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The editors welcome unsolicited lead articles written by practicing attorney, judges, professors, or other qualified individuals. Manuscript length should be approximately 15-30 typed, double-spaced pages. Endnotes should conform to the Sixteenth Edition of A Uniform System of Citation, published by the Harvard Law Review Association.

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Articles

Recent Developments

Annual Survey of




TEXAS Insurance Law

By Elizabeth Von Kreisler* and Suzette E. Selden**

I. INTRODUCTION

This was a very significant year for insurance law, in both legislation and case law.

The recent legislative session resulted in several changes to the Texas Insurance Code, with the aim of addressing a perceived insurance "crisis" arising from natural disasters. The changes, which went into effect on September 1, 2017, are unfavorable for policyholders, since they limit damages and attorney's fees in property damage claims. The legislative changes also give insurers the ability to assume responsibility for the misconduct of agents; effectively giving insurers the ability to remove suits to federal court by eliminating a nondiverse party from the suit. Since the new laws went into effect shortly after Hurricane Harvey, they will likely be the subjects of much litigation very soon. H.B. 1774, 2017 Leg., 85th Sess. (Tex. 2017).

The Texas Supreme Court issued several significant cases this year. Of them, the most important is the much-anticipated *USAA Texas Lloyds Co. v. Menchaca*, No. 14-0721, 2017 WL 1311752 (Tex. Apr. 7, 2017), in which the Texas Supreme Court set forth five rules to clarify when coverage must exist for an insured to maintain a case against an insurer for violating the Texas Insurance Code. Notably, *Menchaca* affirmed *Vail* and limited the application of the "independent injury" rule, but how other courts are applying *Menchaca* suggests that we have not yet achieved clarity regarding when a policyholder must prove injury independent from denied policy benefits, particularly in cases where there has been an appraisal award.

Significant changes were made to the Texas Insurance Code this past session that are not consumer friendly.

Another important decision is *Great Am. Ins. Co. v. Hamel*, 525 S.W.3d 655 (Tex. 2017), a third-party claim case, in which the court considered when a judgment is the product of a "fully adversarial" trial in the meaning of *Gandy*. The court held that whether a trial is fully adversarial depends upon the insured's incentive to vigorously defend the underlying suit, not the adequacy of litigation strategies used in the underlying trial.

Continuing the trend of recent years, hundreds of decisions in insurance cases were made this year, primarily in the federal district courts. In light of the major legal developments in 2017, the scope of this article is narrower than in previous years. Rather than summarize most or all of the insurance cases decided during the reporting period, this year's article is focused on the more important developments, including the legislative changes and all of the Texas Supreme Court decisions affecting insurance law, as well as select Fifth Circuit and Texas courts of appeals cases.

II. LEGISLATIVE CHANGES

Significant changes were made to the Texas Insurance Code this past session that are not consumer friendly. The new law, House Bill 1774/Senate Bill 10, became effective on September 1, 2017, and is codified in the Texas Insurance Code. It is specifically aimed at limiting damages for losses that occur by natural disasters. This new law directly affects property damage claims caused by Hurricane Harvey in Houston and surrounding areas, so we will soon be able to gauge the ramifications of its addition as these cases are litigated.

The new provision, Chapter 542A of the Texas Insurance Code, applies to claims regarding commercial and personal property damage or loss caused by "forces of nature." A "Claim" under 542A is defined as a first-party claim that:

(A) is made by an insured under an insurance policy providing coverage for real property or improvements to real property,

(B) must be paid by the insurer directly to the insured, and

(C) arises from damage to or loss of covered property caused, wholly or partly, by forces of nature, including an earthquake or earth tremor, a wildfire, a flood, a tornado, lightning, a hurricane, hail, wind, a snowstorm, or a rainstorm.

This definition of "Claim" covers a significant portion of first-party litigation in Texas.

Under Texas Insurance Code Section 542.060(a), a claimant in a first-party claim could recover as damages from a liable insurer the amount of the claim and interest on the amount of the claim at 18 percent a year, together with reasonable and necessary attorney's fees. Now, in an action where Ch. 542A applies (i.e., a force of nature claim), the 18 percent interest will not apply. Instead, the insurer will only be liable to the claimant for the amount of the claim and simple interest on the amount of the claim at the rate determined on the date of judgment by adding 5 percent to the interest rate established under Section 304.003, Finance Code, along with reasonable and necessary attorney's fees. This change is extremely favorable to insurance companies, since they will no longer have to pay a potentially high interest rate for failing to pay claims timely. This change significantly diminishes the major legal incentive for insurers to investigate and pay claims promptly.

Also, a claimant must now give its property insurance company at least 61 days notice before filing a lawsuit against the insurance carrier for a natural disaster-related property damage claim. The notice required must provide (1) a statement of the acts or omissions giving rise to the claim, (2) the specific amount alleged to be owed by the insurer for the property damage, and (3) the amount of attorney's fees incurred by the claimant. If an attorney gives the notice on behalf of a claimant, the attorney must provide a copy of the notice to the claimant and include in the notice a statement that a copy of the notice was provided to the claimant. Tex. Ins. Code Sec. 542A.003 (2017).

No later than thirty days after receiving pre-suit notice, the insurer may send a written request to the claimant to inspect the property. The inspection must be completed no later than sixty days after the date the pre-suit notice was received, if reasonably possible. The bill does not apply to Texas Windstorm Insurance Association (TWIA) policies or policies issued by the National Flood Insurance Program.

Another significant change concerns remedies for misrepresentations about a policy. Previously under the Texas Insurance Code, a claimant could sue its agent for misrepresentations about the insurance policy purchased, since the agent is typically the only representative the policyholder has ever dealt with regarding its insurance policy. Now, under Sec. 542A.006, an insurer may elect to accept whatever liability an agent might have to the claimant for the agent's acts or omissions related to the claim by providing written notice to the claimant. If the insurer makes this election before a claimant files an action to which this chapter applies, no cause of action exists against the agent related to the claimant's claim. Evidence of the agent's acts or omissions may be offered at trial, and the trier of fact may be asked to resolve fact issues as if the agent were a defendant, and a judgment against the insurer must include any liability that would have been assessed against the agent. The insurer's election may not be made known to the jury. This new addition to the Texas Insurance Code ensures that Texas claimants will no longer be able to sue their insurance agents in state court if an out-of-state insurer opts for this election. Most insurance companies are out-of-state entities. Thus, if the insurer elects to assume an agent's liability, there will be no in-state agent as a defendant, and the cases will be filed in federal court.

Attorney's fee awards also have changed. This change makes the fee award extremely complex and, like the other statutory changes, favors insurance companies. The amount of attorney's fees that a claimant may be awarded is the lesser of:

> (1) the amount of reasonable and necessary attorney's fees supported at trial by sufficient evidence and determined by the trier of fact to have been incurred by the claimant,
> (2) the amount of attorney's fees that may be awarded to the claimant under another applicable law, or
> (3) the amount calculated by:
>> (A) dividing the claimant's awarded damage amount for loss or damage to covered property by the damage amount stated in the notice demand given under this chapter, and
>> (B) multiplying the amount calculated under paragraph (A) by the total amount of reasonable and necessary attorney's fees supported at trial by sufficient evidence and determined by the trier of fact to have been incurred by the claimant.

Unless pre-suit notice was not given, the court must award attorney's fees supported at trial by sufficient evidence if the amount calculated under (A) above is: (1) greater than or equal to 0.8; (2) not limited by this section or another law; and (3) otherwise recoverable under law. The court cannot award attorney's fees to the claimant if the amount calculated under (A) above is less than 0.2. This attorney fee calculation is very onerous and requires the claimant's lawyer to guess almost exactly what might be awarded at trial in its demand, before any discovery has been conducted. Tex. Inc. Code Sec. 542A.007 (2017).

Additionally, if a defendant (i.e. insurance company) pleads and proves it was entitled to but not given pre-suit notice stating the specific amount alleged to be owed by the insurer at least 61 days before the date the action was filed, the court may not award any attorney's fees incurred after the date the defendant files that pleading with the court.

Unfortunately for Texas consumers, the changes made to the Texas Insurance Code by House Bill 1774/Senate Bill 10 will greatly hinder claims related to force-of-nature property damage. There will no longer be an 18 percent interest penalty to insurance companies for failing to timely pay; the notice provision requires that an attorney guess the precise amount a jury will award for the claim before any discovery is conducted if he wants to ensure recovery of attorney's fees; and claims against agents have been all but eliminated, allowing insurance companies to keep cases in federal court rather than state court. The coming year will allow us to see the implications of the new law as recent hurricane cases begin to be litigated.

III. FIRST PARTY INSURANCE POLICIES & PROVISIONS

A. Homeowners

Without hearing oral argument, the Texas Supreme Court ruled for an insured homeowner on the question of whether a fence attached to an insured's house is a "structure attached to the dwelling" (with the same policy limit as the dwelling itself), as the homeowner contended, or is an "other structure on the residence premises" (with a policy limit of 10% of the dwelling's), as the insurer contended. *Nassar v. Liberty Mutual Fire Insurance Company*, 508 S.W.3d 254 (Tex. 2017) (per curiam).

In *Nassar*, the insured's fence, which attached to his dwelling, sustained $58,000 in damage from Hurricane Ike, well within the policy limit for the dwelling and "any structures attached to the dwelling." But the insurer insisted that the fence was not part of the dwelling but rather an "other structure on the residence premises" with a policy limit of 10% of the dwelling, or $24,720. The policy stated:

> COVERAGE A (DWELLING)
> We cover:
> 1. the dwelling on the residence premises shown on the declarations page including structures attached to the dwelling.
> 2. other structures on the residence premises set apart from the dwelling by clear space. This includes structures connected to the dwelling by only a fence, utility line or similar connection. The total limit of liability for other structures is the limit of liability shown on the declaration page or 10% of Coverage A (Dwelling) limit of liability, whichever is greater.

The policy did not define "structures" in subsection (1) or "other structures" in subsection (2).

The Texas Supreme Court held that the fencing was unambiguously covered under the policy's "dwelling" coverage provision, rather than the "other structures" provision.

The Texas Supreme Court held that the fencing was unambiguously covered under the policy's "dwelling" coverage provision, rather than the "other structures" provision. Previously, a majority of the court of appeals ruled that that policy language was unambiguous and that the insured's proposed interpretation of the policy language claiming the fence is part of the structure would render meaningless the subsection that "includes structures connected to the dwelling only by a fence." The dissent, however, believed that the policy was ambiguous and thus required the court to adopt the interpretation favoring the insureds.

On appeal to the Texas Supreme Court, the insureds argued that the court of appeals improperly applied settled rules of contract interpretation by adopting the insurer's proposed interpretations. The supreme court agreed with the insureds, setting forth the general rules of interpretation, including the special rule for insurance policies that, if a policy is ambiguous, the court "must resolve the uncertainty by adopting the construction that most favors the insured," even if the insurer's construction "appears to be more reasonable or a more accurate reflection of the parties' intent."

Here, the court found that the "dwelling" provision was "straightforward: the policy requires that 'structures attached to the dwelling' be afforded coverage." Without a definition of "structure," the court referred to Black's Law Dictionary for a definition. Black's defines it as "any construction, production, or piece of work artificially build up or composed of parts purposefully joined together." The court applied this definition and concluded that the insureds' fence was a structure because it was artificially constructed, "composed of parts purposefully joined together," and "fastened to the dwelling" in some manner. The insureds' "interpretation is reasonable and the applicable policy language is unambiguous."

The court differentiated between the two coverages, finding that the "other structures" are structures, However, if they are not attached to the dwelling they are afforded separate coverage. The fact that subsection (2)'s "other structures" coverage identified a fence as a "connection" that did not attach an "other structure" to a dwelling did not mean that a fence was not itself a "structure" under subsection (1).

The supreme court correctly rejected the court of appeals' interpretation because it was guessing as to the purpose of the provisions instead of looking at the policy language itself. Thus, the lower court was speculating in a way that favored the insurer or improperly inquired into the provisions' intent:

> The flaw in the court of appeals' reasoning is that, for Liberty Mutual's interpretation to make sense, we must believe that the terms 'connection' and 'structure' are mutually exclusive. Our task, however, is not to find new meaning in relatively common words or to make difficult what is actually quite simple; instead we must apply the plain language from subsection (1) of the insurance policy to subsection (2).

Finally, the supreme court found that the issue of when a fence attached to a dwelling by another fence would become an "other structure" under the policy was a fact issue to be resolved by the finder of fact, who "could reasonably determine that some of the 4,000 feet of fencing constructed of different materials and spanning six acres in a 'network' across the [insureds'] property is not part of the 'structure attached to the dwelling.'" Under the policy's plain language, "courts may have to treat fencing as both part of the 'dwelling' and 'other structures' depending on the circumstances."

IV. FIRST PARTY THEORIES OF LIABILITY

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

In the much-anticipated *USAA Texas Lloyds Co. v. Menchaca*, No. 14-0721, 2017 WL 1311752 (Tex. Apr. 7, 2017), the Texas Supreme Court addressed the relationship between contractual claims and statutory claims brought under the Texas Insurance Code, clarified the "independent injury" rule, and, notably, reaffirmed *Vail v. Tex. Farm Bureau Mut. Ins. Co.*, 754 S.W.2d 129 (Tex. 1988).[1]

Menchaca involved a homeowner's insurance claim for damages caused by Hurricane Ike. The insurer, USAA, inspected the property twice, and both times concluded that the covered damages were less than the policy's deductible. The homeowner, *Menchaca*, sued, asserting both breach of contract and Insurance Code violations, and sought "insurance benefits under the policy, plus court costs and attorney's fees" as damages. At trial, after hearing how USAA conducted the investigation and listening to competing experts argue over the amount of storm-related losses Menchaca suffered, the jury answered "yes" to the question asking whether USAA violated the Insurance Code by not reasonably investigating her claim, answered "no" to the question asking whether USAA failed to comply with the insurance contract, and awarded Menchaca $11,350 for unpaid policy benefits and $130,000 for attorney's fees. USAA moved for post-judgment verdict in its favor, arguing the jury had found that the policy was not breached and that precluded bad-faith or extra-contractual liability.

The trial court denied USAA's motion. The court of appeals affirmed the trial court's judgment for Menchaca. But the Texas Supreme Court reversed and remanded the case for a new trial, iterating five rules concerning whether an injury independent of a right to benefits must exist for an insurer to be liable for violating the Insurance Code.

The issue presented, as phrased by the court, is:

> whether the insured can recover policy benefits based on jury findings that the insurer violated the Texas Insurance Code and that the violation resulted in the insured's loss of benefits the insurer 'should have paid' under the policy, even though the jury also failed to find that the insurer failed to comply with its obligations under the policy.

The supreme court further stated that its opinion seeks "to clarify our precedent by announcing five rules that address the relationship between contract claims under an insurance policy and **tort claims** under the Insurance Code." (emphasis added). The court's phrasing is noteworthy, because Insurance Code claims are statutory claims, not tort claims, which may speak to the scope of the decision.

The "precedent" the court sought to clarify is the perceived conflict between *Vail v. Tex. Farm Bureau Mut. Ins. Co.*, 754 S.W.2d 129 (Tex. 1988), and *Provident Am. Ins. Co. v. Castañeda*, 988 S.W.2d 189 (Tex. 1998), as interpreted by the Fifth Circuit in *Great American Ins. Co. v. AFS/IBEX Fin. Servs., Inc.*, as well as other federal district court cases. In *Vail*, the Texas Supreme Court held that an insured who is wrongfully denied policy benefits need not show any injury independent from the denied policy benefits. In *Castañeda*, the court stated that an insurance company's "failure to properly investigate a claim is not a basis for obtaining policy benefits." 988 S.W.2d 189, 198 (Tex. 1998). In *In re Deepwater Horizon*, 807 F.3d 689, 698 (5th Cir. 2015), the Fifth Circuit interpreted *Castañeda* as "setting out the opposite rule from *Vail*" and questioned *Vail's* continued validity, prompting a certified question to the Texas Supreme Court, but *Deepwater* settled before the question was answered.

Due to the federal courts' misinterpretation of *Castañeda*, a line of cases contradicted *Vail*, misapplied the plain language of § 541.151, ignored the mandate of liberal construction in § 541.008, and created an absurd result by which a statute meant to remedy unfair claim practices does not allow the insured to recover the claim. At the very least, there has been considerable confusion as to whether an insured can recover policy benefits as actual damages caused by an insurer's statutory violation without establishing a contractual right to the benefits.

Menchaca addresses this question directly and answers by articulating five rules. Notably, the rules all refer to "statutory violations," not "torts," and the court characterized the Insurance Code's unfair claims handling provisions as a "supplement" to the parties' contractual rights and obligations. The Texas Supreme Court's five rules for evaluating "statutory violation" are:

> 1. The General Rule: "The general rule is that an insured cannot recover policy benefits for an insurer's statutory violation if the insured does not have a right to those benefits under the policy."
> 2. The Entitled-to-Benefits Rule: "[A]n insured who establishes a right to receive benefits under the insurance policy can recover those benefits as 'actual damages' un-

der the [Insurance Code] if the insurer's statutory violation causes the loss of the benefits," as recognized in Vail.

3. The Benefits-Lost Rule: "[A]n insured can recover benefits as actual damages under the Insurance Code even if the insured has no right to those benefits under the policy, if the insurer's conduct caused the insured to lose that contractual right." Even if the insured cannot establish a present contractual right to policy benefits, the insured can recover them as actual damages under the Insurance Code "because the benefits are actual damages 'caused by' the insurer's statutory violation."

4. The Independent-Injury Rule: "[I]f an insurer's statutory violation causes an injury independent of the insured's right to recover policy benefits, the insured may recover damages for that injury even if the policy does not entitle the insured to receive benefits," and inversely, "an insurer's statutory violation does not permit the insured to recover any damages beyond the policy benefits unless the violation causes an injury that is independent from the loss of the benefits." Thus, the insured may recover damages for an independent injury caused by the insurer's statutory violation, even if the policy does not grant the insured a right to benefits.

5. The No-Recovery Rule: "An insured cannot recover any damages based on an insurer's statutory violation unless the insured establishes a right to receive benefits under the policy or an injury independent of a right to benefits," as stated in Castañeda.

In sum, the court clarified that a determination of no coverage defeats those extra-contractual claims that are predicated on the right to coverage. But the court squarely rejected the insurer's argument that "an insured can never recover policy benefits as damages for a statutory violation." Rather, insureds have two pathways to policy benefits: (1) breach of contract or (2) Insurance Code violations that cause the loss of the benefits or the loss of the contractual right to benefits. Insurance Code violations support recovery of both policy benefits and losses independent of policy benefits.

Additionally, the court's rules clarify what policyholders' lawyers have long maintained—*Vail* is still good law, and the federal court cases finding otherwise are wrong. The court explained:

> The insurer argued that the insureds could not recover policy benefits as damages for statutory violations because "the amount due under the policy solely represents damages for breach of contract and does not constitute actual damages in relation to a claim of unfair claims settlement practices." [*Vail*, supra] at 136. We rejected that argument and held that "an insurer's unfair refusal to pay the insured's claim causes damages as a matter of law in at least the amount of the policy benefits wrongfully withheld." Id. We explained that the insureds "suffered a loss ... for which they were entitled to make a claim under the insurance policy," and that loss was "transformed into a legal damage" when the insurer "wrongfully denied the claim." Id. "That damage," we held, "is, at minimum, the amount of policy proceeds wrongfully withheld by" the insurer. Id.

The court further explained:

> The rule we announced in *Vail* was premised on the fact that the policy undisputedly covered the loss in that case, and the insurer therefore "wrongfully denied" a "valid claim." Id. at 136–37. If an insurer's "wrongful" denial of a "valid" claim for benefits results from or constitutes a statutory violation, the resulting damages will necessarily include "at least the amount of the policy benefits wrongfully withheld." Id. at 136. We confirmed this reading of Vail and reaffirmed the general rule in *Twin City*, 904 S.W.2d at 666. There, we explained that "*Vail* was only concerned with the insurer's argument that policy benefits improperly withheld were not 'actual damages in relation to a claim of unfair claims settlement practices.'" Id. (quoting *Vail*, 754 S.W.2d at 136). We further explained that the Court rejected the insurer's argument in *Vail* because "policy benefits wrongfully withheld were indeed actual damages" under the statute. Id.

Vail has always been good law. The other supreme court cases that appear to contradict it do not actually contradict it and are distinct.

The court directly states that neither *Castañeda* nor *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338 (Tex. 1995) overruled *Vail*:

> In short, *Stoker* and *Castañeda* stand for the general rule that an insured cannot recover policy benefits as damages for an insurer's extra-contractual violation if the policy does not provide the insured a right to those benefits. *Vail* announced a corollary rule: an insured who establishes a right to benefits under the policy can recover those benefits as actual damages resulting from a statutory violation. We clarify and affirm both of these rules today.

And regarding *Castañeda* in particular, the supreme court explained that it had really held that, where only policy benefits are sought, they cannot be recovered through an Insurance Code claim unless the policyholder pleads and obtains "a determination [that the insurer] was liable for breach of the insurance contract." In *Castañeda*, the policyholder did not demonstrate either the existence of coverage or an independent injury, thus the court's holding that "failure to properly investigate a claim is not a basis for obtaining policy benefits."

Concerning its rule #3, the Benefits-Lost rule, the supreme court listed three non-exclusive examples: (1) misrepresentation of a policy's coverage, as in *Royal Globe Ins. Co. v. Bar Consultants, Inc.*, 577 S.W.2d 688 (Tex. 1979); (2) waiver or estoppel of the insurer's right to deny coverage, as in *Ulico Cas. Co. v. Allied Pilots Ass'n*, 262 S.W.3d 773 (Tex. 2008); and (3) an Insurance Code violation that causes the insured to lose policy benefits it would otherwise have had, as in *JAW the Pointe, L.L.C. v. Lexington Ins. Co*., 460 S.W.3d 597 (Tex. 2015). In those situations, the policy benefits are the actual damages suffered as a result of the statutory violation. This is logical and fair. As the court explains, "an insurer that commits a statutory violation that eliminates or reduces its contractual obligations cannot then avail itself of the general rule." This is good news for insureds.

A portion of the Texas Supreme Court's explanation of the Independent Injury Rule, however, is particularly confusing:

> The second aspect of the independent-injury rule is that an insurer's statutory violation does not permit the insured to recover any damages beyond policy benefits unless the violation causes an injury that is independent from the loss of the benefits. Thus, we held in Twin City that an insured who prevails on a statutory claim cannot recover punitive damages for bad-faith conduct in the absence of independent actual damages arising from that conduct.

Taken out of context and in isolation, this portion of the court's analysis would seem to give credence to insurers' positions that an independent injury is always required to sustain an extracontractual cause of action. But such a selective reading is wholly inconsistent with the court's reaffirmation of *Vail*, as well as *Menchaca's* other statements that policy benefits are actual damages recoverable either for breach of contract or for statutory violations. See Michael W. Huddleston, *What We Have Learned From Menchaca,* at pp. 7-9, 14th Annual Advanced Insurance Law Course 2017, State Bar of Texas (June 8-9, 2017). Insureds are cautioned to take measures in briefing and argument to ensure that this passage is not taken out of context.

Further, this excerpt emphasizes that insureds will need to consider whether their injury is due to a breach of contract or if it is truly "independent." *Menchaca* states that "policy benefits" includes damages that "'are predicated on,' 'flow from,' or 'stem from' policy benefits," whereas "independent injury" must be "truly independent," identifying mental anguish damages as an example of an independent injury. On the flipside, if an insured establishes a right to policy benefits, then it can also recover everything "flowing" or "stemming" from those benefits.

The court's reference to *Twin City* also is confusing because it was not really an Insurance Code case. *Twin City* involved a breach of the insurer's duty of good faith and fair dealing, not Insurance Code violations, and thus involved common law punitive damages, not statutory treble damages. Significantly, *Twin City* involved a claim for benefits payable under the Workers Compensation Act, which has an exclusivity provision that bars recovery of benefits unless the damages for breach of the duty of good faith and fair dealing is "separate from the compensation claim and produced an independent injury." 904 S.W.2d at 667. By contrast, the Insurance Code does not require an "independent injury" for actual damages to be trebled, only a "finding by the trier of fact that the defendant knowingly committed the act complained of." Tex. Ins. Code § 541.152(b). The court's statement about *Twin City* appears to be an attempt to illustrate that, in cases where there is no coverage, recovery requires a truly independent injury. Notably, *Twin City* distinguished itself from *Vail* because that case did not address whether "the policy benefits wrongfully withheld will not alone support an award of punitive damages." 904 S.W.2d at 666. Given the obvious distinctions between *Twin City* and *Vail,* as well as *Menchaca's* reaffirmation of *Vail* and its holding that policy benefits can be recovered as actual damages (Rules 2 & 3), it would be wrong to conclude that an independent injury is required to sustain extracontractual causes of action in all circumstances. *See Huddleston*, *supra*.

At the time this article was written, 16 cases had cited *Menchaca*, and several of them applied the decision in a confusing manner.

One consideration for policyholders raised by *Menchaca* is how to frame pleadings and jury questions so that the right predicate is established and reach the proper damages. Lawyers for insureds will need to take some care to tailor their jury charges and their theories of recovery with the *Menchaca* rules in mind. For instance, if an insured seeks policy benefits based on an Insurance Code violation, and there is no independent injury, the insured should also plead and seek a finding either on its right to policy benefits or on a breach of contract. But an insured does not need separate findings on both the existence of coverage and breach of contract. The court has explained that if there is coverage, failure to pay is a breach, and if there is no coverage, then failure to pay is not a breach. The insured should also be sure to plead and seek a finding that its losses were "caused" by the insurer's statutory violations.

Although *Menchaca* reads as a good opinion for policyholders, affirming *Vail* and placing limitations on the Independent Injury Rule, it raises an issue as to how are the lower courts applying it? At the time this article was written, 16 cases had cited *Menchaca*, and several of them applied the decision in a confusing manner. Most of these cases concerned appraisals.

One of the first cases to cite *Menchaca* was *State Farm Lloyds v. Webb*, No. 09-15-00408-CV, 2017 WL 1739763 (Tex. App.—Beaumont, May 4, 2017, pet. filed) (mem. op.), in which the court took the confusing language regarding the independent injury rule from *Menchaca* out of context. The court held that the only damages were policy benefits and that the statutory claims failed as a matter of law.

The first reported case to cite *Menchaca* was *National Security Fire & Cas. Co. v. Hurst,* 523 S.W.3d 840 (Tex. App. – Houston [14th Dist.] 2017, pet. filed). There, the court of appeals held that independent injury is required for any "statutory violation or bad faith" claim to be actionable:

> In order to recover any damages beyond policy benefits, the statutory violation or bad faith must cause an injury that is independent from the loss of benefits. *USAA Tex. Lloyds Co. v. Menchaca*, No. 14-0721, ___ S.W.3d ___, ____ _ ____, 2017 WL 1311752, at *11-12 (Tex. Apr. 7, 2017). The *Menchaca* court recognized that "a successful independent-injury claim would be rare, and we in fact have yet to encounter one." Id. at *12 (citing *Mid–Continent Cas. Co. v. Eland Energy, Inc.*, 709 F.3d 515, 521 (5th Cir. 2013)) (observing "[t]he *Stoker* language has frequently been discussed, but in seventeen years since the decision appeared, no Texas Court has yet held that recovery is available for an insurer's extreme act, causing injury independent of the policy claim.").

The Houston court ignored *Menchaca's* holdings that, if contract benefits are all that is lost, they are recoverable as actual damages under the Insurance Code. The court also confused *Menchaca's* discussion of *Stoker*, which addresses the situation where there is no coverage but the insured wants a statutory recovery anyway—that is the "rare" situation. The situation where there is coverage or the insurer's statutory violation causes the loss of coverage is anything but rare.

Hurst has now been followed by other courts, adding to the confusion about *Menchaca's* statements regarding *Stoker* and independent injury. One such case is *Cano v. State Farm Lloyds,* No. 3:14-CV-2720-L, 2017 WL 3279139 (N.D. Tex. Aug. 2, 2017), where the court applied *Menchaca* in an appraisal case concerning a property damage claim for which the insurer had paid the appraisal amount. The insured alleged the appraisal was too low because it did not include certain covered damages due to the insurer's failure to investigate the loss properly in violation of the Insurance Code and the duty of good faith and fair dealing. After quoting *Menchaca's* summary of its rules, the court stated:

> It is undisputed that Plaintiffs had a right to receive benefits under the insurance policy, as Defendants conceded this point and paid the appraisal award. Recovery of extra-contractual damages that exceed policy benefits requires that the statutory violation or bad faith cause an injury that is independent from the loss of benefits.

Hurst, 2017 WL 2258243, at *6 (citing *Menchaca*, 2017 WL 1311752, at *11-12). Although *USAA Texas Lloyds Co. v. Menchaca* is not a case involving payment of an appraisal award, the Texas Supreme Court used it to "provide clarity regarding the relationship between claims for an insurance policy breach and Insurance Code violations." *Menchaca*, 2017 WL 1311752, at *3. In *Menchaca*, the court stated that "a successful independent-injury claim would be rare, and we in fact have yet to encounter one." Id. at *12 (citing *Mid–Continent Cas. Co. v. Eland Energy, Inc.,* 709 F.3d 515, 521 (5th Cir. 2013)). The *Menchaca* court, however, recognized that "[t]his is likely because the Insurance Code offers procedural protections against misconduct likely to lead to an improper denial of benefits and little else." Id. "The [*Menchaca*] court acknowledged that it has further limited the natural range of injury by insisting that an "independent injury" may not "flow" or "stem" from denial of policy benefits." *Hurst*, 2017 WL 2258243, at *6 (citing *Menchaca*, 2017 WL 1311752, at *12). Id. at *6.

Although the insureds had a right to benefits under the policy, the court went found that the plaintiffs did not allege or raise a fact question "that any independent damages exist" to entitle them to damages beyond the appraisal amount. The only allegation of an "extreme act" was the unreasonable investigation, which the court determined was inadequate to survive summary judgment.

The *Cano* case raises some concerns regarding *Menchaca's* statement that findings of coverage and breach of contract are essentially the same. The *Cano* court determined that coverage existed, but the insurer was not in breach of the contract because it succeeded in proving its affirmative defense of estoppel by having paid the appraisal award. But in this situation, should coverage and breach be considered the same thing? The breach of contract claim did not fail for lack of coverage. Rather, the breach of contract claim failed because of an affirmative defense, estoppel, that did not negate coverage but rather amounted to a concession that coverage existed. *Menchaca's* point about the equivalency of coverage and breach findings was that an insured does not need to have both findings in order to support its statutory claims under the "general rule." Like *Hurst*, *Cano* confuses its situation with that involved in *Stoker*, where there is no coverage but the insured wants to recover under the Insurance Code. In this situation, there was coverage but no breach of contract. As such, the court did not correctly apply the rule.

Another appraisal case citing *Hurst is Carroll v. State Farm Lloyds*, No. H-16-1626, 2017 WL 2999681 (S.D. Tex. Jun. 28, 2017). In this case, the insured took some effort to explain which of *Menchaca's* rules applied and why:

> Plaintiff argues that each of these "rules" supports (or may support) her claims against State Farm. Specifically, Plaintiff argues that Rule 1 clarifies that "extra contractual damages could not be recovered absent a finding of coverage, but if coverage exists, a breach need not also be proven." Plaintiff argues that Rule 2 allows her to "recover actual damages for violations." Plaintiff argues that Rule 3 may apply, but additional discovery is needed. Plaintiff argues that Rule 4 allows recovery if there is a separate and distinct injury from the low payments, and that Rule 5 permits her claims in this case because there was coverage under the Policy and there is an independent loss. None of the scenarios is present in Carroll's case, however, given State Farm's full and timely payment of the appraisal award. The payment of the appraisal award satisfies Plaintiff's right to receive benefits under the Policy and, therefore, there is no "loss of benefits." Plaintiff has not identified nor presented evidence of an independent loss that does not flow or stem from the original denial of policy benefits. As a result, *Menchaca* does not allow Plaintiff to pursue her breach of contract and extra-contractual claims following full and timely payment of the appraisal award. (emphasis added)

The court went on to cite *Hurst*.

The confusion in *Carroll* is that the court's reasoning does not sufficiently address the insured's argument about Rule 3—the fact that an appraisal award was paid does not, standing alone, indicate whether the insured would have been entitled to additional coverage benefits (and a higher appraisal) but for the insurer's statutory violations.

In another appraisal case, *Underwood v. Allstate Fire and Cas. Ins. Co*., No. 4:16-cv-00962-O-BP, 2017 WL 4466451 (N.D. Tex. Sep. 19, 2017), the court found neither coverage nor independent injury existed, and applied *Menchaca's* "general rule that there can be no recovery on extra-contractual claims without a valid breach of contract claim." It further extended the "general rule" to "other types of extra-contractual violations" besides sec. 541.151, "including prompt payment of claims under Texas Insurance Code sec. 21.55, failure to fairly investigate, and bad-faith denial of claims," as well as DTPA and "tort" claims, even though *Menchaca's* rules, as stated, apply to "statutory violations," not "extra-contractual claims" in general. The court's explanation of its ruling is as imprecise as its restatement of the "general rule":

> She has not established a valid breach of contract claim, as stated above in Part I. As a result, the general rule, confirmed in [*Menchaca*], that the insured cannot recover for extra-contractual violations applies. The only exception would be if the independent injury rule applies instead. However, Underwood's claims of damages all "'are predicated on,' 'flow from,' or 'stem from' policy benefits," which precludes recovery under the independent-injury rule, as the Texas Supreme Court held in [*Menchaca*]. As a result, all three extracontractual claims fail.

The court's analysis only focused on two of *Menchaca's* five rules—there are other exceptions to the general rule, i.e., the Benefits-Lost Rule. The court similarly stated later, "The only exception would be if the independent-injury rule applies instead." Presumably, the court thought of exceptions that would be applicable based on the plaintiff's allegations, but statements such as these have the potential to lead to future misapplications.

In yet another appraisal case, *Losciale v. State Farm Lloyds*, No. 4-17-0016, 2017 WL 3008642 (S.D. Tex. Jul. 14, 2017), the court found that because the insurer paid the appraisal award, the insured's breach of contract claim failed, as did the "extra-contractual claims for fraud, bad faith, and violations of the DTPA and the Texas Insurance Code." The court rejected the insured's argument that *Menchaca* "'overruled' the vast legal authority regarding the effect of full and timely payment of an appraisal award," and noted that *Menchaca* is not an appraisal case:

> Plaintiff does not identify on which of [*Menchaca's*] "rules" he relies as support for his Insurance Code claims against State Farm. The Court finds that none apply in this case given State Farm's full and timely payment of the appraisal award. **The payment of the appraisal award satisfies Plaintiff's right to receive benefits under the Policy and, therefore, there is no "loss of benefits."** Plaintiff has not identified nor presented evi-

> dence of an independent loss that does not flow or stem from the original denial of policy benefits. As a result, *Menchaca* does not allow Plaintiff to pursue his Texas Insurance Code claims following full and timely payment of the appraisal award.
>
> **Additionally, Menchaca does not purport to alter the long-standing case law regarding the effect of full and timely payment of an appraisal award.** Post–*Menchaca,* only one Texas Court of Appeals has considered the issue, and it held that prior case law applied in the appraisal context, explaining again that full and timely payment of an appraisal award generally precludes both breach of contract and extra-contractual claims. See, e.g., *Nat'l Security Fire & Cas. Co. v. Hurst*, 2017 WL 2258243 (Tex. App.—Houston [14th Dist.] May 23, 2017). (emphasis added).

Regarding Vail, the court said:

> Plaintiff argues, correctly, that the Texas Supreme Court in *Menchaca* clarified that its decision in [*Vail*] remains intact. In *Vail*, the issue was whether policy benefits improperly withheld were actual damages in relation to a claim of unfair claims settlement practices. The Texas Supreme Court in *Vail* held that the policy benefits were actual damages under the Texas Insurance Code. In Plaintiff's case, however, there are no "improperly withheld policy benefits" because the policy benefits were paid in full by Defendant's payment of the appraisal award. As a result, Plaintiff's reliance on the Vail decision is misplaced.

The *Losciale* court finally articulates what some of the others do not: that *Vail's* rule does not apply because all that was owed to the insured had been paid. It must be that the other appraisal cases are failing to articulate but reaching this same conclusion—that because the insurer paid the benefits that were owed, there are no actual damages caused by the insurer's statutory violations.

The *Losciale* court finally articulates what some of the others do not: that *Vail's* rule does not apply because all that was owed to the insured had been paid.

In all of the appraisal cases cited above, the courts neglected to express two important findings necessary to their conclusions: (1) the court found that the insurer paid all that was owed to the insured by paying the appraisal award, and (2) the court found that there were no statutory acts or omissions causing a loss of benefits. The courts' failures to articulate these findings in their opinions is confusing and amount to a misstatement what *Menchaca* actually held.

Another appraisal case held that the insurer did not breach the contract and that the insured also did not establish any statutory violations based on *Menchaca's* fifth rule that an insured cannot recover damages for statutory violations if there is neither right to benefits nor an independent injury. *Pounds v. Liberty Lloyds of Tex.,* No. 14-16-00263-CV, 2017 WL 3270980 (Tex. App. – Houston [14th Dist.] Aug. 1, 2017, no pet.). The court reasoned:

> We have already determined that Pounds had no right to receive benefits from Liberty Lloyds under the policy because the appraisers determined that the Actual Cash Value of Pounds's claim was an amount below the deductible. In addition, Pounds did not allege that he sustained an independent injury as a result of Liberty Lloyds's handling of his claim. Pounds instead argued that the independent injury rule did not apply. As a result, Pounds did not produce summary judgment evidence creating a genuine issue of material fact that he had sustained an injury independent of a right to benefits under the insurance policy. We therefore conclude that Liberty Lloyds established its entitlement to summary judgment on Pounds's extra-contractual claims.

Pounds correctly recognizes that either a right to benefits or an independent injury will support a claim for a statutory violation. The court did not analyze whether an independent injury existed because the insured did not allege one in his pleadings. This case is slightly different than the other appraisal cases. The justification for the court's finding of no breach or entitlement to benefits is that the appraisal award was below the deductible, not that the insurer had paid the appraisal award.

In a case from the Dallas court of appeals, *Floyd Circle Partners, LLC v. Republic Lloyds*, No. 05-16-00224-CV, 2017 WL 3124469 (Tex. App. – Dallas Jul. 24, 2017, pet. filed), the court extensively discussed the validity of an appraisal before holding that the insurer did not breach its contract with the insured. It concluded that the insured's extra-contractual claims also failed:

> Where a plaintiff's claim for breach of an insurance contract fails, to prevail on an action for violations of chapter 541 of the insurance code, the plaintiff must show either that the insured failed to timely investigate the claim or that the insurer committed an extreme act that caused an injury independent of the policy claim. *Bernstien v. Safeco Ins. Co. of Ill.,* No. 05–13–01533–CV, 2015 WL 3958282, at *2 (Tex. App.–Dallas June 30, 2015, no pet.) (mem. op.); see *USAA Tex. Lloyds Co. v. Menchaca,* No. 14–0721, 2017 WL 1311752, at *11–12 (Tex. Apr. 7, 2017). Republic asserted that FCP provided no evidence that either of these exceptions apply in this case. In its appellate brief, FCP contends the summary judgment evidence shows it sustained an independent injury, namely, having to give its tenants rent discounts and concessions because of the damage to the buildings. **FCP's response to Republic's motion for summary judgment, however, makes no mention at all of FCP's insurance code claims.** It thus cannot be said to have provided any summary judgment evidence of an independent injury. As such, the trial court properly granted summary judgment on the chapter 541 claims. (emphasis added).

The decision seems to be based on a deficiency in the insured's pleadings and summary judgment proof, since the court did not actually decide whether the rent discounts attributable to the building damage could be considered an independent injury.

Another court postponed its summary judgment determination until *Menchaca* was decided. *Certain Underwriters at Lloyd's of London v. Lowen Valley View*, LLC, No. 3:16-CV-04650B, 2017 WL 3115142 (N.D. Tex. Jul. 21, 2017). The coverage issue in this claim for hail loss was whether damages occurred during the policy period or before or after. The court found the insured "failed to provide any evidence that would allow the trier of fact to segregate covered losses from non-covered losses," and thus the insurer was entitled to summary judgment on the insured's breach of contract claim. Focusing on *Menchaca's* "general rule" and "independent injury" exception to the general rule, the court concluded that the insured's statutory claims failed:

> Here, the Court has already determined that Defendants have failed to raise a genuine issue of material fact on their counterclaim for breach of contract. In other words, Defendants have not demonstrated that the claimed damage was "covered" under the Policy. Or in the language of *Menchaca*, they have not demonstrated a "right to receive benefits under the policy." Therefore, Defendants' only route to damages for a statutory violation would be to demonstrate that they suffered an "injury independent of a right to benefits."

Citing *Stoker*, the court held that the insureds provided no evidence that the insurer's "conduct was 'so extreme' as to cause 'injury independent of a right to benefits' under the Policy." The insureds argued that the independent injury rule did not apply because they were seeking the policy benefits as actual damages for the statutory violations. The court disagreed, stating that because the "damages are not covered as a matter of law," an "independent injury is required."

Some cases have correctly understood *Menchaca's* holding that an independent injury is not required in all extra-contractual cases. For example, *Metro Hospitality Partners, Ltd. v. Lexington Ins. Co.*, No. H-15-1307, 2017 WL 3142444 (S.D. Tex. Jul. 25, 2017), where an insured asked the court to reconsider its prior judgment in light of *Menchaca*. The court had earlier concluded that the insured's claim for breach of the duty of good faith and fair dealing failed because the insured "did not present evidence of any injury independent of the injuries it claimed resulted from [the insurer's] denial of the disputed covered loss." The court found that this was no longer an appropriate basis for summary judgment against the insured:

> *Menchaca* clarified that an insured's injury independent of the loss of policy benefits is not necessarily required for recovery on extracontractual bad-faith claims. *Menchaca*, 2017 WL 1311752, at *7–*9. When there is coverage under the policy and a breach, an insured may be able to recover. Id. Metro's failure to provide evidence of an independent injury was the basis for this court's summary judgment opinion. The parties agree that this ground no longer suffices as the basis to grant Lexington's summary judgment motion on Metro's extracontractual claims. The parties dispute whether *Menchaca* changes the result.

Thus the issue before the court became whether the insurer's alleged statutory violations caused the insured to suffer any damages and, in particular, whether the insurer reasonably relied on its investigation and the experts it retained. The court concluded the insured did not meet this standard either: the insurer's investigation was reasonable and, even if it were not, the insured could not show that the insurer's "delay in paying was 'caused by' flaws in the investigation" in light of the insured's failure to cooperate with the insurer's demands for information.

And another case relied on *Menchaca* in reversing an earlier decision for an insurer. *Allen v. State Farm Lloyds* concerned whether a homeowner's policy provided coverage under the dwelling foundation and water damage endorsements for damage caused by plumbing leaks. No. 05-16-00108-CV, 2017 WL 3275912 (Tex. App. – Dallas Aug. 1, 2017, Rule 53.7(f) motion granted). The trial court had rendered judgment for the insurer, but the appellate court reversed. First, the court found that more than a scintilla of evidence supported the insured's coverage claim and that the insureds had raised a fact issue on their claim for breach of contract. The court then addressed the insured's claim under § 541.60(a)(7) for refusing to pay a claim without conducting a reasonable investigation. The trial court granted a directed verdict on the basis that the insureds did not prove an injury independent of the policy benefits. The appellate court reversed, based on *Menchaca*:

> [T]he supreme court has held that when an insured establishes a right to recover under an insurance policy, the insured may recover the policy benefits as actual damages for a statutory violation. In light of the holding in *Menchaca* that no independent injury must be shown for failure to conduct a reasonable investigation when the insured has shown he was entitled to benefits under the policy, and in light of our holding that the [insureds] raised a fact issue about whether they were entitled to benefits under the policy, we conclude the trial court erred by directing a verdict on this statutory claim.

So at least some courts have reversed cases decided under earlier, incorrect applications of the independent injury rule.

Menchaca has been cited in other contexts and for other purposes. It was cited in a decision regarding the scope of an abatement pending appraisal. *Hallak v. Allstate Vehicle and Prop. Ins. Co.*, No. 4:17-cv-00237-O-BP, 2017 WL 4182198 (N.D. Tex. Aug. 29, 2017) (case abated pending appraisal; citing *Menchaca* in support of conclusion that insured could not pursue discovery on his extra-contractual claims during abatement because those claims could proceed only when there is an independent injury that does not flow or stem from the denial of policy benefits). It has also been cited regarding procedural matters, not specific to insurance. *United Scaffolding, Inc. v. Levine*, 60 Tex. S. Ct. J. 1515 (2017) (citing *Menchaca* for proposition that jury finding is immaterial when question should not have been submitted or when it was properly submitted but rendered immaterial by other findings); *Great Am. Ins. Co. v. Hamel*, 525 S.W.3d 655 (Tex. 2017) (citing *Menchaca* regarding propriety of remanding in the interest of justice).

Another context where *Menchaca* was invoked was in a federal court's denial of an insured's motion to remand. *Waste Mngmt., Inc. v. AIG Specialty Ins. Co.*, No. H-16-3676, 2017 WL 3431816 (S.D. Tex. Aug. 9, 2017). An insurer removed a case to federal court, arguing that extracontractual claims against the non-diverse adjuster were improper. The court concluded that the insureds needed to "plead and prove damages that are independent of contract damages, i.e., independent of damages from failure to pay policy benefits," but failed to do so, warranting dismissal of the claims against the adjuster and denying remand. The court cited *Menchaca*:

> This Court observes that recently the Texas Supreme Court addressed this issue in [*Menchaca*]. The Texas Supreme Court opines that the "general rule" is that insured cannot recover policy benefits as actual damages caused by an insurer's statutory violation if the insured does not have a right to those benefits under the policy because the Insurance Code only allows an insured to recover actual damages "caused by" the insurer's statutory violation.

This invocation of *Menchaca* is odd. *Menchaca* did not address Insurance Code claims brought against agents or adjusters, only those brought against insurers. Further, as the court itself noted, the insureds would not have a breach of contract claim against an adjuster that neither issued the policy nor was party to it. That being so, claims against adjusters are outside the scope of *Menchaca's* rules, which address the relationship between breach of contract claims and Insurance Code claims. This may be another situation where the distinction between coverage and breach of contract becomes relevant. As this case suggests, *Menchaca* will be important to bear in mind in crafting petitions to meet federal pleading standards.

The significance of pleadings was also illustrated in *Cruz v. Allstate Vehicle and Prop. Ins. Co.,* No. 4:17-CV-491-A, 2017 WL 3887923 (N.D. Tex. Sep. 5, 2017), in which the district court granted an insurer's motion to dismiss based on the complaint. The court found that the insureds' "complaint seems to be that they did not get paid as much as they think they should have been paid, but they have not alleged any facts to show that Allstate breached a contract between them." Having so concluded, the court then found that the insureds needed to plead facts showing an independent injury resulting from the insurer's wrongful denial of policy benefits. Because they did not so plead, the insured failed to state claims for fraud, civil conspiracy to commit fraud claim, or any violation of the insurance code. Regarding *Menchaca,* the court had this to say in a footnote:

> **The court notes that the Supreme Court of Texas has somewhat muddied (rather than clarified) the waters by its recent opinion** in *USAA Texas Lloyds Co. v. Menchaca*, No. 14-0721, 2017 WL 1311752 (Tex. Apr. 7, 2017). That opinion has not been released for publication and is subject to revision or withdrawal. In any event, the extra-contractual claims plaintiffs assert here are of the type predicated on coverage under the insurance policy. Thus, if there is no breach of contract, the extra-contractual damages do not survive. (Emphasis added)

Based on the way *Menchaca* has been applied so far, it would certainly seem that the independent injury waters are just as "muddied" as ever.

Based on the way *Menchaca* has been applied so far, it would certainly seem that the independent injury waters are just as "muddied" as ever.

B. Prompt Payment of Claims – Article 21.55

An insured was not able to sustain her claim for prompt payment violations where the insurer paid an appraisal award 8 months after the insured's claim was made. *Garcia v. State Farm Lloyds*, 514 S.W.3d 257 (Tex. App.—San Antonio 2017, pet. denied). An insured homeowner suffered damage to her home caused by a storm. In February, the insurer's adjuster inspected the damage and found the damage did not exceed the deductible. The insured sued for breach of contract, breach of the duty of good faith and fair dealing, as well as violations of the Texas Insurance Code, Texas Prompt Payment of Claims Act, and the DTPA. The insurer demanded an appraisal allowed for in the insurance policy. An award was made for an amount in excess of the deductible of $4,382.92, which the insurer paid 3 days after the award was issued in September. The insured rejected the payment of the award and moved to set aside the appraisal award, which the court denied, instead granting summary judgment in favor of the insurer. The insured argued there were genuine issues of material fact on whether the insurer breached the insurance contract because the evidence showed the insurer failed to pay for all the hail-related damage to the house. The insured stated the insurer denied coverage for these items, which the appraiser later included in their appraisal award. The court held the insured failed to raise a fact issue on her breach of contract claim: the fact that the appraisal award differed from the original damages estimate was not evidence of a breach of contract. The insured argued that under *Graber v. State Farm Lloyds*, she was entitled to a claim under the Prompt Payment of Claims Act. No. 3:13-CV-2671-B, 2015 WL 3755030 (N.D. Tex. June 15, 2015), where the court concluded the insurer's full and timely payment of the appraisal award did not preclude the insured's claim for statutory interest under the Act. However, unfortunately for the insured in this case, the court held that, because the insurer undisputedly paid the appraisal award, the insured could not sustain her late payment claim even though the claim was paid almost 8 months after her claim was submitted. The court stated that the cases *Graber* relied on were not appraisal cases, although interestingly, not noted by this court, *Graber* itself was an appraisal case. The court held that for the insured to avoid summary judgment on her bad faith claim, she had the burden to raise a genuine issue of material fact that the insurer "commit[ed] some act, so extreme, that would cause injury independent of the policy claim" or failed to timely investigate her claim, which the court noted the insured did not do. Rather, the court said the evidence only showed a bona fide dispute about the amount necessary to compensate the insured for her home. Finally, the court held both that because the insured failed to present evidence on either her breach of common law bad faith claim or of an independent injury, and the insurer timely paid all covered damages determined by the appraisal award, the insured's statutory bad faith and DTPA claims were foreclosed.

An insured policyholder could not recover under the Prompt Payment of Claims Statute where the policyholder's attorney took exclusive possession of the funds issued by the insurer. A policyholder filed a claim for damages after 5 of its buildings were damaged by a hurricane. The insurer demanded appraisal and paid the appraisal award jointly to the policyholder and its attorney. The policyholder's attorney negotiated the check without the endorsement of the policyholder and retained all of the funds. The policyholder sued its attorney for the funds, which were recovered 9 months later. The policyholder also sued its insurer for violations of the prompt payment statute. The court concluded that the insurer delivered a timely payment in full to the policyholder when it delivered the check to the policyholder's attorney, who was the policyholder's agent. The court held that these agency principles were not displaced by either the prompt payment provisions or the Texas UCC. Additionally, the court said that the delivery of the check to the insured's attorney, acting within the scope of his authority, tolls prompt payment penalties as a matter of law. The court reasoned that writing the check as the insurer did protected insureds in the policyholder's position by requiring their endorsements before proper negotiation. Therefore, the court affirmed the trial court's judgment. *Gusma Properties, L.P. v. Travelers Lloyds Ins. Co*., 514 S.W.3d 319 (Tex. App.—Houston [14th Dist.] 2016, no pet.) (mem. op.).

An insured waived its right to rely upon a jury's finding in support of its appeal concerning its prompt payment cause of action. The insured shopping malls were damaged by a hurricane. The insured made a claim on the policy to recover the value of the lost property at replacement cost. The insurer decided that payment on replacement cost basis was not appropriate because the damaged property was not replaced. Instead, the insurer paid the claims based on actual cash value. The insured sued for breach of the policy, breach of an insurer's duty of good faith and fair dealing, and violations of the prompt payment statute. There were several discrepancies in the jury's answer to the jury questions: some found in favor of the insured, others in favor of the insurer. The trial court ultimately rendered a take-nothing judgment against the insured. The jury answered that the insurer had complied with the policy, but in a later question found that the insurer failed to comply with the requirement that it pay replacement cost value. The appellate court held that because the insured did not raise objections to the conflicting jury answers, the insured waived the complaint and could not later claim it was entitled to a new trial based on an irreconcilable conflict of jury answers. The appellate court held that the evidence at trial would not enable reasonable and fair-minded people to find that the insurer made it impossible for the insured to actually repair or replace the lost or damaged property at either of the malls with new property of comparable material. Therefore, the insured was not entitled to replacement cost value but only actual cash value, which the insurer paid prior to suit. The insured was not entitled to judgment based on any liability of the insurer. Therefore, the insured could not recover any prompt payment penalties. The appellate court affirmed the take nothing judgment against the insured. *Triyar Co., L.L.C. v. Fireman's Fund Ins. Co.*, 515 S.W.3d 517 (Tex. App.—Houston [14th Dist.] 2017, pet. filed).

V. AGENTS, AGENCY, AND VICARIOUS LIABILITY

A. Individual liability of agents, adjusters, and others

An insured property owner sued its insurer and adjuster when the insurer failed to pay a claim for roof hail damage. The insurer removed the case to federal court stating that the adjuster was improperly joined. The court held that the insured stated a plausible claim for relief for violations of the Texas Insurance Code against the in-state adjuster. Evidence included that the adjuster noted a large number of small bare spots on the roof but attributed them to the "caustic effects of pigeon droppings." Therefore, the court remanded the case to county court. *Cohen v. Seneca Ins. Co., Inc.,* No. 3:15-CV-1837-L, 2017 WL 1281254 (N.D. Tex. Mar. 24, 2017).

The finance company argued that nine-days' notice was sufficient because it "substantially complied" with § 651.161(b), but the court disagreed.

B. Premium finance companies

In *BankDirect Capital Finance, LLC v. Plasma Fab, LLC,* 519 S.W.3d 76 (Tex. 2017), the Texas Supreme Court addressed the issue of whether an insurance finance company properly exercised its authority under Tex. Ins. Code § 651.161 when it cancelled an insured's CGL policy nine days after a notice was mailed to the insured. In that case, an insured sued its insurance premium finance company after the finance company cancelled the policy based on the insured's default. The insured was habitually late in making its premium payments to the finance company, and the insurer had twice cancelled the policy before. But each time, the finance company mailed written notice to the insured of its intent to cancel the policy if the past-due premium was not paid. And each time, the insured eventually paid the overdue premium, and the finance company requested the insurer reinstate the policy. However, in the instance at issue in this suit, when the insured missed its premium payment, the finance company sent a notice of intent to cancel the policy that was dated ten days before the cancellation date but not mailed until nine days before the cure deadline stated in the notice. The notice thus violated Tex. Ins. Code § 651.161(b), because the "stated time" in the notice was "earlier than the 10th day after the date the notice [was] mailed." The insured did not pay the past-due premium by the date set out in the notice, and the finance company sent a notice of cancellation to the insurer that evening. Four days later, a fire destroyed one of the insured's work sites. The next day, the insured tendered the overdue amount. The finance company requested that the insurer reinstate the policy, but it refused and denied coverage when the insured was sued concerning the fire damages. Section 651.161(b) states:

> The insurance premium finance company "must mail to the insured a written notice that the company will cancel the insurance contract because of the insured's default in payment unless the default is cured at or before the time stated in the notice. The state time may not be earlier than the 10th day after the date the notice is mailed.

The finance company argued that nine-days' notice was sufficient because it "substantially complied" with § 651.161(b), but the court disagreed. The court refused to adopt a "substantial compliance" standard in interpreting the statute. The language of the notice requirement is clear and unambiguous.

The supreme court distinguished this case from other statutory contexts in which it has recognized a "substantial compliance" standard. In *Roccaforte v. Jefferson County,* 341 S.W.3d 919 (Tex. 2011), a wrongful termination suit cited by the dissent, the plaintiff employee gave notice of suit by hand-delivery instead of by mail, as required by the Local Government Code, but the court in that case found the employee had substantially complied because the defendant county received the notice before the statute's deadline and was able to timely answer the suit. Thus, the *Roccaforte* plaintiff complied with the deadline's mandate, even if its manner was not correct. Here, by contrast, the notice was untimely: the finance company did not even comply with the deadline's mandate. As the court explained, "The 'essential requirement' of a deadline is the deadline, and, as with a missed statute of limitations, the degree of delay matters not: 'A miss is as good as a mile.'" In short, section 651.161 is only satisfied by full compliance, not "substantial" compliance.

The decision in *Roccaforte* was not unanimous. Justice Guzman filed a concurring opinion, and Justice Johnson filed a dissenting opinion, joined by Justice Hecht. Justice Guzman did "not agree with the court's conclusion that failing to 'state' a ten-day post-mailing cure deadline is, in and of itself, insufficient compliance," but nevertheless concurred in the judgment that the finance company "did not comply with section 651.161, substantially or otherwise, because [it] both stated a shortened cure deadline and prematurely cancelled the insurance policy." Justice Johnson dissented because "the Legislature did not specify the consequences of a premium finance company failing to strictly comply with section 651.161(b)'s ten-day requirement, and the factors and language in the Code Construction Act indicate, on balance, that the requirement should be measured by substantial compliance, I conclude that the Legislature did not intend to require strict compliance with that specific provision in the statute." It seems to the authors that the dissent is making complicated a statute that is clear and direct.

VI. THIRD PARTY INSURANCE POLICIES & PROVISIONS

A. Automobile liability insurance

An automobile liability policy's family member exclusion was constitutional, in accord with public policy, and not unconscionable. *Johnson v. State Farm Mut. Auto. Ins. Co.,* 520 S.W.3d 92 (Tex. App. – Austin 2017, pet. denied). An insured's minor son was severely injured while the insured was driving. The insured sued his auto carrier. The policy contained a "family member exclusion" that excluded from liability coverage bodily injury to "any family member, except to the extent of the minimum requirements of Liability Coverage" required by state law. The insured sought a declaration that the family member exclusion was unconstitutional or contrary to public policy and invalid. The insured argued that the family exclusion violated public policy by "acting as a barrier to Texans' freedom to contract and by discouraging family unity." The Third Court of Appeals disagreed, however, citing several precedents, including *Nat'l County Mut. Fire Ins. Co. v. Johnson*, 879 S.W.2d 1 (Tex. 1993) (plurality upheld family member exclusion so long as insurer provided minimum statutory limits required by law), *Liberty Mut. Fire Ins. Co. v. Sanford*, 87 S.W.2d 9 (Tex. 1994) (adopting plurality opinion in Johnson), and several decisions from the Texas courts of appeals.

The insured argued that the family member exclusion was unconstitutional because it violated the Texas Constitution's equal protection and due process clauses. The court rejected those arguments because those constitutional provisions apply to state actors, which the insurer was not. The insured additionally argued that the exclusion violated article XII, section 2 of the Texas Constitution, which provides that laws be enacted "for the creation of private corporations, and shall therein provide fully for the adequate protection of the public…." The insured's argument, as interpreted by the court, was that the Board of Insurance did not have authority to adopt the form policy containing the family member exclusion. The court disagreed, however, because "article XII applies to laws creating private corporations, not to laws regulating insurance policy forms." Having found the exclusion constitutional and in accord with public policy, the court went on to find that the exclusion was not unconscionable: "it is not per se unconscionable for an insurer to 'reduce its risk and boost its solvency' by including a family member exclusion that is promulgated in a state-approved form and complies with the Texas Motor Vehicle Safety Responsibility Act."

The insured also argued that the family member exclusion should be applied at the time the claim is made, not at the time of the accident. The exclusion applied only to family members who resided with the insured. The insured's son lived with him at the time of the accident, which triggered the exclusion, but the son no longer lived with him when the claim was made, which would have meant the exclusion did not bar coverage. The court disagreed, holding that "residency" of a family member is determined at the time of the accident, not the claim, and that the insured's interpretation was unreasonable.

B. Directors & officers liability insurance

As we reported last year, on November 9, 2016, the Texas Supreme Court heard argument on whether the D&O "insured v. insured" exclusion for claims made against any insured by a person who succeeds to the interest of the insured bars a claim by the insured's assignee. The court issued its opinion on February 24, 2017, and held that the exclusion barred the claim, reversing the court of appeals' decision. *Great American Ins. Co. v. Primo*, 512 S.W.3d 890 (Tex. 2017). Primo was an officer and director of Briar Green Condominiums. Briar Green asserted a claim against Travelers, its fidelity insurer, asserting that Primo had wrongfully taken funds from its account. Travelers paid the claim and, in exchange, Briar Green assigned to Travelers all its claims against Primo. Travelers then sued Primo, who tendered his defense request to Great American, the condominium association's D&O insurer. Great American denied the claim under the "insured versus insured" exclusion, which excluded claims "made against any Insured … by, or for the benefit of, or at the behest of … any person or entity which succeeds to the interest of [Briar Green]."

The court of appeals had held that Travelers was an assignee of Briar Green's rights, but that did not make it a successor in interest. The case law on successor in interest includes a party that acquires the other party's rights and responsibilities. The court of appeals determined that, while Travelers acquired Briar Green's rights under the policy, it did not acquire any of Briar Green's responsibilities. Further, the policy did not define successors in interest and the term was at least ambiguous regarding whether it included or did not include an assignee. Therefore, the court of appeals concluded that the trial court erred in rendering summary judgment for Great American based on the exclusion.

The Texas Supreme Court disagreed. The supreme court reasoned that the meaning of "successor" depended upon the character, purposes, circumstances, and context of the contract. Here, because the contract is a D&O insurance policy, the court found that the interpretation should be one that prevents collusive suits between business organizations and their directors and officers. It concluded that the court of appeals' interpretation of the exclusion made "collusive suits more likely, rather than less." The supreme court held that Great American had shown as a matter of law that Travelers was a "successor" within the meaning of the exclusion and that there was no coverage for the claims Primo asserted.

Despite emphasizing the fact that the contract at issue is an insurance policy, the supreme court's analysis neglects to address or even mention the important rules of construction specific to insurance policies: With an ordinary contract, once the court finds the language ambiguous, that creates a fact issue on what the parties intended. *Coker v. Coker,* 650 S.W.2d 391, 393 (Tex. 1983). By contrast, if an insurance policy is subject to more than one reasonable interpretation, it is ambiguous and the interpretation that most favors coverage for the insured will be adopted as a matter of law. *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455, 458 (Tex. 1997). Once an ambiguity is found in an insurance policy that allows coverage, the court must decide in favor of the insured, and there is no fact question on intent. Mark L. Kincaid & Christopher W. Martin, Texas Practice Guide: Insurance Litigation, § 4.7 (2014). Moreover, exceptions of limitations on liability are strictly construed against the insurer and liberally in favor of the insured. *Puckett v. U.S. Fire Ins. Co*., 678 S.W.2d 936, 938 (Tex. 1984); *National Union Fire Ins. Co. v. Hudson Energy Co*., 811 S.W.2d 552, 555 (Tex. 1991). Presumably, the court found that the exclusion was unambiguous and that the lower court's construction was unreasonable, and so these rules of construction did not apply.

While this opinion answers a question about the "insured v. insured" exclusion in D&O policies, it raises other questions about whether a policy is ambiguous or unambiguous. Here, the policy did not define the terms "successor" or "succeed in interest," and the case law provided precedents for both the narrow corporate meaning the appellate court adopted as well as the broader language the supreme court adopted. And, as the appellate court's divided opinion revealed, reasonable minds could and did draw different conclusions.

C. Professional liability insurance – Errors & omissions

Attorneys sued their client who refused to pay their contingency fee, after a judgment was obtained. The client counterclaimed, which triggered the attorneys' professional liability insurance policy. In subsequent coverage litigation between one of the attorneys and her insurer, the Fifth Circuit held that nothing in the prior court's judgment suggested that the attorney should be judicially estopped to claim defense costs in excess of \$668,068.31, since the judgment suggested defense costs far outpacing that figure. However, the court noted that the attorney could not recover fees related to the affirmative prosecution of their affirmative claims, even if the work was "inextricably intertwined" with the defense. Moreover, there was not a breach of the duty of good faith and fair dealing because it was not a claim involving the insured's loss, as the third-party (client) suffered a loss and sued the insured attorneys who then sought coverage from their insurers. The Fifth Circuit also held that the insurer did not have a right of equitable reimbursement against the attorney, its insured, outside of the insurance policy's provisions. *Aldous v. Darwin Nat'l Assurance Co.*, 851 F.3d 473 (5th Cir. 2017).

VII. DUTIES OF LIABILITY INSURERS

A. Duty to defend

In *Federal Ins. Co. v. Northfield Ins. Co.*, 837 F.3d 548 (5th Cir. 2016), a pollution liability insurer sued a general liability insurer, contending that the general liability insurer had a duty to defend their mutual insured against an oil-company's state-court litigation. The underlying litigation was twofold: the owners of land subject to oil and gas interests suit sued both the insured and the oil company from which the insured had purchased the oil and gas interests. When the insured refused to defend or indemnify the oil company in that litigation, the oil company then sued the insured for breach of contract. The insured had two insurance policies: a pollution liability policy issued by Federal and a general liability policy issued by Northfield. Federal acknowledged its duty to defend; Northfield denied coverage. Thus, Federal sued Northfield, seeking both a declaration that Northfield also owed the insured a duty to defend and recovery of 50% of the insured's defense costs. At issue before the 5th Circuit was whether a pollution exclusion in Northfield's policy barred coverage.

The Northfield Policy's "Pollution Endorsement" excluded coverage for:

> '[b]odily injury', 'property damage', 'personal injury', loss of, damage to or loss of use of property, or any other form of liability or damages to which any insured may be subject arising out of the actual, alleged, or threatened discharge, dispersal, release, seepage, migration or escape of pollutants at any time at any location by whomsoever caused.

The Pollution Endorsement defined "Pollutants" as:

> any solid, liquid, gaseous or thermal irritant, contaminant or waste, including but not limited to saline, saltwater, smoke, vapors, soot, dust, fumes, acids, alkalis and chemicals. Waste includes any materials which are intended to be recycled, reconditioned or reclaimed, regardless of whether the waste has the effect of making something impure or hazardous.

The Fifth Circuit compared these policy provisions with the oil company's petition against the insured and concluded that the petition's allegations were so broad and general that it was impossible to determine that all of the claims clearly fell within the exclusion. In particular, the oil company sought a declaration that the insured had "assumed all obligations and liabilities of [oil company] under all agreements insofar as they pertain to the assigned property, including but not limited to, all liabilities for the assessment, remediation, removal, and disposal of hazardous substances." Further, the oil company's pleading did not attach any of the petitions from the landowners' suit and contained little information about the nature of the claims made therein. While the oil company's petition stated that the landowners alleged "environmental damage," the court noted that "environmental damage" could be caused by things other than pollution. As such, although it was plausible that some of the oil company's claims came within the terms of the pollution exclusion, the court correctly concluded that the duty to defend attached because some of the other claims may be covered and all doubts regarding the duty to defend must be resolved in favor of the insured.

The court also examined whether the Underground Resources & Equipment Buyback (UREB) endorsement applied "in the interest of judicial economy," since Federal asserted that endorsement's application in the alternative if the pollution exclusion had applied. The court undertook this analysis "in the event that subsequent allegations by [the oil company] result in the application" of the pollution exclusion, despite its being unnecessary to resolve the duty to defend question at hand. Noting that the UREB endorsement was an extension of coverage, the court determined that Federal had the burden of establishing its application. By its terms, the UREB superseded the pollution endorsement and applied to property damage "included within the 'underground resources & equipment hazard' arising out of the operations performed by you [the insured]…." The Fifth Circuit concluded that this endorsement and its extension of coverage did not apply: the oil company's petition statement that the landowners' suits "allege environmental damage and seek restoration and remediation of the land subject to mineral rights purchased by [the insured]" did not relate to a claim for property damage within the "underground resources & equipment hazard." Further, the oil company's allegations that the insured breached its contract did not assert recovery for property damage under the "underground resources & equipment hazard."

The Fifth Circuit also analyzed whether the Contractual Liability Exclusion applied, even though this issue was not addressed by the district court. At issue was the exception to the exclusion, which Federal had the burden of proving applied. The exclusion excluded coverage for damages the insured was obligated to pay "by reason of the assumption of liability in a contract or agreement," but excepted from that exclusion liability for damages:

> (1) That the insured would have in the absence of the contract or agreement.
> (2) Assumed in a contract or agreement that is an "insured contract", provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an "insured contract", reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of "bodily injury" or "property damage," provided:
>
>> (a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and
>> (b) Such attorney fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.

The policy defined "Insured contract" as including:

> f. That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) un-

> der which you assume the tort liability of another party to pay for "bodily injury" or "property damage" to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

Northfield argued that the exception did not apply because the oil company's suit did not involve assumption of any tort liability but alleged only contractual obligations to clean up or restore the property under the mineral leases and that, as such, there was no "insured contract." The Fifth Circuit disagreed and concluded that the exception to the Insured Contract exclusion applied for purposes of the duty to defend. The oil company had alleged that the contract between it and the insured obligated the insured to indemnify it from any and all claims in connection with the environmental condition of the property, including those arising from the oil company's "alleged negligence, strict liability, and any obligation to comply with environmental statutes…." Thus, the petition alleged that the contract between the oil company and the insured was a contract under which the insured assumed the oil company's tort liability to third persons, bringing it within the exception to the exclusion. Having found that neither the Pollution nor Insured Contract exclusions applied, the Fifth Circuit held that Northfield had a duty to defend the insured.

In another case, the Fifth Circuit concluded that an insurer owed no duty to defend its insured, a chiropractic clinic that was sued by the trademark holder of the terms "ART" and "Active Release Techniques" for allegedly providing ART services directly to customers outside of the parties' licensing agreement and for the clinic's advertisement of "ART" on its website. *Laney Chiropractic and Sports Therapy, P.A. v. Nationwide Mutual Ins. Co.*, 866 F.3d 254 (5th Cir. 2017). The policy provided coverage for "personal and advertising injury," defined as injury arising out of either "The use of another's advertising idea in your 'advertisement'" or "Infringing upon another's copyright, trade dress or slogan in your 'advertisement.'"

The clinic argued that the underlying complaint alleged facts describing three forms of advertising injury: (1) use of the plaintiff's ART "advertising ideas"; (2) trade dress infringement; and (3) slogan infringement. The Fifth Circuit rejected each of these arguments. First, although the policy did not define "advertising idea," the court found the term unambiguously excluded trademarks: "allegations that Laney used the [plaintiffs'] trademarks do not allege the use of [their] advertising ideas because under Texas law, a trademark is not a marketing or advertising device." The court additionally found that an advertisement is "distinct from the product being advertised," and the underlying complaint's allegations centered on the clinic's advertisement of its use of ART, a patented product. Second, the court held that the underlying complaint did not potentially state a trade dress claim because it alleged that the clinic was copying the plaintiffs' entire product, not merely "incidental, arbitrary or ornamental product features." Moreover, the court concluded that allegations of trademark misappropriation "without more, do not allege a trade dress claim." The complaint neither identified any discrete elements of the trade dress it sought to protect nor described how the parties' marketing or websites were aesthetically similar, and thus did not allege a trade dress claim. Finally, the court held that the underlying complaint did not state a claim for slogan infringement because the terms "ART" and "Active Release Techniques," among other phrases, were not slogans but "brand and product names." The policy did not define "slogan," but the parties agreed and the court found that a slogan is a "distinctive cry, phrase, or motto of any party, group, manufacturer, or person; catchword, or catch phrase." According to the court, the complaint did "not allege that the [plaintiffs] used the alleged slogans as catchy, stand-alone phrases," and that the plaintiffs' use of them involved "narrative descriptions of what ART is," as opposed to a "short, catchy phrase" that is found to be a slogan. Therefore, the court held that the underlying complaint did not allege any claims that would be covered by the policy and trigger the insurer's duty to defend the clinic.

The Texas Supreme Court revisited when an insured's assignment of its claims against its insurer to plaintiffs is valid and results in a binding judgment against an insurer.

B. Duty to indemnify

An automobile liability insurer was not liable to pay a default judgment against its insured because it was prejudiced by the insured's failure to comply with the policy's notice provisions. *Hoel v. Old Am. County Mut. Fire Ins. Co.*, No. 01-16-00610-CV, 2017 WL 3911020 (Tex. App. – Houston [1st Dist.] Sep. 7, 2017, pet. filed) (mem. op.). An insured failed to answer a suit against him concerning a car accident with the plaintiff, who thus obtained a default judgment. She then sued the insurer to recover the amount of the default judgment. The insurer argued that it did not owe the amount because it had been prejudiced by the insured's failure to notify it about the suit. In response, the plaintiff presented evidence of correspondence between the insurer and her attorney, including pre-suit settlement negotiations between the insurer and the plaintiff, as well as the plaintiff's letter to the insurer informing it that she had filed suit and attaching copies of the petition and motion for default judgment. The court held that the insurer had no duty to defend or indemnify the insured because the insured did not give the required notice, which prejudiced the insurer. The plaintiff argued that the insurer was not prejudiced because it had actual notice of the suit and ample time to defend the insured. The court disagreed. The opinion does not specify when the plaintiff notified the insurer of the suit or how much time the insurer had to respond before she filed her motion for default judgment, but presumably the insurer's actual notice came after the insured's answer was due, since the court's analysis concerned the prejudicial nature of default judgments. The court explained that "a default judgment is generally prejudicial" and that "the insured's failure to comply with the notice-of-suit provisions resulted in the plaintiff … taking a default judgment against him," and that the insurer was deprived of its ability "to answer and defend against [the plaintiff's] claims, to conduct discovery, and to fully litigate the merits of the claims." Therefore, the insurer was not liable to the plaintiff for the amount of the default judgment against the insured.

C. Settlements, assignments & covenants not to execute

The Texas Supreme Court revisited when an insured's assignment of its claims against its insurer to plaintiffs is valid and results in a binding judgment against an insurer. *Great Am. Ins. Co. v. Hamel*, 535 S.W.3d 655 (Tex. 2017). With more particularity, the court examined "whether a judgment against an insured defendant was the product of a 'fully adversarial trial' and is thus enforceable against the defendant's insurer." The court also considered whether deficiencies in the underlying trial may be effectively remedied by subsequent insurance coverage litigation.

The Texas Supreme Court has previously held that an insurer that wrongfully refuses to defend its insured is barred from collaterally attacking a judgment or settlement between the insured and the plaintiff. *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc*., 256 S.W.3d 660, 671 (Tex. 2008) (insurer that breached duty to defend could not attack agreed judgment, despite lack of trial, where insured had already sued insurer directly and thus retained stake in litigation); *Emp'rs Cas. Co. v. Block*, 744 S.W.2d 940, 943 (Tex. 1988) (in light of failure to defend, insurer "was barred from collaterally attacking the agreed judgment by litigating the reasonableness of the damages recited therein."). But in *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996), the supreme court held that the settlement and assignment of claims was invalid when (1) it was made prior to an adjudication of plaintiff's claims against the insured in a fully adversarial trial; (2) the insurer had tendered a defense; and (3) either the insurer had accepted coverage or made a good faith effort to adjudicate coverage prior to the adjudication of the plaintiff's claim. *Gandy's* holding was "explicit and narrow, applying only to a specific set of assignments with special attributes." *ATOFINA*, 256 S.W.3d at 673. *Hamel* concerned the extent of *Gandy's* applicability to factually distinguishable cases, in particular, whether *Gandy's* requirement of a fully adversarial trial applies to the validity of a judgment, rather than an assignment, and what makes a trial "fully adversarial."

Hamel was the first case since *Gandy* in which a court of appeals affirmed a judgment against an insurer in favor of a plaintiff who took an assignment of the insured's claims. 444 S.W.3d 780 (Tex. App. – El Paso 2014, pet. granted). The El Paso court of appeals rejected the insurer's argument that it was not bound by the judgment against its insured, based on *Gandy.* The Texas Supreme Court reversed the lower court regarding the validity of the judgment, but remanded the case to the trial court to revisit the insured homebuilder's liability and damages.

In *Hamel*, an insured homebuilder was sued after the homeowners discovered water damage caused by defective construction. The insurer wrongfully refused to defend its insured. Consequently, the insured had limited assets to fund its defense. A week before trial to the bench, the homeowners and the insured entered into a Rule 11 agreement that, if the homeowners obtained a judgment against the insured, they would not try to pierce the corporate veil and enforce the judgment against the insured's owner individually and would seek enforcement only against the company's assets, except for the "personal tools of the trade and truck." As it turned out, the insured had no assets beyond those the plaintiffs had agreed to except. The day before trial, the insured executed stipulations of fact instead of responding to outstanding requests for admission. The supreme court characterized the stipulations as "a shift from the position the [insured] took in discovery responses served earlier in the suit." Yet the stipulations were not offered as an exhibit at the trial. The insured presented no witnesses at trial. In lieu of closing argument, the court ordered proposed findings of fact and conclusions of law, but the insured did not submit any. The trial court entered judgment for the homeowners, and the insured subsequently assigned most of its rights against its insurer to the homeowners.

The homeowners then brought the instant suit against the insurer for breach of contract, resulting in a judgment finding the insurer liable for the underlying judgment. In the trial against the insurer, the entire record from the underlying suit was introduced into evidence; as were the stipulations, Rule 11 agreement, contract between the insured and the homeowners, and deposition excerpts. The trial court entered findings of fact and conclusions of law pertaining to each of the elements needed to satisfy *Gandy.*

On appeal, the court of appeals held that an insurance company cannot insist on compliance with an "actual trial" requirement where the insurer has breached its duty to defend. Moreover, the court of appeals concluded that *Gandy's* requirement of a "fully adversarial trial" was satisfied and the underlying judgment was binding on the insurer because the evidence showed that the insured's owner's testimony was truthful and that he was not unduly influenced or affected by any stipulations or agreements between the parties.

The Texas Supreme Court took a different approach and found that, while the assignment of claims was valid, the judgment was not binding on the insurer because it was not the result of a fully adversarial trial. The supreme court first reviewed the scope of *Gandy's* application to the validity of the assignment:

> We have stated that *Gandy's* holding 'was explicit and narrow, applying only to a specific set of assignments with special attributes.' Although in *Gandy* we declined to address whether an assignment that lacked one or more of *Gandy's* characteristics could be invalid, we see no reason to invalidate an assignment when none of those characteristics are present.

Thus, the court held that the insured's assignment to the homeowners of its claims against its insurer was valid.

Despite the assignment's validity, the court concluded that the judgment was not the result of a fully adversarial trial. The Rule 11 agreement in effect eliminated the insured's actual risk by excepting from exposure all assets other than the insurance policy, and the insured's owner testified in the insurance litigation that he did not care.

The supreme court criticized the court of appeals' approach of analyzing the trial record to determine whether the trial had been fully adversarial:

> The court of appeals' approach necessarily requires courts to retroactively evaluate and thus second-guess trial strategies and tactics, which … often produces an inaccurate and reliable result. … Every trial presents unique challenges, requiring subjective judgment calls that may seem in hindsight to have been ill advised. But determining whether and when those calls destroy the 'adversarial' nature of the proceeding is simply not possible.

The court then observed that the insurer's criticism of the insured's trial strategy "is particularly troubling given that it had the opportunity to control the defense in the first instance and wrongfully refused to do so." The court held that "fully adversarial" does not turn on trial details and strategy but on whether the parties oppose each other:

> [T]he controlling factor is whether, at the time of the underlying trial or settlement, the insured bore an actual risk of liability for the damages awarded or agreed upon, or had some other meaningful incentive to ensure that the judgment or settlement accurately reflects the plaintiff's damages and thus the defendant-insured's covered liability loss.

In other words, the proper inquiry is: did the insured have skin in the game? The court went on to state that a "formal, written pretrial agreement" "creates a strong presumption that the judgment did not result from an adversarial proceeding, while the absence of such an agreement creates a strong presumption that it did." The court indicated that the presumption can be overcome by submitting evidence on the insured's stake in the outcome or incentive to defend the underlying suit. The court further commented in a footnote: "We do not mean to imply that a presumption of adversity may be overcome solely by evidence that a defendant has minimal assets. Something more is required to demonstrate a lack of incentive to defend in the absence of an agreement affirmatively removing such incentive." The court seems to be saying that, if the insured and the plaintiff do not have an agreement, the insurer needs to show more than just the insured's lack of assets beyond the policy in order to prove that the defendant lacked an incentive to defend. In *Hamel*, this was apparently satisfied by the insured's owner's testimony that he did not care about the outcome of the case, although the emphasis of the court's analysis is on the insured's lack of assets.

While this test of adversity is a logical expression of the policy concerns expressed in *Gandy*, the court's application of the test in this case is somewhat problematic for assignee plaintiffs. How were the homeowners to know that the insured had no other assets besides the insurance policy? There is nothing in the opinion indicating that, upon entering into the Rule 11 agreement, the homeowners knew that the insured had no assets other than the policy. There is also no indication that the insured itself actually knew this at the time of the Rule 11 agreement, only that its owner testified later that the insured company had no other assets. As a practical matter for plaintiffs, unless the insured wants to provide them with financial information, they would not know whether an insured had other assets that would be at risk, because, in general, a defendant's financial information is irrelevant and undiscoverable.

Another problematic aspect of the court's application of its test is that it seems to be conflating the interests of the insured with those of its owner. While the Rule 11 agreement protected the insured's owner from individual liability under a piercing-the-corporate-veil theory, there is no analysis of whether the corporate veil could, in fact, be pierced. The court simply proceeds on the assumption that the corporate veil could be pierced. Moreover, the insured company itself was not released from liability exposure under the Rule 11 agreement excepting certain assets, which the plaintiffs may not have known were the extent of the insured's assets beyond the policy. In sum, it is unclear whether the court's test for adversity, as applied here, turns on the insured's subjective belief that it has risk exposure or whether it actually has that exposure. But the court's emphasis on the insured's "incentive to defend" would seem to suggest that the insured's subjective belief in risk is what matters—an even more challenging thing for plaintiffs to ascertain prior to entering into an agreement or settlement.

Having concluded that the underlying suit was not "fully adversarial," the supreme court held that the judgment in the underlying suit was not binding on the insurer. But the inquiry did not end there. The court went on to hold that, even if the trial in the underlying suit is not fully adversarial, that deficiency may be cured in a subsequent insurance coverage trial. This is an interesting and significant development. In *Gandy* the Texas Supreme Court said that inquiry into "what might have been" after the parties have changed positions is "ordinarily to be avoided, absent compelling reasons to the contrary." *Hamel* now instructs us "an insurer's wrongful refusal to defend presents a compelling reason to engage in this endeavor despite its difficulty." The court cited practical concerns: When an insurer wrongfully denies a defense, it burdens the insured to defend itself, "often without adequate resources to do so" and "can also leave the plaintiff in an untenable position" since the insured's policy is often the only source of recovery.

Here, the court found that these practical concerns were present and that the parties were likely trying to "make the best out of a bad situation" forced upon them by the insurer's misconduct, and that it would be unfair for the insurer to benefit from the problem it created. And certainly, that is what both *Block* and *ATOFINA* have previously said.

But the court's attempt to remedy the insurer's wrongdoing by allowing the insurance trial to satisfy *Gandy's* "fully adversarial" requirement hardly seems "fair" to plaintiffs. The insurer is being given a second chance to dispute the underlying liability and damages, despite having given up its right and duty to participate in the first trial. The plaintiff is being saddled with the financial burden of trying issues that were already tried, without the benefit of collateral estoppel (per a footnote in the opinion). This result is particularly unfair if the plaintiff is unaware of the insured's incentives when entering into a settlement or Rule 11 agreement. This result is also at odds with *Block* and *ATOFINA's* holdings that an insurer in breach of its duty to defend cannot collaterally attack an agreed judgment. As such, it is cold comfort that the court remanded the case so that the parties could "thoroughly relitigate all aspects of the [homeowners'] claimed damages."

And what were the deficiencies in the insurance litigation necessitating remand? The court listed several, essentially giving the insurer a trial plan:

- The insurer only "briefly questioned one expert witness about various deficiencies, eliciting opinion testimony that the Builder was entitled to a $25,000 settlement credit," and the lack of formal motions or legal arguments on this point;
- Damages attributed to a landscape repair constituted a double recovery;
- The homeowner's testimony was incompetent as to the market value of the property and the housing and moving costs, but the insurer did not question him, and there were no specific findings on these categories of damages.

In fact, evidence must have been developed on each of these enumerated matters during the insurance litigation or the court would not know of them, so it is hard to understand what more evidence would need to be developed to satisfy the "fully adversarial" requirement. If the insurer does a poor job of developing evidence, is that going to be held against the plaintiffs in a subsequent review to decide whether the insurance litigation was fully adversarial?

In short, *Hamel* tells us: *Gandy* applies to both assignments and judgments; settlement agreements create a presumption of no fully adversarial trial; whether a trial is adversarial depends on the insured's incentive, not trial tactics; and the lack of an adversarial trial in the underlying suit may be cured by relitigating liability and damages in the insurance suit.

One court has already had the opportunity to apply *Hamel* and relied upon it to conclude that a property owner did not have standing to assert claims directly against liability insurers. *Landmark Am. Ins. Co. v. Eagle Supply & Manufacturing L.P.*, No. 11-14-00262-CV, 2017 WL 3711228 (Tex. App.– Eastland Aug. 25, 2017, no pet.). Landmark presented a fairly complicated procedural background, the subject of which was property damages allegedly caused by an insured contractor while performing contracted demolition services. The contractor filed for Chapter 11 bankruptcy, and the property owner then sued the contractor in state court and filed a proof of claim in the bankruptcy court. While the bankruptcy proceeding was pending, the property owner added the contractor's pollution and CGL insurers to the state court suit, asserting that they owed contractual obligations to the property owner under the policies to remedy the property damages caused by the insured contractor. Later, a settlement agreement between the property owner and the contractor was filed in and approved by the bankruptcy court. The settlement terms specified that the parties would "take such actions as are necessary to assert, diligently pursue, and effectuate acclaim (or claims), to and against each of the insurance carriers…."

Afterwards, the property owner and contractor proceeded in the state court litigation, with the contractor pleading a general denial to the suit and also asserting causes of action against the insurers for failing to indemnify it and failing to defend it in the bankruptcy court. The contractor asserted that it vigorously contested the property owner's claims in the bankruptcy court and entered into the settlement agreement based upon that court's rulings. The property owner filed a motion for summary judgment against the contractor in the state court suit, which was granted. The property owner then alleged that the contractor "vigorously defended the claims" in bankruptcy court, and asserted claims against the insurers for unfair settlement practices and breach of contract, among other things.

The insurers argued that the property owner lacked standing to bring claims against them. The Eastland appellate court agreed and held that the property owner was not a first-party claimant entitled to bring a direct cause of action against either insurer, nor were the judgments upon which the property owner relied sufficient to allow it to bring direct actions against the insurers. As a third-party claimant, the property owner was precluded from bringing a direct action against the insurers unless and until the contractor's liability was established by final judgment or agreement. The property owner argued that it had two final judgments against the contractor that allowed it to bring a direct action against the insurer: the judgment from the bankruptcy proceeding and the summary judgment against the contractor in the state court litigation. The insurers argued that these judgments were insufficient because they were not the result of a "fully adversarial trial" under *Gandy*.

To resolve this issue, the court relied upon *Hamel's* holding that whether a trial is adversarial "turns on the insured defendant's incentive to defend." The court concluded, "Under *Hamel's* interpretation of *Gandy,* the circumstances in this case establish that neither of the two previous judgments was the result of a fully adversarial trial." The court explained:

> As was the case in *Hamel,* the settlement agreement in this case removed any meaningful incentive for Metex to oppose Eagle's property damage claim at the time each subsequent judgment was rendered. To the contrary, the settlement agreement contained language requiring Metex and its principals "to take such actions as are necessary to assert, diligently pursue, and effectuate a claim (or claims), to and against each of the insurance carriers that provide insurance coverage for the damages." And as was the case in *Hamel*, the settlement agreement rendered the judgment of the bankruptcy court and the underlying summary judgment that Eagle obtained against Metex as being mere formalities. After the settlement agreement was executed, Eagle's property damage claims against Metex no longer involved opposing parties, and the proceedings that followed were not fully adversarial.

Consequently, the court held that neither the bankruptcy court's judgment nor the summary judgment were the result of a fully adversarial trial under *Hamel* and *Gandy,* and that neither was binding on the insurers. The court did note a distinction between the facts here and those in *Hamel*: the insurers here argued that they did not breach a duty to defend because the insured did not request a defense, whereas in *Hamel* the insurer conceded that it had breached its duty.

An insurer was only liable to for amounts in excess of the liability policy's deductible. *ExxonMobil Corp. v. Electrical Reliability Servs., Inc.,* 868 F.3d 408 (5th Cir. 2017). An employee of a subcontractor of Electrical Reliability Services (ERS) filed a personal injury suit against ERS and Exxon. Exxon settled the suit and sought reimbursement from ERS and ERS's insurer, arguing that ERS was contractually obligated to insure Exxon as an additional insured and the insurance policy issued by ERS's insurer required the insurer to pay for the settlement of suit and litigation costs. The Fifth Circuit held that the insurance provision in the contract provided that ERS's "liability insurance policy(ies) … shall: (i) cover [Exxon] and Affiliates as additional insureds." The provision also provided that ERS's obligation to afford coverage to Exxon "shall apply to Supplier's [ERS's] self-insured retentions and/or deductibles." Thus, the contract provided that ERS "shall" cover Exxon as an additional insured and "shall" pay the applicable deductibles, without qualification. Therefore, the Fifth Circuit affirmed the district court's judgment as to ERS's duty to pay the $3 million deductible, and held that ERS's insurer was only liable for any amounts above or not subject to the policy's $3 million deductible.

VIII. THIRD PARTY THEORIES OF LIABILITY

A. Stower*s duty & negligent failure to settle*

A demand letter sufficiently triggered an insurer's *Stower's* duty. *One Beacon Ins. Co. v. T. Wade Welch & Associates,* 841 F.3d 669 (5th Cir. 2016). An attorney missed several discovery deadlines in a case and received death penalty sanctions, but did not report any potential malpractice cases to his insurer when he was renewing his firm's malpractice insurance. The attorney's client did eventually sue him for malpractice. The attorney's client sent a *Stowers* demand to the insurer that would release the law firm but not the individual attorney, which the insurer declined. The firm's insurer then sought declaratory judgment, seeking to rescind the policy or obtain a declaration that the prior-knowledge exclusion barred coverage. The jury in the district court found in favor of the client and the law firm, holding that the attorney could not have reasonably expected his actions to result in a malpractice claim, and that the insurer was grossly negligent in violating its *Stowers* duty. The insurer argued on appeal that the *Stowers* demand was not proper, as it did not offer to release all insureds. However, the Fifth Circuit stated than when faced with a settlement demand over a policy with multiple insureds, an insurer fulfilling its *Stowers* duty "is free to settle suits against one of its insureds without being hindered by potential liability to co-insured parties who have not yet been sued." Id. (citing *Travelers Indemnity Co. v. Citgo Petroleum Corp.*, 166 F.3d 761, 764 (5th Cir. 1999)). Therefore, the Fifth Circuit held the *Stowers* demand was proper. The jury found the insurer committed a violation of Ch. 541 knowing that its conduct was false, deceptive and unfair. The jury also found that the insurer's refusal to settle the malpractice claim against the law firm constituted "gross negligence," and assessed damages for the 541 violation and gross negligence as separate damages. The Fifth Circuit affirmed the district court's holding that both claims related to essentially the same series of actions and the ultimate refusal to settle. Therefore, the district court appropriately made the insured choose between additional damages under Ch. 541 and exemplary damages under *Stowers*.

IX. SUITS BY INSURERS

A. Subrogation

One defendant's insurer had standing to seek reformation of a contract between its insured and a co-defendant. After an assault occurred in an apartment complex, the injured party sought recovery from the complex and property manager and eventually settled. The complex's insurance policy was exhausted in defending the lawsuit. The apartment complex's umbrella insurer paid the portion of the settlement that exceeded the limits of the underlying policy, and then sought reimbursement from the property manager's umbrella policy. The court held that the rights that flow through a subrogation clause do allow an insurer, such as the apartment complex's insurer, to seek reformation of a contract between its insured and a third party. Therefore, the apartment complex insurer had standing to seek reformation of the property manager insurer's policy to list the apartment complex on the schedule of covered properties, so as to permit it to seek reimbursement from the property manager insurer for settlement. *Associated Int'l Ins. Co. v. Scottsdale Ins. Co.*, 862 F.3d 508 (5th Cir. 2017).

X. PRACTICE & PROCEDURE

A. Discovery

The Texas Supreme Court set forth guidelines concerning electronic discovery in mandamus proceedings brought by an insurance company. *In re State Farm Lloyds,* 520 S.W.3d 595 (Tex. 2017). This case is not particularly significant for insurance law, but it concerns any litigation involving electronic discovery, which in this day and age is essentially all litigation.

In two consolidated cases, insured homeowners had sued State Farm Lloyds, their homeowners' insurer, for underpaying their hail damage claims. The insureds had requested electronic data in native form, and the trial court ordered that all electronically stored information be produced in its native format (e.g., Excel, Word, PowerPoint), rather than in the static format the insurer used to store the data. The insurer petitioned for writs of mandamus. The Texas Supreme Court held that no party has a unilateral right to specify the format of discovery and that, when electronic data in a reasonably usable form is readily available, the trial court must balance the burdens with the benefits when ordering production in a different form, and ultimately denied mandamus and remanded the cases so the parties could address the guidelines the court had articulated.

The insurer argued that static format was beneficial because it can be searched, reviewed, and handled without risk of alteration, and that providing native form records would be burdensome.

The insureds wanted native format so they would obtain the metadata associated with those records (e.g., the formulas used in Excel spreadsheets, speaker notes in PowerPoint records, etc.), which would be lost when the native document was converted into a static format, such as a PDF. The insured also introduced evidence that due to storage costs, the production of electronic information in static form is significantly more expensive for the requesting party.

The insurer argued that static format was beneficial because it can be searched, reviewed, and handled without risk of alteration, and that providing native form records would be burdensome. State Farm introduced evidence about its document management system and explained that producing static format was more manageable and convenient, and less burdensome and expensive. However, State Farm did not quantify the time or expense that would be involved in producing electronic records in native form.

Of some passing interest to policyholders' lawyers is State Farm Lloyds' description of how it manages records:

> State Farm offered evidence that it processes more than 35,000 new claims each day and, in the ordinary course of business, information related to those claims is routinely converted into static format. When claims are being processed, claims-related information is necessarily created in native form. With regard to some types of claims-processing information, the native form is static, for example, handwritten notes and photographs. But to facilitate efficient business operations, State Farm employs a central repository—the Enterprise Claims System (ECS)—that is "the system of record" for claims handling at State Farm. Claims-related information originally created in disparate systemic locales must be uploaded to the ECS, where it is converted and stored in secure, read-only formats for data integrity and access (e.g., PDF, TIFF, or JPEG). By consolidating information from different sources into the ECS, the claims-file information becomes readily accessible for processing claims on behalf of policy holders and enables effective management of claims processes. Some ESI information exists solely in the ECS platform, but other information may also exist in native forms elsewhere within thousands of State Farm servers.

This description may help in crafting tailored requests for production or deposition questions. And, based on the court's opinion, tailored requests are exactly what should be made.

Returning to the issue at hand, the court, applying Rules of Civil Procedure 192.4 and 196.4, found that "while metadata may generally be discoverable if relevant and unprivileged, that does not mean production in a metadata-friendly format is necessarily required." Thus, "When a reasonably usable form is readily available in the ordinary course of business, the trial court must assess whether any enhanced burden or expense associated with a requested form is justified when weighed against the proportional needs of the case," which requires a case-by-case balancing of seven factors: (1) the likely benefit of the requested discovery; (2) the needs of the case; (3) the amount in controversy; (4) the parties' resources; (5) the importance of the issues at stake in the litigation; (6) the importance of the proposed discovery in resolving the litigation; and (7) any other articulable factor bearing on proportionality.

The court's explanation of the factors in connection with the cases at hand is of particular interest in insurance litigation. Regarding the likelihood of benefit, the court hypothesized that, if State Farm had to develop an "identification and retrieval process" for native form production, that process could likely have uses beyond the instant cases, which both arose from an extreme weather event that impacted many other insureds. There was no evidence one way or the other for the court to reach a conclusion about this possibility. Regarding the needs of the case, the court noted that the homeowners provided evidence that "captions annotating some photographs of hail damage to a house" were not captured when the photographs were converted to static format, whereas the insurer indicated that the captions were available in a different document called a "caption log." Consequently, the trial court would need to consider both the relative importance of the metadata to the central issues of the case as well as its availability and convenience.

In expounding upon these factors, the supreme court emphasized the need for relevance to the causes of action and the avoidance of speculation and "fishing expeditions." The practical takeaway points for lawyers are: (1) know why you want electronic documents in a particular format; (2) be able to articulate that reason to the court in a way that ties the information sought to the issues in the case; and (3) be prepared to explain why a different format is more burdensome for you and/or less burdensome for the other party. While the court is making an effort at case-by-case pragmatism, this opinion seems to take an all-or-nothing approach—either the requesting party is getting native format or static format. But it is only logical that some cases and circumstances would allow a requesting party to obtain at least some documents in native format. If you cannot obtain native format or metadata for all documents due to expense or burden on the producing party, you might determine which electronic documents are key to some issue in the case, either through initial production or depositions or otherwise, and then subsequently request that those specific documents be produced in native format.

In another discovery case, the Texas Supreme Court addressed an insured's request for discovery of an insurer's attorney's fees in *In re National Lloyds Ins. Co.,* No. 15-0591, 2017 WL 2501107, 60 Tex. Sup. Ct. J. 1165 (Tex. Jun. 9, 2017). In this case, insured homeowners sought discovery of the defendant insurer's and claims adjusters' attorney billing records. When the trial court ordered production, the insurer and adjusters sought mandamus relief.

In *In re National Lloyds*, two hailstorms in Hidalgo County in 2012 resulted in several suits by homeowners against their insurers and adjusters. Those suits were consolidated into a single multi-district litigation court for pretrial and discovery. In four of the suits, the homeowners sought attorney's fees incurred in prosecuting their statutory and contractual claims. The insurer asserted that the homeowners' attorney's fees were excessive for a case of comparable complexity in the location. The insurer itself was not seeking attorney's fees.

In another discovery case, the Texas Supreme Court addressed an insured's request for discovery of an insurer's attorney's fees.

Two months before trial, the homeowners sought a continuance to obtain discovery regarding the insurer's attorney billing information: three interrogatories regarding hourly rates, total amount billed, and total reimbursable expenses; and four requests for production for billing invoices, payment logs, audits, and documents regarding flat-rate billing. The homeowners argued that this information was relevant because, during one of the related MDL cases, the insurer's attorney gave expert testimony regarding attorney's fees and admitted that an opposing party's fees could be considered a factor in determining reasonable fees and used his law firm's billing practices as an example of the proper way to allocate fees in an MDL case. In a split decision, the Texas Supreme Court granted mandamus relief and held:

> 1. Redacting privileged information in an attorney's billing records would be insufficient to mask the attorney's thought processes and strategies;
> 2. Requests for production of all billing invoices, payment logs, ledgers, and summaries, documents showing flat rates, and audits invaded the zone of work-product protection;
> 3. Insurer and claims adjusters did not offensively use their attorney billing records so as to waive the work product privilege, because the insurer stipulated it would not use its own billing records to contest the homeowners' attorney's fees;
> 4. The insurer and adjusters' attorney billing records were not relevant because "an opposing party's litigation expenditures are not ipso facto reasonable or necessary" and thus "do not, in and of themselves, make it any more probable that a requesting party's attorney fees are reasonable and necessary"; and
> 5. The designation of the insurer's counsel as a testifying expert as to the insured's fee request did not trigger the expert witness exception to the work-product privilege so as to allow insured homeowners to obtain the billing records.

The court further explained:

> To the extent factual information about hourly rates and aggregate attorney fees is not privileged, that information is generally irrelevant and non-discoverable because it does not establish or tend to establish the reasonableness or necessity of the attorney fees an opposing party has incurred. A party's litigation expenditures reflect only the value that party has assigned to litigating the matter, which may be influenced by myriad party-specific interests. Absent a fee-shifting claim, a party's attorney-fee expenditures need not be reasonable or necessary for the particular case. Barring unusual circumstances, allowing discovery of such information would spawn unnecessary case-within-a-case litigation devoted to determining the reasonableness and necessity of attorney-fee expenditures that are not at issue in the litigation. This is not a proper discovery objective.

The majority found the homeowners' requests irrelevant, explaining that, "a party subject to repeat litigation, such as an insurer or corporate defendant, may view the precedential value of a case more significantly than an opposing party who might not anticipate ever being involved in similar litigation again." One would expect this comment to be striking to most defense lawyers, who, generally speaking, get paid at reduced hourly rates on account of the repeated business. The court's analysis is making assumptions that may or not be true in this case or in every case, and it seems that this concern would speak more to the weight of the evidence, rather than its relevance, and could be addressed during testimony. Moreover, this point seems to ignore the fact that, generally speaking, parties on each side are doing much of the same work, regardless of whether one side is concerned about a case's precedential value. And the court did not need to make this point to reach its conclusion.

The main justification for not allowing discovery of the insurer's attorney's fees and billing records is that the insurer itself was not seeking attorney's fees. In all but rare cases, it makes sense that one party seeking attorney's fees should not be able to obtain fee records from its adversary who is not seeking attorney's fees, in order to prove up its own claim. But, in the authors' opinion, this is one rare case in which it would have been fair to allow such discovery.

As Justice Johnson's dissenting opinion pointed out, the insurer's attorney was designated as an expert witness on attorney's fees and gave opinion testimony about the plaintiff's attorney's fee request in a similar case, based in part on his personal knowledge from representing the defendant in that case. Given that he could not recall details of the time and fees he billed during cross-examination in the case, the homeowners "reacted rationally" by seeking "specific information and records with which to arm themselves to test" the insurer's attorney's testimony and opinions. In other words, the insureds should have had the opportunity to obtain discovery that would have allowed for fair cross-examination on the witness's personal knowledge of the case, the complexity of the issues and time involved, and the other factors affecting the reasonableness and necessity of the attorney's fees sought. Given insurance industry norms for billing, auditing, and record keeping, it should not have been burdensome for the insurer to produce the records requested.

This case may have real, practical implications, because it allows insurers to use their trial attorneys to critique plaintiff's trial attorneys while shielding their own attorney's time and fees. Another point made by the dissent: "it is no ordinary situation for a party's trial attorney to be designated as a testifying expert to dispute the opposing party's attorney's fee request—at least, it has not been. Things may well change after this case issues."

B. Appraisal

A fire damaged an insured's gas station. After the insurer paid claims based on an independent adjuster's estimates, the insured sued its insurer for breach of contract, breach of the duty of good faith and fair dealing, fraud, and violations of the Texas Insurance Code and Texas Deceptive Trade Practices Act, arguing it was owed more. An appraisal award was issued that was almost exactly the amount previously paid by the insurer. The insured argued that the appraisal award was incomplete because it excluded damage to the gas pump and gas station's awnings, and code upgrade costs. However, the Fifth Circuit held that the insured failed to cite anything in the record showing these items were not included, and stated it is the insured's burden to identify such evidence in order to overcome summary judgment given that the appraisal award states that it, "is inclusive of all FIRE damages sustained to the insured property." Moreover, there was no statutory violation because the insurer made a pre-appraisal award that was undeniably reasonable, as it was more than the panel found due. *Mainali Corp. v. Covington Specialty Ins. Co.*, 872 F.3d 255 (5th Cir. 2017).

Several other appraisal cases are discussed above in section IV. B. regarding the application of *Menchaca*.

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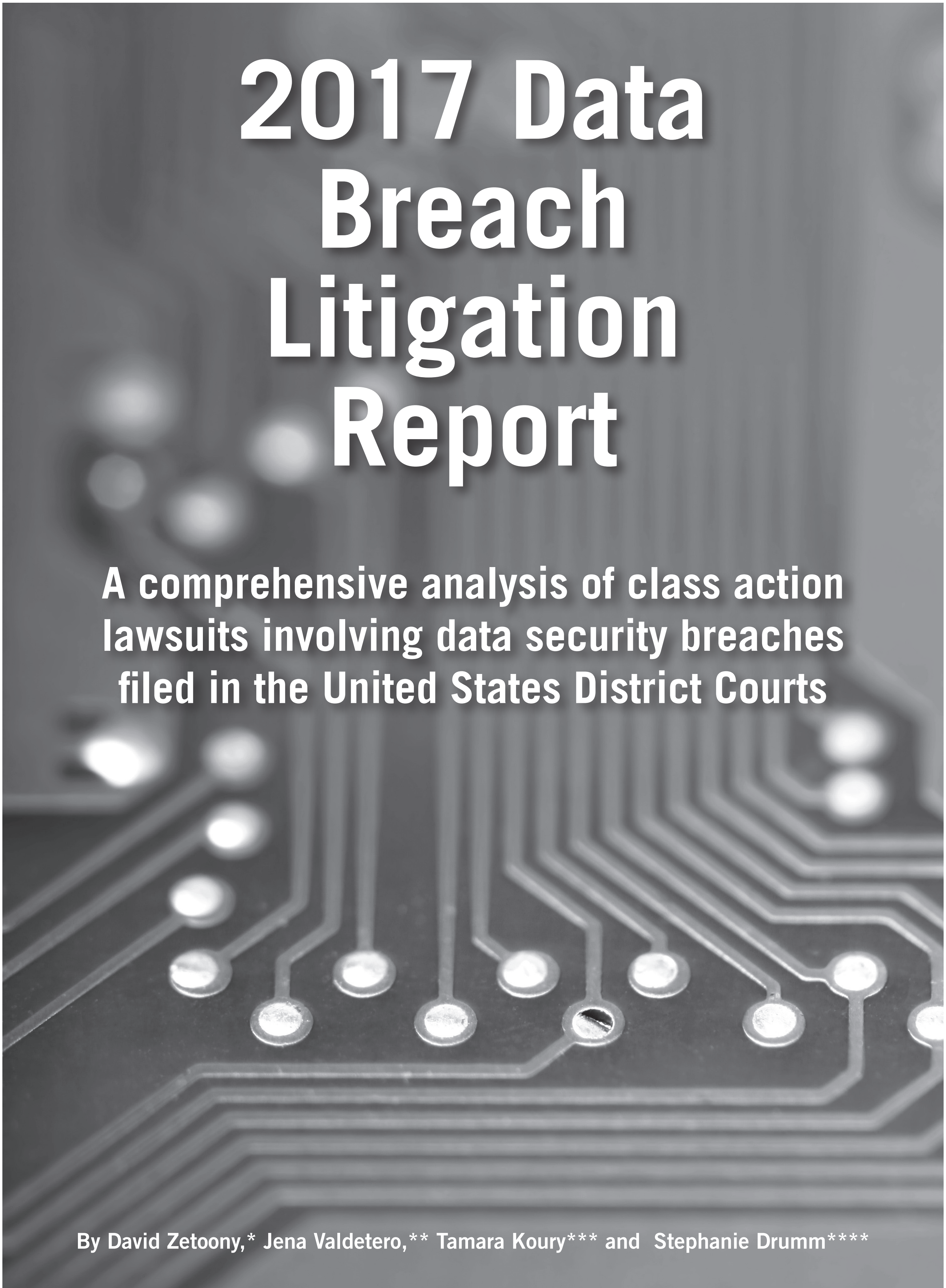
The authors thank Joe K. Longley for his assistance and support.

1 The lead attorney for the policyholders in *Vail* was none other than Mark Kincaid, who was the lead author of this article for many years before his passing in January 2016. We are all too sorry not to have Mark's thoughts about *Menchaca*, but some of his thoughts about the ongoing viability of *Vail* in light of other cases also discussed in *Menchaca* were set forth in the 2010 and 2015 editions of this article. "Annual Survey of Texas Insurance Law 2010," J. of Consumer & Comm. L. 59, 62-64 (2010); "Annual Survey of Texas Insurance Law 2015," 19 J. of Consumer & Comm. L. 91, 95-96 (2016). And, like *Vail*, Mark Kincaid's thoughts expressed in 2010 and 2015 have been validated by the court's opinion in *Menchaca*.



2017 Data Breach Litigation Report

A comprehensive analysis of class action lawsuits involving data security breaches filed in the United States District Courts

By David Zetoony,* Jena Valdetero,** Tamara Koury*** and Stephanie Drumm****

Despite the fact that data breaches do not appear to be going away anytime soon, the risk that a company will face litigation following a data breach remains relatively low year-after-year.

Executive Summary

2016 was another year in which data breaches continued to dominate the headlines, a constant reminder to people that their personal information was vulnerable and the target of criminal attacks. Yet, despite the fact that data breaches do not appear to be going away anytime soon, the risk that a company will face litigation following a data breach remains relatively low year-after-year. The reason is likely tied to the difficulty plaintiffs continue to face establishing that they were injured by a breach and, therefore, have standing as a matter of law to bring suit.

Nonetheless, fear is a powerful marketing strategy, and we continue to see misinformation disseminated to the public about the likelihood of being sued after a data breach. This is not to say that companies should not continue to devote significant resources to breach preparation, information security, and breach response. But we are firm believers in allocating resources in proportion to the risk of harm, and litigation arising from a breach generally does not occur except in cases of public breaches involving large quantities of highly sensitive information.

Bryan Cave LLP began its survey of data breach class action litigation five years ago to rectify the information gap and to provide our clients, as well as the broader legal, forensic, insurance, and security communities, with reliable and accurate information concerning the risk associated with data breach litigation. Our annual survey continues to be the leading authority on data breach class action litigation and is widely cited throughout the data security community.

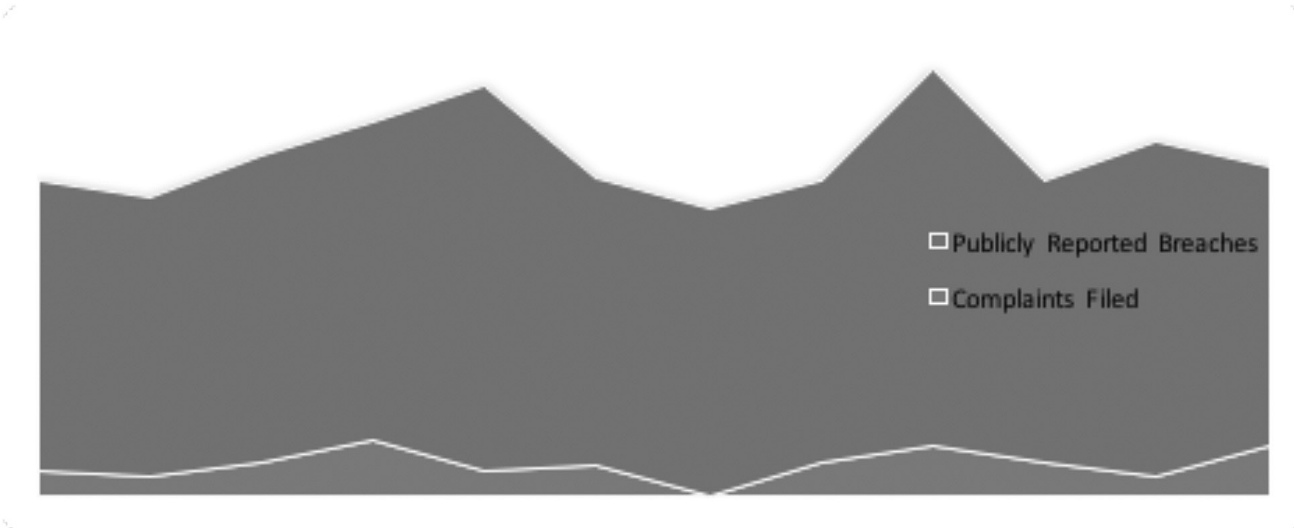
Our 2017 report covers federal class actions initiated over a 12 month period from January 1, 2016 to December 31, 2016 (the "Period"). Our key findings are:

- Modest increase in filings. 76 class actions were filed during the Period. This represents a modest **7% increase in the quantity of cases filed as compared to the 2016 Data Breach Litigation Report** (the "2016 Report").
- Continued "lightning rod" effect. Consistent with prior years, many of these lawsuits cluster around the same high-profile breaches. When multiple filings against single defendants are removed, **there were only 27 unique defendants during the Period**. This indicates a continuation of the "lightning rod" effect noted in previous reports, wherein plaintiffs' attorneys file multiple cases against companies who had the largest and most publicized breaches, and generally bypass the vast majority of other companies that experience data breaches.
- Decrease in filings as a function of the quantity of breaches. Approximately 3.3% of publicly reported data breaches led to class action litigation. Unlike in prior years, in which the percentage of class action lawsuits has remained relatively steady at 4 or 5% of publicly reported breaches, **2016 saw a slight decrease in litigation relative to the number of breaches**.
- Litigation forums cluster around location of defendants. The Northern District of California, the Middle District of Florida, and the District of Arizona were the most popular jurisdictions in which to bring suit in 2016. **Choice of forum, however, continues to be primarily motivated by the states in which the company-victims of data breaches are based**.
- Medical industry disproportionately targeted by the plaintiffs' bar; but may still be underweighted. Like the previous year, **the medical industry was disproportionately targeted by the plaintiffs' bar**. Although 70% of publicly reported breaches related to the medical industry, only 34% of data breach class actions targeted the medical industry or health insurance providers.
- Credit card breach litigation is flat. **The percentage of class actions involving the breach of credit cards stayed relatively constant as compared to the 2016 Report,** with credit and debit cards data accounting for 21% of the type of data involved in data breach class actions in 2016, slightly down from 23% for the previous reporting period. This may reflect the lack of high profile credit card breaches as in past years, difficulties by plaintiffs' attorneys proving economic harm following such breaches, and relatively small awards and settlements in previous credit card related litigation.
- Plaintiffs continue to experiment with legal theories. Plaintiffs' attorneys continue to allege multiple legal theories. **Plaintiffs alleged a total of 21 legal theories during this period**.
- Negligence has emerged as the clear theory of preference. While negligence was the most popular legal theory in the 2016 (and 2015) Report, **it has increased from being included in 75% of cases to being included in nearly 95% of all cases**.
- Plaintiffs are focusing on sensitive categories of information. Plaintiffs' attorneys overwhelmingly focused on breaches in this Period that involved information such as Social Security Numbers, medical treatment information, health insurance information, and security questions and answers, **with 89% of cases in 2016 involving a breach of sensitive data**.

Part 1: Volume of Litigation

A total of 76 complaints were filed during the Period, up 7% from the 2016 Report. The quantity of litigation loosely correlates with the number of publicly reported breaches each month. For example, of the months studied in the Period, September 2016 was the month that saw the highest number of publicly reported data breaches. September (along with April) also saw the greatest percentage of complaints filed.

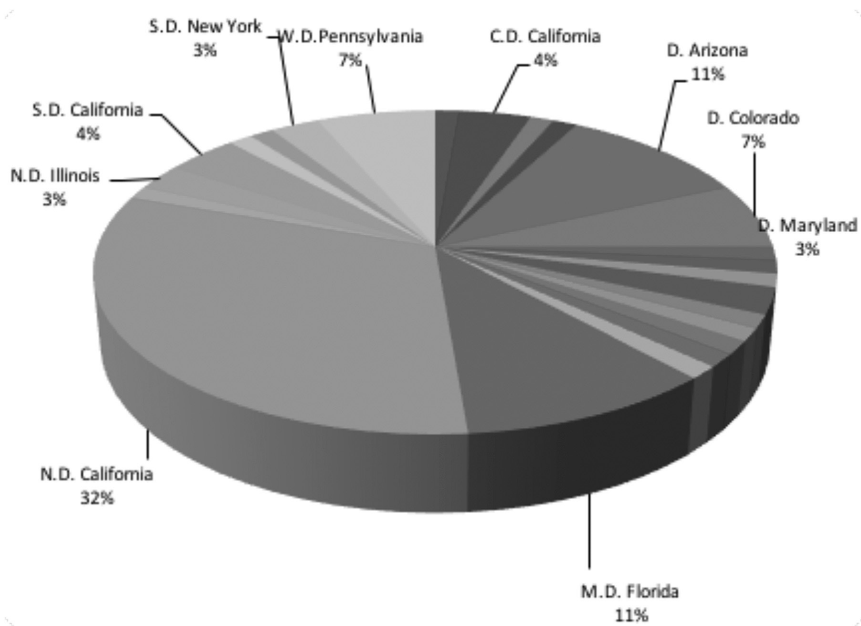
According to the Privacy Rights Clearinghouse Chronology of Data Breaches, 806 breaches were publicly reported during the Period. However, only 76 federal class action complaints were filed during the same timeframe, and these filings related to only 27 unique defendants. As a result, approximately 3.3% of publicly reported breaches led to class action litigation. The overall result is that there has <u>not</u> been an increase in the rate of complaint filings when total complaints are normalized by the quantity of breaches. The following chart provides a breakdown of class action complaints filed with the quantity of publicly reported breaches disclosed during the Period:



Part 2: Favored Courts[6]

The Northern District of California is the preferred forum for filing data breach class action litigation, with almost 40% of all filings originating in that court. However, the high rate was attributable to the fact that 25 of the 76 complaints were filed against Yahoo!, Inc., which is headquartered in Silicon Valley. The concentration of litigation seems to be related to the location of headquarters of the company that encountered the breach. For example, for the first time, we saw an increase in lawsuits filed in Arizona, however, this was due to cases filed against Banner Health, an Arizona company. Similarly, litigation was prevalent in Florida due to a breach involving 21st Century Oncology Holdings, a Florida company.

The following provides a detailed breakdown by district of federal class action filings:[7]

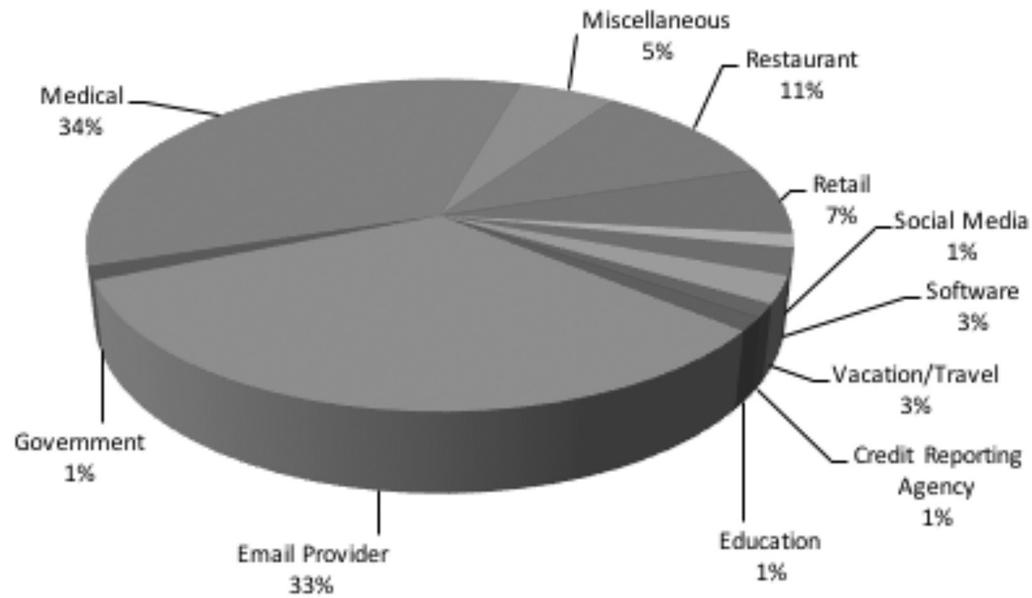


Part 3: Litigation by Industry

The medical industry was the target of the majority of class action complaints (34%), with 26 complaints filed during the Period, a slight decrease from the 2016 Report findings. The retail industry was the target of only 7% of complaints, a slight decrease from the 2016 Report.

2016 saw the emergence of multiple class actions against Yahoo!, Inc. related to disclosure of two major security breaches involving 500 million users and more than 1 billion user accounts. The Restaurant Industry also emerged as a target of class action complaints, with six class actions filed against The Wendy's Company and two against Noodles & Company. In contrast, the consumer reporting agencies saw a steep decline in class actions given the lack of new filings against Experian Information Solutions, which was heavily targeted in 2015.

The following chart provides a detailed breakdown of class action complaint filings by industry sector:

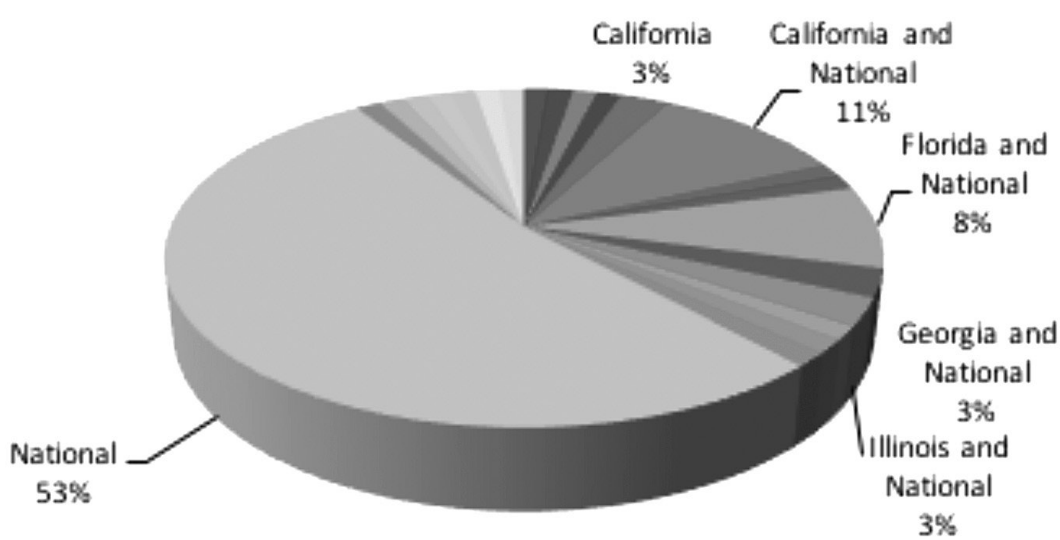


Part 4: Scope of Alleged Class (National v. State)

Access to class action complaints filed in state court differs among states and, sometimes, among courts within the same state. As a result, it remains difficult, if not impossible, to identify the total quantity of class action filings in state court, and any analysis that includes state court filings would include a significant and misleading skew toward states that permit easy access to filed complaints. As a result, we purposefully do not include state court filings in our analysis and instead focus only on complaints filed in federal court and complaints originally filed in state court but subsequently removed to federal court under the Class Action Fairness Act ("CAFA") or federal question jurisdiction.

We find in our dataset a strong preference for class actions that are national in scope. This may mean that plaintiffs' attorneys prefer to allege putative national classes in an attempt to obtain potentially greater recovery. It could also reflect the fact that many companies collect data from individuals without regard to geography. It could also mean, however, that additional complaints that have not been included in our analysis were filed in state court alleging putative classes comprised of single state groups.

Despite the preference for national classes, we again see almost half of complaints allege sub-classes tied to residents in specific states.[8] The following provides a detailed breakdown of the scope of putative classes:[9]

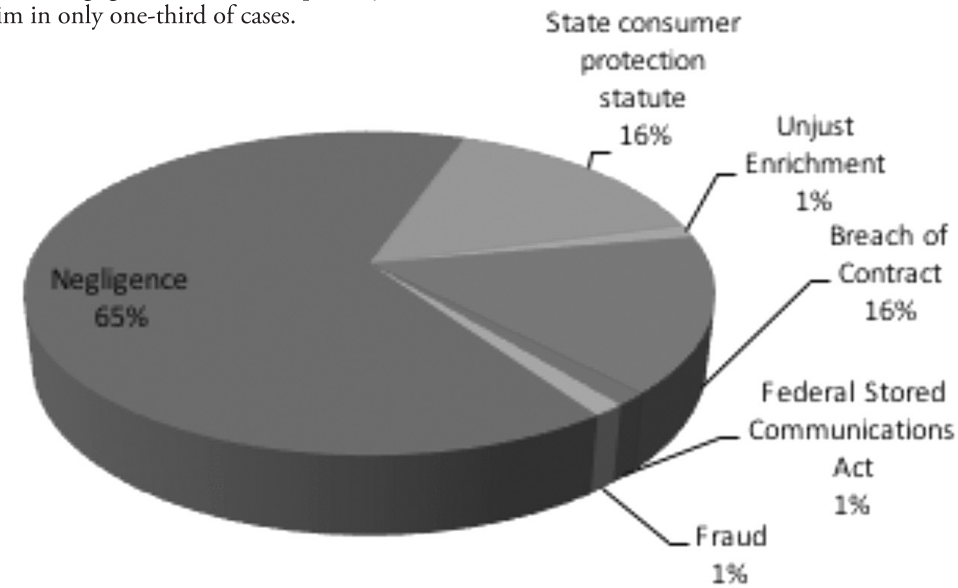


Part 5: Primary Legal Theories

Plaintiffs continue to pursue negligence as the predominate theory under which they sought recovery, with 65% of all class action litigation alleging negligence as the primary theory (*i.e.*, the first count alleged in a complaint), and 95% of all complaints including it as a cause of action. This increase continues a trend from the 2016 Report, in which negligence was also the primary theory, but was the lead claim in only one-third of cases.

Despite 48 states having enacted a data breach notification statute, not a single plaintiff alleged violation thereof as the primary legal theory, although 27% included a violation of the state breach notification statute as a supplemental cause of action.

The following provides a breakdown of the primary theory alleged:



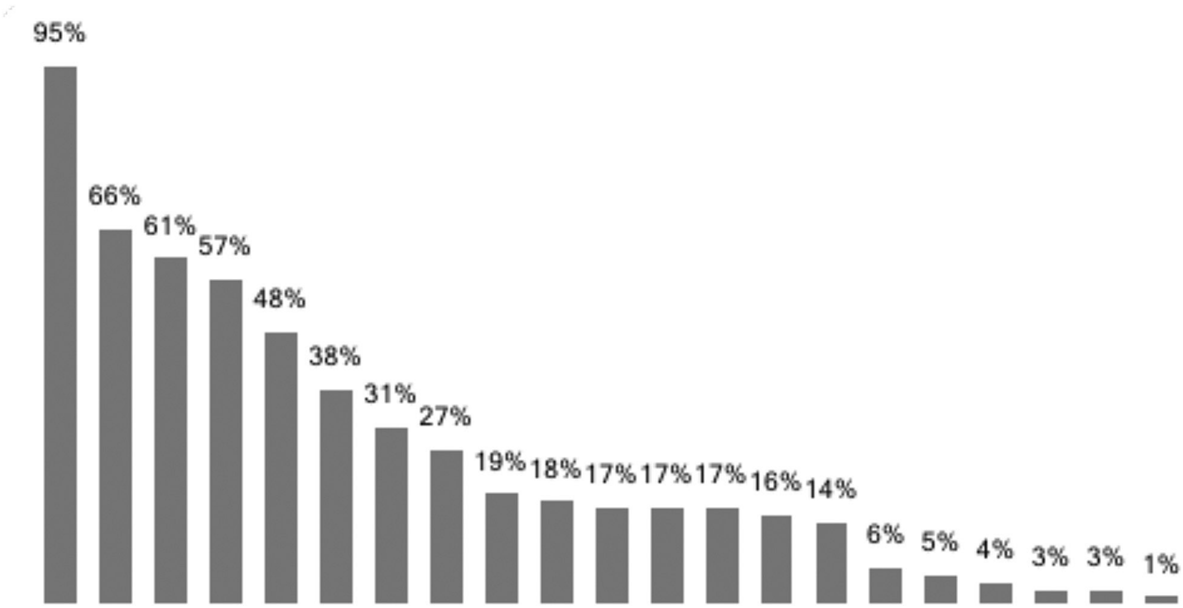
Part 6: Variety of Legal Theories Alleged

Although negligence was the most common theory first put forward by a plaintiff's attorney, most plaintiffs chose to allege more than one theory of recovery, and many plaintiffs' attorneys included theories sounding in contract, tort, and statute.

As indicated in the table below, although plaintiffs' attorneys show a clear preference for some legal theories – *e.g.,* breach of contract, negligence, and state consumer protection statutes – in total they have pursued 21 different legal theories of recovery. "Bailment" or the idea that plaintiffs delivered their private information to defendants and therefore defendants owed them a duty to safeguard the information emerged as a trend in the 2016 Report. That trend continues with bailment alleged in approximately one-fifth of complaints. There has also been an uptick in cases asserting counts for Breach of Covenant of Good Faith and Fair Dealing, which is a derivative breach of contract claim.

The following chart provides a detailed breakdown of the theories utilized by plaintiffs' attorneys in data breach litigation complaints:

Part 7: Primary Type of Data at Issue



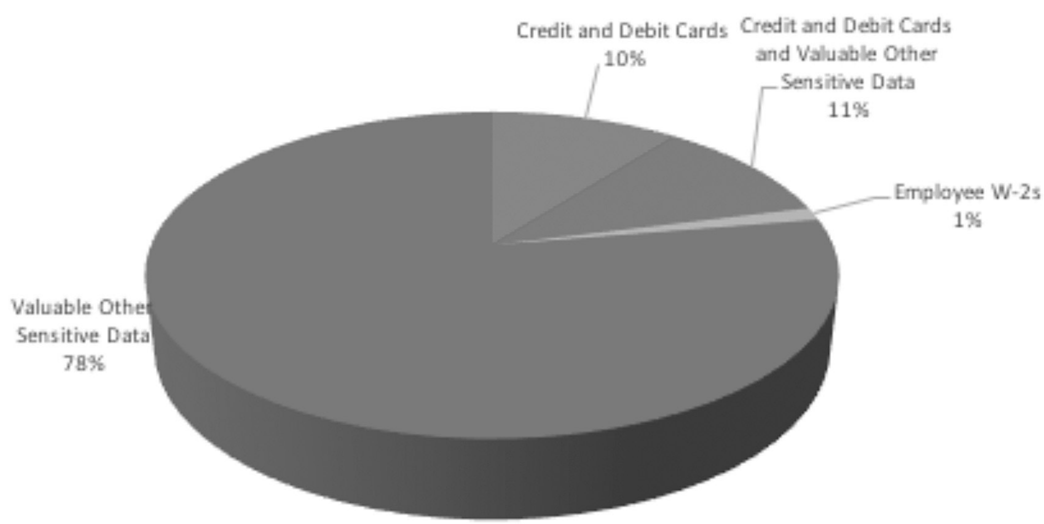
Data drawn from medical records has become the single largest focus of both publicly reported breaches and class action lawsuits. It is no surprise that this industry is increasingly targeted and affected by hacking and data breaches given that it is a $3 trillion industry and accounted for 17.8% of the GDP in 2015.[10]

While 70% of publicly reported breaches involved the medical industry, only 34% of data breach litigation related to this industry. Although the relatively low percentage of lawsuits compared to publicly reported breaches could be considered reassuring, we expect that breaches in the medical industry and class action lawsuits resulting from those breaches will continue to represent a large percentage compared to other industries. Our expectation is based upon a number of factors, including the fact that medical data is reportedly worth substantially more than credit card information on the black market (some estimate 10 times more).[11] This relative value is in part due to the greater amount of personal data contained in health records and because such records have a longer shelf-life compared to credit cards, where the fraud is usually discovered more quickly and the card cancelled.

Despite the value of the data and the fact that it is increasingly targeted, the healthcare industry notoriously spends a low percentage of its budget on security (by some reports, only 1 to 2% on data security) which is significantly less than other sectors, such as the financial sector.[12] Add to that the rapidly increasing role of technology in this industry generally, including increased use of electronic medical records, internet dependent medical devices and the expansion of digital health care, and you have the perfect storm for data breach targets. In addition, there is a focus on health record "interoperability" to promote sharing and access of health information by providers and the patient, as well as value-based reimbursement that promotes collaboration and data sharing between providers. While these are positive developments for health care generally, they present increased data security related risks.

Meanwhile, the trend of decreasing focus on breaches that involved credit cards has continued. The quantity of class actions relating to credit cards declined by 2 percentage points from 23% to 21%. This decrease is likely the result of fewer high profile retail breaches during the Period, as well as difficulties for plaintiffs' attorneys to prove compensable injury in a credit card related data breach. Specifically, the Fair Credit Billing Act ("FCBA") and the Electronic Fund Transfer Act ("EFTA") dictate that a consumer cannot be held responsible for more than $50 in charges so long as the consumer reports the loss or theft of their card (or the unauthorized activity) within two business days of learning about it.[13] In addition, because many banks and payment card networks now voluntarily waive even the $50 most consumers suffer no financial harm as a result of a breach that involves their credit card.

The following chart provides a detailed breakdown of the type of data involved in data breach litigation:



Part 8: Plaintiffs' Firms

More than 72 plaintiffs' firms participated in filing class action complaints related to data security breaches. Although one plaintiffs' firm filed six class action lawsuits, the majority filed only one or two complaints.

Part 9: Methodology

The data analyzed in this report includes consumer class action complaints that were filed against private entities. Complaints that were filed on behalf of individual plaintiffs were excluded.

Data was obtained from the Westlaw Pleadings, Westlaw Dockets, Bloomberg Law, and PACER databases. The sample Period covered January 1, 2016-December 31, 2016. Multiple searches were run in order to find complaints that included – together with "class action" -- the following search terms:

- "security," or "breach" and phrases containing "personal," "consumer," or "customer" at a reasonable distance from the words "data," "information" or it derivations, "record," "report," "email," "number," or "code," or
- "data" at a reasonable distance from "breach,"

Although additional searches were conducted using the names of businesses that were the target of major data breaches (*e.g.*, "Yahoo" and "breach") not all of the complaints filed as a result of these data breaches were found using Westlaw. Any discrepancy may be due in part to the speed at which the multiple filings were consolidated.

All the complaints identified by these searches were read and, after the exclusion of non-relevant cases, categorized in order to identify and analyze the trends presented in this report.

As was the case in Bryan Cave's prior whitepapers, state complaints have been excluded so as not to inadvertently over-represent or under-represent the quantity of filings in any state. Complaints that were removed from state court to federal court were included within the analysis.

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1 Although the 2016 Report indicated that there were 83 cases filed, that number was for a 15-month period. Normalized for a 12-month period, this would have been 71 cases for 2015 as compared to 76 cases for 2016. *See* Bryan Cave LLP, 2016 Data Breach Litigation Report: A Comprehensive Analysis of Class Action Lawsuits Involving Data Security Breaches Filed in United States District Courts.

2 Privacy Rights Clearinghouse estimates that in the Period, 566 of the 806 publicly reported breaches involved the medical industry. *See* http://www.PrivacyRights.org (last viewed August 9, 2017).

3 The 2016 Data Security Report is available at: http://bryancavedatamatters.com/category/white-papers/white-papers-security/.

4 *See* Privacy Rights Clearinghouse Chronology of Breaches available at http://www.privacyrights.org (last viewed August 9, 2017).

5 *Id.*

6 This report does not include complaints filed in state courts. For more information, please see Part 9: Methodology below.

7 The following courts are not labeled in the chart and each represent 2% of the total filings during the Period: Southern District of Illinois, Southern District of Florida, Kansas District Court, Georgia District Court, Louisiana District Court, Missouri District Court, Tennessee District Court, Central District of Illinois, Eastern District of Louisiana, Massachusetts District Court, Eastern District of Michigan, Northern District of Georgia..

8 The 2016 Data Security Report found that almost half of complaints alleged a subclass.

9 The following scopes of putative classes are not labeled in the chart and each represent less than 2% of the total filings for the Period: Arizona and National; Arkansas; Arkansas and National; Australia; Colorado and National; Colorado, Texas, Maryland, California, New Jersey and National; Illinois, Maryland, New Jersey and National; Kansas and National; Massachusetts, Florida and National; Montana; Mexican Nationals, New Jersey and National, New York; North Carolina and National; Ohio and National; and Utah.

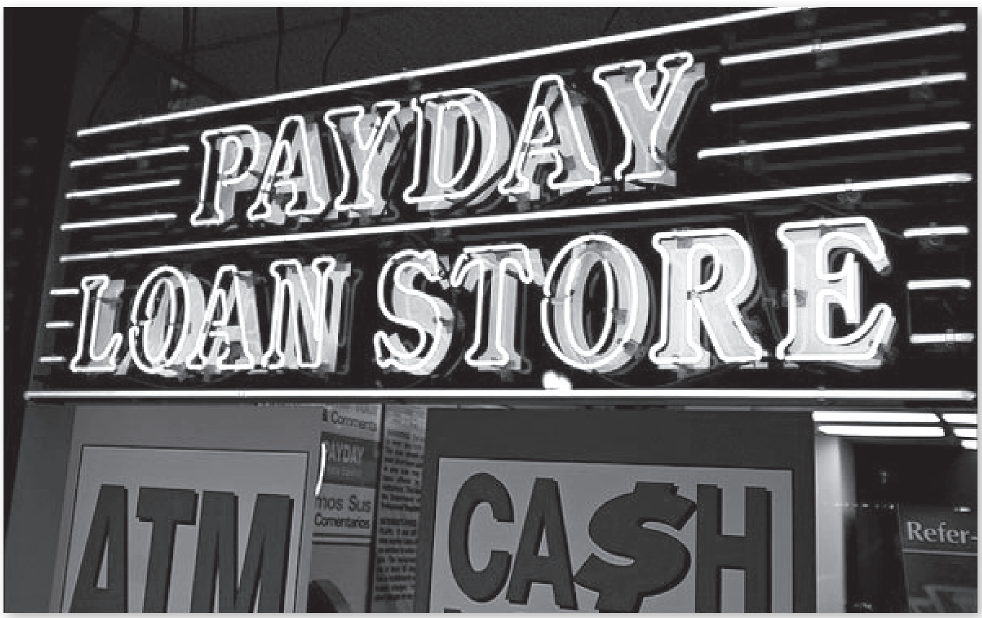
10 Centers for Medicare & Medicaid Services, National Health Expenditure Data, https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html.

11 Caroline Humer, Jim Finkle, *Your medical record is worth more to hackers than your credit card*, Reuters (September 24, 2014), http://www.reuters.com/article/us-cybersecurity-hospitals-idUSKCN0HJ21I20140924.

12 Michael Ash, *The Conundrum of Health Care Security Spending*, SecurityIntelligence (May 2, 2017), https://securityintelligence.com/the-conundrum-of-health-care-security-spending/.

13 *See* FTC Information Sheet, Lost or Stolen Credit, ATM, and Debit Cards *available at* http://www.consumer.ftc.gov (last viewed August 9, 2017).

Prepared Remarks of CFPB Director Richard Cordray on the Payday Rule



Washington, D.C.
October 5, 2017

Thank you for joining us. After a long process of research, outreach, and review of over one million public comments, the Consumer Bureau today has issued a rule aimed at stopping debt traps on payday and auto title loans. The rule is guided by the basic principle of requiring lenders to determine upfront whether people can afford to repay their loans. These strong protections cover loans that require consumers to pay all or most of the debt at once, including payday loans, auto title loans, deposit advance products, and longer-term loans with large "balloon" payments. The new rule also curtails repeated attempts to debit checking accounts that rack up fees and make it harder for consumers to get out of debt. This provision applies to the same kinds of loans and to high-cost installment loans as well. These protections bring needed reform to a market where far too often lenders have succeeded by setting up borrowers to fail.

About 16,000 payday loan stores operate in the 35 states that allow payday lending, along with online lenders. About 95 million people live in the other 15 states and the District of Columbia, where payday lenders do not operate because of caps on interest rates and fees. Payday loans are generally for $500 or less, and they are typically due in full by the borrower's next paycheck, usually in two or four weeks. They are expensive, with annual interest rates of over 300 percent or even higher. As a condition of the loan, the borrower writes a post-dated check for the full balance, including fees, or allows the lender to electronically debit funds from their account. Single-payment auto title loans also have expensive charges and short terms, usually of 30 days or less, but the borrowers have to put up the title to their car or truck as collateral. Some lenders also offer longer-term loans with a series of smaller payments for more than 45 days that then require the entire large balance of the loan to be repaid at the due date. These balloon-payment loans often require access to the borrower's account or auto title.

Loans like these are heavily marketed to financially vulnerable consumers. Though they offer cash-strapped consumers access to credit, the full-payment requirement can make these loans unaffordable. If a borrower living paycheck to paycheck needs a payday loan to cover basic expenses or to recover from a large expense or drop in income, they will probably face the same cash shortfall when they get their next paycheck. Only now, they have the added cost of loan fees or interest. Faced with unaffordable payments, consumers must choose between defaulting, re-borrowing, or failing to pay basic living expenses or other major financial obligations.

Many borrowers in this difficult situation end up rolling over or refinancing their loans again and again. More than four out of five payday loans are re-borrowed within a month, usually right when the loan is due or soon thereafter. In fact, about one-in-four initial payday loans are re-borrowed nine times or more, as consumers pay far more in fees than they borrowed in the first place. Just like payday loans, the vast majority of single-payment auto title loans are rolled over or re-borrowed on the day they come due or soon thereafter. And one-in-five borrowers end up having their car or truck seized by the lender because they cannot repay the debt.

This cycle of piling on new debt to pay back old debt can turn a single unaffordable loan into a long-term debt trap. It is a bit like getting into a taxi for a ride across town, then finding yourself stuck in a ruinously costly cross-country journey, with no exit ramps. With each renewed loan, the consumer pays more fees or interest on the same debt. The consequences are severe. Even those borrowers who renew the loan repeatedly, and at great cost, may still wind up in default and get chased by debt collectors or have their car or truck repossessed. And the repeated attempts by lenders to debit payments from their accounts can add significant penalties, as overdue borrowers get hit with multiple fees and may even have their bank accounts closed.

Our research has shown that the business model for payday and auto title lenders is built on miring people in debt. Whether the borrower is paying to roll over a short-term loan or making interest-only payments on a longer-term loan, the key is that these charges are not reducing how much they owe. And that is how the payday lenders make their profit. Lenders actually prefer customers who will re-borrow repeatedly rather than simply repaying the loan when it comes due. They can continue collecting fees or interest as long as the borrower does not fully repay. So these lenders have no incentive to check to see if borrowers can afford to repay on time because it is more profitable if they cannot. The example of the consumer who takes out one payday loan for an emergency and then pays it right back is a misleading exception to the norm. Most of these loans go instead to people who are re-borrowing the same loan many times.

The rule takes square aim at the practices that produce these outcomes – the failure to underwrite these loans and the business model built on repeated re-borrowing. The primary way the rule stops debt traps is by requiring lenders to do a "full-payment test" upfront to determine whether a consumer can afford to repay their loan without re-borrowing in the next month. Under this approach, lenders have to verify the consumer's income if evidence is reasonably available and pull a credit report to verify financial obligations. The rule also protects borrowers by capping at three the number of short-term loans that lenders can make in quick succession.

For certain short-term loans under $500, lenders do not have to satisfy the components of the full-payment test if they instead offer a "principal-payoff option" to allow borrowers to pay off debt more gradually. With this option, consumers could still take out one loan that meets the restrictions and pay it off in full. For those needing more time to repay, lenders may offer up to two subsequent loans, but only if the borrower pays down at least one-third of the original principal each time. Under this option, lenders cannot lend to borrowers who are still repaying another short-term or balloon-payment loan. They cannot make more than three such loans in quick succession. And they cannot make loans under this option if the consumer has already had more than six short-term loans or has been in debt on such loans for more than 90 days over a rolling 12-month period. The principal-payoff option is also unavailable for loans that take an auto title as collateral.

The new rule also addresses how lenders extract loan payments from consumers' accounts. This part of the rule covers short-term loans, balloon loans, and high-cost longer-term loans where the lender has account access. After two straight unsuccessful attempts, the lender cannot debit the account again unless it gets a new authorization from the borrower. In addition, lenders must notify consumers in writing before attempting to debit an account at an irregular time or for an irregular amount. This allows consumers to question or dispute any unauthorized or erroneous debit attempts, and to arrange to cover unanticipated payments that are due. As a result, fewer consumers will be debited for payments they did not authorize or anticipate, and fewer will be slammed by multiple fees for returned payments and insufficient funds.

In addition to allowing loans to be made under the principal-payoff option, our new rule provides other means for people who need money in an emergency to get an affordable loan. Notably, we have no intention of disrupting lending by community banks and credit unions. They have found effective ways to make small-dollar loans that consumers are able to repay without high rates of failure. For instance, the rule exempts loans made by a lender that makes 2,500 or fewer short-term or balloon-payment loans per year and derives no more than 10 percent of its revenue from such loans. These are usually small personal loans made by community banks or credit unions to existing customers or members. The rule also exempts loans that generally meet the parameters of "payday alternative loans" (or "PAL" loans) authorized by the National Credit Union Administration. These low-cost loans cannot have a balloon payment and have caps on the number of loans that can be made over six months. The rule also excludes from coverage some new "fintech" innovations, such as certain no-cost advances and programs to advance earned wages when offered by employers or their business partners.

Even those borrowers who renew the loan repeatedly, and at great cost, may still wind up in default and get chased by debt collectors or have their car or truck repossessed.

The Bureau has spent five years developing this rule. Over that time, we conducted supervisory examinations and enforcement investigations that have given us deep insight into the business practices of many of these lenders. We analyzed millions of loan records, and published five reports with our findings. We conducted field hearings to hear from local communities and stakeholders on all sides of these issues. We heard stories from faith leaders all over the country about the tragic ways these loans shatter financial stability for the people they serve. And we carefully reviewed well over a million comments on our proposal from all sides: payday and auto title borrowers, consumer advocates, lenders, tribal leaders, state officials, and others.

The final rule issued today applies the underwriting requirements only to lenders of short-term and balloon-payment loans. This is a change from our proposal, which would have required underwriting for a wider swathe of longer-term loans. We want to take more time to consider how the longer-term market is evolving and the best ways to address practices that are currently of concern and others that may arise as the market responds to the reforms prompted by this new rule. We also made many other changes in the rule in response to the comments we received. These changes include crafting the provisions just described for community banks, credit unions, and "fintech" innovations, among others. We modified many components of the full-payment test to make them more manageable and practical and we refined our approach to the principal-payoff option. These changes took considerable time and effort, but they led to the improved rule we are issuing today.

We believe this rule will have a positive impact on communities and borrowers and will improve the market for these products. The principle that lenders must actually evaluate the borrower's chances of success before making a loan is just plain common sense. These protections also are in addition to existing requirements under state or tribal law, which can go beyond federal law to be even more protective of consumers. The states that do not authorize payday loans will not be affected by our rule. In the states that do authorize payday loans, we believe most people will be able to get the credit they need by passing the full-payment test or through one of the other options. And all those who use payday or high-cost installment loans will be safeguarded against multiple attempts to extract payments from their accounts that cause mounting fees and penalties. Ultimately, we believe this rule will allow for responsible lending while ensuring that people are not saddled with unaffordable loans that undermine their financial lives. That important goal is worth all the efforts we have made here. Thank you.

The Consumer Financial Protection Bureau is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives. For more information, visit consumerfinance.gov.

Cordray Announces Resignation From CFPB, Clouding Future of Watchdog Agency

Politico
November 15, 2017

Richard Cordray, the embattled director of the Consumer Financial Protection Bureau, will resign his post at the end of the month, giving President Donald Trump the chance to reshape an agency that has drawn relentless attacks from businesses over its aggressive enforcement.

Cordray made the announcement in an email to bureau staff on Wednesday. "It has been a joy of my life to have the opportunity to serve our country as the first director of the Consumer Bureau by working alongside all of you here," he wrote. "Together we have made a real and lasting difference that has improved people's lives."

Cordray has been rumored to be considering a run for governor of Ohio, but gave no indication Wednesday of his plans.

Trump is likely to put the bureau under the control of Treasury Secretary Steven Mnuchin, who can delegate day-to-day operations to an interim director, according to a White House official and others familiar with the administration's thinking. An interim director can stay at the post indefinitely, or at least until the White House can get a nominee confirmed.

Cordray's departure kicks off a high-stakes scramble to secure the future of the CFPB, a powerful Washington regulator that has cheered consumers and angered businesses as well as Republicans, who have accused it of overreaching. The independent bureau is the only bank regulator not led by a Trump appointee.

"We need to appoint someone who has a proven track record of looking out for consumers," said John Taylor, president of the National Community Reinvestment Coalition. "To do anything that would weaken it by appointing someone who is less committed than Richard Cordray was would be a disservice to consumers."

Trump, never a Cordray fan, has been scouting for his replacement among the ranks of Republican attorneys general. But the partisan grip squeezing Washington, and the agency's supercharged politics, mean that anyone chosen for the job will face a rocky, if not impossible, road to confirmation.

Republicans are floating a handful of agency critics as contenders for the post, including Cordray's biggest foe, House Financial Services Chairman Jeb Hensarling (R-Texas). Hensarling has not expressed interest in the job, according to people close to him.

Hensarling on Wednesday called the bureau a "rogue agency that has done more to hurt consumers than help them" and called Cordray's departure "an excellent opportunity to enact desperately needed reforms."

Keith Noreika, the outgoing acting head of the Office of the Comptroller of the Currency, has also been mentioned, along with Todd Zywicki, a law professor at George Mason University. Both have fiercely opposed the bureau's approach to regulation and enforcement and would face long odds of being confirmed, but could serve as interim directors without Senate approval.

Brian Brooks, an executive vice president and general counsel at Fannie Mae who worked with Mnuchin at OneWest Bank, and former Florida Attorney General Bill McCollum are also mentioned as candidates to lead the bureau.

As the CFPB's inaugural leader, Cordray fashioned the agency into a razor-toothed watchdog with as much bite as bark, racking up a legacy of sweeping regulations that redefined how mortgages are sold, debts are collected and credit card fees are tallied.

More broadly, his bureau gave consumers a strong advocate that returned nearly $12 billion to 29 million wronged customers.

While the agency made headlines with action against mandatory arbitration, payday lending and subprime mortgages, most of its work was done under the radar and in some ways a lot of its heavy lifting has already been done. The bureau spent a good portion of its first six years pushing out rules and studies required by the Dodd-Frank Act that created it and building guardrails for products that had been loosely regulated.

"They inherited a Wild West market," said Mike Calhoun, president of the Center for Responsible Lending and a Cordray supporter. The bureau "cleaned up the mess it had inherited and now has evolved into a more established agency."

With Cordray leaving, political vitriol over the agency's independence and structure should subside.

"You'll see less of an urgency to change the system structurally now that it's in control of the current administration and current Congress," Calhoun said.

Still, the bureau faces an uncertain future. Led by a lone, independent director armed with plentiful funding that can't be withheld by Congress, its broad jurisdiction over banks, mortgage companies, credit card issuers and other financial providers is under fire from Republicans who want to rein it in.

Democrats quickly laid down their markers. Sen. Elizabeth Warren (D-Mass.), who inspired the bureau's creation and helped set it up under President Barack Obama, tweeted that the agency is "no place for another Trump-appointed industry hack."

Warren opposes transforming the bureau into a bipartisan commission, as some have proposed. In a press conference Wednesday, she cited the failure of the Securities and Exchange Commission to act before the 2008 financial crisis. "We need a regulator on the consumer's side who is nimble and able to respond to crises before they bring down the American economy," she said.

Warren was immediately taken to task by industry lobbyists who have pushed for installing a commission at the agency similar to those at the SEC or Federal Deposit Insurance Corp.

"She said today she doesn't want some industry hack to run the CFPB. Well, that's really not her choice right now," said Richard Hunt, president of the Consumer Bankers Association. "They gambled and they lost. There cannot be any whining from the Democrats over who President Trump is going to appoint."

The Consumer Bankers Association, American Bankers Association, Consumer Mortgage Coalition, National Association of Realtors and other groups have endorsed a plan to replace the CFPB's lone-director system with a five-member, commission.

Yet while Cordray's departure might open the door to structural changes, there seems to be little appetite on the Hill for legislation now that Republicans have control over the bureau.

Rep. Blaine Luetkemeyer (R-Mo.), who chairs the consumer credit panel of the House Financial Services Committee, said the debate over whether to replace the CFPB director with a commission is finished for the time being after the idea failed to gain traction with Democrats.

"I just don't see that it's something that's going to get support right now," he said. "Once the Democrats see how [Trump's] new designee could go in there and completely turn that agency upside down compared to where they want it to go, they may be more willing to sit down and talk."

House Republicans declined to pursue installing a commission when they passed a sweeping financial deregulation bill in June.

Cordray's future also remains uncertain. In Ohio and across the country, the former state attorney general is adored among progressives and might be able to raise money quickly despite his shortcomings as a shoe-leather campaigner.

If he chooses to run, he would face a handful of lesser-known but still serious candidates: Dayton Mayor Nan Whaley, former Rep. Betty Sutton, state Sen. Joe Schiavoni, former state Rep. Connie Pillich and former Wayne County Commissioner Dave Kiefer.

Their Republican opponents have been building formidable war chests in a bid to succeed Gov. John Kasich, who is term-limited.

Attorney General Mike DeWine and Secretary of State Jon Husted each raised $2.5 million in the first six months of the year. Rep. Jim Renacci has shuttled $4 million of his own money into his gubernatorial bid. Lt. Gov. Mary Taylor raised $640,000.

Ohio Democrats worry that no candidate will be able to match the fundraising chops of DeWine, Husted, or Renacci — not even Cordray.

"The donor base is just still pretty bedraggled because of 2016," said Sharen Neuhardt, a former Democratic candidate for lieutenant governor who has strong ties to what's left of the Ohio Democratic donor community.

Overdraft Policies Require More Than Compliance With Regulation E

By Vienna Flores*

In the past few years, the Consumer Financial Protection Bureau ("CFPB") has focused on taking action against multiple financial institutions for their overdraft services practices. These practices are regulated by the Federal Reserve Board's "Regulation E", as restated by the CFPB in 12 C.F.R. § 1005.17.

Regulation E prohibits financial institutions from assessing overdraft fees for paying ATM or one-time debit card transactions pursuant to the institution's overdraft service, unless the consumer chooses to opt-in or affirmatively consents to those services. In order to promote compliance with this regulation, the Federal Reserve Board provides a model consent form for financial institutions to use to attain consent for these overdraft services. Notably, this rule does not prevent financial institutions from charging overdraft fees without the consumer's consent for standard overdraft practices, such as the bank authorizing overdrafts for checks or automatic bill payments.

If a consumer chooses to opt-in to overdraft services for ATM or one-time debit card transactions, a financial institution may charge an overdraft fee each time it pays an overdraft and may also charge a daily fee for each day the account remains overdrawn. Regulation E provides no limit or cap to the fees that may be assessed once a consumer choses to opt-in.

With revenues for overdraft and non-sufficient funds fees averaging around $17 billion annually, some financial institutions have attempted to minimize the effect of Regulation E on their income. For example, on January 19, 2017, the CFPB sued TCF National Bank ("TCF") in the United States District Court of Minnesota for devising a strategy to persuade its customers to opt-in to overdraft services. TCF's strategy included: (i) providing monetary incentives to promote TCF employees to aggressively persuade customers to opt-in; (ii) providing TCF employees with a sales pitch that failed to mention fees assessed by choosing to opt-in; (iii) explicitly instructing TCF employees not to explain the overdraft program in a way that would prevent customers from opting in; and (iv) a telephone call campaign to convince existing customers to opt-in by tricking them into believing the TCF services would change if they did not opt-in. Through this strategy, TCF successfully persuaded approximately two-thirds of customers to opt-in to the overdraft services for ATM or one-time debit card transactions. According to the CFPB, this was more than three times the average opt-in rate of other banks.

The CFPB alleged that these unfair and deceptive practices violated Regulation E and the Consumer Financial Protection Act ("CFPA"). The CFPA prevents a bank from engaging in any unfair, deceptive, or abusive act or practice in connection with any transaction with a consumer for a consumer financial product or service, such as overdraft services. An act is considered abusive if it materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service. TCF moved to dismiss the CFPB's causes of action.

On September 8, 2017, the Court dismissed CFPB's causes of action pursuant to Regulation E but denied TCF's motion with respect to the CFPA causes of action. The Court dismissed the causes of action pursuant to Regulation E—regardless of TCF's likely deceptive conduct—because TCF complied with Regulation E's requirements: (i) it provided costumers a

With revenues for overdraft and non-sufficient funds fees averaging around $17 billion annually, some financial institutions have attempted to minimize the effect of Regulation E on their income.

reasonable opportunity to consent to overdraft services; and (ii) it attained affirmative consent from consumers. In analyzing the CFPA causes of action, the Court evaluated the entire transaction or course of dealing to determine whether deceptive or abusive practices occurred. The Court's holding makes clear that compliance with Regulation E alone will not protect a financial institution undertaking conduct that misleads or confuses a consumer in order to cause the consumer to opt-in to overdraft services.

What does this holding mean for financial institutions?

The CFPB is focused on unlawful overdraft practices. Banks should comply with the requirements of Regulation E and ensure that their policies in attaining the required consent are not viewed as unfair, abusive, or deceptive. Although liability will be based on the facts and circumstances of each case, the ruling in the TCF case provides financial institutions with some insight about the practices CFPB may view as violations of the CFPA.

These practices include:

Requiring employees to provide the mandated Regulation E notice early in the account opening process and asking customer to opt in later, after providing immense amounts of account information;

Requiring employees to ask consumers to initial their optional opt-in authorization immediately after being asked to initial other items that are mandatory in opening an account;

Providing bank employees a script that falsely conveys the impression that authorizing overdraft services for ATM and one-time debit card transactions are necessary to open an account; and

Policies that institute monetary incentives for employees that encourage customers to opt-in.

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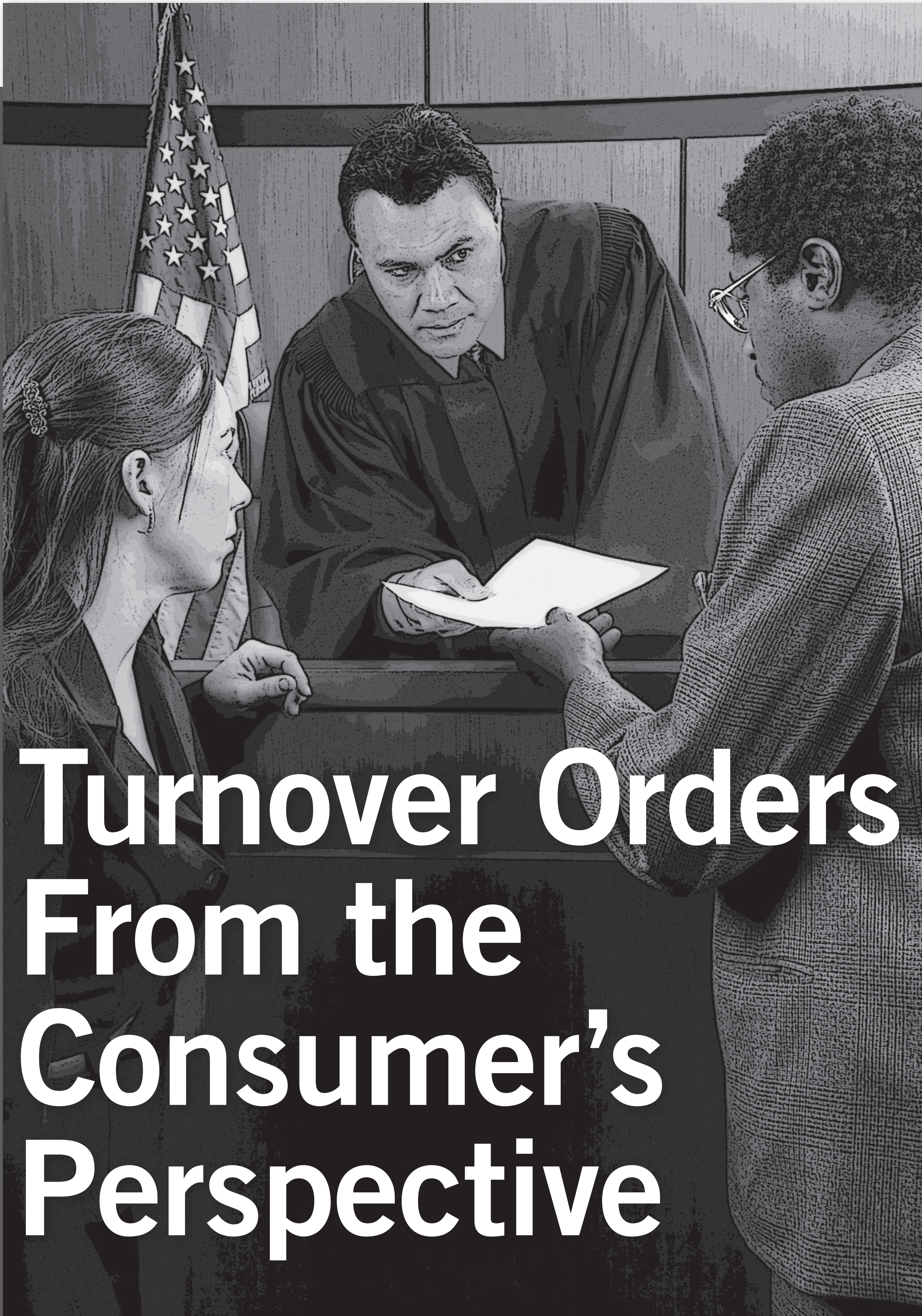


Turnover Orders From the Consumer's Perspective

By Jerry J. Jarzombek*

This article provides a general discussion of the Texas turnover statute.

I. SCOPE

This article provides a general discussion of the Texas turnover statute, Civil Practice & Remedies Code section 31.002. It is not an in-depth study of the turnover statute or turnover receiverships, but a basic treatment of the issues that arise in the trial courts from the perspective of a lawyer who has dedicated his practice to helping consumers. These issues include an examination of the turnover application, the hearing, property that may be subject to turnover, enforcement of the order, motions for new trial and appellate review. Finally, this article discusses how the consumer's attorney might get paid for beating the turnover order.

II. APPLICABLE STATUTES

The turnover statute found at Texas Civil Practice & Remedies Code section 31.002 has recently been amended; the amendment was effective as of June 15, 2017, and amends Section 31.002(a), to delete existing text providing that a judgment creditor is entitled to aid from a court of appropriate jurisdiction through injunction or other means in order to reach property to obtain satisfaction on the judgment if the judgment debtor owns property, including present or future rights to property, *that cannot readily be attached or levied on by ordinary legal process.* These changes apply to the collection of any judgment, regardless of whether the judgment was entered before, on, or after the effective date. The deleted text is shown below.

Tex. Civ. Prac. & Rem. Code § 31.002

Sec. 31.002. COLLECTION OF JUDGMENT THROUGH COURT PROCEEDING.

(a) A judgment creditor is entitled to aid from a court of appropriate jurisdiction through injunction or other means in order to reach property to obtain satisfaction on the judgment if the judgment debtor owns property, including present or future rights to property, that~~:~~

~~(1) cannot readily be attached or levied on by ordinary legal process; and~~

~~(2)~~ is not exempt from attachment, execution, or seizure for the satisfaction of liabilities.

(b) The court may:

(1) order the judgment debtor to turn over nonexempt property that is in the debtor's possession or is subject to the debtor's control, together with all documents or records related to the property, to a designated sheriff or constable for execution;

(2) otherwise apply the property to the satisfaction of the judgment; or

(3) appoint a receiver with the authority to take possession of the nonexempt property, sell it, and pay the proceeds to the judgment creditor to the extent required to satisfy the judgment.

(c) The court may enforce the order by contempt proceedings or by other appropriate means in the event of refusal or disobedience.

(d) The judgment creditor may move for the court's assistance under this section in the same proceeding in which the judgment is rendered or in an independent proceeding.

(e) The judgment creditor is entitled to recover reasonable costs, including attorney's fees.

(f) A court may not enter or enforce an order under this section that requires the turnover of the proceeds of, or the disbursement of, property exempt under any statute, including Section 42.0021, Property Code. This subsection does not apply to the enforcement of a child support obligation or a judgment for past due child support.

(g) With respect to turnover of property held by a financial institution in the name of or on behalf of the judgment debtor as customer of the financial institution, the rights of a receiver appointed under Subsection (b)(3) do not attach until the financial institution receives service of a certified copy of the order of receivership in the manner specified by Section 59.008, Finance Code.

(h) A court may enter or enforce an order under this section that requires the turnover of nonexempt property without identifying in the order the specific property subject to turnover.

1. Why was there a need to change the statute

Below is the "Author's/Sponsor's Statement of Intent" regarding the amendment. It is not a model of clarity.

The turnover statute is a post-judgment remedy enacted to shift the burden of disclosure of assets from the judgment-creditor to the judgment-debtor. Despite the 2005 amendment's adding paragraph h to eliminate the problem, at least two recent lower court decisions appear to require property subject to turnover to a court-appointed receiver to be specifically identified by the creditor in the application for a turnover order and to prove that the property exists. The rulings make the turnover procedure ineffective in that the debtor is advised in the turnover application and at the hearing what property the receiver intends to take possession of seize and gives the debtor an opportunity to dispose of the property even before a receiver can be appointed. Further, in the event specific assets are unknown at the time of the application to the court, a creditor would be precluded from utilizing the statute. Imagine entering a property with a constable and spotting a $40,000 bulldozer, but being unable to seize it.

Recent cases also require a plaintiff to prove that defendant has non-exempt assets that cannot be readily levied upon: often impossible because defendants hide or refuse to disclose assets. The cases also deny Receivers the right to sell real property because real property can be readily sold at the courthouse steps. This opinion not only violates common practice and understanding, it results in much lower sales prices.

2. Why the reasoning of the author/sponsor is flawed

As someone who has dealt with these issues more than once, some of the reasons given for the amendment seem to escape logic. Here are two examples of the flawed logic:

a. Paragraph h [Tex. Civ. Prac. & Rem. Code § 31.002(h)

The author/sponsor complains that two recent lower court decisions require the turnover order to specifically identify the non-exempt property subject to turnover, contrary to Tex. Civ. Prac. & Rem. Code § 31.002(h). Essentially the complaint is that these lower courts have chosen not to follow the law and abuse their discretion. Generally, the test for abuse of discretion is whether the trial court acted without reference to any guiding rules and principles or whether the trial court acted arbitrarily and unreasonably. *See McDaniel v. Yarbrough,* 898 S.W.2d 251, 253 (Tex.1995). However, a trial court has no discretion in determining what the law is and applying the law to the facts. *See Gonzalez v. Reliant Energy, Inc.,* 159 S.W.3d 615, 623-24 (Tex.2005). A failure by the trial court to analyze or apply the law correctly is an abuse of discretion. *Id.* If the author/sponsor is referring to two appellate court decisions, then this would appear to be ripe for consideration by the Texas Supreme Court. *See* Tex. Gov't Code § 22.001(a)(2), (3).

b. Disclosure to the debtor

The author/sponsor complains that the "debtor is advised in the turnover application and at the hearing what property the receiver intends to take possession of seize and gives the debtor an opportunity to dispose of the property even before a receiver can be appointed." But such a disclosure is not required, and usually is not provided. The turnover statute itself does not require notice and a hearing prior to issuance of a turnover order. *See* Tex. Civ. Prac. & Rem. Code § 31.002 ; *see Ex parte Johnson,* 654 S.W.2d 415, 418 (Tex.1983) (stating that notice and hearing prior to issuance of the turnover order was not required under predecessor statute); *Sivley v. Sivley,* 972 S.W.2d 850, 860 (Tex. App. - Tyler 1998, no pet.) ("The statute itself does not provide for notice or a hearing to be afforded a judgment debtor in a turnover proceeding."). The hearing is usually *ex parte,* and the receiver is appointed at the hearing.

3. Where we are as a result of the amendment.

Be mindful that cases which set out the requirements for turnover will incorporate the law prior to the June 15, 2017 effective date, and would apply to a turnover order issued prior to the effective date. A turnover order entered prior to June 15, 2017 will be subject to the prior version of the statute. A turnover order issued on or after June 15, 2017 will be subject to the amendment regardless of when the judgment was entered. The amendment eliminates the requirement that an asset "cannot readily be attached or levied on by ordinary legal process" for turnover to apply. In the most common practice situations, this would seem to eliminate any argument as to the creditor's use of turnover as compared to garnishment in the seizure of accounts at financial institutions.

III. PURPOSE OF TURNOVER

The apparent purpose of the turnover statute is to aid the collection of final money judgments. *Schultz v. Fifth Judicial Dist. Court of Appeals at Dallas,* 810 S.W.2d 738, 739 n. 3 (Tex.1991). The purpose of the turnover statute is to aid diligent judgment creditors in reaching certain types of property of a judgment debtor. *Main Place Custom Homes, Inc. v. Honaker,* 192 S.W.3d 604, 628 (Tex. App. - Fort Worth 2006, pet. denied). The turnover statute is purely procedural; its purpose is to ascertain whether an asset is either in the judgment debtor's possession or subject to her control. *Id.*

IV. TURNOVER RECEIVERSHIP AS COMPARED TO GARNISHMENT

In the world of consumer debt collection, especially collection of credit card debt by both creditors and debt buyers, there has been a surge in the use of turnover receiverships. Consider the filing requirements and the cost, the potential for additional expenses, and the notice requirements.

A. Filing requirements

For turnover relief, a "judgment creditor may move for the court's assistance under this section in the same proceeding in which the judgment is rendered or in an independent proceeding." Tex. Civ. Prac. & Rem. Code § 31.002(d). Garnishment is a "separate suit brought to enforce the judgment." *See Henry v. Ins. Co. of N. Am.,* 879 S.W.2d 366, 368 (Tex. App. - Houston [14th Dist.] 1994, no writ); the ancillary garnishment suit "takes its jurisdiction from the main suit." *Baca v. Hoover, Bax & Shearer,* 823 S.W.2d 734, 738 (Tex. App. - Houston [14th Dist.] 1992, writ denied). An application for turnover relief is brought as a motion, while a garnishment proceeding is a new lawsuit – which requires a filing fee and service on the debtor's bank by a constable.

B. Additional expenses

A garnishment suit requires the payment of a filing fee. If the judgment creditor intends to garnish a financial institution, service of the writ must be by a sheriff or constable. Tex. R. Civ. P. 662. In a turnover, the financial institution will may turn over assets to a receiver upon the receiver presenting a certified copy of the court's order; attorney's fees are awarded to the institution only if there is a contest. Tex. Civ. Prac. & Rem. Code § 31.010.

In a garnishment suit, the garnishee's attorney always gets paid. If the garnishee is discharged upon its answer, the compensation to the garnishee is taxed to the plaintiff/garnishor; in the event of a contest, the court decides which party is responsible for the fees of the garnishee. Tex. R. Civ. P. 677. In a turnover, the financial institution will assess an administrative fee against the judgment defendant's funds, but there will not be an attorney fee for appearing in the case.

C. Applicability to more than one account

A garnishment suit is brought against a single financial institution; a receiver would be able to levy on each bank where the judgment debtor has an account.

D. Longevity

A garnishment suit is brought against a single financial institution, and that's it. If the court finds that the garnishee is indebted to the defendant in any amount, or was so indebted when the writ of garnishment was served, the court shall render judgment for the plaintiff. Tex. R. Civ. P. 668. The funds captured by the writ of garnishment are those held by the garnishee in the account of the judgment debtor on the date the writ is served, and any additional funds deposited through the date the garnishee is required to answer. *Newsome v. Charter Bank Colonial,* 940 S.W.2d 157, 164 (Tex. App. - Houston [14th Dist.] 1996, writ denied). A receivership continues until the judgment is satisfied, or the receivership is closed.

E. Notice

The writ of garnishment, the application and any supporting affidavits must be served on the judgment debtor "as soon as practicable following the service of the writ." Tex. R. Civ. P. 663a. While there is no set time in the rule, fifteen days has been held to be too long. *Lease Finance Group, LLC v. Childers,* 310 S.W.3d 120, 126 (Tex. App. - Fort Worth 2010, no pet.). Section 31.002 requires neither notice nor a hearing before the court is-

The turnover statute gives the court the power to "order the judgment debtor to turn over nonexempt property that is in the debtor's possession or is subject to the debtor's control."

sues a turnover order. *See Ex Parte Johnson,* 564 S.W.2d 415, 418 (Tex. 1983) (stating that notice and hearing prior to issuance of the turnover order is not required).

V. AN OVERVIEW OF THE TURNOVER PROCESS

The turnover statute gives the court the power to "order the judgment debtor to turn over nonexempt property that is in the debtor's possession or is subject to the debtor's control." Tex. Civ. Prac. & Rem. Code § 31.002(b)(1).

A. Discretionary

The statute provides: "The court ***may*** order the judgment debtor to turn over nonexempt property that is in the debtor's possession or is subject to the debtor's control ..." (emphasis added). Tex. Civ. Prac. & Rem. Code § 31.002(b)(1)-(3). The language, therefore, is discretionary, as opposed to mandatory. The requested turnover relief is directed to the sound discretion of the trial court. *Barlow v. Lane,* 745 S.W.2d 451 (Tex. App. - Waco 1988, writ denied). Often creditors claim that they are *entitled* to turnover relief, because the statute says so in 31.002(a). However, the cases interpreting the language come down on the side of turnover relief being discretionary.

B. An injunction

Texas courts have concluded that turnover orders are final, appealable orders because they are analogous to mandatory injunctions requiring a judgment debtor to turn over property. *Schultz v. Fifth Judicial Dist. Court of Appeals at Dallas,* 810 S.W.2d 738, 740 (Tex.1991) (orig. proceeding) ("The turnover order at issue in this case resolved the property rights issues and acted as a mandatory injunction as to the judgment debtor Schultz and the receiver. We therefore hold that the turnover order was in the nature of a mandatory injunction and was appealable."), abrogated on other grounds by *In re Sheshtawy,* 154 S.W.3d 114 (Tex. 2004) (orig. proceeding). A turnover order normally acts as a mandatory injunction since it directs the judgment debtor to undertake some act. *Bahar v. Lyon Fin. Serv., Inc.,* 330 S.W.3d 379, 386 (Tex. App. - Austin 2010, pet. denied).

1. What about Justice Courts issuing turnover orders?

As creatures of statute, justice courts are governed by a legislative grant of jurisdiction. *Color Tile, Inc. v. Ramsey,* 905 S.W.2d 620 (Tex. App. – Houston [14th Dist.] 1995, no writ). The extraordinary remedies of a justice court are stated in the Texas Government Code. "A justice of the peace may issue writs of attachment, garnishment, and sequestration within the justice's jurisdiction in the same manner as judges and clerks of the district and county courts." Tex. Gov't Code § 27.032. There is no statutory authority that permits a justice court to appoint a receiver and issue a turnover order. In the judicial system of this state, a justice of the peace cannot exercise the extraordinary powers of equity jurisdiction in granting injunctions, mandamus and like equitable processes; such powers are conferred exclusively on the district courts. The justice courts, by statute, are given exclusive jurisdiction in certain classes of cases to give relief against wrong and injustice, but they are not granted the power to issue writs of injunctions and mandamus. *L. W. Crawford v. J. Q. Sandridge,* 75 Tex. 383, 12 S.W. 853; *Poe v. Ferguson,* Tex. Civ. App., 168 S.W. 459; *Kieschnick et ux. v. Martin et al.,* Tex. Civ. App., 208 S.W. 948; *Houston Heights Water & Light Ass'n et al. v. Gerlach et al.,* Tex. Civ. App., 216 S.W. 634.

Some justice courts will issue a turnover order, while others will not. My experience has been that some justice courts feel this is an unsettled area of the law, that is to say that some justice courts believe that the statute allows the issuance of turnover orders, while others do not. But, interpretation of a statute is a pure question of law over which a judge has no discretion. *See Mitchell Energy Corp. v. Ashworth,* 943 S.W.2d 436, 437 (Tex.1997). Thus, a trial court has no discretion in determining what the law is or applying the law to the facts. *See Huie v. DeShazo,* 922 S.W.2d 920, 927 (Tex.1996). Consequently, a trial court's erroneous legal conclusion, even in an unsettled area of law, is an abuse of discretion. *See id.* at 927-28. Although a turnover order is not reviewed under a sufficiency of the evidence standard, the lack of any evidence to support a turnover order is a relevant factor in determining whether the trial court abused its discretion in entering it. *See Beaumont Bank, N.A. v. Buller,* 806 S.W.2d 223, 226 (Tex.1991).

a. Justice Courts have issued turnover orders

The Corpus Christi Court of Appeals determined that a turnover order issued by a justice court was voidable (and not void), and not subject to collateral attack. *In re Wiese,* 1 S.W.3d 246, 250–51 (Tex. App. - Corpus Christi 1999, orig. proceeding) (turnover order failed to include evidentiary findings relating to amount of property to be seized and whether debtor owned sufficient property to satisfy judgment and failed to make provisions for debtor's reasonable and necessary business expenses). While the court in *Wiese* gave several reasons for why a judgment is void, stating "a judgment is void if it is apparent that the court rendering the judgment had no jurisdiction of the parties, no jurisdiction of the subject matter, no jurisdiction to render the judgment, or no capacity to act as a court," (*Id.* at 250), it never considered whether the justice court had jurisdiction to issue a turnover order and appoint a receiver.

A Houston Court of Appeals held that the failure to timely prosecute a direct appeal of the turnover order or seek injunctive or mandamus relief prohibiting the execution of the turnover order was fatal to the defendant's appeal. *Davis v. West,* 317 S.W.3d 301, 310 (Tex. App. - Houston [1st Dist.] 2009, no pet.).

b. Proof of facts is a court of no record?

Upon proof of the necessary facts, section 31.002 authorizes the trial court to order affirmative action by the judgment debtor and others to assist the judgment creditor in subjecting such nonexempt property to satisfaction of the underlying judgment. *Schultz v. Fifth Judicial Dist. Court of Appeals at Dallas,* 810 S.W.2d 738, 740 (Tex. 1991). How can there be proof of necessary facts in a court without a court reporter? The application for turnover order and the arguments of counsel are not evidence upon which the trial court could have based its order. *See McCain v. NME Hospitals, Inc.,* 856 S.W.2d 751, 757 (Tex. App. - Dallas 1993, no writ); *Delgado v. Kitzman,* 793 S.W.2d 332, 333 (Tex. App. - Houston [1st Dist.] 1990, no writ). When there is no indication the trial court was presented with or considered any evidence to support the requirements of section 31.002 of the Texas Civil Practice and Remedies Code when it made its ruling, a reviewing court will conclude the trial court abused its discretion in granting the turnover order. *HSM Dev., Inc. v. Barclay Props., Ltd.*, 392 S.W.3d 749, 752 (Tex. App. - Dallas 2012, no pet.).

C. Turned over to whom?

The debtor may be ordered to turn over nonexempt assets to a sheriff or constable, to pay into the registry of the court for satisfaction of the judgment, or the court may appoint a receiver. Tex. Civ. Prac. & Rem. Code § 31.002(b)(1)-(3). Property is not to be turned over directly to the judgment creditor. The potential for error or abuse where turnover is ordered directly to judgment creditors is obvious, considering that the statute allows ex parte entry of the order without notice and hearing. *Ex parte Johnson,* 654 S.W.2d 415, 418 (Tex. 1983).

D. Nonexempt property

Only nonexempt property is subject to turnover. Texas courts have struggled with the issue of what types of property are subject to turnover. *Ex parte Prado,* 911 S.W.2d 849, 850 (Tex. App. - Austin 1995, orig. proceeding). For example, courts cannot order the turnover of "current wages," which are exempt from seizure under the property code. *See* Tex. Prop. Code § 42.001(b)(1) (current wages exempt except to enforce child support). Courts have, however, ordered the turnover of paychecks on the theory that they were no longer exempt as "current wages" once they had been paid to, and received by, an employee who was a judgment debtor. *See, e.g., Schmerbeck v. River Oaks Bank,* 786 S.W.2d 521, 522 (Tex. App. - Texarkana 1990, no writ). Similarly, courts had ordered the turnover of retirement paychecks on the theory that retirement benefits were no longer exempt once they had been paid to, and received by, a judgment debtor. *See, e.g., Cain v. Cain,* 746 S.W.2d 861, 864 (Tex. App. - El Paso 1988, writ denied).

In 1989, however, the legislature overruled this line of cases by amending the turnover statute to provide that a court may not enter or enforce an order that requires a judgment debtor to turn over the proceeds of, or disbursements of, property that is exempt under any statute (except to enforce child support obligations). *See* Tex. Civ. Prac. & Rem. Code § 31.002(f). This amendment was intended, in part, to prevent turnovers of paychecks, retirement checks, and other similar types of assets after a judgment debtor received them. House Comm. On The Judiciary, Bill Analysis, Tex. H.B. 1029, 71st Leg., R.S. (1989). Thus, even when property is no longer exempt under any other statute, if it represents proceeds or disbursements of exempt property, it is not subject to a turnover order. *See Caulley v. Caulley,* 806 S.W.2d 795, 798 (Tex.1991); *Bergman v. Bergman,* 888 S.W.2d 580, 586 (Tex. App. - El Paso 1994, no writ).

E. Attorney's fees

The judgment creditor is entitled to recover reasonable costs, including attorney's fees. Tex. Civ. Prac. & Rem. Code § 31.002(e).

VI. THE APPLICATION FOR TURNOVER

A. What should the application for turnover include?

There is little authority of what has to be in an application for turnover. Here is what the judgment creditor should probably include:

- Facts concerning the original judgment;
- An itemization of the property, documents or records to be turned over;
- A suggestion of where and how the property, documents or records should be stored;
- If a receiver is to be appointed, the application may suggest the appointment of a certain receiver and include a statement of his/her qualifications in light of the nature of the judgment debtor's business or assets.

See David Hittner, *Texas Post-Judgment Turnover and Receivership Statutes,* 45 Tex. B.J. 417, 417-18 (1982).

B. What is often included (whether or not it is correct)

I have seen all sorts of things in applications for turnover relief and requests for an appointment of a receiver. Some things are logical; others make no sense:

- Applications that seek only accounts at financial institutions (prior to June 15, 2017);
- Applications which seek turnover because garnishment is too expensive (prior to June 15, 2017);
- Affidavits that swear to the nonexempt status of bank accounts (that contain proceeds of exempt property);
- Applications that specify the receiver AND the hourly rate at which the creditor's attorney will be paid by the receiver;
- Applications which claim that the receiver is employed by the creditor's attorney;
- Applications and affidavits that claim the debtor owns nonexempt property but fails to identify any;
- Applications and affidavits that claim the debtor never answered post-judgment discovery, when no post-judgment discovery was ever sent;

VII. THE TURNOVER HEARING

The purpose of the hearing is to make a showing to the court. Remember, "upon proof of the necessary facts, it authorizes the trial court to order affirmative action by the judgment debtor and others to assist the judgment creditor in subjecting such nonexempt property to satisfaction of the underlying judgment." *Schultz v. Fifth Judicial Dist. Court of Appeals at Dallas,* 810 S.W.2d 738, 740 (Tex. 1991). It is an abuse of discretion for a trial court to enter a turnover order without any evidence to support the order. *Clayton v. Wisener,* 169 S.W.3d 682, 684 (Tex. App. - Tyler 2005, no pet.). Evidence of nonexempt assets must be admitted into evidence before the trial court can enter a turnover order. *Id.* Motions and arguments of counsel are not evidence. *Id.* Accordingly, before a trial court may grant relief under section 31.002(b), the conditions of section of 31.002(a) must exist, namely,

(1) the entity that is to receive aid must be a judgment creditor;

(2) the court that would grant aid must be one of appropriate jurisdiction;

(3) the aid to be given must be in order to reach property to obtain satisfaction on the judgment; and

(4) the judgment debtor must own property (including present or future rights to property) that:

(a) cannot be readily attached or levied on by ordinary legal process and

(b) is not exempt from attachment, execution, or seizure for the satisfaction of liabilities. *[Note that (4)(a) will not apply to* *an application on or after June 15, 2017, regardless of the date of the underlying judgment]*

Tanner v. McCarthy, 274 S.W.3d 311, 322 (Tex. App. – Houston [1st Dist.] 2008, no pet.). There is an exception to the requirement of the trial court receiving evidence at the turnover hearing. In *Sivley v. Sivley,* 972 S.W.2d 850 (Tex. App. - Tyler 1998, no pet.), "the trial court had already heard on at least three occasions evidence and arguments on the contested issues which culminated in the turnover order. Thus, we conclude that the trial court's decision to grant the turnover order without a hearing or the presentation of evidence was not unreasonable or arbitrary and was not an abuse of discretion." *Id.* at 862.

A. Must be a judgment creditor

While this seems relatively straightforward, remember the trial court "must have some evidence before it that establishes that the necessary conditions for the application of 31.002 exist." *Tanner,* 274 S.W.3d at 322. Importantly, section 31.002 does not specify or restrict the manner in which evidence may be received in order for a trial court to determine whether the conditions of 31.002(a) exist, nor does it require that such evidence be in any particular form, that it be at any particular level of specificity, or that it reach any particular quantum before the court may grant relief under section 31.002. *Tanner,* 274 S.W.3d at 322. In *Henderson v. Chrisman,* 05-14-01507-CV, (Tex. App. – Dallas 4-27-2016, no pet.)(mem. op.), the Chrismans attached an affidavit to their motion for post-judgment turnover stating, in part, that the agreed judgment obtained on September 20, 2013 between the parties was "in all things final, valid, subsisting, unpaid, and is unsatisfied" in the amount of $245,686. They attached the agreed judgment as an exhibit to the affidavit. Thus, the trial court had some evidence before it satisfying this necessary condition."

B. Must be a court of appropriate jurisdiction

1. The court that rendered the judgment

The judgment creditor may move for the court's assistance under this section in the same proceeding in which the judgment is rendered or in an independent proceeding. Tex. Civ. Prac. & Rem. Code § 31.002(d). After its plenary power has expired, a trial court retains the inherent power to enforce its judgments. "The court shall cause its judgments and decrees to be carried to execution … and in such case may enforce its judgment by attachment, fine and imprisonment." Tex. R. Civ. P. 308. The general rule is that every court having jurisdiction to render a judgment has the inherent power to enforce its judgments. *Arndt v. Farris,* 633 S.W.2d 497, 499 (Tex. 1982). In *Haden v. David J. Sacks, P.C.,* 332 S.W.3d 523 (Tex. App. - Houston [1st Dist.] 2009, pet. denied), a Houston court of appeals determined that the "court of appropriate jurisdiction" was initially the trial court. *Id.* at 531.

2. The bankruptcy court

When the debtor filed his petition for bankruptcy, the only court in which the law firm could pursue relief in order to obtain satisfaction of the judgment thus became the bankruptcy court; the bankruptcy court became the only possible "court of appropriate jurisdiction" in which the law firm could pursue its execution efforts. *Id.*

3. An independent proceeding

This would require that the new court have jurisdiction over the parties and over the subject matter. This would limit post-judgment discovery, as discovery must be initiated and maintained in the same trial court where the judgment was rendered. *See* Tex. R. Civ. P. 621a.

C. To reach property to obtain satisfaction on the judgment

This requires a factual showing that the debtor owns assets. This could be that the defendant owns bank accounts, has accounts receivable, rental income, etc. What usually happens is that the application is supported by a conclusory affidavit that makes a statement, often on information and belief and without foundation, as to what the defendant owns. The affiant is not present at the hearing, and frequently the applicant has no other witness who can testify to the defendant's assets, and submits no evidence.

D. The property is not exempt from attachment, execution, or seizure for the satisfaction of liabilities

This requires a factual showing that the assets that the debtor owns are not exempt property, or proceeds of exempt property. In 1991, the Texas Supreme Court interpreted Tex. Civ. Prac. & Rem. Code § 31.002(f) in *Caulley v. Caulley,* 806 S.W.2d 795 (Tex. 1991):

> By prohibiting the turnover of the proceeds of property exempt under any statute, this section necessarily prohibits the turnover of the proceeds of current wages. Tex. Prop. Code § 42.002(8) (listing current wages as one of the personal property items exempt from attachment, execution, and seizure by creditors). *Id.* at 798.

The 1989 amendment was intended, in part, to prevent turnovers of paychecks, retirement checks, and other similar types of assets after a judgment debtor received them. House Comm. On The Judiciary, Bill Analysis, Tex. H.B. 1029, 71st Leg., R.S. (1989). Thus, even when property is no longer exempt under any other statute, if it represents proceeds or disbursements of exempt property, it is not subject to a turnover order. *See Caulley v. Caulley,* 806 S.W.2d 795, 798 (Tex.1991); *Bergman v. Bergman,* 888 S.W.2d 580, 586 (Tex. App. - El Paso 1994, no writ).

Frequently, creditors and their attorneys will argue that once a paycheck is deposited into the defendant's bank it is no longer exempt because it was no longer "current wages." *In the past* Courts had ordered the turnover of paychecks on the theory that they were no longer exempt as "current wages" once they had been paid to, and received by, an employee who was a judgment debtor. *See, e.g., Schmerbeck v. River Oaks Bank,* 786 S.W.2d 521, 522 (Tex. App. - Texarkana 1990, no writ). Similarly, courts had ordered the turnover of retirement paychecks on the theory that retirement benefits were no longer exempt once they had been paid to, and received by, a judgment debtor. *See, e.g., Cain v. Cain,* 746 S.W.2d 861, 864 (Tex. App. - El Paso 1988, writ denied).

In 1989, *the legislature overruled this line of cases by amending the turnover statute* to provide that a court may not enter or enforce an order that requires a judgment debtor to turn over the proceeds of, or disbursements of, property that is exempt under any statute (except to enforce child support obligations). [emphasis added]. *See* Tex. Civ. Prac. & Rem. Code § 31.002(f).

1. When "wages" are not exempt

a. *Hennigan v. Hennigan,* 666 S.W.2d 322 (Tex. App.-Houston [14th Dist.] 1984, writ ref'd n.r.e.)

"Can an attorney's fee for legal services rendered or to be rendered in a single case, or in the transaction of a single matter, or in the transaction of any amount of legal business, in any manner be correctly termed "current wages," where he has not been hired for his services by the day, week, or month, to be paid at the expiration of the time for which he was hired, and not in proportion to the business done? We think not." *Id.* at 324. An attorney engaged in private practice is an independent contractor and does not receive current wages. *Id.* at 324-25.

b. *Brasher v. Carnation Co.,* 92 S.W.2d 573 (Tex. Civ. App. - Austin 1936, writ dism'd)
Cases have developed the concept of "current wages" and have settled on the opinion that the term "implies a relationship of master and servant, or employer and employee, and excludes compensation due to an independent contractor as such." *Id.* at 575.

c. *Stanley v. Reef Securities, Inc.,* 314 S.W.3d 659 (Tex. App - Dallas 2010, no pet.)
Under appropriate circumstances, however, an agreement for compensation, express or implied, will be enforced. But the appropriate circumstances generally require a showing that the partner seeking compensation devoted time and attention to the partnership that was not anticipated at the time the partnership was formed. We do not have those circumstances here. R.H.S.'s restated and amended partnership agreement does not contain any provision for compensating Stanley, previous years' tax returns indicate that Stanley was never treated as an employee before or paid compensation, and there is no evidence that Stanley has devoted any more time or attention to the business than was anticipated at its formation. Because the undisputed evidence shows that Stanley is not R.H.S.'s employee, we conclude that the trial court did not abuse its discretion by concluding that the payments Stanley receives and will receive from R.H.S. are distributions of the partnership and not exempt wages. *Id.* at 668.

2. Other nonexempt assets

a. *Europa Int'l, Ltd. v. Direct Access Trader Corp.,* 315 S.W.3d 654 (Tex. App. - Dallas 2010, no pet.)
At a hearing, Briggs testified Direct Access Trader Corp. owned one hundred percent of the stock in InvestIn Securities Corp. He admitted there is "stock responsive to the turnover order." He further stated InvestIn Securities Corp. is a separate corporation from Direct Access Trader Corp. with separate books and records. Based on this testimony, appellant established appellee, as the judgment debtor, owns property. The burden then shifted to appellee to prove the property is exempt from attachment. This it failed to do. Appellee presented no evidence during the hearing or in any other filing to the court to establish an exemption. To the contrary, Briggs agreed the stock at issue did not meet any of the criteria for exemption under the property code. *See* Tex. Prop. Code § 42.001(a), (b) (describing property exempt from garnishment, attachment, execution, or other seizure). *Id.* at 656-57.

3. Proceeds of a spendthrift trust are exempt

a. *Burns v. Miller, Hiersche, Martens & Hayward, P.C.,* 948 S.W.2d 317 (Tex. App. - Dallas 1997, writ denied)
Allowing the turnover of spendthrift trust distributions would not thwart the trust code or the historical purpose of protecting spendthrift trusts. Nevertheless, the plain language of section 31.002(f) provides that the proceeds or disbursements of property exempt under "any statute" are not subject to a turnover order. Therefore, because spendthrift trust assets are exempt under the trust code, we are constrained to conclude that proceeds and disbursements from such trusts are not subject to turnover orders. *Id.* at 323.

VIII. BEATING THE TURNOVER ORDER

Knowing what the creditor must show to be entitled to turnover relief enables you determine what was not shown. As a general rule, turnover orders are final, appealable orders, *Burns v. Miller, Hiersche, Martens & Hayward, P.C.,* 909 S.W.2d 505, 506 (Tex. 1995) (per curiam), and, therefore, must be attacked on direct appeal. "A direct attack is a proceeding instituted for the purpose of correcting the earlier judgment. It may be brought in the court rendering the judgment or in another court that is authorized to review the judgment on appeal or by writ of error." *Austin Indep. Sch. Dist. v. Sierra Club,* 495 S.W.2d 878, 881 (Tex. 1973). A direct attack can be in the form of a motion for new trial, appeal, or bill of review. *PNS Stores, Inc. v. Rivera,* 379 S.W.3d 267, 275 (Tex. 2012). A restricted appeal is a direct attack on the trial court's judgment and is limited to errors that are apparent on the face of the record. *Alexander v. Lynda's Boutique,* 134 S.W.3d 845, 848 (Tex. 2004); *Quaestor Invs., Inc. v. State of Chiapas,* 997 S.W.2d 226, 227 (Tex. 1999).

A turnover order can be collaterally attacked, but it can only succeed if the turnover order is void. *Browning v. Placke,* 698 S.W.2d 362, 363 (Tex. 1985) (per curiam) (orig. proceeding). A judgment is void only if the court had no jurisdiction over the parties or property, no jurisdiction of the subject matter, no jurisdiction to enter the judgment, or no capacity to act as a court. *Id.* All other errors make the judgment merely voidable, and may only be corrected through a direct attack. *Id.*

Mandamus is the proper method by which to attack a void judgment. *See Gem Vending, Inc. v. Walker,* 918 S.W.2d 656, 658 (Tex. App. - Fort Worth 1996, orig. proceeding); *see also Buttery v. Betts,* 422 S.W.2d 149, 151 (Tex. 1967) (orig. proceeding); *J.A. Bitter & Assocs. v. Haberman,* 834 S.W.2d 383, 384 (Tex. App. - San Antonio 1992, orig. proceeding). Mandamus relief is usually not available if the order complained of is appealable, because an appeal is almost always an adequate remedy at law. *See Republican Party v. Dietz,* 940 S.W.2d 86, 88 (Tex. 1997) (orig. proceeding). "But on rare occasions an appellate remedy, generally adequate, may become inadequate because the circumstances are exceptional." *In re Masonite Corp.,* 997 S.W.2d 194, 197 (Tex. 1999) (orig. proceeding) (holding that mandamus relief is appropriate where trial court's actions show such disregard for guiding principles of law that resulting harm is irreparable).

Note that the proper vehicle to challenge a post-judgment order appointing a master in chancery is a petition for writ of mandamus. *See Simpson v. Canales,* 806 S.W.2d 802, 812 (Tex. 1991); *Bahar v. Lyon Fin. Servs., Inc.,* 330 S.W.3d 379, 388 (Tex. App.—Austin 2010, pet. denied) (post-judgment order appointing master in chancery, even one that is embedded in a turnover and receivership order, is interlocutory and unappealable but may be challenged by mandamus), *Sheikh v. Sheikh,* 248 S.W.3d 381, 394 (Tex. App.—Houston [1st Dist.] 2007, no pet. The First Court of Appeals has held that they do not have appellate jurisdiction to consider an order appointing a master in chancery, even when such order is embedded within a turnover-and-receivership order, and that the proper challenge is by mandamus. *Id.*

A. Initial considerations

Because turnover relief may be sought ex parte, and because most receivers will levy against bank accounts, a consumer will most likely learn of a 'problem' when their debit card does not work while they are in the checkout line at the grocery store. The consumer will call their bank and be told that their account is on hold because of a 'receiver.' Some banks will tell their frantic customer to call a lawyer; others will give them the phone number of the receiver.

Perhaps one of the most important considerations here is *timing,* to determine whether the turnover order is subject to a motion for new trial, restricted appeal or a bill of review. Another important consideration is whether the underlying judgment is void or voidable.

1. Void or voidable

The court of appeals reversed the judgment on which the turnover order is based. *See Matthiessen v. Schaefer,* 900 S.W.2d 792, 798 (Tex. App. - San Antonio 1995, writ denied). "If the underlying judgment is reversed on appeal, then the turnover order must be reversed also." *Matthiessen v. Schaefer,* 915 S.W.2d 479, 480 (Tex.1995). "Without a final judgment, a turnover order is void, and mandamus relief lies to vacate the void order." *In re Alsenz,* 152 S.W.3d 617, 620 (Tex. App. - Houston [1st Dist.] 2004, orig. proceeding).

In *Enis v. Smith,* 883 S.W.2d 662 (Tex.1994), the underlying Nevada judgment was determined to be void for lack of jurisdiction, after a turnover order had been issued in Harris County. The Nevada court vacated its judgment more than thirty days after the Houston trial court granted the turnover motion. When Enis filed a motion to reconsider his motion for new trial in the Harris County court (which was after the Nevada judgment had been vacated), that court overruled it. The trial court abused its discretion in continuing to enforce the turnover order. A void judgment will not support a turnover order. *Id.* at 663.

2. Availability of a direct attack

Most often consumers will be frantically searching for a lawyer when their access to cash has been eliminated. Usually this happens with an inoperable debit card. If the receiver has acted expeditiously, there is probably time for a motion for new trial. If for some reason that is not the case, then it might be necessary to determine if the extended periods in Tex. R. Civ. P. 306a(4) apply, or the attorney should consider a restricted appeal or a bill of review.

B. Challenges to the underlying judgment

1. Plea to the jurisdiction

This would be applicable when, for example, pleadings in a justice court case exceed the jurisdictional limits, but the judgment is within those limits. Another example is when the applicant for turnover relief is a different person or entity from the original judgment creditor.

A judgment or part of a judgment of a court of record or an interest in a cause of action on which suit has been filed may be sold, regardless of whether the judgment or cause of action is assignable in law or equity, if the transfer is in writing. The transfer may be filed with the papers of the suit if the transfer is acknowledged or sworn to in the form and manner required by law for acknowledgement or swearing of deeds. *See* Tex. Prop. Code § 12.014.

"An assignment is a manifestation by the owner of a right of that person's intention to transfer such right to the assignee." *Hermann Hosp. v. Liberty Life Assur. Co. of Boston*, 696 S.W.2d 37, 44 (Tex. App. — Houston [14th Dist.] 1985, writ ref'd n.r.e.). To recover on an assigned cause of action, the party claiming the assigned right must show that the cause of action being assigned existed and was assigned to the party alleging assignment occurred. *Allodial Ltd. P'ship v. N. Tex. Tollway Auth.*, 176 S.W.3d 680, 683 (Tex. App. — Dallas 2005, pet. denied); *Tex. Farmers Ins. Co. v. Gerdes*, 880 S.W.2d 215, 217 (Tex. App. — Fort Worth 1994, writ denied) (to recover on assigned cause of action, party claiming assigned rights must prove cause of action existed that was capable of assignment and cause was assigned to party seeking recovery); *see also John H. Carney & Assocs, v. Tex. Prop. & Cas. Ins. Guar. Ass'n*, 354 S.W.3d 843, 850 (Tex. App. — Austin 2011, pet. denied) (assignee "stands in the shoes" of assignor but acquires no greater right than assignor possessed) (quoting *Deer Park Bank v. Aetna Ins. Co.*, 493 S.W.2d 305, 306 (Tex. Civ. App. - Beaumont 1973, no writ); *Pape Equip. Co. v. I.C.S., Inc.*, 737 S.W.2d 397, 399 (Tex. App. — Houston [14th Dist.] 1987, writ ref'd n.r.e.) (to recover on assigned cause of action, one must plead and prove "a cause of action capable of being assigned *existed and was assigned*" to party alleging theory of assignment).

A trial court must have subject-matter jurisdiction to decide a case. *See Tex. Ass'n of Bus. v. Tex. Air Control Bd.*, 852 S.W.2d 440, 443 (Tex. 1993). A plaintiff bears the initial burden of alleging facts that affirmatively demonstrate the trial court's subject-matter jurisdiction over the suit. *Id.* at 446. A defendant may challenge the trial court's subject-matter jurisdiction through a plea to the jurisdiction. *See Bland Indep. Sch. Dist. v. Blue*, 34 S.W.3d 547, 554 (Tex. 2000).

The purpose of a plea to the jurisdiction is to "defeat a cause of action without regard to whether the claims asserted have merit." *Id.* It does not authorize delving into the merits of the plaintiff's claims, but rather, examining the preliminary issue of whether the merits of those claims should be reached. *Id.* Accordingly, in reviewing the trial court's ruling on a plea to the jurisdiction, a reviewing court will construe the pleadings liberally in favor of the plaintiff and determine if the plaintiff has alleged facts that affirmatively demonstrate the court's jurisdiction to hear the cause. *Tex. Dep't of Parks & Wildlife v. Miranda*, 133 S.W.3d 217, 226 (Tex. 2004); *Villarreal v. Harris Cnty.*, 226 S.W.3d 537, 541 (Tex. App. — Houston [1st Dist.] 2006, no pet.).

If the pleadings lack sufficient facts to affirmatively demonstrate the trial court's jurisdiction but do not reveal incurable jurisdictional defects, the issue is one of pleading sufficiency, and the trial court may either afford the plaintiff

It is well established that strict compliance with the rules of service must be evident from the face of the record for a reviewing court to uphold a default judgment.

an opportunity to amend or await further development of the case's merits. *Miranda*, 133 S.W.3d at 226-27; *Villarreal*, 226 S.W.3d at 541. Conversely, if the pleadings affirmatively negate the existence of jurisdiction, the trial court may grant the plea to the jurisdiction without providing the plaintiff an opportunity to amend. *Miranda*, 133 S.W.3d at 227; *Villarreal*, 226 S.W.3d at 541.

If a plea to the jurisdiction challenges the existence of jurisdictional facts, the reviewing court will consider relevant evidence submitted by the parties when necessary to resolve the jurisdictional issues raised. *Miranda*, 133 S.W.3d at 227; *Bland*, 34 S.W.3d at 555 (confining evidentiary review to evidence relevant to jurisdictional issue). If the evidence creates a fact question regarding the jurisdictional issue, then the movant has failed to establish its right to dismissal. *See Miranda*, 133 S.W.3d at 227-28. However, if the relevant evidence is undisputed or fails to raise a fact question on the jurisdictional issue, the plea to the jurisdiction may be ruled on as a matter of law. *Id.* at 228.

2. Service?

"Jurisdiction over a defendant must be established in the record by an affirmative showing of service of citation…" *Wright Bros. Energy, Inc. v. Krough,* 67 S.W.3d 271, 271 (Tex. App. – Houston [1st Dist.] 2001, no pet.). Lack of proof of proper service constitutes error on the face of the record that defeats the trial court's jurisdiction. *Hubicki v. Festina,* 226 S.W.3d 405, 407 (Tex. 2007); *Primate Construction, Inc. v. Silver,* 884 S.W.2d 151, 152 (Tex. 1994).

It is well established that strict compliance with the rules of service must be evident from the face of the record for a reviewing court to uphold a default judgment. *Primate Constr., Inc. v. Silver*, 884 S.W.2d 151, 152 (Tex. 1994) (citations omitted). If strict compliance is not shown, the service of process is "invalid and of no effect." *Uvalde Country Club v. Martin Linen Supply Co.*, 690 S.W.2d 884, 885 (Tex. 1985) (per curiam). Further, in contrast to the usual rule that all presumptions will be made in support of a judgment, when a default judgment is challenged, "[t]here are no presumptions in favor of valid issuance, service, and return of citation. . . ." *Primate Constr.*, 884 S.W.2d at 152. It is the responsibility of the party who obtains the default judgment to see that service of process is properly accomplished, *see* Tex. R. Civ. P. 99(a), and the responsibility "extends to seeing that service is properly reflected in the record," independent of recitals in the default judgment. *See Primate Constr.*, 884 S.W.2d at 153; *Hunt v. Yepez*, No. 03-04-00244-CV, 2005 Tex. App. LEXIS 6964, at *7-8 (Tex. App.-Austin Aug. 24, 2005, no pet.) (mem. op.).

Rule 107 of the Texas Rules of Civil Procedure governs the return of service and provides in relevant part as follows:

> The return of the officer or authorized person executing the citation shall be endorsed on or attached to the same; it shall state when the citation was served and the manner of service and be signed by the officer officially or by the authorized person. The return of citation by an authorized person shall be verified.

Tex. R. Civ. P. 107. The return of service is not a trivial or merely formulaic document. *Primate Constr.*, 884 S.W.2d at 152. If any of the requirements of Rule 107 are not met, the return is ***fatally defective*** and will not support a default judgment under direct attack. [emphasis added] *See Travieso v. Travieso*, 649 S.W.2d 818, 820 (Tex. App. - San Antonio 1983, no writ); *Rowsey v. Matetich*, No. 03-08-00727-CV, 2010 Tex. App. LEXIS 6532, at *19 (Tex. App.-Austin Aug. 12, 2010, no pet.) (mem. op.).

Most recently I have had a consumer be subjected to post-judgment collection, who is wheelchair bound and unable to speak as the result of a stroke. The process server in the underlying collection suit claims to have personally served him at an address where he has not lived for six years, and describes my Pilipino client as African American.

3. Lack of notice of trial

Constitutional due process requires a party to be served with process and to receive notice of an action to which it is an interested party. *See Fehlhaber v. Fehlhaber*, 681 F.2d 1015, 1027 (5th Cir.1982). A judgment rendered in violation of due process is ***void.*** *Id.; PNS Stores, Inc. v. Rivera*, 379 S.W.3d 267, 273 (Tex.2012). Due process requires that a party receive "reasonable notice" of trial. *See Peralta v. Heights Med. Ctr., Inc.*, 485 U.S. 80, 84, 108 S.Ct. 896, 899, 99 L.Ed.2d 75 (1988).

In *Peralta*, the United States Supreme Court held that "a judgment entered without notice or service is constitutionally infirm," and some form of attack must be available when defects in personal jurisdiction violate due process. 485 U.S. at 84, 108 S.Ct. 896. The Court stated, "[a]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under the circumstances, to apprise interested parties of the pendency of the action. . . ." *Id.* (quoting *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (1950)). Thus, the "[f]ailure to give notice violates 'the most rudimentary demands of due process of law.'" *Id.* (quoting *Armstrong v. Manzo*, 380 U.S. 545, 550, 85 S.Ct. 1187, 14 L.Ed.2d 62 (1965)).

4. Post-answer default

The issue of entering a default judgment without notice arises most often in a post-answer default case. In that instance, well-settled law forbids entering a default judgment against a defendant that has received no notice of the hearing on a motion for default judgment. *See, e.g., LBL Oil Co. v. Int'l Power Servs., Inc.*, 777 S.W.2d 390, 390-91 (Tex. 1989) (citing *Peralta v. Heights Med. Ctr., Inc.*, 485 U.S. 80, 84-85 (1988), and *Lopez v. Lopez*, 757 S.W.2d 721, 723 (Tex. 1988)). A court's ability to impose a "death penalty" sanction is further limited by due process. *TransAmerican Natural Gas Corp. v. Powell*, 811 S.W.2d 913, 917-9188 (Tex. 1991) (orig. proceeding). A court has no power to violate a party's due process rights by investigating possible sanctionable conduct – by hearing or by nonhearing – without notice. *Tarrant County Hosp. Dist. v. Henry*, 52 S.W.3d 434, 454 (Tex.App.-Fort Worth 2001, no pet. & orig. proceeding).

The failure to appear is considered neither an abandonment of the defendant's answer nor an implied confession of any issues. *Stoner v. Thompson*, 578 S.W.2d 679, 682 (Tex. 1979). In the context of a post-answer default, a judgment cannot be rendered on the pleadings. *Id.* The plaintiff still must offer evidence and prove its case. *Paradigm Oil, Inc. v. Retamco Operating, Inc.*, 372 S.W.3d 177, 183 (Tex. 2012); *In re E.M.W.*, No. 14-10-00964-CV, 2011 WL 5314525, at *4 (Tex.App.—Houston [14th Dist.] Nov. 3, 2011, no pet.) (mem. op.) (holding that plaintiff still must offer evidence and prove plaintiff's case as in a judgment following a contested trial).

5. Default as a sanction

In *Wal-Mart Stores, Inc. v. Butler,* 41 S.W.3d 816 (Tex. App. – Dallas 2001, no pet.), the trial court ordered that the parties attend mediation, and that a failure to attend mediation could result in sanctions, including a dismissal or a default judgment. *Id.* at 817. Wal-Mart did not attend mediation in violation of the court's order, and after a hearing on a sanctions motion, the court struck Wal-Mart's answer and entered judgment in favor of the plaintiff. *Id.* Wal-Mart appealed the judgment, based on an abuse of discretion, and the Dallas Court of Appeals reversed and remanded the case. *Id.* at 818. The Dallas Court of Appeals' analysis follows:

> In its sole issue, Wal-Mart asserts the trial court abused its discretion in striking its answer. A trial court possesses all inherent powers necessary for the enforcement of its lawful orders. *Luxenberg v.Marshall*, 835 S.W.2d 136, 141 (Tex.App.-Dallas 1992, no writ). A trial court may impose appropriate sanctions for violations of pretrial orders. *See Koslow's v. Mackie*, 796 S.W.2d 700, 703-04 & n. 1 (Tex. 1990); *Luxenberg*, 835 S.W.2d at 141. Sanctions must, however, be just. *Luxenberg*, 835 S.W.2d at 141.

In *TransAmerican Natural Gas Corp. v. Powell*, 811 S.W.2d 913, 917 (Tex. 1991) (orig. proceeding), the Texas Supreme Court outlined the limitations on a trial court's power to sanction for discovery abuse. First, there must be a direct relationship between the offensive conduct and the sanction. *Id*. Second, the sanction must not be excessive. That is, a sanction should be no more severe than necessary to satisfy its legitimate purposes. *Id*. The court stated:

> A court's ability to impose a "death penalty" sanction is further limited by due process. *See id*. at 917-18. Sanctions that are so severe as to preclude presentation of the merits of the case should not be assessed absent a party's flagrant bad faith or counsel's callous disregard for the rules. Even then, lesser sanctions must first be tested to determine whether they are adequate to secure compliance, deterrence, and punishment of the offender. *See Chrysler Corp. v. Blackmon*, 841 S.W.2d 844, 849 (Tex. 1992).
>
> Although *TransAmerican* was a discovery sanction case, this Court has applied the same standards in determining whether death penalty sanctions were appropriate following violations of a pretrial order. *See Luxenberg*, 835 S.W.2d at 141. Therefore, we review this case in light of *TransAmerican. See id*. By striking Wal-Mart's answer, the trial court precluded it from presenting its case on the merits. Therefore, the trial court was first required to test lesser sanctions. *See Chrysler Corp*., 841 S.W.2d at 849. Because the trial court did not do so, we conclude it abused its discretion in striking Wal-Mart's answer. We reverse the trial court's judgment and remand for further proceedings consistent with this opinion.
>
> *Wal-Mart v. Butler,* 817-818.

C. The standard of review

A turnover order and an appointment of a receiver are reviewed under an abuse-of-discretion standard of review. *See Beaumont Bank, N.A. v. Buller,* 806 S.W.2d 223, 226 (Tex. 1991) (stating that abuse of discretion is standard of review for turnover order); *Matz v. Bennion,* 961 S.W.2d 445, 452 (Tex. App.-Houston [1st Dist.] 1997, pet. denied) (stating that abuse of discretion is standard of review for appointment of receiver). A trial will be reversed for abusing its discretion only if it is found that the court acted in an unreasonable or arbitrary manner. *Buller,* 806 S.W.2d at 226. That is, an abuse of discretion occurs when a trial court acts "without reference to any guiding rules and principles." *Downer v. Aquamarine Operators, Inc.,* 701 S.W.2d 238, 241-42 (Tex. 1985). A corollary principle is that an appellate court may not reverse for abuse of discretion merely because it disagrees with a decision of the trial court, if that decision was within the trial court's discretionary authority. *Id.* at 242. A trial court's issuance of a turnover order, even if predicated on an erroneous conclusion of law, will not be reversed for abuse of discretion if the judgment is sustainable for any reason. *Buller,* 806 S.W.2d at 226.

D. Challenges to the turnover order

1. Is this the court that entered the judgment?

This would require that the new court have jurisdiction over the parties and subject matter jurisdiction. This would limit post-judgment discovery, as discovery must be initiated and maintained in the same trial court where the judgment was rendered. *See* Tex. R. Civ. P. 621a. While this sounds so basic, there have been instances where a turnover order is entered by a court who did not render the judgment.

2. If this court did not enter the judgment, is it a court of "appropriate jurisdiction"?

Consider these facts: suit is brought in a Harris County justice court to recover against a defendant who lives in Burleson County, Texas. The process server erroneously claims that the defendant lives in, and was served in, Harris County. A default judgment is taken against him. More than six years later a turnover proceeding is initiated in another and different Harris County justice court; the application is filed *ex parte,* and notices are mailed to an address where he does not live. The turnover order contains post judgment discovery, in violation of Tex. R. Civ. P. 621a. Is there a lack of jurisdiction? I think so…

3. Does the evidence support the order?

This is the most fertile area for finding grounds to have the trial court vacate the turnover order.

a. Is there a reporter's record?

Often the applicant seeking the turnover order will fail to have the court reporter make a record of the hearing. The non-existence of a record of the hearing is conclusive proof that the creditor did not make the factual showing that is required for the Court to have granted turnover relief, and appointed a receiver. Most likely only the application will be presented to the court, along with some sort of argument. Motions and arguments of counsel are not evidence. *Elkins v. Stotts-Brown,* 103 S.W.3d 664, 669 (Tex. App. - Dallas 2003, no pet.). Under these circumstances, the creditor will never have presented any evidence regarding the nonexempt assets owned by defendant as required by section 31.002 of the Texas Civil Practice and Remedies Code. *Schultz v. Fifth Judicial Dist. Court of Appeals at Dallas,* 810 S.W.2d 738, 740 (Tex. 1991). It is an abuse of discretion for a trial court to enter a turnover order without any evidence to support the order. *Clayton v. Wisener,* 169 S.W.3d 682, 684 (Tex. App. - Tyler 2005, no pet.).

An exception could exist, if there was evidence introduced at trial that would meet the required showing. *See Sivley v. Sivley,* 972 S.W.2d 850, (Tex. App. - Tyler 1998, no pet.).

b. Is there evidence of a judgment?

It would seem that the creditor's attorney would introduce a copy of the judgment, or at least ask the court to take judicial notice of the judgment. Even if this request is made, was there testimony as to an unpaid balance due? Was it sworn testimony, or just argument? If there was testimony, did the creditor have someone testify, or was the lawyer acting as witness? Is there a basis for finding some fault with the testimony? Was there a document introduced? Is there a basis for finding some fault with the admissibility of the document?

c. Is the creditor on the judgment the same as the creditor seeking turnover relief?

If not, is there a proper assignment of the judgment? Many creditor's attorneys argue that the language in the Property Code is permissive, because it says that a transfer <u>may</u> be filed with the papers of the suit if the transfer is acknowledged or sworn to in the form and manner required by law for acknowledgement or swearing of deeds. *See* Tex. Prop. Code § 12.014. While "may" is certainly a permissive word, absence of a proper assignment means a lack of standing. To recover on an assigned cause of action, the party claiming the assigned right must show that the cause of action being assigned existed and was assigned to the party alleging assignment occurred. *Allodial Ltd. P'ship v. N. Tex. Tollway Auth.*, 176 S.W.3d 680, 683 (Tex. App. — Dallas 2005, pet. denied); *Tex. Farmers Ins. Co. v. Gerdes*, 880 S.W.2d 215, 217 (Tex. App. — Fort Worth 1994, writ denied) (to recover on assigned cause of action, party claiming assigned rights must prove cause of action existed that was capable of assignment and cause was assigned to party seeking recovery).

d. Is there evidence of nonexempt property?

In my experience, this is the most frequent omission. Often the application and any supporting affidavit(s) will claim that the defendant has bank accounts, and "on information and belief" or "to the best of my knowledge" those accounts contain nonexempt funds. The most glaring defect is that qualification of knowledge. Should the court consider "information and belief" or "to the best of my knowledge" as meeting the required showing, the affidavit will be legally insufficient. "An affidavit which does not positively and unqualifiedly represent the facts as disclosed in the affidavit to be true and within the affiant's personal knowledge is legally insufficient." *Humphreys v. Caldwell,* 888 S.W.2d 469, 470 (Tex. 1994) (*citing Brownlee v. Brownlee,* 665 S.W.2d 111, 112 (Tex. 1984)); *see also N. P. Davis & Co. v. Campbell & Clough,* 35 Tex. 779, 781 (1872) (affidavits must be made to actual knowledge of the facts, "not to the best of the knowledge and belief" of the affiant); *Caperton v. Wanslow,* 18 Tex. 125, 133 (1856) (finding affidavit based on "information and belief of the party" manifestly insufficient).

IX. GETTING PAID FOR BEATING THE TURNOVER

In anticipation of your hearing to vacate the turnover order, you feel confident that you and your client will emerge victorious. So you decide that getting out of the trap isn't enough; you want more cheese. How can you get it?

A. Liability of the receiver

Generally a receiver has derived judicial immunity:

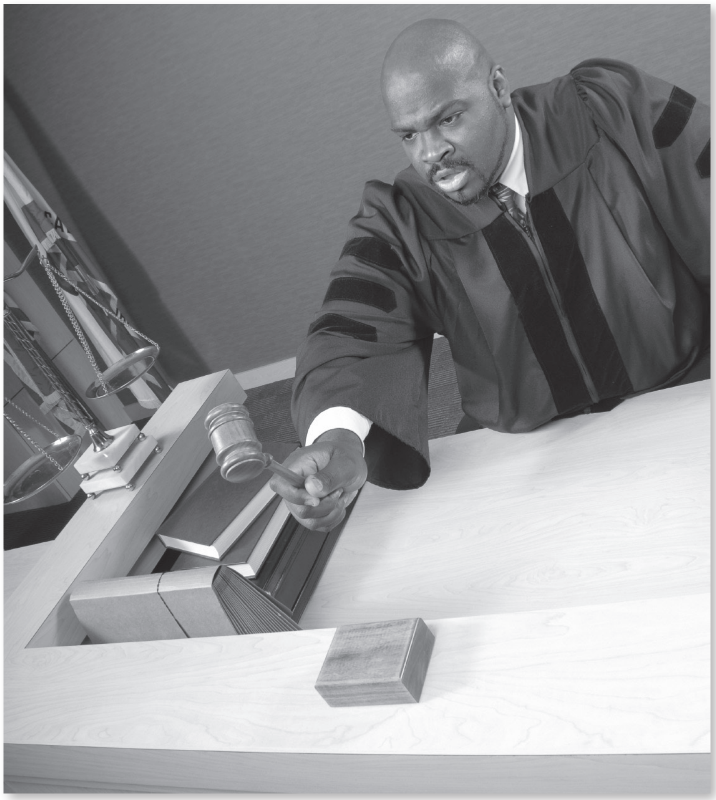
> Generally, once an individual is cloaked with derived judicial immunity because of a particular function being performed for a court, every action taken with regard to that function—whether good or bad, honest or dishonest, well-intentioned or not—is immune from suit. *Halsey,* 87 S.W.3d at 554. Once applied to the function, the cloak of immunity covers all acts, both good and bad.
> *B.K. v. Cox*, 116 S.W.3d at 357.

However, derived judicial immunity is lost when the court officer acts in the clear absence of all jurisdiction and outside the scope of his authority. *See Clements v. Barnes,* 834 S.W.2d 45, 46 (Tex. 1992) (per curiam). Even when a receiver is appointed by the trial court and acts pursuant to a court order, these facts alone do not conclusively establish the receiver's entitlement to derived judicial immunity for all of his functions as receiver. *Alpert v. Gerstner,* 232 S.W.3d 117, 131 (Tex. App. - Houston [1st Dist.] 2006, pet. denied). In *Dallas County v. Halsey,* 87 S.W.3d 552 (Tex. 2002), the Texas Supreme Court stated:

> When entitled to the protection of derived judicial immunity, an officer of the court receives the same immunity as a judge acting in his or her official judicial capacity — absolute immunity from liability for judicial acts performed within the scope of jurisdiction. *Stump v. Sparkman,* 435 U.S. 349, 356-57, 98 S.Ct. 1099, 55 L.Ed.2d 331 (1978) (stating that "[a] judge will not be deprived of immunity because the action he took was in error, was done maliciously, or was in excess of his authority; rather, he will be subject to liability only when he has acted in the 'clear absence of all jurisdiction.'" (quoting *Bradley v. Fisher,* 80 U.S. (13 Wall.) 335, 351, 20 L.Ed. 646 (1871))); *Turner v. Pruitt,* 161 Tex. 532, 342 S.W.2d 422, 423 (1961) (noting that in judicial proceedings in which the court has jurisdiction, a judge is immune for his or her actions).
> *Dallas County v. Halsey,* 87 S.W.3d 554.

1. When does a receiver act outside the scope of his authority or in the absence of jurisdiction?

As a general statement, most receivers act within the confines of the receivership order. However, many do not. A receiver is an "officer of the court, the medium through which the court acts." *Sec. Trust Co. v. Lipscomb Cnty.,* 142 Tex. 572, 180 S.W.2d 151, 158 (1944). A receiver must act only on the authority of the court appointing him. *Knox v. Damascus Corp.,* 200 S.W.2d 656, 659 (Tex. App. - Galveston 1947, no writ). The receiver derives his authority from the trial court and has only those powers that the appointing court may confer upon him. *Id.* The trial court cannot confer the exercise of non-delegable judicial discretion and power to the receiver. *Seagraves v. Green,* 116



Tex. 220, 288 S.W. 417, 424 (1926). As the trial court's agent, the receiver is subject to the trial court's authority, decrees, and orders at all times and in all things pertaining to the administration of the receivership. *Knox,* 200 S.W.2d at 659. A receiver has no constitutional authority to adjudicate parties' rights. *Seagraves,* 288 S.W.at. 239. A turnover order containing receivership powers is reviewed for abuse of discretion. *Bahar v. Lyon Fin. Servs.,* 330 S.W.3d 379, 391 (Tex. App. - Austin 2010, pet. denied; *Moyer v. Moyer,* 183 S.W.3d 48, 51 (Tex. App. - Austin 2005, no pet.).What constitutes a departure from propriety is probably a matter of degree. Here are some things that I have seen in turnover orders:

- Turnover of all assets, present and future, to the Receiver, at his office. Duty to supplement. The Respondent is ordered to turnover all of the listed items, and all similar items. All portions of this order continue until the judgment is paid. For example, the duties to disclose, supplement, turnover, etc., continue. If the items are not presently in existence, or the control of [debtor], [debtor] with knowledge of such assets [is] ordered to turnover the items to the Receiver, immediately upon taking control[.] If [debtor] does not have control of an asset, but receives knowledge of its existence, [debtor] is ordered to notify the Receiver, in writing, immediately, by fax, personal delivery or certified mail.
- Third party liability. The Receiver, and all persons acting under the direction of the Receiver, are immune from liability for all actions taken by them, to the extent that such actions are permitted by this order.
- Access to assets. The Receiver is authorized to take all action necessary to gain access to real property, leased premises, storage facilities, mail and safety deposit boxes, in which real or personal property of [debtor] may be situated, whether owned by [debtor] or not.
- Receiver's fees. Receiver may pay himself fees not less than 25 percent of all proceeds coming into his possession (before deducting out of pocket costs), which the Court finds to be a fair, reasonable, and necessary fee, and distribute all remaining proceeds to [creditor's] attorney in trust for the benefit of [creditor] (not to exceed the total payoff of the judgment), without any further order.

B. Liability of the creditor's lawyer

In the collection of consumer debt, this is a viable area for liability. There are three principal areas here: the Fair Debt Collection Practices Act; the Texas Finance Code (also referred to as the Texas Debt Collection Act); and penalties under Chapter 12 of the Civil Practice & Remedies Code. Relief also may be available through the Deceptive Trade Practices Act.

1. The Fair Debt Collection Practices Act [FDCPA]

This Act applies to an attorney who regularly engages in the collection of consumer debt, when a client is a consumer with regard to the debt being collected. If the judgment creditor is a debt buyer, it also applies to it.

a. Typical claims

This is a proceeding to be filed in federal court, with allegations for false, deceptive and misleading representations in a judicial proceeding. *See* 15 U.S.C § 1692.

b. Damages

Recovery in an FDCPA case consists of four components: statutory damages (up to a maximum of $1,000); actual damages; court costs; and attorney fees. Declaratory relief may also be awarded. *See* 15 U.S.C. § 1692k.

2. The Texas Finance Code

This applies to an attorney who regularly engages in the collection of consumer debt, when a client is a consumer with regard to the debt being collected. If the judgment creditor is a debt buyer or a first party creditor, it also applies to it.

a. Typical claims

This is a proceeding that can be added to the Complaint filed in federal court as an additional count, or filed in state court should you not want to file in federal court. The allegations are the state version of the FDCPA claims for false, deceptive and misleading representations in a judicial proceeding. *See* Tex. Fin. Code § 392.

b. Damages

Recovery in a TDCA case consists of four components: statutory damages (depending on the particular violation, which have a floor of $100 and no ceiling); actual damages; court costs; and attorney fees. Declaratory and injunctive relief may also be awarded. *See* Tex. Fin. Code **§ 392.403**.

c. The Texas Deceptive Trade Practices Act [DTPA]

A violation of chapter 392 of the Finance Code is a deceptive trade practice under Subchapter E, Chapter 17, Business & Commerce Code, and is actionable under that subchapter. *See* Tex. Fin. Code **§ 392.404(a).**

3. Tex. Civ. Prac. & Rem. Code § 12.001 et seq

This applies to anyone who signed a false affidavit in support of the application for turnover.

a. Typical claims

This claim is for the filing of a fraudulent "court record" as that term is defined by Tex. Penal Code § 37.01 and further interpreted by *State v. Vasilas,* 187 S.W.3d 486 (Tex. Crim. App. 2006). Be aware that liability is predicated on the affiant having knowledge that the affidavit is fraudulent of that it is a fraudulent lien or claim against real or personal property. *See* Tex. Civ. Prac. & Rem. Code § 12.002(a).

b. Damages

Recovery in a successful claim consists of a statutory award of the greater of $10,000 or the actual damages caused by the violation; court costs; attorney's fees; and exemplary damages as determined by the court. *See* Tex. Civ. Prac. & Rem. Code § 12.002(b).

C. Liability of the judgment creditor

1. The FDCPA

This applies to the judgment creditor that is a debt buyer, when your client is a consumer with regard to the debt being collected. The attorney and his client can both be defendants in the same case filed in federal court.

a. Typical claims

This is a proceeding to be filed in federal court, with allegations for false, deceptive and misleading representations in a judicial proceeding. *See* 15 U.S.C § 1692.

b. Damages

Recovery in an FDCPA case consists of four components: statutory damages (up to a maximum of $1,000); actual damages; court costs; and attorney fees. Declaratory relief may also be awarded. *See* 15 U.S.C. § 1692k. If the damages flow from the same document (as there are no independent acts or omissions between the two defendants), then there can only be a single recovery of damages.

2. The Texas Finance Code

This applies to the judgment creditor that is a debt buyer or a first party creditor, when your client is a consumer with regard to the debt being collected.

a. Typical claims

This is a proceeding that can be added to the Complaint filed in federal court as an additional count, or filed in state court should you not want to file in federal court. The allegations are the state version of the FDCPA claims for false, deceptive and misleading representations in a judicial proceeding. *See* Tex. Fin. Code § 392.

b. Damages

Recovery in a TDCA case consists of four components: statutory damages (depending on the particular violation, which have a floor of $100 and no ceiling); actual damages; court costs; and attorney fees. Declaratory and injunctive relief may also be awarded. *See* Tex. Fin. Code **§ 392.403.** If the damages flow from the same document (as there are no independent acts or omissions between the two defendants), then there can only be a single recovery of damages.

c. The DTPA

A violation of chapter 392 of the Finance Code is a deceptive trade practice under Subchapter E, Chapter 17, Business & Commerce Code, and is actionable under that subchapter. *See* Tex. Fin. Code **§ 392.404(a).**

3. Tex. Civ. Prac. & Rem. Code § 12.001

This applies to anyone who signed a false affidavit in support of the application for turnover.

a. Typical claims

This claim is for the filing of a fraudulent "court record" as that term is defined by Tex. Penal Code § 37.01 and further interpreted by *State v. Vasilas,* 187 S.W.3d 486 (Tex. Crim. App. 2006). Be aware that liability is predicated on the affiant having knowledge that the affidavit is fraudulent of that it is a fraudulent lien or claim against real or personal property. *See* Tex. Civ. Prac. & Rem. Code § 12.002(a).

b. Damages

Recovery in a successful claim consists of a statutory award of the greater of $10,000 or the actual damages caused by the violation; court costs, attorney's fees; and exemplary damages as determined by the court. *See* Tex. Civ. Prac. & Rem. Code § 12.002(b).

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DECEPTIVE TRADE PRACTICES AND WARRANTY

DTPA CLAIM IS SUBJECT TO FORUM SELECTION CLAUSE

In re Bambu Franchising LLC, ___ S.W.3d ___ (Tex. App—Dallas, 2017).
https://law.justia.com/cases/texas/fifth-court-of-appeals/2017/05-17-00690-cv.html

FACTS: Plaintiff, Bamboo Dynasty, LLC, was a franchisee in Texas who entered into a business agreement with Defendant, Relator Bambu Franchising, LLC. Bambu was the franchisor of Vietnamese-style beverage and dessert restaurants. Dynasty obtained the right to use Bambu's trademark and operating system for a restaurant in Grand Prairie, Texas. The franchise relationship was consummated through a Business Agreement that contained a forum selection clause. The forum selection clause established that any lawsuit relating under the Business Agreement shall be initiated in a State or Federal Court located in San Jose, California.

Dynasty brought this action alleging that Bambu violated the DTPA by failing to make certain required disclosures and failing to pay the $25,000 bond required by the Texas Business Opportunity Act. Bambu moved to dismiss based on the forum selection clause. The trial court denied the motion to dismiss and the original proceeding followed. Bambu asserted that the trial court abused its discretion by refusing to enforce the clause and denying their motion to dismiss. Bambu petitioned for a writ of mandamus.

HOLDING: Writ of mandamus conditionally granted.

REASONING: Bambu argued that Dynasty's claims were subject to the forum selection clause because they arose under the Business Agreement. The court accepted this argument by applying the general rule of enforceability regarding forum selection clauses. Under this rule, a trial court abuses its discretion in refusing to enforce a forum selection clause unless the party opposing enforcement meets its heavy burden of showing that (1) enforcement would be unreasonable or unjust, (2) the clause is invalid for reasons of fraud or overreaching, (3) enforcement would contravene a strong public policy of the forum where the suit is brought, or (4) the selected forum would be seriously inconvenient for trial.

The court determined that Dynasty's extra-contractual claims are subject to the forum selection clause because they involved matters arising under the Business Agreement. Further, the court noted that Dynasty failed to meet its heavy burden to avoid enforcement of the clause and the record did not show that any of the exceptions apply.

A THIRD-PARTY CLAIMANT MAY NOT BRING AN ACTION UNDER THE DTPA OR INSURANCE CODE AGAINST A LIABILITY INSURER

Landmark American Insurance Co. v. Eagle Supply & Manufacturing L.P., 530 S.W.3d 761 (Tex. App.—Eastland, 2017).
https://law.justia.com/cases/texas/eleventh-court-of-appeals/2017/11-14-00262-cv.html

FACTS: Plaintiff-Appellee, Eagle Supply & Manufacturing L.P., owned three power plants in Texas. In the summer of 2011, Eagle contracted with Metex Demolition, LLC for the sale of personal property from the power plants. The contract required Metex to perform various demolition, cleanup and remediation services at the power plants. The contract also required Metex to obtain liability insurance for the demolition work. Landmark American Insurance Co. issued a pollution liability policy to Metex, and Seneca Specialty Insurance Co. issued a general commercial liability policy to Metex.

Eagle filed suit, alleging that Metex damaged its property while performing services under the contract. Eagle received two judgments against Metex. The judgments included the judgment from the bankruptcy proceeding and the summary judgment entered against Metex in the underlying proceedings. Eagle asserted a third-party claim against Landmark and Seneca for unfair claim settlement practices under the Texas insurance code and violations of the DTPA. The trial court denied Landmark and Seneca's motions for summary judgment. Landmark and Seneca brought this permissive appeal of the denial of its motions for summary judgment.

In *Gandy*, the Texas Supreme Court held that a judgment for plaintiff against defendant, rendered without a fully adversarial trial, is not binding on defendant's insurer or admissible as evidence of damages against defendant's insurer.

HOLDING: Judgment reversed and rendered in part, remanded in part.

REASONING: Eagle argued that it had the right to assert a third-party claim against Landmark and Seneca because it had two final judgments against Metex. The court rejected that argument by explaining that the "no direct action" rule applies. The rule states that an injured party cannot sue a tortfeasor's insurer directly until the tortfeasor's liability has been finally determined by agreement or judgment.

The court determined that the two judgments rendered in favor of Eagle were insufficient to bind Landmark and Seneca. In *Gandy*, the Texas Supreme Court held that a judgment for plaintiff against defendant, rendered without a fully adversarial trial, is not binding on defendant's insurer or admissible as evidence of damages against defendant's insurer. *State Farm Fire & Casualty Co. V. Gandy*, 925 S.W.2d 696 (Tex. 1996). The court explained that the settlement agreement entered in the bankruptcy proceeding removed any meaningful incentive for Metex to oppose Eagle's property damage claim at the time each judgment was rendered. To the contrary, the settlement agreement contained terms that required Metex to diligently pursue a claim against each insurance carrier to provide Eagle with insurance coverage for the damages. So, the proceedings that followed were not fully adversarial.

WEBSITE WARRANTY NOT PREEMPTED BY MEDICAL DEVICE ACT

Wildman v. Medtronic, Inc., 874 F.3d 862 (5th Cir. 2017).
https://law.justia.com/cases/federal/appellate-courts/ca5/17-50010/17-50010-2017-10-31.html

FACTS: Plaintiff, Ray Wildman, suffered from chronic back pain and had a neurostimulator device made by Defendant, Medtronic Inc., surgically implanted into his back. The device, intended to block pain signals before they reach the brain, malfunctioned approximately a year and a half after it had been implanted. The surgery to remove the device resulted in an infection that caused Wildman additional pain and forced him to miss several months of work. Wildman sued Medtronic in state court alleging breach of express warranty, contending that the device did not last the nine years Medtronic had claimed it would in written marketing material. Medtronic moved for judgement on the pleadings on the grounds that, among others, the claim was preempted by the 1976 amendment to the Food, Drug, and Cosmetic Act titled The Medical Device Amendments. The district court ruled in favor of Medtronic, finding that the claim was preempted. Wildman appealed.
HOLDING: Reversed and Remanded
REASONING: Medtronic argued that the warranty equated battery life with device life because the primary component of the device was the battery. Therefore, claimed Medtronic, the warranty claimed that battery longevity was the limiting factor to overall longevity. The court rejected this argument and pointed out that the warranty makes a distinction between the battery and the "many components," and focuses on guaranteeing the reliability of the latter. The court continued by referencing the warranty's language that other manufacturers may state that their batteries have a longevity greater than nine years but that customers must understand that many other factors and components are involved in determining the overall longevity of an implanted medical device. But Medtronic was confident that their device was reliable for nine years. The court believed these statements could only reasonably be read as a claim that Medtronic had a competitive advantage over competitors who only vouch for the life of their batteries, and offered an express warranty on the longevity of the entire device.

The court pointed out that the FDA approved a statement that Medtronic's battery life was nine years, but Medtronic had provided no evidence that the FDA had evaluated the longevity of other components.

Whether Wildman could challenge the truthfulness of these statements, the court held, depended on whether the FDA evaluated the longevity of the "many components". The court explained that the essence of a warranty claim is a broken promise and when a claim challenges a representation that the FDA blessed in its approval process, the claim is preempted, but when a claim challenges a warranty that goes above and beyond any guarantee the FDA expressly approved, it is a parallel claim that is not preempted.

The court pointed out that the FDA approved a statement that Medtronic's battery life was nine years, but Medtronic had provided no evidence that the FDA had evaluated the longevity of other components. As a result, the warranty's coverage of the entire device went beyond what the FDA evaluated in its approval process. Therefore, the court ruled, the breach of express warranty claim Wildman asserted was not preempted.

DEBT COLLECTION

PROLONGING LEGAL PROCEEDINGS OR REQUIRING A CONSUMER TO APPEAR AT AN UNNECESSARY HEARING VIOLATES FAIR DEBT COLLECTION PRACTICES ACT

Arias v. Gutman, Mintz, Baker & Sonnenfeldt LLP, 875 F.3d 128 (2nd Cir. 2017).
https://law.justia.com/cases/federal/appellate-courts/ca2/16-2165/16-2165-2017-11-14.html

FACTS: Plaintiff-Appellant, Franklin Arias, became indebted to defendant-appellee, Gutman, Mintz, Baker & Sonnenfeldt LLP ("GMBS") through nonpayment of rent. After obtaining a default judgment in its favor, GMBS sought satisfaction of the debt through garnishment of Arias's bank account. Arias attempted to convince GMBS that the wages in his bank account were exempt from garnishment as protected social security benefits payments. GMBS refused to acknowledge Arias's claims as valid, forcing him to represent himself pro se at a hearing before a state court, where GMBS representatives filed an objection that Arias had not provided the proper documentation demonstrating the exempt nature of the garnished funds. At the hearing that Arias was required to attend, the GMBS representative reviewed the documentation Arias had submitted and immediately withdrew the objection.

Arias sued in federal district court for violations of the FDCPA, and the district court dismissed the claims. Arias appealed.

HOLDING: Vacated and remanded.

REASONING: The FDCPA includes two sections, 1692e and 1692f, which prohibit false, deceptive or misleading representations, as well as collecting or attempting to collect a debt through unfair or unconscionable means. The list of prohibited activities included in these sections is non-exhaustive. The court rejected a claim that these two sections were mutually exclusive.

The court analyzed whether the actions were false, deceptive, or misleading by viewing them from the perspective of the least sophisticated consumer and found them to qualify as violations of FDCPA §1692e. The court determined that the procedural delays and administrative hurdles erected by GMBS prevented Arias from succeeding on his claim to protect his exempt income and thus qualified as violations of FDCPA §1692f. The court found that it was "shockingly unjust or unfair" to require Arias to prepare needlessly for a hearing that GMBS knew was frivolous and that was intended primarily to harass Arias, frustrate his exemption claim, and erect procedural and substantive challenges that a pro se litigant was ill-equipped to handle.

COLLECTOR'S POLICIES AND TRAINING PROCEDURES SUFFICIENT TO SATISFY BONA FIDE ERROR DEFENSE

Berry v. Van Ru Credit, ___ F.3d ___ (D. Utah 2017).
https://ecf.utd.uscourts.gov/cgi-bin/show_public_doc?215cv0150-62

FACTS: The U.S. Department of Education placed Plaintiff Douglas Berry's defaulted loans with Defendant, Van Ru Credit, for collection. Van Ru sent correspondence to Berry informing him that his loans had been referred to Van Ru for collection. A Van Ru representative, Sargon Khayou, contacted Berry and informed him that his student loans were in federal default, and that the Department of Education had the right to pursue an involuntary administrative wage garnishment or a federal tax offset against him should his student loans remain in default. However, Khayou failed to advise Berry during this conversation that Khayou worked for Van Ru.

Berry brought suit against Van Ru, alleging Mr. Khayou placed a telephone call without meaningful disclosure of the caller's identity, violating the FDCPA. Van Ru moved for summary judgment, alleging it was entitled to a bona fide error defense because it did not intend to violate the FDCPA.

HOLDING: Granted.

REASONING: Van Ru claimed that their representatives are provided specific policies and procedures to avoid FDCPA violations and that if Mr. Khayou had followed the training, he would have provided the required meaningful disclosure of Van Ru's identity during the initial call. Therefore, Van Ru argued that the oversight was unintentional and did not amount to an FDCPA violation.

A bona fide error defense must illustrate that the violation was 1) unintentional, 2) a bona fide error, and 3) made despite the maintenance of procedures reasonably adapted to avoid the error.

The court agreed and highlighted that a bona fide error defense must illustrate that the violation was 1) unintentional, 2) a bona fide error, and 3) made despite the maintenance of procedures reasonably adapted to avoid the error.

Mr. Berry argued Van Ru must provide testimony to prove that the violation was unintentional. The court disagreed and held there was no evidence in the record to support Mr. Khayou's lack of disclosure was intentional. The court relied on Van Ru's evidence that there had been several other calls between Berry and Mr. Khayou, during which Mr. Khayou provided meaningful disclosure. The court reasoned that there was no motive for an intentional violation, as there would have been repercussions for violating the policies and procedures, including potential termination. The court also noted that because Mr. Khayou had identified the Department of Education as their client, his error was in good faith, genuine, and bona fide.

The court concluded that Van Ru's extensive evidence of policies and training procedures, including an initial three-week training emphasizing company policy and the laws and regulations governing collection activities, illustrated Van Ru's procedures were reasonably adapted to avoid the error.

A VOICEMAIL FROM A DEBT COLLECTOR THAT MERELY ASKS FOR THE DEBTOR TO CALL BACK CONSTITUTES AN INITIAL COMMUNICATION UNDER THE FEDERAL FAIR DEBT COLLECTION PRACTICES ACT, REQURING THE "MINI MIRANDA" WARNING

Hart v. Credit Control LLC, 871.3d 1255(11th Cir. 2017). https://law.justia.com/cases/federal/appellate-courts/ca11/16-17126/16-17126-2017-09-22.html

FACTS: Appellant, Stacey Hart, was called by Appellee, Credit Control LLC, a debt collector, and was left a message that only stated the name of the party, that they were a debt collector, and that she call them back. Hart brought suit against Credit Control where she alleged that Credit Control violated two provisions of the Fair Debt Collections Practices Act ("FDCPA") by leaving a voicemail that failed to disclose that the debt collector was attempting to collect a debt and that any information obtained would be used for that purpose, as is required of initial communications. The district court dismissed Hart's claims and held that Credit Control's voicemail was not a communication within the meaning of the statute. Appellant appealed to the Eleventh Circuit.

HOLDING: Reversed and remanded in part, affirmed in part.

REASONING: Appellant argued that Appellee violated §1692e(11) of the FDCPA when it failed to make the required disclosures contained in a mini Miranda warning for initial communications in the first voicemail left for her. Appellee contended that it was not required to make such disclosures because the voicemail was not a communication, as it did not reveal much information.

The Court applied ordinary meaning of the statutory language to determine that the voicemail clearly qualified as a communication.

The court opined that the voicemail left by Appellee for Appellant fell firmly within the FDCPA's definition of a communication, "the conveying of information regarding a debt either directly or indirectly to any person through any medium." Because it was Appellee's initial communication with Appellee, the failure to make the required disclosures was a violation of §1692e(11). The court applied ordinary meaning of the statutory language to determine that the voicemail clearly qualified as a communication. The court emphasized that to be considered a communication, the only requirement is that the information must be regarding a debt. Further, the court held that because the voicemail was indeed an initial communication, a "mini Miranda warning," disclosing that the debt collector was attempting to collect a debt and that any information obtained would be used for that purpose, was required to be given.

ARBITRATION

MARKETER THAT CALLED VERIZON CUSTOMERS CANNOT ASSERT ARBITRATION CLAUSE CONTAINED IN CUSTOMERS CONTRACTS WITH VERIZON

In Re Henson, 869 F.3d 1052 (9th Cir. 2017).
http://cdn.ca9.uscourts.gov/datastore/opinions/2017/09/05/16-71818.pdf

FACTS: Plaintiffs Anthony Henson and William Cintron (collectively "Henson"), were cellular and data subscribers who contracted with Verizon under a Customer Agreement. Defendant Turn, Inc., was a "middle man" for internet-based advertisers that separately contracted with Verizon to deliver advertisements to its subscribers. Henson alleged that Turn exploited Verizon users through the installation of its "zombie" cookies by collecting data about users without their knowledge. Furthermore, Henson alleged that Turn used the data collected through the "zombie" cookies for commercial gain without the subscriber's consent.

Henson filed a putative class action on behalf of Verizon subscribers residing in New York against Turn for its alleged use of these "zombie" cookies, claiming Turn engaged in deceptive trade practices and committed trespass to chattels by intentionally interfering with the use and enjoyment of Verizon subscribers' mobile devices. Because Turn was not a signatory in Henson and Verizon's contract, it sought to compel arbitration through equitable estoppel. The district court granted Turn's motion to compel arbitration and stayed the action. Henson timely filed a writ of mandamus to vacate the district court's order compelling arbitration.

HOLDING: Petition granted.

REASONING: Turn argued that equitable estoppel prevented Henson from refusing arbitration against it as a non-signatory. Under the forum state's applicable law, equitable estoppel applies in two circumstances. First, when a signatory to a contract must rely on the terms of the contract in asserting its claims against a non-signatory or the claims are intimately founded in and intertwined with the contract. Second, when the signatory alleges substantially interdependent and concerted misconduct by the non-signatory and a co-signatory, and the allegations of interdependent misconduct are founded in or intimately connected with the obligations of the contract.

First, the court reasoned that because Henson's complaint was replete with allegations of wrongdoing against Turn that had nothing to do with the Customer Agreement, the first circumstance did not apply. Second, the court reasoned that because Henson did not allege collusion between Verizon and Turn, but alleged Turn conducted its practices in secret and without Verizon's consent, the second circumstance also did not apply.

GAS COMPANY THAT GAVE DISCOUNT ON BANK CREDIT CARD CANNOT COMPEL ARBITRATION

White v. Sunoco, Inc., 870 F.3d 257 (3rd Cir. 2017).
http://law.justia.com/cases/federal/appellate-courts/ca3/16-2808/16-2808-2017-09-05.html

FACTS: Appellant, Sunoco a Pennsylvania corporation, sought to force Appellee, Donald White, to enter into mandatory arbitration for his claims against Sunoco pursuant to a credit card agreement that White signed with Citibank– unnamed in the lawsuit. The lawsuit centered around the "Sunoco Rewards Program," which offered customers who purchased gasoline at Sunoco locations using a Citibank-issued credit card a five-cent per gallon discount either at the pump or on their monthly billing statements. White alleged he did not receive a five-cent per gallon discount on every purchase made with his Citibank-issued card.

White filed suit, individually and on behalf a putative class, against Sunoco alleging fraud. Sunoco filed a motion to compel arbitration based on the arbitration clause in the credit card agreement between White and Citibank. The District Court denied Sunoco's motion. Sunoco appealed.

HOLDING: Affirmed.

REASONING: Sunoco argued that equitable estoppel prevented White from refusing arbitration against it as a non-signatory. Under applicable law, equitable estoppel applies in two circumstances. First, if a plaintiff-signatory alleges concerted conduct on the part of both the non-signatory and another signatory, that plaintiff may be equitably estopped from avoiding arbitration with the non-signatory. Second, if a plaintiff-signatory asserts a claim against a defendant in reliance on the terms of an agreement, that plaintiff may be equitably estopped from avoiding arbitration on the basis that the defendant was not a signatory to that same agreement. The court reasoned that equitable estoppel did not apply to White because there was no alleged "concerted conduct" or misconduct on the part of Sonoco and Citibank. Further, the claims that White asserted against Sunoco did not rely on any terms in the card agreement. Therefore, neither of the equitable estoppel scenarios applied.

> **The claims that White asserted against Sunoco did not rely on any terms in the card agreement, therefore neither of the equitable estoppel scenarios applied.**

Sunoco also argued that its promotional materials and the Card Agreement should be read as constituting one "integrated whole" contract between White, Citibank, and Sunoco. The court disagreed, reasoning that Sunoco's own representations that the promotional materials neither constituted an offer nor conferred obligations or terms to "integrate" with the Card Agreement contradicted this position. Lastly, Sunoco argued the Card Agreement's arbitration clause compelled White to arbitrate claims against "connected" entities, of which Sunoco claimed to be one. The court rejected this argument by noting that while the Card Agreement encompassed claims "made by or against anyone connected with [Citibank] or [White] or claiming though [Citibank] or [White]," Sunoco confused the nature of the claims covered with the question of who can compel arbitration.

AMAZON'S ARBITRATION CLAUSE IN ITS CONDITIONS OF USE IS ENFORCEABLE

Wiseley v. Amazon.com, Inc., ___ F.3d ___ (9th Cir. 2017).
http://law.justia.com/cases/federal/appellate-courts/ca9/15-56799/15-56799-2017-09-19.html

FACTS: Plaintiff-Appellant, Allen Wiseley, became involved in a dispute with Defendant-Appellee, Amazon.com, Inc., an online retailer, over advertising practices.

Wiseley filed a class action suit against Amazon in California state court that was removed to the U.S. District Court for the Southern District of California. The district court granted Amazon's motion to compel arbitration and dismiss under the arbitration clause in its Conditions of Use ("COU"). Wiseley appealed.

HOLDING: Affirmed.

REASONING: Wiseley argued that the arbitration clause found in the COU was procedurally unconscionable given its adhesive nature and incorporation of the American Arbitration Association (AAA) rules. In the alternative, Wiseley argued the arbitration clause was substantively unconscionable because: (1) the unilateral modification provision was unconscionable; (2) the clause's exemption of intellectual property claims for injunctive relief made the provision overly harsh and one sided; and (3) the attorneys' fees provision created substantive unconscionability.

The court found that Amazon's arbitration clause was neither procedurally nor substantively unconscionable and, therefore, was enforceable.

The court found that Amazon's arbitration clause was neither procedurally nor substantively unconscionable and, therefore, was enforceable. Adhesion was insufficient to support a finding of procedural unconscionability. Further, alerts on Amazon's account registration and checkout pages featured sufficient notice that clicking the corresponding button constituted agreement to the linked COU. Wiseley was provided with a "reasonable opportunity to understand" he would be bound by additional terms. The arbitration clause was one such term and appeared in the same size font as the rest of the COU with key terms bolded. Incorporation of the AAA rules was also acceptable because Wiseley had reasonable opportunity to understand the rules before accepting the terms.

Wiseley's arguments in favor of substantive unconscionability also failed because Amazon was limited under the unilateral modification by the implied covenant of good faith and fair dealing. In addition, the intellectual property exemption was acceptable because a provision that gives only one party the option of requiring arbitration was not substantively unconscionable. Lastly, the court held provisions related to attorneys' fees were also not unconscionable because they mirrored Washington State's statutory language for providing attorneys' fees for frivolous claims.

ONE-SIDED ARBITRATION AGREEMENT UNCONSCIONABLE AND UNENFORCEABLE

Baxter v. Genworth N. Am. Corp. 224 Cal.Rptr.3d 556 (2017).
https://law.justia.com/cases/california/court-of-appeal/2017/a144744.html

FACTS: Plaintiff Maya Baxter transitioned from being an employee of AssetMark Investment Services, Inc. to an employee of defendant Genworth North America Corp. after Genworth acquired AssetMark. As a condition of her continued employment, Genworth required Baxter to sign an agreement to arbitrate employment disputes according to its alternative dispute resolution program known as "Resolve." After her promotion to a supervisory role, Baxter expressed concern regarding Genworth's employee evaluation protocol that included race, age, and gender coding. As a result, Baxter claimed she was subject to harassment and retaliation. During Baxter's medical leave of absence granted under the California Family Rights Act ("CFRA"), Genworth eliminated Baxter's position. Baxter filed suit against Genworth and AssetMark asserting wrongful termination, associational and racial discrimination in violation of FEHA, and retaliation in violation of the CFRA, the Fair Employment and Housing Act ("FEHA"), and Labor Code section 1102.5. Genworth filed a motion to compel arbitration pursuant to Resolve. AssetMark joined in Genworth's motion.

The trial court denied Genworth's motion and concluded that the arbitration agreement was procedurally and substantively unconscionable rendering it unenforceable. Genworth appealed.

HOLDING: Affirmed.

REASONING: Genworth argued that the trial court erred in finding the agreement procedurally unconscionable. Procedural unconscionability focuses on "oppression" arising from unequal bargaining power and resulting in a lack of both negotiation and meaningful choice. The court found Baxter had no opportunity to negotiate the agreement and, in the interest of maintaining her employment, lacked any meaningful choice but to accept. The court concluded that the facts indicated unequal bargaining power and a "high degree of oppressiveness," thus supporting a finding of procedural unconscionability.

Genworth also argued the trial court erred in finding several provisions substantively unconscionable. The court explained that substantive unconscionability focuses on overly harsh or unfairly one-sided results unreasonably favorable to the imposing party. Courts may refuse to enforce an arbitration agreement if it is both procedurally and substantively unconscionable. Genworth contended Resolve's prohibition of employees' communication with co-workers simply limited access to Genworth's proprietary information outside of formal discovery. The court disagreed and noted the prohibition did not apply to Genworth and is thus unfairly one-sided.

Genworth further argued that Resolve permitted arbitrators to allow additional discovery and thus its default limits were not unconscionable. The court again disagreed and inferred that a reasonable arbitrator would be constrained under Resolve to sufficiently expand discovery to avoid frustrating statutory rights to prove claims. Genworth then asserted that

Resolve did not shorten the statute of limitations that would apply to file a court action. Because a party would have up to three years to file a FEHA action, the court found a one-year limitation under Resolve insufficient to protect employees' statutory rights.

Genworth next argued that Resolve did not preclude pursuing administrative remedies, however the court inferred Resolve may preclude employees' rights to an administrative investigation before a FEHA claim must be arbitrated. Finally, Genworth argued the trial court erred in refusing to sever offending provisions. The court construed the provisions as signifying a "systematic effort to impose arbitration" favorable to the employer and asserted that no single provision could be severed to remove the "unconscionable taint from the agreement."

MISCELLANEOUS

SECOND CIRCUIT AFFIRMS DISMISSAL BASED ON *SPOKEO*

Katz v. Donna Karan Co. Store, L.L.C., 872 F.3d 114 (2d Cir. 2017).
http://caselaw.findlaw.com/us-2nd-circuit/1874398.html

FACTS: Plaintiff-Appellant, Yehuda Katz, was a private citizen who made two separate purchases from Defendant-Appellee, Donna Karan Co. Store, L.L.C., at locations in New York and New Jersey. Katz claimed that both locations operated by Defendant provided him a sales receipt that printed the first six digits of his credit card number.

Katz filed suit, alleging that by publishing the first six digits of his card number, Defendant had violated §1681c(g)(1) of the FACTA, which prohibited the printing of more than the last five digits of the card number. The district court dismissed Katz's complaint on the basis that the complaint lacked well-pleaded facts, and Katz appealed. The circuit court vacated and remanded the case to allow him an opportunity to replead his claim in light of the Supreme Court of the United States recent decision in *Spokeo Inc. v. Robins*, 136 S. Ct 1540 (2016). On remand, the district court granted Defendant's motion to dismiss for lack of subject matter jurisdiction, finding that Katz did not plead a concrete injury-in-fact sufficient to establish Article III standing.

HOLDING: Affirmed.

REASONING: Katz argued Defendant's printing of the first six digits of his credit card number violated FCTA requirements, which created a heightened vulnerability of Katz's information. The court applied a two-part test to evaluate the concrete harm requisite for standing to sue under a bare procedural violation, where: (1) a plaintiff must demonstrate that Congress conferred the procedural right to protect a plaintiff's concrete interests as to the harm in question; and (2) that the procedural violation presents a risk of real harm to that concrete interest. First, the court reviewed the district court's analysis of the scope and purpose of the "procedural right" provided by FACTA, and agreed that §1681c(g)(1) was enacted to protect customers by preventing disclosure of identifying information about the cardholder.

Second, in light of Defendant's fact-based Rule 12(b)(1) motion, the burden shifted to Katz to prove an increased risk of harm from identity theft. The district court was not clearly erroneous in its factual findings that the first six numbers of a credit card only identify the institution issuing the card, and not the cardholder's information. The receipt did not increase the risk of real harm. Because Katz failed to establish a concrete injury sufficient to maintain Article III standing, his suit was properly dismissed.

COURT APPROVES A CY PRES ONLY SETTLEMENT

In re Google v. Holyoak, 869 F.3d 737 (9th Cir. 2017).
http://caselaw.findlaw.com/us-9th-circuit/1871595.html

FACTS: Plaintiffs-Objectors were five members of a class of Google Search users ("Objectors") that used Google Search in the United States between October 25, 2006 and April 25, 2014. When users submit search terms to Google, it returns a list of relevant websites in a new webpage, the "search results page." When a user then visits a website via that search results page, that website is allegedly privy to the search terms the user submitted to Google because Google generates a unique "Uniform Resource Locator" ("URL") that includes the user's search terms. Every major desktop and mobile web browser by default reports the URL of the last webpage that the user viewed before clicking on the link to the current page as part of the "referrer header" information.

The *cy pres doctrine* permits a court to distribute unclaimed or non-distributable portions of a class action settlement fund to the "next best" class of beneficiaries for the indirect benefit of the class.

A class action suit was filed, alleging that Google violated users' privacy by disclosing their Internet search terms to owners of third-party websites. Following mediation, the parties reached a settlement providing that Google would pay $8.5 million. After attorney's fees, administrative costs, and incentive payments to the named plaintiffs, the remaining $5.3 million was allocated to six cy pres recipients provided they agreed "to devote the funds to promote public awareness and education, and/or to support research, development, and initiatives, related to protecting privacy on the internet." After a hearing, the district court certified the class for settlement purposes and preliminarily approved the settlement. Objectors filed objections. Following a final settlement approval hearing, the district court granted final approval of the settlement. Objectors appealed.

HOLDING: Affirmed.

REASONING: Objectors argued that the cy pres only settlement should not have been approved because other mechanisms would permit a miniscule portion of the class to receive direct payments, such as a lottery system or by offering five to ten dollars per claimant on the assumption that few class members would make claims. The court rejected that argument by explaining that the *cy pres doctrine* permits a court to distribute unclaimed or non-distributable portions of a class action settlement fund to the "next best" class of beneficiaries for the indirect benefit of the class. The district court's finding that the settlement fund was non-distributable accorded with precedent that deemed direct monetary payments infeasible where each class member's individual recovery would be de minimis. The recovery here would be de minimis according to precedent because each of the 129 million class members would only be entitled to four cents in recovery.

Objectors also argued that the district court rubber-stamped the settlement and class members effectively had no right to complain about the parties' choice of compromise. The court rejected that argument by explaining that cy pres awards must meet a nexus requirement by being tethered to the objectives of the underlying statute and interests of the silent class members. The district court appropriately found that the cy pres distribution addressed the objectives of the Stored Communications Act and furthered the interests of the class members because the six cy pres recipients are "established organizations" that were selected because they are "independent," have a nationwide reach and "a record of promoting privacy protection on the Internet," and "are capable of using the funds to educate the class about online privacy risks." The cy pres recipients do not have to be the recipients that Objectors consider ideal.

FUNDRAISING COMPANY DID NOT VIOLATE THE TELEPHONE CONSUMER PROTECTION ACT WHEN CALLING A NUMBER ON THE NATIONAL DO NOT CALL REGISTRY TO PROMOTE A BREAST CANCER CHARITY

Spiegel v. Reynolds, ___ F.3d ___ (N.D. Ill. 2017).
https://www.leagle.com/decision/infdco20171011h88

FACTS: Plaintiff, Marshall Spiegel, received four calls from Defendant, Associated Community Services ("ACS"), seeking donations and/or the purchase of goods or services on behalf of the Breast Cancer Society ("Society"). Spiegel had been on the National Do Not Call Registry for eleven years at the time of the phone calls in question. Spiegel filed suit against the Reynoldses, who ran the charity, and ACS for violating the Telephone Consumer Protection Act's (TCPA) do-not-call provisions. Spiegel sought class certification for himself and similarly situated individuals. ACS filed a motion for summary judgment on the grounds that no material facts were genuinely disputed and that its calls to people on the do-not-call registry were made "on behalf of" a tax-exempt nonprofit organization, and thus not covered by the TCPA, and that its calls to people on the do-not-call registry were not "telephone solicitations" covered by the TCPA.

The District Court granted ACS's motion for summary judgment. Spiegel appealed.

HOLDING: Affirmed

REASONING: Spiegel claimed that ACS violated the TCPA by placing calls to phone lines listed on the do-not-call registry. The court rejected this claim as a matter of law because the calls were made "on behalf of" the Society, a tax exempt organization, and thus were not covered by the TCPA which prohibit telephone solicitations to numbers on the national do-not-call registry. The court opined that for purposes of the TCPA, a call is deemed to have been placed on behalf of a tax-exempt nonprofit organization when it was placed "for the benefit of or in the interest of the nonprofit." In this instance, ACS had the burden of showing that it made the solicitation calls on behalf of the Society, acting in the Society's interest and as its agent. The court ruled that ACS and the Society contract and interactions reflected a genuine agency relationship. The court emphasized that the contracts allowed the Society to exercise control over the manner of ACS's solicitations by giving the Society the right to review and veto the solicitation scripts and other materials used by ACS. The court held that with this evidence any reasonable jury must find that ACS made the call on behalf of the Society, as the Society's agent.

For purposes of the TCPA, a call is deemed to have been placed on behalf of a tax-exempt nonprofit organization when it was placed "for the benefit of or in the interest of the nonprofit".

The court also held that even if ACS had not been calling on behalf of a tax-exempt nonprofit, it would still be entitled to summary judgment because its calls were not "telephone solicitations" covered by the TCPA. According to the court, telephone solicitation is defined as "the initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services." The court agreed with ACS's contention that the definition does not include requests for money donations that do not encourage buying, renting, or investing. As such, the court held that as a matter of law the ACS calls were not TCPA covered telephone solicitations.

PLAINTIFF IN FEDERAL COURT WHO WAS PREVIOUSLY DECEIVED BY ALLEGEDLY FALSE OR MISLEADING ADVERTISING POSSESSES ARTICLE III STANDING

Davidson v. Kimberly-Clark Corp., 873 F.3d 1103 (9th Cir. 2017).
https://law.justia.com/cases/federal/appellate-courts/ca9/15-16173/15-16173-2017-10-20.html

FACTS: Appellant, Jennifer Davidson, purchased "flushable" wipes from Defendant-Appellees, Kimberly Clark Corp., Kimberly-Clark Worldwide, Inc., and Kimberly Clark Global Sales, LLC (collectively "Kimberly-Clark"). Kimberly-Clark advertised the wipes Davidson bought as "flushable." Davidson alleged that the flushable wipes Kimberly-Clark manufactured "are not in fact flushable." Davidson claimed she would not have bought the product had it not been for the false advertising. Davidson also alleged that she would still purchase flushable wipes made by Kimberly-Clark if she could be confident they were in fact flushable.

Davidson originally filed in state court. Kimberly-Clark removed to federal court under Class Action Fairness Act. The district court held that Davidson did not have Article III standing because Davidson was "unlikely to purchase Kimberly-Clark's flushable wipes in the future," failed to adequately allege why the representation "flushable" on the package was false, and failed to allege how she suffered harm due to her use of the wipes. Davidson appealed.

There is a split between courts in the Ninth Circuit about whether a previously deceived customer who brings a false advertising claim can allege that her inability to rely on the advertising in the future is an injury sufficient to grant her Article III standing in order to seek injunctive relief. Many courts have held that the previously deceived, but now enlightened, plaintiff simply does not have standing under Article III to ask a federal court for an injunction. Other courts have held the plaintiff does face an actual and imminent harm because the plaintiff will not be able to rely on the defendant's representations in the future, or because the plaintiff may purchase the mislabeled product in the future assuming the false misrepresentation had been corrected.

HOLDING: Reversed and remanded.

REASONING: Davidson argued that she established standing to seek injunctive relief because (1) she would be unable to rely on the label "flushable" when deciding in the future whether to purchase Kimberly-Clark wipes and (2) Kimberly-Clark's false advertising threatened to invade her statutory right to receive truthful information from Kimberly-Clark about the wipes. The court accepted this argument and held that Davidson properly alleged she faced a threat of actual harm by not being able to rely on future claims by Kimberly-Clark and this harm was sufficient to have standing to seek an injunctive relief.

Article III of the United States Constitution has three irreducible constitutional minima for standing: injury-in-fact, causation, and redressability. In order to prove standing, the plaintiff bears the burden to prove that her injury-in-fact is concrete, particularized, actual or imminent, fairly traceable to the challengeable action, and redressable by a favorable ruling. Davidson's claims that she would have had no way of determining whether the representations were in fact true constituted a threatened actual or imminent injury, thereby establishing Article III standing to assert a claim for injunctive relief.

AN UNACCEPTED OFFER CANNOT MOOT A CASE

Conrad v. Boiron, Inc., 869 F.3d 536 (7th Cir. 2017). https://law.justia.com/cases/federal/appellate-courts/ca7/16-3656/16-3656-2017-08-24.html

FACTS: Appellant, Chad Conrad, was among the class members that were not satisfied with the settlement agreement of a class action filed against Appellee, Boiron, over deceptive marketing of their homeopathic flu products. In the agreement, Boiron was to (1) pay refunds to past buyers, (2) revise its labels to make them accurate, and (3) let future customers request refunds within 30 days of purchase. Conrad filed a new class action suit against Boiron for deceptive marketing of their homeopathic flu products under the Illinois Consumer Fraud and Deceptive Business Practices Act ("ICFA"). Boiron offered to settle Conrad's claim, however, he refused to accept the settlement. The district court granted Boiron's motion to dismiss and the deposit of a settlement amount above the maximum Conrad could recover to moot his claim. The district court refused to certify Conrad's proposed class and found his individual claim moot. Conrad appealed.

HOLDING: Affirmed in part and remanded.

REASONING: Conrad argued the district court's refusal to certify the class, as well as its holding that a settlement payment that would fully satisfy his claim under the ICFA, did not render his case moot. The court of appeals identified the reasons why the district court did not err in refusing to certify Conrad's proposed class action and explained why an unaccepted offer cannot moot a case.

First, the court considered whether the potential named representative would act in the best interests of the unnamed class members. Other factors the court considered included the combination of low-value claims and small class size would leave the class members with a negligible award. The court held these factors were both proper and necessary for its determination of the potential named representative would act in the best interest of the class. The court reasoned the remedies that were in place for the disappointed Boiron customers undermined Conrad's ability to demonstrate that he could bring additional value to the absentee class members. The appellate court held the district court did not abuse its discretion in refusing to certify Conrad's proposed class action because his suit would provide little benefit beyond Boiron's existing guarantee.

Second, the appellate court addressed whether a defendant's monetary deposit with the court, given that it would fully satisfy a plaintiff's claim, rendered the plaintiff's case moot. The court relied on the Supreme Court opinion of *Campbell-Ewald Co. v. Gomez,* 577 U.S. ___ (2016). The Court stated, "an unaccepted settlement offer or offer of judgment does not moot a plaintiff's case." A manufacturer's payment into the court's registry of an amount that fully satisfied a consumer's claim did not render his case moot. The appellate court explained negative-value cases may be rational if the party hoped to establish an important principle through the case. The court further stated Conrad did not have standing to request injunctive relief under the ICFA because he knew, among other things, about Boiron's refund program. Therefore, the court held Conrad's claim was an individual claim for money.

TOLLING OF STATUTE OF LIMITATIONS STOPS IMMEDIATELY WHEN A CLASS-ACTION SUIT IS DISMISSED-WITH OR WITHOUT PREJUDICE-BEFORE THE CLASS IS CERTIFIED

Collins v. Village of Palatine, 875 F.3d 839 (7th Cir. 2017). https://law.justia.com/cases/federal/appellate-courts/ca7/16-3395/16-3395-2017-11-16.html

FACTS: Plaintiff-Appellant, Michael Collins, was issued a parking ticket by Defendant-Appellee, Village of Palatine. The ticket was placed under his car's windshield wiper blades and displayed his personal information. Collins filed suit against Palatine on behalf of himself and a proposed class, asserting that the display of his personal information violated the Driver's Privacy Protection Act ("DPPA").

The suit was filed nearly nine years after the event in question, well outside the DPPA's four year statute of limitations. However, the determination on whether Collins' claim was timely filed was complicated by an earlier filing of nearly identical claims against Palatine by a third party, Jason Senne. Senne's claim was ultimately defeated via summary judgment, prior to class certification, and through the appeals process that decision was affirmed. The Supreme Court denied certiorari and Senne's attorney filed an immediate successor class action to preserve class claims and filed this subsequent suit naming Collins as class representative.

Palatine moved to dismiss on the grounds that the claims were time barred because the statute of limitations resumed when the district court dismissed Senne's lawsuit. Collins responded that the dismissal was inappropriate because the limitations period was tolled until the Supreme Court denied Senne's petition for certiorari and therefore his suit was timely filed and the class should be certified. The district court rejected Collins' assertions and denied the motion for class certification. Collins appealed.

HOLDING: Affirmed.

REASONING: The court discussed precedent that established that when tolling occurs to preserve the claims of putative class members, that tolling continues only so long as the putative class action is alive. Further, that once certification of the class is denied, the limitations clock immediately starts ticking again, as it does at other procedural intervals. The court explained that these intervals include when a class member opts out of a certified class, when the class component of a suit is voluntarily dismissed, or when the court dismisses an uncertified class action suit for lack of subject matter jurisdiction. In other words, the court reasoned, the statute of limitations resumes for putative class members of an uncertified class when the suit is dismissed without prejudice or when class certification is denied.

The court discussed precedent that established that when tolling occurs to preserve the claims of putative class members, that tolling continues only so long as the putative class action is alive.

The court expressed that in the current case the question of class certification was never addressed because the district court initially dismissed the case with prejudice and later entered summary judgment. The court explained that it does not matter for tolling purposes whether a suit is dismissed with prejudice or not and that plaintiff was not entitled to take advantage of tolling beyond the date when the district court dismissed. At that point, the court said, the parties are on notice that they must take steps to protect their rights or suffer the consequences.

Additionally, the court looked at concerns for judicial efficiency and stated that continuing to toll the limitations period beyond the dismissal of a noncertified class claim would encroach more severely on the interests underlying statutes of limitations, the purpose of which is to protect defendants against stale or unduly delayed claims.

Therefore, the court held that the statute of limitations was tolled when Senne filed suit on behalf of a proposed class and it began to run again when the district court dismissed that case, which resulted in the statute of limitations expiring long before Collins filed the current case.

CLASS ACTION THAT AWARDED ONLY FEES TO COUNSEL IS DISMISSED

Buren v. Doctor's Associates Inc. ___ F.3d ___ (7th Cir. 2017). https://law.justia.com/cases/federal/appellate-courts/ca7/16-1652/16-1652-2017-08-25.html

FACTS: An Australian teenager measured his Subway Footlong sandwich and discovered that it was only eleven inches long. The teenager disclosed his findings on the Internet and brought it to the attention of plaintiffs lawyers across the United States, who then sued Defendant, Doctor's Associates Inc. ("Subway"), under state consumer-protection laws and sought class certifications under FRCP 23. However, it was determined that no compensable injury existed. Therefore, the attorneys sought injunctive relief. The parties settled and the trial court preliminarily approved the settlement.

Theodore Frank, and other class members, objected and alleged that the settlement only enriched the lawyers and class representatives, but not the class members themselves. The trial court disagreed. The judge certified the class, and approved the settlement, including the class counsel's request for $520,000. Frank appealed.

HOLDING: Reversed and remanded.

REASONING: The class counsel and Subway both argued that the settlement provided meaningful benefits to the class because Subway had bound itself to a set of procedures designed to achieve better bread-length uniformity. The court rejected this argument and stated that after the settlement there was still the same chance that Subway would sell a class member a sandwich that was shorter than advertised. Thus, the court determined, the injunctive relief approved by the district judge was utterly worthless.

The court explained that in a decision to certify a class and approve a settlement, the district judge has discretion concerning certification. In utilizing this discretion, the judge must give the requirements for the class undiluted, even heightened, attention.

Further, the court clarified that Rule 23(a) requires that the class representatives fairly and adequately protect the interests of the class, and a class settlement may not be approved unless it is fair, reasonable, and adequate. Therefore, with these principles in mind, objectors to the settlement play an essential role in the judicial review of proposed settlements of class actions.

The court then discussed that if a class action settlement does not provide effective relief to the class and its main purpose is to pay the class lawyers and representatives enough to "go away" then the settlement must fail, as it has not fit its duty and purpose under Rule 23(a). In such instances, the court reasoned, the district court should refuse to certify or decertify the class if it has meaningless relief to the putative class.

Therefore, the court held that because the settlement yielded fees for class counsel and zero benefits for the class, the class should not have been certified and the settlement should not have been approved.

RECEIVING AN UNWANTED FAX IS ENOUGH TO HAVE STANDING UNDER THE U.S. SUPREME COURT'S SPOKEO RULING

America's Health & Res. Ctr., Ltd. v. Promologics, Inc., ___ F.3d ___ (N.D. Ill. 2017).
https://www.leagle.com/decision/infdco20171103h54

FACTS: Health-Scripts and Jansen Pharmaceuticals sent America's Health & Resource Center ("AHRC") and Affiliated Health Group, Ltd. a three-page fax RVSP form addressed to nurse practitioners and physicians assistants. The fax invited them to a free promotional educational activity; a dinner program on treatment options for adult patients with Type 2 diabetes mellitus. The fax identified Jansen as the sponsor. The RSVP form provided that by submitting the form, registrants understood that they would be giving Health-Scripts permission to use their personal information in order to provide them with information and offers from healthcare companies. AHRC and Affiliated brought a class action lawsuit under the Telephone Consumer Protection Act ("TCPA") against Health-Scripts and Jansen, alleging that the form Health-Scripts faxed lacked TCPA-required opt out notices. Health-Scripts and Jansen filed motions to dismiss.
HOLDING: Granted in part and denied in part.
REASONING: AHRC and Affiliated argued that because the TCPA prohibited faxing unsolicited advertisements, the fax sent by Health-Scripts constituted an unsolicited advertisement because the fax was a pretext for promotion of Jansen's medications at the seminar where they planned to gather and sell seminar registrant's data.

The court identified three reasons why AHRC's and Affiliated claim fell within the TCPA. First, AHRC and Affiliated gave Health-Scripts and Jansen fair notice of their TCPA claim by pleading the date on which they received the fax sent by Health-Scripts and attaching it to the complaint.

Second, courts within the Northern District of Illinois have recognized that faxes promoting a free seminar may constitute an unsolicited advertisement because free seminars are often a pretext to market products or services.

Third, AHRC and Affiliated had Article III standing because they asserted an injury in fact and post-Spokeo courts in the Northern District of Illinois circuit have repeatedly held that mere receipt of a fax alleged to lack TCPA opt-out notices constituted sufficient harm for purpose of Article III standing. The court reasoned that a plaintiff alleging a violation under the TCPA need not allege any additional harm beyond the one Congress has identified.

STREAM OF COMMERCE DOCTRINE ALLOWS A FORUM STATE TO ASSERT JURISDICTION WHERE A DEFENDANT PLACED GOODS INTO THE STREAM OF COMMERCE WITH THE EXPECTATION THAT THE GOODS WILL BE PURCHASED IN THE FORUM STATE

Align Corp. v. Boustred, ___ P.3d ___ (Colo. 2017).
https://scholar.google.com/scholar_case?case=15245483901763636106&q=Align+Corporation,+Ltd.+v.+Boustred&hl=en&as_sdt=6,44&as_vis=1

FACTS: Allister Mark Boustred, a Colorado resident, purchased a replacement main rotor holder manufactured by Align Corporation Limited, a Taiwanese corporation, and distributed by Horizon Hobby, Inc., a Delaware-based corporation, for his radio-controlled helicopter from a retailer in Fort Collins, Colorado. Align had no physical presence in the United States, but it contracted with United States-based distributors to sell its products to retailers who sell them to consumers. Boustred installed the main rotor holder to his helicopter and was injured in Colorado when the blades held by the main rotor holder released and struck him in the eye. Boustred filed claims for strict liability and negligence against both Align and Horizon in Colorado.

Align filed a motion to dismiss for lack of personal jurisdiction. The district court denied the motion. A division of the court of appeals affirmed the district court's ruling. Align appealed.
HOLDING: Affirmed.
REASONING: Align argued that selling its products through a distributor turned the distribution and sale of its products into the unilateral activity of a third party that cannot be properly considered in the minimum contacts analysis. The court rejected that argument, finding that *World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286 (1980), and its stream of commerce doctrine, was the controlling precedent in determining whether a non-resident defendant has sufficient minimum contacts with Colorado for a court to assert specific personal jurisdiction therein. This doctrine established that a forum state may assert personal jurisdiction where a plaintiff shows that a defendant placed goods into the stream of commerce with the expectation that the goods will be purchased in the forum state.

Applying the doctrine to the instant case, the court then concluded that Boustred made a sufficient prima facie showing of personal jurisdiction under the doctrine to defeat Align's motion to dismiss. The court reasoned that the documentary evidence reasonably supported an inference that the presence of the allegedly defective main rotor holder in Colorado was placed into the stream of commerce with the expectation that the products will be purchased in Colorado. Specifically, Align placed its products into the stream of commerce by using four distributors in the United States that sold its products across the United States, including Colorado. Additionally, Align placed no limitation on where Horizon could distribute. Over $350,000 worth of Align products were sold in Colorado. Given this, Align should have reasonably anticipated being summoned to a Colorado court. Because Boustred's injuries arose out of Align's contacts with Colorado, Boustred established a prima facie showing of specific jurisdiction over Align.

THE LAST WORD

This issue contains all the usual articles and updates, but perhaps the most significant development in the world of consumer law during the past few months was the resignation of Richard Cordray, Director of the Consumer Financial Protection Bureau. (*See* pages 84 to 85)

Shortly before his resignation became effective, however, Director Cordray appointed Leandra English as Deputy Director, pursuant to the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Dodd Frank, which created the agency, also provides the deputy director becomes acting director when the agency's top spot is vacant. At almost the same time Cordray appointed English, President Trump named Mick Mulvaney, his director of the Office of Management and Budget, to head of the agency. These dual appointments led to a showdown over who would take charge of the CFPB.

English filed a lawsuit requesting a temporary injunction but the judge ruled that he would not issue an emergency order, blocking Trump from installing Mulvaney. Attorneys for English have filed fresh paperwork challenging President Trump and his pick to lead the consumer watchdog. In the meantime, while litigation continues, Mulvaney heads the Bureau. Stayed tuned for the next episode of this continuing drama.

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