances where the requisite unambiguous intent to arbitrate may be lacking: (1) where a contract contains one or more dispute resolution clauses that conflict and (2) where a party has received insufficient notice of an arbitration clause in a document that is external to the contract.

The court reasoned that the agreement to arbitrate was ambiguous because the purchase agreements, the public report and the condominium declaration stated different dispute resolution terms. The public report created further ambiguity by stating that the document provisions were enforceable in a court of law. The court held that the arbitration provision in the condominium declaration was unenforceable because the terms of the various condominium documents were ambiguous with respect to the Homeowners' intent to arbitrate.

**U.S. DISTRICT COURT FINDS "SIGN-IN-WRAP" ARBITRATION AGREEMENT INVALID AND UNENFORCEABLE**

Berkson v. Gogo LLC,____F.Supp.2d____ (E.D.N.Y. 2015).
http://www.gpo.gov/fdsys/granule/USCOURTS-nyed-1_14-cv-01199/USCOURTS-nyed-1_14-cv-01199-0

**FACTS:** Plaintiffs, Adam Berkson and Kerry Welsh ("Plaintiffs"), brought a class action suit against Gogo, LLC and Gogo, Inc. (collectively "Gogo"). Plaintiffs alleged that Gogo misleadingly increased sales and profits by getting customers to purchase a service that automatically renewed on a monthly basis without sufficient notice or consent. Plaintiffs brought a cause of action for common law breach of the implied covenant of good faith and fair dealing, unjust enrichment, and violation of various consumer protection statutes.

**The issue of the "sign-in-wrap," which is a hybrid version of "browsewrap" and "clickwrap" electronic contracts, brings forth a policy question to be determined by the court.**

Gogo responded by filing a motion to transfer venue, compel arbitration and dismiss for lack of standing. The first two motions were based upon the "terms of use" created by Gogo that they argued Plaintiffs officially agreed to when they subscribed to Gogo's in-flight Wi-Fi service. Plaintiffs alleged that these provisions were hidden so they should not be held liable for such a misleading form of agreement.

The issue of the "sign-in-wrap," which is a hybrid version of "browsewrap" and "clickwrap" electronic contracts, brings forth a policy question to be determined by the court. The central factual legal question was whether Plaintiffs had given effective notice of the need to inquire as to the "terms of use" before agreeing to them. The court ruled in favor of the Plaintiffs and denied Gogo's motions for transfer of venue and to compel arbitration. Gogo appealed.

**HOLDING:** Denied.

**REASONING:** The court inferred, absent testimonial evidence about the expertise of the Plaintiffs with respect to internet use, the Plaintiffs were average internet users and uninformed that they were binding themselves to a "sign-in-wrap." The court applied a test to analyze the validity of electronic contracts in general, and the test casts significant doubt on

"sign-in-wrap" and clickwrap agreements because they do not adequately present material terms to Internet users.

For the third motion (denial for lack of standing), the Plaintiffs had to show that, as consumers, Plaintiffs suffered an injury-in-fact on the date the merchant charged their credit card(s) without authorization. Plaintiff Berkson, as well as other members of the class were able to provide credit card statements where Gogo had misleadingly charged their accounts. The court determined this was sufficient evidence to prove denial of Gogo's motion for lack of standing.

**UBER ARBITRATION AGREEMENT HELD UNCONSCIONABLE AND UNENFORCEABLE**

Mohamed v. Uber Technologies, Inc., ____ F.Supp.3d ____ (N. D. Cal. 2015).
http://www.employmentlawblog.info/images/uber%20decision.pdf

**FACTS:** Plaintiffs, Gillette and Mohamed, were drivers for Uber Technologies ("Uber") and each signed an arbitration agreement upon assuming employment with Uber. Uber later terminated Gillette and Mohamed as a result of information from background reports. When both parties filed suit against Uber for violations related to the use of these reports, Uber moved to compel all claims to arbitration, under the terms of arbitration agreements signed by the plaintiffs. Both challenged the enforceability of these agreements.
**HOLDING:** Motion to compel denied.
**REASONING:** The court found the terms in the contracts that reserved the adjudication of the validity and enforceability of the arbitration provisions were unenforceable as they did not pass the "clear and unmistakable" test. The court reasoned that because one of the provisions indicated that the enforceability of the arbitration provision was to be decided by the "arbitrator" and another provision indicated that the "court" might also find provisions in the contract unenforceable, these terms were not "clear and unmistakable."

**Uber failed to notify the plaintiffs that they may be required to pay considerable fees to arbitrate.**

The court also determined that the terms of the agreements were unconscionable, applying the test of "procedural unconscionability" that focuses on "surprise" and "oppression." The court found that both elements were met, because Uber failed to notify the plaintiffs that they may be required to pay considerable fees to arbitrate if they agreed to the arbitration agreement and that they would not be required to pay such fees if they opted-out. Uber also failed to ensure the drivers felt free of any pressure and were made aware of the ability to "opt-out" of the arbitration agreement. Thus the court found that both agreements were surprising and oppressive to the plaintiffs; therefore, the arbitration agreement was unenforceable.

**REVIEW OF ARBITRATION AWARD IS SO LIMITED IT MAY NOT BE VACATED EVEN IF THERE IS A MISTAKE OF FACT OR LAW**

Campbell Harrison & Dagley, L.L.P. v. Hill, 782 F.3d 240 (5th Cir. 2015).
http://www.leagle.com/decision/In%20FCO%2020150402108/CAMPBELL%20HARRISON%20&%3B%20DAGLEY,%20L.L.P.%20v.%20HILL

**FACTS**: Two law firms ("the Firms"), brought suit against former clients, ("Hill"), to recover fees due under an existing contingent fee arrangement. Hill agreed to pay the Firms hourly fees plus an undivided 15% interest in Hill's recovery. Later, Hill fired the Firm and retained a new firm for representation. Hill settled for $188 million. The Firms then attempted to collect $3.2 million in payment for their legal services, but Hill refused to pay. The Hills then arbitrated their rights to payment under the agreement. The arbitrator awarded the Firms $3.2 million in hourly fees and an additional $25 million for contingency fees.

In district court the Firms moved to confirm, and the Hills moved to vacate the award on the grounds of unconscionability and public policy. The district court held that ethical rules would deem collecting hourly fees plus a contingency fee unethical. The Firms appealed.
**HOLDING**: Affirmed in part, reversed and rendered in part and remanded.
**REASONING**: The Fifth Circuit reinstated the arbitration award on the grounds that under Texas law, the review of an arbitration award is very limited. The court held that the district court had misapplied the standard of review. The court stated that the review of an arbitration award is so limited that the award may not be vacated even if there is a mistake of law or fact. The court went on to discuss that they did not have the authority to substitute for the judgment of an arbitrator because the court would have reached a different decision itself.

**THE RIGHT TO CHALLENGE AN ARBITRATION AWARD ON GROUNDS SET FORTH IN THE FEDERAL ARBITRATION ACT CANNOT BE WAIVED BY CONTRACT**

Atlanta Flooring Design Centers, Inc. v. R.G. Williams Const., Inc, 773 S.E.2d 868 (Ga. Ct. App. 2015).
http://www.leagle.com/decision/In%20GACO%2020150716185/ATLANTA%20FLOORING%20DESIGN%20CENTERS,%20INC.%20v.%20R.%20G.%20WILLIAMS%20CONSTRUCTION,%20INC.

**FACTS**: R.G. Williams Construction Inc. ("Williams") hired Atlanta Flooring Design Centers, Inc. ("AFDC") as a subcontractor for a flooring project. The parties entered into a governing contract that set forth the provisions regarding any disputes that would arise under the agreement. The subcontractor agreement stated that any disputes would be resolved by arbitration, and that the award rendered by the arbitrator would be final and binding. The contract also stated that the parties could take steps to confirm an arbitration award, but it provided an express waiver of the parties' rights to challenge an arbitration award. A dispute was submitted to arbitration, and the arbitrator rendered an award.

AFDC filed a motion pursuant to the Georgia Arbitration Code (the "GAC") seeking a court order vacating the award. The reviewing court ruled that the language in the governing agreement precluded any challenge to the arbitration award. AFDC appealed.

**HOLDING**: Reversed.

**REASONING**: The court of appeals held that the GAC does not permit contracting parties to contractually waive or eliminate a party's right to apply to a court to vacate or modify an award based on statutory grounds. Because Georgia tracks federal arbitration law, the court looked to statutes interpreting the Federal Arbitration Act (the "FAA"). The court concluded that permitting parties to contractually eliminate judicial review of awards contradicts the text of the FAA, frustrates the intent and leaves parties without any safeguards against abuse by the arbitrator. Based on the FAA, the court concluded that an agreement that prohibits a party from challenging an arbitration award conflicts with and frustrates public policy as expressed in the GAC, thus the agreement is void and unenforceable.

**QUESTION OF WHETHER CONTRACTUAL DEADLINE FOR INITIATING ARBITRATION APPLIED WAS FOR ARBITRATORS NOT COURT TO DECIDE**

G.T. Leach Builders, LLC v. Sapphire V.P., L.P., 458 S.W.3d 502 (Tex. 2015).
http://law.justia.com/cases/texas/supreme-court/2015/13-0497.html

**FACTS:** Defendant-Appellant, G.T. Leach Builders, LLC ("G.T. Leach") was a general contractor in Texas that was sued by Plaintiff-Appellee, Sapphire V.P., L.P. ("Sapphire"), a property developer for negligence and breach of contract. Sapphire claimed that G.T. Leach was responsible for construction defects that caused a condominium project to sustain water damage.

The contract between G.T. Leach and Sapphire had an arbitration agreement that imposed a deadline to demand arbitration and required "any claim arising out of the contract to be subject to agreed private arbitration." Sapphire, however, claimed that G.T. Leach was barred from requesting arbitration because it requested arbitration after the contractual deadline.

**The Court explained that procedural arbitrability encompasses issues such as time limits, while substantive arbitrability deals with issues such as enforceability and the scope of an arbitration agreement.**

G.T. Leach filed a motion for interlocutory appeal and the court of appeals ruled in favor of Sapphire, finding that G.T. Leach was too late to demand arbitration under the contract. G.T. Leach filed a writ of certiorari arguing that arbitrators should decide whether a contractual deadline for initiating arbitration is to be applied.

**HOLDING:** Reversed.

**REASONING:** The Texas Supreme Court held that the dispute between Sapphire and G.T. Leach about the arbitration deadline was a "claim arising out of the contract" within the arbitration agreement. Thus the contract unequivocally subjected the dispute to arbitration instead of the Court.

The Court also distinguished between substantive arbitrability and procedural arbitrability. The Court explained that procedural arbitrability encompasses issues such as time limits, while substantive arbitrability deals with issues such as enforceability and the scope of an arbitration agreement. The Court held that courts should decide substantive arbitrability questions while procedural arbitrability questions should be decided by arbitrators, thus the procedural issue related to the time limit for arbitration under the arbitration agreement was unrelated to any substantive issues.

## BANKRUPTCY

### DEBTOR WHO CONVERTS FROM A CHAPTER 13 TO A CHAPTER 7 IS ENTITLED TO RETURN OF POST PETITION WAGES NOT DISTRIBUTED BY THE CHAPTER 13 TRUSTEE

Harris v. Viegelahn, 135 S.Ct. 1829 (U.S. 2015).
https://scholar.google.com/scholar_case?case=6882960002787385239&hl=en&as_sdt=6&as_vis=1&oi=scholarr

**FACTS**: Petitioner, Charles Harris ("Harris"), was indebted to multiple creditors and was behind on his mortgage payments to Chase. Harris filed for Chapter 13 bankruptcy and the court planned monthly withholding from his wages that would be distributed to his secured creditors first, including Chase, by a trustee, Mary Viegelahn ("Vieglahn"). Harris again failed to make his monthly mortgage payments and the bankruptcy court permitted Chase to foreclose on his home. Harris's wages continued to be withheld and sent to Viegelahn, but she did not make any payments to Chase causing the withheld wages to accumulate. Harris then converted his plan to a Chapter 7 bankruptcy and then Viegelhan distributed the remaining balance to his unsecured creditors. Harris moved the bankruptcy court for a refund.

**The Court noted that filing for Chapter 7 bankruptcy only affects the debtor's assets prior to the filing.**

Harris moved the bankruptcy court to order Viegelahn to return the amount distributed to his unsecured creditors arguing that Viegelahn lacked authority to distribute the funds after the conversion. The bankruptcy court granted Harris's motion, the district court affirmed, the Fifth Circuit reversed, and the Supreme Court granted certiorari.

**HOLDING**: Reversed and remanded.

**REASONING**: The Supreme Court held that undistributed funds should be returned to the debtor. The Court noted that filing for Chapter 7 bankruptcy only affects the debtor's assets prior to the filing, and assets the debtor acquired after filing for Chapter 7 bankruptcy remain the property of the debtor. The Supreme Court discussed congressional intent, which allows a debtor to make a fresh start by converting a Chapter 13 bankruptcy to a Chapter 7 bankruptcy in good faith. For that reason, no penalty should be exacted in the form of requiring the disbursement of assets acquired after the filing date. The Supreme Court unanimously agreed that once a Chapter 13 bankruptcy is converted to a Chapter 7 bankruptcy in good faith, any assets acquired after the filing of the Chapter 13 revert back to the debtor.

### DEBTOR CANNOT APPEAL BANKRUPTCY COURT'S REJECTION OF PROPOSED PLAN

Bullard v. Blue Hills Bank, 135 S.Ct. 1686 (2015).
https://supreme.justia.com/cases/federal/us/575/14-116/

**FACTS:** Plaintiff, Louis Bullard ("Bullard"), financed his house with a mortgage held by Defendant, Blue Hills Bank ("Bank"). Bullard filed a petition for Chapter 13 bankruptcy and a proposed repayment plan. The repayment plan denoted that the house was worth substantially less than the amount Bullard owed the Bank and called for him to pay only a small fraction of the unsecured claim. The Bank rejected the plan. The Bankruptcy Court refused to confirm the plan and ordered Bullard to submit a new plan within thirty days.

Bullard appealed to the First Circuit Court of Appeals, which dismissed his appeal for lack of jurisdiction. The court noted that it would only have jurisdiction if the appeal was a final order of the Bankruptcy Appellate Panel and that an order denying confirmation was not final as long as the debtor remained free to propose another plan. The Supreme Court granted certiorari to address how to define the immediately appealable proceeding in the context of the deliberation of Chapter 13 plans.

**HOLDING:** Affirmed.

**REASONING:** Bullard argued for a plan-by-plan approach, alleging that both an order denying confirmation and an order granting confirmation terminate the proceeding and are thus final and appealable. The Bank viewed "a proceeding" as the entire process of considering plans and claimed that an order denying confirmation was not final because it left the debtor free to propose another plan.

The Court accepted the Bank's view of a proceeding holding that a bankruptcy court's order denying confirmation of a proposed repayment plan with leave to amend is not a "final" order that the debtor can immediately appeal. The Court reasoned that a plan confirmation or case dismissal alters the status quo, while denial of confirmation with leave to amend changes little with regard to the parties' rights and obligations. The Court also pointed to the language in 28 U.S.C. §157(b)(2)(L) and stated that the inclusion of the phrase confirmation of plans, combined with the absence of any reference to denials, suggested that Congress viewed the larger confirmation process as the proceeding and not the ruling on each specific plan.

The Court stated that if a question is important enough that it should be addressed immediately, the appellate process has several mechanisms of interlocutory review to address such cases. An ordinary case treating only confirmation or dismissal as final will not unfairly burden a debtor because he maintains the right to propose plans that he can freely modify.

### BANKRUPTCY COURT MAY NOT AWARD FEES TO PROFESSIONALS FOR DEFENDING FEE APPLICATIONS

Baker Botts L.L.P. v. ASARCO LLC., 135 S.Ct. 2158 (2015).
http://www.bankruptcybulletin.org/bankruptcy-bulletin/2015/9/7/baker-botts-llp-v-asarco-llc-no-compensation-for-defending-fee-application-on-appeal

**FACTS**: Respondent ASARCO LLC ("ASARCO") hired Petitioner Baker Botts LLP ("Baker Botts") to assist it in carrying out its duties as a Chapter 11 debtor in possession. When ASARCO emerged from bankruptcy, Baker Botts filed fee applications requesting fees under §330(a)(1) of the Bankruptcy Code, which

permits bankruptcy courts to award reasonable compensation for necessary services rendered by professionals. ASARCO challenged the applications, but the Bankruptcy Court rejected ASARCO's objections and awarded Baker Botts fees for time spent defending the applications. ASARCO appealed to the district court, which held that the law firms could be awarded fees for defending their fee applications. The Fifth Circuit reversed, holding that §330(a)(1) did not authorize fee awards for defending fee applications.
**HOLDING**: Affirmed.
**REASONING**: The U.S. Supreme Court held the basic point of reference for awards of attorney's fees is that each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise. Congress applied this "American Rule" in §330(a)(1) for fee-defense litigation. Professionals are hired to serve as estate's administrator for the benefit of the estate, and §330(a)(1) authorized "reasonable compensation for actual, necessary services rendered." The word "services" ordinarily refers to "labor performed for another." Thus, the phrase "reasonable compensation for services rendered" implied loyal and disinterested service in the interest of a client. Time spent litigating a fee application against the bankruptcy estate's administrator cannot be fairly described as "labor performed for" – let alone "disinterested service to" – that administrator. Had Congress wished to shift the burdens of fee-defense litigation under §330(a)(1), it could have done so, as it has done in other Bankruptcy Code provisions.

## MISCELLANEOUS

### EXEMPLARY DAMAGES CAP IS NOT AN AFFIRMATIVE DEFENSE

Zorrilla v. Aypco Constr. II, ____S.W.3d____ (Tex. 2015). http://law.justia.com/cases/texas/supreme-court/2015/14-0067.html

**FACTS:** Homeowner Mirta Zorilla ("Zorrilla") agreed to pay construction contractor, Aypco Construction II, L.L.C. and its owner Jose Luis Munoz ("Aypco"), for certain construction services at two residential properties in May 2007. Zorrilla refused to pay several invoices for charges related to construction work.

Aypco brought an action against Zorrilla for breach of contract and fraud. The district court entered judgment on special jury verdict for Aypco and awarded them exemplary damages, in excess of the statutory cap, because Zorrilla did not assert the cap as an affirmative defense to the excess damages award until her motion for new trial. The appellate court affirmed, noting the split amongst the appeals court regarding the exemplary damages cap as an affirmative defense. The Texas Supreme Court granted the petition for review.
**HOLDING:** Reversed.
**REASONING:** In addressing whether the statutory cap on exemplary damages was an affirmative defense or could be asserted in a motion for new trial, the Texas Supreme Court held that the exemplary damages cap did not constitute an affirmative defense. The exemplary damages cap applied automatically when invoked, and Zorrilla did not need to prove any additional facts.

### RULE 68 OFFER TO INDIVIDUAL PLAINTIFF DOES NOT MOOT CLASS ACTION

Hooks v. Landmark Indus. ___F.3d___(5th Cir. 2015). http://www.ca5.uscourts.gov/opinions %5Cpub%5C14/14-20496-CV0.pdf

**FACTS:** Plaintiffs-Appellant David Hooks ("Hooks") withdrew funds from an ATM operated by Defendant-Appellee Landmark Industries, Inc. ("Landmark"). During the transfer, Hooks was charged for the withdrawal without any posted notice on or at the ATM. Hooks sued Landmark seeking statutory damages for alleged violations of the Electronic Funds Transfer Act ("EFTA").

At trial, Landmark tendered an offer of judgment to Hooks under Rule 68 of the Federal Rules of Civil Procedure that would cover the full statutory amount of one thousand dollars. Hooks motioned to strike the offer of judgment. Hooks then motioned for an extension deadline to file a motion for class certification. Landmark filed a motion to dismiss for lack of subject matter jurisdiction, which the district court granted. Hooks appealed.
**HOLDING:** Reversed.
**REASONING:** Landmark argued Hooks' individual claim and class action suit were moot by his rejection of the offer under Rule 68. Hooks argued that the offer was not a complete offer of judgment because it only included reasonable attorney's fees accrued through the date of the offer, and it did not include post offer fees. The court stated that an incomplete offer of judgment does not render a plaintiff's claim moot.

**The court followed the Ninth and Eleventh Circuit's reasoning that an unaccepted Rule 68 offer cannot moot an individual's claim.**

The court considered the split of authority in the federal appellate courts and rejected the argument that a rejected Rule 68 offer of judgment could moot a plaintiff's claims. The court held that an unaccepted offer of judgment to a named plaintiff in a class action is a legal nullity with no operative effect and nothing in Rule 68 alters that principle. The court followed the Ninth and Eleventh Circuit's reasoning that an unaccepted Rule 68 offer cannot moot an individual's claim. The court noted that a contrary ruling would result in allowing defendants to unilaterally moot named-plaintiffs' claims in a class action context.

The court was not deprived of the ability to enter relief, thus the claim was not mooted. The court concluded that even if Landmark's offer were complete, it did not moot Hooks's claim as the named plaintiff in the class action because Hooks's individual claim was not mooted by the unaccepted offer, and neither were the class claims.

### UNDER THE TCPA RECIPIENT DOES NOT HAVE TO PRINT OUT FAX TO HAVE A CLAIM UNDER THE ACT

Imhoff Investment, L.L.C. v. Alfoccino, Inc, 792 F.3d 627 (6th Cir. 2015).
http://caselaw.findlaw.com/us-6th-circuit/1706917.html

**FACTS:** Plaintiff Avio, Inc. alleged that Defendant Alfoccino violated the Telephone Consumer Protection Act ("TCPA") by hiring Business to Business Solutions ("B2B") to send unsolicited facsimile advertisements to Avio and a class of similarly situated persons. In 2006, Tony Shushtari ("Tony"), an operator of Alfoccino, hired B2B and directed B2B to send out 20,000 faxes to local businesses on behalf of the two Alfoccino restaurants. Tony assumed that B2B obtained permission from its fax recipients before sending them ads but did not testify that he instructed B2B to do so. B2B's fax logs show that B2B faxed Alfoccino's ad to Avio on two dates in 2006; both transmissions were successfully completed.

The district court found that Avio lacked Article III standing to pursue its claim and, as a secondary basis for dismissal, that Alfoccino could only be held vicariously liable—not directly liable—under the statute, and Avio failed to offer sufficient evidence for a jury to find Alfoccino vicariously liable for the faxes B2B transmitted. Avio appealed.

**HOLDING:** Reversed and remanded.

**REASONING:** The court examined the TCPA and found that Congress intended to remedy a number of problems associated with junk faxes, including the cost of paper and ink, the difficulty of the recipients' phone line being tied up and the stress on switchboard systems. To remedy this situation, Congress authored the TCPA to give recipients of unsolicited fax advertising the legal right to recover damages and obtain injunctive relief from the senders of those faxes when senders lacked a prior business relationship with the recipient. Viewing or printing a fax advertisement was not necessary for Avio to suffer a violation of the statutorily created right to have its phone line and fax machine free of the transmission of unsolicited ads. The court concluded that a plaintiff doesn't have to see the fax to discern whether it is an advertisement or not because a reasonable trier of fact could find by a preponderance of the evidence that the content of the two faxes at issue was advertising material prohibited by the TCPA.

### MINOR CHANGES IN TELEMARKETING LANGUAGE DO NOT DEFEAT CLASS CERTIFICATION

Reyes v. Netdeposit, LLC, ____F.3d____(3rd Cir. 2015).
http://law.justia.com/cases/federal/appellate-courts/ca3/14-1228/14-1228-2015-09-02.html

**FACTS:** Appellant, Reynaldo Reyes ("Reyes"), received an unsolicited phone call from a telemarketer informing Reyes that he qualified for a free government grant. After Reyes provided his bank account information, the telemarketer relayed the account information to Appellees, Zions First National Bank ("Zions Bank"), and its payment-processor subsidiaries, Netdeposit, LLC and MP Technologies (together, "Modern Payments"). Zions Bank processed two debits from Reyes's account and transferred the debits back to the telemarketer. Reyes brought a class action suit and alleged that Modern Payments violated the Racketeer Influenced and Corrupt Organizations Act ("RICO") by operating a fraudulent enterprise that was a complete sham.

The district court denied Reyes's motion to certify a class to sue because Reyes failed to satisfy the commonality and predominance requirements of class action certification. Reyes appealed.

**HOLDING:** Vacated and remanded.

**REASONING:** Reyes argued that although the fraudulent transactions and the language used in perpetrating the transactions varied, class treatment was appropriate because the overall business model of each transaction was a "complete sham." The solicitations operated in an inherently fraudulent way by seeking bank account information from those contacted. The court accepted Reyes's argument, reasoning that the underlying facts, conduct, and objectives of the fraudulent transactions were common to all class members and predominated over the various particularized circumstances of each individual. In supporting the class certification, the court stated, "If absolute conformity of conduct and harm were required for class certification, unscrupulous businesses could victimize consumers with impunity merely by tweaking the language in a telemarketing script or directing some (or all) of the telemarketers not to use a script at all but to simply orally convey a general theme designed to get access to personal information such as account numbers."

**Unscrupulous businesses could victimize consumers with impunity merely by tweaking the language in a telemarketing script.**

### PROVIDING CREDITOR WITH A CELL PHONE NUMBER IS "PRIOR EXPRESS CONSENT" UNDER THE TELEPHONE CONSUMER PROTECTION ACT ("TCPA")

Hill v. Homeward Residential, Inc.,____F.3d____ (6th Cir. 2015).
http://tcpablog.com/wp-content/uploads/2015/08/Hill-v-Homeward.pdf

**FACTS:** Appellant, Stephen M. Hill ("Hill"), obtained a mortgage loan that transferred to Appellee, Homeward Residential, Inc. ("Homeward"), a loan servicer. Hill provided Homeward his cell phone number, to be used if Homeward needed to contact him about the loan. Hill fell behind on his mortgage and eventually defaulted on the loan despite numerous modification attempts. When Hill continued to fail to pay his mortgage payments on time, Homeward called him numerous times to collect its payments.

Upset by the repeated calls, Hill filed suit and argued that Homeward violated the Telephone Consumer Protection Act ("TCPA") by using a device capable of autodialing his cell phone number without his consent. The district court ruled in favor of Homeward. Hill appealed.

**HOLDING:** Affirmed.

**REASONING:** The court first noted that a party who gives an invitation or permission to be called at a certain number, has given

its express consent under the TCPA with respect to that number. The court explained that a creditor does not violate the TCPA when it calls a debtor who has provided his number in connection with an existing debt.

The court explained that creditors can call debtors only to recover payment for obligations owed, not on any topic whatsoever, and a debtor does not need to give his consent to automated calls, specifically, his general consent to being called on a cellphone constitutes prior express consent. Because Hill gave Homeward permission to receive calls on his cell number in connection with his existing debt, the court found his actions constituted prior express consent.

### FALSITY REQUIRES ALL REASONABLE EXPERTS AGREE

In re GNC Corp., 789 F.3d 505, 508 (4th Cir. 2015).
http://law.justia.com/cases/federal/appellate-courts/ca4/14-1724/14-1724-2015-06-19.html

**FACTS**: A marketing company and upset customers ("Customers") of joint health supplements brought a class action against GNC Corporation and Rite-Aid ("GNC") claiming GNC violated several consumer protection laws by misrepresenting the effectiveness of the supplement products.

The supplements all contain glucosamine and chondroitin, and most contain additional purportedly active ingredients. Customers claimed that GNC violated consumer protection laws of various states by marketing the supplements in question as promoting joint health. However, scientific studies have shown that glucosamine and chondroitin are not effective in treating the symptoms of osteoarthritis.

The district court granted GNC's motion to dismiss for failure to state a claim. Customers appealed.
**HOLDING**: Affirmed.
**REASONING**: The Fourth Circuit stated that the requirements to satisfy a claim for false and misleading statements are that all reasonable experts agree on the falsity of the product in question. The court agreed with some of the Customers' studies, however, the court stated that in order to state a false advertising claim on a theory that representations have been proven to be false, Customers must allege that all reasonable experts in the field agree that the representations are false. If the Customers cannot do so because the scientific evidence is equivocal, then they have failed to plead that the representations based on this disputed scientific evidence are false. The court concluded that the Customers failed to state a claim upon which relief could be granted and affirmed the holding of the lower court.

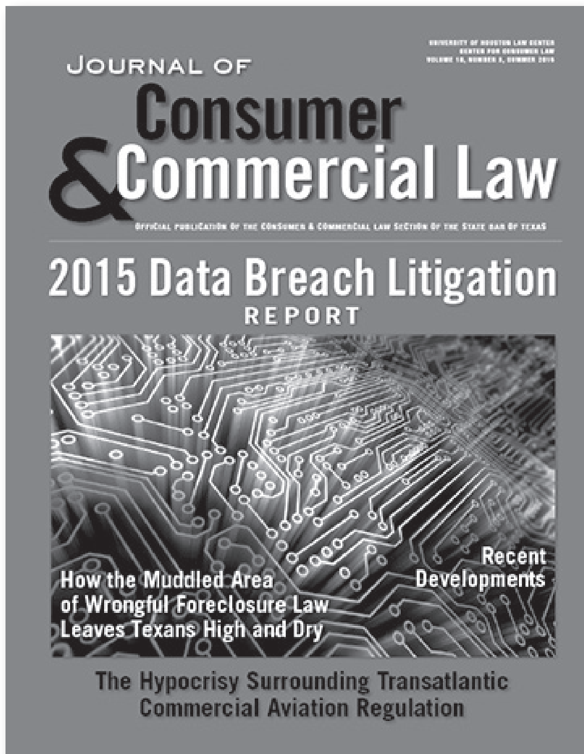
### NO ADVERTISEMENT, NO TELEPHONE CONSUMER PROTECTION ACT LIABILITY

Sandusky Wellness Center v. Medco Health Solutions, 788 F.3d 218 (6th Cir, 2015).
http://www.ca6.uscourts.gov/opinions.pdf/15a0110p-06.pdf

**FACTS:** Plaintiff, Sandusky Wellness Center ("Sandusky"), a healthcare provider, sued Defendant, Medco Health Solutions, ("Medco"), a pharmacy benefit manager, alleging Medco faxed two unsolicited advertisements prohibited by the Telephone Consumer Protection Act ("TCPA"). Medco faxed Sandusky two formulary updates, informing Sandusky of certain plan-preferred drugs to lower medication costs for Sandusky's patients with Medco insurance policies. Neither fax contained pricing, ordering, or other sales information.

**The TCPA defines "advertisement" as "any material advertising the commercial availability or quality of any property, goods, or services."**

The district court granted Medco's motion for summary judgment, holding that the primary purpose of Medco's faxes were informational rather than promotional. Sandusky appealed.
**HOLDING:** Affirmed.
**REASONING:** Sandusky alleged Medco violated the TCPA by sending two advertisements to its fax machine. The TCPA defines "advertisement" as "any material advertising the commercial availability or quality of any property, goods, or services." 47 U.S.C. § 227(a)(5). The court found no evidence that Medco's faxes were ads under the TCPA because they lacked a necessary commercial aspect in failing to promote goods or services to be bought or sold and failing to have profit as an aim. The court rejected Sandusky's argument and held Medco's faxes were not advertisements within the meaning of the TCPA, finding no reasonable jury could conclude the faxes were commercial in nature.

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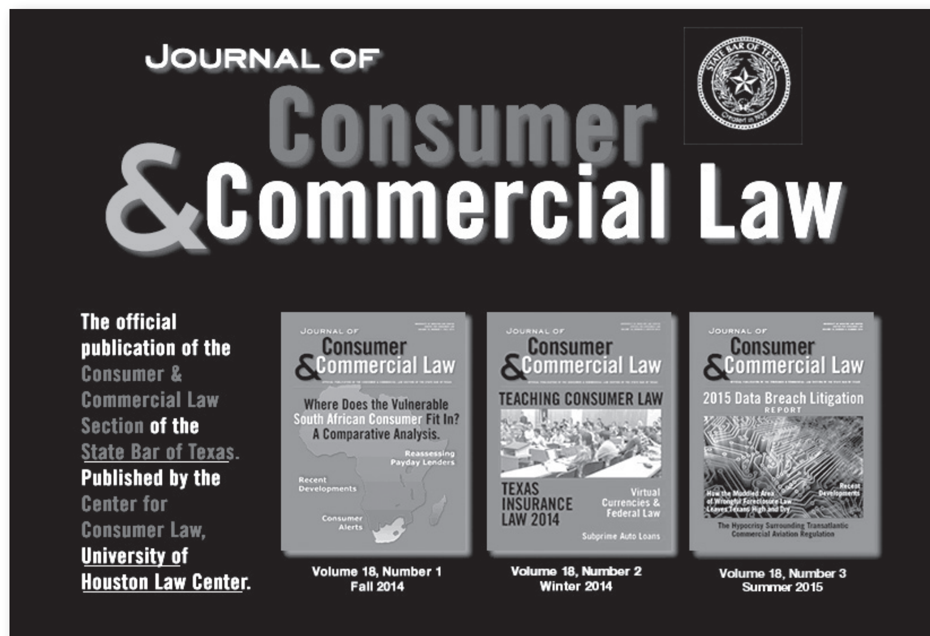


# For back issues of the *Journal*, visit the *Journal's* website at: www.jtexconsumerlaw.com

# THE LAST WORD

In 2014, the Consumer and Commercial Law Section of the State Bar of Texas established the Craig Jordan Consumer Protection Writing Competition. The competition was established to honor the life of Craig Jordan, a section founder and nationally recognized and respected consumer protection attorney.

This year the Section held the first competition, and had its first two winners. First place went to Amanda Brett Ethridge, for her article "*Too Qualified or Not Qualified Enough*," discussing the Mortgage Reform and Anti-Predatory Lending Act of 2010. Second place was awarded to Lauren A. Fisher Flores, for her article, *Notario Fraud—Protecting the Vulnerable Among Us.* Both articles appear in this issue of the *Journal*, and I know you will find them valuable and interesting.

This issue includes two additional articles, discussing a very important and relevant topic, class actions. The first explains "fail safe" class actions under the Telephone Consumer Protection Act, while the second continues the ongoing discussion of *Concepcion* and *Italian Colors Restaurant.* There also is an interesting article discussing India's "Constitutional Contract," and its relationship to the India's consumer protection laws. Add to all of this the twenty case digests in the *Recent Developments* section, and the numerous *Alert* cases, and I think you will agree this is an outstanding issue.

Richard M. Alderman
Editor-in-Chief

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