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TEACHING CONSUMER LAW

TEXAS INSURANCE LAW 2014

Virtual Currencies & Federal Law

Subprime Auto Loans

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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

TEACHING CONSUMER LAW

By Alvin C. Harrell*

I. Introduction

On May 30 – 31, 2014 the Center for Consumer Law of the University of Houston Law Center presented "Teaching Consumer Law in a Virtual World" (the Conference), the seventh biannual presentation of a unique conference devoted to issues in teaching consumer protection law.[1] The Conference Co-Chairs were: Richard M. Alderman, Interim Dean, Dwight Olds Chair in Law and Director of the Center for Consumer Law at the University of Houston Law Center; and Nathalie Martin, the Frederick M. Hart Chair in Consumer and Clinical Law at the University of New Mexico School of Law. The 2014 Conference was held at the Hilton Santa Fe Historic Plaza Hotel in Santa Fe, New Mexico. During the Conference, Dean Alderman announced that the 2016 Conference will also be held in Santa Fe.

The Conference is designed primarily for doctrinal and clinical professors, adjunct faculty and others interested in teaching consumer protection law, though there is also a heavy dose of material for practitioners (largely from a plaintiff's perspective). The 2014 Conference was held in cooperation with the University of New Mexico and the National Association of Consumer Advocates (NACA), the latter being an organization devoted to protecting consumers from unfair and deceptive practices. It comes as no surprise that the focus of the Conference is on avenues (including litigation and regulation) for helping consumers obtain legal redress against merchants and creditors.

Richard Alderman introduced the 2014 Conference and Co-Chair Nathalie Martin. He announced his retirement as University of Houston Law Center Interim Dean but noted that he will continue as Director of the Center for Consumer Law and a Chair of the Conference. The Conference will continue to be held biannually with Santa Fe as the regular venue.

This article reports on the presentations at the 2014 Conference. As such, the focus is to describe the comments of other speakers (always a risky endeavor); an effort has made to separate instances where your author's views are expressed. Your author thanks the other speakers for their assistance in preparing this article but, as always, your author is responsible for any errors and interested parties should not attribute specific comments or views to a speaker without further, direct confirmation.

II. Increasing the Prominence of Consumer Law and Influencing Policy

A. Dee Pridgen

Dee Pridgen, the Carl M. Williams Professor of Law and Social Responsibility at the University of Wyoming College of Law, made the first presentation, as part of a panel entitled "Increasing the Prominence of Consumer Law and Influencing Policy," recounting her choice of a law career as a means to influence and improve society. She reported that she was attracted to academia as a means to promote social justice through teaching and scholarship. She stressed that the latter need not be dry and uninteresting (your author tried not to take offense at that remark). She cited as examples Elizabeth Warren's *Making Credit Safer,*[2] and articles by Kathleen Engel and Patricia McCoy,[3] noting that these articles contributed to development of the Dodd-Frank Act.[4] She also cited: *Seduction by Plastic,*[5] which contributed to the Credit Card Act; and Chris Peterson's *Payday Lending in Military Towns,*[6] which influenced amendments to the Military Loan Act.

Professor Pridgen's current project is to analyze studies by "conservative" law professors attacking state consumer protection laws (UDAP laws) and alleging that the resulting lawsuits are too costly and unpredictable. She said that these studies promote alternative model acts sponsored by the American Legislative Exchange Council (ALEC). She argued that these model laws seek to eliminate private rights of action.[7]

Professor Pridgen argued that the ALEC proposals would have the effect of eliminating private rights of action by: reimposing a justifiable reliance requirement for misrepresentation claims; eliminating statutory damages, thus limiting damages to out-of-pocket losses; eliminating consumer attorney fees unless the defendant had a willful intent to deceive; requiring a showing of ascertainable loss; constraining class actions; and imposing a one year statute of limitations, or a limit of four years after the "first instance." She posited that Consumer Law teachers and scholars can make a difference by writing and publishing on these issues.

B. Prentiss Cox

Prentiss Cox is an Associate Professor of Law at the University of Minnesota School of Law, and previously served as Assistant Attorney General and Manager of the Consumer Enforcement Division of the Minnesota Attorney General's Office. He posited that, to increase the influence of the academy, law schools should increase the racial diversity of the teachers of Consumer Law. In addition, he emphasized three points. First, he noted that there are multiple ways teachers and scholars can influence public policy, *e.g.,* by:

- using scholarship to shift public perceptions and discussion;
- identifying unfair and deceptive acts and practices (UDAP) (as in Dee Pridgen's article[8]);
- projecting issues through the media;
- supporting law reforms (drafting, testifying, etc.); and
- litigating cases or assisting litigators.

Second, he noted that consumer law offers opportunities to engage directly in policymaking, because:

- consumer law matters to consumers, policymakers and society;
- the Bureau of Consumer Financial Protection (CFPB) is a relatively new regulatory agency devoted to expanding consumer protection regulation, and this offers new policy-making opportunities;
- there is an imbalance of resources, and the CFPB can help counterbalance this;
- consumer advocacy centers offer other avenues to participate; and
- the polarization of views on consumer law issues creates opportunities for specialists to mediate between opposing views.

Third, to increase the prominence of the Consumer Law course, Professor Cox suggested increasing the importance of public service in academia as compared to teaching and publica-

tion. Such service could include: engaging in litigation; testifying; and drafting legislation or regulations. This improves scholarship and increases the importance of the academy, bringing together scholars and practitioners. He said that the Consumer Law course should not mimic other parts of the academy, but instead should seek to create its own unique role by combining service and scholarship.

C. Peter Holland

Peter Holland is a Clinical Instructor in the Consumer Protection Clinic at the University of Maryland Law School. He cited Dee Pridgen's *Wrecking Ball* article[9] as a counterpoint to the ALEC proposal.[10] He also opined that an imbalance of resources can be addressed by dealing with the media. For example, he described a call he received from the *American Banker* about debt collection, explaining how he established a rapport with the reporter by helping the reporter cover his assigned topic. Professor Holland suggested that academics make an effort to establish relationships through the media office of the university -- to funnel ideas to the media through this office. He pointed out that the media is a free, powerful resource, and suggested that academics cultivate relationships with reporters. In this regard, he offered the following practical "rules":

Rule 1: Ask the reporter: Who are you, what is your subject and deadline. Ask for submission of the reporter's questions in advance by e-mail. Respond by e-mail.

Rule 2: Do not respond spontaneously (your author has found this to be excellent advice).

Rule 3: Clarify and specify what is on or off the record. Agree on this before discussing any issue. Define what the terminology means. Ask for your quotes to be submitted in advance for your approval before publication. Otherwise, assume that everything is on the record. Specify that off-the-record material can be used for background but not quotation or attribution.

Richard Alderman added a suggestion from the floor: Be available to the media. He said they will continue to use you as a resource if you help and respond to their deadlines. Reporters need more stories and more help, and more quickly than in past. But, he said, think before you speak. He noted that the American Association of University Professors (AAUP) offers inexpensive malpractice insurance for academics, to protect against defamation suits.

D. Jeff Sovern

Jeff Sovern is a Professor of Law at St. John's University in New York City. He covered three basic topics: First, writing op-eds; second, how many schools teach Consumer Law?; and third, the role of "elite" law reviews.

First, as to op-eds (*e.g.*, newspaper editorials), he suggested: Turn your law review article into an op-ed. More people read op-eds, and law review editors like the prior (or subsequent) media attention.

He then addressed how to write an op-ed, *e.g.*, *To Catch a Creditor*:[11] Start with a human-interest story (*e.g.,* from news reports or hearing testimony). The downside to this approach is that it may seem to be an isolated event; however, the author can use statistics or other news articles to make the case that it is a widespread problem. Then ask: Why did this happen? To answer this question, it may be helpful to identify problems in the marketplace or with existing law. Acknowledge the counter-arguments and explain why they are wrong. Then propose a solution (*e.g.*, via the courts, CFPB, Federal Trade Commission (FTC), Congress). Then reach a conclusion: Refer back to the story at the beginning, to tie it all together. All in 750 words or less. Submit the op-ed to one place at a time.

Some op-eds hang on a "news-hook" while others are "evergreen" articles. A news-hook article responds to a recent news event. The risk is that it may get stale. Evergreen pieces do not depend on specific news, but relate to continuing problems. These have less risk of staleness; and if rejected, they can always be sent to a blog. But many editors prefer op-eds that connect to a recent event in the news.

Second, Professor Sovern addressed the role of the Consumer Law course in law schools. He reported that fifty-five law schools offer a course on Consumer Law, while 119 (roughly sixty percent) do not. Elite schools are no more likely to teach consumer law than non-elite schools, and (as regards his third point) elite law reviews reflect this, despite the prominence of consumer law in the news (*e.g.,* the DoddFrank Act and CFPB, etc.). Professor Sovern compared the number of articles on consumer law published in recent years in the *Harvard Law Review* –where consumer law is taught, and the *Stanford Law Review* – where it is not taught, and reported that Harvard's law review published considerably more about consumer law than Stanford's. Professor Sovern noted that one lesson from this is that Consumer Law faculty may have difficulty securing placements in elite law reviews.

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David Landers opined from the audience that one solution is for the school to develop adjuncts to teach Consumer Law, since full time faculty may not want to do so (or may view it as an inopportune career path). This allows an emphasis on the importance of consumer remedies, but at the cost of reduced scholarship.

III. Debt Collection Update

Dick Rubin is a nationally-known appellate law practitioner with a record of success in the United States courts of appeals. He discussed suing on time-barred debts,[12] and the "laundering" of bad debts.[13] He reported that a common defense argument is that the statute of limitations is an affirmative defense that must be proved; however, he said this defense has been rejected by courts under Fair Debt Collection Practices Act (FDCPA) section1692e(5) -- which makes it a violation to falsely threaten to sue.[14] He also cited the recent decision in the *McMahon* case,[15] holding that merely asking a consumer to pay a time-barred debt is a FDCPA violation, even if the debt collector does not threaten to sue, because an offer to settle could lead the consumer to think that litigation is threatened. The United States Court of Appeals for the Seventh Circuit said its decision conflicts with those in the Third and Eighth Circuits,[16] but Rubin argued that there is no conflict. He noted that the same issue is pending in the Sixth Circuit.[17] He noted that the split can be resolved by CFPB regulation, *e.g.*, by requiring notice to the debtor that the debt is timebarred and cannot be sued on.

Rubin also noted that the United States Courts of Appeals for the Second, Third and Seventh Circuits have split on what is needed for a consumer to "prevail" in order to recover attorney fees under the FDCPA. He said the normal rule is, if the plaintiff establishes liability, he or she gets attorney fees. The amount may depend on the degree of success. In *Johnson v. Eaton*,[18] however, the United States Court of Appeals for the Fifth Circuit disagreed, creating a circuit split. In *Marx v. General Revenue Corp.,*[19] the United States Supreme Court held that the plain language of the FDCPA, as codified at 15 U.S.C. section 1692k, requiring bad faith, is overcome by the general standard embodied in Rule 54; Rubin said the same result may attain to reject the *Johnson* rationale since the circuits that permit an award of fees and costs without any award of actual damages do so because of the general federal rule allowing an attorney fee award to the prevailing plaintiff once legal liability is established. He opined that the *Johnson v. Eaton* split may also go to the Supreme Court.

As regards the FDCPA disclosure requirement at 15 U.S.C. section 1692g (requiring at least thirty days notice), Rubin predicted that a CFPB rule will provide model language. For now, there is a split between the Third and other Circuits.[20] A question is whether following the plain language of the FDCPA is required. The Third Circuit said no; other Circuits have said yes.[21] He also noted that there is a three-way split as to whether collector-to-debtor's attorney communications are covered by the FDCPA.[22] Yet another question is whether a consumer can sue for FDCPA violations in bankruptcy.[23] Again, the courts are split.[24] Also unresolved is the issue of the least versus unsophisticated consumer.[25]

IV. What's New with the FTC?

Lesley Fair is a Senior Attorney with the Federal Trade Commission (FTC) Bureau of Consumer Protection. She began her presentation by noting that 2014 is the 100th anniversary of the FTC. She addressed four illustrative areas of major interest to the FTC:

- financial services for low income consumers;
- deceptive health and safety claims;
- privacy rights; and
- new technology.

Fair cited several examples of evolving financial "scams," *e.g.*, text messages sent to collect debts. Another example is the case where a debt collector faked a caller ID to impersonate Ed McMahan. In yet another case noted by Fair, a subprime auto creditor was sued by the FTC as both a creditor and debt collector. She also cited the issue of tribal payday loans, noting that a court rejected tribal protection for these loans in a recent CFPB case. She noted that these are challenging, resource-intense cases. Fair also reported that the FTC is stepping up its auto credit scrutiny, citing a case where the advertised car price was after a down payment of $5,000. She also described a new website: consumer.gov. It is designed to be easy to read and helpful to nonEnglish speakers. The FTC is also seeking coalitions and outreach with the legal services community.

Deceptive Health and Safety claims are another current focus. Companies are expected to have scientific bases for their claims. The FTC works with state attorneys general and private legislators in these cases. Visual representations must be accurate and substantiated. "Blurred lines" problems include advertisements that look like news items. Fair noted that this is not a new issue, it has been around since 1917. Consumers have a right to know if they are seeing an advertisement. Also, paid endorsements need to be disclosed as such, not presented as unbiased news reporting.

New technology is receiving increased attention. Some people may think this is only for the wealthy, but in fact the smartphone is a lifeline for the poor. This raises new consumer protection issues, *e.g.*, phony virus alerts impersonating a telephone servicer. Clicking in response triggers charges. Kids' apps allow minors to buy things without their parents' knowledge (*see, e.g.,* the Apple FTC settlement[26]). Smartphones are increasingly being used as payment devices, and this also raises new concerns.[27] A basic FTC position across these issues is: If effective disclosures cannot be given, don't do it -- the ad should not be run.

At the time of the Conference, the FTC report on Data Brokers was just out,[28] covering the "Internet of Things," *e.g.,* including cookies in computers of household appliances, which report data over the Internet to other computers. Ms. Fair also mentioned the *Aaron Rents* case:[29] This involved rent-to-own laptops that included software to identify the consumer's location and activate a web cam to film the consumers without their knowledge and without notice.

She suggested ways that academics and the FTC can work together, noting that the FTC welcomes scholarly publications. Academics also can: file public comments; attend FTC workshops; get free FTC consumer materials for consumers; subscribe to the FTC blog; and use FTC case studies.

V. Economic Justice and Consumer Law

A. David Lander

David Lander is a Partner in the St. Louis law firm of Greensfelder, Hemker, & Gale, and an Adjunct Professor at Saint Louis University School of Law. He noted the connections between consumer law and economic justice, and suggested the need for integration of the latter into the Consumer Law course. He teaches a course on the history of consumer credit and its influence on society, and a separate policy-oriented course on economic justice. He noted that there are four basic models for consumer protection: free markets; "soft" paternalism; "hard" paternalism; and prohibition. He said that issues of economic justice may influence which alternative is chosen.

Professor Lander emphasized the importance of looking at the supply as well as the demand for credit. He cited a casebook on economic justice,[30] which now includes materials on consumer law.

B. Kathleen Engel

Kathleen Engel has taught three courses at Suffolk University Law School in Boston: Credit and Catastrophe (focusing on the financial crisis); Comparative Financial Regulation (how the crisis played out in different countries); and Consumer Credit.[31] The goal in each is to teach the financial crisis by emphasizing the links between consumer protection and the financial system, taking into account consumer behavior, incentives and systemic effects. She noted that consumer law is not a sideshow, but rather a central issue in the economy.

Professor Engel organizes her Consumer Credit course topically. Examples of topics include mortgages, auto loans and credit cards, all of which are important in our understanding of finance and the economy. After introducing the students to each topic--usually with materials she has assembled, she asks: what rules exist and what rules are needed? These open-ended questions engage the students with the material, and make them think not just about what the law says, but also what protection they believe the law should provide. As part of the discussions, Prof. Engel directs exploration of the economic and social impacts of consumer credit products, *e.g.*, student loans.

The courses are not conducted as lectures or like a seminar. Professor Engel uses powerpoint presentations to introduce concepts and then asks questions to generate class discussion. The students do group work in class and also have assignments outside of class that involve applying concepts and evaluating the law. One of the students' favorite assignments involves going into the community to inquire about credit transactions. Students visit payday lenders, tax refund companies, banks to learn about bank-linked credit cards, and other providers of credit.[32] They have to write up their experiences and assess whether the credit providers violated any consumer laws.

Prof. Engel discussed the importance of students learning statutory analysis. In her experience, students come to the class with very little experience in taking deep dives into statutes. Because of this, she gives the students many opportunities to develop these skills.

Professor Engel cited challenges with her approach to teaching consumer credit, including the fact that payday and auto title lending are important in consumer law, but have nothing to do with the financial crisis. Another problem is that law students don't know how to study or prepare for the exam (it is more like a graduate school class).

For the exam, Professor Engel sometimes provides copies of real loan documents and a state law, and asks: Does this loan comply with the state law? She typically partners a question like this with a question that requires students to analyze the connections between certain credit products and the larger economy. The exam typically consists of ten true/false questions with explanations. The students receive points for: the correct answer; identifying the law; and analyzing it correctly (these are in addition to the two essay questions). The true/ false questions primarily focus on statutory analysis.

C. FollowUp Discussion

Professor Lander described a class he teaches on Federal Reserve Board surveys. It is a one-hour class and includes consumer sentiment surveys. He said that schools should not ignore the importance of the revolution in consumer finance.

Professor Engel noted that she brings in guest lecturers who cover consumer issues, *e.g.,* Assistant Attorneys General, legal services attorneys, and private practitioners. The students become very excited about practicing in the field, but she queried: how do we provide jobs for all of these graduates?

Professor Lander also described his consumer bankruptcy course, noting that it has changed to increase the emphasis on bankruptcy as a consumer protection tool (with reduced emphasis on issues such as preferential transfers).

VI. Virtual Currency Update

Julie Hill is an Associate Professor of Law at the University of Alabama. She described the increasing use of Bitcoins and other virtual currencies as a payment mechanism, noting that current laws are not drafted to deal with these issues.[33]

Professor Hill raised the initial question: What are virtual currencies? She noted that virtual currencies are electronic mediums of exchange, but are not legal tender. They arose from on-line computer games, used for keeping score with currencies initially not interchangeable into dollars. Some games then allowed the currencies to be bought and sold, for dollars. Crypto-currencies were the next stage, *e.g.*, Bitcoin, allowing an exchange between bitcoins and dollars, unrelated to a computer game. This allows the bitcoins to be used for payment in private transactions. Bitcoins were developed from a published paper using computer programs, with numerous variations.[34] Bitcoins in "circulation" now total over $5 billion.

Professor Hill raised the initial question: What are virtual currencies? She noted that virtual currencies are electronic mediums of exchange, but are not legal tender.

Professor Hill described how Bitcoins work. Bitcoin users see an app that allows their use as a payment mechanism. The program substitutes for a bank, in essence assuring that the same money is not spent twice. A central ledger assures security and anonymity. The program is the financial intermediary. Bitcoin "miners" create the entries that assure security, in return for receiving new bitcoins. There are development teams and Bitcoin exchanges that convert bitcoins into real currencies and vice versa.

Criminal law issues identified by Professor Hill include counterfeiting[35] and money laundering.[36] Concerns that virtual currencies will be treated as illegal counterfeits have receded, but the use of virtual currencies to facilitate other crimes is a concern. In this respect, Bank Secrecy Act (BSA) issues predominate. Money services businesses are subject to special rules. Is dealing in virtual currency a money services business (MSB)? The Department of Justice (DOJ) says the user is not a MSB, but that a Bitcoin exchange is a MSB, subject to the BSA.[37] The DOJ made this point clearly when it arrested and convicted Charlie Shrem (then vice president of the Bitcoin Foundation) for facilitating money laundering through a Bitcoin exchange.[38]

Tax law is also a major issue. Under tax law, bitcoins are now treated as property rather than currency.[39] Therefore, any appreciation in value is a capital gain when spent. Multiple and meticulous recordkeeping is required for numerous small transactions.

Professor Hill noted that Bitcoin issues do not fall easily within the existing bank regulatory systems. Federal Reserve Chariman Janet Yellen has noted that Bitcoin is "a payment innovation that is taking place entirely outside the banking industry."[40] Moreover, due to regulatory efforts aimed at third-party payment processors, banks may be hesitant to offer bank accounts to Bitcoin exchanges.[41]

Finally, securities and consumer protection laws do not squarely cover Bitcoin, or Bitcoin transactions.

At this point, using bitcoins is legally and economically risky; bitcoins can have a volatile value. One other thing is clear, however: The creator of Bitcoin is smart, publicity shy, and unknown.

VII. Consumer Credit Update - Ten Things We Need to Teach Our Students (About)

Your author presented a paper titled as above,[42] intended to highlight current issues that arguably deserve attention in a Consumer Law course. This, of course, suggests again a root problem for academics teaching Consumer Law, discussed through-out the Conference: What to include in the Consumer Law course, given a modern legal environment overflowing with legal issues and controversies? Your author's program materials and presentation offered one view selected from an avalanche of potential topics.

It can be noted that this also illustrates the crux of a modern controversy, or at least a dilemma: Is there too much law? Some lawyers (and academics) of course would like to have more law, and the more complex the better. Advocates of a regulatory approach always can find problems that need attention, creating a dynamic that favors increased regulation. This is not limited to the plaintiffs' side (although more and increasingly complex laws and regulations obviously offer greater potential for violations and litigation); some defense lawyers also associate legal complexity and increased regulation with their own interests and livelihood. We are all entitled to advocate policies that we favor, for whatever reason.

But this modern trend reinforces an age-old conundrum for Consumer Law academics, as probably all of us recognize the inability to cover everything in an adequate manner in a law school course (even if we could know and understand it all). Indeed, this has been a continuing theme since the beginning of the Teaching Consumer Law Conferences. Hence, the inevitable quandary: What to put in and what to leave out? This can be particularly difficult with regard to emerging and cutting edge issues, which may turn out to be "the next big thing" or, alternatively, much ado about nothing. To some extent all of the speakers at the Conference addressed this; your author's presentation merely added one more voice to the chorus.

Your author highlighted ten current issues that arguably deserve at least some attention in a Consumer Law course, while recognizing that others will disagree and/or have their own lists. And of course, some academic courses are directed at more narrow segments of the law that may exclude the broad reach of this list. Your author's list of issues and developments is essentially as follows:

- The demise of private subprime lending;[43]
- the impact of expanded regulation on the availability of consumer financial services;[44]
- developments affecting private student lending and for-profit schools;[45]
- federal regulation of debt collection;[46]
- regulation of the Internet;[47]
- the TILA/RESPA integrated disclosure rule;[48]
- increased consolidation in the financial services industry;[49]
- cybersecurity, privacy, identity theft, and electronic money;[50]
- CFPB initiatives regarding vehicle sales finance and fair lending;[51] and
- the limited but continuing vitality of contract law and party autonomy.[52]

While one would not expect much in the way of agreement on any of these issues, some of them were covered elsewhere in the Conference presentations and materials (suggesting some consensus, at least as to the relevance of those issues). Your author's perspective on these issues probably differs from that of many others, *e.g.,* with regard to the extent that laws and regulations are having dramatic effects on the structure of the consumer finance industry, consequently affecting the cost and availability of financial services. While your author believes that the full range of such matters deserves consideration in any public policy debate (and in the Consumer Law course), the focus of the presentation was merely an effort to identify broad areas of current or important legal developments.

VIII. View from the Trenches

A. Richard Feferman

Richard Feferman is a partner in the New Mexico law firm of Feferman & Warren, and the 2013 recipient of the National Consumer Law Center's Vern Countryman Consumer Law Award. He addressed the issue of access to the courts, opining that arbitration and classa ction waivers currently constitute the greatest threat to private consumer rights.

He also addressed the problems associated with sales of damaged used vehicles. He argued that it is common for damaged vehicles to be sold to consumers without disclosure of the damage, observing that private actions are needed as a remedy. He offered the following scenario: The salesman verbally denies that there is damage, or the vehicle sales contract discloses a "possible salvage title." A salvage title is not provided because the certificate of title has been "laundered," and the dealer denies any knowledge of this. But the consumer cannot trade-in the vehicle because it is later discovered that the car has been wrecked or suffered other damage.[53]

Feferman suggested that the consumer should sue the selling dealer for fraud and misrepresentation. Often there is physical evidence of the damage, but the dealer has withheld the documentation. The consumer's attorney should talk to the prior owner, who may report that the dealer gave him or her a reduced trade-in allowance due to the damage. Also, Feferman suggested that the consumer's attorney subpoena documents from CARFAX. If there is an arbitration clause, he suggested the use of arbitration to get the needed documentation. He said that seventy percent of these cases also involve the TILA. Nonetheless, it seems to your author that improved disclosure of "title brands," as provided in UCOTA, also would also help.

B. Cary Flitter

Cary Flitter practices consumer law in Pennsylvania and New Jersey, and serves as Adjunct Professor at Temple University Beasley School of Law in Philadelphia and Widener University School of Law in Delaware. His Consumer Law course covers only private remedies. Three primary examples: the FDCPA;[54] the Telephone Consumer Protection Act (TCPA);[55] and the Fair Credit Reporting Act (FCRA).[56] He noted that there are only a small number of consumer lawyers in each state, despite the high demand. Fees-hifting provisions, *e.g.,* in the FDCPA, TCPA and FCRA, help to solve the funding problem for consumer plaintiffs. He cited as a problem the scenario of a collection agency masquerading as a law firm. He noted that the consumer may need a remedy outside the FDCPA, and suggested the possibility of restitution based on an unjust enrichment argument. He said a case is pending on this issue.

He also mentioned another case of interest: a FDCPA/privacy case where his firm challenged the standard practice of displaying the consumer's account number above the consumer's name and address on routine debt collection correspondence. Flitter noted that most prior litigation under 15 U.S.C. section 1692f(8) had been dismissed due to bad facts, and initially his case suffered the same fate. However, subsequent to the Conference the United States Court of Appeals for the Third Circuit reversed, holding that the account number practice implicates consumer privacy, a core issue under the FDCPA.[57]

C. Ira Rheingold

Ira Rheingold is Executive Director of the National Association of Consumer Advocates (NACA), a cosponsor of the Conference. He began by saying it was a pleasure to be in a room with academics who use reason, as compared to the political rhetoric in Washington D.C. He noted that there were those who tried to warn of the 2007 – 2008 financial crisis, and said that for a while after 2008 the banks were quiet. Now, however, he said it is like the financial crisis never happened; the same lobbyists are still there, urging resumption of the old ways. Rheingold stated that the House Financial Services Committee wants to repeal the Dodd-Frank Act but has lost that fight. He said the Dodd-Frank Act was the first productive consumer protection law passed in twenty-something years. He predicted that the CFPB Arbitration Study will provide empirical information to support CFPB restrictions on arbitration, but noted that a brutal fight will result.

As to residential mortgages, he opined that "all rational thought is gone." He queried: What will mortgage origination look like over the next ten years? He said that what is needed is expanded affordable housing programs from Fannie and Freddie. Rheingold noted that European housing markets are different from those in the U.S.; they don't worry about home ownership, instead providing other safety nets so that consumers don't need to own homes as a wealth-building device. Housing is used to solve other problems in the U.S., as a substitute for a safety net (*e.g.*, providing financial security). He said that mortgage origination, servicing and foreclosure rules need to be used to protect consumers but this is not being considered in Washington.

IX. Consumer Law from an International Perspective

A. Joasia Luzak

Joasia Luzak is an Associate Professor at the Institute of Private Law at the University of Amsterdam and a member of the University's research institute, the Centre for the Study of European Contract Law (CSECL). Her discussion focused on the European approach to consumer privacy. An issue is: how to provide clear and comprehensive information on the issue of "cookies," as required in Europe.[58] Online service providers need guidance. She said that some cookies can be helpful, in storing information to facilitate consumer choice, but others are not. Disclosure and consent are required, along with an option to renege. The European Union (E.U.) Article 5(3) ePrivacy Directive requires informed consent in advance. But not every E.U. member state accepts the opt-in principle; some still require consumers to optout. To be effective, Professor Luzak said that a privacy notice needs to: (1) attract the attention of the reader; (2) truthfully reveal the privacy policy; and (3) be understandable, *i.e.*, "Privacy for Dummies." The purpose should be to inform, not provide substantive legal protection. Current policies are directed at the age sixteen reader level, but half of the consumers in the U.K. read at the age eleven level.

One of the terms agreed to states that the consumer was selling his or her soul and would submit to torture by fire upon default. Apparently this was not enough to capture the attention of most readers.

She reported that Dutch guidelines are not specific. The U.K. guidelines require the notice to: have an adjustment to the level of the reader; explain the purpose of the cookies used; disclose any third-party sharing; have a layering of information; and be designed so that the disclosure is prominent.[59] But the U.K. guidelines are not yet being enforced, and even then they will be enforced only in response to complaints, and authorities will give violators a second chance.[60] Other problems cited by Professor Luzak include a lack of standardization and enforcement, and unclear rules.

She cited a British study that set up a website to see if consumers read terms and conditions -- the consumers who read the terms would see that opting out would earn them a gift certificate. Very few consumers checked the box as needed to receive the gift certificate. This may suggest that few consumers cared enough to read the disclosures. Professor Luzak also reported that one of the terms agreed to stated that the consumer was selling his or her soul and would submit to torture by fire upon default. Apparently this was not enough to capture the attention of most readers.

B. Jacolien Barnard

Jacolien Barnard is a Senior Lecturer at the Department of Mercantile Law at the University of Pretoria in South Africa. She addressed the search for the "ordinary consumer" in a multicultural society. She noted that it is important to talk to consumers in a language they understand. The new South Africa Consumer Protection Act (the Act) is an umbrella law, providing comprehensive coverage with a focus on vulnerable consumers. It is the first South African law protecting fundamental consumer rights.

Under the Act, the consumer has a right to notices and information in plain language, with average intelligence level and literacy content, significance and importance. South Africa has eleven languages. There is not yet any case law guidance, thus legal writers are important. Simple language in notices is important, so that it can be understood by consumers without a dictionary or lawyer. The format should make the notice prominent. Jacolien said the common law assumes equal bargaining power, but this is often not the case with South African consumers.

The average literacy level in South Africa is grade seven. Moreover, the ordinary consumer concept may differ for different types of transactions. She said that South Africa generally looks to the E.U. standards regarding such things as: vulnerable consumers; mental or physical infirmity; age; and credulity.

C. Trish O'Sullivan

Patricia (Trish) O'Sullivan is a Business Law Lecturer in the School of Accountancy at Massey University, Albany Campus, Auckland, New Zealand. Her topic was online shopping in New Zealand and Australia -- specifically the incorporation of terms into online shopping contracts. She conducted the following empirical research to determine how terms are being incorporated into online shopping contracts in practice: She posed as a consumer and shopped, up to the point of payment, after creating an online account. She then recorded whether the method used to incorporate terms was a "click-wrap" or "browse-wrap" and noted the number of words in each set of terms. Typically "on site" shoppers do not agree to the terms before the sale; but it is easier to do this in online transactions.

Common law rules on incorporation of terms in a signed contract provide that the parties are bound even if they don't read the terms and if terms are not signed they may be incorporated by sufficient notice.[61] The common law also recognizes the effect of a change-in-terms notice.[62] "Click-wrap" and "browse-wrap" terms are commonly used in electronic contracts (giving rise to issues regarding the adequacy of notice).[63] This requires prominent disclosure before agreement.

"Click-wrap" essentially means the consumer is required to indicate consent to the contract terms by checking a box or clicking "I agree" prior to entering payment information; "browse-wrap" essentially means the link to view the terms and conditions is disclosed at the bottom of each webpage, typically in small print.[64] A Robert Hillman survey of ninety-two law students indicated that only about four percent read the full terms and conditions in the contract.[65] Unusual or onerous terms may require enhanced disclosure.[66]

Results of the survey indicate that websites using browsewrap disclosures typically put the link to the terms at the bottom of the page without further reference to the terms, and this is not sufficient notice. In New Zealand, fifty-two percent of the retail websites in the survey used browse-wrap; in Australia sixty-eight percent used browse-wrap. The combined results for New Zealand and Australia showed that sixty percent of the fifty websites reviewed used browse-wrap. O'Sullivan opined that this method does not provide sufficient notice to consumers.

In addition, different terminology is sometimes used to describe the same crucial terms. In *Spreadex Ltd v. Cochrane*[67] a child created a $60,000 deficit in trading securities on a website. Click-wrap was used to incorporate the terms but the court said that the notice given was insufficient due to the excessive number of words in the terms and the fact that there were four separate documents containing terms. O'Sullivan said this suggests that even click-wrap may not provide sufficient notice.

X. Making the Most of Consumer Clinics

A. Mary Spector

Mary Spector is an Associate Professor of Law and Co-Director of the SMU Dedman School of Law Civil Clinic (the SMU clinic). Her subject was: integrating research into the clinic curriculum.

The traditional clinic model is to provide service to the community by having students work with clients under faculty supervision, while training the students in practical skills.[68] The SMU clinic conducts a general civil practice, including home and auto repairs, identity theft, debt collection, etc. Professor Spector said the consumer's credit report often plays a central role. The client may ask: How will settlement affect my credit report? An answer is that the clinic can help, *e.g.,* students can help the consumer rent an apartment despite a flawed credit report. But on reflection, clients may need more going forward. Professor Spector queried: What else can be done?

The SMU clinic Credit Reporting Project is designed to address this. It includes: (1) community outreach; (2) direct assistance (*e.g.,* helping to pull credit reports for consumers); (3) talking to consumers about the accuracy of their credit report (a seventy percent error rate was found); (4) research; and (5) policy advocacy -- using data from the project and sharing it with other advocates.

An inherent challenge for clinics is to get the right cases for students to handle. The Credit Report Project generated such cases, based on data from the survey, *e.g.*, helping consumers who could not get their credit reports. The Credit Report Project indicated a fifty-five percent to sixty-six percent to eighty-three percent success rate in consumers seeking a credit report. The survey questions allowed consumers to achieve a better success rate, and improved the project.

B. Max Weinstein

Max Weinstein is a Senior Clinical Instructor on Law in the Predatory Lending/Consumer Protection Clinic at the Legal Services Center of Harvard Law School (the Harvard clinic). He began by noting that clinical teaching by representing consumers can expand the nonclinical curriculum. Bankruptcy, foreclosure, and debt collection issues are common parts of the practice in a clinic; observers have noted that the student loan debt burden is a factor in some of these cases. Many students are mired in debt for useless academic programs. Student loan debt now exceeds $1 trillion, and is the largest category of consumer debt. Federal student loans are not considered in "default" for 270 days; but federal student loans are subject to nonjudicial garnishment. These loans are difficult to discharge in bankruptcy.[69]

The Harvard clinic has a program designed to address predatory student loans: It targets for-profit schools, and the securitization of student loans. This provides practical practice opportunities for students. Policy advocacy also benefits from this experience. There is also a law school course at Harvard devoted to student loans, with doctrinal teaching derived from the clinical experience.

C. Karen Meyers

Karen Meyers is an Assistant Attorney General and Director of the Consumer Protection Division for the Office of the New Mexico Attorney General. She addressed the intersection between practice, policy and learning, including efforts to educate the public. This helps to develop regulations to respond to changing needs in the marketplace. New Mexico programs include: externships; clinics; and a government lawyering clinic. A goal is to increase collaborations for consumer rights. She said that law schools are a good resource for these efforts, and vice versa.

She raised a question relating to clinics as a teaching tool: Do clinic cases allow students to achieve a lawyer perspective *re* systemic problems, or do they limit the lessons to individual issues and cases? She opined that the expanded sharing of information helps to achieve a larger perspective. A goal is to identify where practice, learning and policy overlap. She cited as an example a case where the refinancing of installment loans became a series of interest-only loans because the consumers could not afford the payments. Attorney General data on this type of problem can inform the clinic's representation of consumers. A student-focused symposium could further share this information.

Assimilating the information with a focus on systemic effects would benefit both the Attorney General and law school clinics. It also would provide benefits regarding: enforcement actions (state and federal); shared research; critical legal analysis; expert testimony; and training Attorney General attorneys.

D. Ted Mermin

Ted Mermin teaches Consumer Law at the University of California Berkeley (UCB) School of Law and is Senior Advisor to the Consumer Justice Clinic at East Bay Community Law Center. He also directs the Public Good Law Center. He left a previous position as Deputy Attorney General (DAG) at the United States Department of Justice to teach consumer law to the Prime Minister of Thailand at UCB. He said the biggest issue for the clinic is credit card debt collection by debt buyers, and as DAG he needed to answer these questions. He now teaches a Consumer Protection Law course at UCB, "keeping it real" by conducting field trips to check cashers, the meat department at a supermarket, and a car dealer. Students conduct research and writing projects; there is no exam. Research papers result, and some are published in law reviews. He also files amicus briefs in consumer cases, drafted by students.

One issue is how to expand the effects of these programs on campus. His suggestions include: Form a student group; offer more courses on consumer law; have students petition for a course with a particular adjunct teacher; encourage alumni involvement (*e.g.,* by meeting with alumni groups); have a speakers program; make connections with local practitioners; create a skills-oriented course (*e.g.,* How to Run a Consumer Law Practice); sponsor and support legislation.

XI. Report by Richard Alderman – People's Law School and the Center for Consumer Law and Consumer Complaint Center

Richard Alderman introduced the second day of the Conference, noting again the positive response to the Santa Fe venue and describing current activities of the Center for Consumer Law (Center), including a new Consumer Complaint Center.

He discussed the "law for the lay-person" programs the Center conducts and reported that more than 55,000 people have attended the sessions of the "People's Law School." Richard explained that these programs are very good for developing relationships between the community, the law school, and the bar, and offered to assist anyone who is interesting in starting a "People's Law School" at his or her institution.

He also discussed the new Consumer Complaint Center (CCC), and the "Consumer Dispute Resolution" course at the University of Houston Law Center. The course places students with the CCC to assist consumers with their disputes. The Center receives approximately 300 - 400 complaints a month and works with consumers and the other party to resolve the dispute. The CCC does everything short of filing suit. Richard explained that the program has had great success in resolving disputes, and offers students an opportunity to learn consumer law, while engaging in client counseling and informal mediation.

XII. Class Action Update

Lonny Hoffman is the Associate Dean and Law Foundation Professor at the University of Houston Law Center. He reported that the last two years have been "pretty rough" for class action plaintiffs, with the United States Supreme Court decisions in *Italian Colors* and *Concepcion*.[70] But there are other important recent developments.

Dean Hoffman began by citing some history: Since 1997, the Supreme Court has tightened the requirements for class actions.[71] In *Walmart*,[72] the Supreme Court rejected class certification. Then in 2013, two cases addressed the materiality and predominance requirements.[73]

Dean Hoffman began by citing some history: Since 1997, the Supreme Court has tightened the requirements for class actions.

When a plaintiff alleges that a class of consumers relied on a false advertisement or injury, the defendant may argue that there is no commonality because of different suffering levels, *e.g.*, factual dissimilarities. *Amgen* raised a fundamental issue: Does materiality have to be proved at the class certification stage? The Supreme Court held that, *i.e.,* all will fail or prevail in unison. But this did not increase the class certification requirements. Then in *Comcast v. Behrend*,[74] Justice Scalia seemed to move toward a stricter interpretation. This continued in *Walmart*, taking back some of what *Amjen* suggested. *Comcast* said a class needs two things: (1) a common injury; and (2) the damages must all derive from the same injury. Thus, the plaintiff must prove commonality as to both the liability and the remedy (*i.e.,* the remedy must match the liability). This raises the possibility of single-issue classes, a trend that is likely to increase.

There is also a trend toward a Rule 23 requirement of ascertainability, *i.e.*, all class members must be ascertainable at class certification. *Carrera v. Bayer*[75] articulates this, to protect absent class members. This may require a dilution of claims.

Dean Hoffman argued that the role of class actions is endangered by this focus on the injury, because class actions also serve a role in discouraging wrongful behavior, and avoiding windfalls to wrongdoers. He said that deterrence, not only the remedy, should be a key factor.

One major change not seen in 2013 concerns the Fair Labor Standards Act (FLSA), which creates a private right of action (including a class action) to enforce claims to pay for employee overtime (but requires an opt-in by class members). This opt-in requirement limits FLSA class actions. In 2011, when *Walmart* reduced other class actions, some plaintiffs switched to arguing that Rule 23 applies to the FLSA, overriding the FLSA limitation to opt-in members. However, the Fifth Circuit rejected this argument.[76]

Nonetheless, Dean Hoffman noted, a singular truth remains with regard to collective actions -- class certification is the crucial stage, and is essential to class actions as a private remedy.

XIII. Innovative Teaching

A. Mark Steiner

Mark Steiner is the Godwin Lewis PC Research Professor and Professor of Law at South Texas College of Law. He began by noting that Consumer Law is on the Texas Bar Examination each year: the bar exam subject includes the Texas Deceptive Trade Practices Act, the Texas Debt Collection Act (TDCA),[77] FDCPA and Texas Insurance Law. He said that Consumer Law is taught three-to-four times each academic year at South Texas, with a full enrollment each time. His course materials include a chapter on debt collection, with excerpts from twenty-one cases, articles, and media reports.

Professor Steiner said the second greatest outrage among students in the class is the poor evidence commonly offered by debt buyers. He also raised two questions for law teachers: Who is acting like a lawyer in class; who is doing most of the talking? The professor or the students? Professor Steiner emphasizes the latter, using problems (his materials have seventy-five problems, allowing coverage of fifteen problems and student recitations per class). He bans laptops.

Professor Steiner noted that the FDCPA and TDCA definitions and scope provisions are different (*e.g.*, this affects when lawyers and creditors are debt collectors). His approach is to raise the problem, and ask the students for their best arguments, including the crucial: why?

B. Ashok Patil

Ashok Patil is a Chair Professor of Consumer Law and Practice for the Ministry of Consumer Affairs, Government of India. His discussion addressed teaching a Consumer Law course in India, with a focus on misleading advertisements, including an explanation of professional and consumer legal education in India. India has a federal system of government, with national law that is implemented by the states. There are exclusive court systems at the state and federal levels for consumer law; he said that sometimes implementation is weak at the state level.

Class actions are viewed as public interest litigation. The Consumer Law course includes a class field trip for students to buy and use advertised cosmetics for two months, typically with no result, suggesting that the advertised claims were false; the students then notify the companies and ask for a response. Then the students file lawsuits in consumer courts. These courts provide simple procedures, and the students can represent themselves. Company lawyers sometimes threaten the students or offer gifts to settle, and sometimes even threaten the school. This research was submitted to the consumer protection agency, which held conferences and has urged law reform. Professor Patil is drafting a proposed amendment.

The goals of the exercise include: consumer law reform; education of the students; and to provide the students with practical experience.

C. Monika Jagielska

Monika Jagielska is the Dean's Deputy on International Co-operation, Faculty of Law and Administration, and Associate Professor of Private and International Law, at the University of Silesia in Katowice, Poland. Her presentation focused on teaching consumer law in formerly socialist countries -- using Poland as the example. She reported that some problems are common throughout much of the world. Common issues relate to, *e.g.*, Bitcoins and other virtual currencies, and privacy. She then described how consumer law developed in the formerly socialist countries of Eastern Europe.

The collapse of the Iron Curtain led to the development of consumer markets. In the 1970s, there was a single civil code in Poland, with no consumer protections; these were viewed as being unneeded in a nationalized economy. There was a basic structure of protective legal concepts, somewhat similar to the West, including standard contract terms and a right to withdraw, but reality did not reflect these basic consumer rights or the schoolbook mythology. By the 1980s, the results had become clear: There were no goods on the shelves, and there were lines for food. Consumer goods were largely unavailable, so there was no use for consumer protections. Citizens did not trust government authorities for consumer protection or anything else.

In the 1990s there was a transition from socialism to a free market. The old rules were rejected. Consumer protection was introduced into the civil code, but many consumers were unprepared and suspicious of the law. There remained a lack of trust in government. Consumer Law was introduced in schools. Many consumer scams were evident, including misrepresentation and bad contracts, because citizens had no background or experience with such transactions. The courts also lacked the needed experience.

The twenty-first century brought accession to the E.U. and E.U. consumer directives, requiring changes in the civil code including separate consumer laws. This represented a major change in Polish law; the only debate was the timetable, not the merits of the change. It was a massive challenge to integrate the E.U. directives into existing Polish law -- and it was not always an improvement. Professor Jagielska said that, even today, many Polish citizens do not understand consumer law and still don't trust the government.

XIV. Consumer Arbitration

Theodore (Teddy) Rave is an Assistant Professor of Law at the University of Houston Law Center. He began by summarizing the Federal Arbitration Act (FAA).[78] He noted that arbitration is a creation of contract; if there is no contract, there is no arbitration. Professor Rave noted that small consumer claims have a negative litigation value, thus there is a need for class actions. He said that the purpose of arbitration is to prevent class actions, citing an example created by General Mills: If you "liked" Cheerios on Facebook, you agreed to arbitrate claims (this has now changed due to public pressure and a *New York Times* article).

In the 1990s, arbitration clauses typically had extreme terms and often were rejected by courts. Companies then moved to adopt more consumer-friendly arbitration clauses to address the courts' concerns. California courts adopted a blanket rule saying arbitration was largely unconscionable *per se*. However, the United States Supreme Court rejected this in *Concepcion*.[79]

Professor Rae noted that there is a tendency to compare the cost of litigation and arbitration, with the latter being much lower, but argued that the settlement of cases means that much litigation is like arbitration (so that the larger expense of litigation is often a myth). But he noted that arbitration encourages early settlement of small claims, and may be better for the individual consumer than a class action. The Supreme Court recognized this in *Concepcion*.

In *American Express Co., et al v. Italian Colors*, the Supreme Court adopted a formalistic approach that suggests the courts do not want to individually measure the validity of each arbitration clause.

Nonetheless, Professor Rave said that there are policy risks in this approach -- arbitration reduces the deterrent effect of class actions, by allowing companies to pay only a few small claims. He said that courts are prioritizing the need for compensation of individual consumers over the broader effect of deterrence.

In a class action settlement, there is equal bargaining power, unlike arbitration (where the parameters are determined in an adhesion contract). But review by the courts on contract grounds limits this. In *Concepcion*, the arbitration clause really was effective and favorable to consumers. Thus, as noted, favoring compensation over deterrence may help individual consumers. However, in *American Express Co., et al v. Italian Colors*,[80] the Supreme Court adopted a formalistic approach that suggests the courts do not want to individually measure the validity of each arbitration clause; this may open the door to more onerous contract terms. Professor Rave said the Ninth Circuit has rejected this but the Sixth Circuit and Tenth Circuit lean the other way, limiting the unconscionability theory as a means to attack arbitration.

He said that this undercuts the incentives for lawyers to seek out wrongdoing via class actions, and may reduce the pressure on companies and arbitrators to provide consumer-friendly protocols. He concluded that the ongoing CFPB initiatives offer the best prospects for reform on behalf of those who oppose arbitration.[81]

XV. Computerized Delivery of Consumer Law

Katie Porter is a law professor at the University of California Irvine, where she specializes in consumer and commercial law. In February 2012, she was appointed by California Attorney General Kamala Harris as an independent monitor of the banks in the nationwide $25 billion National Mortgage Settlement. She described the California Monitor Program's work in taking complaints from over 5,000 California homeowners and engaging mortgage companies in oversight.

Her first point was that technology can be deployed much more effectively to give consumers information and assistance with legal problems. She stressed that this is not legal advice or assistance, in the sense of providing representation. She noted that consumers with legal problems often can be substantially helped by receiving more tailored, usable information than is delivered on most websites or handouts. For example, the California Monitor Program built an interactive, question-and-answer tool that helped consumers determine if they were eligible, as a prima facie matter, for National Mortgage Settlement relief. This site delivered legal information using technology and freed up lawyers on staff for investigation and negotiation after consumers had established their eligibility for relief. She described how computerized intake systems can help consumers organize the relevant information and more effectively tell their stories--which is really describing their legal problems.

Her second point related to the use of technology to gather data to further enforcement efforts. She opined that the first line of defense for financial institutions often is: this is a one-off problem. Porter said that data can disprove this factually. Tracking violations using a database also allows the aggregation of data, *e.g.*, comparing market share to the volume of complaints for individual companies. This may defeat a "one-off" defense and facilitate efforts to address violations that harmed thousands of consumers, rather than seeking an individual remedy as traditional attorney representation would do.

XVI. Nonjudicial Foreclosure and Unlawful Detainers

John Campbell teaches at the University of Denver Sturm College of Law. He addressed issues relating to the eviction of homeowners following a nonjudicial foreclosure. He noted that nonjudicial foreclosure is expedited; it happens quickly and (by definition) without judicial review. It has its origins in English law, developed in the landlord-tenant context. It allows eviction in a summary proceeding, treating the foreclosed homeowners essentially as tenants. The plaintiff must prove: (1) title; (2) unlawful possession; and (3) damages.

Despite its nonjudicial character, Campbell said that the expedited proceeding may have some res judicata-like effects, meaning that the former homeowner may have a limited ability to defend by attacking the foreclosure after-the-fact. Statutes in some states prohibit a subsequent inquiry as to title (in other states the result may be the same under the doctrine of collateral estoppel or res judicata). However, some states allow judicial review of the foreclosure after-the-fact in the eviction proceeding. Some states allow a collateral attack on the foreclosure after-the-fact only after the eviction, in a separate suit. However, wrongful foreclosure can have adverse effects on the consumer's credit report and in other ways, with a result that the consumer cannot afford to file suit. If so, the eviction becomes a claim suppressant. The foreclosure may even prevent the consumer from renting a new home, and the incentive to litigate is diminished once the house is lost. Courts have generally upheld expedited evictions.

Professor Campbell cited potential solutions that include: elimination of nonjudicial foreclosure as inappropriate in a modern securitization scenario; allowing full foreclosure defenses in evictions following a nonjudicial foreclosure (but he noted that this would allow a res judicata defense against a subsequent separate suit for wrongful foreclosure); and a mandatory stay of eviction upon assertion of a defense to prevent irreparable harm.

XVII. Consumer Law from an International Perspective

A. Richard Alderman

Richard introduced this segment by noting that it is difficult to explain to a foreign audience how arbitration works in the U.S., *e.g.*, to preclude judicial review. He explained the benefits of exploring international consumer law issues in this context.

B. Strict Product Liability in South Africa

Corlia Van Heerden is the ABSA Chair in Banking Law at the University of Pretoria, South Africa. She described her goal of expanding the students' minds in the area of South African consumer law, using products liability as an example. Until recently, South Africa lacked a statutory framework for products liability. Judge-made law made the development of products liability law difficult, but a 2003 Supreme Court case was a breakthrough, acknowledging the need for legislative intervention in order to introduce a regime of strict products liability. This led to the 2008 Consumer Protection Act (the Act),[82] recognizing a no-fault basis for products liability.

The South Africa Consumer Protection Act preserves the consumer's common law rights and also permits reference to foreign law (but expressly prohibits the use of black magic!). There is a heavy reliance on E.U. directives. The Act broadly defines "consumer" to include users and "goods" to include intangible property. The range of defenses received attention, along with the level of proof, and who is liable. The South African legislature considered the cost of litigation to be anti-consumer, and the Act mandates a preliminary mediation procedure.

The Act provides six provisions to facilitate redress, seeking preventative as well as remedial functions and including a recall function. The Act is modeled on the E.U. product liability directive. Anyone in the supply chain is liable, regardless of negligence. This includes service providers, and creates joint and several liability. Damages can include personal injury and property loss.

The Act provides strict products liability but the liability is not absolute. Defenses include: (1) compliance with applicable regulations; (2) the defect did not exist at that stage; (3) the defendant engaged in marketing only; and (4) the defendant merely followed instructions. Also, contributory negligence is a defense. There is a three-year statute of limitations.

There is some ambiguity in the Act, *e.g.*, the definition of “defect,” which incorporates a consumer expectations test, is problematic. Definitions within definitions create further uncertainties. Also, although the draft bill initially made provision for the development risk defense, this defense was not retained in the Act. But there is concern as to the adverse impacts on consumer prices and innovation if no defenses are allowed.

Professor Van Heerden observed that the Act is evidence that South Africa is moving toward a proper mix of strict and fault-based products liability.

XVIII. What’s New at the CFPB?

Kelly Cochran is the Assistant Director for Regulations at the Bureau of Consumer Financial Protection (CFPB). She began by recognizing the role of law professors in creating and supporting the CFPB.

Three years later, the CFPB has 1,300 employees and four main divisions: supervisory; enforcement (including expanded authority beyond that provided by prior law); consumer response; and research. The main areas of nonbank supervision include: mortgages; payday lending; student loans and student loan servicing; credit reports; and debt collection. She said the CFPB conducted 100 supervisory actions in 2013; and 150 were expected in 2014. Compliance management systems are a focus.

With regard to enforcement, there were thirty-one enforcement actions in the one-year period ending in March 2014. These resulted in significant monetary and other relief, including mortgage balance reductions. Fair lending enforcement is also very active. With regard to the consumer response function, payday lending and debt collection are the biggest areas of complaints. The CFPB operates a confidential portal for consumer input, relays the information to the respective institutions, and gives the consumer a right to respond, with possible referral to enforcement staff.

With respect to consumer engagement and empowerment, “Ask the CFPB” has resulted in 300,000 hits per month, helping consumers make major decisions. The research, markets, and regulations division provides a rule-writing function. The CFPB has been busy with the Dodd-Frank Act requirements but is now looking more deeply beyond the Dodd-Frank Act. There is an increased focus on discretionary rule-writing measures, *e.g.*, overdraft protection programs, debt collection, and stored value products.

Research models are being developed -- with a core focus to create new models. More research is scheduled, *e.g.*, the arbitration study, debt collection, and small dollar credit products. Data compilations are crucial, and are being made more accessible. Markets research teams include staff with deep operational experience, *e.g.*, electronic mortgage closings including state law. A goal is to develop and require best practices regarding operational issues and procedures.

What is next? Many consumer issues and areas need attention, beyond the Dodd-Frank Act. Potential solutions include: First, work deeper on existing regulations, supervision and enforcement of new rules, including follow-ups and lookbacks (to review and amend rules). Second, go broader, beyond the Dodd-Frank Act (*e.g.* with regard to mortgages). There is a focus on the four Ds: Deceptive Acts; Debt Traps; Dead-Ends; and Discrimination. There will be an increased emphasis on discretionary rules; this requires a data-driven process and administrative record. One goal is to generate greater public input through the Internet.

Third, increase the supervision of nonbanks and issue related new rules. The next target is auto lending and finance. Fourth, work smarter, so as to ingrain the DNA for the long-term and work with partners, creating alternatives to rulemaking.

Cochran suggested ways for academics and practitioners to engage with CFPB, *e.g.*: provide input; respond to CFPB outreach; participate in advisory boards; and encourage consumer in-

Speakers’ dinner in Santa Fe.

put. Use the "Tell your story" feature on the CFPB website. She also suggested creating university partnerships with the CFPB.

IXX. Observations and Conclusion

Along with presenting the usual diverse views on a wide variety of issues, the 2014 Conference again highlighted a basic conundrum in consumer protection law, which arguably should also be a focus of legal education and policymaking. There is no shortage of sharp (and in some cases outright deceptive, unfair or abusive) practices, naïve consumers and poor decisionmaking, and the ever-increasing complexity of our laws and society seem to exacerbate these problems.[83] It is not a challenge to identify examples. It is, however, a challenge to devise laws, regulations and processes to minimize the damage and provide appropriate redress for these problems, without impairing desirable and legitimate transactions.

This challenge goes to the basic function of a legal system, as a means to order society and provide a dispute resolution system. And it goes to the heart of a legal education and the legal profession. If we get it wrong, in any direction, consumers will suffer (even if we as lawyers and educators do not).

If legal education is to survive in its traditional role, academics must seek to overcome our sometimes myopic (and quite natural) instincts to view these issues entirely as advocates of narrow interests, and instead recognize broad and diverse perspectives, costs and benefits. This is not to deny the importance of narrow advocacy, but only to suggest that effective advocacy as to doctrinal issues in an academic setting also suggests the need for recognition that there are multiple views, costs and benefits in every policy choice.

Richard Alderman's Conference is to be applauded for providing another opportunity for illustration and emphasis of all these points.

** Professor, Oklahoma City School of Law. He also serves as editor of The Consumer Finance Law Quarterly Report and was editor of The Annual Survey of Consumer Financial Services Law in The Business Lawyer, 1989-2013.*

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1 Reports on previous Conferences are available as follows: Alvin C. Harrell, *Teaching Consumer Law,* 6 J. Tex. Consumer L. 50 (2003); Alvin C. Harrell, *Teaching Consumer Law, Part Two,* 8 J. Tex. Consumer L. 2 (2004); Alvin C. Harrell, *Teaching Consumer Law, Part Three,* 10 J. Consumer & Comm. L. 46 (2006); Alvin C. Harrell, *Teaching Consumer Law, Part Four,* 12 J. Consumer & Comm. L. 8 (2008); and Alvin C. Harrell, *Teaching Consumer Law, Part Five,* 14 Consumer & Comm. L. 87 (2011). Your author was unable to provide a report on the sixth (2012) conference due to a scheduling conflict.

2 Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 Univ. Pa. L. Rev. 1 (2008).

3 Kathleen C. Engel & Patricia McCoy, *A Tale of Three Markets*, 82 Tex. L. Rev. 439 (2003); Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 Tex. L. Rev. 1255 (2002).

4 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

5 Oren Bar-Gill, *Seduction by Plastic*, 98 Nw. Univ. L. Rev. 1373 (2004).

6 Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loan in Military Towns*, 66 Ohio St. L. J. 653 (2005).

7 *See* Dee Pridgen, *Wrecking Ball Disguised as Reform: ALEC's Model Act on Private Enforcement of Consumer Protection Statutes*, 39 N.Y. Univ. Rev. of Law and Social Change [in press] (2015), *available at* http:11ssrn.com/abstract=2426381.

8 *Id.*

9 *Id.*

10 Described in Pridgen, *supra* note 7 and noted *supra* this text at Part II.A.

11 Jeff Sovern & Ira Rheingold, *To Catch a Creditor*, N.Y. Times (July 10, 2013), *available at* http://www.nytimes.com/2013/07/11/opinionl/to-catch-a-creditor.html? r=0

12 *See also* Timothy E. Goldsmith & Nathalie Martin, *Testing Materiality Under Unfair Practices Acts: What Information Matters When Collecting Time-Barred Debts?*, 64 Consumer Fin. L. Q. Rep. 372 (2010).

13 *See generally* Peter A. Holland, *Junk Justice: A Statistical Analysis of 4,400 Lawsuits Filed By Debt Buyers,* 26 Loyola Consumer L. Rev. 179 (2014) (provided as part of the Conference materials). Rubin noted that this is an issue likely to be addressed by the CFPB. *See also, e.g.,* Lauren Compisi, et al, *Federal and Municipal Developments Affecting Debt Collection, Foreclosure, Servicemember and FCRA Requirements,* 67 Consumer Fin. L. Q. Rep. 256, 263 (2013).

14 *See* 15 U.S.C. § 1692e(5).

15 McMahon v. LVNV Funding, LLC, F.3d 1010 (7th Cir. 2014).

16 See *id.*

17 Buchanan v. Northland Group, No. 13-2523. All of these issues and cases are discussed in the program materials provided for the Conference. *See* Richard J. Rubin, Circuit Splits Under the FDCPA – May 2014, program materials for Teaching Consumer Law 2014 (Center for Consumer Law 2014).

18 80 F.3d 148 (5th Cir. 1996).

19 133 S. Ct. 1166 (2013).

20 *Compare, e.g.,* Graziano v. Harrison, 950 F.2d 107 (3d Cir. 1991) *with* Clark v. Absolute Collection Service, Inc., 741 F.3d 487 (4th Cir. 2014). Other relevant case citations are provided in the Conference program materials. *See* Rubin, *supra* note 17.

21 *See supra* note 20.

22 *See* Rubin program materials, *supra* note 17, at 4.

23 *Id.* at 8.

24 *Id.*

25 *Id.* at 7.

26 *In the Matter of* Apple, Inc., Federal Trade Commission, Docket No. C-444 (Mar. 25, 2014), *available at* http://www.ftc.gov/sites/default/files/documents/cases/140115appleagree.pdf.

27 FTC Staff Report, Paper, Plastic . . . or Mobile?, an FTC Workshop on Mobile Payments (Mar. 2013), *available at* www.ftc.gov/os/2013/03/130306mobilereport.pdf.

28 http://www.ftc.gov/system/files/documents/reports/data-brokers-call-transparency-accountability-report-federal-trade-commission-may-2014/140527databrokerreport.pdf.

29 *In re* Aaron's, Inc., Federal Trade Commission, Consent Order, File, No. 1223264, *available at* http://www.ftc.gov/sites/default/files/documents/cases/131022aaronsagree.pdf.

30 Emma Coleman Jordan & Angela P. Harris, Economic Justice, Race, Gender, Identity and Economics: Cases and Materials (2d ed. Foundation Press 2011).

31 Professor Engel's program materials for the Conference, entitled "Teaching the Financial Crisis Through Consumer Law," explain her approach and will be published at: 18 J. of Consumer & Comm. L. [in press] (2015).

32 It is a federal crime to file a false financial statement, so the students do not actually complete applications.

33 Professor Hill's remarks were drawn from an article forthcoming in this issue of the Journal of Consumer and Commercial Law. *See* Julie Andersen Hill, *Virtual Currencies and Federal Law,* 18 J. Consumer & Comm. L. [in press] (2015).

34 *See, e.g.,* Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, https://bitcoin.org/bitcoin.pdf (2008).

35 *See* 18 U.S.C. § 336 (2014).

[36] *See*: 31 U.S.C. § 5330 (2014); 31 C.F.R. § 1022.380 (2014).

[37] Fin. Crimes Enforcement Network, Dep't of Treasury, FIN-2013-G001, Guidance: Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies 1 (Mar. 18, 2013), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf.

[38] *See*: Indictment, U.S. v. Faiella, 14-CRIM-243 (S.D.N.Y. Apr.10, 2014); Press Release, U.S. Attorney's Office, Southern District of New York, Bitcoin Exchanges Plead Guilty in Manhattan Federal Court In Connection with the Sale of Approximately $1 Million in Bitcoins for Use on the Silk Road Website (Sept. 4, 2014), http://www.justice.gov/usao/nys/pressreleases/September14/FaiellaShremPleasPR.php. *See generally* Marcus A. Asner, Andrew Joseph Shipe & Alexandra L. Mitter, *Taming the "Wild West:" Regulators Take Aim at Unregulated Virtual Currencies*, 67 Consumer FIn. L.Q. Rep. 397 (2013).

[39] I.R.S. Notice 2014-21, 2014-16 I.R.B. 938, *available at* http://www.irs.gov/pub/irs-drop/n-14-21.pdf.

[40] Steven Russolillo, *Yellen on Bitcoin: Fed Doesn't Have Authority to Regulate It in Any Way*, Wall St. J. Blog (Feb. 27, 2014, 12:43 PM), http://blogs.wsj.com/moneybeat/2014/02/27/yellen-on-bitcoin-fed-doesnt-have-authority-to-regulate-it-in-any-way/.

[41] *See, e.g.,* Marjorie J. Pierce & Jeremy T. Rosenblum, *DOJ Hits Bank Target in "Operation Choke Point,"* 67 Consumer Fin. L.Q. Rep. 243 (2013) (discussing DOJ efforts to regulate third-party payment processing through "Operation Choke Point").

[42] A revised version is being published in the Consumer Finance Law Quarterly Report. *See* Alvin C. Harrell, *Ten Current Issues Affecting Consumer Financial Services Law,* 68 Consumer Fin. L.Q. Rep. [in press] (2014).

[43] *See, e.g.,* Nick Timiraos & Deborah Soloman, *U.S. Backs Off Tight Mortgage Rules,* Wall Str. J., May 14, 2014, at A1 (noting this problem).

[44] *Id. See also, e.g., KPMG: Compliance Is Drag on Bank Growth,* 74 Directors & Trustees Digest No. 10 at 1 - 2 (Oct. 2014) (40% of bankers surveyed cited regulatory limitations on products and services as the factor having the greatest negative impact).

[45] *See, e.g.,* John L. Culhane, Jr., *CFPB Impact on Student Lending and Loan Servicers*, 68 Consumer Fin. L.Q. Rep. 40 (2014).

[46] *See supra* this text Part III.

[47] *See, e.g.,* L. Gordon Crovitz, *The U.N. Trumps Silicon Valley,* Wall Str. J., Oct. 20, 2014, at A17.

[48] *See, e.g.,* Stephen F.J. Ornstein, Scott D. Samlin, R. Colgate Selden & Rinaldo Martinez, *At Long Lase . . . New Mortgage Loan Disclosures Issued: TILA and RESPA Engaged! Wedding Set for August 2015,* 67 Consumer Fin. L.Q. Rep. 323 (2013).

[49] *See, e.g.,* Ryan T. O'Shields, Historic *Literature Presages Dodd-Frank Act as a Death Knell for Community Banks,* 67 Consumer Fin. L.Q. Rep. 326 (2013).

[50] *See, e.g., supra* this text Part VI.

[51] *See, e.g., infra* this text Part XVIII.

[52] *See, e.g.,* Alvin C. Harrell, Commentary, *Reflections on the Mortgage, Housing and Financial Crisis,* 68 Consumer Fin. L.Q. Rep. 123 (2014).

[53] It can be noted that the creditor who finances the consumer's purchase of the damaged vehicle also is at risk in this scenario. It also can be noted that enactment by the states of a modern, uniform certificate of title statute such as the Uniform Certificate of Title Act (UCOTA) would go a long way toward alleviating these problems, by preventing this "laundering" of titles; however, the efforts to enact UCOTA have not received significant support from either the industry or consumer advocates.

[54] *See supra* Part III.

[55] Codified at 47 U.S.C. § 227.

[56] Codified at 15 U.S.C. §§ 1681 – 1681x. *See also* Regulation V, 12 C.F.R. pt. 1022.

[57] Douglas v. Convergent Outsourcing, 765 F.3d 299 (3d Cir. 2014).

[58] *See, e.g.,* Joasia Al Luzak, Privacy Notice for Dummies? Towards European Guidelines on How to Give 'Clear and Comprehensive Information' on the Cookies' Use in Order to Protect the Internet User's Right to Online Privacy, Amsterdam Law School Legal Studies Research Paper No. 2013-65, Centre for the Study of European Contract Law Working Paper No. 2013-12, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2350209.

[59] *See id.*

[60] *Id.*

[61] *See, e.g.*: Parker v. South Eastern Railway, 2 CPD 416 (1877); Harvey v. Ascot Dry Cleaning Co Ltd., NZLR 549 (1953); Spurling Ltd v. Bradshaw, 2 All ER 121 (1956), 1 WLR 461 (1956); Thornton v. Shoe Lane Parking, 2 QB 163 (1971), 1 All ER 686; MacRobertson Miller Airline Services v. Commissioner of State Taxation (WA), 133 CLR 125 (1975), 8 ALR 131, 50 ALJR 348; Oceanic Sun Line Special Company Inc. v. Fay, 165 CLR 197 (1988), 79 ALR 9, HCA 32 (1988); L'Estrange v. Graucob, 2 KB 394 (1943); Toll (FGCT) Pty Ltd v. Alphapharm Pty Ltd, 219 CLR 165 (2004), 211 ALR 342; HCA 52 (2004), BC200407463.

[62] *See supra* note 61. The idea being that either party to an ongoing relation constituting essentially a series of separate contracts can propose a change in terms going forward, and alternatively either party can then terminate the relation if they don't agree.

[63] There is usually a good discussion and update on these issues under U.S. law, going back several years, in the American Bar Association Annual Survey of Cyberspace Law. *See, e.g.*: Juliet M. Moringiello & William L. Reynolds, *Electronic Contracting Cases 2009 – 2010,* 66 Bus. Law. 175 (2010); Juliet M. Moringiello & William L. Reynolds, *Electronic Contracting Cases 2008 – 2009,* 65 Bus. Law. 317 (2009).

[64] *Id.*

[65] *See*: R. A. Hillman & J. J. Rachlinski, *Standard Form Contracting in the Electronic Age,* 77 N.Y. Univ. L. Rev. 429 (2002); R. A. Hillman, *Online Consumer Standard Form Contracting Practices: A Survey and Discussion of Legal Implications,* in Jane Winn (ed.), Consumer Protection in the Age of the 'Information Economy' 283 (Ashgate Publishing Ltd, Aldershot, England 2006). *See also supra* Part IX.A.

[66] Lord Denning in Spurling Ltd v. Bradshaw, 2 All ER 121 (1956), 1 WLR 461 (1956).

[67] Spreadex Ltd v. Cochrane, EWHC 1290 (Comm) (Eng. & Wales 2012).

[68] *See, e.g.,* descriptions of various clinics in the report on the 2010 Conference, at Alvin C. Harrell, *Teaching Consumer Law, Part Five,* 14 J. Consumer & Comm. L. 87, 94 - 95 (2011).

[69] *See, e.g.,* U.S. Bankruptcy Code, as codified at 11 U.S.C. § 523 (non-dischargeable debts).

[70] American Express Co., *et al* v. Italian Colors, 133 S.Ct. 2304 (2013); AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740 (2011). *See also infra* Part XIV.

[71] *See, e.g.*: Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds, 133 S.Ct. 1184 (2013); *Italian Colors*, 133 S.Ct. 2304.

[72] Wal-Mart Stores, Inc. v. Dukes, 131 S.Ct. 2541 (2011).

[73] *See* discussion immediately below and cases cited *infra* at notes 74 - 75.

[74] Comcast Corp. v. Behrend, 133 S.Ct. 1426 (2013).

[75] Carrera v. Bayer Corp, 727 F.3d 300 (3d Cir. 2013).

[76] Roussell v. Brinker Intern., Inc., 441 Fed. Appx. 222 (5th Cir. 2011).

[77] Tex. Fin. Code tit. 5 ch. 392, *available at* http://www.statutes.legis.state.tx.us/Docs/FI/htm/FI.392.htm.

[78] Codified at 9 U.S.C. §§ 1 – 16. *See also supra* Part XII.

[79] AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740 (2011).

[80] 133 S.Ct. 2304 (2013).

[81] *See, e.g.,* Christine A. Scheuneman, Joseph T. Lynlak, III & Amy L. Pierce, *The CFPB's Arbitration Study - A Warning to Consumer Financial Service Companies,* 68 Consumer Fin. L.Q. Rep. 32 (2014).

[82] *See also supra* Part IX.B.

[83] Which are not unknown in other contexts, even within the legal profession.

ANNUAL SURVEY OF

Texas Insurance Law

2014

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I. INTRODUCTION

This year's survey of Texas insurance cases harvested a smaller crop – 142, down from 150 last year and 300 two years ago. Here are some of the highlights of cases discussed in this article.

In *Greene v. Farmers Ins. Exch.*, No. 12–0867, 2014 WL 4252271 (Tex. Aug. 29, 2014), the Texas Supreme Court allowed an insurer to rely on a policy's vacancy clause to deny coverage, even though the vacancy did not cause the loss. The court also held that the "contractual liability" exclusion does not apply to poor workmanship, in *Ewing Constr. Co. v. Amerisure Ins. Co.*, 420 S.W.3d 30 (Tex. 2014).

The supreme court also addressed the consequences when an insurer pays a plaintiff but a hospital lien is not satisfied, *McAllen Hosps., L.P. v. State Farm Co. Mut. Ins. Co. of Tex*, 433 S.W.3d 535 (Tex. 2014), while a court of appeals decided whether an insurer can challenge the amount of a hospital lien, in *Allstate Indem. Co. v. Memorial Hermann Health System*, 437 S.W.3d 570 (Tex. App.—Houston [14th Dist.] 2014, no pet.).

The court of appeals also considered a new provision in the prompt payment of claims statute, which gives more time to a life insurer that files an interpleader. In *Prudential Ins. Co. v. Durante*, No. 08–12–00077–CV, 2014 WL 4259434 (Tex. App.—El Paso Aug. 29, 2014, pet. granted), the court held the insurer did not qualify for the extension.

The Fifth Circuit returned to one of its favorite *Erie*-guesses, despite the fact that the Texas Supreme Court has demurred on the issue several times. In *Star-Tex Resources, L.L.C. v. Granite State Ins. Co.*, 553 F. App'x 366 (5th Cir. 2014) (per curiam), the court looked outside the eight corners to consider extrinsic evidence to decide a liability insurer had no duty to defend, where the extrinsic evidence related solely to a fundamental issue of coverage that did not overlap with the merits. The Fifth Circuit also addressed whether an insurer had a disqualifying conflict that would let the insured choose its own lawyer, at the insurer's expense, in *Graper v. Mid-Continent Cas. Co.*, 756 F.3d 388, 393 (5th Cir. 2014).

Another case solved the *Gandy* problem of assigning an insured's claim to the plaintiff, *Great American Ins. Co. v. Hamel*, No. 08–11–00302–CV, 2014 WL 4656618 (Tex. App.—El Paso, Sept. 19, 2014, no pet.). And several cases dealt with plaintiff's inability to adequately segregate fees between recoverable claims and non-recoverable ones.

Finally, one thoughtful district court broke the trap of having an adequate "fair notice" state court pleading be judged by the stricter federal *Twombly-Iqbal* standard. *Esteban v. State Farm Lloyds*, No. 3:13–CV–3501–B, 2014 WL 2134598 (N.D. Tex. May 22, 2014).

II. FIRST PARTY INSURANCE POLICIES & PROVISIONS

A. Automobile

Where a named insured rejected UIM and PIP coverages in writing and then renewed her policy seven more times, the insurer was not required to offer UIM and PIP coverage again. Further, the character of the policies as renewal policies was not altered by the fact that, in later years, her son was added as another named insured. *Cain v. Progressive County Mut. Ins. Co.*, No. 14–12–00954–CV, 2014 WL 4638923 (Tex. App.—Houston [14th Dist.] Sept. 18, 2014, no pet.).

Loss of use damages were not available for a total loss. An insured was hit by another driver, totaling the insured's tow truck. The driver's insurance company paid its policy limits, which replaced the truck. Then the insured sued his under-insured insurer, after it refused to pay him for his loss-of-use damages for not being able to operate his business for four months while he found a replacement truck. The court held that in a total-loss case, a chattel owner can recover only the market value of the property, not loss-of-use damages. *Am. Alternative Ins. Corp. v. Davis*, No. 10-13-00275-CV, 2014 WL 2917081 (Tex. App.—Waco June 26, 2014, pet. filed).

An automobile insurer was entitled to summary judgment where the policy unambiguously excluded coverage for an uninsured motor vehicle that was "owned by or furnished or available for the regular use of [the insured] or any family member." *Mata v. State Farm Mutual Insurance Co.*, No. 04-14-00239-CV, 2014 WL 6474223 (Tex. App.—San Antonio Nov. 19, 2014).

B. Homeowners

The supreme court held that a vacancy clause negated coverage, even though the vacancy did not harm the insurer. *Greene v. Farmers Ins. Exch.*, No. 12–0867, 2014 WL 4252271 (Tex. Aug. 29, 2014). The homeowner's insurance policy provided that coverage was suspended effective sixty days after the dwelling became vacant. It was undisputed that Greene's house was vacant, but it was also undisputed that the vacancy did not cause the fire. The court first considered the anti-technicality statute, Tex. Ins. Code § 862.054, which provides that a breach or violation of a policy warranty, condition, or provision does not render the policy or contract void and is not a defense to a suit for loss, unless it contributed to cause the destruction of the property. The court held the statute did not apply because the vacancy was not a "breach" of the policy.

The supreme court held that a vacancy clause negated coverage, even though the vacancy did not harm the insurer.

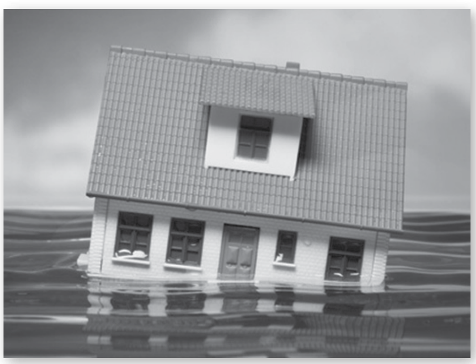
The court also distinguished its prior decisions requiring that an insurer show prejudice before a failure to comply with the policy excuses coverage. For instance, in *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691 (Tex. 1994), the court held that breach of a consent to settlement clause did not excuse liability, where the insurer was not prejudiced. S*ee also Lennar Corp. v. Markel Am. Ins. Co.*, 413 S.W.3d 750 (Tex. 2013). Similarly, the court held that late notice that did not prejudice the insurer would not void coverage in *PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630 (Tex. 2008), and *Prodigy Communications Corp. v. Agric. Excess & Surplus Ins. Co.*, 288 S.W.3d 374 (Tex. 2009). The court distinguished these cases, holding that the vacancy clause in the present case was material, but the breaches in the other cases were immaterial.

Finally, the court distinguished its holding in *Puckett v. U.S. Fire Ins. Co.*, 678 S.W.2d 936 (Tex. 1984), where the court refused on public policy grounds to allow an insurance company to avoid coverage based on the insured's immaterial breach of a condition requiring an airworthiness certificate for the airplane that was insured. The court distinguished *Puckett* because in this case the court found there was no breach. Further, the court held that it is for the legislature and Texas Department of Insurance to decide what coverage should be and to establish public policy. The court reasoned that TDI had made a policy choice by approving the insurance form in this case, which allowed the limitation on coverage.

Justice Boyd, joined by Justice Willett, concurred, but he found the court's decision in conflict with the prior decisions in *PAJ*, *Prodigy*, *Lennar,* and *Hernandez*. Balancing consistency with disruption, the concurring justices would limit the prejudice requirement to those four cases applying to late notice and settlement without consent, but would not extend it further.

The standard mortgage clause in a residential insurance policy provides coverage to a mortgagee for a loss by fire of a vacant property, despite the policy's vacancy clause. *SWE Homes, LP v. Wellington Ins. Co.*, 436 S.W.3d 86 (Tex. App.—Houston [14th Dist.] 2014, no pet.). An insured's mortgagee sought coverage for a fire loss to a vacant dwelling. The insurer denied coverage on grounds that the vacancy clause excluded coverage. The court of appeals disagreed. The mortgage clause stated that the mortgagee could recover under the policy despite "any act or neglect of the mortgagor." The court concluded that although there was no coverage for the insured because the property had remained vacant for the period specified by the vacancy clause, the mortgagee could still recover because it had complied with all of the provisions in the mortgage clause. Interpreting the policy otherwise would render the mortgage clause meaningless and would violate section 862.055 of the Insurance Code, which prohibits the interest of a mortgagee under a fire insurance contract from being invalidated by an act of the mortgagor or an occurrence beyond the mortgagor's control.

In another homeowner's case, water damage was excluded as flood damage. An insured homeowner sought coverage for property damage caused by water diverted onto his property when a third party placed large cylinders across a drainage ditch. The insurer denied coverage, arguing that the overflow of water onto the insured's property was excluded from coverage as flooding, regardless of the cause of the overflow. The court of appeals agreed. Because the policy did not define "flood," the court used the common meaning "a rising and overflowing of a body of water." It did not matter that the overflow of water was caused by the presence of obstructions on top of a ditch in light of language in the policy that said it excluded the loss "regardless of … the cause of the excluded event[.]" *George v. State Farm Lloyds*, No. 07-12-00465-CV, 2014 WL 2481894 (Tex. App.—Amarillo May 19, 2014, no pet.).



C. Commercial Property

An insured that suffered property damage only to find that the property coverage it had was not what it requested was entitled to recover damages without obtaining a coverage determination from the court. *Insurance Alliance v. Lake Texoma Highport, LLC*, No. 05-12-01313-CV, 2014 WL 6466851 (Tex. App.—Dallas Nov. 19, 2014). The jury found that the insurance agency breached its contract with the insured to obtain property coverage of $15,000,000 without sublimits or co-insurance penalties. The agency argued that because the broker had given seventeen different policy versions that required the insured to get the court to determine what coverage was actually provided. The court of appeals rejected this argument and presumed that the jury resolved any questions about the insured's coverage when it made its damage findings. The jury was asked to determine the amount of coverage that would have been available, less the amount of coverage that was actually obtained.

Theft of copper sheeting owned by a customer was not covered by a warehouse company's commercial property policy, where it was covered by the customer's own policy. *United Nat. Ins. Co. v. Mundell Terminal Servs., Inc.*, 740 F.3d 1022 (5th Cir. 2014). The warehouse company had a policy that covered its business personal property and property held by others. However, the policy had an exclusion for property that was covered under another policy. The court held this exclusion applied. The court found that the customer's interests were insured under both the warehouse policy and the customer's own policy. The court concluded that the "other insurance" clause applied because the customer's insurance covered the same property interest in favor of the same party – i.e. the customer's interest in the copper.

The court rejected the warehouse company's argument that the court should not reach this conclusion, because that would subject the warehouse company to a subrogation claim by the customer's insurer. The court noted that the warehouse company could have purchased liability insurance for such a risk but did not.

A commercial property insurer's failure to give the mortgagee notice of cancellation did not affect the cancellation as to the insured. *Molly Props., Inc. v. Cincinnati Ins. Co.*, 557 F. App'x 258 (5th Cir. 2014) (per curiam). It was undisputed that the insurer gave cancellation notice to the insured and that the insured failed to pay its premiums. The court rejected the insured's argument that it was a third-party beneficiary of the contract between the insurer and the mortgagee. The court found no evidence that that agreement was made for the benefit of the insured.

An insured trucking company's video game consoles were stolen while in its terminal. *W.W. Rowland Trucking Co., Inc. v. Max Am. Ins. Co.*, 559 F. App'x. 253 (5th Cir. 2014). The parties agreed that theft was a covered peril. However, the insurer argued that an exclusion applied that required the insured's terminals to be "100% fenced, gated, locked, and lighted 24 hours per day, 7 days per week," or else the "[c]overage is null and void." An investigation showed that thieves had entered and left the terminal by cutting a hole in the fencing. The Fifth Circuit held that Texas's Anti-Technicality Statute applied, which requires a causal link between the breach in the policy provision and the loss in order for an insurer to deny a claim under a property insurance policy. Therefore, the court ordered the insurer to pay the claim.

A commercial building was "vacant" within the meaning of a commercial property policy where it had been unoccupied for several years. *Bedford Internet Office Space, LLC v. Travelers Cas. Ins. Co.*, No. 3:12–CV–4322–N, 2014 WL 4230315 (N.D. Tex. Aug. 25, 2014). The fact that it had been leased to a new tenant did not change the outcome, where the tenant had not yet moved in and neither the tenant nor the landlord were engaged in any "customary operations" as required by the policy.

A property owner's claims for water damage caused by a defective roof were barred by the exclusion for negligent work. *Mag-Dolphus, Inc. v. Ohio Cas. Ins. Co.*, No. H–13–08S2, 2014 WL 4167497 (S.D. Tex. Aug. 13, 2014). The court found that the exclusion was unambiguous. The court also held it was not against public policy for the insurer to rely on the exclusion, rejecting the insured's argument that the insurer should have inspected and noticed the defective work because the roof was replaced as a result of a prior leak claim.

D. Life insurance

Where a life insurance policy lapsed for non-payment of premium a year before the insured died, the life insurer did not breach its contract by refusing to pay. *Lombana v. AIG Am. Gen. Life Ins. Co.*, No. 01–12–00168–CV, 2014 WL 810858 (Tex. App.—Houston [1st Dist.] Feb. 27, 2014, pet. denied).

An ex-wife was not entitled to proceeds under a life insurance policy where she was named as beneficiary prior to the divorce. The court relied on the statute that provides that a divorce makes an earlier designation of a spouse as policy beneficiary ineffective. No exceptions provided by the statute applied in this case. *Branch v. Monumental Life Ins. Co.*, 422 S.W.3d 919 (Tex. App.—Houston [14th Dist.] 2014, no pet.). The ex-wife also could not claim ownership of the policy based on her payment of premiums, where the prior court in the divorce action had awarded ownership to the husband.

An ex-wife was not entitled to proceeds under a life insurance policy where she was named as beneficiary prior to the divorce.

The *Branch* court also held that the fact that the insurer attached a sample policy to its interpleader petition did not affect the ex-wife's claim. The insurer was not required to attach the policy in issue, but could summarize its provisions. Further, in the interpleader action, it was the ex-wife's burden to prove her entitlement to the proceeds, not the insurer's burden to negate it.

A widow was entitled to fifty percent of life insurance proceeds where her husband filed a change of beneficiary form designating her as primary beneficiary for that portion, even though the form was rejected because it was ambiguous as to the contingent or additional beneficiary designations. Although the policy required a change of beneficiary form "in a form that meets our needs," the court found that the insured substantially complied with the change of beneficiary designation. Although the contingent beneficiary designation was unclear, it was undisputed that the designation of the widow as primary beneficiary for fifty percent was clear. *Prudential Ins. Co. v. Durante*, No. 08–12–00077–CV, 2014 WL 4259434 (Tex. App.—El Paso Aug. 29, 2014, pet. granted).

The death of an insured during the two-year contestability period bars a life insurance policy from becoming incontestable. *Mut. of Omaha Life Ins. Co. v. Costello*, 420 S.W.3d 873 (Tex. App.—Houston [14th Dist.] 2014, no pet.). The insured under a life insurance policy died within the two-year contestability period set forth in the policy. After investigating the claim, the insurer concluded that the insured had misrepresented her health history in the insurance application. It then denied the claim and rescinded the policy. The beneficiary sued to recover the policy proceeds and, after litigating for several years, argued that the insurer failed to contest the validity of the policy within two years by failing to institute its own court proceeding. The court of appeals rejected this argument. Section 1101.006 of the Insurance Code requires that a policy "must provide that a policy in force for two years from its date of issue during the lifetime of the insured is incontestable, except for nonpayment of premiums." The court found that the language "during the lifetime of the insured" means that an insured must survive the two-year contestability period for the policy to become incontestable. As a result, the insurer could challenge the policy's validity.

E. Title insurance

The Fifth Circuit held that a title insurance policy providing survey coverage covered a flowage easement that was larger than depicted by the survey. *Lawyers Title Ins. Corp. v. Doubletree Partners, L.P.*, 739 F.3d 848 (5th Cir. 2014). Doubletree bought land that it planned to develop. Lawyer's Title provided the title insurance and offered Doubletree expanded survey coverage. Doubletree later discovered a serious error in the survey: it substantially underrepresented the area of the property that was subject to a flowage easement that allowed the federal government to flood that portion of the property.

The policy originally excluded "any discrepancies, conflicts, or shortages in area or boundary lines, or any encroachments or protrusions, or any overlapping of improvements." Because Doubletree paid for survey coverage, this exception was amended to exclude only "shortages in area." The parties disputed the effect of this language. Lawyers Title argued that the policy still did not cover the flowage easement, because it was not a boundary line or encroachment. Lawyers Title argued that these terms referred to defects at the boundary of the property. On the other hand, Doubletree argued that the words could be read to also include the flowage easement.

The court found both interpretations were reasonable and, therefore, held that it had to construe the language of this exclusion in favor of coverage. The court went on to say that, because the policy was subject to two interpretations and was ambiguous, it could consider "extraneous evidence to determine the true meaning of the instrument." After considering correspondence related to the policy, the court again concluded that Doubletree's interpretation of the policy was reasonable.

The *Doubletree* court erred on this second point. The court cited *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 333-34 (Tex. 2011). But that case – while it included an insurance company as a party – involved a lease, not an insurance policy. As the Fifth Circuit correctly recognized in other parts of its opinion, once a policy is subject to more than one reasonable interpretation, it is construed in favor of coverage, as a matter of law. While the courts may consider extraneous evidence to determine the true meaning of an instrument with regard to other types of contracts, that is not true with insurance policies.

The *Doubletree* court also held that the flowage easement exception in the policy did not apply, because it was ambiguous. The exception provided that the insurer did not insure against loss arising out of the "flowage easement"…"and shown on survey." The court found Doubletree's interpretation was reasonable and that this language could be taken to mean that only the easement as shown on the survey was accepted. Because the survey failed to show the full extent of the easement, it was not "shown on the survey."

Finally, the court held that an exclusion did not apply. The exclusion precluded coverage for any defect "created, suffered, assumed or agreed to by the insured claimant." The court agreed with Doubletree's argument that because Doubletree did not know the extent of the easement, it did not create, suffer, assume, or agree to it.

A dedication agreement that affected real property's historic status and use was not a defect in title. Although it affected the value of the property, it did not affect ownership. *McGonagle v. Stewart Title Guar. Co.*, 432 S.W.3d 535 (Tex. App.—Dallas 2014, pet. filed). The court further held that the dedication agreement also fit within an exclusion for defects and encumbrances "assumed or agreed to by the insured claimant." The evidence showed that the dedication agreement was attached to the purchase contract and was known to the buyers, even though they believed that the agreement was deleted.

An insured purchased several properties in Tulum, Mexico for hotel development. *Citigroup Global Markets Realty Corp. v. Stewart Title Guar. Co.*, 417 S.W.3d 592 (Tex. App.—Houston [14th Dist.] 2013, no pet.). It obtained title insurance for the properties. The title insurer researched the properties and learned of a 1981 decree by the Mexican federal government that appropriated land to create the Tulum National Park. However, the insurer's report noted the tracts purchased by the insured were not affected by the condemnation. The insurer did not list the decree as an exception from coverage in its title policies. In its efforts to develop the properties, the insured learned that several of the properties were not developable because they were subject to the decree and within the Park. The insured and its lender both filed suit against the title insurer.

The jury found the insured knew of an encumbrance on ten of the sixteen properties on the date of purchase. On appeal, the court held that sufficient evidence supported that finding. The evidence at trial showed that several of the insured's agents had discussed a decree in the zone where the property was located, that the property was in the park, and that they were aware of the risk that they might not be able to build anything because of zoning and archeological restrictions. Therefore, the insured knew of and assumed or agreed to the effects of the decree on those ten properties.

The jury also found the insured did not know about the decree and did not assume or agree to its effect as to six properties, but awarded zero damages. The court also found that the evidence was sufficient to support this result. The jury was asked to determine damages by selecting the lesser of the amount for which the properties were insured or the difference between the value of the insured estate as insured and the value of the insured estate as subject to the decree. Under the language "as insured," the properties were already taken or acquired by the decree in 1981. The jury could thus conclude that the value of the properties as insured was identical to their value subject to the decree.

F. Other policies

A policy styled as "Automated Teller Machine and Contingent Cash In Transit" that provided coverage for theft from an armored motor vehicle company did not require the insured to first exhaust all remedies against potentially responsible third-parties before the insurer would become obligated to pay for the loss. *Certain Underwriters at Lloyd's of London Subscribing to Policy Number: FINFR0901509 v. Cardtronics, Inc.*, 438 S.W.3d 770 (Tex. App.—Houston [1st Dist.] 2014, no pet.). The president of an armored car company who worked for Cardtronics, owner of several automated teller machines, stole $16,000,000. The insurer refused to pay, asserting that the policy required that Cardtronics first exhaust any remedies it had against the armored car company and any insurer for the armored car company.

The court rejected the insurer's argument as unreasonable. There was nothing in the policy that expressly required exhaustion of remedies. The coverage language said, "we will only pay for the amount of loss you cannot recover: (1) under your contract with the armored motor vehicle company; and (2) from any Insurance or indemnity carried by, or for the benefit of customers of, the armored motor vehicle company." The court rejected the argument that the "cannot recover" language required Cardtronics to first seek recovery from others before the insurer was obligated to pay. The insurer's construction conflicted with other provisions in the policy that required Cardtronics to submit a proof of loss by a certain deadline and the insurer to respond to the claim by a certain deadline, and Cardtronics to file suit by a certain deadline. None of these deadline provisions could apply if Cardtronics were first required to pursue recovery from others. The court harmonized the provisions of the policy by accepting Cardtronics' proposed construction that would require the insurer to pay whatever amount Cardtronics was unable to recover from others by the time its proof of loss was due. The court found this interpretation was reasonable and gave meaning to all of the provisions of the policy.

III. FIRST PARTY THEORIES OF LIABILITY

A. Breach of Contract

An insured debtor still had the right to sue a property insurer for underpayment of a water damage claim, even after foreclosure, where the amount of the claim was more than the amount of the debt. *Peacock Hospitality, Inc. v. Ass'n Cas. Ins. Co.*, 419 S.W.3d 649 (Tex. App.—San Antonio 2013, no pet.).

A court rejected a life insurance beneficiary's argument that the insurer breached an implied oral contract to reinstate a life insurance policy that had lapsed for non-payment of premium. *Lombana v. AIG Am. Gen. Life Ins. Co.*, No. 01–12–00168–CV, 2014 WL 810858 (Tex. App.—Houston [1st Dist.] Feb. 27, 2014, pet. denied) (mem. op.). The court found no evidence that the insurer's representative had authority to enter into such an oral contract and no evidence of the parties' "mutual assent" or meeting of the minds. Further, the beneficiary admitted she knew that a premium payment would be required for the policy to be reinstated, and it was undisputed that no premium payment was made.

The insureds in *Salazar v. State Farm Lloyds*, No. H-13-1904, 2014 WL 2862760 (S.D. Tex. June 24, 2014), sued their insurer for breach of the policy and extra-contractual duties for denying their claim for damage loss to the home interior caused by water leaking from plumbing pipes under the home. The court held that the insurance policy's dwelling foundation endorsement explicitly and unambiguously limited liability for foundation damage to fifteen percent of the dwelling limit of liability. Therefore, the insurer's motion for summary judgment on that issue was granted.

An insured's building incurred damage from a hailstorm. The insured did not give notice to the insurer about the damage for at least nineteen months. The insurer demonstrated that other, non-covered perils could have contributed to the insured's loss. Therefore, the court held that summary judgment in favor of the insurer should be granted on the breach of contract claim. Additionally, because the insured failed to provide summary judgment evidence to raise a genuine fact issue that they suffered an injury independent of their policy claim, summary judgment was also granted in favor of the insurer on the insured's statutory and common law bad faith claims. *Hamilton Prop. v. Am. Ins. Co.*, No. 3:12-CV-5046-B, 2014 WL 3055801 (N.D. Tex. July 7, 2014).

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

Where a life insurer properly denied coverage under a policy that had lapsed for non-payment of premium, the court also properly dismissed the plaintiff's claims for unfair insurance practices, deceptive trade practices, and breach of duty of good faith and fair dealing. *Lombana v. AIG Am. Gen. Life Ins. Co.*, No. 01–12–00168–CV, 2014 WL 810858 (Tex. App.—Houston [1st Dist.] Feb. 27, 2014, pet. denied).

In *USAA Texas Lloyd's Co. v. Menchaca*, No. 13-13-00046-CV, 2014 WL 3804602 (Tex. App.—Corpus Christi July 31, 2014, pet. filed), an insured's house was damaged in a hurricane. After submitting the claim to her insurer, the insurer said the damage was under the deductible amount so no payment would be made. The insured sued her insurer. At trial, the insurer stipulated to the reasonableness of the insured's electrician's estimate, which was over the deductible amount. The jury returned a verdict stating that the insurer did not fail to comply with the terms of the insurance contract, but found that the insurer did refuse to pay a claim without conducting a reasonable investigation. On appeal, the insurer argued that because the jury found no breach of contract, the insured's extra-contractual claims must fail. The appeals court disagreed, holding that the insurer complied with the policy, but violated the insurance code, and the insurer would have been contractually obligated to pay policy benefits had the insurer complied with the insurance code. Therefore, the court affirmed.

A jury's failure to find an insurance broker liable for misrepresentations and unfair insurance practices was supported by evidence that the broker never made any direct misrepresentations to the insured or the insured's agent, and the broker provided the insurance policy that its intermediate broker requested. *Insurance Alliance v. Lake Texoma Highport, LLC*, No. 05-12-01313-CV, 2014 WL 6466851 (Tex. App.—Dallas Nov. 19, 2014).

Although the court in *Lawyers Title Ins. Corp. v. Doubletree Partners, L.P.*, 739 F.3d 848 (5th Cir. 2014), found in favor of the insured on coverage under a title insurance policy, the court nevertheless agreed that the insured failed to state a claim for statutory claims for unfair insurance and deceptive trade practices. The court found that the insurer had a reasonable basis for denying the claim, even though the court ultimately rejected that basis.

An insured sued his insurer for failing to conduct a reasonable investigation of his home foundation claim. The insurer hired both an engineer and plumber to investigate the claim, and both concluded that the foundation movement was not the result of a plumbing leak. The insured's expert was asked during his deposition if there was a problem with the investigation process, to which he answered "no." Therefore, the court found that the insurer was entitled to summary judgment on the issue of conducting a reasonable investigation. *Walker v. Nationwide Prop. & Cas. Ins. Co.*, 992 F. Supp. 2d 703 (W.D. Tex. 2014).

An insurance agent was entitled to summary judgment on the plaintiffs' misrepresentation claims, where there was no evidence that the agent made any false representations about specific terms of their policy. The plaintiffs alleged that the agent misrepresented coverage because they requested coverage for "all perils possible," but the policy contained an exclusion for negligent workmanship. *Mag-Dolphus, Inc. v. Ohio Cas. Ins. Co.*, No. H–13–08S2, 2014 WL 4167497 (S.D. Tex. Aug. 13, 2014).

The insureds did not have a reasonable basis for recovery against the investigator because the investigator was not engaged in the business of insurance, as defined in the Insurance Code.

An investigator was held not to be engaged in the business of insurance and thus not a proper party to a suit under the Insurance Code. *Michels v. Safeco Ins. Co. of Indiana*, 544 F. App'x 535 (5th Cir. 2013). Insureds sued both their homeowner's insurer and its investigator for violations of the Insurance Code, seeking coverage for smoke damage to their home that occurred during the Bastrop wildfires. The trial court dismissed the investigator, who was a non-diverse party, as improperly joined. The Fifth Circuit affirmed. It held that the insureds did not have a reasonable basis for recovery against the investigator because the investigator was not engaged in the business of insurance, as defined in the Insurance Code. The investigator was an engineer hired only to determine the cause and extent of damages to the home, knew nothing about the coverage of the policy, and made no decisions with respect to insurance coverage.

C. Prompt Payment of Claims

A court held that an insurer was liable for prompt payment penalties where the insurer filed an interpleader action but did not do so within ninety days as required by the statute. The court held that the insurer was not entitled to the additional thirty days and instead had to pay the claim within sixty days, because the insurer did not receive "notice of an adverse, bona-fide claim." The court held that there was no bona-fide adverse claim, where the widow was clearly entitled to fifty percent of the proceeds and the children were entitled to the other half. *Prudential Ins. Co. v. Durante*, No. 08–12–00077–CV, 2014 WL 4259434 (Tex. App.—El Paso Aug. 29, 2014, pet. granted).

An insured sued his uninsured-motorist insurer for failing to pay a claim in accordance with the five-day payment provision under Tex. Ins. Code § 542.057. That section requires an insurer to pay the insured within five business days after notice that the insurer will pay all or part of the claim. In this case, the insured and insurer were exchanging settlement offers, and the insured argued that the insurer was required to pay the amount it had offered in settlement within five days of making the offer, even though the insured rejected the offer. The court held that the fact the insurer "approved" part of the claim for settlement purposes is not a notice of acceptance for the purpose of the prompt-payment statute. *Terry v. Safeco Ins. Co. of Am.*, 972 F. Supp. 2d 965 (S.D. Tex. 2013).

A prompt pay violation does not turn on whether the insured suffered an independent injury or the reasonableness of the insurer's position. Because the insurer had a duty to defend and breached that duty, the insurer violated the statute by erroneously rejecting the insured's requests for a defense and delaying payment of fees and expenses incurred in the underlying litigation. *Admiral Ins. Co. v. Petron Energy, Inc.,* 1 F. Supp. 3d 501 (N.D. Tex. 2014).

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

Although the court in *Lawyers Title Ins. Corp. v. Doubletree Partners, L.P.*, 739 F.3d 848 (5th Cir. 2014), found in favor of the insured on coverage under a title insurance policy, the court nevertheless agreed that the insured failed to state a claim for breach of the duty of good faith and fair dealing. The court found that the insurer had a reasonable basis for denying the claim, even though the court ultimately rejected that basis.

Fees incurred in a coverage action are not an injury independent of the denial of policy benefits within the meaning of Chapter 541 of the Insurance Code. *Admiral Ins. Co. v. Petron Energy, Inc.,* 1 F. Supp. 3d 501 (N.D. Tex. 2014). A district court granted an insurer's motion for summary judgment as to all of the insured's claims for unfair insurance practices. In particular, the court found that there was insufficient evidence that the insured suffered any injury independent of the insurer's denial of policy benefits. The fees and litigation expenses incurred by the insured in this coverage action were not an independent injury.

The court erred by requiring proof of an independent injury other than the amounts owed under the policy. This goes directly against the supreme court's holding that policy benefits are damages recoverable under the statutory cause of action and may even be damages as a matter of law. "We hold 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." *Vail v. Texas Farm Bureau Mut. Ins. Co.*, 754 S.W.2d 129, 136 (Tex. 1988).

E. Fraud

A life insurer was not liable for fraud by nondisclosure related to information it gave a beneficiary about reinstating a lapsed policy, because there was no confidential or fiduciary relationship giving rise to a duty to disclose. Further, there was no evidence of any material misrepresentation to support a claim for fraud. *Lombana v. AIG Am. Gen. Life Ins. Co.*, No. 01–12–00168–CV, 2014

WL 810858 (Tex. App.—Houston [1st Dist.] Feb. 27, 2014, pet. denied).

F. ERISA

An ERISA plan administrator did not abuse its discretion by denying disability benefits to a plan participant. *Spenrath v. Guardian Life Ins. Co. of Am.*, 564 F. App'x 93 (5th Cir. 2014) (per curiam). An ERISA plan participant sued a plan administrator under ERISA for wrongfully denying her long-term disability benefits. In particular, the participant argued that the administrator failed to credit the medical evidence contained in the record that showed her disability. The administrator argued that it based its decision on the entire administrative record. The Fifth Circuit held that the administrator did not abuse its discretion. The evidence showed that the administrator examined the participant's medical evidence. Its denial letter specifically discussed much of the participant's evidence. A panel of independent medical specialists, upon which the administrator relied, also thoroughly considered the evidence. Further, the administrator did not abuse its discretion by failing to consider the participant's subjective evidence. Instead, it relied on the panel of medical specialists to determine whether there was a disparity between her subjective complaints and the objective findings, and the panel concluded there were discrepancies. Finally, the administrator did not abuse its discretion by relying on expert opinions that allegedly mischaracterized the evidence. None of the alleged errors in the expert testimony undermined the administrator's ultimate conclusion or affected the substantial nature of the evidence in its support. The administrator did not act arbitrarily by giving more weight to the conclusions of the independent experts than to the participant's providers.

Substantial evidence supported an ERISA plan administrator's decision to deny accidental death benefits. *McCorkle v. Metropolitan Life Ins. Co.*, 757 F.3d 452 (5th Cir. 2014). An ERISA plan beneficiary sought benefits under her deceased husband's accidental death coverage. Her husband, the plan participant, had visited his family doctor complaining of stress and trouble sleeping. The doctor ruled out depression and treated the participant for insomnia and anxiety with a prescription of Lunesta. One evening, he took Lunesta as prescribed and a few hours later shot himself. The coroner reported the death cause as "suicide," but noted that he was under the influence of Lunesta and thus did not "consciously and intentionally t[ake] his own life." The plan administrator denied benefits. The district court found the denial improper and reversed. In its review of the case, the Fifth Circuit emphatically noted that district courts are serving in an appellate role when they review administrative denials of benefits and that the administrator's determination must be affirmed unless it is arbitrary or not supported by at least substantial evidence, even if that determination is not supported by a preponderance. The Fifth Circuit held that substantial evidence supported the plan administrator's determination that the participant committed suicide. The participant died of a self-inflicted gunshot wound, not an accidental discharge of a gun. The possibility that the participant was hallucinating was insignificant in the court's analysis.

IV. THIRD PARTY INSURANCE POLICIES & PROVISIONS

A. Automobile liability insurance

An exception to an exclusion did not create coverage for an injured employee. An employee was injured at work when his concrete truck rolled over. His employer did not subscribe to workers' compensation insurance. However, his employer filed a claim for his injuries under its business auto policy, and then assigned its insurance claim to the employee. The insurance policy provided that it did not insure bodily injury to an employee of the insured arising out of or in the course of employment by the insured. The employee argued that an exception to the exclusion applied: "But this exclusion does not apply to bodily injury to domestic employees not entitled to workers' compensation benefits or to liability assumed by the insured under an insurance contract." The employee argued that "domestic employee" is ambiguous because it could either refer to employees who work in a household or to employees who are citizens of the United States, and he would fall under the latter. The court held that "domestic employee" unambiguously referred to employees who work in a home. Consequently, the exception did not apply. *West v. S. Co. Mut. Ins. Co.*, 427 S.W.3d 576 (Tex. App.—Dallas 2014, no pet.).

B. Comprehensive general liability insurance

The fact that a general contractor entered into a contract in which it had agreed to perform construction in a good workmanlike manner did not trigger the contractual liability exclusion. *Ewing Constr. Co. v. Amerisure Ins. Co.*, 420 S.W.3d 30 (Tex. 2014). The contractor agreed to build tennis courts for a school district, but the tennis courts immediately started to flake, crumble, and crack. The liability insurer denied the contractor's claim. The liability insurer relied on the contractual liability exclusion, which excludes coverage for "'property damage' for which the insured is obligated to pay damages by reason of the assumption of liability in the contract or agreement."

The insurer argued that by agreeing to perform in a good and workmanlike manner, the contractor assumed liability in the contract and, therefore, the loss was excluded. The supreme court disagreed and instead agreed with the contractor that the agreement to build the tennis courts in a good and workmanlike manner did not enlarge the contractor's obligations beyond any general common law duty it had. Because the contract did not expand the contractor's obligations, there was not an "assumption of liability" within the meaning of the exclusion.

The supreme court also rejected the insurer's argument that if it held the exclusion inapplicable that would convert a liability policy into a performance bond. The court noted that, while this exclusion did not apply, other exclusions could.

The point the *Ewing* court made was applied, *Blanton v. Continental Ins. Co.*, 565 F. App'x 330 (5th Cir. 2014). At issue was whether a liability policy covered the insured's substandard conduct in installing and later repairing two diesel engines in a boat. After the decision in *Ewing*, the insurer conceded that the contractual liability exclusion did not preclude coverage. However, the court found that other exclusions applied. First, the defective installation and subsequent repairs were excluded by a provision that excluded liability arising out of a defect, deficiency, or inadequacy in "your product" or "your work." Moreover, the exception for loss that is sudden and accidental did not apply, because the underlying petition alleged that the defects appeared over time. The policy also excluded damage to "your product," which the court held clearly included the engines that the insured installed and later attempted to repair.

The loss of use claim by the boat owner was also excluded under a ship repairs liability policy, which excluded loss due to "demurrage, loss of time, loss of freight, loss of charter and/or similar and/or substituted expenses." The court held that the meaning of "demurrage" was well settled to include loss of use of a vessel. Further, the ship repairs liability policy also excluded "the expense of redoing the work improperly performed by [the insured] or on [the insured's] behalf or the cost of replacement of materials, parts or equipment furnished in connection therewith."

In *Crownover v. Mid-Continent Cas. Co.*, 757 F.3d 200

(5th Cir. 2014), homeowners initiated arbitration against their contractor, with the arbitrator determining that the homeowners had a meritorious claim for breach of the express warranty to repair contained in the contract. The contractor went bankrupt, so the homeowner sued the contractor's insurer. The insurer argued that an exclusion applied. The exclusion stated, "[t]his insurance does not apply to [ ] 'property damage' for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement." The Fifth Circuit held that, because the only ground on which the arbitrator awarded damages to the homeowners was breach of the express warranty to repair in the contract, the exception to the exclusion for "liability the insured would have in the absence of the contract or agreement" did not apply. Therefore, summary judgment in favor of the insurer was affirmed.

Under Texas law, "and" can be used disjunctively, rather than conjunctively. *Trammell Crow Residential Co. v. Am. Protection Ins. Co.*, 574 F. App'x 513 (5th Cir. 2014) (per curiam). Trammell Crow operated a number of apartment complexes in Colorado and was sued by residents due to a mold problem. APIC was paid funds from Trammell Crow's expense account to reimburse its defense costs. Trammell Crow then sued APIC, alleging that it was not required to reimburse APIC's defense costs. The question on appeal was whether APIC's costs and expenses in the litigation with the other insurer qualified as a "claim expense" under the APIC policy. A claim expense under the policy included expenses "incurred by the insured and by us[.]" Trammell Crow argued that APIC's defense costs were not claim expenses because they were incurred exclusively by APIC, rather than by both APIC and Trammell Crow. However, the Fifth Circuit determined that "and" in the definition was disjunctive, and that costs incurred by either or both Trammell Crow or APIC qualified as a "claim expense." Thus, the court held that Trammell Crow was required to reimburse APIC's defense costs up to the amount of the deductible under the policy.

The policy did not expressly exclude coverage for punitive damages. Therefore, the policy covered the punitive damages awarded against the insured in the underlying suit.

Punitive damages were covered by a CGL policy. A judgment including punitive damages was rendered against the insured in Colorado. The insurer denied coverage for the punitive damages award, arguing that it was against Colorado law to do so. Having determined that Texas law applied, the court concluded that the policy's plain language provided coverage for the judgment. The policy covered "those sums that [the insured] becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage'…." The policy did not expressly exclude coverage for punitive damages. Therefore, the policy covered the punitive damages awarded against the insured in the underlying suit. *Tesco Corp. (US) v. Steadfast Ins. Co.*, No. 01-13-00091-CV, 2014 WL 4257737 (Tex. App.—Houston [1st Dist.] Aug. 28, 2014, no pet.).

An "own, rent, or occupy" exclusion precluded coverage for a tenant that leased a portion of the property and conducted its operations there. The tenant "occupied" the premises, including the roof, which it damaged. *Liberty Mut. Fire Ins. Co. v. Lexington Ins. Co.*, No. 04–13–00586–CV, 2014 WL 4823614 (Tex. App.—San Antonio Sept. 30, 2014, no pet.).

C. Umbrella/excess insurance

Umbrella insurers were obliged to pay losses in excess of the underlying policies even though the underlying policies were exhausted by claims that would not have been covered by the umbrella policies. *Indem. Ins. Co. of N. Am. v. W&T Offshore, Inc.*, 756 F.3d 347 (5th Cir. 2014). W&T Offshore sustained significant damage to its energy exploration and development operations as a result of Hurricane Ike. W&T had several layers of coverage. The primary and umbrella policies allowed recovery for removal of debris expenses. The primary policies also allowed coverage for property damage and operators' extra expenses, but the umbrella policies did not. W&T's property damage and operators' extra expense claims exhausted the underlying policies. The umbrella insurers sought a declaratory judgment that they were not obliged to pay their policy limits for removal of debris, because the underlying policies were exhausted by claims that would not have been covered by the umbrella policies.

The district court accepted this argument, but the Fifth Circuit reversed. The Fifth Circuit relied on the plain language of a provision in the umbrella policies stating that they would pay amounts in excess of the "retained limit." That phrase was defined to include all sums above the underlying policy limits, without specifying that the underlying claims had to be covered. In contrast, another provision of the policy provided that the umbrella insurers had additional duties, including the duty to defend, when the underlying limits were exhausted by claims that would have been covered by the umbrella policy.

D. Homeowners liability insurance

A homeowner's liability policy did not cover the negligence of a son that led to the father's injuries, where the policy excluded coverage for bodily injury "to you or an insured." The father was defined as both "you" and "an insured." The court rejected the argument that the severability clause made a difference. That clause provided that "this insurance applies separately to each insured." No matter which insured's perspective was considered, the exclusion still excluded the father as "you" and "an insured." *Hodges v. Safeco Lloyds Ins. Co.*, 438 S.W.3d 698 (Tex. App.—Houston [1st Dist.] 2014, no pet.).

V. DUTIES OF LIABILITY INSURERS

A. Duty to defend

A liability insurer's duty to defend its homebuilder insured for claims for "property damage" caused by water leaks was triggered where the suit alleged that the injury manifested itself during the policy term. The duty was triggered where the suit alleged water damage that occurred during the policy period, even though it may have manifested or been discovered later. *Great Am. Ins. Co. v. Hamel*, No. 08–11–00302–CV, 2014 WL 4656618 (Tex. App.—El Paso, Sept. 19, 2014, no pet.).

A liability insurer had a duty to defend a city sued on several theories that could impose liability apart from any excluded liability for "inverse condemnation." *City of College Station, Tex. v. Star Ins. Co.*, 735 F.3d 332 (5th Cir. 2013). The city was sued by a real estate investment company that wanted to develop commercial property. Because of zoning issues with the city, the company sued the city alleging: (1) that the city's actions were discriminatory and lacked a rational basis violating its 14th Amendment right to equal protection; (2) that the city's repeated denials of requests for rezoning were arbitrary and capricious, violating its 14th Amendment right to substantive due process; (3) that the city's intentional actions in denying the zoning requests constitute a taking in violation of the Texas constitution; and (4) that the city's individual council members had intentionally interfered with the company's existing and perspective contracts and business relationships for its development. The city's insurer refused to defend or indemnify the city, asserting that all of the claims fell within the "inverse condemnation" exclusion in the policy.

The court found that inverse condemnation is a legal term of art used to refer to an action brought by a property owner seeking just compensation for a regulatory "taking." The inverse condemnation exclusion excepted coverage for "any liability … actually or allegedly arising out of or caused or contributed to by or in any way connected with any principal of imminent domain, condemnation proceeding, [or] inverse condemnation … by whatever name called." The court found that the third cause of action fit within the exclusion, but the others did not. The court found that the city could be liable under the other theories independent of any liability arising out of the inverse condemnation. Therefore, the insurer had a duty to defend.

The Fifth Circuit held that an insurer did not have a disqualifying conflict that allowed the insured to choose its own defense counsel, in *Graper v. Mid-Continent Cas. Co.*, 756 F.3d 388, 393 (5th Cir. 2014). The court relied on *N. Cnty. Mut. Ins. Co. v. Davalos,* 140 S.W.3d 685 (Tex.2004), to reject the argument that an insured is entitled to select its own counsel when the *potential* for a conflict of interest exists. "Instead, the test to apply is whether 'the facts to be adjudicated in the [underlying] lawsuit are the same facts upon which coverage depends.'"

The court rejected the insured's argument that the rule should be flexible and permit a disqualifying conflict to arise when the insurer has hired attorneys who may be tempted to develop facts or legal strategy that ultimately could support the insurer's coverage position. The court rejected this argument and held that the "same facts" test in *Davalos* is the proper analysis.

Under this analysis, the court found that the fact issues raised by the reservation of rights letter were different from the facts at issue in the underlying infringement case. First, the underlying case raised the issue of limitations, and the insurer reserved its right to deny the claim because it occurred before the beginning of the policy. The court held these were different issues. On the limitations issue, the question was when the claim accrued, not when the accident infringement occurred. The court conceded that of course the claim could not accrue until after the infringing acts occurred. Nevertheless, the court concluded that the limitations determination would lack the specificity necessary to decide whether the claim was covered under the policy. An adjudication of when the plaintiff's claim accrued would not be a judicial ruling necessarily deciding when the infringing conduct occurred.

Second, the court held that the plaintiff's allegation that the insureds acted willfully in infringing the copyright did not raise the same issue as whether the insureds acted "with the knowledge that the act would violate the rights of another," within a policy exclusion. The court reasoned that "willful" under the Copyright Act includes both knowing and reckless conduct, so that a finding that the defendants acted willfully would not necessarily establish whether they acted knowingly within the meaning of the exclusion.

The court's reasoning on the first issue seems a bit facile. The court conceded that accrual would encompass the date the act occurred, because a plaintiff cannot discover his claim until after the act has occurred. Therefore, deciding that the plaintiff's claims accrued before a certain date would necessarily establish that the conduct occurred before a certain date. If the date for limitations was prior to the date for coverage under the policy, then litigating the accrual date would necessarily also litigate the occurrence date for purposes of denying coverage.

The Fifth Circuit reiterated that, in certain situations, a court may look to evidence outside the eight-corners in determining an insurer's duty to defend. *Star-Tex Resources, L.L.C. v. Granite State Ins. Co.*, 553 F. App'x 366 (5th Cir. 2014) (per curiam). An insured sought defense for a suit against it concerning an auto collision caused by the insured's employee. The insurer denied coverage, relying on the policy's exclusion for damages arising out of use of an auto. The insured argued that this exclusion did not apply because the petition in the underlying suit did not state that the employee was driving or operating an automobile at the time of the collision, only that the auto collision was caused by the employee's negligence. The Fifth Circuit held that, based on the pleadings, it could not determine whether there was a potentially covered claim, as other reasonable inferences were possible that would not place the employee in an automobile at the time of the accident. However, the court concluded that it could consider extrinsic evidence to determine whether the insurer owed a duty to defend because it was "initially impossible to discern whether coverage is potentially implicated and … the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits[.]" In particular, the court looked at a notice of claim sent to the insurer by the plaintiff, which stated that the employee was driving the car. In looking at the eight corners as well as this extrinsic evidence, the court held that the insurer had no duty to defend the insured.

A liability insurer owed a defense to a correctional facility sued for civil rights violations for withholding prescription medications from a prisoner. The civil rights endorsement in the policy covered "'bodily injury' caused by alleged civil rights violations, so long as such violations and any resulting injuries are not expected or intended from the standpoint of the insured." The claim arose when the insured withheld prescription medications from a prisoner, allegedly resulting in his death. In the underlying suit, the defendant invoked the medical malpractice limits provided for "health care" providers. The insurer argued that this position was inconsistent with the insured's position that withholding medications was not "medical services" within the meaning of the policy exclusion. The court noted that estoppel applies when a party takes one position and then later assumes a contrary position or when a party asserts to another's disadvantage or right inconsistent with the position the party previously took. The court held neither form of estoppel applied. The position taken in the underlying case did not involve the same language as the coverage case. Further, the position taken in the underlying case benefited the insurer by limiting the amount of the defendant's exposure. *LCS Corr. Svcs., Inc. v. Lexington Ins. Co.*, No. 2-13-CV-287, 2014 WL 1787771 (S.D. Tex. May 5, 2014).

An insurer did not owe a duty to defend the employee of an insured because the employee was not an "insured."

An insurer did not owe a duty to defend the employee of an insured because the employee was not an "insured." The pleading in the underlying suit alleged that the employee's actions were not in connection with his employment. Under the eight-corners rule, that allegation removed the employee from the definition of an "insured." The additional statement in the pleading that the employee alleged he was acting in the course and scope of his employment was insufficient to establish a duty to defend. The eight-corners rule focuses on the plaintiff's factual allegations, not the defendant's allegations. *Carter v. Westport Ins. Corp.*, 997 F. Supp. 2d 590 (S.D. Tex. 2013).

Doubts as to whether a complaint's allegations trigger coverage should be resolved in the insured's favor. *Canal Ins. Co. v. XMex Transport, LLC*, No. EP-13-CV-156-KC, 2014 WL 4385941 (W.D. Tex. Sept. 4, 2014). An insured trucking company sought a defense from its insurer relating to litigation concerning a fatal truck accident. One plaintiff in the underlying suit alleged that the individual defendants were acting in the course and scope of their employment with the insured; another plaintiff alleged that they were not. None of the pleadings specifically identified the truck at issue. Yet the court concluded that the allegations in the pleadings were sufficient to trigger coverage under the policy. Following the general rule that "the insurer is obligated to defend if there is, potentially, a case under the complaint within the coverage of the policy," the court resolved doubts in the pleadings in favor of the insured.

Summary judgment favored an insured, but not an additional insured in *Burlington Ins. Co. v. JC Instride, Inc.*, No. H-13-2844, 2014 WL 3057063 (S.D. Tex. July 7, 2014). An insured general contractor was hired by a company to clean mud tanks owned by another company. An employee of the hiring company was injured when he got into a mud tank that contained caustic materials, contrary to the insured's representation to him. The employee sued the owner of the tank and the insured. The tank owner sought a defense as an additional insured from the insured's liability insurer. The insurer denied coverage on the grounds that the policy's employee exclusion applied. The insured also sought coverage, which was granted subject to a reservation of rights, but eventually denied on grounds that the policy's pollution exclusion applied. The district court considered both of these arguments in deciding the parties' cross-motions for summary judgment. The court concluded that the employee exclusion excluded coverage for the tank owner as an additional insured. The employee was "hired to do work for or on behalf of" the insured, by virtue of the contract between the employer cleaning company and the insured. Thus, the insurer had no duty to defend the tank owner. However, the court found that the insurer did have a duty to defend the insured. Although the caustic materials in the mud qualified as pollutants under the policy, the pollution exclusion did not apply because the employee was injured by entering the mud tank, not by a "dispersal" or emission of the caustic materials.

In reconsidering a prior decision, a district court found that it was correct in not considering extrinsic evidence to decide an insurer's duty to defend. The extrinsic evidence in question overlapped with the merits and contradicted the allegations in the underlying litigation. *Admiral Ins. Co. v. Petron Energy, Inc.,* 1 F. Supp. 3d 501 (N.D. Tex. 2014). Additionally, the policy's auto exclusion did not apply to preclude a duty to defend. Whether the tortfeasor in the underlying suit was alleged to be an employee of all employers or a single employer made no difference because a jury could conclude that the tortfeasor was an employee of only one of the employers. The court further concluded that the earlier ruling on the insurer's duty to indemnify was premature.

The court also determined that an insurer breached its contract by failing to tender a defense to the insured in an underlying suit. The court's earlier decision wrongly applied the independent injury test for "extra-contractual" damages, applicable under some sections of the Texas Insurance Code, to the insured's breach of contract claim. The insured did not need to show it suffered increased fees in the underlying suit, only that they had incurred legal expenses due to the insurer's failure to provide a defense. *Admiral Ins. Co. v. Petron Energy, Inc.,* 1 F. Supp. 3d 501 (N.D. Tex. 2014).

A garage liability insurer had neither a duty to defend nor a duty to indemnify an employee involved in an automobile accident that occurred while he was driving his employer's vehicle during a personal trip. The employee was not an "insured" under the policy because he was on vacation and his use of his employer's vehicle was in the capacity of a customer and unrelated to his employment. *Sentry Select Ins. Co. v. Home State Co. Mut. Ins. Co.*, 994 F. Supp. 2d 789 (E.D. Tex. 2013).

A regulatory complaint may be considered a "claim" under a "claims made and reported" policy. An insurance agency sued its liability insurer after the insurer denied coverage for the agency in an underlying suit. The insurer argued that it owed no duty to defend or indemnify because the "claim" occurred before the policy commenced. The court agreed. The policy provided coverage for "claims made and reported" during the policy period. Here, the plaintiff in the underlying suit had filed a complaint about the agency with the Texas Department of Insurance a year before the policy commenced. The court concluded that the complaint with TDI constituted a claim under two definitions in the policy: it was a "demand against any insured" and "a … regulatory investigation against any insured." *Regency Title Co., LLC v. Westchester Fire Ins. Co.*, 5 F. Supp. 3d 836 (E.D. Tex. 2013).

B. Duty to indemnify

Two insurers insured an ambulance company that was named in a personal injury lawsuit after a patient was injured while being loaded into an ambulance. *Nat'l Cas. Co. v. W. World Ins. Co.*, 553 F. App'x 373 (5th Cir. 2014). The insurers disputed which of them had a duty to indemnify the insured. One policy, issued by National Casualty, covered damages resulting from use of an auto; the other policy, issued by Western World, excluded damages resulting from use of an auto. The Fifth Circuit found that the damages resulted from use of an auto and that National Casualty had a duty to indemnify. Although the gurney was not touching the ambulance when the incident occurred, one of the EMTs was touching both the gurney and the ambulance and had begun the process of placing the patient into the ambulance.

An earlier appeal in the case regarding the duty to defend had determined that "the 'sole purpose' of the alleged attempt to place [the patient] in the ambulance was to use the ambulance"; "[t]he alleged attempt to load her into the ambulance 'directly caused' her injury"; and "[a]ttempting to load a patient onto an ambulance is 'not an unexpected or unnatural use of the vehicle.'" The court concluded that it was bound to this earlier opinion because it was now determined that the patient was injured while being placed into the ambulance.

Justice Owen dissented, reasoning that there was no "use" of an auto when the patient was dropped from a gurney just before EMTs were about to place her into an ambulance and, further, that the conclusions of the prior case were not binding because they were based on the pleadings, and not on the evidence at trial.

A liability policy did not cover an arbitration award against a law firm for improper billing practices. *John M. O'Quinn, P.C. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. 4:00-CV-2616, 2014 WL 3543709 (S.D. Tex. July 17, 2014). A class of plaintiffs sued their prior law firm seeking reimbursement of expenses associated with an earlier class action lawsuit because the expense reimbursement was not contemplated by the representation agreement. The plaintiffs prevailed and recovered the expenses and disgorgement of some fees the law firm had earned. The law firm sought indemnity from its umbrella insurance carrier, which denied the claim. The trial court granted summary judgment for the carrier, finding no coverage. The court found that the law firm did not suffer a "Loss" within the meaning of the policy because the damages awarded against the firm were restitutionary in nature. The court also found that the "Professional Legal Services" provision did not provide coverage because the firm's billing and fee-setting practices, from which the underlying suit arose, were not an integral part of the legal representation that it provided to the plaintiffs. Additionally, any coverage would have been excluded because the loss arose from the firm's "gaining profit or advantage to which it was not legally entitled."

C. Settlements, assignments, and covenants not to execute

In the first successful case since *Gandy*, a court of appeals affirmed a judgment against an insurer in favor of a plaintiff who took an assignment of the insured's claims. In *Great American Insurance Co. v. Hamel*, No. 08–11–00302–CV, 2014 WL 4656618 (Tex. App.—El Paso, Sept. 19, 2014, no pet.), the court rejected the insurer's argument that it was not bound by the judgment against its insured, based on the Supreme Court's decision in *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996). In *Hamel*, a home builder was sued after the homeowners discovered water damage caused by defective construction. The insurer refused to defend, contending that the loss was excluded. The plaintiffs then proceeded to a bench trial where they presented evidence of the builder's negligence and the extent of their damage. The trial court ruled in their favor. The builder then assigned to the plaintiffs its claims against the insurer. The plaintiffs proceeded to trial against the insurer, resulting in a judgment finding the insurer liable for the underlying judgment.

The insurer argued that under *Gandy*, the underlying judgment was not binding because it did not result from an "actual trial" as required by the policy language. The policy provided that suit could be brought against the insurer only to recover on a judgment that is "obtained after an actual trial." The court rejected this argument, holding that an insurance company cannot insist on compliance with an actual trial requirement where the insurer has breached its duty to defend.

The court also found sufficient evidence to support the trial court's findings that the builder defended himself in good faith, his testimony was truthful, and was not unduly influenced or affected by any stipulations or agreements or understandings between the parties. The court found there was no evidence that the underlying judgment was collusive or fraudulent. The court therefore concluded that the *Gandy* requirement of a "fully adversarial trial" was satisfied and the underlying judgment was therefore binding on the insurer.

The court also found *Gandy* distinguishable. The settlement and assignment of claims in *Gandy* was held 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 (a) the insurer has accepted coverage, or (b) the insurer has made a good faith effort to adjudicate coverage prior to the adjudication of the plaintiff's claim. The court found none of these factors present in this case.

An umbrella liability insurer sued its insured and the insured's commercial general liability insurer, seeking a declaration that it had no duty to indemnify the insured against a jury verdict. *Empire Indem. Ins. Co. v. N/S Corp.*, 571 F. App'x 344 (5th Cir. 2014) (per curiam). The Fifth Circuit held that a settlement between the plaintiff and the insured in the underlying suit extinguished any obligation of the umbrella insurer to indemnify the insured. In particular, the settlement reached in the underlying suit contained an unconditional release. The agreed judgment, entered after the settlement was executed, could not revive the insured's liability. Because the insured was not, and could never be, legally liable for the judgment based on the full release in the settlement agreement, the umbrella insurer had no duty to indemnify.

D. Excess & primary coverage

An employee of an insured was involved in a car accident while driving a truck owned by another insured. The employer's insurer asked the truck insurer to tender a defense when the injured party sued the employer. The truck insurer declined, stating it would share the defense costs. The Fifth Circuit held that the "other insurance" clauses in the two insurers' policies did not limit liability or coverage based on the existence of other available insurance, so the clauses did not conflict, which would have resulted in the defense costs being shared pro rata. Because the clauses did not conflict, the court held that under the terms of the "other insurance" clauses, the truck insurer was obligated to provide primary coverage to the employer and was liable for the entirety of the defense. *Am. States Ins. Co. v. Ace Am. Ins. Co.*, 547 F. App'x. 550 (5th Cir. 2013).

An excess insurer's coverage was triggered even though the underlying insurers settled for an amount less than their policy limits. *Plantation Pipe Line Co. v. Highlands Ins. Co.*, No. 11-12-00029-CV, 2014 WL 4346160 (Tex. App.—Eastland Aug. 29, 2014, pet. filed). An insured pipeline company sought coverage relating to a leak in one of its underground pipelines. The pipeline company had many layers of insurance. It reached a settlement with its lower-level insurers for less than the full limits of those policies, but agreed to pay the difference between the underlying settlement amounts and the underlying policy limits. The pipeline company then sued its top tier excess liability insurer, which denied coverage, arguing that the lower-level insurers had not actually paid the full limits of their policies. The court disagreed. The policy did not require the lower-level insurers to pay "full policy limits" before coverage attached; it required them to pay "ultimate net loss." Although that phrase was not defined in the excess policy, it was defined in a lower-level policy, the terms of which were adopted by the excess policy. Under the lower-level policy, "ultimate net loss" meant "all sums which the insured or … his insurer, or both, become legally obligated to pay as damages, … by … settlement [.]" Using this definition, the court concluded that the excess insurer was liable because the pipeline company and the other carriers altogether paid a sum in excess of the attachment point of the excess policy.

VI. THIRD PARTY THEORIES OF LIABILITY

A. Fraud

A certificate submitted to a state agency was not misrepresentation of coverage. An insured pest control company sued its insurer and insurance agent for fraud and misrepresentation after the insurer denied liability coverage for a suit brought against the insured by a homeowner for an allegedly improper wood destroying insect inspection (WDI). The policy excluded WDIs from coverage, but the insurer issued a certificate of insurance sent to the Texas Department of Agriculture that did not list any categories of pest control work as excluded. Because the certificate filed with the state did not identify any exclusion, the insured argued that it reasonably relied on the fact that full coverage was provided. The court of appeals disagreed. The insured had previously acknowledged in the application for insurance and the renewal application that the insurance did not include coverage for liability arising from WDI. Also, the plain language of the endorsements in the original and renewal policies excluded coverage for inspection services. The certificate specifically stated that it neither amended, extended, or altered the

The certificate specifically stated that it neither amended, extended, or altered the coverage afforded by the policies and was furnished for information only.

coverage afforded by the policies and was furnished for information only. The court concluded that the policies and application would not have caused a reasonable person to believe that the insured had coverage for liability arising from inspections, including WDI. Consequently, the insured could not prove its causes of action for DTPA, insurance code violations, fraud, and negligent misrepresentation. *Simon v. Tudor Ins. Co.*, No. 05-12-00443-CV, 2014 WL 473239 (Tex. App.—Dallas Feb. 5, 2014, no pet.).

VII. DAMAGES & OTHER ELEMENTS OF RECOVERY

A. Attorney's fees

An award of attorney's fees was reversed and remanded where the plaintiff's attorney did not segregate time, or estimate the allocation of time, between breach of contract and statutory claims that allow fee recovery and negligence claims that do not allow fees. *Prudential Ins. Co. v. Durante*, No. 08–12–00077–CV, 2014 WL 4259434 (Tex. App.—El Paso Aug. 29, 2014, pet. granted).

In *United Nat'l Ins. Co. v. AMJ Investments, L.L.C.*, No. 14-12-00941-CV, 2014 WL 2895003 (Tex. App.—Houston [14th Dist.] June 26, 2014, no pet.), a building's owner and its property insurer disputed the amount the insurer should pay under the policy after the building sustained damage from a hurricane. The court of appeals upheld the bad faith claims that the lower court found against the insurer, but reversed the attorney's fee award. The insured's attorney used the lodestar method of proving attorney's fees, but had not kept billing records. Instead, he estimated the amount of time it took him for general tasks, such as discovery. The court held that the insured failed to introduce evidence that was sufficiently specific to permit the determination of a reasonable fee for its attorney's services, and reversed and remanded.

An insured did not have to segregate attorney's fees awarded against an insurance agency found liable for breach of contract and an insurance broker found liable for negligence where the insured's claims against both arose out of the same transaction and resulted in a single injury where the agency and broker failed to provide the coverage the insured requested. *Insurance Alliance v. Lake Texoma Highport, LLC*, No. 05-12-01313-CV, 2014 WL 6466851 (Tex. App.—Dallas Nov. 19, 2014). The court reasoned that although there was some testimony about actions specific to the broker, the jury could have determined that any fees the insured spent dealing with the broker would have been incurred anyway to bring its claims against the agency.

B. Mental Anguish

In *Great American Insurance Co. v. Hamel*, No., 08–11–00302–CV, 2014 WL 4656618 (Tex. App.—El Paso, Sept. 19, 2014, no pet.), the plaintiffs recovered mental anguish damages along with their property damage in a suit against the builder for negligent construction that allowed water damage. On appeal, the insurer argued that mental anguish damages were not recoverable, because the plaintiffs presented no evidence of any physical manifestations so that their mental anguish damages did not constitute damages because of "bodily injury." *See Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819 (Tex. 1997). The plaintiffs responded that their mental anguish was because of "property damage," and was therefore covered. The court did not accept either argument, but instead held that mental anguish is not recoverable based solely on negligent property damage, citing *City of Tyler v. Likes*, 962 S.W.2d 489 (Tex. 1997). The evidence in this case only showed that the builder was negligent, not that he acted with a heightened degree of misconduct that would allow a recovery of mental anguish damages.

VIII. DEFENSES & COUNTERCLAIMS

A. Accord & satisfaction

A property insurer's prior payment for a claim related to Hurricane Ike in 2008 did not support the defense of accord and satisfaction in a subsequent suit based on another claim arising from another storm. The court found evidence that the insurer issued a $2,500 settlement check, but there was no evidence that the insureds ever accepted it or released their claims. *Mag-Dolphus, Inc. v. Ohio Cas. Ins. Co.*, No. H–13–08S2, 2014 WL 4167497 (S.D. Tex. Aug. 13, 2014).

B. Allocation

Plaintiffs who suffered water damage to their home that covered several policy years were not required to allocate those damages between or among insurers or policies. *Great American Insurance Co. v. Hamel*, No. 08–11–00302–CV, 2014 WL 4656618 (Tex. App.—El Paso, Sept. 19, 2014, no pet.),

C. Attorney's fees for vexatious litigation

A federal magistrate abused his discretion by awarding attorney's fees against the insured's lawyers for unreasonably and vexatiously multiplying proceedings in violation of 28 U.S.C. § 1927. *Lawyers Title Ins. Corp. v. Doubletree Partners, L.P.*, 739 F.3d 848 (5th Cir. 2014). The Fifth Circuit held that there was no evidence that the attorneys had asserted the extra-contractual claims against the title insurer in bad faith, for any improper motive, or in reckless disregard of any duty owed to the court. Instead, the evidence showed that the attorneys felt obliged to assert the claims as compulsory counterclaims and had offered to put those claims on hold pending resolution of the breach of contract issues, but the insurer's attorneys had rejected this offer.

D. Insurer's waiver of, or estoppel to assert, defenses

A beneficiary could not assert that an insurer was estopped from denying coverage on a life insurance policy that had lapsed for non-payment of premium. The court held that when a valid contract exists covering the alleged promise, a plaintiff cannot recover under promissory estoppel. In this case, the policy governed the terms under which the insurer would pay. Therefore, promissory estoppel would not apply. *Lombana v. AIG Am. Gen. Life Ins. Co.*, No. 01–12–00168–CV, 2014 WL 810858 (Tex. App.—Houston [1st Dist.] Feb. 27, 2014, pet. denied).

The court also found no evidence of continued negotiations or representations by any authorized person on behalf of the insurance company, so waiver did not apply.

E. Payment

Payment of an insurance settlement check to an insured without the endorsement of a mortgagee as copayee does not constitute payment to a "holder" and thus does not discharge the insurer of its liability. *Viewpoint Bank v. Allied Prop. & Cas. Ins. Co.*, No. 05-12-01370-CV, 2014 WL 3867810 (Tex. App.—Dallas Aug. 7, 2014, pet. filed). In settlement of an insurance claim, an insurer issued checks payable jointly to its insured and the insured's mortgagee. After the insured negotiated and deposited checks without the mortgagee's endorsement and retained all of the proceeds, the mortgagee sued the insurer to recover payment. Relying on *McAllen Hospitals, LP v. State Farm Mut. Ins. Co. of Tex.*, 433 S.W.3d 535 (Tex. 2014), the court held that the insurer was not discharged from its liability on the underlying obligation or the checks under article 3 of the UCC. Additionally, the mortgagee had a conversion cause of action against the insurer under the UCC, and that remedy was not exclusive. Consequently, the insurer was obligated to pay the checks to the mortgagee.

F. Reformation

In *Lawyers Title Ins. Corp. v. Doubletree Partners, L.P.*, 739 F.3d 848 (5th Cir. 2014), the court held that an insurer was entitled to reform an insurance policy that was issued without the exception and coverage agreed to by the parties. The insurer and insured both agreed that a title insurance policy would include an exception for a flowage easement and additional survey coverage purchased by the insured. Due to a software error, the policy was issued without those forms. The court held that reformation is proper when (1) an original agreement exists between the parties, and (2) a mutual mistake occurred in reducing the agreement to writing. The evidence showed that the parties agreed to the easement and additional coverage, so the first prong was satisfied. The court also held the mistake was mutual because, even though the insurer unilaterally made the mistake, the insured knew a mistake had been made because it had agreed to the easement in the title commitment and had paid for the additional coverage that was mistakenly omitted.

G. Restitution

An insurer could not recoup payments under equitable theories of restitution, unjust enrichment, and subrogation, where the insurance contract addressed the issues in dispute. *Gotham Ins. Co. v. Warren E&P, Inc.*, No. 12–0452, 2014 WL 1190049 (Tex. Mar. 21, 2014). The insurer provided coverage for an oil well operator in case of an oil well blow out. After an oil well blew out and the insurer paid, the insurer then sought to recoup its payments based on its argument that the operator breached the insurance contract by not using due diligence and made misrepresentations about the amount of its interest.

The court held that the insurer could not proceed on its equitable claims because it was limited to contractual claims where the policy addressed the matter at issue. As shown by the insurer's contract claims, there were provisions in the policy that addressed the issues. There was some evidence that the operator breached the due diligence requirement in the policy by failing to use a proper blowout preventer. There was some evidence that the operator misrepresented its interest in the well, which affected the amount owed by the insurer. Therefore, the Court remanded for determination of the insurer's contract claims.

IX. PRACTICE & PROCEDURE

A. Appraisal

An appraisal award could not be disregarded for being non-itemized. *Michels v. Safeco Ins. Co. of Indiana*, 544 F. App'x 535 (5th Cir. 2013). Insureds sued both their homeowner's insurer and its investigator seeking coverage for smoke damage to their home that occurred during the Bastrop wildfires. The trial court granted the insurer's motion to compel appraisal. The insureds argued on appeal that the appraisal award should have been disregarded because it was not fully itemized and thus not in compliance with the policy. The Fifth Circuit disagreed and held that the insureds were estopped from making this argument, because the insureds' appraiser had requested that the umpire use a non-itemized, lump sum form. Further, the award substantially complied with the policy. The appraisers prepared itemized estimates, met to discuss them, and then submitted disputes to the umpire.

In *United Neurology, P.A. v. Hartford Lloyd's Ins. Co.*, 995 F. Supp. 2d 647 (S.D. Tex. 2014), the insured attempted to have an appraisal award regarding property damage caused by a hurricane set aside. The insured argued that the award was improper because the appraisers looked at causation in determining the award. The court held that appraisal panels act within their authority when they determine whether damage was caused by a covered event or was the result of non-covered pre-existing conditions like wear and tear, or in this case, neglect under the terms of the policy. Therefore, the insured's motion to set aside the award was denied.

The "law of the case" doctrine prevented an insured from re-litigating an insurer's liability under a homeowner's policy. *Farmers Group Ins., Inc. v. Poteet*, 434 S.W.3d 316 (Tex. App.—Fort Worth 2014, pet. denied). An insured's house was damaged by soot. She sought coverage from her home insurer. The insurer invoked the appraisal process, but failed to ever designate its appraiser and instead initiated a lawsuit asking the court to appoint an umpire. That suit was ultimately dismissed for want of prosecution. The insured then sued the insurer for breaching the contract. In an initial appeal of summary judgment, the court of appeals determined that the insured failed to present evidence of her damages by failing to segregate between covered and uncovered losses. However, the court remanded the case on the issue of the insurer's breach of the appraisal provision. In the remand, the parties disputed the scope of the trial. In particular, the insurer argued that the law of the case precluded retrial of any damages except for those associated with the appraisal process itself. The insured argued, however, that her recoverable damages should include the full amount of her claimed loss. She based her argument on the appraisal provision in the policy, which said that an award under that provision would be "binding" on both parties. Her point was that, had appraisal taken place, it would have determined the extent of her damages. The court agreed with the insurer, holding that the scope of the trial on remand was limited to the appraisal and the damages resulting from breach of the appraisal clause. The law of the case applied to preclude the insured from attempting to recover any damages relating to the property. Further, the court noted that an appraisal does not necessarily determine the amount of a covered loss. An appraisal amount may include both covered and uncovered losses, and causation is a liability question for the courts. Consequently, the insured was incorrect in arguing that the insurer would have compensated her for her loss, covered or not, if the insurer had complied with the appraisal provision.

B. Arbitration

The court in *Why Nada Cruz, L.L.C. v. Ace American Ins. Co.*, 569 F. App'x. 339 (5th Cir. 2014), held that an arbitrator did not exceed his powers in dismissing an arbitration where the insured did not file for arbitration until over two years after the date of the loss. The arbitrator held that the policy required that the request for arbitration be filed one year from the date of loss. A letter to the insurer stating that the insured would request arbitration did not meet the requirement for actually filing for arbitration.

C. Choice of law

A New York resident purchased an insurance policy, which, through a series of assignments, allowed a settlement trust to acquire the rights to the "pay on death benefits." After the insured's death, the settlement trust submitted a request to the insurer for payment. The insurer refused, arguing the rights were fraudulently acquired as part of a stranger owned life insurance scheme. The settlement trust sued the insurer. The insurer argued that New Jersey law should apply because the policy application had choice of law contacts with New Jersey. The other two interested jurisdictions were Texas, where the insurer was domiciled and suit was filed, and New York, where the insured was a resident. New Jersey law conflicted with Texas and New York law on the issue of the insurer's ability to challenge the validity of the insurance policy based on the insurable interest requirement once the contestability period had expired. The court held that New York law applied, relying on *Restatement (Second) of Conflicts of Laws* section 192, which creates a choice of law presumption in favor of the jurisdiction where the insured was domiciled at the time she applied for life insurance. *American Nat'l Ins. Co. v. Conestoga Settlement Trust*, No. 04-13-00719-CV, 2014 WL 3734215 (Tex. App.—San Antonio July 30, 2014, pet. filed).

Texas law, and not Colorado law, applied in a liability coverage dispute regarding coverage for a Colorado judgment against an insured that included an award of punitive damages. *Tesco Corp. (US) v. Steadfast Ins. Co.*, No. 01-13-00091-CV, 2014 WL 4257737 (Tex. App.—Houston [1st Dist.] Aug. 28, 2014, no pet.). The court concluded that Texas law governed the scope of coverage under the policies by looking at various factors. In particular, the insurer had its principal place of business in Texas, the insured did business in Texas, the policies were negotiated and executed in Texas, and the policies were issued from underwriters in Texas through a Texas broker. The only connection to Colorado was that the underlying judgment was entered there. Moreover, applying Colorado law would invalidate a portion of the policy, whereas applying Texas law would uphold it. The court noted that the law favors applying the law of the state that would uphold the validity of the contract.

D. Discovery

The supreme court held that a request for other claim files was overly broad and that the trial court, therefore, abused its discretion by allowing such discovery. *In re Nat'l Lloyds Ins. Co.*, No. 13–0761, 2014 WL 5785871 (Tex. Oct. 31, 2014) (per curiam). Irving's home was damaged by storms in Cedar Hill in 2011 and 2012. She contended that the insurer undervalued her claims and sued for unfair insurance practices. She sought discovery of other claims handled by the same adjusters and adjusting company. The trial court allowed discovery limited to those adjusters and to other Cedar Hill policyholders. To support her contention that her claims were undervalued, Irving proposed to compare the insurer's evaluation of the damage to her home with its evaluation of damage to other homes. The supreme court held this discovery was overly broad because it was not probative of how the insurer handled Irving's claim. The court held there were too many variables regarding the other claims for them to be relevant to Irving's claim. The court noted that it was not holding that evidence of other claims can never be relevant in coverage litigation, but that it was irrelevant in this case.

E. Experts

In a suit against a builder for water intrusion damage to a home, the trial court properly allowed expert testimony from a repair contractor and an engineer regarding the extent and timing of the damage. *Great Am. Ins. Co. v. Hamel*, No., 08–11–00302–CV, 2014 WL 4656618 (Tex. App.—El Paso Sept. 19, 2014, no pet.). The court found both experts were sufficiently qualified by their experience and education to give opinions about the wetness of wood in the house and the progression of wood rot caused by the water leaks.

A building's owner and its property insurer disputed the amount the insurer should pay under the policy after the building sustained damage from a hurricane. *United Nat'l Ins. Co. v. AMJ Inv., L.L.C.*, No. 14-12-00941-CV, 2014 WL 2895003 (Tex. App.—Houston [14th Dist.] June 26, 2014, no pet.). The trial court found that the insurer had knowingly violated the Texas Insurance Code. The insurer argued on appeal that it could not have knowingly failed to settle the claim when its liability was reasonably clear because there was no evidence that its liability was "reasonably clear," and also argued that its reliance on expert advice is not evidence of bad faith. The court held that in some circumstances, reliance on expert advice can be evidence of bad faith. In this case, although the insurer argued it properly relied on its experts, there was evidence that the insurer agreed to pay for repairs as set forth in its consultant's estimate. Therefore, the jury could have concluded that once the insurer reached that agreement, it was no longer reasonable for the insurer to rely on the contrary opinion of other experts.

Where the insurer cross-examined the insured's witness about whether he was an expert and elicited testimony that he was an expert on determining damages under a policy, that provided sufficient expert testimony to calculate the money owed under a policy that fell short of the policy that was requested. *Insurance Alliance v. Lake Texoma Highport, LLC*, No. 05-12-01313-CV, 2014 WL 6466851 (Tex. App.—Dallas Nov. 19, 2014).

F. Hospital liens

The Texas Supreme Court held that a hospital's lien was not discharged by the insurer's settlement check made jointly payable to the hospital and plaintiff, where the plaintiff deposited the check without the hospital's knowledge or endorsement. *McAllen Hosps., L.P. v. State Farm Co. Mut. Ins. Co. of Tex*, 433 S.W.3d 535 (Tex. 2014). The court held that the check that was jointly payable to the injured party and the hospital did not constitute "payment" under the hospital lien statute, Tex. Prop. Code § 55.007. Therefore, the release was not valid, the cause of action was revived, and the hospital retained its lien.

The Texas Supreme Court held that a hospital's lien was not discharged by the insurer's settlement check made jointly payable to the hospital and plaintiff, where the plaintiff deposited the check without the hospital's knowledge or endorsement.

The court did not address whether the hospital had a direct action against the insurer because that issue was not properly raised. However, the court did strongly suggest that there would be no private cause of action, because no such remedy appears in the statute. The court also noted that the hospital had the ability to sue the bank that accepted the deposit without both required endorsements, but that remedy did not preclude the hospital seeking other remedies.

Another court held that an insurer subject to a hospital lien had standing to seek declaratory judgment that the charges were unreasonable. *Allstate Indem. Co. v. Memorial Hermann Health System*, 437 S.W.3d 570 (Tex. App.—Houston [14th Dist.] 2014, no pet.). The hospital rendered services and treatment totaling $4,956.50 to Allstate's insured and perfected a hospital lien for that amount. Allstate then paid on behalf of its insured $2,118.12 to the injured plaintiff, without getting a release of the hospital lien. When the hospital sent a demand letter for the full amount, Allstate obtained a review, which found that the reasonable charges were only $1,081.88, which Allstate tendered to the hospital. Allstate then sued for declaratory judgment that it either had the right to challenge the reasonableness and necessity of the services or that the lien statute denied Allstate due process.

The court held that Allstate had standing to seek declaratory relief. Allstate was affected by the lien because Allstate paid the settlement funds that were subject to the lien. Allstate had a real and substantial controversy involving a genuine conflict of tangible interest and not merely a hypothetical dispute. The court also found that Allstate had alleged an injury to the extent the hospital was claiming it was entitled to pay more than Allstate asserted was reasonable.

G. Motion for new trial

An order granting a new trial was reversed on mandamus review. *In re United Servs. Automobile Ass'n*, No. 01-13-00508-CV, 2014 WL 4109756 (Tex. App.—Houston [1st Dist.] Aug. 21, 2014) (orig. proceeding). Insured homeowners sued their homeowner's insurance company for violations of the Insurance Code after their home was damaged by Hurricane Ike and a subsequent flood. Following trial, the jury awarded the insureds $400,000 in damages. The insureds moved for a new trial, which the trial court granted, and the insurer sought a writ of mandamus to overturn that order. The court of appeals granted the mandamus and ordered that judgment be entered on the verdict, finding that all five of the trial court's reasons for granting the motion were incorrect. In particular, the court of appeals found that it was an abuse of discretion to grant a new trial because: (1) the evidence supported the jury's finding that the insurer did not breach the policy by failing to make a payment within days of a notification of payment; (2) the insurer's closing argument did not violate the order in limine; (3) the jury's award for diminished value of the insured's home was not against the weight and preponderance of the evidence; (4) the jury's failure to award attorney's fees in the event of an appeal was consistent with the evidence because the insured's attorney never testified to the amount of fees reasonable or necessary for an appeal, only what the cost of an appeal would be; and (5) the jury's verdict as to mental anguish damages was supported by a finding that the insurer "knowingly" made misleading statements, because "knowingly" was included in one of the jury questions.

H. Removal and remand

Where a plaintiff sued State Farm Lloyds and its adjuster for unfair insurance practices, a separate State Farm entity could not remove the case to federal court claiming improper joinder of the adjuster and asserting diversity of citizenship. *Jongh v. State Farm Lloyds*, 555 F. App'x 435 (5th Cir. 2014) (per curiam). After Dr. Jongh filed suit against State Farm Lloyds and its adjuster, contending that they improperly investigated and underpaid her claims, State Farm filed an answer asserting that it had been incorrectly named as State Farm Lloyds. However, State Farm did not intervene or otherwise request that the state court substitute it as the proper party. State Farm then removed the case to federal court contending that the adjuster was improperly joined, that it was diverse, and that therefore the federal court had diversity jurisdiction. The case proceeded to a bench trial resulting in a take-nothing judgment in favor of the adjuster and State Farm.

The Fifth Circuit held that State Farm and State Farm Lloyds are separate entities. State Farm was never a party to the suit, as it had not been substituted in, and therefore lacked the authority to remove the case to federal court.

The court also rejected the argument that the adjuster was improperly joined to defeat diversity. State Farm Lloyds and the adjuster were both Texas citizens. There was no improper joinder to defeat diversity jurisdiction, because there was no diversity with any of the actual parties to the suit. While State Farm was diverse, it was not a party to the suit.

In a fairly routine case, a federal court held that the plaintiff could properly state claims for unfair insurance practices against an insurance adjuster. *Esteban v. State Farm Lloyds*, No. 3:13–CV–3501–B, 2014 WL 2134598 (N.D. Tex. May 22, 2014). The court rejected the insurer's argument that the adjuster was not subject to liability, because he was not an employee of the insurance company. The court rejected this argument because of the statutory language and holdings of the Texas Supreme Court and Fifth Circuit that establish that it is the adjuster's conduct that creates liability under Texas Insurance Code Chapter 541, not his status as an employee.

The court noted that the federal pleadings standard under *Twombly* and *Iqbal* is arguably more stringent than the Texas "fair notice" requirement.

In a very significant part of the court's decision, the court then considered whether the plaintiff's pleadings stated a claim against the adjuster. The court addressed what has been a very thorny issue for plaintiffs – In judging the sufficiency of the pleadings, does the federal standard or the Texas "fair notice" standard apply? The court noted that the federal pleadings standard under *Twombly* and *Iqbal* is arguably more stringent than the Texas "fair notice" requirement. This has proven to be a trap for plaintiffs who file state court petitions that are sufficient under the fair notice standard, but then are judged on removal under the more stringent federal standard. Application of the more stringent federal standard leads to dismissal of the plaintiff's claim, where a pleading that was insufficient under the "fair notice" standard would only require re-pleading.

The court concluded that fundamental fairness compelled applying the Texas "Fair Notice" standard and cited a Fifth Circuit opinion to that affect. *See De La Hoya v. Coldwell Banker Mex. Inc.*, 125 F. App'x 533, 537-38 (5th Cir. 2005).

The court then concluded that the plaintiff had sufficient allegations against the adjuster. She alleged that he improperly adjusted her claim; that his report failed to include many of her damages; that his estimate did not allow adequate funds to recover repairs; that he misrepresented the scope of damage as well as the amount of insurance coverage; that he engaged in the business of insurance and was therefore a person under Chapter 541; and that he had improperly adjusted her claim and misrepresented certain key facts. The court found these allegations while "relatively spare and lacking in specificity," were sufficient under the lenient Texas "Fair Notice" standard.

I. Res Judicata & collateral estoppel

Insureds' claims for damage from a water leak were not barred by res judicata or collateral estoppel based on the insurer's prior payment of a claim related to Hurricane Ike in 2008. The court found summary judgment evidence establishing that the later claim resulted from a subsequent storm. Therefore, the prior litigation and claim settlement did not bar the subsequent suit. *Mag-Dolphus, Inc. v. Ohio Cas. Ins. Co.*, No. H–13–08S2, 2014 WL 4167497 (S.D. Tex. Aug. 13, 2014).

J. Severance & separate trials

A court issued a writ of mandamus compelling a trial court to grant severance of the plaintiff's breach of contract and unfair insurance practice claims under an uninsured/underinsured motorist policy. *In re Progressive Co. Mut. Ins. Co.*, 439 S.W.3d 422 (Tex. App.—Houston [1st Dist.] 2014, orig. proceeding). The court recognized that severance is not always required. However, the court cited several other courts that concluded severance is required with UM/UIM coverage because the insurer is not liable for breach of contract until the insured first proves that the other driver was negligent and under-insured, and the amount of the plaintiff's damages. The court concluded that it would be manifestly unjust to require the parties to engage in discovery on extra-contractual claims that was much broader than discovery on the breach of contract claim.

K. Standing

A ship owner that was harmed by an insured shipyard's negligence had standing to sue the shipyard's liability insurer. *Nat'l Liab. & Fire Ins. Co. v. R&R Marine, Inc.*, 756 F.3d 825 (5th Cir. 2014). A ship sank at a shipyard during Hurricane Humberto. The shipyard's liability insurer sued the shipyard and the vessel's owner to disclaim liability under the policy. The vessel owner counterclaimed that the policy obligated the insurer to cover all sums for which the shipyard became liable and also asserted negligence claims against the shipyard. The shipyard was found to be negligent and liable to the vessel owner. After determining the shipyard's negligence liability, the court analyzed whether its insurer was liable to the vessel owner under the policy. The Fifth Circuit held that the vessel owner had standing to bring its counterclaim against the insurer under Federal Rule of Civil Procedure 13(a), even though no final judgment had established the shipyard's liability at the time the counterclaim was filed, which would preclude standing under Texas law. The Federal Rules of Civil Procedure were controlling, and under Rule 13(a), which was designed to promote judicial economy, the owner's counterclaim was compulsory. The court further held that the insurer's liability was limited to its policy limits and reduced the damages award accordingly. The court also held that attorney's fees were unavailable to the vessel owner under chapter 542 of the Insurance Code, because that chapter does not apply to marine insurance. However, attorney's fees were recoverable under section 38.001 of the Texas Civil Practice & Remedies Code. Making an *Erie* guess, the court concluded that the vessel owner was a third-party beneficiary and could sue to enforce the policy and thus recover attorney's fees under section 38.001. Finally, the court reduced the judgment interest from 18% to 6%, because the 18%, derived from section 542.060 of the Insurance Code, did not apply to marine insurance.

A plaintiff's assignment of claims to her insurer precluded her from having standing to assert claims. *Pringle v. Atlas Van Lines*, No. 4:13-CV-571-O, 2014 WL 1577870 (N.D. Tex. Apr. 16, 2014). The plaintiff asserted that a moving company lost and damaged several of her items in a move. The insurer for the entity that arranged the move reached a settlement with plaintiff and paid the agreed amount, obtaining an assignment of her claims. However, plaintiff still brought suit against the entity that arranged the move and the mover. The court held the evidence established that plaintiff assigned the claims arising out of the shipment of her household goods to the insurer, and therefore, she lacked standing to pursue her claims against them.

Plaintiffs in a tort suit could not simultaneously sue an insurer and its insured. *In Re First Mercury Ins. Co.*, 437 S.W.3d 34 (Tex. App.—Corpus Christi 2014) (orig. proceeding). The family of a shooting victim sued a security company and its liability insurer, alleging negligence on the part of the company and fraud by the insurer in connection with a settlement agreement with another victim. The insurer filed a plea to the jurisdiction, contending that it was not directly liable to the family. The trial court denied the plea, and the insurer sought mandamus relief, which was granted. The court of appeals held that the family lacked standing because they did not have a direct claim against the insurer until final judgment or agreement established that the security company was liable to the family. The court also determined that the insurer lacked an adequate remedy by appeal because allowing the family to proceed simultaneously against the insurer and the insured would create potential conflicts of interest for the insurer, and evidence pertaining to the allegedly fraudulent settlement would introduce prejudicial evidence concerning the existence of insurance.

A similar decision was reached in *Debes v. General Star Indem. Co.*, No. 09-12-00527-CV, 2014 WL 3384679 (Tex. App.—Beaumont July 10, 2014, no pet.) (mem. op.). There, a landlord sued its tenant's property insurer for breach of contract, alleging that the insurer failed to compensate him under the policy for his losses arising from a fire in the leased property. The court held that the landlord lacked standing to bring the suit because he was neither an insured nor a third-party beneficiary to the policy. The policy named only the tenant as the insured, and there was no evidence that the tenant assigned her breach of contract claim to the landlord. Thus, the landlord lacked privity with the insurer to bring the claim. Further, the policy contained no language that showed an intent of the insurer and tenant to confer any benefit on the landlord. Consequently, the landlord was not a third party beneficiary to the policy.

A federal court denied an insured's motion to dismiss or abate a liability insurer's declaratory action in deference to the pending state court underlying tort suits. *Canal Ins. Co. v. Xmex Transp., LLC*, 1 F. Supp. 3d 516 (W.D. Tex. 2014). The insurer's coverage suit and the underlying tort suits were not parallel actions because the insurer was not a party to the underlying suits and the insurer's duties under the policy were not before the state court. Also, while the question of the insurer's duty to indemnify would require the federal court to address many of the factual questions at issue in the underlying state actions, there was no res judicata concern because the federal court could not rule upon the duty to indemnify until the underlying suits were over. Other factors under the *Trejo* and *Brillhart* standards supported the federal court retaining the insurer's action.

The insurer's coverage suit and the underlying tort suits were not parallel actions because the insurer was not a party to the underlying suits and the insurer's duties under the policy were not before the state court.

L. Subrogation

As a matter of first impression, the Waco Court of Appeals held that a workers' compensation carrier may use the MCS-90 endorsement to recover its subrogation interest from the automobile liability insurer of an employer. *S. Co. Mut. Ins. Co. v. Great West Cas. Co.*, 436 S.W.3d 348 (Tex. App.—Waco 2014, no pet.). An employee was involved in a vehicle collision while acting in the course and scope of his employment. The collision injured the underlying plaintiff. The employer's liability insurance company denied coverage of the plaintiff's claims because the vehicle was not one covered by the policy. The plaintiff then sought compensation for his injuries through his workers' compensation carrier, which paid him. As the plaintiff's subrogee, the workers' compensation carrier sued the employer's liability insurer for the amount it paid the plaintiff, pursuant to a federal motor carrier endorsement, the MCS-90, which was attached to the liability insurer's policy with the employer. The liability insurer argued that the workers' compensation carrier could not recover through the MCS-90 endorsement because the endorsement was not applicable to disputes among insurers. The workers' compensation carrier argued that it could by asserting its subrogation rights. The court agreed with the workers' compensation carrier. The MCS-90 endorsement makes an insurer liable for any liability resulting from the negligent use of any vehicle by the insured, even if the vehicle is not covered under the policy. Because of its subrogation rights, the workers' compensation carrier gained the plaintiff's right to sue the liability insurer and recover under the MCS-90 endorsement.

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Virtual currencies are growing in popularity and expanding in number.

Virtual Currencies & Federal Law

Julie Andersen Hill*

Virtual currencies are growing in popularity and expanding in number.[1] People can use them to buy everything from a sandwich at Subway to a trip to space with Virgin Galactic. Some attorneys even accept virtual currencies as payment for legal services.

The rise of virtual currencies, like many innovations, poses legal questions. Most existing laws do not contemplate the existence of virtual currencies. Can existing U.S. criminal law, tax law, banking law, securities law, and consumer protection law nevertheless be applied to virtual currencies? This article provides an update on federal regulators' recent attempts to tackle these questions. Because virtual currencies are new, the law is still developing. There are unanswered questions and the current answers are subject to change. Nevertheless, we must start somewhere.

I. What Are Virtual Currencies and How Do They Work?

First, some background on virtual currencies is helpful. A virtual currency is "a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction."[2] The first virtual currencies were created as part of massive multiplayer online games. In these games, participants "earn" virtual currency by performing tasks within the game (for example, killing monsters or selling virtual land). Although the game rules often provide that the virtual currency has no value outside the game, players sometimes ignore this instruction and exchange it for dollars or goods and services outside the game.[3]

Next came cryptocurrencies operating outside of online gaming. Of the cryptocurrencies, Bitcoin is the pioneer and most prominent example. In 2008, "Satoshi Nakamoto" posted a white paper online entitled *Bitcoin: A Peer-to-Peer Electronic Cash System*.[4] The paper explained how Bitcoin works and within a few months, the payment system was up and running. Since then, many cryptocurrencies have been born, and each is trying to attract a sustainable group of users.[5] So far though, Bitcoin (with a market capitalization of more than $5 billion) is the undisputed market leader.[6]

So how does Bitcoin work? A webpage maintained by Bitcoin's core developers describes it this way: "From a user perspective, Bitcoin is nothing more than a mobile app or computer program that provides a personal Bitcoin wallet and allows a user to send and receive bitcoins with them."[7] Unlike other payment systems that typically involved at least one financial institution, virtual currencies are often described as "peer-to-peer"—that is, they allow direct payments from one person to another without any middle-men taking their cuts. Instead of trusted middlemen, Bitcoin uses an encrypted network to verify and process each transaction. As Bitcoin's core developers explain:

> Behind the scenes, the Bitcoin network is sharing a public ledger called the "block chain". This ledger contains every transaction ever processed, allowing a user's computer to verify the validity of each transaction. The authenticity of each transaction is protected by digital signatures corresponding to the sending addresses, allowing all users to have full control over sending bitcoins from their own Bitcoin addresses. In addition, anyone can process transactions using the computing power of specialized hardware and earn a reward in bitcoins for this service. This is often called "mining".[8]

In sum, Bitcoin is a system that allows users to transfer money directly to other users. While traditional payment systems rely on banks or other financial intermediaries to process transactions and prevent double spending, Bitcoin instead depends on authentication by a network of unaffiliated "miners."

People sometimes describe Bitcoin as an anonymous payment system, but it is more accurately described as a pseudonymous payment system. As just explained, all transactions are recorded on the public block chain.[9] If a user makes her Bitcoin address public or repeatedly uses the same address, it can be relatively easy to discover a user's transactions. Newer cryptocurrencies may promise greater anonymity,[10] but in a world where the National Security Agency (NSA) conducts widespread online surveillance, it is questionable whether any online transactions are beyond government discovery.[11]

Miners aren't the only third parties that facilitate Bitcoin transactions. Virtual currencies would have limited utility if users were unable to trade bitcoins for other currencies. Many users want to purchase bitcoins with U.S. dollars, or convert bitcoins into Japanese yen. The aptly named Bitcoin exchanges match buyers and sellers.[12]

With this basic understanding of virtual currencies we turn to the legal issues raised by virtual currencies.

II. Criminal Law

Perhaps the first legal question to be answered is whether virtual currencies are legal at all. Some commentators wondered whether virtual currencies run afoul of counterfeiting laws.[13] In 2009, federal prosecutors indicted Bernard von NotHaus for creating "Liberty Dollars." The press releases announcing the von NotHaus indictment and subsequent conviction seemed hostile to all alternative currencies that might "compete" with the U.S. dollar,[14] leading to speculation that virtual currencies were also illegal counterfeits. But the Liberty Dollars case is not directly analogous to virtual currencies for two reasons. First, Liberty Dollars were not virtual; they consisted of actual coins and paper notes.[15] Second, there was evidence that von NotHous attempted to pass off Liberty Dollars as U.S. dollars.[16] It seems unlikely that virtual currencies would be similarly confused with official U.S. currency. At any rate, prosecutors brought no counterfeit actions against virtual currency users, and in November 2013 the Department of Justice (DOJ) acknowledged that "many virtual currency systems offer legitimate financial services and have the potential to promote more efficient global commerce."[17] Thus, it seems the DOJ does not believe counterfeiting laws completely preclude virtual currencies.

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Instead, law enforcement officials have turned their attention to virtual currencies' facilitation of other crimes. In 2012, a Federal Bureau of Investigation (FBI) report noted that the pseudonymous nature of Bitcoin could attract criminals seeking to launder money from criminal enterprises or direct clean money to illicit enterprises (for example, purchasing illegal drugs or financing terrorism).[18] The FBI noted that its ability to track such payments depended in part on Bitcoin users' efforts to keep transactions confidential.[19]

But even when Bitcoin users are sneaky, law enforcement officials have tools to track down criminals. Federal authorities regulate Bitcoin exchanges (businesses that exchange bitcoins for non-virtual currencies) as "money services businesses" under the Bank Secrecy Act.[20] Under the Act and its implementing regulations, money services businesses like check cashers, money transmitters, and currency exchanges, must register with the Department of the Treasury.[21] Failure to register can result in civil[22] and criminal[23] penalties. Once registered, money services businesses must maintain anti-money laundering programs.[24] They also have specific reporting and recordkeeping requirements that are designed to help law enforcement officials detect criminal activity and determine the identity of the criminals.[25]

Because the Bank Secrecy Act and its regulations do not mention virtual currencies, there was confusion about whether virtual currency activities fell under their purview. The Financial Crimes Enforcement Network (FinCEN) issued guidance explaining that "[a] user of virtual currency is not [a money services business] . . . and therefore is not subject to . . . registration, reporting, and recordkeeping regulations."[26] Those who simply buy and sell goods or services with virtual currency do not have specific Bank Secrecy Act responsibilities. On the other hand, "exchangers" are considered money services businesses. "An exchanger is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency."[27] The key factor as to whether a person or entity is a "user" or an "exchanger" is whether that party is engaging in virtual currency transactions for its own account or whether it is engaging in trades on behalf of counterparties, creditors, or other third-parties. Those who trade on their own behalf or for their own account are "users." For example, those who mine Bitcoin or other virtual currency and then exchange it or spend it for their own benefit are likewise "users" and not obligated under the Bank Secrecy Act. But if exchange services are provided to others, the person or entity is an "exchanger" and is subject to the registration, reporting, and recordkeeping requirement.[28]

If there was any doubt about whether federal law enforcement officials would use the Bank Secrecy Act against virtual currency exchangers, it ended with the arrest and conviction of prominent Bitcoin entrepreneur Charlie Shrem. [29] At the time of his arrest, Shrem was the Vice President of the Bitcoin Foundation and founder of BitInstant, a New York-based Bitcoin exchange.[30] Shrem was accused of using BitInstant to funnel more than a million dollars in bitcoins to those purchasing illegal drugs in the online market known as Silk Road. Shrem and a co-defendant were indicted for operating an unlicensed money transmitting business, conspiracy to launder money, and willful failure to file a suspicious activity report.[31] Ultimately, Shrem pled guilty to operating an unlicensed money transmission business.[32] Shrem's prosecution put exchanges on notice that they may end up in trouble for facilitating payments to or from illicit enterprises.

Of course, Bank Secrecy Act prosecutions are unlikely to stamp out all virtual money laundering and other crimes. Just as money laundering persists in the non-virtual world, some online laundering and criminal activity is likely to escape detection.[33] Indeed, Bitcoin's peer-to-peer design may be uniquely suited to avoid anti-money laundering measures that have "focused upon the use of key professions as de facto policemen, guarding entry points into the financial system and limiting the ability of criminals to transfer value without scrutiny."[34] As law enforcement gains experience in dealing with virtual currencies and as currencies evolve, legal changes in this area seem likely.

III. Tax Law

Criminal is not the only law with widespread implications for virtual currencies. As Supreme Court Chief Justice John Marshall famously noted in *McCulloch v. Maryland*, "the power to tax involves the power to destroy."[35] If virtual currency users thought they would avoid the scrutiny of U.S. taxing authorities, they underestimated Uncle Sam's interest in boosting government revenues. For the Internal Revenue Service (IRS) the threshold question was not whether to tax virtual currencies, but how. Are virtual currencies "property" or are they a foreign "currency"?

The IRS issued a notice just this year concluding that "[f]or federal tax purposes virtual currency is treated as property."[36] It further stated that "[g]eneral tax principles applicable to property transactions apply to transactions using virtual currency."[37]

Figuring out taxable income from bitcoin appreciation is not conceptually difficult. Suppose you bought 250 bitcoins for $.05 each. Your basis in the bitcoins would be $12.50. Now assume that bitcoins appreciated substantially, so that one bitcoin is now worth $1000. Feeling happy, you buy a Lamborghini with your 250 bitcoins. Your gain would be the value of the bitcoins at the time you purchased the Lamborghini ($250,000) minus the basis ($12.50): $249,9897.50.[38]

If virtual currency users thought they would avoid the scrutiny of U.S. taxing authorities, they underestimated Uncle Sam's interest in boosting government revenues.

But even if every transaction is conceptually simple, it is possible that tax issues could quickly become a nightmare for virtual currency users. Suppose instead of spending your bitcoins on a Lamborghini, you use them more like a regular currency. Several times a day you buy relatively inexpensive items, like your morning coffee. Every transaction requires the same analysis. Transacting life in bitcoins requires better recordkeeping that most people maintain for their checking accounts.

And there are still a number of questions. For example, when you spend bitcoins from your wallet which ones are you spending? If you acquired bitcoins at different times, some bitcoins might have a different basis. Thus, spending them might result in different amounts of gain (or loss). Can you pick which ones you are spending first or instead apply some standard accounting rule?[39] What about international transactions?[40] Where are they taxed?[41]

The bottom line is that there is not currently an easy mechanism for assessing and collecting taxes on virtual currencies. As payment systems evolve so may tax laws.

IV. Banking Law

Because traditional payment systems often involve banks acting as intermediaries, traditional payments systems are regulated by banking law. So where do banks, the traditional payment systems facilitators, fit into the virtual currency legal framework? According to Federal Reserve Chair Janet Yellen, Bitcoin is "a payment innovation that is taking place entirely outside the banking industry."[42] "To the best" of Yellen's "knowledge, there is no intersection at all" between Bitcoin and banks that are regulated by the Federal Reserve.[43] Thus, Yellen concludes that "[t]he Federal Reserve simply does not have authority to supervise or regulate Bitcoin in any way."[44] Among other things, this means that consumer bitcoin accounts are not protected by federal deposit insurance.

But if Bitcoin and other virtual currencies gain significant traction, it seems unlikely that banks will be content to stand on the sidelines.[45] If banks want to embrace virtual currencies, can they?

At present, banks are reluctant to even provide bank accounts denominated entirely in U.S. dollars to virtual currency exchangers.[46] In 2011, the Federal Deposit Insurance Corporation (FDIC) issued a report warning banks about the risks associated with third-party payment processor relationships. The report contained a list of "merchant categories that have been associated with high-risk activities," including payday loans, money transfer networks, on-line gambling, and pornography.[47] The FDIC warned banks to conduct extra due diligence and implement "a program of ongoing monitoring for suspicious activity" when dealing with these merchants.[48] Responding to this guidance, banks were reluctant to offer account services to Bitcoin-related businesses.[49]

After the FDIC's high risk list attracted complaints that it unfairly targeted lawful businesses, the FDIC eliminated the list.[50] However, the FDIC reiterated that banks must "properly manage customer relationships."[51] "Financial institutions that fail to adequately manage [third-party] relationships may be viewed as facilitating a payment processor's or merchant client's . . . unlawful activity and, thus, may be liable for such acts or practices."[52] Given the pseudonymous nature of Bitcoin payments[53] it is difficult for banks to determine whether any of the payments made by its Bitcoin customers are illegal. Thus, in the near-term, it seems likely that banks will continue to avoid Bitcoin.

V. Investment Law

The most frequently asked question about Bitcoin is probably whether buying bitcoins will make you rich.[54] The price volatility of bitcoins offers the potential for both massive returns and massive losses. In January 2013, a single bitcoin traded for less than $20. At some points, a single bitcoin has traded for more than $1,000. Now (December 2014), that bitcoin is worth around $375.[55]

The Securities and Exchanges Commission (SEC) warns would-be investors that Bitcoin is risky. Investments related to Bitcoin "may have a heightened risk of fraud."[56] The SEC has already charged one person for running a Ponzi scheme that purported to be investing in bitcoins.[57] The SEC also warns that "fraudsters and promoters of high-risk investment schemes may target Bitcoin users."[58] In one instance "the SEC suspended trading in the securities of Imogo Mobile Technologies because of questions about the accuracy and adequacy of publicly disseminated information about the company's business, revenue and assets."[59] Some of Imogo's information related to its reported development of a mobile Bitcoin platform. Finally, the SEC warns that "[i]f fraud or theft results in you or your investment losing bitcoins, you may have limited recovery options. Third-party wallet services, payment processors and Bitcoin exchanges that play important roles in the use of bitcoins may be unregulated or operating unlawfully."[60]

So far the SEC's Bitcoin-related warnings and actions involve rather straightforward application of securities laws: if you create an investment product or company that involves bitcoins or Bitcoin-related products, you cannot entice investors by lying about what you are doing. The SEC's enforcement has not focused on the agency's authority to regulate Bitcoin directly.

Could the SEC directly regulate Bitcoin as a "security"? The answer, according to SEC Chairman Mary Jo White, is a definite maybe. She has stated that "[w]hether a virtual currency is a security under the federal securities laws, and therefore subject to our regulation, is dependent on the particular facts and circumstances at issue."[61]

Perhaps the strongest regulatory hook for the SEC is a category of securities called "investment contracts." The Securities Act of 1933 gives the SEC regulatory authority over "investment contracts"[62] —a phrase that is both "vague and broad."[63] In *SEC v. W.J. Howey Company*, the Supreme Court established a three part test for investment contracts.[64] According to *Howey* an investment contract is any contract, transaction, or scheme involving (1) an investment of money, (2) in a common enterprise, (3) with the expectation that profits will be derived from the efforts of another person.[65] Commentary is mixed as to whether virtual currencies satisfy the *Howey* factors.[66]

Like the SEC, the Commodity Futures Trading Commission (CFTC) views Bitcoin as risky. CFTC Commissioner Bart Chilton called Bitcoin a "shadow currency" and potential "house of cards."[67] CFTC is exploring the extent of its jurisdiction over Bitcoin.[68] So far, the only items the CFTC has clearly declared within its realm of authority are derivatives of bitcoins, like futures and swaps. TeraExchange recently launched the first CFTC-registered swap execution facility for bitcoins.[69]

Thus, while it is clear that the SEC and CFTC believe that Bitcoin is risky, it is not clear whether securities or futures laws apply directly to bitcoins or other virtual currencies.

VI. Consumer Protection

What about other consumer protections for users of virtual currency? Federal law protects consumers who make payments electronically, by debit card, and by credit card. If a consumer's payment information is stolen and used by a thief to make unauthorized payments, the consumer is typically on the hook for at most fifty dollars.[70] This is true even if the customer's own negligence caused the payment information to be stolen in the first place. Furthermore, in some circumstances, a consumer who pays by credit card can have charges removed from her account simply because a seller did not deliver goods or services as promised.[71] In sum, electronic payments, debit cards, and credit cards all use systems that allow charges to be reversed, and federal law protects consumers by specifying when banks must grant reversals.

It is unlikely that any of the existing federal payment protections apply to Bitcoin payments. The Truth in Lending Act's protections extend only to credit card payments.[72] Credit cards are defined as "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit."[73] But bitcoins are not credit devices.[74] Payment in bitcoins satisfies the obligation immediately; the buyer is not promising to pay later.

The Electronic Fund Transfers Act is similarly inapplicable to Bitcoin payments. The Act protects "any transfer of funds . . . which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a *financial institution* to debit or credit an account."[75]

But payment in bitcoins (or other virtual currencies) is not made through financial institutions.[76] Thus, the Electronic Fund Transfers Act does not apply.

Moreover, Bitcoin was created specifically with the idea that payments cannot be reversed. On the topic of consumer protection, Bitcoin's core developers note that "Bitcoin is freeing people to transact on their own terms."[77] They explain:

> [W]hile merchants usually depend on their public reputation to remain in businesses and pay their employees, they don't have access to the same level of information when dealing with new consumers. The way Bitcoin works allows both individuals and business to be protected against fraudulent chargebacks . . . .[78]

In other words, Bitcoin does not contain a mechanism for reversing wholly fraudulent transactions. In the event a seller does not deliver the promised goods or services, the payment cannot ordinarily be reversed without the seller's cooperation. Bitcoin does leave "public proof that a transaction [took] place, which can potentially be used in a recourse against businesses with fraudulent practices."[79] But any such recourse, is likely more difficult than the current procedures for reversing credit card payments.

It is possible the technological innovations could provide Bitcoin users some or all of the protections currently offered credit and debit card users. Bitcoin's protocol can allow transactions to be processed only after authorized by multiple signatures. This allows for the possibility of a third party provided escrow-like service. "Such services could allow a third party to approve or reject a transaction in case of disagreement between the other parties without having control on [sic] their money."[80] But buyers and sellers would have to opt into any escrow service. Unlike the protections offered by the Truth in Lending Act and the Electronic Fund Transfers Act, multiple signature authenticantion would not be an automatic part of any transaction.

While federal regulations do not currently provide significant protections for virtual currency users, federal consumer watchdogs are eyeing Bitcoin suspiciously.

While federal regulations do not currently provide significant protections for virtual currency users, federal consumer watchdogs are eyeing Bitcoin suspiciously. A Government Accountability Office Report in June 2014 noted "emerging consumer protection issues" in virtual currencies, and recommended the Consumer Financial Protection Bureau (CFPB) collaborate with other federal regulators in devising ways to regulate virtual currencies.[81] The report noted that the CFPB "has authority to issue and revise regulations that implement federal consumer financial protection laws, including the Electronic Fund Transfer Act."[82] In August 2014, the CFPB issued a consumer advisory warning of the dangers of virtual currencies. Among other things, the CFPB warns that "[i]f you trust someone else to hold your virtual currencies and something goes wrong, that company may not offer you the kind of help you expect from a bank or debit or credit card provider."[83] The CFPC encourages consumers who "encounter a problem with virtual currency or a virtual currency company" to submit an online complaint to the CFPB.[84] What exactly the CFPB will do with virtual currency complaints, remains to be seen.

Finally, to the extent that Bitcoin is just a new-fangled hook for old-fashioned fraud, existing consumer protection laws apply. For example, a federal district court, at the request of the Federal Trade Commission (FTC), issued a temporary restraining order against Butterfly Labs, a business that purportedly built computers for bitcoin mining.[85] The FTC complained that Butterfly Labs collected customer money, but failed to produce the computers as promised.[86] Regardless of the technology or product being sold, deceptive or misleading practices are punishable.

VII. Conclusion

This discussion of virtual currencies is meant as an introduction. Additional legal questions involving virtual currencies are already percolating,[87] and new questions are likely to arise.

In spite of legal uncertainty, Bitcoin enthusiasts claim the currency is less costly and less vulnerable to inflationary pressures.[88] But not everyone is a fan. Warren Buffet's business partner, Charles Munger, once described Bitcoin as "rat poison."[89]

One thing, however, is clear: virtual currencies are on the frontier of current payment systems technology. Most existing law did not contemplate the existence of virtual currencies. As consumers explore virtual currencies, the law will have to adjust and adapt.

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[1] This article was presented at the *Teaching Comsumer Law in a Virtual World Conference*, May 2014.

[2] Fin. Crimes Enforcement Network, Dep't of Treasury, FIN-2013-G001, Guidance: Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies 1 (Mar. 18, 2013), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf [hereinafter FinCEN Guidance].

[3] Steven Chung, Note, *Real Taxation of Virtual Commerce*, 28 Va. Tax Rev. 733, 740-44 (2009).

[4] Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, https://bitcoin.org/bitcoin.pdf (2008). Satoshi Nakamoto's true identity is still a mystery.

[5] They include Dogecoin (which sponsored NASCAR driver Josh Wise's car at the Aaron's 499 at Talladega Superspeedway), RonPaulCoin (named in honor of the libertarian congressman from Texas), and Coinye (a humorous currency named after rapper Kanye West that appears to have folded after West was un-amused). *See NASCAR Digest*, The Hawk Eye, July 6, 2014, at 5B; Britt Peterson, *That'll Be Three RonPaulCoins: In Bitcoin's Wake, a Wild World of Cryptocurrency Names*, Boston Globe, Sept. 21, 2014, at K2.

[6] Crypto-Currency Market Capitalizations, https://coinmarketcap.com/ (last visited Dec. 4, 2014).

[7] *Frequently Asked Questions: How Does Bitcoin Work?*, Bitcoin.org, https://bitcoin.org/en/faq#how-does-bitcoin-work (last visited Sept. 27, 2014). "Bitcoin – with capitalization, is used when describing the concept of Bitcoin, or the entire network itself. . . . bitcoin – without capitalization, is used to describe bitcoins as a unit of account." *Some Bitcoin Words You Might Hear*, Bitcoin.org, https://bitcoin.org/en/vocabulary (last visited Sept. 27, 2014).

[8] *Id.* For more fulsome descriptions of the Bitcoin protocol *see* Nakamoto, *supra* note 4.

[9] *Some Things You Need to Know*, Bitcoin.org, https://bitcoin.org/en/you-need-to-know (last visited Sept. 27, 2014) ("All Bitcoin transactions are stored publicly and permanently on the network, which means anyone can see the balance and transactions of any Bitcoin address. However, the identity of the user behind an address remains unknown until information is revealed during a purchase or in other circumstances.").

[10] Andy Greenberg, *Darkcoin, the Shadowy Cousin of Bitcoin, Is Booming*, Wired (May 21, 2014, 6:30 AM), http://www.wired.com/2014/05/darkcoin-is-booming/.

[11] *See, e.g.*, G. Alex Sinha, *NSA Surveillance Since 9/11 and the Human Right to Privacy*, 59 Loy. L. Rev. 861 (2013) (discussing NSA online surveillance).

[12] *See* Nikolei M. Kaplanov, Student Article, *Nerdy Money: Bitcoin, the Private Digital Currency, and the Case Against Its Regulation*, 25 Loy. Consumer L. Rev. 111, 121-23 (2012).

[13] *See* Reuben Grinberg, *Bitcoin: An Innovative Alternative Digital Currency*, 4 Hastings Science & Tech. L.J. 159, 182-94 (2011); Paul H. Farmer, Jr., Note and Comment, *Speculative Tech: The Bitcoin Legal Quagmire & the Need for Legal Innovation*, 9 J. Bus. & Tech. L. 85, 94-98 (2014). In particular, the Stamp Payments Act of 1862 states that:

> Whoever makes, issues, circulates, or pays out any note, check, memorandum, token, or other obligation for a less sum than $1, intended to circulate as money or to be received or used in lieu of lawful money of the United States, shall be fined under this title or imprisoned not more than six months, or both.

18 U.S.C. § 336.

[14] Press Release, U.S. Attorney's Office, Western District of North Carolina, Four Defendants Indicted in Unlawful Coin Operation (June 3, 2009), *available at* http://www.fbi.gov/charlotte/press-releases/2009/ce060309.htm ("People understand that there is only one legal currency in the United States. When groups try to replace the U.S. dollar with coins and bills that don't hold the same value, it affects the economy."); Press Release, U.S. Attorney's Office, Western District of North Carolina, Defendant Convicted of Minting His Own Currency (Mar. 18, 2011), *available at* http://www.fbi.gov/charlotte/press-releases/2011/defendant-convicted-of-minting-his-own-currency ("Along with the power to coin money, Congress has the concurrent power to restrain the circulation of money which is not issued under its own authority in order to protect and preserve the constitutional currency for the benefit of all citizens of the nation. It is a violation of federal law for individuals . . . to create private coin or currency systems to compete with the official coin and currency of the United States.").

[15] Grinberg, *supra* note 13, at 192-94

[16] *Id.*

[17] *Beyond the Silk Road: Potential Risks, Threats and Promises of Virtual Currencies: Hearing Before the S. Comm. on Homeland Security & Governmental Affairs*, 113th Cong. ___ (2013), (written statement of Mythili Raman, Acting Assistant Att'y General, U.S. Dep't of Justice Criminal Division), *available at* http://www.hsgac.senate.gov/download/?id=ac50a1af-cc98-4b04-be13-a7522ea7a70d.

[18] Federal Bureau of Investigation, Intelligence Assessment: Bitcoin Virtual Currency: Unique Features Present Distinct Challenges for Deterring Illicit Activity (Apr. 24, 2012), *available at* http://cryptome.org/2012/05/fbi-bitcoin.pdf.

[19] For example, to increase privacy, users can create a new Bitcoin address for each incoming payment and use services that anonymize the Internet Protocol (IP) address associated with payments. *See id.* at 5.

[20] *See id.* at 8.

[21] 31 U.S.C. § 5330 (2014); 31 C.F.R. § 1022.380 (2014). The statute uses the term "money transmitting business," but the regulations use the term "money services businesses."

[22] 31 U.S.C. § 5330(e).

[23] 18 U.S.C. § 1960 (2014).

[24] 31 C.F.R. § 1022.210.

[25] 31 U.S.C. § 5313; 31 C.F.R. §§ 1010.311 to .315, 1022.300 to 3320, 1022.400, and 1022.410.

[26] FinCEN Guidance, *supra* note 2, at 1.

[27] *Id.* at 2 (emphasis omitted).

[28] *See id.* 2-3. Similarly, "administrators" are money services businesses under the Act. "An administrator is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency." *Id.* at 2 (emphasis omitted).

[29] While, Shrem is the most high-profile person charged, he is not the only virtual currency exchanger to face criminal prosecution. *See, e.g.*, Press Release, U.S. Dep't of Justice, Digital Currency Business E-Gold Pleads Guilty to Money Laundering and Illegal Money Transmitting Charges (July 21, 2008), *available at* http://www.justice.gov/opa/pr/2008/July/08-crm-635.html; Press Release, U.S. Attorney's Office, Southern District of New York, Manhattan U.S. Attorney Announces Charges Against Liberty Reserve, One Of World's Largest Digital Currency Companies, And Seven Of Its Principals And Employees For Allegedly Running A $6 Billion Money Laundering Scheme, May 28, 2013, *available at* http://www.justice.gov/usao/nys/pressreleases/May13/LibertyReservePR.php.

[30] *The Coin Prince: Inside Bitcoin's First Big Money-Laundering Scandal*, The Verge (Feb. 4, 2014), http://www.theverge.com/2014/2/4/5374172/the-coin-prince-charlie-shrem-bitinstant-bitcoin-money-laundering-scandal.

[31] Indictment, U.S. v. Faiella, 14-CRIM-243 (S.D.N.Y. Apr.10, 2014).

[32] Press Release, U.S. Attorney's Office, Southern District of New York, Bitcoin Exchanges Plead Guilty in Manhattan Federal Court In Connection with the Sale of Approximately $1 Million in Bitcoins for Use on the Silk Road Website (Sept. 4, 2014), http://www.justice.gov/usao/nys/pressreleases/September14/FaiellaShremPleasPR.php.

[33] *See* Catherine Martin Christopher, *Whack-A-Mole: Why Prosecuting Digital Currency Exchanges Won't Stop Online Money Laundering*, 18 Lewis & Clark L. Rev. 1 (2014); Danton Bryans, Comment, *Bitcoin and Money Laundering: Mining for an Effective Solution*, 89 Ind. L.J. 441 (2014).

[34] Robert Stokes, *Anti-Money Laundering Regulation and Emerging Payment Technologies*, 32 No. 5 Banking & Fin. Services Pol'y Rep. 1, 3-4 (2013).

[35] 17 U.S. 316, 431 (1819).

[36] I.R.S. Notice 2014-21, 2014-16 I.R.B. 938, *available at* http://www.irs.gov/pub/irs-drop/n-14-21.pdf

[37] *Id.*

[38] Nickolas Argy, *IRS Denies Bitcoin Exalted Currency Status*, CoinTelegraph (May 14, 2014, 4:35 PM), http://cointelegraph.com/news/111446/irs_denies_bitcoin_exalted_currency_status.

[39] Christopher Rajotte et al., *Bitcoin Taxation: Understanding IRS Notice 2014-21*, Bitcoin Mag. (Apr. 4, 2014), http://bitcoinmagazine.com/11942/bitcoin-tax-understanding-irs-notice-2014-21/.

[40] *See, e.g.*, Omri Y. Marin, *Are Cryptocurrencies 'Super' Tax Havens?*, 12 Mich. L. Rev. First Impressions 38 (2013).

[41] *See* Benjamin W. Akins et al., *A Whole New World: Income Tax Consideration of the Bitcoin Economy*, ___ Pit. Tax Rev. ___ (2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2305863.

[42] Steven Russolillo, *Yellen on Bitcoin: Fed Doesn't Have Authority to Regulate It in Any Way*, Wall St. J. Blog (Feb. 27, 2014, 12:43 PM), http://blogs.wsj.com/moneybeat/2014/02/27/yellen-on-bitcoin-fed-doesnt-have-authority-to-regulate-it-in-any-way/.

[43] *Id.*

[44] *Id.*

[45] Marc Hochstein, *Wells Fargo Meets with Bitcoin Experts to 'Learn More,'* Am. Banker, Jan. 15, 2014, *available at* 2014 WLNR 1139598 (reporting that Wells Fargo executives met with Bitcoin experts because the Bank has "invested in payment systems we want to understand everything that's relevant about it").

[46] Marc Hochstein, *Why Bitcoin Matters For Bankers*, Am. Banker Mag., Mar. 2014, at 18; Kashmir Hill, *Bitcoin Companies and Entrepreneurs Can't Get Bank Accounts*, Forbes.com, (Nov. 15, 2013) http://www.forbes.com/sites/kashmirhill/2013/11/15/bitcoin-companies-and-entrepreneurs-cant-get-bank-accounts/.

[47] FDIC, *Managing Risks in Third-Party Payment Processor Relationships*, Supervisory Insights, Summer 2011, at 3-12, *available at* http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum11/managing.html.

[48] *Id.*

[49] Hochstein, *supra* note 46; Hill, *supra* note 47.

[50] Rob Blackwell, *FDIC Withdraws Alleged 'Hit List' of High-Risk Merchants*, Am. Banker, July 29, 2014, *available at* 2014 WLNR 20615636.

[51] *Id.*

[52] FDIC, Financial Institution Letter, FIL-3-2012, Payment Processor Relationships (Jan. 31, 2012), *available at* http://www.fdic.gov/news/news/financial/2012/fil12003.pdf (emphasis omitted). *See also* FDIC, Financial Institution Letter, FIL-43-2013, FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers that Engage in Higher-Risk Activities (Sept. 27, 2013), *available at* http://www.fdic.gov/news/news/financial/2013/fil13043.pdf ("Financial Institutions need to assure themselves that they are not facilitating fraudulent or other illegal activity.").

[53] *See supra* notes 9-11 and accompanying text.

[54] *Cf.* Catherine Martin Christopher, *Why On Earth Do People Use Bitcoin?*, ___ Bus. & Bankr. L.J. ___ (2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2470628 (noting that "[t]he old standby of 'buy low, sell high,' applies to Bitcoin as well as it does to anything else, and plenty of people buy bitcoins because they believe that the current price is less than the price will be in the future").

[55] *Market Price (USD)*, Blockchain.info, http://blockchain.info/charts/market-price?timespan=2year&showDataPoints=false&daysAverageString=1&show_header=true&scale=0&address= (last visited Dec. 4, 2014).

[56] SEC Office of Investor Education and Advocacy, Investor Alert: Bitcoin and Other Virtual Currency-Related Investments (2014), *available at* http://investor.gov/news-alerts/investor-alerts/investor-alert-bitcoin-other-virtual-currency-related-investments#.U2qKkqxOXcs [hereinafter SEC Bitcoin Investor Alert].

[57] SEC v. Shavers, Case No.: 4:13-CV-416 (E.D. Tex. Aug. 6, 2013), *available at* 2013 WL 4028182. The SEC had earlier issued an Investor Alert related specifically to virtual currencies and Ponzi schemes. SEC Office of Investor Education and Advocacy, Investor Alert: Ponzi Schemes Using Virtual Currencies (2013), *available at* http://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf.

[58] SEC Bitcoin Investor Alert, *supra* note 56.

[59] *Id.*

[60] *Id.*

[61] Letter from Mary Jo White, Chairman, SEC to Senator Thomas R. Carper, Chairman, Committee on Homeland Security and Government Affairs (Aug. 30, 2013), *available at* http://online.wsj.com/public/resources/documents/VCurrenty111813.pdf.

[62] 15 U.S.C. § 77b(a)(1) (2014).

[63] Grinberg, *supra* note 13, at 196. *See also* Ruoke Yang, *When is Bitcoin a Security Under U.S. Securities Law?,* 18 J. Tech. L & Pol'y 99, 111 (2013) (noting that "courts have been quite inconsistent in their approaches in interpreting 'common enterprise'").

[64] 328 U.S. 293, 298-99 (1946).

[65] *Id.*

[66] *Compare* Grinberg, *supra* note 13, at 199 (concluding that "because there is likely no common enterprise, Bitcoin is unlikely to be an investment contract") *with* Farmer, *supra* note 13, at 103 ("Bitcoins can satisfy the requirements of Howey [for being an "investment contract] . . . ; therefore, Bitcoins could be defined as securities through the broad stroke of the securities acts . . . .").

[67] *Squawk Box* (CNBC television broadcast May 7, 2013), *available at* http://video.cnbc.com/gallery/?video=3000166533&play=1.

[68] Ryan Tracy & Scott Patterson, *Bitcoin Oversight Is Beyond the Purview of Central Bank*, Wall St. J., Feb. 28, 2014, at A2.

[69] Helen Bartholomew, *Tera Launches Regulated Bitcoin Swap Platform*, Int'l Fin. Rev., Sept. 12, 2014, *available at* 2014 WLNR 25326697.

[70] 15 U.S.C. §§ 1643, 1693g (2014).

[71] *Id.* § 1666.

[72] *Id.* §§ 1643, 1666.

[73] *Id.* § 1602(m).

[74] "Credit" is defined as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." *Id.* § 1602(f).

[75] *Id.* § 1693a(7).

[76] "[T]he term 'financial institution' means a State or National bank, a State or Federal savings and loan association, a mutual savings bank, a State or Federal credit union, or any other person who, directly or indirectly, holds an account belonging to a consumer." *Id.* § 1693a(9). As explained in Parts I and IV, financial institutions do not process bitcoin transactions.

[77] *Frequently Asked Questions: What about Bitcoin and consumer protection?*, Bitcoin.org, https://bitcoin.org/en/faq#what-about-bitcoin-and-consumer-protection (last visited Sept. 27, 2014).

[78] *Id.*

[79] *Id.*

[80] *Id.* *See also* John Villasenor, *Could 'Multisig' Help Bring Consumer Protection to Bitcoin Transactions?*, Forbes.com, (Mar. 3, 2014) http://www.forbes.com/sites/johnvillasenor/2014/03/28/could-multisig-help-bring-consumer-protection-to-bitcoin-transactions/ (describing the potential of multiple signature protocols for consumer protection).

[81] Government Accountability Office Report, Virtual Currencies: Emerging Regulatory, Law Enforcement, and Consumer Protection Challenges (May 2014).

[82] *Id.* at 16.

[83] CFPB, Consumer Advisory: Risks to Consumers Posed by Virtual Currencies (Aug. 2014), *available at* http://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf.

[84] *Id.*

[85] FTC v. BF Labs, Inc., Case No. 4:14-cv-00815-BCW (W. Dist. Mo. Sept. 18, 2014) (Ex Parte Order), *available at* http://www.ftc.gov/system/files/documents/cases/140923utterflylabstro.pdf.

[86] *Id.*

[87] For example: Can campaign contributions be made using bitcoins? Does intellectual property law apply to Bitcoin? How will U.S. law interact with international efforts to regulate virtual currencies?

[88] *What Are the Advantages of Bitcoin?*, Bitcoin.org, https://bitcoin.org/en/faq#what-are-the-advantages-of-bitcoin (last visited Sept. 27, 2014).

[89] *Banks May Take Lessons from Bitcoin*, Denver Post, May 12, 2014, at 3C.

Subprime Auto Loans

The Rising Menace of Wall Street's Latest Darling

by Jeff Kirk*

Barely six years after the subprime-mortgage lending crisis threatened to implode the American economy, Wall Street is at it again. The nation's biggest banks, hedge funds, and private equity groups are fueling a new wave of subprime borrowing, to the tune of hundreds of billions of dollars. This time, however, mortgages are not the focus; instead, subprime auto loans have emerged as the hot new investment vehicle of the moment. According to the Federal Reserve Bank of New York, the number of subprime auto loans issued to borrowers doubled between 2009 and 2014.[1]

As was the case with subprime mortgages, today's subprime auto loans are being bundled by the thousands and collateralized into bond instruments that are sold off in pieces to the highest bidders, generally investors seeking double-digit returns in a market where interest rates on whole hover stubbornly close to zero. Despite the inherent issues in trading complex securities similar to the ones that sparked a worldwide recession, Wall Street has been successfully marketing these bonds to even the most stalwart institutional investors, including insurance companies and public pension funds.[2] On the flip side, subprime auto loans offer substantially reduced risk levels in contrast with subprime mortgages, thanks in no small part to the comparative ease of gaining repossession of a vehicle versus a domicile.

Despite the fact that subprime auto loans give formerly "untouchable" borrowers an opportunity to purchase vehicles once entirely out of reach, they nonetheless rankle consumer advocates for a simple reason: subprime loans target some of the nation's most desperate and least financially savvy consumers, many of whom have experienced extended periods of dire financial straits, and they are offered at interest rates often bordering on usurious. As a result, consumer advocates are questioning whether further regulation of this burgeoning industry is needed, and if so where the tipping point between protecting consumers and potentially reducing—or even cutting off—their access to auto loans lies.

NATURE OF THE BEAST: SUBPRIME LENDERS AND THEIR PREY

Broadly speaking, a subprime borrower is a consumer with a credit score below 600, and the auto loans they are effectively forced to use—if only because the alternative is usually not having a car, period—can have annual interest rates approaching 30 percent.[3] Numerous actions can lead to a consumer developing a subpar credit record, but they generally involve periods of acute financial distress owing to the failure of a business or a marriage, or in many cases an unexpected family illness not covered—in part or in full—by health insurance.[4]

Contrary to popular belief, myriad means exist for decimating one's credit score aside from actions as drastic as declaring bankruptcy, including failure to make continuous on-time payments for credit cards with a revolving balance. Furthermore, the short sale of a home—which involves paying the lienholder(s) of a mortgage less than the balance due—is just as detrimental to a consumer's credit score as declaring bankruptcy, according to FICO.[5]

While subprime mortgages and subprime vehicle loans differ substantially, one difference in particular is simple but key: a consumer can forego purchasing a home and rent one, but car ownership is a requisite for an overwhelming majority of American households.[6] An estimated 91 percent of American adults commute to work using their personal vehicles.[7] In most cases these drivers lack any other reasonable transport option; on average, only 27 percent of American jobs are accessible via public transit service in less than 90 minutes, and nearly half of the residents of the suburban South—including people residing in the Houston, Dallas, and Austin suburbs—have no access to public transportation of any sort.[8] Even for poor-credit consumers who can get by without making a monthly housing payment—in many cases because they are cohabitating with family or friends—ready access to a car is often an absolute necessity.

Enter the subprime auto lender. The difference between home and auto loans is key from a lender's perspective as well: home foreclosure is inevitably a messy process, and often one that cannot be completed without going through state-level courts.[9] In contrast, a lender seeking repossession of a motor vehicle can not only do so absent judicial intervention[10]; in many cases they can take constructive possession without leaving their desks. Modern technology has given lenders the ability to disable vehicles via any computer or smartphone with Internet access. So-called "driver-interrupt devices" allow both lenders and "repo men" to disable a car at the click of a mouse button until any outstanding loan balance has been paid, and they are increasingly being installed in vehicles purchased with subprime loans.[11] Despite numerous complaints about the devices, auto dealers typically respond by noting that borrowers nearly always assent to their installation.[12] They also point out that "constructive repossession" is much less stressful and embarrassing than actual repossession, which often involves a forcible vehicle removal at a borrower's home and a trip to a repo yard to regain possession, coupled with a hefty repo fee.[13]

Modern technology has given lenders the ability to disable vehicles via any computer or smartphone with Internet access.

FEEDING THE BEAST: LENDERS AND THEIR AMPLE INVESTORS

While banks specializing in subprime auto loans dominate the industry—one such bank, Santander Consumer USA, financed nearly one-quarter of all subprime car loans in the first half of 2014[14]—many of America's biggest traditional lending institutions are also significant players in the game. Wells Fargo, for instance, manages a total of over $50 billion in auto loans, and in 2013, 17 percent of its loans were given to consumers with credit scores of 600 or less.[15] Further, the dollar amounts fueling the industry as a whole are staggering. As of the first quarter of 2014, American consumers had outstanding auto loans valued at nearly $900 billion,[16] and 27 percent of the loans originated in 2013 were subprime in nature—a rise of 130 percent since the aftermath of the 2008 financial crisis.[17]

Collateralized subprime auto-loan instruments have proven appealing to an investor base well beyond the norm. Thanks to their high returns-on-investment—at a time when most auto loan-backed securities yield returns of only one percent to four percent[18]—and substantially lower risk levels in contrast with subprime mortgages, the new loan vehicles are being backed by groups ranging from private equity firms to credit unions.[19] On top of that, Wall Street banks are securitizing subprime auto loans in nearly the same fashion they once did with subprime mortgages. After collectively pooling thousands of auto loans into a single instrument, the banks divvy it up and sell its pieces to the likes of hedge funds and high-yield mutual funds. In effect, any buyer with an appetite for (marginal) risk in return for sizable returns is fair game. As one example, Prestige Financial Services of Utah recently offered a $390 million bond issue of bundled subprime loans with an average interest rate of 18.6 percent. Investment orders for the deal exceeded the amount available for sale by 400 percent.[20]

These buying frenzies are taking place despite the inherent risk of an unexpectedly large number of defaults at around the same time—precisely the turn of events that sparked the 2008 economic crisis.[21] Nonetheless, purchasers of collateralized subprime auto-loan instruments are presumably betting that this risk is outweighed by the reward of double-digit returns. Also, the sheer necessity of car ownership as described above precludes the possibility of a huge decline in overall sales, and in turn reduces levels of risk exposure for bond investors. Even though purchases of brand-new vehicles often decline precipitously during recessions, the total number of vehicles on the road typically remains roughly the same.[22]

As another example of an unsettling similarity with the subprime mortgage boom, bond rating agencies are bestowing these new collateralized auto-loan instruments with their highest marks. Prestige's recent bond offering, for instance, received a triple-A rating from Standard & Poor's, and a similar one the company offered in 2013 yielded the same S&P rating.[23] Nonetheless, buyers of such bonds in general have no viable means of vetting the information bond issuers provide them. As one former analyst put it, "[i]nvestors are basically taking the issuer's word that they follow certain procedures," noting that such a practice leaves ample opportunity for fraud.[24] The question remains, however, whether this possibility will deter investors eager for high-yield returns.

REINING IN THE BEAST: CONSUMER ADVOCATES STRIKE BACK

The subprime auto loan industry has historically proven difficult to police, particularly because high-interest-rate loans are generally legal under state and federal law. Nonetheless, a coalition of city, state, and federal agencies has been taking aggressive steps as of late to rein in subprime lending practices.

The Consumer Financial Protection Bureau—created as part of the Dodd-Frank Wall Street Reform and Consumer

The subprime auto loan industry is booming, thanks in large part to the millions of Americans whose low credit scores deter them from financing a vehicle purchase any other way.

Protection Act of 2010, which established a series of consumer protections in the wake of the 2008 economic crisis—has been aggressively pursuing subprime lenders for their anti-consumer loan practices. In September, for instance, the Bureau proposed direct federal oversight of nonbank auto finance companies for the first time, which would include entities like GM Financial as well as other automakers' financing arms.[25] The CFPB has also targeted multiple subprime lenders for violations of the so-called "Furnishers Rule," an element of Dodd-Frank that requires lenders to provide accurate consumer data to credit reporting agencies. In November, for example, the Bureau announced a consent order with the financing arm of Phoenix-based DriveTime—a nationwide used-car franchise—for violating the Rule, including an $8 million penalty.[26]

The CFPB has company in its federal ranks: the Justice Department and its many arms have subprime lenders in their sights as well. The U.S. Attorney for the Southern District of New York is scrutinizing whether GM fully disclosed the creditworthiness of subprime borrowers to investors who purchased stakes in its collateralized loan instruments.[27] Additionally, in Alabama, a U.S. Attorney secured a grand jury indictment last summer against a Birmingham auto dealer, alleging multiple counts of conspiracy and fraud for falsifying customer loan applications.[28] Worsening matters further for the industry, the Securities and Exchange Commission has piled on it as well. In October Ally Financial—now the nation's largest auto lender[29]—announced that it, too, was under SEC investigation for its loan-collateralization practices.[30]

Adding to the mix, state- and municipal-level agencies are putting significant pressure on the industry's lending practices in areas outside of federal purview. In November, for instance, the New York City Department of Consumer Affairs announced that it had issued subpoenas to two subsidiaries of Santander, seeking to determine whether used-car dealers were misleading low-income car buyers by failing to disclose various "fees" hidden in the fine print of their purchase contracts.[31] Further, banking giant Capital One quietly disclosed in its latest 10-Q filing that the New York District Attorney's Office has been investigating its subprime lending practices.[32] At this point one can wonder whether subprime auto loans constitute a legitimate though flawed business, or a house of cards on the verge of collapse.

CONCLUSION

The subprime auto loan industry is booming, thanks in large part to the millions of Americans whose low credit scores deter them from financing a vehicle purchase any other way. The question remains, however, how long this latest "car rush" will last. The industry is taking hits from myriad sources—city, state, and federal agencies alike—and regulators across the board appear determined to keep this investment vehicle from rolling out of control. Still, one hopes that a happy medium between two extremes—helping down-on-their-luck consumers obtain auto loans that would otherwise be out of reach, and manipulating desperate consumers into signing fraudulent and financially deleterious auto-purchase contracts—can ultimately be found.

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1 Alice Holbrook, *Is There a Subprime Auto Loan Bubble?*, USA Today (Sept. 27, 2014), *available at* http://www.usatoday.com/story/money/personalfinance/2014/09/27/subprime-auto-loan/16272641/.

2 Jessica Silver-Greenberg & Michael Corkery, *In a Subprime Bubble for Used Cars, Borrowers Pay Sky-High Interest Rates*, N.Y. Times: DealBook (Jul. 19, 2014), http://dealbook.nytimes.com/2014/07/19/in-a-subprime-bubble-for-used-cars-unfit-borrowers-pay-sky-high-rates/.

3 Michael Corkery & Jessica Silver-Greenberg, *Miss a Payment? Good Luck Moving That Car*, N.Y. Times: DealBook (Sept. 24, 2014, 9:33 PM), http://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/.

4 Over 60 percent of personal bankruptcies come as a result of medical bills. *See, e.g.*, David U. Himmelstein, MD et al., *Medical Bankruptcy in the United States, 2007: Results of a National Study*, American Journal of Medicine, Aug. 2009, at 741-746, *available at* http://www.pnhp.org/new_bankruptcy_study/Bankruptcy-2009.pdf.

5 Michelle Singletary, *What's Worse for Credit Score—Foreclosure, Short Sale or Deed in Lieu?*, Wash. Post, Aug. 30, 2011, *available at* http://www.washingtonpost.com/business/economy/whats-worse-for-credit-score--foreclosure-short-sale-or-deed-in-lieu/2011/08/30/gIQAbnTaqJ_story.html.

6 For purposes of discussion, I am including auto leases as a de facto means of ownership. While one can obviously lease a home as well, an auto lease bears much more in common with a traditional auto loan than a home lease, including a fixed interest rate and a term generally ranging from 36 to 72 months.

7 National Consumer Law Center, Consumer Credit Regulation § 10.3.1.1 at 447 n.53 (citing U.S. Dep't of Transp., Bureau of Transp. Statistics, NHTS 2001 Highlights Report, BTS 03–05 (Washington, D.C. 2003)).

8 Adie Tomer, Metropolitan Policy Program, Brookings Institution, *Where the Jobs Are: Employer Access to Labor by Transit* (2012).

9 As of this writing, 22 states require judicial foreclosures. *See, e.g.*, Mortgage Bankers Association, *Judicial Versus Non-Judicial Foreclosure*, http://www.mbaa.org/files/resourcecenter/ foreclosureprocess/judicial-versusnon-judicialforeclosure.pdf.

10 *See* U.C.C. § 9-609(b) (2002).

11 Corkery & Silver-Greenberg, *supra*.

12 Robert Szypko, *Your Car Won't Start. Did You Make the Loan Payment?*, NPR (Oct. 16, 2014), http://www.npr.org/blogs/alltechconsidered/2014/10/16/356693782/your-car-wont-start-did-you-make-the-loan-payment.

13 *Id.*

14 Jim Henry, *After Probe of Santander, GM Financial, Who's Next Among Subprime Auto Lenders?*, Automotive News (Aug. 8, 2014), http://www.autonews.com/article/20140808/ FINANCE_AND_INSURANCE/140809801/after-probe-of-santander-gm-financial-whos-next-among-subprime-auto.

15 Silver-Greenberg & Corkery, *supra*.

16 Press Release, Consumer Finance Protection Bureau, *CFPB Proposes New Federal Oversight of Nonbank Auto Finance Companies* (Sept. 17, 2014), http://www.consumerfinance.gov/newsroom/cfpb-proposes-new-federal-oversight-of-nonbank-auto-finance-companies/.

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18 Kate Kelly, *New Debt Crisis Fear: Subprime Auto Loans*, CNBC (Oct. 1, 2014), http://www.cnbc.com/id/102049575.

19 Corkery & Silver-Greenberg, *supra*.

20 *Id.*

21 Silver-Greenberg & Corkery, *supra*.

22 *See* Kelsey Mays, *Why Used-Car Prices Will Remain High*, Cars.com

(May 23, 2012), http://blogs.cars.com/kickingtires/2012/05/used-car-prices.html (the total number of cars on American roads declined only negligibly, from 241 million to 240 million, as a result of the economic crisis).

[23] Silver-Greenberg & Corkery, *supra*.

[24] Matt Robinson et al., *Auto Loans: A Subprime Market Grows in the Shadows*, Bloomberg Businessweek (Oct. 2, 2014), http://www.businessweek.com/articles/2014-10-02/auto-loans-a-subprime-market-grows-in-the-shadows.

[25] Press Release, Consumer Finance Protection Bureau, *supra*.

[26] Jim Henry, *More Subprime Lenders Are On the Hot Seat*, Automotive News (Nov. 26, 2014, 11:30 AM), http://www.autonews.com/article/20141126/FINANCE_AND_INSURANCE/311269996/more-subprime-lenders-are-on-the-hot-seat.

[27] Michael Corkery & Jessica Silver-Greenberg, *Focusing on G.M. Unit, U.S. Starts Civil Inquiry of Subprime Car Lending*, N.Y. Times: DealBook (Aug. 4, 2014, 9:23 PM), http://dealbook.nytimes.com/2014/08/04/focusing-on-g-m-unit-u-s-starts-civil-inquiry-of-subprime-car-lending/.

[28] Jessica Silver-Greenberg & Michael Corkery, *Loan Fraud Inquiry Said to Focus on Used-Car Dealers*, N.Y. Times: DealBook (Oct. 1, 2014, 10:00 PM), http://dealbook.nytimes.com/2014/10/01/loan-fraud-inquiry-said-to-focus-on-used-car-dealers/.

[29] Peter Rudegeair, *Ally Financial Overtakes Wells Fargo as Top U.S. Auto Lender*, Reuters (Dec. 1, 2014, 10:43 AM), http://www.reuters.com/article/2014/12/01/us-autos-loans-idUSKCN0JF2NK20141201.

[30] Sarah Mulholland, *Ally Says SEC Requested Documents in Subprime Auto Probe*, Bloomberg (Oct. 31, 2014, 4:19 PM), http://www.bloomberg.com/news/2014-10-31/ally-says-sec-requested-documents-in-subprime-auto-lending-probe.html.

[31] Rachel Abrams, *New York City Agency Subpoenas 2 Santander Auto Lenders*, N.Y. Times: DealBook (Nov. 14, 2014, 5:51 PM), http://dealbook.nytimes.com/2014/11/14/new-york-agency-investigates-auto-loans/.

[32] *Capital One's Subprime Auto Lending Business Under Probe*, Zacks.com (Nov. 5, 2014), http://www.zacks.com/stock/news/153089/capital-ones-subprime-auto-lending-business-under-probe.

Consumer News Alert Recent Decisions

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

FEDERAL CIRCUIT COURTS

Mandatory water and sewer charges do not involve a debt under Fair Debt Collection Practices Act. The Second Circuit held that sewer and water charges were similar to municipal taxes levied automatically in connection with ownership of property, and are not a debt for purposes of the FDCPA. *Boyd v. J.E. Robert Co., Inc.*, 765 F.3d 123 (2d Cir. Aug. 27, 2014). http://caselaw.findlaw.com/us-2nd-circuit/1676576.html

Debtor generally is not required to show intentional or knowing violation under Fair Debt Collection Practices Act and may assert claim without first disputing the debt. The Fourth Circuit held that a consumer does not have to first dispute her debt to maintain an action under the FDCPA. The court also held that a debt collector's letter stating an account had not been satisfied when the debt had been fully paid was false on its face and misrepresented to character, amount and legal status of the debt, in violation of the FDCPA. *Russell v. Absolute Collection Servs., Inc.*, 763 F.3d 385 (4th Cir. Aug. 15, 2014). http://law.justia.com/cases/federal/appellate-courts/ca4/12-2357/12-2357-2014-08-15.html

Magnuson-Moss Warranty Act does not apply to a manufactured home. The Sixth Circuit held that a manufactured home was not a consumer product as defined by Magnuson-Moss. The court recognized that although a manufactured home might be a "consumer product," the size, construction, and permanence of this home at issue illustrate that it is not a "consumer product." *Bennett v. CMH Homes, Inc.*, 770 F.3d 511 (6th Cir. Oct. 30, 2014). http://law.justia.com/cases/federal/appellate-courts/ca6/13-5560/13-5560-2014-10-30.html

FDCPA requires suit be filed in the smallest geographic area that is relevant for determining venue. The Fair Debt Collection Practices Act requires a debt collector file suit in the "judicial district or similar entity" where the contract was signed or the debtor resides. The Seventh Circuit held that this language means the smallest geographic area that is relevant for determining venue in the court system in which the case is filed. Overruling its earlier decision, the court held that in Marion County, which has nine small claims courts, the smallest area is a township. *Suesz v. Med-1 Solutions, LLC*, 757 F.3d 636 (7th Cir. July 2, 2014). http://law.justia.com/cases/federal/appellate-courts/ca7/13-1821/13-1821-2014-07-02.html

The Fair Debt Collection Practices Act requires a debt collector file suit in the "judicial district or similar entity" where the contract was signed or the debtor resides.

Class action settlement attorney's fee award unacceptable. The Seventh Circuit disapproved a negotiated attorney's fee award in a class action under the Fair and Accurate Credit Transactions Act. Under the terms of the settlement, each class member who responded positively was to receive a $10 coupon that could be used at any RadioShack store. The face value of all the coupons was $830,000. RadioShack was to pay class counsel $1 million. The Seventh Circuit reevaluated the value of the settlement to class members and the benefits of costs incurred and, noting Radio Shack's fragile financial condition, stated "A renegotiated settlement will simply shift some fraction of the exorbitant attorneys' fee awarded class counsel in the existing settlement that we are disapproving to the class members. *Aliano v. RadioShack Corp.*, 768 F.3d 622 (7th Cir. Sep. 19, 2014). http://law.justia.com/cases/federal/appellate-courts/ca7/14-1658/14-1658-2014-09-19.html

Class action settlement reversed. The Seventh Circuit reversed a negotiated class action settlement that required defendant to pay $1.93 million in fees to class counsel, plus $179,676 in expenses, $1.5 million in notice and administration costs, $1.13 million to the Orthopedic Research and Education Foundation, $865,284 to the 30,245 class members who submitted claims, and $30,000 to the six named plaintiffs ($5,000 apiece). Class members, led by the Center for Class Action Fairness, objected. The Seventh Circuit reversed. The Court noted the settlement was "a selfish deal between class counsel and the defendant, disserves the class." It questioned: "for conferring these meager benefits class counsel should receive almost $2 million?" *Pearson v. NBTY, Inc.*, 2014 WL 6466128 (7th Cir. Nov. 19, 2014). http://law.justia.com/cases/federal/appellate-courts/ca7/14-1198/14-1198-2014-11-19.html

Guarantor is not an applicant under Equal Credit Opportunity Act. The Eighth Circuit held that wives who executed guaranties of loans to a limited liability corporation company in which their husbands had an interest were not protected by the ECOA. In so holding, the court refused to follow a federal reserve Board interpretation that held the term "applicant" included a guarantor. *Hawkins v. Community Bank*, 761 F.3d 937 (8th Cir. Aug. 5, 2014). http://caselaw.findlaw.com/us-8th-circuit/1674696.html

The Ninth Circuit held that the arbitration agreement Sirius XM Radio relied upon was not enforceable because the user did not know he had any agreement with Sirius XM, let alone an arbitration agreement.

Arbitration agreement is unenforceable. The Ninth Circuit held that the arbitration agreement Sirius XM Radio relied upon was not enforceable because the user did not know he had any agreement with Sirius XM, let alone an arbitration agreement. The plaintiff purchased a Toyota truck. The truck came with a 90-day trial subscription to Sirius XM satellite radio. The plaintiff did not have to sign any documents to receive or activate the radio, it was activated just after his purchase. The court noted that "[h]ere, by contract, there is no evidence that Knutson purchased anything from Sirius XM, or ever knew that he was entering into a contractual relationship with the satellite radio service provider." *Knutson v. Sirius XM Radio Inc.*, 771 F.3d 559 (9th Cir. Nov. 10, 2014). http://law.justia.com/cases/federal/appellate-courts/ca9/12-56120/12-56120-2014-11-10.html

Agreement requiring before tribal panel is unenforceable. The Eleventh Circuit held that a defendant could not compel arbitration of consumer claims before the Cheyenne River Sioux Tribal Nation in South Dakota. The court found that arbitral forum was integral to the parties' agreement, but unavailable, and therefore the dispute could remain in federal court. The loan agreement called for disputes to be "resolved by Arbitration, which shall be conducted by the Cheyenne River Sioux Tribal Nation by an authorized representative in accordance with its consumer dispute rules." The district court initially compelled arbitration and the consumer twice tried to demand arbitration. In response, the Tribe explained it did not conduct arbitration. Based on that evidence, the district court changed course and refused to compel arbitration. The Eleventh Circuit affirmed. It found the tribe was unavailable and because the agreement had many references to the Tribe the choice of that arbitral forum was "integral" to the arbitration agreement. The pervasive references to the Tribe also prevented the court from using the severability clause to "sever" the choice of forum and compel arbitration in some alternative forum. *Inetianbor v. CashCall, Inc.*, 768 F.3d 1346 (11th Cir. Oct. 2, 2014). http://scholar.google.com/scholar_case?case=15896596615980030399&q=Inetianbor+v.+CashCall,+Inc&hl=en&as_sdt=6,32&as_vis

STATE COURTS

Arbitration clause requiring only one party must arbitrate, allowing other to litigate, is unenforceable. The Arkansas Supreme Court held that an arbitration clause was unenforceable due to a lack of mutuality because one party reserved the right to litigate. *Reg'l Care of Jacksonville, LLC v. Henry*, 2014 Ark. 361 (Ark. Sep. 11, 2014). http://law.justia.com/cases/arkansas/supreme-court/2014/cv-14-37.html

Arbitration clause that lacks mutuality is unenforceable. The Arkansas Supreme Court held that an arbitration clause that required only the consumer to arbitrate was unenforceable. The court stated:

> This court has been resolute that there is no mutuality of obligation where one party uses an arbitration agreement to shield itself from litigation, while reserving to itself the ability to pursue relief through the court system. As set out above, Alltel clearly reserved to itself the option of pursuing remedies other than arbitration, without the consequence of waiver. Moreover, that reservation and protection was limited solely to Alltel and was not extended to the customer. Succinctly put, Alltel provided itself with an "out" to the required arbitration[…]

Alltel Corp. v. Rosenow, 2014 Ark. 375 (Ark. Sep. 18, 2014). http://law.justia.com/cases/arkansas/supreme-court/2014/cv-13-995.html

Arbitrator has the power to issue sanctions over $600 Million. The Minnesota Supreme Court unanimously confirmed an arbitration award of over $600 million in punitive sanctions. Although the appellant argued the arbitrator exceeded his authority by severely sanctioning appellant for fabricating evidence, the court concluded that the parties' agreement gave the arbitrator power to impose the sanctions. The parties' arbitration agreement provided that arbitration would proceed "in accordance with the rules then in effect of the American Arbitration Association. The arbitrator may grant injunctions or other relief in such dispute or controversy." The relevant AAA rules in turn empowered the arbitrator to "grant any remedy or relief that would have been available to the parties had the matter been heard in court." The court found that both the language of the agreement and the incorporated rule were broad enough to allow the arbitrator to issue sanctions, even big sanctions, against a party who fabricated evidence. *Seagate Technology, LLC v. Western Digital Corp.*, 854 N.W.2d 750 (Minn. Oct. 8, 2014). http://law.justia.com/cases/minnesota/supreme-court/2014/a12-1944.html

Arbitration agreement unenforceable as illusory and lacked consideration. The Missouri Supreme Court found an employee's arbitration agreement was unenforceable. The court concluded that, "there was no consideration to create a valid arbitration agreement" for two reasons: continued at-will employment was insufficient consideration; and the arbitration agreement was illusory. The court characterized the arrangement as at-will employment, and followed earlier Missouri cases finding "continued at-will employment is not valid consideration to support" an arbitration agreement. The arbitration agreement also allowed the employer "to amend, modify or revoke this agreement upon thirty (30) days' prior written notice to the Employee." The court concluded that that statement allowed the employer to modify the agreement "unilaterally and retroactively," making it illusory. *Baker v. Bristol Care, Inc.*, 2014 WL 4086378 (Mo. Aug. 19, 2014). http://law.justia.com/cases/missouri/supreme-court/2014/sc93451.html

Arbitration agreement is unenforceable because it did not contain clear and unambiguous language that the plaintiff is waiving her right to sue. The New Jersey Supreme Court invalidated an arbitration provision in a debt-adjustment company contract, largely by characterizing arbitration as a waiver of a citizen's right under the New Jersey Constitution to a trial by jury. The court assumed that "an average member of the public may not know…that arbitration is a substitute for the right to have one's claim adjudicated in a court of law." Given that framing of the issue, the court found the arbitration clause lacked "clear and unambiguous language that the plaintiff is waiving her right to sue or go to court to secure relief," and therefore was unenforceable. *Atalese v. U.S. Legal Servs. Group*, 99 A.3d 306 (N.J. Sep. 23, 2014). http://caselaw.findlaw.com/nj-supreme-court/1678725.html

The New Jersey Supreme Court invalidated an arbitration provision in a debt-adjustment company contract, largely by characterizing arbitration as a waiver of a citizen's right under the New Jersey Constitution to a trial by jury.

RECENT DEVELOPMENTS

DECEPTIVE TRADE PRACTICES AND WARRANTIES

BORROWER WAS NOT A CONSUMER UNDER THE DTPA

Rojas v. Wells Fargo Bank N.A., 571 Fed. Appx. 274 (5th Cir. 2014) (unpublished).
https://www.ca5.uscourts.gov/opinions%5Cunpub%5C13/13-50884.0.pdf

FACTS: Appellee, Wells Fargo Bank N.A. ("Wells Fargo"), foreclosed on the house of Appellant, Shannon Rojas ("Rojas"), after Rojas defaulted on her mortgage payments. Rojas brought suit seeking to quiet title and alleged breach of contract, fraud, violation of DTPA and other claims against Wells Fargo. After removal to federal court, the district court upheld Wells Fargo's motion to dismiss the complaints for failure to state claims. Rojas appealed.
HOLDING: Affirmed.
REASONING: Under the DTPA a mortgagor only qualifies as a consumer if her "primary objective in obtaining the loan was to acquire a good or service, and that good or service forms the basis of the complaint." Because the subsequent loan servicing and foreclosure activities formed the basis of Rojas's claim, rather than goods or services acquired in the original transaction, the court concluded that Rojas was not a consumer under the DTPA.

MAGNUSON-MOSS WARRANTY ACT DOES NOT APPLY TO A MANUFACTURED HOME

Bennett v. CMH Homes, Inc., 770 F.3d 511 (6th Cir. 2014).
http://law.justia.com/cases/federal/appellate-courts/ca6/13-5560/13-5560-2014-10-30.html

FACTS: Plaintiffs, manufactured home buyers ("Plaintiffs"), purchased a manufactured home from CMH Homes, Inc. ("Defendant"). As part of the sales agreement, Defendant warranted that for new homes, installation at the initial home-site would be completed in accordance with applicable government requirements. Plaintiffs noticed defects in the home prior to closing. Defendant assured Plaintiffs that it would repair the home, but failed to do so to the Plaintiffs' satisfaction.

Plaintiffs filed suit and claimed a breach of contract and breach of warranty under the Magnuson-Moss Warranty Act ("MMWA"). The district court found that Defendant's installation failed to meet the applicable government requirements by including unlicensed crew members to install the manufactured home. The district court awarded damages to Plaintiffs who subsequently appealed the awarded amount. Defendant cross-appealed to challenge both liability and the damage amount in controversy.
HOLDING: Reversed and remanded.
REASONING: The MMWA limits its protections to consumer products. The court looked at both the legislative history and a canon of statutory construction in determining whether manufactured homes are consumer products under MMWA. The court reasoned that the size, construction, and permanence of Plaintiffs' home make it more like tangible personal property than a consumer product and thus concluded that MMWA does not apply to a manufactured home.

IN PRESENTING EVIDENCE OF DETRIMENTAL RELIANCE UNDER DTPA THERE IS NO REQUIREMENT THAT A CONSUMER USE THE ACTUAL WORDS "RELY" OR "RELIANCE"

THE DTPA DOES NOT REQUIRE THE CONSUMER TO BE THE PERSON WHO ACTUALLY PURCHASED OR LEASED THE SERVICES

McLeod v. Gyr, 439 S.W.3d 639 (Tex. App. 2014).
http://www.morelaw.com/verdicts/case.asp?n=05-12-01607-CV&s=TX&d=68305

FACTS: Plaintiff, Alfred Gyr ("Gyr"), retained Defendant, Bruce B. McLeod ("McLeod"), to handle his immigration matters. McLeod was to file Gyr's N-400 application for naturalization of a United States citizen. Although McLeod had never previously represented a person in connection with an N-400 application, McLeod told Gyr that he was a specialist in immigration. Gyr paid McLeod $23,000.00 for his services in connection with the N-400 application. McLeod submitted the application three times, and it was rejected three times.

Gyr sued McLeod for deceptive trade practices. The trial court rendered a final judgment in favor of Gyr on his claims under the DTPA. McLeod filed a motion for new trial, which the trial court denied.
HOLDING: Affirmed.
REASONING: The court sought to determine how much evidence one must present to sufficiently prove detrimental reliance. A consumer may maintain a DTPA action where the use or employment by any person of a false, misleading, or deceptive act or practice that is specifically listed in the statute and relied on by the consumer to his detriment is a producing cause of the consumer's economic damages. The court highlighted that a consumer must show that he detrimentally relied; however, there is no requirement that a consumer use the actual words "rely" or "reliance." Asserting that such words did not necessarily have to appear in Gyr's testimony, the court determined that Gyr presented sufficient evidence to prove his detrimental reliance on McLeod's false representations.

The court determined that Gyr presented sufficient evidence to prove his detrimental reliance on McLeod's false representations.

The court highlighted that it was also unnecessary that Gyr be the person who actually purchased or leased McLeod's services to qualify as a consumer under the DTPA. McLeod argued that Gyr was not a consumer because he obtained the funds to pay McLeod from other people. The court stated that Gyr acquired McLeod's services, and his complaint arises from false representation made in connection with the purchase of those services. The court thus concluded that Gyr had standing to show that the deceptive conduct was a producing cause of his injury.

CONSUMER CREDIT

EQUAL CREDIT OPPORTUNITY ACT'S ("ECOA") DEFINITION OF APPLICANT INCLUDES A GUARANTOR

RL BB Acquisition, L.L.C. v. Bridgemill Commons Dev. Grp., L.L.C., 754 F.3d 380 (6th Cir. 2014).
http://law.justia.com/cases/federal/appellate-courts/ca6/13-6034/13-6034-2014-06-12.html

FACTS: Defendants, H. Bernard and Starr Stone Dixon ("Bernard" and "Starr"), refinanced a debt with BB&T bank. Both Bernard and Starr executed personal guarantees as part of the refinancing. BB&T subsequently sold the debt to plaintiff, RL BB Acquisition, L.L.C. ("RL BB"). Several years later, Bernard defaulted on the loan, and RL BB sued on Starr's guaranty to collect the debt.

As an affirmative defense, Starr asserted that her guaranty was unenforceable since it violated the ECOA and Regulation B's prohibition on requiring spouses to guarantee loans. 12 C.F.R. §202.7(d)(5); 12 C.F.R. §1002.7(d)(5). The district court held that, because Starr signed as a "guarantor" and not an "applicant," she was not permitted to raise an ECOA violation as an affirmative defense. Starr appealed.

HOLDING: Reversed and remanded.

REASONING: The court, applying the two-step *Chevron* analysis, first determined that the statutory definition of applicant was ambiguous and could be read to include a guarantor. Second, the court determined that while ECOA's definition of applicant did not expressly include guarantors, Regulation B's definition of applicant did for the purpose of enforcing the Regulation B spouse-guarantor rule.

The court next looked at whether ECOA's remedies included asserting violations of the statute and Regulation B as an affirmative defense in an action to recover a debt. The court determined that, although the recoupment affirmative defense was not expressly in the statute, it did expressly permit the court to grant equitable relief as necessary to enforce the law. Thus, the court held that a defendant guarantor may raise a violation of ECOA and Regulation B as an affirmative defense of recoupment.

GUARANTOR IS NOT AN APPLICANT UNDER EQUAL CREDIT OPPORTUNITY ACT ("ECOA")

Hawkins v. Cmty. Bank of Raymore, 761 F.3d 937 (8th Cir. 2014).
http://caselaw.findlaw.com/us-8th-circuit/1674696.html

Facts: Plaintiff, Valerie Hawkins ("Hawkins"), executed a personal guaranty to secure her husband's loans in favor of Defendant, Community Bank of Raymore ("Community"). After Hawkins's husband failed to make payments due under the loan agreement, Community declared the loans to be in default and demanded payment from Hawkins as the guarantor. Hawkins filed action against Community, seeking an order declaring that her guaranty was void and unenforceable. Community moved for summary judgment on Hawkins's ECOA claim.

The court held that the plain language of the ECOA provides that a person is an applicant only if she requested credit, but executing a guaranty was not a credit request.

The district court granted Community's motion for summary judgment, concluding Hawkins was not an "applicant" within the meaning of the ECOA, and Community had not violated the ECOA by requiring her to execute the guaranty. Hawkins appealed.

Holding: Affirmed.

Reasoning: Hawkins claimed that Community's guaranty requirement constituted discrimination against her on the basis of her marital status, violating the ECOA. The court rejected this argument. Under the ECOA, an "applicant" is an individual who must apply to a creditor directly for credit, or indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit, and "apply" means to make an appeal or request formally and often in writing, and usually for something of benefit to oneself.

Thus, the court held that the plain language of the ECOA provides that a person is an applicant only if she requested credit, but executing a guaranty was not a credit request. A secondary, contingent liability did not amount to a request for credit. A guarantor engages in different conduct, receives different benefits, and exposes herself to different legal consequences than does a credit applicant, so Hawkins did not qualify as an applicant protected by the ECOA.

DEBT COLLECTION

MORTGAGEE'S DISCUSSIONS WITH HOMEOWNERS REGARDING LOAN MODIFICATION WERE NOT COMMUNICATIONS IN CONNECTION WITH A DEBT UNDER TDCA

Singha v. BAC Home Loans Serv., L.P., 564 Fed. App'x. 65 (5th Cir. 2014).
http://www.ca5.uscourts.gov/opinions%5Cunpub%5C13/13-40061.0.pdf

FACTS: Appellants, Robert and Amarjit Singha ("Singhas"), signed a promissory note deed of trust naming the Mortgage Electronic Registration System ("MERS") as beneficiary in connection with a residential home purchase. MERS subsequently assigned the deed to appellee, BAC Home Loans Servicing, L.P. ("BAC"). After defaulting on the loan two years later, the Singhas and BAC modified the loan agreement. BAC accepted several payments but then rejected a payment, asserting it would only accept full reinstatement. The Singhas again requested modification but did not finish the paperwork and submitted the partially completed application two weeks before the scheduled foreclosure sale. BAC denied their request for modification, and the property was sold at a foreclosure sale.

The Singhas brought suit in Texas state court. BAC removed the case to Texas federal district court. The district court dismissed the Singhas' claims for breach of contract, claims under the Texas Debt Collection Act ("TDCA"), and various tort claims. The Singhas appealed.

HOLDING: Affirmed.

REASONING: The Singhas claimed that BAC was not a proper mortgagee and had no right to foreclose, and by notifying the debtor of that foreclosure, BAC had falsely represented that it had such a right. Specifically, a BAC representative told the Singhas that BAC would modify the loan if they made all payments required under the first agreement and later represented that the loan had been modified. The court found that BAC was a proper mortgagee, so threatening foreclosure was expressly permitted by the TDCA.

While the court did not expressly hold that modification discussions would never be debt collection activities, it concluded that the Singhas' specific communications with BAC were not misrepresented communications in connection with debt collection. Rather, they were communications related to the negotiation of the modification of a debt.

DEBTOR GENERALLY IS NOT REQUIRED TO SHOW INTENTIONAL OR KNOWING VIOLATION UNDER FAIR DEBT COLLECTION PRACTICES ACT ("FDCPA") AND MAY ASSERT CLAIM WITHOUT FIRST DISPUTING THE DEBT

Russell v. Absolute Collection Servs., Inc., 763 F.3d 385 (4th Cir. 2014).
http://www.ca4.uscourts.gov/Opinions/Published/122357.P.pdf

FACTS: Appellee, Diane Russell ("Russell"), owed a debt to Sandhills Emergency Physicians ("Sandhills"), so Sandhills hired debt collector appellant, Absolute Collection Services, Inc. ("ACS"). Russell paid the debt to Sandhills directly instead of ACS. Despite this complete payment, ACS sent demand letters falsely asserting the debt remained due and threatened to report it to credit bureaus as past due.

Russell did not dispute the debt as authorized by the FDCPA, but filed suit under the Act. Russell claimed that she was not required to prove ACS intentionally or knowingly violated the FDCPA in order to recover damages. The district court denied ACS's motion for judgment as a matter of law. ACS appealed.

HOLDING: Affirmed.

REASONING: ACS argued that a debtor must: (1) dispute the debt before filing a claim under the FDCPA; and (2) prove an intentional or knowing violation on the part of the debt collector. The court held that the FDCPA does not require a debtor to first dispute the validity of a debt in order to state a claim under §1692e. ACS's interpretation would give collectors free rein to make false or deceptive representations about the status of a debt if the debtor failed to dispute the debt.

Russell did not dispute the debt, as authorized by the FDCPA, but filed suit under the Act.

The court also held that a debtor is not required to show an intentional or knowing violation on the part of the debt collector to recover damages. The FDCPA excludes liability for unintentional violations resulting from bona fide errors, Russell was entitled to recover damages because ACS did not prove the violations resulted from a bona fide error as defined in the Act.

TEXAS AND FEDERAL DEBT COLLECTION ACTS REQUIRE CONSUMER DEBT

Garcia v. Jenkins Babb, L.L.P., 569 Fed. App'x. 274 (5th Cir. 2014).
https://www.ca5.uscourts.gov/opinions%5Cunpub%5C13/13-10886.0.pdf

FACTS: Appellants, Israel and Melissa Garcia ("Garcias") incurred a debt that appellees, Jenkins/Babb, L.L.P. ("Jenkins Defendants"), were contracted to collect. The Jenkins Defendants initiated a collection action in state court against the Garcias, and a judgment was entered.

The Garcias responded by filing suit in federal court alleging that the Jenkins Defendants' attempts to collect the debt violated the FDCPA and the TDCPA. The district judge found that the Garcias' complaint lacked any facts to suggest that their debt was incurred through a consumer transaction, and dismissed the claims with prejudice. The Garcias appealed.

HOLDING: Affirmed.

REASONING: The court held that for a collection practice to be actionable under the FDCPA and TDCPA, the debt at issue must have arisen from a consumer transaction. The Garcias failed to factually support this allegation. The court noted that the FDC-

PA and TDCPA both expressly require consumer debt obligations to have been incurred primarily for personal, family, or household purposes.

In determining whether a debt is a consumer debt, the court focused on the precise transaction for which the loan proceeds were used. A complaint based on the FDCPA or TDCPA could not survive a motion to dismiss if it merely restates language from the statute without any accompanying facts. The court explained that because the Garcias did not specify what item was purchased, what service was paid for, or whether the item or service was intended for personal or family use, they failed to identify facts fundamental to their claim.

FDCPA REQUIRES SUIT TO BE FILED IN THE SMALLEST GEOGRAPHIC AREA THAT IS RELEVANT FOR DETERMINING VENUE

Suesz v. Med–1 Solutions, L.L.C., 757 F.3d 636 (7th Cir. 2014). http://law.justia.com/cases/federal/appellate-courts/ca7/13-1821/13-1821-2013-10-31.html

FACTS: Defendant Med-1 Solutions ("Med-1"), a debt collector, sued Plaintiff Mark Suesz ("Suesz") in small claims court. The court where Med-1 filed suit was located in a township where neither Suesz lived nor where the contract for which he was being sued was signed. Subsequent to a judgment entered against him, Suesz asserted that Med-1 had a practice of filing collection lawsuits in small claims courts located in townships where the debtor defendants neither live nor sign the contracts on which they are sued.

Suesz filed suit against Med-1 for violating the FDCPA venue provision. The district court dismissed the case, stating that pursuant to the standard for the key statutory term "judicial district" set out in *Newsom v. Friedman*, 76 F.3d 813 (7th Cir. 1996), townships were not separate judicial districts, and that debt collectors were permitted to file suit in any township within the county. Suesz appealed, and the Seventh Circuit affirmed. Suesz' petition for rehearing en banc was granted.

HOLDING: Reversed and remanded.

REASONING: The court evaluated the *Newsom* approach for defining the FDCPA's venue protection provision's statutory term in controversy, "judicial district." To protect vulnerable debtors from forum-shopping—a common abusive debt collection tactic that makes default more likely—the FDCPA states that a debt collector must sue to collect a debt only in the "judicial district or similar legal entity" in which the consumer signed the contract in question or in which the consumer resides at the commencement of the action. The court reasoned that the township small claims courts in the county in this case must be regarded as occupying separate judicial districts in order to effectuate the statute's protection, and thus overturned *Newsom*.

The correct interpretation of "judicial district" is the smallest geographical area relevant to venue in the court system in which the case is filed.

The Seventh Circuit then sought to determine a new standard for defining a relevant judicial district or similar legal entity. The court stated that *Newsom*'s plain language approach did not provide meaningful guidance because the language was too vague. The court also highlighted the inadequacy of *Newsom*'s alternative court administration approach, displaying how the approach resulted in more debt collection abuse in the present case. The court adopted a venue approach that focuses on geographic divisions rather than jurisdiction and thus concluded that the correct interpretation of "judicial district" is the smallest geographical area relevant to venue in the court system in which the case is filed.

ARBITRATION

TRIBAL ARBITRATION AGREEMENT IS UNCONSCIONABLE

Jackson v. Payday Fin., L.L.C., 764 F.3d 765 (7th Cir. 2014).
http://law.justia.com/cases/federal/appellate-courts/ca7/12-2617/12-2617-2014-08-22.html

FACTS: Plaintiff, Deborah Jackson ("Jackson"), entered into an online loan transaction to receive a small, high-interest loan from Defendants, Payday Financial, L.L.C. and other defendant entities ("Loan Entities"). The loan agreement stated that it was governed by the Indian Commerce Clause of the US Constitution and the laws of the Cheyenne River Sioux Tribe; it contained a forum selection clause requiring arbitration to resolve any dispute conducted by the Cheyenne River Sioux Tribal Nation in accordance with its consumer dispute rules, and the terms of the loan agreement.

Plaintiff filed suit in Illinois state court, alleging violations of state usury statutes and state consumer fraud statutes. Loan Entities removed the action to federal district court and moved to dismiss based on improper venue, arguing the agreement required arbitration at the Cheyenne River Indian Reservation. The district court dismissed the case for improper venue, finding the allegedly illegal loan agreement did not invalidate the forum selection clause, and the Plaintiff's agreement to arbitrate was not made fraudulently under duress. Plaintiff appealed.

HOLDING: Reversed and remanded.

REASONING: The court held that arbitration agreements are unenforceable when they are unreasonable. The arbitration agreement in the instant case was unreasonable because it was procedurally and substantively unconscionable. It was procedurally unconscionable for three reasons: (1) the tribe had no set of procedures for selecting arbitrators or conducting arbitral proceedings; (2) the inconsistent language specified not only exclusive tribal court jurisdiction but also tribal arbitration, which made it difficult for Plaintiff to understand what she was agreeing to; and (3) Loan Entities' use of the Indian Commerce Clause may have caused Plaintiff to believe she was compelled to agree to the provision.

The court also found the arbitration clause to be substantively unconscionable. Because the dispute resolution method in the loan agreement simply did not exist, part of the loan agreement was illusory and, therefore, unreasonable.

ARBITRATION AGREEMENT UNENFORCEABLE AS ILLUSORY AND LACKED CONSIDERATION

Baker v. Bristol Care, Inc.,____ S.W.3d ____(Mo. 2014) (unpublished).
https://www.courts.mo.gov/file.jsp?id=77100

FACTS: Appellant, Bristol Care, Inc. ("Bristol"), employed Appellee, Carla Baker ("Baker") and after promoting Baker, drafted an employment agreement and an arbitration agreement for her. The agreement provided that all legal claims the parties may have against one another be resolved by arbitration, and Bristol "reserves the right to amend, modify or revoke this agreement upon 30 days' prior written notice to the Employee."

Bristol subsequently terminated Baker's employment, and Baker filed suit. Bristol moved to compel arbitration, and the trial court denied the motion. Bristol appealed.

HOLDING: Affirmed.

REASONING: Bristol argued the arbitration agreement was valid because there were two sources of consideration: 1) Baker's promotion and continued employment with benefits; and 2) Bristol's promises to arbitrate claims arising from Baker's employment and to assume the costs of arbitration. First, the court held that continued at-will employment was not valid consideration to support an arbitration agreement because Bristol made no legally enforceable promise to act in a way it was not already entitled to. Bristol could still terminate an employee for any reason. The court disagreed with Bristol's argument that Baker's entitlement to severance pay following termination constituted consideration above and beyond continued at-will employment. Even if Baker had the right to recover severance pay, Baker was still an at-will employee, and the arbitration agreement still lacked valid consideration.

The court held that continued at-will employment was not valid consideration to support an arbitration agreement.

Second, the court disagreed with Bristol's assertion that the parties mutually promised to arbitrate, as the promise was conditioned on Bristol's "right to amend, modify or revoke" the agreement. This language allowed Bristol to modify the agreement unilaterally and retroactively, making it illusory, and thus was not valid consideration.

ARBITRATION AGREEMENT IS UNENFORCEABLE BECAUSE IT DID NOT CONTAIN CLEAR AND UNAMBIGUOUS LANGUAGE THAT THE PLAINTIFF IS WAIVING HER RIGHT TO SUE

Atalese v. U.S. Legal Servs. Grp., L.P., 99 A.3d 306 (N.J. 2014).
http://caselaw.findlaw.com/nj-supreme-court/1678725.html

FACTS: Plaintiff, Patricia Atalese ("Atalese"), contracted with defendant, U.S. Legal Services Group, L.P. ("USLSG"), for debt-adjustment services. The service contract contained an arbitration provision. Later, Atalese became unhappy with USLSG's services and filed suit. USLSG moved to compel arbitration.

The trial court granted USLSG's motion to compel arbitration pursuant to the service contract, and the appellate court affirmed, finding that the agreement's lack of an express waiver of the right to seek relief in court did not bar enforcement of the arbitration clause. Atalese appealed.

HOLDING: Reversed and remanded.

REASONING: Atalese contended that the arbitration clause did not clearly and unequivocally state its purpose in depriving her of the right to sue in court. USLSG argued that the term "arbitration" was universally understood, and the arbitration clause was sufficiently clear and adequately advised Atalese of her sole remedy.

The court explained that an enforceable arbitration clause must contain sufficiently clear language to place a consumer on notice that he or she is waiving the right to sue. To qualify as sufficiently clear, the arbitration clause must be phrased in plain language that is understandable to the reasonable consumer. The plain language must at least provide the reasonable consumer with constructive notice of the distinction between arbitration and judicial dispute resolution. The court applied these principles and found that the arbitration clause did not include the clear and unambiguous language required to compel arbitration and was

AGREEMENT REQUIRING ARBITRATION BEFORE TRIBAL PANEL IS UNENFORCEABLE

Inetianbor v. CashCall, Inc., 768 F.3d 1346 (11th Cir. 2014). http://media.ca11.uscourts.gov/opinions/pub/files/201313822.pdf

FACTS: Plaintiff, Abraham Inetianbor ("Inetianbor"), refused to pay a bill from his loan servicer, Defendant, CashCall, Inc. ("CashCall"), after he believed he had satisfied the terms of the loan. CashCall then reported the purported default to credit agencies, reducing Inetianbor's credit score.

Inetianbor sued CashCall, and CashCall moved to compel arbitration pursuant to Inetianbor's loan agreement. The district court denied the motion because the arbitration agreement contained an integral forum selection clause, and the specified forum was not available to arbitrate the dispute. CashCall appealed.
HOLDING: Affirmed.
REASONING: First, the court applied the integral provision rule that precludes arbitration whenever choice of forum is integral to the agreement to arbitrate. The court reasoned that the agreement's express language that arbitration "shall be conducted by the Cheyenne River Sioux Tribal Nation," and many other tribal forum references, strongly indicated that the drafter considered arbitration an integral part of the agreement.

The court then applied an availability analysis to determine whether the specified forum required the tribe's involvement and reasoned that the express language "by" the Tribe and before an "authorized representative" required direct participation from the Tribe. The court also determined that the evidence that the Tribe did not involve itself in arbitration between private parties was further support that the forum was unavailable. Thus, CashCall's intent to specify the tribal forum was an integral part of the arbitration agreement, and, because it was unavailable, the arbitration clause was unenforceable.

SPOUSE IS NOT NECESSARILY BOUND BY AN ARBITRATION AGREEMENT SIGNED BY HER HUSBAND

Zinante v. Drive Elec., L.L.C.,____ Fed. App'x. ____(5th Cir. 2014) (unpublished).
http://www.ca5.uscourts.gov/opinions%5Cunpub%5C14/14-20072.0.pdf

FACTS: Mark Zinante ("Mark"), the husband of Plaintiff-Appellee, Joy Zinante ("Zinante") purchased a golf cart from Defendant-Appellant, Drive Electric, L.L.C. ("Drive Electric") on the internet. As part of the transaction, Mark electronically consented to Drive Electric's Terms & Conditions of sale, which included an arbitration provision. Some time later, the golf cart allegedly started a house fire.

Zinante brought suit against Drive Electric for negligence and gross negligence. Drive Electric moved to compel arbitration based on the arbitration agreement in the sales contract. The court denied the motion and Drive Electric appealed.

Under Texas law there is no presumption of third party beneficiary status in the husband and wife context.

HOLDING: Affirmed.
REASONING: Drive Electric first argued that Zinante was equitably estopped from arguing the arbitration provision did not apply to her. The court found that the estoppel doctrine did not apply because Zinante's suit was not based on any of the contract terms. Drive Electric argued alternatively that Zinante's suit was based on the sales contract through the doctrine of intertwined claims. The court rejected this line of reasoning because Zinante's claims were neither derived from, nor intertwined with the terms of the contract between Mark and Drive Electric.

Drive Electric then argued that Zinante was bound by the arbitration provision as a third-party beneficiary of the contract. The court rejected this argument, asserting that under Texas law there is no presumption of third party beneficiary status in the husband and wife context and so such status does not confer without a clearly spelled out provision in the contract. The court found that the sales contract did not fulfill this requirement, and thus Zinante was not bound by the arbitration agreement.

ARBITRATION CLAUSE IN CUSTOMER AGREEMENT IS UNENFORCEABLE FOR LACK OF MUTUAL ASSENT

Knutson v. Sirius XM Radio Inc., ____ F.3d ____(9th Cir.2014). http://cdn.ca9.uscourts.gov/datastore/opinions/2014/11/10/12-56120.pdf

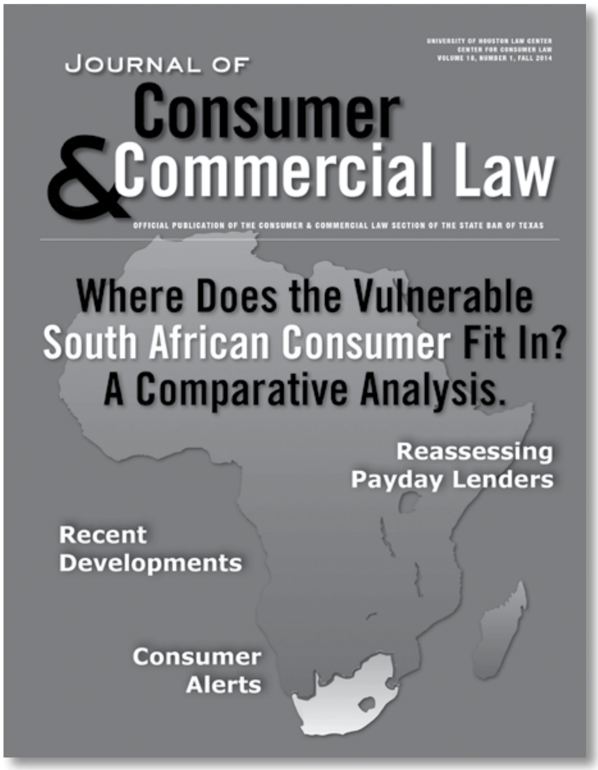
FACTS: Plaintiff, Erik Knutson ("Knutson"), purchased a vehicle that included a trial satellite radio service subscription from Defendant Sirius XM Radio Inc. ("Sirius XM"). Several weeks later, Knutson received a "Welcome Kit" from Sirius XM that included a contract, which contained an arbitration provision. The contract also stated that Knutson agreed to the terms of the agreement if he did not object within three days of the subscription activation, despite the fact that the activation occurred weeks before he received the Welcome Kit. During the trial period, Knutson also revealed several unauthorized calls from Sirius XM to his personal cell phone.

Knutson subsequently sued Sirius XM in district court for violating the federal Telephone Consumer Protection Act. The district court found that both parties consented to the contract terms and that the arbitration was valid and enforceable. Knutson appealed.
HOLDING: Reversed and remanded.
REASONING: Knutson argued that there was no mutual assent to the terms because he was not given an opportunity to review

the arbitration clause at the time his satellite radio subscription was activated. To identify whether a valid contract between the parties was formed, the court considered whether a reasonable person in Knutson's position would understand that he had agreed to the arbitration provision, and whether failure to cancel the trial subscription within three days constituted implied assent.

A reasonable person in Knutson's position could not be expected to understand that purchasing a vehicle would simultaneously bind him to a contract with Sirius XM.

The court found that a reasonable person in Knutson's position could not be expected to understand that purchasing a vehicle would simultaneously bind him to a contract with Sirius XM. Knutson could not have been obligated to act where there was no effective notice that any action was required and so he could not practically have assented to an arbitration provision. The court explained that Knutson did not affirmatively enroll in a subscription service, so nothing indicated he had read the terms of the contract. The court thus held that there was no mutual assent to the contract, rendering the arbitration clause unenforceable.



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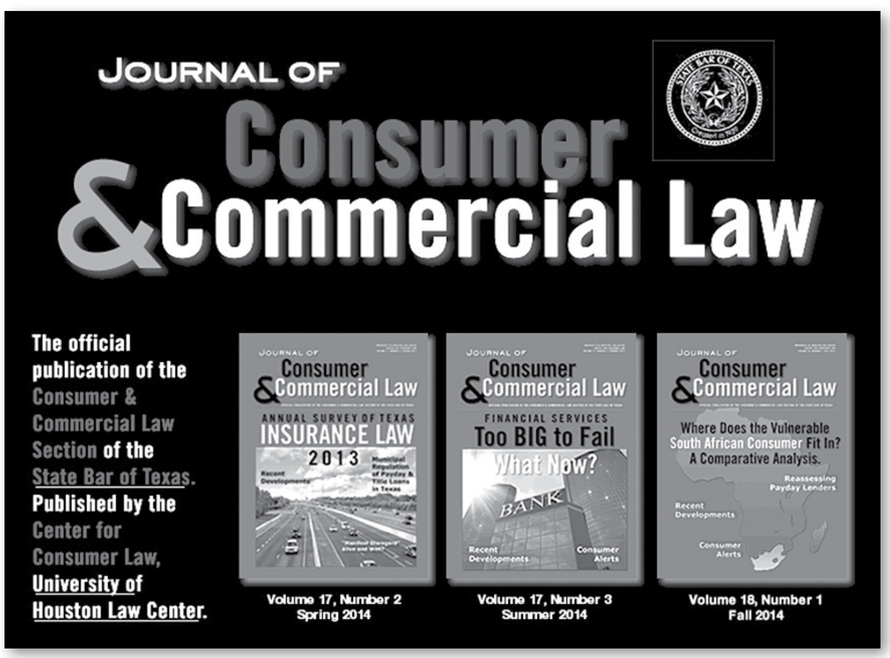

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THE LAST WORD

The *Journal* staff always tries to publish articles that our readers will find interesting, useful, and informative. In this issue, I think we make a triple play. *Teaching Consumer Law* discusses the recent international conference on teaching consumer law, providing a very interesting look at what consumer law professors are thinking and talking about. The *Insurance Law Update* article, on the other hand, may be the most useful source available for consumer attorneys to stay up-to-date on the most recent developments in insurance law. The article discusses more than 140 cases decided during the past year. And, informative articles on Bitcoin and subprime auto loans, examine two developing areas of consumer law that most of us know very little about.

I hope you enjoy this issue, and I look forward to a great 2015 for all of us.

Richard M. Alderman
Editor-in-Chief

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