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UK CLE

KENTUCKY CONSUMER LAW CONFERENCE

September 2004

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KENTUCKY CONSUMER LAW CONFERENCE

September 2004

Presented by
OFFICE OF CONTINUING LEGAL EDUCATION
UNIVERSITY OF KENTUCKY COLLEGE OF LAW

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KENTUCKY CONSUMER LAW CONFERENCE

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INTRODUTCION AND OVERVIEW OF CONSUMER PROTECTION LAWS REGARDING PRODUCTS AND SERVICES

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SECTION A

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INTRODUCTION & OVERVIEW OF CONSUMER PROTECTION LAWS REGARDING PRODUCTS AND SERVICES

I. THE KENTUCKY CONSUMER PROTECTION ACT

Many statutes in Kentucky have the effect of protecting consumers. The largest concentration of consumer protection statutes can be found in KRS 367. However; by statute the Consumer Protection Act is designated as that portion of the Chapter extending from KRS 367.110-300. (See KRS 367.120(2))

A. History

In the late 1960's, early 1970's, commentators called Kentucky a "Happy Hunting Ground" for fraud and deception. Consumers in the state were being victimized by a get rich quick scheme promoted by Glenn Turner called Dare To Be Great. At the same time, Ralph Nader was making headlines through his book, "Unsafe at Any Speed". Bait and Switch and price gouging were the norm. Vacuum cleaners were sold with claims that they would clean the air and, as a result, the consumer would not "catch cancer". Into this breach, a tiny consumer protection movement began to emerge and grow.

Most states enacted their Consumer Protection Statutes between 1965 and 1975. (**Unfair and Deceptive Acts and Practices** 5th Edition-National Consumer Law Center p. 1.) Kentucky was no exception.

In 1968 the Kentucky Attorney General and the Governor both established Consumer Advisory Councils.[1] The Governor's Council proposed a methodology for processing consumer complaints. The Attorney General's council concentrated on protecting consumers from deceptive practices. The Governor and the Attorney General who were of different parties were often at odds. At that time, Consumer Protection was considered such a radical proposal that a business group circulated a flyer suggesting that consumer advocates were furthering the Communist conspiracy.

A proposed Consumer Act failed in the 1970 session of the General Assembly. A Consumer Protection Act was finally enacted and became effective June 15, 1972. The first portion of the Act, KRS 367.110-150 was the result of the recommendations of the Governor's Council and the second portion (KRS 367.160-300), which mainly involves law enforcement, resulted from the Attorney General's Council.

Originally the Consumer Protection Act did not contain a prohibition against "Unfair " acts or practices. This portion of the Act was added in 1976. The operative portion of the Act now reads "Unfair, false, misleading or deceptive acts or practices in the conduct of any trade or

---

[1]The Governor at the time was Louie Nunn. The Attorney General was John B. Breckinridge followed by Ed Hancock.

commerce are hereby declared unlawful." The term "unfair" is to be construed as "unconscionable". (KRS 367.170)

B. UDAP

The concept of Consumer Protection was slow to emerge in Kentucky as well as most southern and rural states in the 1960's and 1970's. *Caveat Emptor* or Buyer Beware was the predominant theme in Business/Consumer relations. The then Attorney General, John Breckinridge was careful to appoint members of his Council from business, labor, consumer groups, farm and law. This Counsel used as its model what was then generally known as a "Little FTC Act". The "Little FTC Act" originated from the Federal Trade Commission and has evolved into what today is known as the UDAP laws. (Unfair, Deceptive Acts or Practices) The prohibition clause of the UDAP laws was generally modeled after the FTC's which prohibits "Unfair or Deceptive" acts or practices. (15 U.S.C. 45(a)(1))

C. Kentucky Modifications of the "Little FTC Act" or UDAP

As a result of the competing factions on the Attorney General's Council, the Kentucky UDAP or Little FTC Act was modified from the Model act proposed by the FTC. For instance, Kentucky is the only state with a prohibition clause in its Consumer Protection Act that reads "unfair, false, misleading or deceptive" instead of simply "unfair or deceptive". The terms "false" and "misleading" add little or nothing to the prohibition against "deceptive" practices and are essentially a duplication.

D. Anti-Trust

An Anti-Trust Act, patterned after the Sherman Anti-Trust Act, was placed in the middle of the Consumer Protection Act. (See **Borg-Warner Protective Servs. Corp. V Guardsmark, Inc, 946 F. Supp 495 (E.D. Ky. 1996) affirmed 156 F. 3d 1228 (6th Cir. 1998)**) The Anti-Trust Act prohibits every contract, combination or conspiracy in restraint of trade or commerce in the Commonwealth. (KRS 367.175) This statute was enacted in 1976 subsequent to the enactment of the original Consumer Protection Act in 1972. The Anti-Trust Act did not reference the Consumer Protection Act; therefore, other provisions of the Act such as the investigative authority of the Attorney General may not apply. The placement in the statute books of the Anti-Trust Act was made by the then Statute Revisor of the Legislative Research Commission. Its placement may result in confusion or misinterpretation; although, there are no known cases on the subject at this time.

II. THE PROVISIONS OF THE CONSUMER PROTECTION ACT

The Consumer Protection Act can be divided into several parts as follows:

A. Collecting Complaints, Educating and Disseminating Information and Legislative Advice (KRS 367.150)

When the Kentucky Consumer Protection Act was drafted it was envisioned that the Attorney General's Office would be a "One-Stop Shop" for Consumer redress. Accordingly, the Act requires the Attorney General to:

1. Promote the coordination of consumer protection activities of all departments of state, county and city governments concerned with activities involving consumer interests;

2. Study the operation of all laws and state policies affecting consumers and recommend to the Governor and the Legislature, new legislation, rules, regulations, orders and policies in the consumers' interest;

3. Provide a central clearing house of information by collecting and compiling consumer complaints and inquiries, and forwarding them to the proper governmental agencies if appropriate.

4. Organize, promote and conduct consumer education programs within the Commonwealth and to hold conferences on problems affecting consumers.

5. Appear before any federal, state or local governmental branch, commission, department, rate-making or regulatory body or agency, to represent consumers' interests and to be made a real party in interest to any action on behalf of consumer interests involving a quasi-judicial or rate-making proceeding of any state or local governmental branch, commission, department, agency, or rate-making body.

B. The Consumers' Advisory Council (KRS 367.130)

The Consumers' Advisory Council is made up of sixteen members appointed by the Governor. In addition, the Attorney General serves as Chairman. The Council is attached to the Attorney General's Office for administrative purposes. The Council is to act in an advisory capacity on consumer affairs as they deem necessary and as directed by the Governor, the Attorney General or the legislative branch of government. The Council is the successor to the Consumer Protection Councils initiated by Governor Nunn and Attorney General Breckinridge noted in footnote # 1. It has advised on consumer legislation which has been forwarded to the Governor and the General Assembly for consideration. This function works in coordination with the Attorney General's role as the consumer advocate before the General Assembly or what might be termed the chief consumer lobbyist.

As a result of these powers enumerated in KRS 367.150 the Attorney General's Office has developed several sections or programs, in addition to its law enforcement functions. These include:

1. Mediators who collect consumer complaints and attempt to find a satisfactory solution to matters that do not generally involve unfair or deceptive acts or practices. These complaints may be discoverable through the Kentucky Open Records Act. KRS 61.870 *et seq.*

2. A consumer education program in which material and talks are disseminated throughout Kentucky.

3. Appearances before the Kentucky General Assemble on behalf of consumer interests to promote laws benefitting and protecting consumers and to defend consumer interests when necessary. By this statute, the Attorney General became the lobbyist for consumers.

4. An office of Rate Intervention to appear before rate making and regulatory Boards and Commissions to represent consumer interests. This has resulted primarily in appearances before the state Public Services Commission for utility rates and the Department of Insurance in Health Insurance rate cases.

C. The law enforcement function of the Attorney General for violations of the Consumer Protection Act

The primary function of the Attorney General with respect to the Consumer Protection Act is to enforce that portion of the Act which prohibits "Unfair, false, misleading, or deceptive acts or practices in the conduct of any trade or commerce." (KRS 367.170) To pursue this function the Act provides for the following powers:

D. Investigation (KRS 367.240 and 250)

Consumer Protection cases are generally complex in nature. As a result, the investigation of a consumer case is the most important function. Usually if the facts are there, the case is there. However; the facts must be developed and meticulously documented.

Prior to filing litigation pursuant to the Consumer Protection Act the Attorney General may investigate allegations by using compulsory process. The General Assembly provided for investigations by the Attorney General through either an Investigative Demand or a Subpoena.

E. Investigative Demand (KRS 367.240)

When the Attorney General has reason to believe that a person has engaged in, is engaging in, or about to engage in any act or practice made unlawful by the Consumer Protection Act, or when he believes it to be in the public interest that an investigation be made, he may issue an investigative demand to obtain information or other evidence. However; no person who has a

place of business in Kentucky shall be required to appear or present documentary material or evidence outside the county where he has his principal place of business in the Commonwealth. At any time prior to the return date specified in an investigative demand, or within twenty days after the demand has been served, a petition to extend the return date, or to modify or set aside the demand, stating good cause, may be filed in the Circuit Court.

F. Subpoenas (KRS 367.250)

In addition to other powers conferred upon him by the Consumer Protection Act, the Attorney General may issue subpoenas to any person or conduct hearings in aid of any investigation or inquiry. A portion of this statute; however, states that any information obtained pursuant to the powers conferred by the Consumer Protection Act shall not be made public or disclosed by the Attorney General or his employees beyond the extent necessary for law enforcement purposes. Although there are no direct cases on the subject, it appears likely that the term "powers" in this section refers to information obtained as a result of an investigative demand or subpoena. It is unlikely that this section refers to consumer complaints which the Attorney General collects and compiles pursuant to KRS 367.150(6) since that section anticipates that the Attorney General's office will be a central clearing house for such information. A private practitioner may find consumer complaints collected by the Attorney General very useful in assessing his or her case. As noted, such information is generally available through an open records request (KRS 61.870 *et seq.*)

If a person fails to obey any subpoena or investigative demand issued by the Attorney General, the Attorney General may apply to a Circuit Court and request an order:

A. Granting injunctive relief to restrain the person from engaging in the advertising or sale of any merchandise or the conduct of any trade or commerce involved in the alleged violation; and

B. Vacating, annulling, or suspending the corporate charter of a corporation created under the laws of the Commonwealth or revoking the authority to do business in the Commonwealth of a foreign corporation; and

C. Granting other appropriate relief.

Prior to the issuance of a final order, the person charged with failing to answer an investigative demand or subpoena shall be afforded an opportunity for a hearing on the merits of the demand or subpoena. Disobedience of a final order entered by the court shall be punished as a contempt thereof.

Any person may apply to a Circuit Court for an order to protect such person from any unreasonable investigative action taken pursuant to the Consumer Protection Act.(KRS 367.260) This section of the Act may be broader than the similar section in KRS 367.240 and could conceivably protect a person or business from unreasonable investigative action pursuant to the private cause of action section of the Act (KRS 367.220).

G. Cases interpreting the investigative powers of the Attorney General

The leading Kentucky case on the Attorney General's authority to issue compulsory process pursuant to the Consumer Protection Act is ***Commonwealth ex rel Hancock v Pineur* Ky. 533 S.W.2d 527 (1976).** Citing ***U.S. v. Morton Salt Co.* 338 U.S. 632, 70 S. Ct 3577, 94 L. Ed. 401 (1950)** the court held that a governmental investigation into corporate matters may be of such a sweeping nature and so unrelated to the matter properly under inquiry as to exceed the investigatory power. But it is sufficient if the inquiry is within the authority of the agency, the demand is not too indefinite and the information sought is reasonably relevant. The court recognized the requirements of the statute, but noted that nowhere does it say or imply that the conditions for the issuance of an investigative demand must be stated on its face and there is an even less suggestion that there is a requirement that factual details be so provided that it may be determined upon the face of the demand that the grounds upon which the Attorney General acted are in fact reasonable.

Two years later, the Kentucky Court of Appeals issued an opinion which, while acknowledging Pineur, appeared to attempt to modify its holding. The court in ***Ward v Commonwealth* Ky App 566 S.W.2d 426 (1978)** held that the Attorney General did not have the authority to issue an investigative demand based upon one letter of complaint from only one person. The court's reasoning appears to be bottomed upon a belief that the issuance of a demand based upon only one letter was arbitrary and an abuse of power. Had that case been appealed, it is doubtful that it would have been upheld in the Supreme Court.

H. Attorney General's Injunctive Relief (KRS 367.190)

Whenever the Attorney General has reason to believe that any person is using, has used, or is about to use any method, act or practice that is unfair or deceptive, he may move for a restraining order, or a temporary or permanent injunction in a Circuit Court to prohibit such practice. In order to obtain a restraining order it is necessary for the Attorney General to show that a person will suffer immediate harm, loss or injury. If a defendant moves for the dissolution of a restraining order the court shall hold a hearing within five business days. In order to obtain a temporary or permanent injunction, it is not necessary for the Attorney General to allege or prove that an adequate remedy at law does not exist or that irreparable injury, loss or damage will result if the injunctive relief is denied. The requirements for the Attorney General in a consumer protection action is less stringent than the requirements found for injunctions in general found in C.R. 65.

I. Restitution (KRS 367.200)

In addition to injunctive relief to halt unfair or deceptive acts or practices, the Attorney General may seek and obtain restitution for victimized consumers. KRS 367.200 states that the court may make such additional orders or judgments as may be necessary to restore to any person in interest any money or property which they may have lost as a result of a violation of the Consumer Protection Act.

In ***Commonwealth ex rel. Beshear v. ABAC Pest Control, Inc.*, Ky. App. 621 S.W.2d 705** (1981) the court held that in enacting KRS 367.200, the legislature intended to vest the Attorney General with the authority to seek restitution on behalf of defrauded consumers, and that the authority may be exercised concurrently with his authority to maintain an action for injunctive relief. The case of ***In re Glenn Turner Enterprises Litigation*, 521 F.2d 775 (3d Cir., 1975)**; however, accepted the Attorney General's position that he does not represent individual consumers pursuant to this statute.

J. Assurance of Voluntary Compliance

As an alternative to injunctive relief, the Attorney General can accept what is generally thought to be a lessened remedy in the form of an Assurance of Voluntary Compliance (AVC). An AVC must be filed with a Circuit Court but shall not be considered an admission of violation for any purpose. If a person fails to comply with a AVC; however, such failure shall be considered a willful violation of the act and possibly subject the person to civil penalties pursuant to KRS 367.990(2).

K. Private Cause of Action (KRS 367.220)

Of particular interest to the private practitioner is that portion of the Consumer Protection Act which permits a private cause of action for a violation of the Act. KRS 367.220 provides that any person who purchases goods or services primarily for personal, family or household purposes and thereby suffers an ascertainable loss of money or property as a result of the use of an unfair or deceptive act or practice may maintain an action in the Circuit Court to recover actual damages and that the court may also provide such equitable relief as it deems necessary or proper. Nothing in the statute is to be construed to limit a person's right to seek punitive damages where appropriate.

It is important to note that for a private cause of action to succeed, the party bringing the action must be able to allege and prove that they purchased "goods or services" and that those goods or services were primarily for "personal, family or household purposes". Such person must also be able to show an ascertainable loss of money or property. The courts have made it clear that while the Attorney General may prosecute an action that might not involve goods or services primarily used for "personal, family or household purposes" ***Commonwealth v North American Van Lines, Inc*, Ky. App. 600 S.W.2d 459 (1979),** a private cause of action pursuant to KRS 367.220 does not have that latitude ***Hunt Enters. V. John Deere Indus. Equip. Co.*, 18 F. Supp. 2d 697 (W.D. Ky.1997); *Stephens v North American Van Lines, Inc.*, Ky. App. 600 S.W.2d 459 (1979); Aud v Illinois Cent. R.R., 955 F. Supp. 757 (W.D. Ky 1997).**

L. Where to Bring a Private Cause of Action (KRS 367.220(1)

A private cause of action must be brought in a Circuit Court. That Circuit Court may be:

A. Where the seller or lessor resides;

B. Where the seller or lessor has his principal place of business;

C. Where the seller or lessor is doing business;

D. Where the purchaser or lessee resides; or

E. Where the transaction occurred.

It has been suggested that the wide choice of forums provides a means for "forum shopping"; however, it also encourages private consumer actions. (See Baxter, Private Right of Action Under the Consumer Protection Act-New Avenues for Recovery, Vol.43, No. 4, October 1979, Ky. Bench and Bar P. 8) The court may, at its discretion, award actual damages and may provide such equitable relief as it deems necessary or proper. The statute does not provide for punitive damages; however, it states that nothing shall be construed to limit a person's right to seek punitive damages where appropriate. Upon commencement of an action, the clerk of the court shall mail a copy of the complaint to the Attorney General. Likewise any judgment or decree shall be mailed to the Attorney General.

The practitioner may want to check to be sure that the Clerk mails a copy of the complaint in their action to the Attorney General. The purpose of this provision is to alert to Attorney General to deceptive practices occurring within the state. This gives the AG the ability to bring an action to protect all consumers and, as an incidental reward, gives the consumer bringing the action additional leverage. Furthermore, any permanent injunction, judgment or order of the court made as a result of an action of the Attorney General pursuant to KRS 367.190, shall be prima facie evidence in an action brought by a consumer pursuant to the private cause of action section of the Consumer Protection Act.

M. Privity of Contract

To maintain a private cause of action pursuant to the Consumer Protection Act there must be privity of contract. As noted by the court in **Skilcraft Sheetmetal, Inc. v. Kentucky Machinery, Inc., Ky App 836 S.W.2d 907 (1991)**

> "From our reading this statute as a whole, we conclude a subsequent purchaser may not maintain an action against a seller with whom he did not deal or who made no warranty for the benefit of the subsequent purchaser. The language of the statute plainly contemplates an action by a purchaser against his immediate seller.."

(See also ***Anderson National Sec. Fire & Casualty Co.*, Ky App 870 S.W.2d 432 (1993)**and ***Winburn v. Liberty Mut. Ins. Co.*, 933 F. Supp. 664 (E.D. Ky 1996))**

N. Statute of limitations for private actions

Pursuant to KRS 367.220(5), the statute of limitations for bringing a private cause of action pursuant to the Consumer Protection Act is within two years of the time the act or practice was used or within one year after any action of the Attorney General has been terminated.

O. Attorney's Fees

KRS 367.220(3) states:

> In any action brought by a person under this section, the court may award, to the **prevailing party**, in addition to the relief provided in this section, reasonable attorney's fees and costs. (Emphasis added)

It is important to note that unlike some other states, Kentucky's provision for attorneys fees does not apply only to consumers. The statute reads "prevailing party" and could mean that a business defendant would be entitled to its attorneys fees if they prevailed.

Whether to grant attorney's fees and costs, and how much, is within the sound discretion of the trial court. ***Alexander v S & M Motors, Inc.*, Ky. 28 S.W.3d 303 (2000)**

III. SELECTED CASES DEFINING "UNFAIR, FALSE, MISLEADING OR DECEPTIVE" (KRS 367.170)

The core of the Consumer Protection Act resides in KRS 367.170 which reads:

> (1) Unfair, false, misleading, or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.
>
> (2) For the purposes of this section, unfair shall be construed to mean unconscionable.

"Trade" and "commerce" means the advertising, offering for sale, or distribution of any services and any property, tangible or intangible, real, personal or mixed, and any other article, commodity, or thing of value, and shall include any trade or commerce directly or indirectly affecting the people of this Commonwealth. KRS 367.110(2)

The intent of the General Assembly when it enacted the Consumer Protection Act was to provide a "strong and effective consumer protection program to protect the public interest and the well-being of both the consumer public and the ethical sellers of goods and services". (KRS 367.120) To this end all departments, agencies, officers, and employees of the Commonwealth

are required to fully cooperate with the Attorney General in carrying out the functions of the Act. (KRS 367.160) It is the duty of the Commonwealth and county attorneys to lend to the Attorney General such assistance as he or she may request in the commencement and prosecution of court actions pursuant to the act or they may institute such actions themselves with the prior approval of the Attorney General. (KRS 376.300)

Cases

A. Constitutionality and Piercing the Corporate Veil

The first reported case under the Consumer Protection Act is arguably the most important. In ***Dare to be Great v Commonwealth ex rel Hancock* Ky., 511 S.W.2d 224 (1974)** the court faced the two issues of whether the Act was unconstitutionally vague and whether to pierce the corporate veil.

Citing **Federal Trade Com'm v Colgate-Palmolive Company, 380 U.S. 374, 85 S.Ct. 1035, 13 L.Ed.2d 904 (1965)** the court found that the words "false, misleading and deceptive have meanings which are generally well understood by those who want to understand them." (See also ***Commonwealth ex rel. Beshear v. ABAC Pest Control, Inc.,* Ky. App. 621 S.W.2d 705** (1981)) The court also found that because the agents had common ties of employment and selling schemes were intertwined, the entire corporate scheme were simply the "alter ego" of its founder Glen W. Turner. As stated by the court:

> Generally a corporation will be looked upon as a separate legal entity but when the idea of separate legal entity is used to justify wrong, protect fraud or defend crime the law will regard the corporation as an association of persons.

(See also ***Lewis LP Gas, Inc. V. Lambert*, Ky 113 S.W.3d 171(2002)** for a discussion of the elements of the alter ego doctrine.)

B. Unfair

An automobile manufacturer's warranty policy, as it related to one particular consumer was considered unfair and unconscionable in **Ford Motor Co. v. Mayes, Ky App 575 S.W.2d 480 (1981).**

C. Negative Option Billing Practice

In **Kentucky ex rel. Gorman v. Comcast Cable 881 F.Supp. 285 (W.D.Ky 1995),** the court found that the use of a plan of "negative option billing" could be a violation of the state Consumer Protection Act. The court also found that there was no Federal Preemption under the federal 1992 Cable Act.

D. Material non-disclosure

Failure to disclose a motor vehicles pre-sale history when selling it as new can constitute a false, misleading or deceptive act under the Consumer Protection Act. ***Smith v. GMC*, Ky. App 979 S.W.2d 127 (1997).**

E. Federal Injunction to Enjoin State Enforcement of the Consumer Protection Act

The doctrines of abstention and comity precluded a federal court from interfering with the state Attorney General's enforcement of the Consumer Protection Act. ***Hearing Aid Assoc. V Bullock*, 413 F. Supp. 1032 (E.D. Ky 1976).**

F. The purchase of insurance is a service under the Consumer Protection Act

The purchase of an insurance policy is a purchase of a "service" intended to be covered by the Consumer Protection Act. ***Stevens v. Motorists Mut. Ins. Co.*, Ky., 759 S.W.2d 819 (1988)** False statements to the public, to shareholders, and to the Insurance Commissioner can bring an insurance company within the purview of the Consumer Protection Act. **Commonwealth ex rel. Chandler v. Anthem Ins. Cos., Ky App, 8 S.W.3d 48 (1999)**

G. Not every breach of contract is a violation of the Consumer Protection Act

Not every failure to perform a contract is sufficient to trigger application of the Kentucky Consumer Protection Act. The statute requires some evidence of a unfair, false, misleading, or deceptive act and does not apply to simple incompetent performance of contractual duties unless some element of intentional or grossly negligent conduct is also present. **Sparks v. Re/Max Allstar Realty, Inc., Ky App. 55 S.W.3d 343 (2000)**

H. Mootness

Mootness exists in the issuance of an injunction pursuant to the Consumer Protection Act only where events make it absolutely clear the allegedly wrongful behavior could not reasonably be expected to recur. ***Commonwealth ex rel. Stephens v. Isaacs*, Ky App 577 S.W.2d 617 (1979)**

I. Medical Claims

Mere medical malpractice is not a violation of the Consumer Protection Act. A complaint that does not relate to the entrepreneurial, commercial, or business aspect of the practice of medicine does not state a cause of action. ***Simmons v Stephenson*, Ky. App. 84**

S.W.3d 926 (2002) Conversely, it would appear that just because medical malpractice has occurred, there is no prohibition against alleging and proving that a physician or other medical professional engaged in unfair or deceptive acts or practices as it relates to the entrepreneurial, commercial, or business aspect of their practice.

IV. ANALYZING THE CASE

Consumer Protection cases usually involve complex and often difficult issues. A thorough investigation and analyzation of the facts prior to filing a complaint in court is a necessity. In analyzing a particular set of facts to determine whether they involve "false misleading or deceptive" acts or practices, it is often helpful to keep in mind that deceptive practices essentially involve a lie. A lie can be told by representing a patent untruth, or it can done by leaving out essential information in the form of a material non-disclosure. In either case a lie has been told. Many times practitioners look for the overt lie, but overlook the half truth or the material non-disclosure. Likewise, those engaging in deceptive practices sometimes mistakenly believe that they can get away with deception if they tell a half truth, but not the whole truth.

A. Investigation and Discovery

Business tends to operate in patterns. If a particular practice works once and is successful, chances are it will be used again.

B. Pattern

If a factual dispute develops in a consumer case, it is often useful to contact other consumers to determine whether a pattern of conduct can be shown. Defendants traditionally resist an attempt to discover their customer list. An alternative to a lengthy discovery process is to obtain complaint letters that might have been received by the Attorney General's Office or the Better Business Bureau. The information in their files may serve a source of information from other individuals who might have been victimized by the practice in question or provide much needed documentation on the issue. Contacting other consumers can produce a wealth of information in a consumer case.

C. Sales Presentation and Salespersons

Many organizations hold sales seminars and meetings to train their representatives on how to sell the product or service. Many times the sales presentation is reduced to writing. In addition, there are occasions when there are two or more presentations for the same product or service. One may be for show, and the other(s) for actual use and training. During investigation and discovery the practitioner should be careful to obtain all documents and recordings of sales presentations and not just any sanitized version.

Sales persons tend to commit their presentations to memory and make the same presentation over and over. When examining a sales person, it is often helpful to ask them to "mock out" their presentation as though the examiner is a potential buyer. In such instances the sales person will likely either rattle off the presentation and include any deceptive material, or attempt to sanitize the presentation in an obvious way as he or she goes along. Useful evidence can often be obtained in this way.

There is nothing that will "ice" a case for a consumer faster than to find a present or former sales person who will explain how he or she was trained and how they used a deceptive sales presentation. Invariably the defendant will complain that this is a disgruntled or rogue employee. However; the truth coming from the "horse's mouth" so to speak, is very effective. In discovery, the plaintiff should always ask for a list of present and past sales persons if a deceptive sales presentation was used. Always establish that the principal was either responsible for the deceptive presentation or that the principal knew of its existence. The business will likely fight to the death to keep from disclosing such information.

V. OTHER CONSUMER PROTECTION STATUTES

A. Buying Clubs (KRS 367.395)

The Buying Club or Vacation Clubs statute (KRS 367.395 *et.seq.*) is a statute for practices that were problematic in 1982 , but which have become less problematic today. The statute defines a "Buying club" in part as an organization which for a consideration provides or purports to provide its members with the ability to purchase goods or services at discount prices. An exception is an non-profit organization. The statute provides for cancellation of membership, requirements for price comparisons and a bond requirement for such buying clubs.

B. Home Solicitation Sales (KRS 367.410)

What has been generally referred to as the "three day cooling off period " law is often misunderstood. Of primary importance is the fact that it only applies when goods or services are personally solicited at a residence of the buyer and the buyer's agreement to purchase is there given. It does not include a sale made pursuant to prior negotiations between the parties at a business establishment. The act provides for cancellation of a home solicitation sale until midnight of the third business day after the day on which the buyer signs an agreement or offer to purchase. It does not apply to goods or services which are provided without delay because of an emergence and the seller makes a good faith beginning of performance or when the goods cannot be returned to the seller in good condition, to sales of insurance or sales under $25.00. A home solicitation notice is required, but if it complies with the FTC Act Home Solicitation Rule (Title 16, CFR, Chap. I, Subchapter D, Part 429) a separate notice is not required. (OAG 74-729) After

cancellation the seller must tender to the buyer any payments made by him and the buyer must tender any goods he received to the seller.

C. Telephone Solicitations

Telephone solicitations will be covered elsewhere in this Handbook and will not be detailed here.

D. Recreation and Retirement Use Land Sales (KRS 367.470)

This statute was designed to address the problem of the sale of undeveloped land to be used for recreation and retirement and which is never later developed. The statute requires a statement of the buyer's rights, a performance bond by the seller, restrictions on the use of maintenance fees, and an easement in common areas. Other consumer rights are also found in the statute. Certain sub-dividers are exempted (15 U.S.C. secs. 1701-1720). A violation of certain parts of the statute can be a Class C felony (KRS 367.990(15)).

E. Subscription Sales of Printed Material (KRS 367.510)

Magazine and book salesmen are often a plague on the consumer. Solicitors are required by this statute to annually register with the county clerk of the county in which they are solicitating. Such sales must be on a subscription basis and payable on installments or on a cash basis or by contract or note and the delivery must be contingent on a future event such as a down payment or one or more installments. School organizations are exempt. All orders or contracts for such printed material are void and unenforceable at the option of the purchaser if the solicitator is in violation of the statute. All magazines (not newspapers) mailed into Kentucky shall have on their label the expiration date of the subscription.

The Supreme Court of Kentucky decided that the General Assembly can constitutionally require nonresidents engaged in the business of soliciting orders, via interstate telephone for magazines to register in each county in which they solicit. ***Budget Marketing, Inc. V. Commonwealth,*** **Ky. 587 S.W.2d 245 (1979)**

E. Negative Option Plan (KRS 367.570)

Books and records (CD's) are often sold by means of a negative option plan. The plan often requires the subscriber to send a card or notification to the company within a prescribed time in order to prevent the company from sending and billing such subscriber for the merchandise being sold. KRS 367.570 specifies the disclosures the seller must make to the subscriber as well as the seller's duty thereunder. A violation of the act shall be considered an unfair, false misleading or deceptive act or practice in violation of the Consumer Protection Act (KRS 367.170).

G. Consumer Credit Contracts (KRS 367.600)

This statute attempts to allow consumers to assert defenses for goods or services acquired for personal, family, or household purposes, notwithstanding the Holder in Due Course Doctrine found in the UCC (K.R.S. 355.3-302). The Kentucky law has an exception for contracts taken which are in compliance with any trade regulation issued by the Federal Trade Commission or any regulation issued by the Board of Governors of the Federal Reserve System or similar federal agency.

H. Solicitation for Charitable and Civic Purposes (KRS 367.650)

What percentage of money collected goes to the charity and what percentage goes to the Professional Solicitor? This statute attempts to require an up front disclosure of this information if the professional solicitor will receive more than 50% of the gross receipts of the funds solicited as his or her compensation. KRS 367.667(3) Unfortunately, this portion of the statute was declared unconstitutional in violation of the First Amendment in ***Kentucky State Police Professional Association v. Chris Gorman, Attorney General,* 870 F. Supp. 166 (E.D. Ky 1994)**. However; this issue has been addressed in a later opinion by the U.S. Supreme Court in **Illinois v Telemarketing Associates, Inc., et al., 538 U.S.600; 123 S. Ct. 1829; 155 L. Ed. 2d 793 (2003)** wherein the Court ruled that state Attorneys General may maintain fraud actions when fundraisers make false or misleading representations designed to deceive donors about how their donations will be used. The Illinois Attorney General's deceptive practice action was allowed when it was alleged that the charitable solicitation was a facade and the amount of funds paid over to the charity was merely incidental to the solicitors private pecuniary benefit. A professional solicitor or his organization who receives more than 50% of the funds received as his or her compensation might be liable pursuant to a Consumer Protection Act violation depending upon the individual fact pattern.

The Charitable Solicitation Act contains other provisions designed to protect those who make charitable contributions. These include a requirement that professional solicitors and fundraising consultants register with the Attorney General (KRS 367.652), a requirement that federal Form 990 be filed by a charitable organization prior to any solicitation (KRS 367.657)and that a financial report of a solicitation campaign be filed with the Attorney General (KRS 367.658). It is an unfair, false, misleading, or deceptive act and practice in violation of KRS 367.170 to lead anyone to believe that a solicitation is for a charitable organization without being authorized in writing to do so. It is also a violation to utilize a name or symbol so closely related or similar to that used by another charitable organization that its use would tend to confuse or mislead a solicited person (KRS 367.667).

A large volume of information on professional solicitors and charitable organizations are collected by the Attorney General each year. Help in obtaining this information can be had by calling the Consumer Protection Division at (502) 696-5389.

I. The Mobile Home Lemon Law (KRS 367.710)

The Mobile Home Lemon Law presumes that a mobile home is nonmerchantable if within the first 12 months after delivery it has a defect which cost the owner at least 4 % of the purchase price to repair and which requires repair or replacement on 3 separate occasions. After a mobile home qualifies as nonmerchantable, the manufacturer shall at its option, return the price paid by the seller or supply a new mobile home of the same model and year.

J. Business Opportunities (KRS 367.801)

One of the saddest forms of fraud and deception is what has been termed the "nest egg" fraud. It is disheartening to see a person or couple lose their life savings on the promise of a fly-by-night shark that they will get rich or obtain financial security as a result of a business opportunity.

Persons engaging in the sale of business opportunities in the Commonwealth must register with the Attorney General (KRS 367.805), furnish a bond, and furnish information specified in the statute. Any representation regarding potential sale, income or profit from the business opportunity must be based upon the actual earnings made by existing consumer/investors. If examples of earnings claims are in excess of the average net earnings realized by all of the investors, then there must be a complete disclosure of the average net earnings actually realized by all of the investors. There is a 30 day cooling off period for qualifying business opportunities.

Exemptions from the provisions of the act include when the offeror meets the FTC definition of a franchise and complies with 16 C.F.R. 436 et seq; offers a security pursuant to KRS 292.313; offers an ongoing business for sale; or offers a not-for-profit sale of sales demonstration equipment for $500.00 or less. (KRS 367.807) Violations of parts of the Act can be a Class C felony (KRS 367.990(13)).

K. Pyramid Sales Act (KRS 367.830)

A pyramid distribution plan is any plan, program, device, scheme or other process by which a participant gives consideration for the opportunity to receive compensation or things of value in return for inducing other persons to become participants in the program. It is unlawful in the Commonwealth for any person to establish, promote, operate, or participate in any pyramid distribution plan. (KRS 367.832) Violation of the statute is a Class C felony.
(KRS 367.990(21)(a))

Although prosecuted under federal law, the practitioner is directed to ***United States v. Gold Unlimited, Inc.*, 177 F.3d 472 (6 Cir. 1999)**. There the court analyzed the federal law as it relates to pyramid sales. The company's conviction was upheld.

L. Health Spas (Body Building) (KRS 367.900)

Pursuant to this statute, the term "Health spa" means a facility which purports to improve the person's physical condition or appearance through participation in sports activities, fitness training, exercise, or body building. It does not include nonprofit organizations.

Individuals or companies operating a Health Spa must file a registration with the Attorney General and furnish a surety bond for compensation to any member who suffers loss of money paid due to the insolvency of the health spa, the cessation of its operation or failure to open for business within 90 days from the sale of the first contract. A purchaser shall be entitled to cancel his or her contract within 3 business days following the purchase of the membership contract. Other rights of the purchaser is specified in the statute which includes the right to cancel for death, medical disability and in some instances, relocation.

M. Going out of Business Sale (KRS 365.410)

No one may hold a "Going out of Business Sale" without first obtaining a license to hold such a sale from the county clerk and posting a bond of $1,000.00. The application for the license must include a full and complete inventory which shall be posted at the front door and in the sales room. No person conducting such a sale shall add any goods to the stock for inclusion in the sale. The Attorney General may enforce the provisions of this statute by injunction and civil penalty.

N. The Uniform Commercial Code (KRS Chapter 355)

The Uniform Commercial Code contains many provisions that may help, or in some cases hurt the practitioner in a Consumer Protection case. Volumes of material have been written on this subject. Listed below are selected provisions that may be of help in a consumer case:

1. The unconscionable contract or clause provision (KRS 355.2-302; KRS 355.2A-108).

2. The Holder in Due Course provision (K.R.S. 355.3-302; see also Subpart 9 of the UCC).

3. Revocation of Acceptance (KRS 355.2-608).

4. Implied warranty of fitness for a particular purpose (KRS 355.2-315; KRS 2A-213).

O. The Magnuson Moss Warranty Act (22 U.S.C. sec 2301-2312)

The Magnuson Moss Warranty Act (22 U.S.C. sec. 2301-2312) will be discussed in greater detail in the context of automobiles in chapter 7 of this Handbook.

VI. SELECTED CRIMINAL STATUTES

Certain criminal statutes may have a bearing on civil consumer protection actions. The Commonwealth's Attorney, County Attorney or in some cases the Attorney General has state jurisdiction to prosecute such cases. However; the practitioner should be aware of such statutes since they might affect the outcome of their civil case. Many times a court will allow probation in a criminal case on condition that the defendant makes full restitution.

A. Theft by deception (KRS 514.040)

Theft by deception is a Class A misdemeanor unless the value of the property, service, or the amount of the check or sight order is three hundred dollars ($ 300) or more, in which case it is a Class D felony.

B. False Advertising (KRS 517.030)

(1) A person is guilty of false advertising when, in connection with the promotion of the sale of or to increase the consumption of property or services, he knowingly makes or causes to be made a false or misleading statement in any advertisement addressed to the public or to a substantial number of persons.

(2) False advertising is a Class A misdemeanor.

Bait Advertising (KRS 517.040)

(1) A person is guilty of bait advertising when in any manner, including advertising or other means of communication, he offers to the public or a substantial number of persons property or services as part of a scheme or plan with the intent not to sell or provide the advertised property or services: (a) At the price at which he offered them; or (b) In a quantity sufficient to meet the reasonably expected public demand, unless the quantity is specifically stated in the advertisement; or (c) At all.

(2) Bait advertising is a Class A misdemeanor.

(See also the Federal Trade Commission's "Guides Against Bait Advertising at 16 C.F.R. Part 238.)

VII. SELECTED DEFENSES TO DECEPTIVE PRACTICE CLAIMS

A. Puffing

Although there are no known Kentucky cases on this subject at this time, mere puffing during a sales presentation is generally a valid defense to a deceptive practice claim. Adjectives such as "good", "better" or "best" may be considered puffing in certain cases and such terms may not rise to the level of deception. To show that a claim is puffing, it may be necessary to show that it is an exaggeration and harmless. A test for determining whether a representation is mere puffing could be (a) whether the statement was specific; (b) the comparative knowledge of the buyer and seller; (c) whether the representation pertained to a past, current, or future event or condition. **Humble Nat'l Bank v. DCV, Inc., Tex App., 933 S.W.2d 224(1997); (See sec. 4.2.10 of the 5th Edition "Unfair and Deceptive Acts and Practices", National Consumer Law Center 2002; See also *Rodio v. Smith, N.J., 587 A.2d 621(1991)*;** "You're in good hands with Allstate" is nothing more than puffery".; but see also ***Miller v. William Chevrolet/Geo, Inc., 326 Ill. App. 3d 642;762 N.E.2d 1(2001)*** "Unlike phrases such as "expert workmanship," or "magnificent" which courts have found to be mere statements of value ***Breckenridge v. Cambridge Homes, Inc., 246 Ill. App. 3d 810, 823, 616 N.E.2d 615, 623, 186 Ill. Dec. 425 (1993)***), "executive driven" is sufficiently susceptible of interpretation as a factual description of a car's history to defy our characterizing it as "puffing" as a matter of law.")

B. Mistake

A bona fide error might be a defense to a deceptive practice action. Such errors, if accepted, should be limited to clerical errors or mistakes in computing numbers. A pattern or practice utilizing mathematical errors; however, would not act as a defense. Likewise, a good faith defense based upon an attorney's or other professional's advise would not normally be successful. Similarly, the lack of knowledge on the part of a seller making a false statement would not normally be a valid defense. **(See sec. 4.2.6 of the 5th Edition "Unfair and Deceptive Acts and Practices", Id)**

C. Arbitration

The appearance of compulsory arbitration clauses in consumer contracts have become increasingly prevalent. Such clauses may seek to foreclose a consumer's right to trial by jury. It may also attempt to foreclose meaningful discovery. Likewise, the costs for the consumer to arbitrate a claim may be staggering.

While overcoming arbitration clauses may be difficult, these difficulties are not insurmountable. For in depth research on this subject, the practitioner is referred to the National Consumer Law Center publication **"Consumer Arbitration Agreements-Enforceability and Other Topics" (2001).**

VIII. RESOURCES FOR THE PRACTITIONER

Throughout this overview, various references have been made to the Kentucky Attorney General's Office and the National Consumer Law Center.

A. The Attorney General

The Assistant Attorneys General in the Consumer Protection Division are among the most knowledgable in the nation. A telephone conference with one of these individuals may save numerous hours of research. The Attorney General's phone number is (502) 696-5300. The Consumer Protection Division's direct line is 564-5389. Ask for an attorney in the Consumer Protection Division that deals with your area of interest.

B. The National Consumer Law Center

The National Consumer Law Center is a non-profit organization located at 77 Summer Street, 10th Floor, Boston, Massachusetts 02110. It can be reached by internet at www.consumerlaw.org. The Center acts as a resource on consumer law and has many excellent publications on consumer law issues. Anyone researching a consumer law issue should visit their website.

C. Contributors to this Handbook

Finally, it would be a travesty not to mention the fine men and women who have contributed to this CLE Handbook. These are the leading practitioners in this area of the law in Kentucky.

Robert V. Bullock

FINANCE & LENDING ISSUES FOR THE CONSUMER LAW ATTORNEY

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SECTION B

FINANCE & LENDING ISSUES FOR THE CONSUMER LAW ATTORNEY

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PART 1

USURY & KENTUCKY CONSUMER CREDIT LAW

USURY & KENTUCKY CONSUMER CREDIT LAW

Consumer credit statutes and regulations generally do one or more of the following:

a) limit the rate of interest that can be charged on a loan. See e.g. the Usury Statute at KRS 367.010 et seq.

b) limit the types of fees that can be included in the principal balance upon which interest is charged. See e.g. The Retail Installment Contract Act at KRS 371.210 et. seq.

c) require disclosures of the true cost of credit. See e.g. The Truth In Lending Act at 15 U.S.C. 1601 et. seq. The Truth In Lending Act requires disclosure of the cost of credit as the "Finance Charge" and cost on an annualized bases as the "Annual Percentage Rate".

The cost of credit includes more than just interest; it also may include document preparation fees, loan origination fees; underwriting fees; brokers fee; funding fees, etc. that are financed in the loan balance. Accordingly, the 'Finance Charge" will often exceed the interest total and the Annual Percentage Rate will often exceed the interest rate.

USURY: KRS 367.010

Statutory Basis of Interest: The right to charge interest on a loan, debt, or other legal obligation is a right created by statute. *See, Coleman v. Reamer's Executor,* 237 Ky. 603, 36 S.W.2d 22 (1931). Statutes may designate a charge as interest for purposes of usury or as a charge falling outside usury limits. *See, e.g.,* KRS 368.100 ("deferred deposit" charges are service fees); KRS 371.260 (charges on a retail installment contract are "time price differential").

Rate of Interest: the usury statute at KRS 367.010 sets the legal rate of interest at 8% per annum; allows the parties by written agreement, to set any interest rate for loans exceeding $15,000.00, and for loans less than $15,000 set a maximum rate equal to the lesser of 19% per annum, or 4% in excess of the discount rate on 90 day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve District where the transaction is consummated.

Non-Applicability: The usury statute is not applicable where other, specific statutes have been enacted. KRS 360.022.

Substance Over Form: Courts look beyond the formal language of a written obligation to determine if charges are really interest. See , *Hamilton v. York,* 987 F. Supp 953 (E.D. Ky, 1997, quoting *Hurt v. Crystal Ice & Cold Storage Co.*, 286 S.W.2d 1055, 1056-57 (Ky. 1926):

The cupidity of lenders, and the willingness of borrowers to concede whatever may be demanded or to promise whatever may be exacted in order to obtain temporary relief from financial embarrassment, as would naturally be expected, have resulted in a great variety of devices to

evade the usury laws; and to frustrate such evasions the courts have been compelled to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that the mere form is immaterial, but that it is the substance [*956] which must be considered.

See also, *White v. Check Holders, Inc.,* Ky. 996 S.W.2d 496 (1999); *Commonwealth ex rel. Chandler v. Kentucky Title Loan, Inc.*, Ky.App., 16 S.W.2d 312 (1999).

Civil Penalty : KRS 360.020 states:

The taking, receiving, reserving, or charging a rate of interest greater than is allowed by KRS 360.010, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover, in an action in the nature of an action of debt, twice the amount of the interest thus paid from the creditors taking or receiving the same: provided, that such action is commenced within two (2) years from the time the usurious transaction occurred.

KRS 360.010 is worded virtually identically to the National Banking Act at 12 U.S.C 86. Courts construe statutes such as KRS 360.020 & 12 U.S.C. 86 to first require forfeiture of all interest on the contract. As no interest is then owed, interest is not considered received until the debtor has made payments totaling the principal. After sufficient payments have been made to pay the principal, a payment is considered to be interest, within the meaning of the statute, for which the debtor may recover twice the interest paid. However, if a specific payment is designated by the parties as an interest payment, twice the amount of such payment may be recovered, regardless of whether the principal has been paid.

Conduct That May Result in Usury: Any systematic procedure that results in the taking, receiving, reserving, or charging more interest than was agreed to in the contract could result in usury. For example, *unless permitted by the parties note, mortgage, or security agreement or by applicable statute or regulation*, the following practices are potentially usurious: charging interest on a 365/360 daily basis[1]; failing to timely apply payments to principal reduction; failing to apply payments in the manner prescribed by the note and/or mortgage; applying payments to the lender's or servicer's fees and costs of doing business, rather than to principal reduction; assessing fees after default for reinstatement and or forbearance of acceleration and collection.

State Statutes Regulating Interest or Fees in Specific Instances: A non-exhaustive list of Kentucky statutes setting interest rates or defining charges as something other than "interest" includes:

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[1] See *American Timber & Trading Co. v First Nat. Bank* (1973, CA9 Or) 511 F2d 980, cert den (1975) 421 US 921, 43 L Ed 2d 789, 95 S Ct 1588.

Loans in the nature of "deferred deposits" (holding a check before cashing). KRS 368.100;

General retail installment contract. KRS 371.210;

Retail installment contract for motor vehicles. KRS 190.110;

Financing for variable rate contracts for mobile homes. KRS 360.150;

Pawns. KRS 226.080;

Loans made by banks chartered by the Commonwealth of Kentucky. KRS 287.214, 287.215 (but have option of proceeding under usury statute);

Credit cards/revolving credit cards by a Kentucky chartered bank or national bank located in Kentucky. KRS 287.740, 287.750;

Small loan companies (loans of $15,000 or less). KRS 288.530, 288.533;

Savings and loan associations. KRS 289.451;

Title pledge agreements. KRS 368.260.

FEDERAL PREEMPTION OF STATE LAW

The federal government has preempted states' usury laws in a number ways. Preemptions of state laws pertaining to loans made by national banks are among the most common.

National Bank Act: The National Bank Act sets interest rates for federally chartered banks at the higher of (i) 1% above the discount rate on 90-day commercial paper as set by the Federal Reserve Bank in the district where the bank is located or (ii) at the interest rate allowed lenders in the state where the bank is located. 12 U.S.C. §§ 85-86; *see also,* 12 C.F.R. § 7.4001, defining interest under the Act.

Most Favored Lender Doctrine: The National Bank Act's "most favored lender doctrine" allows national banks to use the interest rate allowed lenders located in the state where the bank is located. Under this doctrine, national banks may charge the highest rate of a competing lender of the *type* of loan the national bank is making. Therefore, a national bank making a consumer loan inside Kentucky for under $15,000 could charge the rates allowed small loan companies under KRS 288.530 and must comply with restrictions that are material to interest rate determination such as maximum loan charges and service charges. *See, Northway Lanes v. Hackley Union Nat'l. Bank and Trust*, 464 F.2d 855 (6th Cir. 1972);

National Banks May Export Interest Rates: the most favored lender doctrine allows a national bank to export its interest rate across state lines. *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978). By Regulaton, the OCC has defined "interest" within the meaning of the National Bank Act to include any charge compensating the bank for extending credit or for any default or breach by the borrower, including among other things, late fees, over limit fees, membership fees, annual fees, NSF fees, document preparation fees, and premiums or commissions earned on insurance sold to guarantee

repayment.. 12 C.F.R. § 7.4001(a). This means the national bank can export laws regarding the foregoing fees, *Id* at (b). See also, *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996).

Federalization & Removal to Federal Court of Usury Claims against National Banks: The Supreme Court in *Ben. Nat'l Bank v. Anderson, 539 U.S. 1 (2003)* held that the National Bank Act renders all usury claims against National Banks federal claims under the act and subject to removal to federal court, even if pleaded as state law claims.

O.C.C.'s Expansive and Controversial 2004 Preemption Regulations: In February, 2004 the Office of the Comptroller of the Currency (O.C.C.) adopted four expansive regulations that purport to preempt state laws that "obstruct, impair or condition a national bank's ability to fully exercise" its powers under the National Bank Act, including through subsidiaries. In essence, the regulations hold that no state law applies to national banks unless the law has only an "incidental affect on the business of banking". See 12 C.F.R. §§7.407(b), 7.408(d), 7.409(b), 34.4(a). The regulations, among other things, purport to preempt all state laws pertaining to rates of interest, credit terms, escrow accounts, security for loans, loan to value ratios, etc. For an extensive analysis of OCC's 2004 preemption regulations, see National Consumer Law Center, The Cost of Credit (2d ed. 2000 & Supp 2004) at §3.4.6.2.

At the time of this writing, it is not known whether these regulations will withstand the scrutiny of Congress and the courts. It is important to remember, however, that these regulations pertain only to national banks; that most egregious mortgage loans and servicing abuses are made by entities other than national bank; that usury claims can still be made against national Banks pursuant to 12 U.S.C. §§ 85 and 86; and that usury claims based upon the charging of fees and expenses not agreed to in the parties contract, in some instances, could be enhanced by subject to O.C.C.'s broad definition of interest appearing at 12 C.F.R. § 7.4001(a).

Expansion of Most Favored Lender Doctrine to Federally Insured State Institutions: The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA) extends the most favored lender doctrine to federally insured state institutions. Pub. L. No. 96-221, 94 Stat. 161 (1980) (codified throughout provisions of Title 12 of the U.S. Code dealing with specific financial institutions). *Greenwood Trust v Massachusetts*, 971 F.2d 818 (1st Cir. 1992); *Venture Properties v. First Southern Bank*, 79 F.3d 90 (8th Cir. 1996). These state financial institutions may export a number of different fees if such fees are defined as "interest" in their home states and even though not included in the numerical rate disclosed to and charged to borrowers. *Id.* Under DIDA, states can reassert control over credit charges by affirmative action. *See,* DIDA, Pub. L. No. 96-221, Title V §§ (501)(b), 525. With respect to express limitations on interest rate, Kentucky is *not* one of the states that has reasserted control. Not surprisingly, a number of state banks (and perhaps some national banks) have located in banking friendly states solely for the reason of exporting high interest rates on credit cards to other states.

Other Federal Regulation: Other federal regulations may preempt state regulation of interest rate and other charges for specific types of loans funded or guaranteed by the federal government, especially residential mortgage loans. (*e.g.*, Veterans Administration loans). Among the most important is DIDA at 12 U.S.C. 1735f-7a, which for federally related lenders, preempts

The provisions of the constitution or the laws of any State *expressly limiting* the rate or amount of interest, discount points, finance charges, or other charges, which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance which is

(A) secured by a first lien on residential real property, by a first lien on all stock allocated to a dwelling unit in a residential cooperative housing corporation or by a first lien on a residential manufactured home [but with respect to manufactured housing only if the creditor covered by this part complies with the consumer protection regulations appearing at 12 C.F.R. § 590.4(b)]

12 U.S.C. 1735f-7a [emphasis supplied]

It is doubtful whether DIDA preempts Kentucky's usury statute with respect to mortgage loans in excess of $15,000.00, because KRS 360.010 appears not to "*expressly*" limit the rate of interest the parties may agree to, but merely requires that the lender abide by the rate it agreed to in writing. As such it is a legitimate consumer protection provision. See e.g *Grunbeck v. Dime Sav. Bank of New York,* 74 F3d 331 (1st Cir. 1996), holding that statute precluding compound interest is a legitimate consumer protection provision and not an *express limitation* on the rate of interest and therefore is not preempted.

A summary of the various preemptive statutes, which appears in National Consumer Law Center, The Cost of Credit (2d ed. 2000 & Supp 2004) at §3.4.6.2. can be found in the Appendix to this Chapter.

KENTUCKY INSTALLMENT SALES ACTS: STATUTES PREVENTING INFLATION OF THE PRINCIPAL BALANCE UPON WHICH INTEREST IS CHARGED

The Retail Installment Sales Contract Act at KRS 371.210 to 371.665 and The Motor Vehicle Installment Sales Contract Act, KRS 190.090 to 190.990 both provide for forfeiture of the finance charges for non-accidental violations of the statute. In *Barnes v Community Trust Bank* 121 S.W. 3d 520, 521-22 (Ky. App. 2003), the court noted that The Retail Installment Sales Contract Act "is a consumer protection statute mandating the content of retail installment sales contracts in the context of consumer goods." The court further stated that "[t]he Motor Vehicle Retail Installment Sales Act contains similar consumer protections to the more general Retail Installment Sales Act, but is specifically tailored to the sale of motor vehicles." The statutes appear intended to prevent creditors from loan packing through the use of unauthorized or unexpected "add-ons" after the cash price has been agreed upon and from inflating the principal balance upon which interest is charged.

The Retail Installment Sales Contract Act does this by statutorily defining the principal balance at KRS 371.210(13)as follows:

Principal balance" means the cash sale price of the goods or services which are the subject matter of a retail installment contract plus the amounts, if any, included therein, if a separate identified charge is made therefor and stated in the contract, for insurance and official fees, less the amount of the buyer's down payment in money or goods or both.

The act limits official fees to those prescribed by law for perfection of a lien. KRS 371.210(11). The act requires that the amount included for insurance fees include a disclosure of the types of insurance and term of coverage. KRS.371.220(5)(d). The act defines time price differential as

"the amount which is paid or payable for the privilege of purchasing goods or services to be paid for by the buyer in installments over a period of time. It does not include the amount, if any, charged for insurance premiums, delinquency charges, attorneys fees, court costs, or official fees." KRS.371.210.(9).

Typical violations of the content limitations in the act would appear to include the following if financed in the principal balance: charges for official fees in excess of those actually paid to public officials; document preparation fees; loan origination fees; pre-paid finance charges; insurance charges unaccompanied by disclosure of the type or term of the insurance; and possibly insurance charges in excess of sums the seller paid to the insurance company. It would appear difficult for creditors to contend that these fees are part of the cash price for "services which are the subject matter of a retail installment contract" etc. KRS 371.990 (3) states:

> Any person who violates any provision of KRS 371.210 to 371.330 except as a result of an accidental or bona fide error shall be barred from the recovery of any time price differential, or any delinquency or collection charge under or in connection with the related retail installment contract or retail charge agreement..."

The Motor Vehicle Retail Sales Installment Act contains similar definitions and appears to function similarly to the Retail Installment Sales Contract Act. In addition, it places a ceiling on finance charges, prescribed at KRS 190.110. The ceiling limits finance charges to $11.00 per hundred for new vehicles, $13.00 per hundred to one and two year old vehicles, and $15.00 pre hundred for vehicles more than two years old by model year. This ceiling allows greater interest charges than it may initially appear because KRS 190.110(4) allows the finance charge to be pre-computed by the add-on method.[2] Installment contracts assigned to out of state finance companies sometimes violate the ceilings.

Like the Retail Installment Sales Contract Act, the Motor Vehicle Retail Sales Installment Act defines the principal balance as the cash sale price minus the down payment plus insurance and other benefits and official fees. KRS 190.100(2). This content based definition of the principal balance prevents evasion of the ceiling on finance charges by inflation of the principal balance, upon which "[s]uch finance charge shall be computed." KRS.190.110(2).

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[2] The add-on method permits pre-computation of finance charges without accounting for the payments that will be made. In other words, it does not account for the reduction of principal via the monthly payments. To calculate allowable charges, multiply the interest rate by the amount financed and multiply the result by the number of years of the contract.

No reported cases explain the operation of the act. It would appear, however, that charges for official fees in excess of those paid to public officials; document preparation fees, particularly those charged for the preparation of credit related documents; and processing fees paid to financing companies may run afoul of the act. KRS. 190.090 (3) provides that a willful violation of any provision of KRS 190.090 to 190.140 by any person shall bar his recovery of any finance, delinquency or collection charge on the contract. The FTC Holder Notice required in all retail installment contracts would render the holder liable for the seller's violations of acts regulating installment sales contracts.

PART 2

TRUTH IN LENDING RESCISSION

TRUTH IN LENDING RESCISSION

August, 2004

I. Scope: Rescission of Non Purchase Money Mortgages on Principal Residence

Truth In Lending ("TILA") rescission can eliminate a non-purchase money mortgage on the consumer's home, thwart foreclosure, and vastly reduce the sums the consumer owes. This outline addresses TILA rescission as it applies to closed-end credit only.

II. Overview of Truth In Lending Rescission

A. TILA Rescission and Transactions to Which It Applies: 15 U.S.C. 1635 & Regulation Z at 12 CFR 226.23, and Staff Commentary at 226.23

TILA's rescission provisions are found at 15 U.S.C. Sec. 1635; Reg. Z 226.23, applying to closed end credit; Reg. Z. 225.15, applying to open end credit; and the Official Federal Reserve Board Staff Commentary ("Commentary") to the foregoing sections of Reg Z. "Unless demonstrably irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive...." *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565, (1980).

Potentially rescindable non-purchase money mortgage transactions include: (1) home equity loans; (2) home improvement contracts and loans; (3) refinancing of residential mortgages by a new creditor; (4) refinancing of residential mortgages by the same creditor, but only to the extent of new credit.

Important Limitation: TILA rescission does not apply to residential mortgage transactions in which the mortgage secures the funds advanced for the acquisition or construction of the residence.

B. Basis of the Right of Rescission: Three Day Cooling Off Period Activated Only By Accurate, Clear, and Conspicuous Disclosure Within Meaning of TILA

TILA provides a consumer three business days to assess the wisdom of any transaction in which the collateral is the consumer's pre-existing ownership interest in her home. Reg. Z 226.23(b) grants a consumer a right to rescind a transaction in which a non-purchase money security interest is taken on his residence that remains until midnight of the third business day following whichever occurs LAST:

(1) consummation of the contract;
(2) delivery of the right of rescission forms required by TILA; or
(3) delivery of the material TILA disclosures in the clear, conspicuous, and accurate manner required by TILA

If the creditor fails to furnish the material TILA disclosures or the notice of the consumer's right to rescind in the manner prescribed by the Act, the right to rescind remains unexpired until the

expiration of three years, or the sale or transfer of the consumer's ownership interest in the property, whichever occurs first. Reg. Z Sec. 226.23(a)(3).

C. Exercising the Rescission in writing.

Any consumer whose right of rescission has not expired can cancel the transaction by notifying the creditor in writing. Reg. Z Sec. 226.23(a)(2). If more than one consumer has a right of rescission and rescinds, the rescission is effective as to all consumers. Id. at (a)(4). A rescission is effective against the original creditor and assignees. 15 U.S.C. Sec. 1641.

D. Effects of Rescission: Reverse of Common Law Rescission. Designed to place the Consumer in *Status Quo Ante*, often at the Expense of the Creditor.

Reg Z. Sec 226.23 (d) Effects of rescission.

> (1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void and the consumer shall not be liable for any amount, including any finance charge.
>
> (2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.
>
> (3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value. At the consumer's option, tender of property may be made at the location of the property or at the consumer's residence. Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.
>
> (4) The procedures outlined in paragraphs (d) (2) and (3) of this section may be modified by court order.

[Emphasis supplied. NOTE the omission of paragraph (d)(1) from modification.]

> Commentary 226.23(d)(1). Termination of security interest. Any security interest giving rise to the right of rescission becomes void when the consumer exercises the right of rescission. The security interest is automatically negated regardless of its status and whether or not it was recorded or perfected. Under section 226.23(d)(2), however, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.

In short, upon rescission, the mortgage is void, and the consumer is liable only for the original loan proceeds ('real proceeds"), or for the property purchased, or, at the consumer's option, the property's reasonable value. The consumer is not liable for any finance charge or other incidental charges such as credit insurance charges, license, filing and official fees, title search fees, and document preparation fees.

Statutory Damages: If the matter is litigated, the creditor may be liable for statutory damages of twice the finance charge but not more than $2000 for the original disclosure violation that caused the right of rescission to remain unexpired; additional statutory damages of $2000 for any failure to comply with its rescission obligations; and the debtor's attorney fees. 15 U.S.C. 1640(a); 15

U.S.C. 1635(g). Assignees are liable for statutory damages to the extent they can be determined from the documents assigned. 15 U.S.C. 1641(a).

F. Property Vesting in Consumer Without Obligation and Other Remedies

Occasionally, the creditor could lose the right to recover the real proceeds. The rescission rules of Regulation Z are meant to be implemented by the parties outside court. The creditor's tender to the consumer of all amounts paid on the contract provides the consumer a portion of the funds he will have to tender to the creditor. The voiding of the security interest frees equity in the consumer's residence that can serve as collateral to enable the consumer to obtain any additional funds he may need to complete his tender. If the creditor refuses to complete its obligations in the rescission process, the process is thwarted since most consumers will not have the equity necessary to secure the funds to complete their tender. Additionally , in accordance with the steps specified by Reg. Z, the consumer's duty to tender never arises. Recognizing this, courts have fashioned numerous remedies — including allowing the proceeds to vest in the consumer without obligation — to enforce TILA rescission when a creditor fails to acknowledge the rescission or tender. Examples
include:

Sosa v. Fite, 498 F.2d 114 (5th Cir. 1974): creditor ignored rescission and debtor's tender; must return debtor's payments, pay $2000 statutory penalties, release mortgage, forfeit loan proceeds, and pay debtor's attorney fees.

Gill v. Mid-Penn Consumer Discount Co., 671 F. Supp. 1021 (E.D. Pa. 1987): consumer's tender obligation arises only if creditor releases security interest within 20 days. Held: consumer awarded statutory penalties, attorney fees, excused from payment of outstanding balance, mortgage void. See also, *Family Financial Services v. Spencer* 677 A2d 479 (Conn. App. 1996).

Shepherd v. Quality Siding and Window Factory, Inc., 730 F. Supp. 1295 (D. Del. 1990): where no evidence creditor tried to cheat debtor, debtor awarded statutory penalties, attorney fees, mortgage void, debtor must pay sums owed after rescission via monthly payments without interest. See also *Mayfield v. Vanguard Savings and Loan Assoc.*, 710 F. Supp. 143 (E.D. Pa., 1989).

But see, *Buckles vs. Thorp Loan and Thrift Co.*, 189 B.R. 752, 764 (Bankr. Minn. 1995); and similar cases holding that the court can condition the rescission and voiding of the mortgage on the consumer's tender. See *Williams vs. Homestake Mortgage Co.*, 968 Fed. 2d 1137 (11th Cir. 1992) for a discussion of a Court's, use of its equitable powers to "condition" voidance of the security interest.

G. Using Bankruptcy After Rescission To Overcome Consumer Tender Problems

Reg. Z Sec. 226.23, on it's face, entitles the creditor only to an unsecured claim or judgment. Some bankruptcy courts, recognizing this, have allowed rescission and held the creditor unsecured. This means that in Chapter 7 bankruptcies, the creditor would take nothing. See *In*

re Piercy, 18 B.R. 1004 (Bankr. W.D. Ky. 1982). In Chapter 13, the creditor would receive the same percentage payment granted other unsecured creditors. See In re: *Myers* 175 B.R. 122 (Bank Bankr. D. Mass. 1994); *In re Chancy*, 33 B.R. 355 (Bankr. N.D. Okla.1983). But see, *Buckles* Supra at 189 B.R. 752 (Bankr. Minn. 1995); In re: *Lynch*. 170 B.R. (Bankr. D. M. H. 1994).

There is a split in the case law concerning whether a debtor can satisfy his rescission obligations in Bankruptcy. For a good discussion of the case law, resulting in the conclusion that the creditor is unsecured, but (surprisingly) should have a separately classified 100% claim see, *Williams v. Bank One* 291 B.R. 636 (Bankr. E.D. Pa. 2003).[1]

III. Finding TILA Disclosure Violations To Obtain Statutory Damages And Extend the Right Of Rescission, Reg. Z 226.4 & 226.23.

Truth In Lending rescission has potential to save the home of a consumer debtor threatened by foreclosure arising from a home equity loan or home improvement loan or contract. To accomplish this result, counsel must find a TILA disclosure violation sufficient to establish that the right of rescission remains unexpired.

To find a disclosure violation that extends the rescission period, counsel must develop a working knowledge of TILA at 15 U.S.C. 1601 et seq.; Regulation Z at 12 C.F.R. Part 226; and the Commentary 12 C.F.R. Part 226, Supp. 1. *Most important is Reg. Z 226.4 defining the finance charge.*

A. Overview of TILA

TILA is designed to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid uninformed use of credit. 15 U.S.C. 1601.

In any TILA case, counsel should emphasize TILA is not merely a technical statute, but plays a central role in assuring the efficient furnishing of consumer credit, which, central to our economic well-being.[2]

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[1] It is surprising that the Court grants a creditor that violated an important consumer protection statute a more favorable classification and treatment than the other unsecured creditors who violated no laws. Given that the bankruptcy code provides for the elimination and stripping down of various security interests to the benefit of unsecured creditors, bankruptcy judges, having to weigh the interests of all the creditors as well as the debtor, appear generally less likely to deviate from Regulation Z's unambiguous directive that upon valid rescission the mortgage is void, leaving the parties as unsecured creditors of one another.

[2] The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. 15 U.S.C. 1601(a).

TILA applies to consumer credit transactions that are subject to a finance charge or payable by written agreement in more than four installments and that are offered or extended by a creditor who has extended such credit more than 25 times in the preceding or current calendar year.

The Act requires that consumer credit disclosures be (1) clear and conspicuous; (2) grouped together; (3) segregated from other materials; (4)in a legible, written form that the consumer may keep; and (5) reflect the parties legal obligations.

Note: TILA'*s "amount finanaced"* discloses the amount of credit furnished, and "finance charge" discloses the cost of credit, but the TILA disclosures are not necessarily part of the contract. Usually, the Note or Promise to Pay is the contract. The *principal* of the Note or Promise to Pay *may exceed* the TILA disclosed *"amount financed"* because the *principal* contains lender financed costs of credit, such as points, loan fees, funding fees, origination fees etc that are costs of credit that do not appear in the *amount financed.*

B. 15 U.S.C. 1632, Reg. Z 226.17. Accurate Disclosure is the Touchstone of the Act

TILA Act reflects a transition in congressional policy from a philosophy of "the buyer beware" to one of "let the seller disclose." *Morning v. Family Publications, Inc.* 98 S. Ct. 1642, 1648.

Statutory Damages: TILA Section 1640 allows a consumer to recover any actual damages, plus, for a specified list of violations, statutory damages of twice the finance charge but not less than $100 nor more than $1,000. In closed end transactions secured by real estate or by a dwelling, the statutory damages are not less than $200 nor more than $ 2000. No showing of actual damage is necessary for a recovery of statutory damages. For disclosure violations, only one statutory damage award may be granted per transaction.
For closed-end disclosures, statutory damages attach for failure to clearly, conspicuously, and accurately disclose

THE AMOUNT FINANCED;

THE FINANCE CHARGE;

THE ANNUAL PERCENTAGE RATE;

THE TOTAL OF PAYMENTS;

THE NUMBER, AMOUNT AND DUE DATES OF PAYMENTS; AND

THE SECURITY INTEREST IDENTIFIED BY TYPE.

C. Violations Extending Rescission Rights. 15 USC 1602(u)

For rescission purposes, the right to rescind may remain unexpired for failure to clearly, conspicuously, and accurately disclose the following "material" disclosures:

THE AMOUNT FINANCED

THE FINANCE CHARGE ("COST OF CONSUMER CREDIT AS A DOLLAR AMOUNT")

THE ANNUAL PERCENTAGE RATE

THE TOTAL OF PAYMENTS, AND

THE NUMBER, AMOUNTS, AND DUE DATES OF PAYMENTS.

THE HOME OWNERSHIP AND EQUITY PROTECTION ACT DISCLOSURE warning the consumer that he could lose is his home. This disclosure is only required in certain high rate or high points and fees loans. HOEPA disclosure is usually triggered by points and fees exceeding 8% of the loan amount or an APR exceeding by 8 percentage points the rate on comparable treasury notes.. See outline on HOEPA.

D. Finding Under-disclosed Finance Charges That Establish An Unexpired Right to Rescind.

The usual cause of an unexpired right to rescind is a creditor's failure to allocate a charge to the finance charge, more specifically the pre-paid finance charge, resulting in an under-disclosed finance charge and annual percentage rate. Regulation Z at 12 C.F.R. 226.4 defines the finance charge as the "cost of consumer credit as a dollar amount". It includes any charge imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." Whenever an item appears in the amount financed which item should be part of the finance charge, the amount financed is overstated and the finance charge and annual percentage rate are under-stated resulting in material disclosure violations that could extend the rescission period.

Tolerances; TILA has tolerances that must be exceeded before a consumer has an unexpired right to rescind under Section 1635. After the creditor has initiated a "judicial or non-judicial foreclosure process on the primary dwelling of the obligor", an understatement of the finance charge of $35 or more is necessary to extend the right to rescind. See, 15U.S.C. 1635(i). Overstated finance charges are not grounds for rescission.

A consumer not foreclosed upon, has an unexpired right to rescind only if the finance charge is under-stated by one-half of one percent of the credit extended, unless the loan is a refinancing of a purchase money loan by any lender in which case the consumer has an unexpired right to rescind only if the finance charge is understated by one percent of the credit extended. See, 15 U.S.C. 1605(f). In addition, it appears that for offensive rescission the understatement must be by at least $200. See, 15 U.S.C. 1649. Since most cases are defensive in nature, and since most understated finance charges are in excess of $35, these limitation will rarely come into play.

E. Rule of Thumb for Undisclosed Finance Charges

To determine whether the Pre-paid Finance Charge were properly disclosed, first determine the lender's computation of the Pre-paid Finance Charge by subtracting the Amount Financed on the TILA disclosure from the Principal on the Note. Then Compare the itemization of pre-paid finance charges and/or Settlement Statement with Reg.Z, 226.4 and Commentary thereto to see if their are items omitted from the pre-paid finance charge that the Regulation requires be included.

The following broad rule of thumb may be a helpful starting point:

Any sum not charged in a comparable cash transaction that is a condition or incident to entering a credit transaction, or becomes profit on the furnishings of credit, or in a transaction secured by

real property is a charge payable to a third party that is not reasonable or bona fide, is a FINANCE CHARGE.

Reg. Z Sec 226.4 refines this rule by defining certain charges as finance charges and listing charges that may be excluded from the finance charge.

F. Examples of Finance Charges: Charges Imposed As Conditions to Extension of Credit. Reg. Z Sec. 226.4(b)

Buyers points, loan origination fees, brokers fees, funding fees, underwriting fees, finders fees, credit service charges, most settlement charges, premiums for private mortgage insurance, and similar fees are finance charges because they are directly imposed as conditions to the extension of credit. Reg. Z 226.4(b).

G. Excess Statutory and Lien Filing Fees Resulting In Under-disclosed Finance Charges. Reg. Z Sec. 226.4(e)

Taxes and fees prescribed by law for determining the existence of, perfecting, or releasing security interests may be excluded from the finance charge. Any charge for such fees in excess of the fees or taxes prescribed by law and actually paid is an undisclosed finance charge that results in an understated disclosure of the finance charge.

Similarly, fees in excess of actual license, title, and registration fees, if such excess fees are not charged to cash customers, should be finance charges. See Williams v. Bill Watson Ford, Inc., 423 F. Supp. 345 (E.D. La. 1976). Counsel should check with the county clerk or taxing authorities to make certain such claimed fees were in accordance with the law and actually paid.

H. Certain Fees in Mortgage Transactions that Become Finance Charges When they Are Not Bona Fide And Reasonable. Reg. Z Sec. 226.4(c)(7).

In transactions secured by real property or residential mortgages, fees for title examinations, abstract of title, title insurance, property survey and similar purposes; preparing deeds, mortgages, and reconveyance settlement and similar documents; and fees for notaries, appraisers, and credit reports; and certain escrow fees are not finance charges if the fees are bona fide and reasonable. See Reg. Z 226.4(c)(7). Excessive or duplicate fees of the types mentioned above are not uncommon and result in an understated finance charge and annual percentage rate and an overstated amount financed. Fees of the types mentioned above that are charged as payable to third parties, but are not actually paid, or which are paid for bogus services not actually performed would also appear to be finance charges. Fees for preparation of Truth In Lending disclosure documents are always finance charges. Commentary Sec. 226.4(a).

I. Insurance Disclosure Violations Resulting In Under-disclosed Finance Charge. Reg. Z Sec. 226.4(d)

Creditors may exclude from the finance charge premiums for property insurance or credit life, accident, health, disability and loss of income insurance only if they are actually paid and satisfy the disclosure requirements listed at Reg. Z 226.4(d).

Most of the insurance disclosures required by 226.4(d) are pre-printed on the disclosure statement, but potential violations remain. For example with respect to:

- credit life, accident, health, or disability insurance, the creditor may fail to have the consumer sign or initial a statement acknowledging the insurance is voluntary and requesting the insurance, or omit term of the insurance when the term is less than the term of the transaction.

- With respect to property insurance, creditors may fail to disclose the term the insurance when the term is less than the term of the transaction, or fail to disclose that the consumer can purchase the insurance from an insurer of his choice.

- Such omissions would preclude exclusion of the insurance charges from the finance charge and result in an understated finance charge and annual percentage rate and overstated amount financed.

- Private Mortgage Insurance if paid for by the consumer is always a finance charge and must be disclosed in the Finance Charge and payment schedule.
  Commentary 226.4(a)(3)(i).

J. Violation of Delay of Performance Rule: Reg. Z 226.23(c): Spiking

The creditor may disburse no money other than in escrow, perform no services, and deliver no materials until the rescission period has expired. Violation of this rule is called "spiking". Particularly in the home improvement context, premature performance (spiking) interferes with the consumer's right to reflect for three days on the wisdom of the transaction and undermines the three day rescission notice. . Accordingly, many courts have held that spiking results in an unexpired right to rescind. See NCLC, Truth In Lending (4th ed. 1999) Sec. 6.8.4.2 and cases cited thereunder.

K. Violations Pertaining to The Number of Disclosure Forms and Right to Rescind Notices Furnished

Regardless of who is liable on the note, each consumer whose ownership interest is or will be subject to the security interest in the residence has a right to rescind and has a right to receive one copy of the TILA disclosures and two copies of the notice of the right to rescind. Reg. Z 226.23 (a)(1) and 226.23(b). Commentary 226.23(b)(1). In the typical home equity loan in which the home is owned by a husband and wife, the couple should receive two Truth In Lending Disclosure forms and four notices. Failure to provide the required number of

disclosure forms and notices results in an unexpired right to rescind as to the consumer who did not receive the disclosure or required number of rescission notices, and one consumer can rescind for all. Reg Z 226.23(a)(4). See e.g. . *Williams v. BankOne, N.A. (In re Williams)*, 291 B.R. 636, 645 (Bankr.E.D.Pa. 2003); *Stone v. Mehlberg,* 728 F.Supp. 1341, 1353 (W.D.Mich. 1990).

Preserve Poof: Victims of high cost loans receive numerous documents, which they often preserve untouched in envelope or folder furnished them at closing; it is essential to preserve proof of the documents that client has received, by having a knowledgeable person count them and prepare an affidavit stating the number of TILA disclosure statements and Notices of Right to Cancel among the documents.

L. Violations Resulting From Inaccuracies in the Notice of Right to Rescind. Reg. Z 226.23(b).

The right to rescind will remain unexpired if the creditor fails to provide information required at Sec. 226.23(b) in the rescission form. The form should be carefully compared with that section. Common errors are (1) use of outdated forms, (2) filling in the wrong date on which the right to rescind would normally expire (usually as a result of forgetting about Sundays or holidays), (3) omitting such date entirely, (4) supplementing the notice of the right to rescind with a separate written, but inaccurate, explanation of that right, or an inaccurate oral explanation. See, e.g. *Jenkins v. Landmark Mortgage Corporation,* 696 F.Supp. 1089 (W.D. Va.1988) (Closing attorney orally misstated rescission rights rendering rescission notice "unclear" and resulting in unexpired right to cancel.).

Wrong Federal Reserve Forms: The Federal Reserve furnishes model forms that creditors can use to notify consumers of their rescission rights. One form is used when the transaction is fully rescindable; another is used for extensions of new credit by the original creditor, resulting in a transaction that is partially rescindable. Furnishing the wrong form will result in an unexpired right to rescind in a defensive rescission (See 15 U.S.C. 1635(i)(1)(B), and most probably in an offensive rescission. See 15 U.S.C. 1635(h)

IV. Drafting the Rescission Letter After Finding The TILA Violations: To Specify the Disclosure Violations or Not

A. Assess whether rescission is wise, keeping in mind the difficulties the client may face in completing her part of the rescission and that rescission without right will breach the contract. In most cases, the client already will be in default so the risk of placing the client in breach is a minor consideration.

B. After determining that rescission is appropriate, counsel should give careful thought to the drafting of the rescission letter.

It is sufficient to state only that the client cancels the contract.

In may be preferable, nevertheless, to draft a detailed letter specifying the violations that have resulted in the unexpired rescission right. This evidences good faith, may lead to faster resolution, and may provide a stronger basis for a court's ordering that the property or funds vest in the consumer without obligation if the creditor fails to fulfill its rescission obligations.

Counsel electing to specify violations, therefore, should be certain to specify that the list of violations is not an exclusive list, and allege an under-disclosed finance charge generally, as at least one court has denied rescission where the consumer specified the wrong violation in an otherwise rescindable transaction.

V. Steps Following Creditor's Response

The creditor's response to the consumer's rescission will determine the next steps. If the creditor honors rescission, releases the mortgage, and tenders the payments to the consumer or properly credits the consumer's account, counsel may assist the consumer in obtaining a loan to pay the consumer's obligation pursuant to the rescission. If no funds can be obtained, counsel may consider discharging the consumer's tender obligation, or a portion thereof, over time via Chapter 13 of the Bankruptcy Code; seeking a court order modifying the second and third steps of the rescission procedure by allowing the consumer to pay over time by regular monthly payments, or tendering a judgment lien against the property for the amount owed post rescission. If, as is likely, the creditor refuses to perform its part of the rescission, counsel can file an action, including counterclaim to foreclosure, in federal or state court, or an adversary proceeding in bankruptcy court seeking avoidance of the mortgage; vesting of money or in the consumer without obligation; alternatively, seeking to limit any judgement against the consumer to an unsecured judgment in the sum owed after rescission; recovery of statutory penalties; recovery of costs and attorney fees.

VI. Satisfying Your Clients' Tender Obligation

A. Loan from a bank, credit union, rural development, family or friends (may need co-signor)

B. Is there no tender obligation because payments made plus statutory penalties wipe out the obligation?

C. Structure your case to maximize the opportunity for vesting without obligation.

- To maximize chance of vesting, your rescission letter might clearly explain the bases for your rescission, with citations from the statute and Reg Z. Option: client sends letter simply stating "I cancel". You follow up immediately with letter explaining basis.

- Attempt to show that all times relevant, the creditor could have no reasonable doubts that your rescission was valid.

- Attempt to show creditor bad faith or that the equities favor the debtor and that the creditor's conduct has prejudiced the debtor's rescission rights: For example, furnishing

adverse and/or inflated credit report after valid rescission; following policy of "stonewalling rescissions; failing to investigate your client's allegation; post rescission harassing collection practices; basing the loan on inflated appraisals that render it impossible for the consumer to borrow the funds to tender etc.

•Furnish creditor credible information that establishes your client has the ability to tender the sums owed after rescission: i.e., with a loan commitment or notarized statement from lender. Option: file notice of ability to tender in court record.

•When can't procure funds to tender:

(1) Seek to tender the sum owed post rescission via court ordered monthly payments without interest.

(2) Tender via Chapter 13 Bankruptcy: You can litigate the entire case in the bankruptcy court via adversary proceeding. REMEMBER, if you choose bankruptcy court as the forum, always rescind prior to filing the bankruptcy case. This defeats any argument that the Trustee should exercise the rescission and not your client.

(3) Discharge tender obligation in Ch 7. Remember, assured of keeping residence only when debtor can exempt the equity created by the rescission.

(4) A valid rescission voids the mortgage automatically. Reg Z Sec 226.23(d)(1). Contend that the most the creditor is entitled to is an unsecured judgement in the amount owed post rescission.

(5) If desperate, tender a judgement, which can be secured by a judgement lien, in the amount owed post rescission (but be sure to reserve your claims for damages that might offset the judgement). Move for summary judgement for statutory damages, and, if granted, seek to offset them against amount owed post rescission. (TILA does not permit unilateral offset of statutory damages; must be awarded them first.)

6. Negotiate a loan modification with the creditor. In conjunction with negotiations have the property appraised by a reputable appraiser. You'll find that a significant proportion of high cost loans are based on grossly inflated appraisals. Roughly 80% of the accurately appraised value of the property should set an outside limit on the "new principal" in a loan modification.

VII. Defeating Creditor's Pleas for "Conditional Rescission".

Some Courts, failing to note the obvious differences between a statutory TILA rescission and an equitable common law rescission,"condition" the consumer's rescission on the tender of the amounts owed post rescission. See e.g. *Williams v. Homestake* 968 F2d 1137 (11th Cir. 1992). Some of these courts have allowed the creditor to retain it's mortgage until the tender has been satisfied, have placed deadlines on the tender, and ordered that the rescission be denied if the tender is not timely made. See *Buckles vs. Thorp Loan and Thrift Co.*, 189 B.R. 752, 764 (Bankr. Minn. 1995). One court, in a case that should be limited to its facts, upheld summary

judgement against a debtor who offered no evidence of a plan or ability to satisfy his tender obligation. See, *Yomamoto v Bank of New Your* 329 F3d 1167 (9th Cir.2003). Such decisions often refer to the court's broad equitable powers applicable to equitable remedies such as rescission as a basis for altering the structure laid out by Reg Z. Such decisions fail to recognize that TILA rescission is a statutory consumer protection remedy that as written assures that the *consumer* is returned to the *status quo ante* even if doing so renders it impossible to return the creditor to the precise position it occupied before consummation. (For example, the creditor never recovers creditor financed appraisals, broker's fees, and other closing costs). The following might prove helpful in demonstrating that these decisions are a judicial "re-write" of TILA rescission that conflicts with well-established principals of administrative law, statutory construction, and, with respect to TILA, virtually unfettered deference to the regulations, commentary, and opinions of the Federal Reserve Board.

1. Courts cannot resort to equity to re-write statutes and administrative regulations. The Bankruptcy Court in *In Re Reddington* 90 B.R. 429, 431-32 (Bankr. Ill. 1988) rejected a plea for an equitable modification of a Bankruptcy Rule and in summarizing the law on this point stated,

As the Ninth Circuit states in *In re Shoreline Concrete Co. Inc.,* 831 F.2d 903 (9th Cir. 1987), "a fundamental principle of equity jurisprudence is that 'equity follows the law.' *Hedges v. Dixon County,* 150 U.S. 182, 192, 14 S. Ct. 71, 74, 37 L. Ed. 1044 (1893). Courts of equity are bound to follow express statutory commands to the same extent as are courts of law. *Hedges,* 150 U.S. at 192, 14 S. Ct. at 74; *Badaracco v. Commissioner*, 464 U.S. 386, 104 S. Ct. 756, 78 L. Ed. 2d 549 (1984) ('courts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement'); *Heppner v. Alyeska Pipeline Serv. Co.,* 665 F.2d 868, 872 (9th Cir. 1981) (in absence of drafting error, courts are powerless to avoid effects of plain language of statute)."

2. TILA grants the Federal Reserve Board ("the Board") broad authority to prescribe regulations to carry out the purposes of the Act. The Boards' "regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. Sec.1604

With respect to administrative regulations generally, "If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 843, 844 (1984)

3. "Unless demonstrably irrational, Federal Reserve Board staff opinions construing [TILA] or Regulation should be dispositive...." *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565, (1980). TILA reflects a transition in congressional policy from a philosophy of "the buyer beware" to one of "let the seller disclose." *Morning v. Family Publications, Inc.* 98 S. Ct. 1642,

1648 (1973). TILA is construed liberally to protect consumers. *Adams v. Plaza Finance Co.* 168 F3d 932 (7th Cir. 1999); *Edwards v. Your Credit, Inc.* 149 F3d 427 (5th Cir. 1998).

4. The by virtue of both Reg Z and the Commentary has stated that upon rescission the mortgage is void and automatically negated and that only the procedures following the negation of the mortgage are modifiable by judicial action. See, Reg Z. Sec 226.23 (d) Effects of rescission, quoted at page 2 supra, and Commentary 226.23(d)(1) , which states,

"The security interest is automatically negated regardless of its status and whether or not it was recorded or perfected."

5. In light of the deference given the Board's regulations and commentary there is no such thing as "conditional" voiding of the security interest dependent on the consumer's first making tender. Had the Board intended that courts can condition the voiding of the security interest on the consumer's tender the Board would not have limited the Court's modifications to paragraphs (2) and (3) of Reg Z, Sec 226.23(d), while leaving paragraph (1), which states that the security interest is void, immune from modification.

6. The Board's Regulations and Commentary are not demonstrably irrational, particularly in light of the consumer protection nature of the statute. The statute at 15 U.S.C. Sec 1635 reads as follows:

Return of money or property following rescission

When an obligor exercises his right to rescind under subsection (a) of this section, he is not liable for any finance or other charge, and any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission. Within 20 days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, downpayment, or otherwise, and shall take any action necessary or appropriate to reflect the termination of any security interest created under the transaction. If the creditor has delivered any property to the obligor, the obligor may retain possession of it. Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor, except that if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value. Tender shall be made at the location of the property or at the residence of the obligor, at the option of the obligor. If the creditor does not take possession of the property within 20 days after tender by the obligor, ownership of the property vests in the obligor without obligation on his part to pay for it. The procedures prescribed by this subsection shall apply except when otherwise ordered by a court.

7. The foregoing language of 15 U.S.C. Sec 1635(b) establishes that the Board's pronouncements that the security interest is "void" and "automatically negated" is not "demonstrably irrational" as the statute itself states that upon rescission the security interest "becomes void." Morever, Sec 1635(b) recognizes the "substance" vs "procedure" distinction that permeates many areas of the law. Sec 1635(b) limits court modification of the rescission to the "procedures" proscribed by the subsection as opposed to the "substantive" requirements that the consumer" shall not liable for any finance or other charge, and any security interest given by

the obligor, including any such interest arising by operation of law, becomes void". Accordingly, the Board's Commentary holding that the security interest is "automatically negated" should be dispositive. *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565, (1980).

8. 15 U.S.C. Sec 1635(b), Reg Z Sec 226.23(d)(1); and the Commentary at Sec 226.23(d)(1) unambiguously pronounce that upon rescission the security interest becomes void and is "automatically" negated. Given such lack of ambiguity, Courts are precluded from looking beyond he text to determine the meaning of the statute and regulations. Nevertheless, decisions such as *Williams v. Homestake* 968 F2d 1137 (11th Cir. 1992) that hold that courts may condition the voiding of the security interest on the consumer's tender have quoted from the legislative history::

"the courts, at any time during the rescission process, may impose equitable conditions to insure that the consumer meets his obligations after the creditor has performed his obligations as required by the act." S.Rep. No. 368, 96th Cong., 2d Sess. 29 (1980)

But, this quote omits the next sentence, which confirms Congress' faith in the Board to prescribe the parties' specific obligations, and other relevant portions of the entire passage:

> "Upon application by the consumer or the creditor, a court is authorized to modify this section's procedures where appropriate. For example, a court might use this discretion in a situation where a consumer in bankruptcy or wage earner proceedings is prohibited from returning the property. The committee expects that the courts, at any time during the recission process, may impose equitable conditions to insure that the consumer meets his obligations after the creditor has performed his obligations as required under the act. The committee further expects that the federal regulatory agencies will make clear to both creditors and consumers their respective obligations under the act's recission procedures." S.Rep. No. 368, 96th Cong., 2d Sess. 29 (1980) [emphasis supplied]

The passage supports the substantive versus procedure distinction discussed above and limits the court's role to modifying the procedures or process "after the creditor has performed his obigations" as opposed to changing substantive rights, and confirms Congress' delegation to the Board to clarify the parties obligations. Pursuant to that delegation, the Board unambiguously stated that upon the consumer's rescission, the security interest is "automatically negated".

VIII. Common TILA violations that have Occurred in Kentucky Transactions Known to the Author and could result in unexpired right to rescind.

1. Lien filing fees more than $35 in excess of actual fee.

2. $40.00 Courier fee imposed by creditor

3. Document preparation fee that included charges for preparing TILA disclosures.

4. Document preparation fee that included a "redraw fee' in case of an abortive closing requiring that some documents be redrawn; but was no abortive closing.

5. Standard appraisal fee for" drive by" appraisal conducted by creditor.

6. Standard attorney title search fee, where identical title search performed in the previous month and title search at issue limited to update.

7. Payment schedule on one of two TILA disclosure forms furnished to joint debtors illegible.

8. Inclusion of $75 prepaid finance charges in the amount financed.

9. Providing joint debtors with only one TILA disclosure form and two notices of right to cancel.

10. Providing joint debtors with only one TILA disclosure form and four notices of right to cancel.

11. Creditor, after debtor's rescission, corrects error thereby opening up a new three day rescission period, so debtor cancels within the three day period.

12. Creditor furnishes consumers copy of letter to home office to debtor, which letter explains that creditor has explained to debtor their rescission rights and provides an explanation of those rights; unfortunately, the explanation is incorrect, arguably rendering the correct notices of right to rescind unclear.

13. Creditor overlooked cross collateralization, spreader clause.

14. Creditor omitted transaction date, and date upon which three day rescission period normally would end.

15. Creditor omitted address to which rescission should be mailed.

16. Charging a brokers fee when no broker involved.

17. Charging a fee in excess of $150 for title insurance, disclosing the fee as paid to "public officials", and disclosing that amounts paid to closing attorney include the title insurance.

Apparent double charge could result in an understated finance charge. See e.g. *Therrien v. Resource Financial Group, Inc.* 704 F. Supp. 322 (D.N.H.,1989)

18. Failing to disclose term of credit insurance on insurance disclosure where term less than loan term.

19. Grossly inflated appraisal, designed solely to justify loan, not value property. Fee for bogus appraisal *may* be finance charge, resulting in unexpired right to rescind, coverage because not reasonable and bonafide. To be reasonable and bona fide and qualify for exclusion from the finance charge an appraisal fee must be reasonable in amount and for a service that was actually performed. See *Bell v. Parkway Mortg., Inc.* (In re Bell), 309 B.R. 139, 152 (Bankr. D. Pa., 2004). Such a "service" should be an independent market value assessment in accordance with industry standards, applicable ethics and licensing requirements.

20. Amounts for private mortgage insurance mis-stated in the payment schedule.

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PART 3

HOME OWNERSHIP & EQUITY PROTECTION ACT

HOME OWNERSHIP & EQUITY PROTECTION ACT

HOME OWNERSHIP & EQUITY PROTECTION ACT (HOEPA) Requirements for certain mortgages at 15 U.S.C 1639 & Reg Z at 226.32 & 226.34 can result in an unexpired right to rescind pursuant to the Truth In Lending Act,(TILA) at 15 U.S.C. 1635. Applies to non-purchase money mortgages with high annual percentage rate and/or high points and fees. For detailed discussion and analysis see, National Consumer Law Center, Truth In Lending, ch 9 (5th ed. 2003) and annual supplements thereto.

A. **HOEPA covers closed end loans otherwise subject to TILA rescission.** HOEPA contains additional disclosure requirements; designates prohibited loan terms, and specifies prohibited acts and practices; provides enhanced statutory damages; and expands assignee liability.

B. Coverage is triggered by the following:

The APR Trigger: APR exceeding by more then 8 percentage points the yield on treasury securities with comparable maturities at the time the loan was made. For treasury bond rates to visit www//bog.frb.fed.us/releases/h15/data on the net. In the event the loan period falls midway between two treasury bond maturity periods, select the lower rate. See, Reg Z, Commentary 26.32(a)(1)(i)-4.

The Points and Fees Trigger: points and fees exceeding 8% of the "total loan amount" and "payable at or before closing". The total loan amount is generally the "amount financed" but can be less. Points and fees include

(1) all finance charges, except interest, including per diem interest, and time price differential;
(2) all brokers commissions;
(3) all credit insurance premiums (but only for loans after 10/1/2002); (4) all settlement charges that can be excluded from the finance charge under Reg Z, Sec. 226.4(c)(7) unless the charge is reasonable, the creditor receives no direct or indirect compensation, and the charge is not paid to an affiliate of the creditor. Reg Z, Sec 226.32(b).

C. Activation by either trigger requires, in addition to all other TILA requirements, compliance with the requirements of 15 USC 1639 and Reg Z 226.32, including

DISCLOSURE REQUIREMENTS: three days prior to consummation the creditor must give the consumer a disclosure containing statutorily mandated language appearing at 15 U.S.C. 1639(a) and Reg Z 226.32(c) in "**conspicuous type size.**" The disclosure must warn the consumer that "you could lose your home and any money you have put into it" and that signing the loan application and receiving these disclosures creates no obligation to complete the transaction; and disclose the APR; the periodic payment amount; the amount borrowed; for variable rate loans, that the interest rate and the monthly payment could change, and the maximum monthly payment; any balloon payment; and the amount of any financed credit insurance premiums.

The HOEPA disclosure is a material disclosures as defined at 15 U.S.C 1602(u). Accordingly, failure to provide the HOEPA disclosures timely in the manner required by the Act results in an unexpired right to rescind. Each consumer with an ownership interest in the dwelling must receive a copy of the HOEPA disclosure. Reg Z, Commentary Sec.226.23(b).

If the APR or periodic payment amount is changed prior to closing, new HOEPA disclosures must be timely furnished.

PROHIBITED LOAN PROVISIONS AND LIMITATIONS: Inclusion Results in Unexpired Right to Rescind and Enhanced Damages: See, 15 U.S.C. 1639; Reg Z. 226.32; 15 U.S.C. 1640.

1. No Prepayment Penalties *unless* the loan satisfies the following five conditions:

    a. Prepayment penalty must, by it's terms, not apply to a refinancing by the original creditor or an affiliate thereof.[1]

    b. Loan can't result in monthly indebtedness exceeding half consumer's income.

    c. Income and expenses must by verified.

    d. Prepayment penalty must not apply after 5 years from consummation of the mortgage.

    e. Prepayment Penalty must not otherwise be prohibited by law.

2. No increase in interest rates upon default.

3. No balloon payments for loans of less than 5 years.

4. No negative amortization.

5. No refunds or rebates calculated by method less favorable than actuarial method.

6. No more than two periodic payments financed in loan proceeds.

7. No due on demand clause.

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[1] "[A] mortgage referred to in section 1602(aa) of this title may contain a prepayment penalty if ...the penalty applies only to a prepayment made with amounts obtained by the consumer by means other than a refinancing by the creditor under the mortgage, or an affiliate of that creditor;" 15 U.S.C 1639

PROHIBITED ACTS AND PRACTICES that result in enhanced damages but not unexpired right to rescind. Reg Z at 226.34.

1. No furnishing of loan proceeds to a contractor unless (a) through instrument payable both to consumer and contractor or (b) at consumer's election, pursuant to written escrow agreement signed by consumer, contractor, and creditor before date of payment.

2. Must include Notice to Assignee that loan subject to HOEPA and that assignee could be liable for all claims and defenses that borrower could assert against the original creditor.

3. No refinancing into a second HOEPA loan within a year by the creditor, assignee, or servicer unless in consumer's best interest.

4. No extension of credit without regard to consumer's repayment ability where consumer can show this is part of pattern and practice.
Presumption that creditor lending without regard to repayment ability if creditor engages in pattern and practice of failing to verify and document ability to repay.

5. No making open end loan to avoid HOEPA. Open end loan must have reasonable expectation of repeated transactions.

CONSEQUENCES FOR VIOLATING HOEPA: RESCISSION, ENHANCED DAMAGES; AND EXPANDED ASSIGNEE LIABILITY: Failure to provide the HOEPA disclosure or a HOEPA loan containing "a provision prohibited by sec. 1639 ... shall be deemed a failure to deliver the material disclosures ... for the purposes of section 1635". See, 15 U.S.C. 1639(j)and 15 U.S.C. 1602(u). This provides a consumer:

(A) **an unexpired right to rescind**; (but remember if only violation is prohibited act or practice as described at Reg Z 226.34, then no rescission, only HOEPA enhanced damages.)

(B) the **statutory damages available in any rescission case**, should the creditor fail to timely comply with a valid rescission (usually $2,000);
(C) **attorney fees**; and,

(D) unless the creditor can show that the compliance failure was not "material" within the meaning of the common-law, **enhanced damages equal to the "finance charges and fees paid by the consumer".** 15 U.S.C. 1640(a). Consumers should contend that this includes an amount equal to all finance charges paid, at closing ("prepaid finance charges"[2]) and as part of their monthly payments.

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[2] Reg Z recognizes prepaid finance charges as paid by the consumer. That's why they are call "pre*paid*". "Prepaid finance charge" means any finance charge paid separately in cash or by check before or at consummation of a transaction, or withheld from the proceeds of the credit at any time. Reg Z 226.2(23).

HOEPA enhanced damages can be viewed as double the rescission amount that must be returned to the consumer: HOEPA is meant to discourage high cost loans.[3] One way it does so is by doubling the rescission amount that must be returned by the creditor. It does so by first causing the creditor to lose the finance charges and fees via rescission and then by requiring the creditor to pay to the consumer a sum equal to the finance charges and fees paid by the consumer.

Multiple enhanced damages, a possibility: another way HOEPA discourage high cost loans is making enhanced damages available for a failure to comply with "any requirement" of Section 1639. 15 U.S.C Sec. 1640(a)(4). It, therefore, appears that multiple violations result in multiple damage awards. By contrast, TILA's general prohibition of multiple statutory damage awards applies only to "multiple failures to disclose." 15 U.S.C Sec. 1640(g). Accordingly, a creditor failing to provide the HOEPA notice and making a loan containing prohibited loan terms and/or aging in prohibited practices could be liable for two or more enhanced damage awards.

(E.) **EXPANDED ASSIGNEE LIABILITY**

Assignees always subject to rescission. Sec. 1641(c).

Assignees subject to statutory damages and enhanced damages to extent violations are apparent on face of the relevant documents. Sec 1641(a)

Unless assignee can prove by a preponderance of evidence that a reasonable person would not have been able to determine that the instrument was high rate mortgage or high points and fees mortgage as defined at sec. 1605(aa), assignee is subject to enhanced damages, and damages based on any other claims, including TILA damages, that could be asserted against the creditor to the extent of all remaining indebtedness plus all sums the consumer has paid in connection with the transaction. Sec. 1641(d). This latter provision functions similarly to the FTC Holder Rule. The Commentary clarifies that assignee is liable for all claims that could be asserted against the creditor not just those arising from TILA. Commentary 226.34(a)(2)-3.

Some creditors set the points and fees just below the 8%, threshold. A tactic in HOEPA cases should be to move a charge into the points and fees so that the 8% threshold is exceeded. This could result in both a disclosure violation and prohibited practice and possible multiple enhanced damages, in addition to rescission and other rights available.

[3]The Joint Statement of the Conference Committee on HOEPA stated, "[T]he Conferees believe that these loan structures are potentially dangerous when misused and warrant a *heightened degree of consumer protection* in order to ensure that borrowers are not victimized by abusive lending practices." H.Rep. No. 103-652, at 22 (August 2, 1994) (emphasis added).

Common, clear-cut, potential, and arguable violations seen in Kentucky:

1. Failure to provide HOEPA disclosure three days in advance of closing.

2. Failure to provide separate HOEPA disclosure to each consumer with rescission rights.

3. Points and fees threshold exceeded after additional charges allocated to points and fees. Common because many creditors bump up against 8% threshold by making 7.95% to 7.99% loans. Can occur when official fee exceeds those actually paid to public officials; when third party fees not otherwise finance charges become points and fees because they were paid to the creditor or affiliate; when courier fees, flood determination fees, or settlement fees not included in finance charge when, under certain circumstances, they have to be; or when document preparation fees not reasonable.

4. Failure to disclose varying payment levels on HOEPA disclosure.

5. Failure to disclose balloon payment on HOEPA disclosure.

6. Pre-payment penalty contains no limitation stating that penalty does not apply in event of refinancing by creditor or affiliate. Very common. See, *McIntosh v Irwin Union Bank & Trust*, 215 F.R.D. (U.S.Dist.C. Ma. 2003).

7. HOEPA disclosure warning consumer that could lose home etc. in same type size as other text on disclosure and on other documents in apparent violation of Sec. 1639 requirement that this language be in "conspicuous type size". See model form at Appendix H-16 to Reg Z.

8. Note with prepayment penalty results in monthly debt exceeding 50% of consumer's monthly income. *May* result from improper or excessive "gross up" of non-taxable income.
9. Yield Spread Premium[4], especially when combined with pre-payment penalty that is required to assure lender under all circumstance recaptures it, *may* be a broker's commission payable by the consumer at or before closing and therefore a point and fee triggering HOEPA coverage.[5]

10. Fee for bogus appraisal *may* be point and fee triggering HOEPA coverage because not reasonable and bonafide. Many high cost loans are based upon appraisals that are grossly inflated to assure the loan "goes through". To be reasonable and bona fide and qualify for exclusion from the finance charge an appraisal fee must be reasonable in amount and for a service that was actually performed. *Bell v. Parkway Mortg., Inc.* (In re Bell), 309 B.R. 139, 152 (Bankr. D. Pa., 2004). Such a "service" should be an independent market value assessment in accordance with industry standards, applicable ethics and licensing requirements, and designed to assure adequate collateral for the loan.

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[4] A yield spread premium is compensation paid by the lender to the mortgage broker for obtaining a loan in which the borrower pays a greater rate of interest than the lender normally would charge. The lender recaptures the YSP from the increased interest over the life of the loan and, in the event of an early payoff, from the pre-payment penalty which is always paired with a YSP.

[5] *Webster v. Centrix Home Equity Corp* 300 B.R. 787 (Bankr. OK, 2003) holds the YSP is a point and fee within the meaning of HOEPA, but see, *Mourer v. Equipment Corp. of America*, 309 B.R. 502 (U.S. Dist, S.D. Mi. 2003). Neither case analyzes the effect of the pre-payment penalty guaranteeing recapture of the YSP on the issue of whether the YSP is payable by the consumer "at our before closing".

PART 4

KENTUCKY HIGH COST LOAN ACT

KENTUCKY HIGH COST LOAN ACT

For mortgage loans that exceed HOEPA's points and fees and APR triggers, KRS. 360.100 offers the following additional protections:

1. Covers purchase and non-purchase money mortgages between $15,000 and $200,000

2. Prohibits flipping of subsidized mortgages

3. Limits prepayment penalties to 36 months, with the amount of penalty decreasing each year (1st year – 3%, 2nd year - 2%, 3rd year – 1%)

4. Prohibits balloon payments

5. Limits fees to modify, renew, extend or amend a high-cost loan – must be less than half of fees that would be charged to refinance

6. Expands on notice given to borrower prior to closing – recommends shopping for the best rate and seeking counseling – and requires the lender to make available to the borrower a video, CD or DVD explaining his or her rights under this law prior to closing

7. Requires lender to determine in each case that borrower has ability to repay loan based on income and other expenses, not on borrower's equity in home

8. Prohibits any lender from charging points and fees if a high cost loan is refinanced within one year into another high cost loan

9. Prohibits same lender from charging points and fees on refinancing into another high cost loan at any time, except on new proceeds

10. Prohibits same lender who refinances into another high cost loan from financing any prepayment fees or penalties and from financing points and fees in excess of 4% of total amount, excluding third party real estate fees

11. Prohibits lender from financing single premium credit insurance

12. Prohibits mandatory arbitration clauses that are oppressive, unfair, unconscionable or that do not comply with consumer standards of the American Arbitration Association

13. Limits late fees to 5% of amount past due or $10, and states that late fees may be charged only once with respect to a late payment

14. Limits lender to a $10 fee for borrower to obtain written payoff

15. Requires lender to provide borrower with written notice of default and right to cure at least 30 days prior to initiating foreclosure

16. Prohibits lender from recommending or encouraging default when refinancing is anticipated

17. Establishes that a violation of this Act is usury, but requires borrower to chose remedies between usury (lender forfeits all interest and borrower may recover twice interest paid) or Consumer Protection Act (actual damages plus attorney fees.)

APPENDIX

FEDERAL PREEMPTION OF STATE LAWS

a. National Bank Act, 12 U.S.C. § 85 (interest rates), § 24 (general bank powers), § 24a (financial subsidiaries), § 371 (real estate-secured lending), § 484 (visitorial restrictions)(original act effective date: 1873); see Tiffany v. National Bank of Missouri, 85 U.S. 409 (1873) [reprinted at Appx. B.4, infra].

Comment: National bank may charge higher of state most favored lender rate or alternative federal ceiling. Preemption of state laws affecting the business of lending permitted by regulation. Operating subsidiaries are entitled to same preemption rights as their parent banks, according to regulation.

State Opt-out? No

Regulations: 12 C.F.R. §§ 7.4000 (visitorial restrictions), 7.4001 (definition of interest), 7.4002 (non-interest fees) (replacing § 7.7310), § 7.4006 (applicability of state law to operating subsidiaries), 7.4008, 7.4009, 34.3, 34.4 (terms and conditions of loan and other related bank activities), 7.500 et seq. (electronic activities).

Manual: § 3.4S

b. DIDA § 501(a) (first mortgage preemption), 12 U.S.C. § 1735f-7a (effective date Apr. 1, 1980) [reprinted at Appx. B.1, infra].

Comment: Preempts state usury ceilings on credit secured by first lien on residential real estate or mobile home. Lender must be federally related or making over $1 million per year in residential mortgage and mo-bile home loans or credit sales. Preemption only applies to mobile homes if creditor complies with OTS consumer protection regulations.

State Opt-out? Yes. State opportunity to opt-out of interest preemption on first mortgage expired 4/1/83. Opportunity to opt-out of provisions regulating points or pre-paid charges does not expire, and may be done im-plicitly. Whole or partial opt-out jurisdictions include: CO, GA, HI, ID, IA, KS, ME, MA, MN, NB, NV, NC, PR, SC, SD (Wisconsin repealed its § 501(a)(1) opt-out effective May 4, 1998).

Regulations: 12 C.F.R. § 590 (general OTS first mortgage preemption regulations); 12 C.F.R. § 590.4 (OTS con-sumer protection regulations for mobile home loans or credit sales).

Manual: §§ 3.6.3S, 3.6.5.2S

c. DIDA §§ 521—523 (alternate ceiling), 12 U.S.C. §§ 1463(g) (savings and loans), 1785(g) (credit unions), 1831d(a) (commercial banks) (effective Apr. 1, 1980) [reprinted at Appx. B.2, infra].

Comment: Allows federally insured depositories to charge interest up to the federal alternative ceiling and, by judicial interpretation, extends most favored lender status to these institutions.

State Opt-out? Yes, no expiration date on opportunity to opt-out. Jurisdictions remaining opted-out: IA, PR, WI (Ne-braska opted out between 1982 and 1988; Massachusetts opted-out between 1981 and 1986; Colorado dropped its opt-out in 1994; Maine dropped its opt-out in 1995; North Carolina dropped its opt-out in 1995 as to loans, mortgages, credit sales, and advances made in the state after effective date of July 1, 1995).

Regulations: 12 C.F.R. § 560.110 (replacing 12 C.F.R. § 571.22, 61 Fed. Reg. 50,951, 50,965 (Sept. 30, 1996)).

Manual: §§ 3.6.2S, 3.6.5.3S

d. FHA/VA preemption, 12 U.S.C. §§ 1709-la, 1735f-7, 1709(b)(5); 38 U.S.C. § 3728. State law preempted June 30, 1976 and December 21, 1979. FHA authority to set interest ceiling revoked effective Nov. 30, 1983.

Comment: Preempts state interest ceilings on FHA or VA insured home loans.

State Opt-out? Yes. See 12 U.S.C. § 1709-1a(b) (effective June 30, 1985) and 12 U.S.C. § 1735f-7(b) (effective Dec. 21, 1979). Adoption or amendment of applicable state usury law after effective date of federal statute negates preemption associated under § 1735f-7(b). Preemption extends to VA loans through 38 U.S.C. § 3728. Mere amendment or reenactment of usury law after effective date of preemption may satisfy opt-out requirement.

Regulations: 24 C.F.R. §§ 200 et seq. (FHA); 38 C.F.R. § 36.4201 et seq. (VA).

Manual: § 3.7S

e. National Credit Union Act, 12 U.S.C. § 1757 (effective date 1934) (1980 amendment substituted the 15% annual ceiling for a 1% per month rate).

Comment: Regulates the types of loans which federally chartered credit unions may make. Sets maximum interest rate at 15% unless temporarily raised at the discretion of National Credit Union Administration Board. The maximum was raised to 21% effective May 12, 1980, and changed to 18%, effective May 14, 1987, 52 Fed. Reg. 8061 (Mar. 16, 1987). It has remained at 18% since that time. It is scheduled to revert to 15% on March 8, 2005, unless otherwise provided by the NCUA Board. 12 C.F.R. § 701.21(c)(7)(ii).

State Opt-out? No.

Regulations: 12 C.F.R. § 701.21.

Manual: § 3.85

f. Depository Institutions Act, Pub. L. No. 97-320 (Oct 15, 1982) (including **Alternate Mortgage Transactions Par-ity Act,** codified at 12 U.S.C. §§ 3801–3805) (effective Oct. 15, 1982) [reprinted at Appx. B.3, infra].

Comment: Expanded authority of federally chartered lenders to issue variable rate mortgages and other creative financing terms and to enforce due-on sale clauses. AMTPA (DIA Title VIII) grants state lenders, which have received any state license(s) necessary to engage in home mortgage lending, the option of following the appropriate federal lending regulations. This statute does not affect interest rate ceilings.

State Opt-out? Yes. Option expired Oct. 18, 1985. Opt-out states: AZ, MA, ME, NY, SC, WI (New York's opt-out does not apply to manufactured housing).

Regulations: 12 C.F.R. § 560 (federal savings and loans); 12 C.F.R. § 560.220 (state savings and loans, non-de-pository "housing creditors"); 12 C.F.R. § 34.21(a) (national banks); 12 C.F.R. § 34.24 (state com-mercial banks); 12 C.F.R. § 701.21 (credit unions).

Manual: § 3.9S

g. Home Owners' Loan Act, 12 U.S.C. §§ 1461, 1463, 1464 (enactment date 1933).

Comment: Federal savings and loan associations and subsidiaries may charge higher of state most favored lender rate or alternative federal ceiling. Broad preemption via regulation of other loan terms, conditions, and related activites.

State Opt-out? No.

Regulations: 12 C.F.R. §§ 560.1 et seq., 559.3(h), (n) (operating subsidiaries).

Manual: § 3.5S

AUTOMOBILES: SALES & FINANCING ISSUES

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SECTION C

AUTOMOBILES: SALES & FINANCING ISSUES

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Automobiles: Sales & Financing Issues

I. Troubleshooting Overview – Where to Look and What to Look for?

Very few clients ever come into the office announcing they have a usury problem or a problem under the Truth in Lending Act. More likely, a consumer may be complaining about a car that is falling apart or there is an impending repossession. Nevertheless, a consumer attorney must review the complete transaction between the client, the dealer and the financial institution in order to adequately represent the client.

A. Follow the Paper Trail

There may be a number of documents necessary to evaluate your client's case. While some of the documents may turn out to be irrelevant, the attorney should initially review all of them. Some of the documents listed below may not be readily available to the client depending upon the stage of the transaction and practice of the dealership. For example, a buyer in the middle of a "yo-yo"(see discussion below) sale may not have any documents:

- A document variously called a "Buyer's Order," "Purchase Order," "Retail Contract," or similar names. This document usually contains the purchase price of the auto, sales/use tax, filing fees, document fees, and trade-in allowance.
- Any rider or other separate document stating the sale or lease is conditional upon financing.
- The financing document which may be either (1) a retail installment sales contract (RISC) usually to be assigned to a financial institution but not always, (2) a note and security agreement normally payable to a financial institution, or (3) a lease which typically lists a financial institution as the lessor and the consumer as the

lessee. These documents should contain the disclosures required under the Truth in Lending Act.

- For used autos, any "Due Bill" or "We Owe" document promising work to be done on the automobile.
- For used autos, the "Buyer's Guide" mandated by the Federal Trade Commission to be affixed to the automobile.
- For new cars, the "sticker" listing the MSRP of the vehicle plus any dealer add-ons.
- A copy of the title and registration.
- A copy of the Application for Certificate of Title/Registration (commonly referred to as a "VTR"). The dealer may not have provided a copy of this to the buyer but it should be available from the County Clerk.
- A copy of any service agreement or extended warranty that may have been purchased together with any pamphlets or other documents related to the service agreement or extended warranty.
- Any evidence of insurance that may have been purchased through the transaction such as credit life and disability insurance or GAP insurance.
- Copies of service orders or repairs.

The attorney may also want the client to obtain a copy of the client's credit report after determining which credit reporting agency the dealer uses.

The dealer will have additional documents directly related to the transaction with the buyer/lessee set up in individual files. While there may be many other documents the dealer has which are relevant, the individual file for each transaction (sometimes referred to as "the deal

file") is a good starting point. The dealer may deny inspection by the consumer's attorney until the case is in litigation and formal discovery initiated. It is highly recommended that the attorney inspect the dealer's original file, rather than a copy, in order to better detect possible alterations.

The dealer's file should contain many of the documents requested from the client. In addition the file may contain:

- Notes about the transaction which might show how the sales price and payment terms were negotiated.
- The credit application.
- Notes about the financing aspect of the transaction which may include records of calls made to financial institutions.
- Any "recap sheet" which would show the profit made on the transaction and where it was made. Small dealerships may not have a recap sheet and some dealers may simply store the information in a computer and not place it in the physical file.

The attorney should be aware that many dealers make notes on the outside of the file and not in documents inside the file.

B. Follow the Money Trail

The usual incentive for committing fraud is money. Therefore, it is useful to be able to track the flow of money and find out who is profiting from the transaction.

In the typical sale transaction, the may receive a trade-in, a down payment and a retail installment contract. The stated trade-in value may or may not reflect the true value received by the dealer. For example, the "N.A.D.A. Official Used Car Guide" lists trade-in values, loan values, and retail values of automobiles. A dealer may only give the buyer credit for the trade-in

value of the auto and may use a "black book" value which is tied closer to auction prices than the N.A.D.A. guide. If the dealer does auction it or sell it to another dealer, then the trade-in or black book value may be close to what is realized by the dealer. If the dealer keeps the trade-in and resells it, the dealer will make a profit on the resale. This consumer is not given credit for this profit and the dealer recap sheet previously mentioned will not show this profit.

On the other hand, the allowance for the trade-in may be higher than wholesale value in order to make the down payment look larger than it really is for two reasons. First, it may enhance financing by a bank or other financial institution because it shows as a larger down payment. These institutions are familiar with this practice and may allow it to a limited degree provided they are comfortable with the buyer's credit worthiness. The second reason a trade allowance may be higher than wholesale is to make the buyer feel more comfortable with the deal while increasing the true cost to the buyer in other ways.

Someone unfamiliar with automobile sales may simply assume dealers make their money by selling cars and trucks at a higher price than what they paid. For many dealerships, however, the real money is made elsewhere. It may be made by adding expensive accessory items to new autos or by selling credit insurance. *See, infra* at II(B)(6).

Once the transaction is completed, the credit contract is most often sold. The contract may be sold "with recourse" or "without recourse." If sold with recourse, the dealer bears the ultimate risk of non-payment and will have to buy back the contract from the lender if the consumer defaults. In these types of arrangements, a dealer reserve is often set up by the lender. The lender holds back part of the price payable to the dealer to account for possible charge backs where borrowers default and the dealer buys back the loans. If the loan is sold without recourse, the lender bears the risk of default in all but a few instances (e.g., forged borrower's signature).

II. Step by Step – Looking for Problems at Every Stage

There are opportunities for unscrupulous dealers to take advantage of consumers at practically every step of their relationship – advertising, sales negotiations, the closing, and even after.

A. Advertising Scams

1. Bait and Switch

One of the oldest advertising scams is the "bait and switch." The bait is an alluring product advertised at an attractive price. The switch happens when the customer comes to the place of business and is deliberately switched to another product. This can be done in several different ways. Most commonly, the consumer is told the advertised product is sold out or is of inferior quality. The consumer is then switched to a different, higher-priced product.

Different statutory and regulatory provisions prohibit bait and switch advertising. They include:

- Criminal penalties for bait advertising if specific intent can be shown. KRS 517.040. These can be applied to any person, not just a dealer.
- The Federal Trade Commission's "Guides Against Bait Advertising," 16 C.F.R. 238.
- Motor Vehicle Commission regulations against bait advertising, 605 KAR 1:190, which was promulgated under the Commission's authority to suspend, deny, or revoke a dealer license for false or misleading advertising under KRS 190.040(I).

The Motor Vehicle Commission regulations on bait advertising may be particularly helpful because they deal specifically with motor vehicles advertised by dealers. Section 2 of the

regulation merely provides that "Licensees shall not use misleading or bait advertising." In turn, "bait advertising" is defined as:

> (4) "Bait advertising" means an alluring but insincere offer to sell or lease a product, to obtain leads to persons interested in buying merchandise of the type advertised and to switch consumers from the advertised product to another product for a higher price or on a basis more advantageous to the dealer. Advertising a new motor vehicle at a price which does not include all equipment listed as standard equipment by the manufacturer without disclosing such fact, or failing to disclose any such equipment for the purpose of advertising a low price and "baiting" the customer into charges above the advertised price is prohibited. No practice shall be pursued by the advertiser which will discourage the sale of the advertised product with the intent and purpose of selling other merchandise instead.

605 KAR 1:190 § 1(4). An "alluring but insincere offer" is arguably easier to prove than the specific intent required by KRS 517.040. Likewise, the regulatory definition of "bait advertising" prohibits, not just a price increase, but any switch to terms "more advantageous to the dealer." The term "advertising" means "any oral, written or graphic statement which offers vehicles for sale or lease or which indicates the availability of vehicles . . ." and includes not only the expected mass media advertisements but also signs, handbills, and even business cards. 605 KAR 1:190 1:190 § 1(1). This has possible implications in "yo-yo" or "spot delivery" abuses. *See,* discussion *infra* at II(B)(8).

2. Other Laws

The Motor Vehicle Commission has promulgated regulations aimed at curbing misleading advertising and includes a number of specific prohibitions in addition to the prohibition against bait advertising. 605 KAR 1:190.

The Kentucky Consumer Protection Act, KRS 367.170, prevents any unfair, false, or misleading act or practice in trade or commerce. Consumers have a private right of action under

KRS 367.220 and can seek actual damages and equitable relief. KRS 367.220(1). This also opens the possibility of attorney fees. KRS 367.220(3).

It is a misdemeanor for any person to knowingly make a false or misleading statement in an advertisement addressed to the public or to a substantial number of people. KRS 517.030. This criminal statute may also be used as the basis of a civil claim.

Finally, a plaintiff can prove common law fraud if she can establish, by clear and convincing evidence, that the advertisement consisted of (a) material representation (b) which is false (c) either known to be false or made recklessly (d) made to induce one to act (e) actual reliance and (f) damages caused by the misrepresentation. *See, United Parcel Service v. Rickert*, Ky., 996 S.W.2d 464, 468 (1999). The plaintiff is entitled to the benefit of its bargain, not to just money paid out by the plaintiff. *Id.* at p.470 ; *see also, Dempsey v. Marshall,* Ky., 344 S.W.2d 606, 607 (1961).

B. Types of Unethical Practices

Once a prospective buyer enters a dealership, an unethical dealer may use a number of methods to increase the cost to the buyer.

1. How Much Can You Afford?

One of the first things any dealer wants to know is how much the buyer is willing and able to spend. The dealer may simply press the buyer for the monthly payment the buyer can afford. In truth, many consumers do make buying decisions on the monthly payment. By getting the consumer to reveal this information early in the process, however, a dealer will have a feel for how much the consumer can pay in extras which can be a very high profit source. For both new and used car sales, this may lead to expensive add-on items. For used cars, this may lead to

an increase in the purchase price of the autos, especially at the buy here, pay here lots where an asking price may not be put on the cars.

Some dealers may go further than simply pressuring the consumer for information on their monthly budge and actually perform an unauthorized credit check. A credit check can only be done for certain enumerated reasons such as in connection with a firm offer of credit or by authorization of the consumer. 15 U.S.C. § 1681(b)(3). Simply going for a test drive or asking about prices and credit terms is not a sufficient reason to pull a credit report. *See*, Letter from David Medine (FTC) to Karen Coffey, Texas Automobile Dealers Association (Feb. 11, 1998). Obtaining this information gives the dealer an obvious advantage in negotiations with the buyer. In addition to giving a dealer a negotiating advantage, the number of credit checks may lower a consumer's credit score because multiple credit checks may be viewed as an indicator of credit stress. A consumer may never find out about this practice, however, because they either ultimately buy and finance an auto through the dealer or they simply never review their credit report for credit inquiries.

2. Negotiating Tactics

Auto dealers may use a variety of highly questionable tactics in negotiating the sales price on autos. One favorite tactic is to simply wear down a buyer by stalling. The buyer may get handed from one salesman to the next, then to a "closer" or sales manager, and then finally to the finance manager (known as "F&I" for finance and insurance). This process typically lasts a couple of hours but can last several hours. By this time, the buyer is so emotionally committed to the sale that it is difficult to back away from the deal. Those with less than excellent credit may be particularly vulnerable because of concerns about credit approval.

During the sales process, many dealers use a method called the "four-square method" to negotiate. Here, the dealer divides a sheet into four quadrants, like a cross. Each of these quadrants will contain an item that the salesperson finds helpful in negotiations – price of auto to be sold, monthly payment, down payment, and trade-in value. Skillful use of the four-square method can be likened to the infamous shell game where the pea mysteriously disappears in plain view. Even a wary consumer may find himself talking about monthly payments instead of the purchase price. The purchase price on the final contract may be different than the one on the four-square sheet.

These sales tactics are studied and deliberate. They are used to wear down a consumer's resistance to a variety of questionable sales tactics.

3. Excessive Pricing

Although excessive pricing issues is not limited to used car sales, it is there that the problem may be most clearly seen. Unsophisticated consumers or those with credit problems may pay several thousand dollars more for an auto than it is worth. Later, they may try to cancel the sale, erroneously believing there is a three day right of recision. When faced with this situation, the consumer attorney should look carefully at potential discriminatory credit or sales practices. *See, infra* at III(A). An attorney might be able to claim that excessive price alone is unconscionable in violation of the Kentucky Consumer Protection Act (KRS 367.170) and the Uniform Commercial Code (KRS 355.2-302 for sales and 355.2A-108 for leases). However, this may be a difficult argument to win absent additional facts. For example, one court has determined that a price overcharge may be an unfair or deceptive practice where the dealer misrepresented the sticker price and the wholesale value of the trade-in. *Davis v. Wholesale Motors, Inc.*, 949 P.2d 1026 (Haw. App. 1997).

4. Pricing Misrepresentations

New cars are required to have a "Munroney Sticker" which, among other items, lists the manufacturer's suggested retail price (MSRP) and delivery costs charged the dealer by the manufacturer on passenger cars and station wagons. 15 U.S.C. § 1231-1232.

There is no direct private cause of action under this statute. *Reiff v. Don Rosen Cadillac-BMW, Inc.*, 501 F.Supp. 77 (E.D.Pa.1980). However, some courts have held it is an unfair and deceptive practice under state law to hide the sticker in order to charge a higher price. *Suris v. Gilmore Liquidating, Inc.*, 651 So.2d 1282 (Fla. App. 1995) (misrepresenting "sticker" price on demo while removing true sticker); *Ciampi v. Ogden Chrysler Plymouth, Inc.*, 634 N.E.2d 448 (Ill. App. 19894) (car with 13,000 miles on it allegedly represented as "new" auto and sticker price hidden); *contra, Ambre v. Joe Madden Ford*, 881 F.Supp. 1187 (N.D. Ill. 1995).

5. Packing

Many of the financial based add-ons discussed in the next section occur through a process called "packing." The seller may intentionally inflate the monthly payment during the sales negotiations in order to add items such as credit life insurance after the price has been finalized. If they notice these charges at all, they may be mislead into believing they are not being charged for the service. In some instances, the finance manager may actually obscure part of the document while closing the deal. Where there is no room to increase the monthly payment and include the options, the dealer may increase the term of the loan without the consumer noticing.

6. Add-ons

Add-ons can come in one of two flavors. Dealer add-ons like rust-proofing, fabric protection (e.g., "Scotch Guard"), and pin-striping are often simply added to the sticker price listed on the auto's window. They cost the dealer little but may be expensive for the buyer.

Advertising prices without listing these add-ons may constitute bait advertising. See discussion on bait and switch, *supra*. Outside the area of bait advertising, it would be difficult to mount a challenge against this practice.

Many buyers have become aware of the overpriced front end add-ons but are blissfully unaware of the back end add-ons. Profit from the back-end items may often be gleaned from the dealer recap sheet. Back end add-ons can take several forms:

- Credit life, health and disability insurance.
- GAP insurance.
- Extended warranties or service contracts.
- Documentation fees or similar fees.

A dealer may earn commissions of 30% to 50% on credit life and health insurance, GAP insurance, and extended warranties or service contracts where the warrantor or administrator is a third-party. In fact, many dealers make more money on these items than they do in selling their cars and trucks. Unlike some states, the rate of commissions paid to dealers and others are not disclosed when insurers file their rates with the Kentucky Department of Insurance.

a. Credit Life or Health Insurance

Dealers and lenders can require credit life or health insurance as a requirement for the extension of credit but may have to include it as part of the finance charge under the Truth in Lending Act. 15 U.S.C. § 1605(b). This has the effect of substantially raising the Annual Percentage Rate (APR) on the loan and may dissuade a buyer from finalizing the deal. A dealer or lender will not have to include it as part of the finance charge (it will be part of the amount financed) if (a) the insurance coverage is not a factor in approving credit, (b) this is clearly disclosed to the consumer, and (c) the consumer affirmatively agrees to it in writing after the cost

is disclosed. *Id.* A dealer who nevertheless requires the consumer to take the insurance violates the Truth in Lending Act. A dealer or lender which denies credit because the consumer does not take the supposedly optional credit life insurance violates the Equal Credit Opportunity Act. *Bryson v. Bank of New York*, 584 F.Supp. 1306, 1318 (S.D. N.Y. 1984).

b. GAP Insurance

GAP insurance became popular when auto leases became popular as a means of financing automobile acquisitions. It is sometimes sold when autos are purchased. GAP insurance comes into play when the consumer's automobile is "totaled" in an accident and the amount paid by the auto insurance company (fair market value) is less than that needed to pay off the lease or loan. Like other forms of insurance sold by dealers, the dealers earn commissions on GAP insurance. Regulation Z was amended to treat GAP insurance (referred to as "debt cancellation fees" in Regulation Z) the same as credit life and health insurance under the Truth in Lending Act. 12 C.F.R. § 226.4(b)(10) and 226.4(d)(3).

c. Extended Warranties/Service Contracts

Warranties are covered in another chapter in this treatise. However, it is important to understand that the Magnuson-Moss Warranty Act prohibits a seller or supplier from disclaiming or modifying any implied warranty arising under state law if the seller or supplier makes any type of written warranty or, within 90 days from the time of sale, enters into a service contract covering the product. 15 U.S.C. § 2308(a). A warrantor who offers a "limited" warranty may limit the duration of the implied warranty to the same time period as the "limited" warranty provided that the limitation is conscionable and clearly disclosed on the face of the warranty statement. If a "full" warranty is extended, the duration of the implied warranties may not be

modified. 15 U.S.C. § 2308(b). Any disclaimer or other limitation of rights is ineffective. 15 U.S.C. § 2308(c).

d. Documentation Fees

Dealers routinely add documentation fees to supposedly cover the cost of preparing the documents, transferring title, and recording the lien. The actual fees charged by the government for filing and recording are normally separate from the documentation fee. In reality, many dealers charge document fees which bear no relationship to the cost of providing this "service." Section 11 of 605 KAR 1:190 may be of benefit where a dealer advertises a price in local media. The price advertised must include "all charges which the customer must pay for the vehicle" including such items as "additional dealer profit" and "additional dealer margin." Documentation fees are not specifically mentioned in the regulation but, if mandatory, then should be listed in part of the advertised price.

On the other hand, if the fees are optional then failing to disclose their optional nature by pre-printing them on a sales document may be a deceptive act. *See, Motzer Dodge Jeep Eagle, Inc. v. Ohio Atty. Gen.,* 642 N.E.2d 20 (Ohio App. 1994); *but see, Nigh v. Koons Buick Pontiac GMC, Inc.*, 143 F.Supp.2d 535 (E.D. Va. 2001)(no misrepresentation where consumer believed fee was mandatory government fee when it was actually only required by dealer).

7. Misrepresenting Sales/Use Tax

Some dealers may overcharge consumers the amount of sales or use tax. The easiest way to detect this is by comparing the registration received when a car is titled or title is transferred with either the purchase order (signed before the retail installment contract). The consumer may not have a copy of the purchase order.

This scam is perpetrated in different ways. In sales of both new and used vehicles, the dealer may charge sales tax on the full amount of the sales price of the vehicle, without giving credit for any trade-in. For used vehicles, the dealer may charge tax based upon an inflated sales price of the vehicle but then remit tax based upon the book value of the vehicle. For new autos, use tax is calculated at 90% of MSRP but an unethical dealer may charge the consumer on the full sales price.

8. Yo-Yo Sales

In order to close the sale, dealers like to deliver the newly purchased automobile to the consumer on the spot, even when the lender has not given final approval for the loan. Typically, the sale is made conditional upon receiving financing within a specified time period. Dealers call these "spot deliveries" and there is not necessarily anything wrong with this practice. A dishonest dealer, however, may use a spot delivery to increase the overall price to the consumer. This is referred to as a "yo-yo sale" because the dealer plays the consumer like a yo-yo, first letting her out of the dealership and then reeling her back.

A yo-yo sale typically happens when a dishonest dealer knows or has reason to know the consumer will not receive credit at the rate specified in the retail installment contract. The dishonest dealer will then call the consumer and inform her that financing on the agreed terms cannot be approved but that financing may be approved on different terms, usually at a higher interest rate. If the consumer balks, the dealer may tell her that the trade-in has already been sold (which may or may not be true). The dealer may also demand immediate payment of high rental fees found in the conditional portion of the contract. Faced with these pressures, a consumer may find he has no choice but to accept the new financing arrangements.

The consumer attorney is in a better position to help the consumer if the consumer has not accepted the new contract. If the trade-in has already been sold, then there are several possible claims that can be brought including common law fraud, violation of the Kentucky Consumer Protection Act (KRS 367.170, 367.220), and the tort of conversion and trover.

In *Hensley v. Paul Miller Ford*, Ky., 508 S.W.2d 759 (1974) the Court determined that an action for trover and conversion was appropriate under facts essentially similar to the modern yo-yo sale. The Court described the facts as follows:

> We find that within two hours after Hensley took to Mach I for a test run, and to see if he could obtain a loan, Ford sold the Cyclone without legal title and with the understanding that it would not be sold until Hensley completed the financing arrangements. It is also noted that Ford was aware of Hensley's inability to obtain a loan for the purchase of a car a few weeks before.

Id. at 762.

Damages for conversion and trover would be for the fair market value of the trade-in. *See, Batson v. Clark*, Ky.App., 980 S.W.2d 566 (1998). As indicated in *Hensley*, punitive damages are also available may also be available. Note, however, that the standard for granting punitive damages is now governed by KRS 411.186.

A dealer's knowledge of potential credit problems of the buyer may be inferred if the dealer targets consumers with credit problems. In other instances, knowledge of the dealer may be established by carefully reviewing notes in the dealer's file and by reviewing the consumer's credit history. The dealer should run a credit check and should have a good idea of the consumer will qualify for certain financing. If the dealer fails to run a credit check, then an argument can be made that the knowledge of credit problems should be imputed to the dealer because of its recklessness.

In a more recent case, a jury returned a verdict of $8,600 in actual damages (value of auto, loss of use, inconvenience) and $50,000 in punitives. *Piles and Warner v. Craig and Bishop, Inc., d/b/a/ Sonny Bishop Cars*, No. 03-CI-07221 (Jefferson Circ. Aug. 5, 2004).

If the consumer has already signed a new contract, all is not necessarily lost. The tort of fraud or deceit may still be available to the consumer as may a claim under the Consumer Protection Act.

In those cases where there is not a conditional agreement based upon approval of financing, then the dealer is normally the creditor and should finance the deal itself. This is because the typical financing arrangement is a retail installment contract with the dealer as assignor, even if the name of a bank is printed on a contract.

9. Laws to Consider

Possible application of the Truth in Lending Act and Equal Credit Opportunity Act have been discussed in context with particular problems. There may be other claims or defenses of a more general nature which can be asserted.

The Uniform Commercial Code implies a duty of good faith in all contracts. KRS 355.1-203. A court can grant relief from unconsionable terms of a contract. KRS 355.2-302 (sales) and 355.2A-108 (leases). A claim for rescission based on material misrepresentation or fraud can be made without barring other remedies. KRS 355.2-721 and 355.2A-505.

The difficulty in seeking rescission for fraud is the responsibility most people have for reading and being bound by their contracts. As the Court in *Cline v. Allis-Chalmers Corporation*, Ky.App., 690 S.W.2d 764, 766 (1985) stated "negligence in failing to read the contract prevents any reliance on oral representations at the time of his signing. Therefore, the lease or the purchase order in the instant case may not be rescinded on the basis of fraud." There is an

important but subtle difference, though, when a claim for the tort of fraud is brought by a party who did not read the contract. A person has the duty to exercise ordinary care in reading their contracts but the exercise of that ordinary care is a question of fact when the plaintiff with one factor being the extent the party is entitled to rely upon the one who procured his signature. *Id.* at pp. 766-767 (plaintiff had prior dealings with defendant).

The buyer may be able to revoke acceptance of the automobile under the Uniform Commercial Code well after taking delivery. In *Bell v. Louisville Motors, Inc.*, Ky.App., 573 S.W.2d 351 (1978), the Court held that the issue of whether acceptance had been revoked within a reasonable time was an issue of fact. The buyer sued for recision and for violation of the Consumer Protection Act where he claimed the seller had misrepresented the truck as new when it was not. The buyer claimed he did not learn of facts supporting his claim until after he had driven the truck 3,000 miles.

A disclaimer of implied warranties by the dealer does not prevent a buyer from revoking acceptance. *Ford Motor Co. v. Mayes, Ky.App.*, 575 S.W.2d 480 (1978). Where the manufacturer has a policy where it refuses to recognize this statutory remedy, it commits a violation of the Consumer Protection Act. *Id.*

Revocation of acceptance usually requires a tender of the automobile back to the seller. This may be difficult on the consumer who has to get to and from work. In *Greene v. Waddell*, Ky.App., 657 S.W.2d 589 (1983), the Court held that the buyer who continues using the motor vehicle could still bring an action for fraud and violation of the Consumer Protection Act (odometer had 44,000 miles on it but engine had 80,000 miles on it)..

The Kentucky Consumer Protection Act, KRS 367.170, prevents any unfair, false, or misleading act or practice in trade or commerce. Consumers have a private right of action under

KRS 367.220 and can seek actual damages and equitable relief. KRS 367.220(1). This also opens the possibility of attorney fees. KRS 367.220(3).

C. Failure to Disclose Damage or Repairs

Not all fraud and misrepresentations need to be made affirmatively. In certain circumstances, the law recognizes a duty to inform – even in the sale of automobiles.

1. Damage to Vehicles

A dealer is expressly required by statute to disclose to a buyer damages done on new automobiles in the following circumstances:

- The dealer must disclose damage done in transit where the damage exceeds six percent of the vehicle's sticker price not including damage to glass, tire and bumpers replaced by identical manufacturer's equipment. The dealer must then certify to the consumer that the vehicle has been repaired to the manufacturer's standards. The manufacturer, and not the dealer, is then liable for "any concealed damage." KRS 190.0491(5).
- When damage exceeding $1,000 (formerly $300) occurs after delivery to the dealer, the dealer must certify to the consumer that the vehicle has been repaired to the manufacturer's standards. Liability for concealed damage remains with the dealer and not the manufacturer. KRS 190.0491(5).
- An individual or licensed dealer is required to disclose in writing any damages which exceed $1,000 (formerly $300) while the vehicle is in that person's possession. KRS 186A.540.

The provisions of KRS 186A.540 apply to non-dealers as well as dealers. *Potter v. Bruce Walters Ford Sales, Inc.*, Ky.App., 37 S.W.3d 210 (2000). The statute requires mechanical

repairs which exceed the statutory limit be disclosed. *Smith v. General Motors*, Ky.App., 979 S.W.2d 127 (1998).

KRS 190.010(23) defines "fraud" as including "an intentional failure to disclose material fact." The Court in *Smith v. General Motors*, Ky.App., 979 S.W.2d 127 (1998) used this statute as one, independent basis for determining the dealer had a duty to disclose unsuccessful repair attempts, leaving a "new" van which continued to stall. This, in turn, supported a claim for common law fraud against the dealer. Using this rationale, a repair attempt that did not exceed the $1,000 limits found in the above statutes might, nonetheless, still have to be disclosed if it were a material fact.

The Court in *Smith* also held there was a duty to disclose "where one party to a contract has superior knowledge and is relied upon to disclose same." *Id.* at 129. *See also,* Bryant v. Troutman, Ky., 287 S.W.2d 918 (1956) (latent defect in real estate). Thus, the plaintiff had a claim for both the tort of fraud and for violation of the Consumer Protection Act. Most recently, the Kentucky Supreme Court has recognized the tort of negligent misrepresentation where the parties are in privity of contract. *Presnell Const. Managers, Inc. v. Eh Const., LLC*, Ky., 134 S.W.3d 575 (2004). The Court specifically adopted § 552 of the Restatement (Second) of Torts. *Id.* at 576.

2. Branded Titles

A motor vehicle may be damaged to the extent it cannot be repaired at a cost less than its retail value. In that event, the owner is required to surrender the certificate of title to the automobile. KRS 186A.295(1)(a). These are sometimes referred to as "junk vehicles." KRS 186A.510(3). Chapter 186A contemplates that these vehicles will be taken out of service, never to return. Junk vehicles, as defined by Kentucky law, should not be confused with motor vehicles

which are branded as "salvage" in Kentucky. Nor should they be confused with out-of-state title brands which may even include a "junk" brand.

If a motor vehicle is sufficiently damaged in Kentucky, it receives a salvage title. It receives the salvage title if it has been wrecked or damaged to the extent that the cost of parts and labor exceed 75% of the fair market value of the automobile as established by the NADA price guide. KRS 186A.520(1). A motor vehicle which has been "water damaged" in Kentucky must also receive a salvage title. KRS 186A.530(4). The vehicle is considered to be water damaged if it has been partially or completely submerged above the dashboard, regardless of the dollar amount of the damage. KRS 186A.510(7). A hail-damaged vehicle, however, does not receive a salvage title. *See,* KRS 186A.555.

Think of the salvage title as a temporary title. Once the vehicle has been repaired, the owner can apply for a new title which is branded as a "rebuilt vehicle" on the face of the title. KRS 186A.530(1), (2). Other states have titles brands which may contain different words such as "junk" or "rebuildable." Those states may have different standards for branding titles. Kentucky may issue a Kentucky salvage title (and later a branded title) on those vehicles if the applicant submits at least two photographs of the vehicle showing the damage and also submits two estimates verifying damage to the vehicle is less than 75% of the retail value of the auto. KRS 186A.530(5).

Before the statute was amended to allow for the continuation of a title brand on autos from other states, Kentucky was known as a "title washing" state. A person could get a "clean" title with no brand on it by simply having it titled in Kentucky. There are still a few states where this can be done and a Kentucky consumer can still end up with a vehicle where the title has been

washed from another state. Kentucky's statute has had the effect, however, of reducing the number of such vehicles dumped in Kentucky.

A motor vehicle dealer must notify a buyer of a title brand in two ways. First, there must be notice on a sticker of the automobile. KRS 186A.530(7)(a). Second, the dealer must obtain the signature of the buyer on a notification form approved by the Transportation Cabinet. KRS 186A.530(7)(a) and 186A.530(8). A non-dealer must also disclose a title brand on forms prepared by the Cabinet. KRS 186A.530(7)(b); *see also, Preferred Automotive Sales, Inc. v. Sisson*, Ky.App., 44 S.W.3d 818 (2001).

If the dealer fails to procure the buyer's signature on the notification form, the sale is voidable at the option of the buyer. The option must be exercised within 45 days of issuance of the title. KRS 186A.530(8). This is designed to give a reasonable amount of time for a buyer to receive the title and review it. The statute explicitly provides that the statute's provision does not bar other remedies available to the buyer. *Id.*

One important limitation is that the notice provisions do not apply to motor vehicles more than ten model years old. KRS 186A.530(9). That does not mean, however, that the title brand comes off after ten years. A buyer might still be able to claim fraud or violation of the Consumer Protection Act in the appropriate circumstances.

The notice requirements also do not apply to hail-damaged vehicles since they never receive a salvage title. *See*, 186A.555. Instead, they receive a special brand. *Id.*

3. Duty to Disclose Previous Consumer Owner

KRS 190.080 was enacted to help a consumer determine the history of a used car before buying it. The statute requires dealers to place a notice on the windshield of every used car informing buyers of their right to seek the name and contact information of the previous

consumer owner. KRS 190.080(3). The statute then makes it unlawful to refuse to furnish the name and contact information of the previous consumer owner if requested by a prospective buyer provided that information is known or available. KRS 190.080(2). Note that the statute specifically refers to notice when there is a "used car" for sale, not a "motor vehicle" which would include more types of automobiles. Violation of the statute can result in criminal penalties. KRS 190.990(1).

This statute is most likely to be of assistance to the consumer buys a car with a defect or problem that may have been discoverable by contacting the previous consumer owner. It might be one fact in many upon which to base a claim of fraud or violation of the Consumer Protection Act.

D. Disclosure Under the Truth in Lending Act

The Truth in Lending Act, 15 U.S.C. § 1601, *et seq.*, was first passed in 1968 to enable consumers to judge the true cost of credit and has been amended several times. In the context of automobile financing, it covers both the traditional credit purchase and auto leases. Loans and retail installment contracts are regulated by 12 C.F.R. 226, commonly referred to as Regulation Z. That portion of the Truth in Lending Act (TILA) dealing with consumer leases is known as the Consumer Leasing Act, 15 U.S.C. § 1667 - 1667e, and is regulated under 12 C.F.R. 213, commonly referred to as Regulation M. This discussion is merely a brief introduction highlighting a few key provisions of the TILA.

1. Scope

For loans, the Act covers "creditors" which means anyone who either regularly extends consumer credit or the person to whom the financial obligation is initially payable on the fact of the obligation. 15 U.S.C. § 1602(f). For traditional auto loans, "regularly extends credit" means

more than 25 transactions per year. 12 C.F.R. 226.2(a)(17). There must be more than four installments to come within the scope of the Act. 15 U.S.C. § 1602(f).

The Consumer Leasing Act covers "lessors" which includes those who both lease personal property or arrange for such leases more than five times in a calendar year. 12 C.F.R. 213.2(h). The CLA applies to leases of more than four months in duration. 15 U.S.C. § 1667(1).

The most significant limitation in the scope of the TILA is that it is limited to credit transactions where the amount financed is under $25,000. 15 U.S.C. § 1603(3). For consumer leases, the "total contractual obligation" cannot exceed $25,000. 15 U.S.C. § 1667(1), 12 C.F.R. 213.2(e)(1). This term is not the same as the total of payments made on the lease and excludes the residual value amount or purchase-option price and amounts collected by the lessor but paid to others, such as taxes. Official Staff Commentary § 213.2(e)-3. Down payments or trade-ins used to reduce the capitalized cost are considered part of the "total contractual obligation." *Eastwood v. General Electric Capital Auto Lease, Inc.*, 825 F.Supp. 306 (N.D. Ga. 1993); *Sanders v. Gold Key Lease, Inc.*, 906 F.Supp.197 (S.D.N.Y. 1995). For example, where a consumer makes a $10,000 down payment in cash and trade-in and the regular lease payments excluding the amount paid for taxes is $16,000 over the course of the lease, then total contractual obligations would be $26,000 and would not be within the scope of the Consumer Leasing Act.

2. Required Disclosures in Credit Transactions and Regulation Z

Traditional automobile loans, whether structured as a retail installment contract or a note payable to a bank, are considered "closed end" credit transactions requiring certain information to be disclosed. Regulation Z requires a number of items to be disclosed with perhaps three of the most critical being the amount financed, finance charge, total of payments, and Annual Percentage Rate (APR). *See,* 12 C.F.R. 226.18.

(a) Amount Financed

The "amount financed" must be disclosed and is calculated by:

(1) determining the principal amount or cash price (less any downpayment);

(2) adding any amounts financed by the creditor but which are not part of the finance charge;

(3) subtracting any prepaid finance charges.

12 C.F.R. § 226.18(b).

(b) Finance Charge

Often the most critical item to determine is the finance charge since this will effect both the amount financed and APR. It includes "any charge payable directly or indirectly by the consumer . . . as an incident to or a condition of the extension of credit." 12 C.F.R. 226.4(a). Therefore, any charge applicable to credit customers not applicable to cash customers would be a finance charge unless specifically exempted under 12 C.F.R. § 226.4(c).. Regulation Z contains a non-exclusive list of items which are included as part of the finance charge such as interest, time price differential, debt cancellation fees (GAP insurance), and premiums for credit life and health insurance written in connection with a credit transaction. 12 C.F.R. § 226.4(b). These insurance premiums, however, may be excluded from the finance charge if certain conditions are met.

Premiums for credit life, health, and accident insurance may be excluded only if:

- The insurance is optional and this fact is disclosed;
- The premium for the initial term is disclosed and, if the coverage term is less than the term of the credit transaction, then this fact is disclosed; and
- The consumer makes an affirmative request in writing for the insurance after receiving the disclosures.

15 U.S.C. § 1605(b)(1); 12 C.F.R. 226.4(d)(1). GAP insurance is a type of debt cancellation fee and is treated the same as credit life insurance for determination of whether the premium is a finance charge or not. 12 C.F.R. § 226.4(d)(3); Official Staff Commentary § 226.4(b)(10); *see also*, *Sapia v. Regency Motors of Metairie, Inc.*, 726 F.3d 747 (5th Cir. 2002).

Auto dealers may receive substantial commissions from the sale of credit life and health insurance. Where borrowers are verbally told that purchasing the insurance is not optional, then the premiums should logically be included in the finance charge and there may also be a claim for an unfair or deceptive act under the Kentucky Consumer Protection Act. A creditor may violate the Equal Credit Opportunity Act when it lists insurance as being optional but then denies the consumer credit. *See*, *infra* at III(A)(1)(c).

(c) Annual Percentage Rate

The Annual Percentage Rate must be disclosed using that particular term. 15 U.S.C. § 1638(a)(4). Tolerances for the disclosure of the APR may be as great as one-fourth percentage point. 15 U.S.C. § 1607(c). Regulation Z contains a number of methods of calculating APR, some of which are quite complex. In some instances, there may be multiple methods of determining the APR which are acceptable for determining the APR. For example, booklets containing tables of finance charges may be obtained from the Federal Reserve Board or a creditor may use software applying one of the approved formulas. One such software program approved for banks by the Office of the Comptroller of the Currency can be downloaded for free from the OCC's web site at www.occ.gov/aprwin.htm.

3. Remedies for Violations on Traditional Auto Loans

A consumer can recover actual damages resulting from a violation of the TILA. 15 U.S.C. § 1640. The consumer may recover statutory damages, with or without actual damages, if there is

a failure to clearly, conspicuously, and accurately disclose amount financed, finance charge, annual percentage rate, total of payments, payment amounts and schedule, and the security interest identified. by type. Statutory damages include twice the finance charge but not less than $100 and not more than $1,000 in the case of an individual action. There are also special damage provisions for class actions.

While attorney fees may be awarded when the consumer properly rescinds a transaction relating to a home, there is no right to attorney fees under TILA on typical automobile loans. *See*, 15 U.S.C. § 1640(c). For that reason, the attorney may want to plead that an inaccurate disclosure is also a deceptive act in violation of the Kentucky Consumer Protection Act which does allow attorney fees at the discretion of the court. KRS 367.220.

4. Consumer Leasing Act Disclosures

Leasing became a widespread method of consumer financing of automobile use during the 1990s. As certain problems surfaced, the Federal Reserve Board found it necessary to amend Regulation M. It did so effective October 1, 1996, though compliance was optional until January 1, 1998. 62 Fed Reg. 51006 (Sept. 30 1997) *as corrected by* 62 Fed. Reg. 53733 (Oct. 16, 1997). These changes should be kept in mind when evaluating the precedential value of cases.

A lease is a consumer lease if the lessee is a natural person and the property is used for personal, family, or household purposes and otherwise falls within the scope of the Consumer Leasing Act. 15 U.S.C. § 1667(1). When liability at the end of the lease term is based on the estimated value of residual value, there are special limitations on liability that do not apply to non-consumer leases or leases outside the scope of the Act. There is a rebuttable presumption that the estimated residual value (estimated at lease inception) is unreasonable where it exceeds the actual residual value (at lease end) by more than three monthly payments. 15 U.S.C. § 1667b.

Further, in such cases, a lessor cannot collect excess liability without bringing an action. The real kicker is that "In all actions, the lessor shall pay the lessee's reasonable attorney's fees." *Id.* That means the lessor pays attorney fees for the consumer whether it wins or loses. With higher prices for automobiles, however, it is not that unusual for leases to fall outside this protection.

There are a number of items that need to be disclosed under Reg. M. 12 C.F.R. § 213.4. The Federal Reserve Board has developed model forms so dealers and lessors have no excuse for a form which does not make adequate disclosures Items to be disclosed in motor vehicle leases include:

- A description of the property – typically year, make, model and VIN;
- Itemization of amounts to be paid at lease consumation or delivery;
- How amounts paid at lease consumation or delivery are be made (e.g., cash or trade-in);
- Positive equity in trade-in. This is an area in which dealers sometimes slip. If there is zero or negative equity, it can simply be disclosed as zero or left blank;
- Number, amounts, and due dates under the lease and the total amount of the periodic payments;
- An itemization and total of "other charges" not included in the periodic payments or disclosed elsewhere. For example, this would include a processing fee but not taxes or other fees collected by the lessor for payment to third parties;
- Gross capitalized cost and agreed upon value of the vehicle. Prior to the amendment of Reg. M, lessors were not required to disclose the capitalized cost to consumers which sometimes resulted in payments based on a capitalized cost well above sticker price. The agreed upon value can be thought of as the sticker price

or negotiated value of the vehicle plus, at the lessor's option, fees for such items as title and licensing. It does not include service contracts and insurance. The term "gross capitalized cost" means the agreed upon value of the property together with items paid over the term of the lease such as insurance, service contracts and payoffs on existing loans or leases. 12 C.F.R. § 213.4(1). Dealers and manufacturers sometimes hide the balance due on a lease covering the trade-in by increasing the agreed upon value. This is a violation of Regulation M. It is part of the gross capitalized cost but not the agreed upon value. The lease should contain a statement notifying consumers of their right to a written itemization of these items added to the agreed upon value. *Id.*;

- Capitalized cost reduction. This is the total of any rebates to the consumer, cash payment, net trade-in and other non-cash credit;
- Adjusted capitalized cost. This is the gross capitalized cost less capitalized cost reduction;
- Residual value. This is an estimate of the value of the vehicle at the end of the lease term. Residual values may or may not be available in accepted guide books;
- Depreciation attributed to the vehicle stated as a monthly figure;
- Rent charges as part of the monthly payment;
- Total of base periodic payments which includes depreciation and rent charges;
- Number of payments during the lease term;
- Base periodic payment which is the total of base periodic payments divided by the number of payment periods in the lease. This is the amount of the monthly lease payment before taxes and similar charges are added;

- Total periodic payment which includes the basic periodic payment plus any other monthly payments (e.g., taxes)
- Te method of determining the amount of any penalty or charge for early termination and default. This should be a formula which can be calculated from the lease itself. *See, Applebaum v. Nissan Motor Acceptance Corpt.,* 226 F.3d 214 (3rd Cir. 2001) (construing old Regulation M);
- Disclosures relating to maintenance and excess wear and tear;
- Purchase option price.

III. Credit Scams

A. Discriminatory Practices

1. Equal Credit Opportunity Act

Certain discriminatory credit practices are illegal. The Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691 *et seq.*, is both the broadest and most narrow applicable statute. It is broadest because of the wide class of persons it protects and is the most narrow because it deals with solely with credit practices.

It prohibits discrimination bases upon sex, marital status, age, race, color, religion, national origin, the exercise of rights under the Consumer Credit Protection Act (15 U.S.C. § 1601 *et seq.*), and receipt of income from public assistance. 15 U.S.C. § 1691. It is not restricted to the valuation of credit worthiness; it covers the complete credit transaction involving the application process and collections. 12 C.F.R. § 202.2(m). It covers small business applicants as well as traditional consumer applicants. *See*, 15 U.S.C. § 1691a(b) (definition of "applicant") and 15 U.S.C. § 1691a(f)(definition of "person").

The Act covers "creditors" which is broadly defined as "any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit." 15 U.S.C. § 1691a(e). The typical car dealer who has the dealership listed as the creditor in a retail installment contract and regularly arranges for an extension of credit is a creditor under this section. *Cannon v. Metro Ford, Inc.*, 242 F.Supp.2d 1322 (S.D.Fla.2002).

The Federal Reserve Board has defined credit transactions covered under the Act very broadly:

> Credit transaction means every aspect of an applicant's dealings with a creditor regarding an application for credit or an existing extension of credit (including, but not limited to, information requirements; investigation procedures; standards of creditworthiness; terms of credit; furnishing of credit information; revocation, alteration, or termination of credit; and collection procedures).

12 C.F.R. 202.2(m).

Leases have been held to be credit transactions with the scope of the ECOA. *Brothers v. First Leasing*, 724 F.2d 789 (9th Cir. 1984); *Ferguson v. Park City Mobile Homes*, 1989 WL 111916 (N.D. Ill. 1989).

In addition to banning many forms of discrimination, regulations under the Act actually prohibits asking about sex, race, color, religion, or national origin except for some very narrow circumstances. 12 C.F.R. § 202.5(b). A creditor is also generally banned from inquiring about the marital status of a person unless the person resides in a community property state or is relying upon property located in such a state for repayment. 12 C.F.R. § 202.5(d)(1).

a. Sex/Marital Status Discrimination

Creditors are banned from seeking the co-signature of a spouse on an unsecured extension of credit if the applicant would otherwise qualify for credit. 12 C.F.R. § 202.7(d)(2). If a security interest is being granted, then "a creditor may require the signature of the applicant's spouse or other person on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the property being offered as security available to satisfy the debt in the event of default. . . ." 12 C.F.R. § 202.7(d)(4).

An interesting scenario presents itself where one spouse applies for credit to purchase a car but wants the auto in the couple's joint names. The creditor can require the non-applicant spouse to sign a security agreement but not a document holding the non-applicant spouse personally responsible for the debt. In home mortgages, it is common to have a separate note and mortgage to create a security interest in the real estate. In automobile credit transactions, however, there is typically only one document which provides for both personal liability and for a security interest in the auto. This arguably violates the ban on requiring spouses to co-sign for loans.

b. Racial Discrimination

Claims based on racial discrimination may be based upon overt discrimination, disparate treatment, or disparate impact. The use of credit scores and yield spread premiums present twists to these traditional analyses of possible discrimination.

The ban on asking about an applicant's race means the applicant's credit score is pivotal in the decision to grant credit. Credit reporting agencies rate a person's credit on a number of factors. The exact factors and how they are weighted are claimed to be proprietary. However, certain factors certainly are used in determining a credit score: income, amount and nature of

debt, debt to income ratio, past payment history, arrest or conviction record, whether an applicant is a homeowner, length of residence at the current address, lawsuits and bankruptcies. In addition, credit reporting agencies may have a separate credit score for use in evaluating automobile purchases or leases because an person may be more likely to pay for an automobile than an unsecured credit card.

The use of credit scores is generally laudable but there has been some debate about whether there are inherently discriminatory factors used in determining these scores. For example, does the use of zip code data influence the credit score and result in a type of "redlining" to discriminate against those who live in a minority neighborhood? In *Cherry v. Amoco Oil Company,* 490 F.Supp. 1026 (N.D. Ga. 1980), the Court ruled that the plaintiff (a white female) could not prove a *prima facie* case of discrimination because she could not show that the applicants rejected from the zip code area were disproportionally minority (creditors are generally banned from asking for race information). In addition, many of the low performing zip codes were predominately white. *Id.* at 1031.

One African-American claimed a violation of the ECOA because his arrest record was used to deny him credit. The plaintiff argued that African-Americans were more likely to be arrested than whites because of discriminatory police departments which, in turn, had a disparate impact on African-Americans. The court rejected this contention because there was no statistical evidence to back up this contention. *A.B. & S. Auto Service, Inc. v. South Shore Bank of Chicago,* 962 F.Supp. 1056 (N.D. Ill. 1997).

The use of credit scores may, in fact, be helpful in establishing statistical evidence of discrimination. At least three recent cases filed as class actions claim that defendant financial institutions allow dealers to mark up loans above the actual approved rate (see discussion on

yield spread premiums). *(Thompson v. WFS Financial, Inc., Pakeman v. American Honda Finance Company*, and *Herra v. Toyota Motor Credit Corporation*, information retrieved from plaintiffs' lawyer's web site at http://www.lieffcabraser.com/auto-loan-discrimination.htm on August 4, 2004). The dealer mark-up then results in a higher cost of credit to minority auto buyers compared to the cost of credit of whites with similar credit scores and income.

c. Discrimination Based on Exercise of Consumer Rights

The Consumer Credit Protection Act, 15 U.S.C. § 1601 *et seq.,* is the umbrella which covers a number of federal consumer credit protection laws including the Equal Credit Opportunity Act, Truth in Lending Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, and others. A creditor discriminating against one who exercises rights under any part of the Consumer Credit Protection Act violates the ECOA. 15 U.S.C. § 1691(a)(3).

There is a violation of this provision where a creditor declines credit based upon the refusal to purchase credit life where, as required by the Truth in Lending Act, the credit form indicated such insurance was optional. *Bryson v. Bank of New York,* 584 F.Supp. 1306, 1318 (S.D. N.Y. 1984). In another instance, a finance company violated this provision when it required a borrower to sign a release of a Truth in Lending claim on another transaction as a condition for obtaining an emergency loan. *Owens v. Magee Finance Service of Bogalusa, Inc.*, 476 F.Supp. 758, 764 (E.D. La. 1979).

d. Explanation of Adverse Action

An important procedural safeguard built into the ECOA is the requirement that a creditor notify an applicant in writing within 30 days of any adverse action taken on the application and the reasons for the adverse action. 15 U.S.C. § 1691(d)(1) and (2). Regulation B further defines the term "adverse action" as including "A refusal to grant credit in substantially the amount or on

substantially the terms requested in an application unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms) . . ." and the applicant accepts 12 C.F.R. § 202.2(c)(2)(v)(1).

e. Remedies

Remedies for individual actions brought under ECOA include equitable and injunctive relief, actual damages, punitive damages not to exceed $10,000, and reasonable attorney fees. 15 U.S.C. § 1691e. Class actions may recover actual damages and punitive damages not to exceed the lesser of $500,000 or 1% of the net worth of the defendant. *Id.* Actual damages may include mental anguish, damage to credit reputation and out-of-pocket expenses. *See, Fischl v. General Motors Acceptance Corp.*, 708 F.2d 143 (5th Cir. 1983). A violation of a substantive provision and a violation for the failure to report the reasons for adverse action are separate violations which may result in separate punitive damage awards. *Ricci v. Key Bancshares of Maine, Inc.*, 662 F.Supp. 1132 (D. Me. 1987).

f. Statute of Limitations

There is a two year statute of limitations for bringing an ECOA action which starts to run from the date of the violation. 15 U.S.C. § 1691e(f).

g. Other Protections Against Discrimination

There are a number of other statutes which forbid discriminatory practices which might potentially occur during the sale and financing of an automobile. A finding of a violation of 42 U.S.C. § 1981, 1981a, or 1982 entitles the plaintiff to attorney fees. 42 U.S.C. § 1988(b). A violation of sections 1981 or 1981a allows a court to include expert fees as part of the attorney fees.

All persons "shall have the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens. . . ." 42 U.S.C. § 1981(a). The refusal to extend credit based on race is a violation of this statute. *Bagley v. Lumbermens Mut. Cas. Co.*, 100 F.Supp.2d 879 (N.D.Ill.2000); *Davis v. Strata Corp.*, 242 F.Supp.2d 643, (D.N.D.,2003). However, unlike the ECOA, this statute is not limited to credit contracts. It applies to all contracts so that discriminatory pricing contracts would also be covered.

Compensatory damages include future economic loss, emotional pain, and inconvenience. 42 U.S.C. § 1981a(b)(3). Punitive damages may be assessed in proper circumstances with the amount partially dependent upon the number of persons the defendant has employed. *See*, 42 U.S.C. § 1981a(b)(3).

Racial discrimination is also prohibited by 42 U.S.C. § 1982 which provides that "All citizens of the United States shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property." Section 1981 and 1982 are considered to be *in pari materia* and to be construed together. *Garrett v. Tandy Corp.*, 295 F.3d 94, 102 (1st Cir. 2002). There has to be a property right involved and, in one case, a court held the credit practices of a material supplier did not violate this statute because those practices did not effect the plaintiff's right to purchase or lease property. *Davis v. Strata Corp.*, 242 F.Supp.2d 643, (D.N.D. 2003).

h. State Law

Kentucky law prohibits certain discriminatory credit practices based on race, color, religion, national origin or sex. KRS 344.400(1). Specifically, a person cannot used these factors

to deny credit or increase fees or collateral required to secure credit based. *Id.* A plaintiff may recover actual damages and reasonable attorney fees. KRS 344.450. There does not appear to be a statute which prohibits discrimination in the sales of goods or contracts generally.

B. Dealer Kickbacks on Financing – Yield Spread Premiums

Traditionally, an automobile dealer or other merchant who wanted a bank to finance a credit sale by purchasing a retail installment contract often had to sell the contract at a lower price than stated on the contract. The contracts were thus sold at a discounted rate to cover the risk to the bank or other financial institution. Competition among lenders, however, as turned this around. Financial institutions now often pay commissions or "dealer incentives" for the right to buy the contracts. These are really just kickbacks.

Sometimes the dealer incentive is simply a straight fee for each loan purchased, often in the range of $100 to $300. The more serious problem occurs when the financial institution authorizes the dealer to charge interest at a rate greater than the minimum rate at which the financial institution will approve. The lower rate is called the "buy rate." If the consumer agrees to a higher rate than the buy rate, the difference in the buy rate and the final contract rate is called the "yield-spread premium." In exchange for the higher interest rate sold to the consumer, the dealer receives a larger kickback.

KRS 190.010(23) defines "fraud" as including "an intentional failure to disclose material fact." The dealer's failure to disclose that it has added two to four percent onto the loan is surely a material fact and the failure to disclose is surely intentional (or at least a question of fact). Moreover, the Court in *Smith v. General Motors*, Ky.App., 979 S.W.2d 127 (1998), reaffirmed a line of cases holding that one with superior knowledge in a contractual relationship may be under a duty to disclose facts to the other part. *See also*, *Presnell Const. Managers, Inc. v. Eh Const.*,

LLC, Ky., 134 S.W.3d 575 (2004)(recognizing the tort of negligent misrepresentation). In *Morton v. Bank of the Bluegrass*, Ky.App., 18 S.W.3d 353, 359 (1999), the Court held that a bank officer "had a fiduciary duty to disclose 'material facts affecting the loan transaction' such as eligibility for credit life insurance. . . ."

Actions on this in other states have had mixed results. The Alabama Supreme Court has determined there is not a duty to disclose the dealer kickback in a common law fraud claim. *Bramlett v. Adamson Ford, Inc.*, 717 So.2d 781 (Ala. 1997). One unreported case in Tennessee has determined that the dealer misrepresented the rate charged by Ford Motor Credit. *Adkinson v. Harpeth Ford-Mercury, Inc.,* 1991 WL 17177 (Tenn.App. 1991); *compare, Harvy v. Ford Motor Credit Co.,* 1999 WL 486894 (Tenn.App. 1991)(*Harpeth* distinguished because consumer sued FMC and not dealer). Case law is still evolving in this area.

In anticipation of litigation on this matter, some finance contracts now disclose that the dealer may negotiate the interest rate but do not disclose the actual buy rate. Even in this scenario, if a dealer affirmatively misrepresents the minimum ratethis is an affirmative misrepresentation of fact which should be actionable under common law fraud and the Consumer Protection Act.

C. Usury

Most automobile sales are in the form of a retail installment contract with finance fees regulated by KRS 190.110. Rates are calculated using the add-on method of interest and are based on the age of the motor vehicle:

- 11% for model years not earlier than the year of sale;
- 13% for model years 1 or 2 years earlier than the year of sale;
- 15% for all other model years.

Id.

The add-on method of interest was first used as a simple way of calculating interest which does not take into consideration installment payments made during the loan term. Using the standard formula to determine interest payable (Principal x Rate x Time = Interest), the add-on method simply calculates the Interest as if only one lump sum is payable at the end of the term. Thus, the simple or actuarial interest rate will be higher when installment payments are made and the actuarial rate will depend upon the length of the loan and the payment period (monthly, weekly, etc.). This is one of the reasons the Truth in Lending Act was first passed. The Annual Percentage Rate is used to show the true cost of credit which is essentially the actuarial rate of interest plus other charges considered to be part of the finance charge.

Most retail installment contracts do not show the add-on method because KRS 190.110(4) allows the seller to compute the finance charge on a simple interest basis. Here are a few examples of what the add-on rates would be when converted to their equivalent simple interest rates:

Term	Add-on Rate	Simple Interest Rate
1 yr., monthly payments	11%	19.71%
1 yr., monthly payments	13%	23.2%
1 yr., monthly payments	15%	26.62%

The rates were determined by using a spreadsheet application which contained an amortization template and using trial balances to determine the rates. Weekly payments, as is common in "buy here pay here" lots, would result in higher equivalent simple interest rates.

If a bank or other financial institution directly lends money to a consumer using a note, rather than retail installment contract, other interest rates might apply. The determination of the

correct usury rate can be a complex analysis involving federal and state law and is beyond the scope of this chapter.

IV. Odometer Fraud

One method of defrauding buyers is by rolling back the automobile's odometer or by disconnecting it for a period of time. Although this type of fraud can be committed with any type of automobile, it is more likely to occur in used automobiles which have been driven more miles than the typical auto of that age. Rolling back the odometer on a two year old automobile from 50,000 miles to 20,000 miles can substantially add to the value of that vehicle.

A. Federal Law

The Motor Vehicle Information and Cost Savings Act (commonly referred to as the Federal Odometer Act) was first passed in 1972 and subsequently amended and recodified at 49 U.S.C. § 32701 – 32711. The Act applies to all "persons" which includes corporate entities and employees and agents of dealers such as a mechanic who physically rolls back an odometer.

The Act provides that a person may not:

- Disconnect, reset, or alter an odometer with intent to change the mileage recorded. 49 U.S.C. § 32703(2);
- Sell, advertise, install or use a device that causes an odometer to register an incorrect amount. 49 U.S.C. § 32703(1);
- Operate a motor vehicle on a street or road with intent to defraud and knowing the odometer is disconnected or not working. 49 U.S.C. § 32703(3); or
- Change the mileage on an odometer during a repair or, if it cannot be repaired without changing the mileage, the odometer must be reset to zero and a notice attached to the left door frame of the vehicle. 49 U.S.C. § 32704(a);

- Remove the notice attached to the door frame with intent to defraud. 49 U.S.C. § 32704(b).

1. Information to Be Disclosed

When transferring title, the transferor must disclose odometer readings at the time of the transfer. 49 C.F.R. § 580.5(c)(1). The transferor must certify:

- To the best of the transferor's knowledge, the disclosure reflects the actual mileage; or
- The mileage exceeds the mechanical odometer limits; or
- The odometer reading differs from the actual mileage and that the transferee should not rely upon the mileage stated by the odometer.

49 C.F.R. § 580.5(e).

As discussed below, these disclosures may be made on an existing title in the case of used vehicles. Some unscrupulous dealers may simply warn the transferee that the actual mileage may be different than the odometer in an attempt to insulate themselves from liability. However, at least a couple of courts have ruled that the dealer can only make this certification if the dealer has reason to know the actual mileage is different than that showing on the odometer. *See, Nieto v. Pence*, 578 F.2d 640 (5th Cir.1978); *see also, Denmon v. Nick's Auto Sales*, 537 So.2d 796 (La. App. 1989). In a series of interpretive letters, the National Highway Traffic Safety Administration (NHTSA) has taken the position that a dealer who makes this certification without reason to do so is in violation of 49 C.F.R. § 580.4. *See, e.g.*, Opinion Letter from Nat'l Highway Traffic Safety Admin. to Frank E. McCarthy, Nat'l. Auto Dealers Ass'n., Clearinghouse No. 43,095U (Jan 14, 1987); Opinion Letter from Nat'l Highway Traffic Safety

Admin. to Russell P. Laurens, Ga. Office of Consumer Affairs, Clearinghouse No. 43,0958S (June 16, 1986).

2. Form of Disclosure

For new motor vehicles for which a new title has not been previously issued, the odometer disclosure is made on a form separate from the title. 49 C.F.R. § 580.5(g). This disclosure is not filed with the state so the dealer must retain a copy for five years. *See*, 49 C.F.R. § 580.8. Odometer disclosures do not have to be made on transfers of new motor vehicles between the manufacturer and dealer or between dealers. Disclosure must be made before the first sale to a person who actually intends to use the vehicle. 49 C.F.R. § 580.17(b).

Where a title already exists (i.e., a used vehicle), the federal law requires disclosure of the odometer reading be made on the existing title to the motor vehicle. 49 C.F.R. § 580.5. The title may be assigned several times among dealers before it sold to the end user. A new title is not issued for each of these dealer assignments but the mileage disclosure must be made.

3. Retention of Records

Federal regulations require records related to odometer disclosure be retained for five years. 49 C.F.R. § 580.08. This includes (i) dealers who are required to retain a copy of each mileage statement they issue and receive, (ii) lessors of motor vehicles who receive an odometer disclosure they receive from their lessees, and (iii) dealers who must retain a copy of their powers of attorney which have been granted to them by their transferors. In each instance, the records must be kept in a manner "that permits systematic retrieval." *Id.*

4. Remedies

A person may bring a civil action in federal or state court for violation of any part of the Act (or regulations or orders) if the violation was done with intent to defraud. A person may

recover the greater of either three times actual damages or $1,500 plus costs and reasonable attorney fees. The action must be brought within 2 years of violation. 49 U.S.C. § 32710.

A person who knowingly and willfully violates the Act or regulation may be fined and imprisoned up to 3 years. 49 U.S.C. § 32709(b). The Secretary of Transportation may impose a civil penalty of up to $2,000 for each motor vehicle involved in a violation, not to exceed total penalties of $100,000. 49 U.S.C. § 32709(a) and the United States Attorney General may seek injunctive relief. 49 U.S.C. § 3209(c). The chief law enforcement officer of each State (typically, the State Attorney General) may bring an action in state or federal court to enjoin violation of the law and to seek those damages authorized by section 32710 on behalf of injured persons.

B. State Law

Kentucky law is substantially similar to the federal law on odometer fraud and is found at KRS 190.260 through 190.320. One who violates the provisions of the law with intent to defraud is liable to the transferee for the greater of three times actual damages or $1,500 plus attorney fees. KRS 190.310(1). Venue is in the county where the purchaser resides. KRS 190.310(2). Since no specific statute of limitations is imposed, the five year statute of limitations for an action based on statute would be applicable. *See,* KRS 413.120(2).

V. The Federal Trade Commission-Used Car Rule

A. Source and Status

The FTC's used car rule was published November 19, 1984, in 49 F.R. 45725 and became effective on May 9, 1985. 16 C.F.R. §455. The FTC published an extensive Commentary and Analysis in the material immediately preceding the rule as published in the Federal Register. The FTC reviewed it and made minor changes in December, 1995.

B. Scope and Coverage

The rule covers all sellers of motor vehicles who sell or offer to sell a used motor vehicle five times or more in any 12-month period. It is not limited to a motor vehicle dealer as defined by state law. A used vehicle is one which has been driven more than the limited use necessary to move or road test it prior to delivery to a consumer. Thus, the rule does apply to a typical new car dealer's inventory of demonstrators, executive cars, etc. The rule covers sales to all buyers except for used vehicle dealers.

Banks and financial institutions, lessors selling to lessees, and businesses selling to their employees are exempted from the rule. The rule does not apply to motorcycles, agricultural products, vehicles sold for scrap, or vehicles meeting certain size requirements (8,500 pounds gross vehicle rating; 6,000 pounds curb weight; and less than 64 square feet of frontal area).

Compliance with the rule requires an understanding of basic warranty law and the effect and implications of the Magnuson-Moss Consumer Product Warranty Act. The rule requires special compliance procedures in the area of written warranties, implied warranties and "service contracts" as defined in Magnuson-Moss.

C. Substantive Provisions of the Rule

The rule essentially makes it unlawful to (i) misrepresent the mechanical condition of any used motor vehicle, (ii) misrepresent the existence of or terms of a warranty, and (iii) fail to disclose prior to sale certain substantive provisions of the warranty. It is this last provision which has the most impact on used car sales and the attempt to enforce any indebtedness due because of the sale.

All used car sellers must include two required sentences in their contract of sale. The contract may be a separate contract or it could be the Retail Installment Contract which the financer later buys. The required sentences are:

The information you see on the window form for this vehicle is part of this Contract. Information on the window form overrides any contrary provisions in the contract of sale.

16 C.F.R. § 455.3(b). Even if the language is not contained in the contract, however, the rule affirmatively incorporates the warranty disclosures made in the window form into the contract and overrides any language in the contract. *Id.* However, a dealer may not make any statements which alter or contradict the terms of the window form. 16 C.F.R. § 455.4.

A "Window Form" must be properly completed and properly displayed. Before the revisions in January, 2001, the form had to be displayed on the side window of every used car offered for sale and could not be removed. The rule now provides that the form be "prominently and conspicuously in any location on a vehicle and in such a fashion that both sides are readily readable." 16 C.F.R. § 455.2(a)(1). The amended rule also allows a dealer to remove the sticker temporarily during any test drive but it must be reattached as soon as the test drive is finished.

The original of the window form must be given to the consumer at the time the sale is consummated. The Rule specifies the exact size for the form and further mandates specific wording. The Rule also requires the form to be printed in 100% black ink on white paper.

D. Spanish Language Sales

If a dealer conducts a sale in Spanish, the window form must be displayed in both English and Spanish and specific language is mandated for information about implied warranties, if applicable. 16 C.F.R. § 455.5.

E. Effect of Violation

While the Rule does not grant a specific cause of action or provide for recovery of specific civil penalties, a violation of the Rule would likely constitute an unfair trade practice.

VI. Repossession Issues

A. Right to Peacefully Repossess

A secured creditor has the right to repossess collateral covered by the security agreement or may simply render the property unusable (but not damage it). KRS 355.9-609. The statute makes it clear that the creditor can use non-judicial repossession only if there is no breach of peace.

In *First and Farmers Bank of Somerset, Inc. v. Henderson*, Ky.App., 763 S.W.2d 137 (1989), the Court held that creditor unlawfully converted property of the debtor when it repossessed the property causing a threat of a breach of peace, but no actual breach of peace. The court said the strong verbal objection and the limited intervention of a sheriff's deputy was sufficient proof that there was a threat of a breach to peace. In the same case, the Court noted that there was nothing wrong in removing the boat from a garage which had its doors open. *Id.* at 39.

B. Disposition of the Collateral

If the debtor consents, the creditor has the option of retaining the repossessed auto in satisfaction of the debt or selling the auto in certain circumstances. KRS 355.9-620(1). For consumer goods, the debtor can only consent if the debtor does not possess the collateral. KRS 355.9-620(2). The creditor cannot accept the collateral in partial satisfaction in consumer transactions. KRS 355.9-620(7). If the debtor has paid 60% of the cash price or principal amount of loan for consumer goods, the creditor must properly dispose (usually sell) of the collateral. KRS 355.9-620(7). The disposition must typically take place within 90 days. KRS 355.9-620(6).

If the secured party elects or is required to sell the property, it may dispose of the collateral in any commercially reasonable manner. KRS 355.9-610. The creditor must give reasonable notice before disposition of the collateral. KRS 355.9-612. Requirements of the notice

in consumer-goods transactions are set out in KRS 355.9-613. The secured party can recover reasonable repossession costs, preparation and disposition costs, and reasonable attorney fees if allowed in the contract. KRS 355.9-608(a) and 9-615(1)(a).

A commercially reasonable sale includes a public or private sale if such sale is commercially reasonable. KRS 355.9-610. In the case of dealer only auctions, the sale may be commercially reasonable but not be the type of sale at which the creditor can purchase back the collateral. The creditor can buy back collateral at a public sale or at a private sale if the collateral is the kind customarily sold on a recognized market to where there are widely distributed price quotations. Auctions open only to dealers should not be considered to be public sales:

> Although the term is not defined, as used in this Article, a "public disposition" is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. "Meaningful opportunity" is meant to imply that some form of advertisement or public notice must precede the sale (or other disposition) and that the public must have access to the sale (disposition).

Official Comment 7 to U.C.C. § 9-610. *See also, Ford Motor Credit Co. v. Solway,* 825 F.2d 1213 (7th Cir. 1987).

Likewise, used autos are not the type of goods that can be sold in a recognized market or are the subject of widely distributed standard price quotations:

> A "recognized market," as used in subsection (c) and Section 9-611(d), is one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market. A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions.

Official Comment 7 to U.C.C. § 9-610.

If the secured party or related party purchases nonetheless buys back the collateral, then the surplus or deficiency is calculated using a sales amount the collateral *would* have brought in a proper sale. KRS 355.9-615(6).

C. Remedies for Violation of UCC

There are several potential remedies available under Article 9 including injunctive relief, KRS 355.9-625(1) and damages for any loss incurred as a result of violation including loss for a debtor's inability to obtain credit or increased costs of alternate financing. KRS 355.9-625(2). If, however, the debtor utilized KRS 355.9-626 to reduce or eliminate a deficiency after repossession, the debtor can only recover for loss of any surplus.

Perhaps the most potent arrow in a consumer's quiver is that found in KRS 355.9-625(3)(b) which provides that, if the collateral is consumer goods, the debtor or co-signer may recover a minimum of the amount of the credit service charge (interest) plus 10% of the cash price or principal amount.

Where there is an action for deficiency or surplus relating to consumer transactions, the UCC has adopted a very flexible rule and states the courts "may continue to apply established procedures." KRS 355.9-626(2). Thus, a consumer's attorney is free to argue that a commercially unreasonable sale completely bars any deficiency even though that remedy is no longer specifically enumerated in the UCC.

D. Early Termination Penalties in Leases

Early termination fees in leases must not be penal in nature. The Federal Consumer Leasing Act allows penalties or early termination fees "only at an amount which is reasonable in the light of the anticipated or actual harm caused by the delinquency, default, or earl termination" but can take into consideration the difficulties in proving loss. 15 U.S.C. § 1667b(b).

The failure to discount accelerated lease payments on default is an unlawful penalty and not liquidated damages because it bears no relationship to anticipated harm. *Moore v. Ford Motor Credit Co.*, Ky.App., 778 S.W.2d 657 (1989); *see also,* KRS 355.2A-504.

E. Problems With the Insolvent Dealer

A problem sometimes arises where a dealer becomes insolvent before transferring title to the consumer. A bank may be claiming a security interest in the recently purchased automobile or another dealer may be refusing to transfer title on a used auto purchased by the consumer because that dealer has not been paid by the insolvent dealer. The problem is exacerbated when the dealer has already sold the trade-in.

Where another dealer or the manufacturer may be claiming an interest in the vehicle purchased by the consumer, it appears that the interest of the consumer prevails under one of two statutes. KRS 355.9-320(1) states in pertinent part that "a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence." A similar result is reached under KRS 355.2-403(2) which states that "Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in the ordinary course of business."

A problematic situation arises when a bank has a floor plan financing arrangement with the dealer and claims a security interest in the auto purchased by the consumer. KRS 355-9-320 does not cover this situation because the bank is not the seller. In any event, KRS 355.9-303 provides that the issue of perfection or non-perfection of security interests in goods covered by a certificate of title (like motor vehicles) are covered by the certificate of title law. Unless the floor

plan financier has recorded its lien on the certificate of title, then its security interest is unperfected. *See*, KRS 186A.190(1).

AUTOMOBILES: WARRANTY ISSUES

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SECTION D

AUTOMOBILES: WARRANTY ISSUES

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You probably get several calls a year from clients complaining of their automobile purchases. Whether new or used, the purchase of a car is fraught with landmines for the unsuspecting buyer. A little knowledge of sales law, common law fraud, and the consumer protection laws will help you serve your clients well.

Here's the typical scenario. Your client purchases an automobile (new or used). After owning it for a few weeks, maybe a few months, the automobile develops problems--structural, electrical, mechanical. The computer system goes out. He/she takes it back to the auto dealer, and he is more than willing to fix it under the new car's manufacturer's warranty or any service contract. If it's used, often there is no written warranty or service contract, so the consumer has to pay for the repairs.

During the "sales" phase, invariably the car salesman has "sold" your client on the car: a "cream puff," "A-1 excellent condition," driven by the proverbial "old lady back and forth to church." After his purchase, the client might learn that the history of the car was not accurate. It may be the car was bought at an auto auction, or it has a salvage/rebuilt title, or it was a flood car from a Florida hurricane. Sometimes the "executive program car" was really an Avis rental car. And most times you learn these facts well after the date of purchase.

The element that makes these cases difficult for the consumer or his lawyer is the value of the claim. The "damages" for the mechanical problems, or the salvage title or the misrepresentations of prior history, are only a few thousand dollars. How can you seek redress in an economically-reasoned manner? What laws protect you? Principally, there are five: sales (UCC) laws, Kentucky's Lemon Law (KRS 367.840, et seq.), the Federal Warranty Act

(Magnuson-Moss Act - 15 U.S.C. 2301, et seq.), Kentucky's Consumer Protection Act (the "KCPA"), and common law fraud.

Kentucky's Sales Law

There are usually two principal remedies under sales law--breach of warranty and revocation of acceptance.

Express Warranties - Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and became part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise. KRS 355.2-313(1)(a).

Implied Warranty of Merchantability - A warranty that the goods shall be merchantable is implied. Merchantability for automobiles is generally defined as "fit for the ordinary purposes for which such goods are used." KRS 355.2-314(1) and (2)(c).

Implied warranties are almost always excluded by a simple though conspicuous "As Is" disclaimer clause in the contract. (KRS 355.2-316)

Revocation of Acceptance - The buyer may revoke his acceptance of the vehicle if there is a nonconformity that substantially impairs the value to him, if he accepted: (1) on the reasonable assumption that the nonconformity would be cured and it has not been seasonably cured, or (2) the nonconformity was unknown at the time of acceptance and reasonably difficult to discover.

Note: the nonconformity, though sounding subjective, is an objective standard. Capitol Cadillac Olds v. Roberts, Ky., 813 S.W.2d 287 (1991).

There are a number of "traps" related to revocation that one must be aware of:

- the buyer must be given notice of the revocation (preferably in writing).
- revocation must be within a reasonable time (probably referring to some time subsequent to the discovery of the nonconformity).
- there must be no substantial change in the condition of the vehicle.
- the seller must be given the opportunity to cure the defect, unless the defect is reasonable "uncurable." (Example: car was previously totalled.)
- the buyer must not exercise any ownership over the vehicle after he revokes acceptance. KRS 355.2-602(2)(a); KRS 355.2-608(3).

The damage recoverable under express and implied warranties is generally the difference in fair market value "as warranted" and "as received." This usually requires expert testimony. The damage recoverable for revocation is the sales price.

Revocation, while securing a good result (i.e., he gets his money back), is risky. The assessment of proper revocation is a matter of law, which means the judge can do anything. Your client gives up the car, keys, title--and a year and a half later, in a pretrial, the judge may say the car was not returned in the same condition, or he determines that revocation did not occur within a reasonable time frame.

Quare: Who is going to take a case for a client whose damages might be $2,000.00 after two years of litigation?

Kentucky's Lemon Law (KRS 367.840)

This provision is found under the Consumer Protection Statutes, KRS Chapter 367. It applies only to new cars, KRS 367.840, and limits remedies for defects that appear within 12,000 miles or twelve (12) months following date of delivery to the buyer, whichever is earlier. It

provides a remedy for any resident of Kentucky who buys a new car (i.e., not limited to consumer use "primarily for household use" as defined in KRS 367.010, the general consumer protection statute).

Violation and Remedies Under Kentucky's Lemon Law

If a defect arises within the time frame set forth, and the manufacturer or the dealership is unable to cure the defect after a reasonable number of attempts during the 12-month/12,000 mile period, then the manufacturer, at the option of the customer, must provide a full refund, or provide a comparable replacement vehicle, KRS 367.842(1) and (2), less a reasonable offset for use of the vehicle.

The reasonable opportunity to cure the defect is four or more attempts to fix the same defect, or the same defect keeps the car out of service for a cumulative total of at least thirty (30) days. KRS 367.842(3)(a) and (b). The additional advantage of recovery under the Lemon Law is that attorneys' fees may be awarded to a prevailing plaintiff, at the court's discretion. KRS 367.842(9).

Sounds great? Not really. As a practical matter, the Kentucky Lemon Law statute is worthless. This statute in practice provides no more protection than the written factory warranty, except that it forces the manufacturer to enforce the written warranty under the threat of an attorney fee award to the plaintiff. And most cars don't develop a nonconformity as defined under the statute--a defect that fails to conform with an express warranty such that the defect "substantially impairs the use, value, or safety of the motor vehicle," KRS 367.841(6)--within the first twelve months of ownership. Almost never does the typical consumer spend the time (nor have the patience) to bring a vehicle in for repairs for the same defect four times or more, and

rarely is a car out of service for a particular defect for over thirty days (remember the 12-month limitation). If you took the car in three times, the manufacturer could keep the car for seven days at a time, and still not hit the threshold).

In addition, the Lemon Law requires the consumer to participate in Alternative Dispute Resolution (i.e., arbitration), as set out in KRS 367.860 or in 16 CFR Part 703. (Fayette County is fortunate enough to have the Better Business Bureau's Auto Line, which provides the requisite arbitration forum.) The decision of the arbitration panel is binding on the manufacturer, but not binding on the consumer. And only then, after you've participated in arbitration, can you file a lawsuit against the manufacturer.

Quare: How many clients will you see that have a substantial nonconforming defect in a new motor vehicle within 12 months or 12,000 miles of purchase that hasn't been fixed in at least four attempts (or is out of service for thirty days), have participated in arbitration, and still have the desire (and financial wherewithal) to then file a lawsuit to seek redress? Not many--it's a lot easier to sell the car.

The Magnuson-Moss Act (15 U.S.C. 2301, et seq.)

This statute is also known as the Federal Warranty Act. It applies to the sale of any consumer goods, including automobiles, where a written warranty or service contract is provided. It also expands the definition of "consumer goods" to include all items "normally used" for personal or family use. 15 U.S.C. 2301(1). This allows a business lessee to invoke the Act. Business Modeling Techniques, Inc. v. General Motors Corp., 474 N.Y.S.2d 258 (1984).

Violation and Remedies Under The Magnuson-Moss Act

This Act provides consumers the same protections as Kentucky's Lemon Law, and a great deal more. It provides the same remedy, but it extends the window for asserting the claim. The remedies, replacement or full refund at the option of the consumer, are available for any noncurable defect for the entire period of the warranty or service contract. The typical manufacturer's warranty is 3 years/36,000 miles, so a defect occurring at 25,000 miles is covered. And there is no statutory provision for an offset for use of the vehicle. Defense counsel will attempt to argue, with probably no success, that the dealer is entitled to a 34¢ per mile offset. There is no statutory or decisional law that so permits. Of course, defense can argue to the jury that an offset is appropriate--equally as unsuccessful.

The Magnuson-Moss Act, like Kentucky's Lemon Law, also requires that the consumer participate in arbitration before bringing a lawsuit. It also provides attorneys' fees to a prevailing plaintiff, at the discretion of the court, but seems to presume recovery of attorneys' fees by stating that fees may be awarded, unless the court deems an award of fees inappropriate. 15 U.S.C. 2310(d)(2). A Magnuson-Moss Act claim may be brought in any federal district court or any state court of competent jurisdiction. 15 U.S.C. 2310(d)(1). In almost all cases, these claims should be brought in state court (you need a hometown jury!).

There are two additional benefits of the Magnuson-Moss Act. First, it applies to any written express warranties, including service contracts. If a consumer purchases a 5-year/75,000 mile service contract, the car is covered for any noncurable defects for the duration of the service contract. The other huge advantage is that the warrantor cannot disclaim any implied warranties during the coverage period. 15 U.S.C. 2308(a). In the case of automobiles, this principally

applies to the implied warranty of merchantability and the implied warranty of use for a particular purpose. See KRS 355.2-314 and KRS 355.2-315. In other words, if one buys a service contract or has a written manufacturer's warranty, the "as is" disclaimer is invalid for the duration of the contract or warranty.

As an example, your client buys a used car with a service contract. Car dealers will always sell these service contracts because they're a sucker deal for consumers (like credit life insurance). They're expensive and don't provide a lot of coverage. You've experienced this if you've ever tried to enforce the provisions of one of these service contracts. Of the several dozen "service contract" cases I've looked at, almost every one involved the service contractor's attempts to avoid "coverage" because the car was not "maintained properly." Some of these nefarious companies demand that the consumer prove that he customarily changed the oil every 3,000 miles, or other ridiculous notions. Also, car dealers take a percentage, sometimes as high as 50-70% of the premium, if they sell the service contract, which should tell you what you're really receiving in terms of risk/benefit analysis.

Under Magnuson-Moss, if your client drives the car from the lot and one of the doors falls off, that's not covered under the service contract, but it would probably be a breach of the implied warranty of merchantability, i.e., is the vehicle as purchased reasonably fit for ordinary driving? Probably not. So when a dealer sells a car "as is," along with a service contract, he violates the Magnuson-Moss Act *ab initio*, the consumer can sue for breach of implied warranties, and recover his attorneys' fees as well under the Act. Now, that provides great comfort for a purchaser of a used car. And the real beauty of this is that the car dealers have no clue that they can't rely on "AS IS" disclaimers when they sell a service contract.

As a rule of thumb, an attorney is almost always better served by utilizing the protections found in the Magnuson-Moss Act. If there is any breach of warranty claim, assert a claim under Magnuson-Moss, if applicable.

Consumer Protection Act (KRS 367.110, et seq.)

If your claim extends beyond a breach of warranty, you may be able to recover under Kentucky's Consumer Protection Act ("the KCPA"), KRS 367.110, et seq., which provides, quite simply, that any act during the sale or lease of a consumer good which is "false, unfair, misleading or deceptive" violates the Act. KRS 367.170((1) "Unfair" is defined as "unconscionable." KRS 367.170(2). Consumer goods are defined as those purchased or leased "primarily for personal, family, or household purposes." KRS 367.220(1). One can recover "actual damages or other equitable relief" as the court deems necessary and proper. KRS 367.220(2). The Act is to be interpreted broadly in favor of the consumer. Commonwealth v. Telcom Directories, Inc., Ky., 806 S.W.2d 638 (1991). This statute can be a very effective tool if your client has been dealt with in a less than straightforward fashion by a car dealer.

Three principal advantages of the KCPA are the broad language encompassing consumer fraud, the venue provision, and the attorney fee provision. First, under the KCPA, scienter is not an issue; knowledge or intent to defraud are not requisite elements. Sparks v. Re/Max Allstar Realty, Inc., Ky. App., 55 S.W.3d 343 (2000). Nor does the Act require actual deception of some person in order to violate the Act. Telcom Directories v. Commonwealth, Ky. App., 833 S.W.2d 848 (1991). However, the Capitol Olds case requires proof of a "conscious and voluntary act or omission." Second, the plaintiff may bring this action in his county of residence, providing a hometown advantage. However, one circuit judge held that the venue provision for a defendant

corporation (KRS 452.450) trumps the Consumer Protection venue provision ("shall" versus "may"). Third, attorneys' fees may be awarded to a successful plaintiff, at the discretion of the court. But the language of the statute may give you cause to pause. The fee provision states that the "prevailing party" may recover its fees, so it is a double-edged sword. It requires some confidence in one's case before asserting a claim under the CPA. Obviously, a competent attorney should advise the client of this "risk of loss." One should also be leery of the limitation period for a CPA claim, which is two years after the commission of the violative act. KRS 367.220(5). There is also a seldom-used limitation of "one year after the state's Attorney General has taken any action on its own." Id. The limitation for a Magnuson-Moss claim and a Lemon Law claim are also two years.

Proof of Damages

An expert on difference in valuation is needed under Consumer Protection Act or breach of warranty claims (to establish "actual damages"). Obviously, you can prove purchase price for revocation and fraud through your client.

Attorneys' Fees

This is really what consumer law is about–the ability of the consumer to recover his attorneys' fees. It provides an attorney with the incentive to take a particularly egregious case forward to trial. It provides the real hammer to recalcitrant defendants who think they have nothing to lose, and know they have more money than the consumer. Under the Federal Warranty act, the fees are probably recoverable. Under Kentucky's consumer statutes, the court may award fees.

The seminal decision on attorneys' fees in a consumer case against car dealers is Alexander (and Don Pisacano) v. S&M Motors d/b/a Lexus Store of Lexington, Ky., 28 S.W.3d 303 (2000). Therein, the Supreme Court of Kentucky essentially said: anything the circuit court does with regard to attorneys' fees is discretionary (read the brilliant and cogent dissenting opinion, on the way the law should be!).

Alexander v. Lexus: Salvage title Lexus sold. Verdict: $23,000 compensatories (price of vehicle); $75,000 punitives. Attorney fee bill - $25,000; Fees awarded - "0." ("Plaintiff received enough in punitives.")

Childers v. Ken Ray Motors: "One owner, A-1, Cream Puff." Verdict - $6,000 compensatories, $25,000 punitives. Attorney fee bill - $25,000; Fees awarded - "0." ("You got enough in punitives.")

The Supreme Court upheld the trial court's decision, saying it's discretionary.

Other Cases: Chilton v. Bluegrass Chrysler (sold as "new" a car with previous paint damage)

Anderson County (Judge Stewart)
Compensatories: $23,000 purchase price
Punitives - $175,000
Attorney fee bill - $42,000
Fees awarded - $42,000

Kocinski v. Freedom Dodge (sold a "program, executive lease" car, which was really an AVIS rental car)

Fayette County (Judge Clark)
Compensatories: $6,000
Attorney fee bill: $42,000
Fees awarded - $39,000

Note: It only takes a few visionary judges, like Judges Clark and Stewart, to send a very strong message that these dealers better deal fairly with the consumer public.

Common Law Fraud

There remains one other viable means of recovery for a car transaction, and that is found under Kentucky's common law fraud cases. These cases provide a recovery if one has been intentionally defrauded. Common law fraud is generally the only means by which you can have a jury instructed on punitive damages. A fraud claim requires: 1) a false statement made to a consumer by a seller 2) with the intent that the consumer rely on the statement, 3) that the consumer in fact relied on the statement, and 4) had the consumer known the truth of the statement, he/she would not have executed the agreement, sale, or contract, and 5) the seller knew the statement was false or acted in reckless disregard for whether the statement was true or not true, and 6) the consumer was damaged as a result. See Wahba v. Don Corlett Motors, Inc., Ky. App., 573 S.W.2d 357 (1979); Johnson v. Cormney, Ky. App., 596 S.W.2d 23 (1979).

Instructions

Some sample instructions are provided as an exhibit.

CONCLUSION

If you're like most attorneys, you probably receive a number of calls from clients who have problems with car purchases. A little knowledge of Kentucky's sales law, Lemon Law, Consumer Protection Act, the Federal Warranty Act (Magnuson-Moss Act), and common law fraud will go a long way in helping your clients and determining possible remedies.

Exhibits:

KRS 367.840

KRS 367.841

KRS 367.842

KRS 367.843

KRS 367.845

KRS 367.846

KRS 355.2-314

KRS 355.2-608

Alexander (and Don Pisacano) v. S&M Motors d/b/a Lexus Store of Lexington, Ky., 28 S.W.3d 303 (2000)

Smith v. General Motors Corporation, Ky. App., 979 S.W.2d 127 (1998)

Sample Jury Instructions:

Chilton v. Blue Grass Chrysler-Plymouth, Inc.

Washington v. Blue Grass Chrysler-Plymouth, Inc.

KRS § 367.840

C
Baldwin's Kentucky Revised Statutes Annotated Currentness
Title XXIX. Commerce and Trade
Chapter 367. Consumer Protection (Refs & Annos)
Defective New Cars

→367.840 KRS 367.841 to 367.844 to be construed liberally; purposes

KRS 367.841 to 367.844 shall be liberally construed and applied to promote the underlying purposes of KRS 367.841 to 367.844, which purposes are:

(1) To protect consumers who buy or lease new motor vehicles that do not conform to applicable warranties by holding manufacturers accountable for certain nonconformities;

(2) To limit the number of attempts and the amount of times that a manufacturer or its agents shall have to cure such nonconformities; and

(3) To require manufacturers to provide, in as expeditious a manner as possible, a refund, not to exceed the amount in KRS 367.842, or replacement vehicle that is acceptable to the aggrieved consumer when the manufacturer or its agents fail to cure any nonconformity within the specified limits.

HISTORY: 1998 c 54, § 1, eff. 7-15-98; 1986 c 387, § 1, eff. 7-15-86

NOTES OF DECISIONS AND OPINIONS

Refund 1

1. Refund

New car purchaser was not bound by "decision" of manufacturer's consumer appeals board finding that her car had been repaired where "decision" was not within scope of matter submitted to it for arbitration; customer had demanded return of her money and did not submit to dispute resolution whether car could be or had been repaired. Tackett v. Campbell Corp. (Ky.App. 1989) 781 S.W.2d 758. Arbitration ⚷ 82(5)

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KRS § 367.841

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Title XXIX. Commerce and Trade
Chapter 367. Consumer Protection (Refs & Annos)
Defective New Cars

→367.841 Definitions

(1) "Buyer" means any resident person who buys, contracts to buy, or leases a new motor vehicle in the Commonwealth of Kentucky. In the case of the lease of a new motor vehicle, "buyer" shall mean the lessor, lessee, or both.

(2) "Manufacturer" means any person or corporation, resident or nonresident, who manufactures or assembles new motor vehicles, including new conversion van manufacturers, which are sold in the Commonwealth of Kentucky.

(3) "Motor vehicle" means every vehicle which is self-propelled, and which is intended primarily for use and operation on the public highways and required to be registered or licensed in the Commonwealth prior to such use or operation; however, "motor vehicle" shall not include:

(a) Any vehicle substantially altered after its initial sale from a dealer to an individual;

(b) Motor homes;

(c) Motorcycles;

(d) Mopeds;

(e) Farm tractors and other machines used in the production, harvesting, and care of farm products; or

(f) Vehicles which have more than two (2) axles.

(4) "New motor vehicle" means a motor vehicle which has been finally and completely assembled and is in the possession of a manufacturer, factory branch, distributor, wholesaler, or an authorized motor vehicle dealer operating under a valid sales and service agreement, franchise, or contract for the sale of such vehicle granted by the manufacturer, factory branch, distributor, or wholesaler which is, in fact, new and on which the original title has never been issued.

(5) "Express warranty" or "warranty" means the written warranty, so labeled, of the manufacturer of a new automobile, including any terms or conditions precedent to the enforcement of obligations under the warranty.

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KRS § 367.841

(6) "Nonconformity" means a failure to conform with an express warranty in a manner which substantially impairs the use, value, or safety of the motor vehicle.

(7) "Reasonable allowance for use" means the amount directly attributable to a consumer's use of the vehicle other than those time periods when the vehicle is out of service due to the nonconformity.

HISTORY: 1998 c 96, § 1, c 54, § 2, eff. 7-15-98; 1986 c 387, § 2, eff. 7-15-86

Legislative Research Commission Note (7-15-98): This section was amended by 1998 Ky. Acts chs. 54 and 96 which do not appear to be in conflict and have been codified together.

KRS § 367.841, KY ST § 367.841

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KRS § 367.842

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Title XXIX. Commerce and Trade
Chapter 367. Consumer Protection (Refs & Annos)
Defective New Cars

→367.842 Options of buyer if manufacturer unable to repair nonconformity in new motor vehicle; rights of lienholder; resolution of disputes; dealer not liable

(1) If, after a reasonable number of attempts, the manufacturer or its agents are unable to repair the nonconformity in the motor vehicle to the express warranty during the first twelve thousand (12,000) miles of operation or during the first twelve (12) months following the date of delivery to the buyer, whichever is the earlier date, that buyer shall report the nonconformity, in writing, to the manufacturer.

(2) If, within the period specified in subsection (1) of this section, the manufacturer or its agents, are unable to repair or correct any nonconformity or defect that substantially impairs the use, value, or safety of the motor vehicle, after a reasonable number of attempts, the manufacturer, at the option of the buyer, shall replace the motor vehicle with a comparable motor vehicle, or accept return of the vehicle from the buyer and refund to the buyer the full purchase price. The full purchase price shall include the amount paid for the motor vehicle, finance charge, all sales tax, license fee, registration fee, and any similar governmental charges plus all collateral charges, less a reasonable allowance for the buyer's use of the vehicle. Refunds shall be made to the buyer and lienholder, if any, as their interests may appear on the records of ownership kept by the Department of Vehicle Regulation. The provisions of this section shall not affect the interests of a lienholder, unless the lienholder consents to the replacement of the lien with a corresponding lien on the automobile accepted by the consumer in exchange for the automobile having a nonconformity, the lienholder shall be paid in full the amount due on the lien, including finance charges and other charges, before an exchange of automobiles or a refund to the consumer is made. It shall be an affirmative defense to any claim under this section that:

(a) The nonconformity, defect, or condition does not substantially impair the use, value, or safety of the motor vehicle; or

(b) The nonconformity, defect, or condition is the result of abuse, neglect, or unauthorized modification or alteration of the motor vehicle by the buyer.

(3) It shall be presumed that a reasonable number of attempts have been undertaken to conform a motor vehicle to the applicable express warranty if, within the first twelve thousand (12,000) miles of operation or during the period of, twelve (12) months following the date of original delivery of the motor vehicle to the buyer, whichever is the earlier date:

(a) The same nonconformity, defect, or condition has been subject to repair four (4) or more times by the manufacturer, but such nonconformity, defect, or condition continues to exist; or

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(b) The vehicle is out of service/use by reason of repair of the same nonconformity, defect, or condition for a cumulative total of at least thirty (30) calendar days.

(4) Disputes arising under subsection (2) of this section concerning refund or replacement shall be resolved through the dispute resolution system established under either KRS 367.860 to 367.870, or 16 C.F.R. part 703. Such remedy shall be pursued prior to seeking any judicial relief under KRS 367.843.

(5) Nothing in this chapter may be construed as imposing any liability on a dealer or creating a cause of action by a consumer against a dealer.

(6) Nothing in this section shall in any way limit the rights or remedies which are otherwise available to a buyer under any other law.

(7) Any agreement entered into by a buyer for the purchase of a new motor vehicle which waives, limits, or disclaims the rights set forth in this section shall be void as contrary to public policy.

(8) Any action brought pursuant to this section shall be commenced within two (2) years after the date of original delivery of the new motor vehicle to the buyer.

(9) A court may award reasonable attorney's fees to a prevailing plaintiff.

HISTORY: 1986 c 387, § 3, eff. 7-15-86

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KRS § 367.843

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Chapter 367. Consumer Protection (Refs & Annos)
Defective New Cars

→367.843 Action for relief by purchaser

Any person who purchases a motor vehicle and thereby suffers any ascertainable loss of money or property, real or personal, as a result of a violation of KRS 367.842, may bring an action under the provisions of KRS 367.220 for relief.

HISTORY: 1986 c 387, § 4, eff. 7-15-86

KRS § 367.843, KY ST § 367.843

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KRS § 367.845

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Title XXIX. Commerce and Trade
Chapter 367. Consumer Protection (Refs & Annos)
Defective New Cars

→367.845 Enforcement of provisions of KRS 367.842 to 367.844 by Attorney General

Noncompliance with the provisions of KRS 367.842 to 367.844 by a manufacturer shall be unlawful. The Attorney General shall have authority to enforce KRS 367.842 to 367.844 in accordance with powers provided by KRS 367.190 and 367.230, pertaining to acts declared unlawful by KRS 367.170. Any expenses accruing to the Attorney General from the provisions of KRS 367.842 to 367.844 shall be assessed by his office upon the motor vehicle manufacturer involved in any action cited in the provisions herein.

HISTORY: 1986 c 387, § 6, eff. 7-15-86

KRS § 367.845, KY ST § 367.845

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KRS § 367.846

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Chapter 367. Consumer Protection (Refs & Annos)
Defective New Cars

→367.846 Application of KRS 367.840 to 367.845

KRS 367.840 to 367.845 shall apply to new motor vehicles purchased after July 15, 1986, and to motor vehicles leased after July 15, 1998.

HISTORY: 1998 c 54, § 3, eff. 7-15-98; 1986 c 387, § 7, eff. 7-15-86

KRS § 367.846, KY ST § 367.846

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KRS § 355.2-314

C
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Title XXIX. Commerce and Trade
Chapter 355. Uniform Commercial Code (Refs & Annos)
Article 2. Sales (Refs & Annos)
Part 3. General Obligation and Construction of Contract

→355.2-314 Implied warranty: merchantability; usage of trade

(1) Unless excluded or modified (KRS 355.2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (KRS 355.2-316) other implied warranties may arise from course of dealing or usage of trade.

HISTORY: 1958 c 77, § 2-314, eff. 7-1-60

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NOTES OF DECISIONS AND OPINIONS

In general 1
Creation by sale 2
Creation of merchantability 3
Defective design 4
Fitness of purpose relative to seller 5
Mitigation of damages 6
Negligence 7
Pleadings 8

1. In general

Blood containing hepatitis virus is unavoidably unsafe and there is no implied warranty that it is free of the virus. McMichael v. American Red Cross (Ky. 1975) 532 S.W.2d 7.

One who accepts an order and supplies a cooling system is a merchant. Frantz, Inc. v. Blue Grass Hams, Inc. (Ky. 1974) 520 S.W.2d 313.

Unless expressly excluded by the contract of sale, there is in every sale an implied warranty that the article sold is reasonably suited to the use for which it is intended. (Annotation from former KRS 361.150 and 361.160.) Frick Co. v. Wiley (Ky. 1942) 290 Ky. 665, 162 S.W.2d 190.

Even if common-law action for breach of implied warranty existed in favor of building owner against manufacturer of fireproofing containing asbestos, Uniform Commercial Code (UCC), which had been adopted by time building was constructed, was dispositive and thus provided proper statute of limitations for breach of warranty claims; enactment of UCC in Kentucky was clear expression of legislative intent to occupy field of commercial transactions. Farm Credit Bank of Louisville v. U.S. Mineral Products Co. (W.D.Ky. 1994) 864 F.Supp. 643. Common Law ⚷ 12; Sales ⚷ 431

2. Creation by sale

Warranty provision concerning fitness and merchantability of goods apply to services where sale is one of goods and the services are necessary to insure that those goods are merchantable and fit for the ordinary purpose. Riffe v. Black (Ky.App. 1977) 548 S.W.2d 175. Sales ⚷ 272; Sales ⚷ 273(1)

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Claim against helicopter repairman under breach of warranty provisions of Uniform Commercial Code for personal injuries sustained in helicopter crash would be dismissed since transaction between parties did not involve transaction in goods but involved rendition of services in which sale of goods was incidental. T-Birds, Inc. v. Thoroughbred Helicoptor Service, Inc. (E.D.Ky. 1982) 540 F.Supp. 548. Sales ⚷ 246

3. Creation of merchantability

There is an implied warranty by the distributor that the appliance sold is merchantable and fit for use, and the damages may be the value of the appliance. Belcher v. Hamilton (Ky. 1971) 475 S.W.2d 483.

Where the language excluding implied warranties is not conspicuous, there is an implied warranty of fitness. Massey-Ferguson, Inc. v. Utley (Ky. 1969) 439 S.W.2d 57.

Where contract under which contractors were to cover home with stucco paint provided that proposal, properly accepted, should constitute the entire contract, that there were no verbal agreements, and that all verbal statements were merged in the written agreement, the statutory implied warranty of fitness for special purpose, if any, arising because of negotiations between homeowners and salesman was excluded by the provisions of the writing, and therefore homeowners could not recover damages for breach of implied warranty of fitness. Amos v. Montgomery (Ky. 1960) 339 S.W.2d 471. Contracts ⚷ 205.35(4)

Under statute providing that where buyer makes known to seller particular purpose for which goods are required and it appears that buyer relies on seller's skill or judgment, there is an implied warranty that goods shall be "reasonably fit" for such purpose, the quoted words mean something more than barely usable. Halterman v. Louisville Bridge & Iron Co. (Ky. 1955) 280 S.W.2d 175. Sales ⚷ 279

The Court of Appeals takes judicial notice that word "Quonset" has specific connotation sufficient to involve applicability of provision of Uniform Sales Act that there is no implied warranty of fitness of article sold under patent or other trade name for any particular purpose to facts in action for breach of implied warranty that a Quonset type building, purchased by plaintiff from defendant, was reasonably fit for plaintiff's intended use thereof. Halterman v. Louisville Bridge & Iron Co. (Ky. 1953) 254 S.W.2d 493. Evidence ⚷ 20(1)

Where an apparently worthless second-hand tractor was sold, jury should be given instructions on implied warranty, there being no distinction made between new and second-hand goods as regards implied warranty under this section. (Annotation from former KRS 361.150.) Moss v. Yount (Ky. 1944) 296 Ky. 415, 177 S.W.2d 372.

Where the seller knows that the purchaser is buying the goods to sell in his retail trade, there is an implied warranty that the goods are of a merchantable quality. (Annotation from former KRS 361.150.) Porter v. Craddock (W.D.Ky. 1949) 84 F.Supp. 704.

4. Defective design

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Genuine issue of fact as to whether new van's stalling at highway speeds was material defect rendering vehicle unmerchantable precluded summary judgment for dealership and manufacturer in buyer's action for breach of implied warranty of merchantability. Smith v. General Motors Corp. (Ky.App. 1998) 979 S.W.2d 127. Judgment ⚷ 181(29)

Defect may be proved by a sufficient quantum of circumstantial evidence for purposes of breach of implied warranty of merchantability claim. Smith v. General Motors Corp. (Ky.App. 1998) 979 S.W.2d 127. Sales⚷ 441(3)

KRS 361.150 creates an implied warranty of fitness for use under which a retailer may be held liable for sale to consumer of tainted food in sealed packages, even though retailer had no opportunity to examine contents. (Annotation from former KRS 361.150.) Martin v. Great Atlantic & Pacific Tea Co. (Ky. 1946) 301 Ky. 429, 192 S.W.2d 201.

Failure of automobile air bag to inflate at time of accident did not amount to breach of warranty by automobile manufacturer, absent credible evidence that air bag should have deployed; testimony of plaintiff's expert was as consistent with non-deployment of air bag as it was with deployment. McCoy v. General Motors Corp. (C.A.6 (Ky.) 1999) 179 F.3d 396. Evidence ⚷ 571(6); Sales ⚷ 441(3)

5. Fitness of purpose relative to seller

The purchaser of a front-end loader which caught fire and destroyed itself due to a manufacturing defect is precluded from recovering from the manufacturer in a product liability tort action based on the doctrine of strict liability because Restatement (Second) of Torts §402A, adopted by the Kentucky Supreme Court as the standard for recovery in such cases, does not intend to place liability on the manufacturer where the damage is limited to harm to the product itself, and under KRS 355.2-314 and 355.2-315, the purchaser is left with only his contractual remedy. Falcon Coal Co. v. Clark Equipment Co. (Ky.App. 1990) 802 S.W.2d 947.

Where no contractual relation was shown between seller of boat, which exploded, and injured guest of buyer's son, seller was not liable to the guest for injuries under theory of breach of implied warranty or representation. Caplinger v. Werner (Ky. 1958) 311 S.W.2d 201. Sales ⚷ 255; Shipping ⚷ 27

6. Mitigation of damages

For express warranty purposes, a buyer may not rely blindly on a statement or affirmation that he knows is incorrect and a buyer does not disregard any special knowledge he possesses or his accumulated experience with the product in determining whether to enter the bargain. Overstreet v. Norden Laboratories, Inc. (C.A.6 (Ky.) 1982) 669 F.2d 1286. Sales ⚷ 262

7. Negligence

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KRS § 355.2-314

Where there was no showing that milk bottle which collapsed and injured buyer's hand was sold and where there was no showing that bottle had a specific defect which caused the accident, there was no breach of implied warranty of fitness. Rowe v. Oscar Ewing Distributing Co. (Ky. 1962) 357 S.W.2d 882. Sales ⚷ 284(1)

Where seller sold truck by written contract disclaiming implied warranties and sole respect in which buyer claimed that truck was unsuitable for purpose for which intended to be used was that front wheels had a slight shimmy or wobble which, after continued use by buyer without notice to seller of the defect, allegedly caused driver's loss of control and an accident, there was no such breach of covenant or condition as would justify rescission on theory of failure of consideration. L.R. Cooke Chevrolet Co. v. Culligan Soft Water Service of Lexington (Ky. 1955) 282 S.W.2d 349. Sales ⚷ 115

Under Kentucky law, plaintiff has burden of establishing causation in claims of strict liability, as well as in claims of negligence and breach of implied warranty. Morales v. American Honda Motor Co., Inc. (C.A.6 (Ky.) 1995) 71 F.3d 531. Products Liability ⚷ 75.1; Sales ⚷ 439

Evidence that building owner did not learn that building had been "contaminated" with asbestos fibers until time well within limitations period precluded summary judgment against owner on Kentucky law claims against manufacturer of fireproofing containing asbestos for strict liability, breach of postmanufacture/sale duty to warn and negligence. Farm Credit Bank of Louisville v. U.S. Mineral Products Co. (W.D.Ky. 1994) 864 F.Supp. 643.

8. Pleadings

In action on statutory implied warranty in connection with sale of engine used in manufacturing ice, wherein buyer alleged that it relied on seller's superior knowledge concerning capacity of engine and that engine would not perform work properly, buyer was properly required to make petition more definite and certain by setting forth contract between parties, so as to show basis of charge of breach of warranty and enable court to determine whether warranty was waived by the parties. Citizens Ice & Fuel Co. v. Fairbanks, Morse & Co. (Ky. 1943) 293 Ky. 64, 168 S.W.2d 586. Pleading ⚷ 367(3)

Answer and counterclaim in action for balance due for firecrackers sold to defendant held to state cause of action for breach of implied warranty of their quality and fitness for defendant's purpose. Balfour-Guthrie & Co. v. L.S. Du Bois Son & Co. (Ky. 1932) 245 Ky. 640, 54 S.W.2d 13. Sales ⚷ 435(1)

KRS § 355.2-314, KY ST § 355.2-314

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KRS § 355.2-608

C
Baldwin's Kentucky Revised Statutes Annotated Currentness
Title XXIX. Commerce and Trade
Chapter 355. Uniform Commercial Code (Refs & Annos)
Article 2. Sales (Refs & Annos)
Part 6. Breach, Repudiation and Excuse

→355.2-608 Revocation of acceptance in whole or in part

(1) The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

HISTORY: 1958 c 77, § 2-608, eff. 7-1-60

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KRS § 355.2-608

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NOTES OF DECISIONS AND OPINIONS

In general 1
Buyer's rights and duties 2
Reasonable time after discovery 3
Substantial impairment of value 4

1. In general

Under KRS 355.2-608, the remedy of revocation of acceptance may be predicated upon discovery of a latent defect and must occur within a reasonable time after the purchaser discovered or should have discovered the grounds for it; although the statute focuses on whether the nonconformity substantially impairs the value of the goods to the purchaser, that test must be evaluated by objective standards. Capitol Cadillac Olds, Inc. v. Roberts (Ky. 1991) 813 S.W.2d 287.

Testimony of patient's physician did not conclusively establish that physician's alleged failure to disclose risks involved in taking oral polio vaccine was consistent with standard of practice at time vaccine was administered, so as to warrant summary judgment for physician, particularly in light of unsettled state of Kentucky informed consent law. Snawder v. Cohen (W.D.Ky. 1990) 749 F.Supp. 1473. Federal Civil Procedure ⚷ 2515

2. Buyer's rights and duties

A buyer's actions do not necessarily have to be detrimental to the seller's interest to preclude revocation, only inconsistent with any intention to revoke, and since breeding a thoroughbred mare is an extremely delicate and risky business involving decisions about which stallion to use, which veterinarian to employ, and when the breeding should occur, a buyer's attempt to breed a mare after learning of defects in her is an act of dominion precluding revocation of his acceptance of the mare. Chernick v. Casares (Ky.App. 1988) 759 S.W.2d 832.

A warranty limited to parts and labor did not fail in its essential purpose so as to allow the buyer to revoke acceptance where the seller was not given a reasonable time to correct the defect and the buyer revoked his

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acceptance before determining whether the seller's latest attempt to correct the defect was effective. Cline v. Allis-Chalmers Corp. (Ky.App. 1985) 690 S.W.2d 764.

A seller may limit the buyer's remedy to repair or replacement of defective parts unless the remedy fails of its essential purpose. When a car dealer fails within a reasonable time to correct a defect which substantially impairs the value of a new motor vehicle, the buyer is entitled to revoke his acceptance. Ford Motor Co. v. Mayes (Ky.App. 1978) 575 S.W.2d 480. Sales ⚷ 120

Sale of truck occurred and title passed to buyer at time of delivery, in absence of exclusive agreement between parties to the contrary, and when buyer accepted truck, and in absence of subsequent revocation of acceptance, he became obligated to pay contract price, notwithstanding fact that buyer was unable to license truck because county court clerk never received title documents from seller. Lexington Mack, Inc. v. Miller (Ky. 1977) 555 S.W.2d 249 . Sales ⚷ 183; Sales ⚷ 201(1)

3. Reasonable time after discovery

Ordinarily the question of whether a buyer has notified the seller of his intent to revoke his acceptance of goods "within a reasonable time" is a fact issue to be submitted to the jury, but there are some situations in which a buyer has delayed so excessively that his actions become untimely as a matter of law. Chernick v. Casares (Ky.App. 1988) 759 S.W.2d 832. Sales ⚷ 130(3.5)

One of the purposes behind the "reasonable time" requirement of KRS 355.2- 608 is to limit prejudice to the seller which results from natural deterioration of the goods over time, and thus the type of goods involved may be dispositive of what constitutes a reasonable time in which to revoke acceptance, with perishable or seasonal goods demanding prompter action; a thoroughbred brood mare has a limited useful life, and since its value depreciates rapidly, three years between the purchase of a brood mare and an attempted revocation of her is clearly an unreasonable time. Chernick v. Casares (Ky.App. 1988) 759 S.W.2d 832. Sales ⚷ 126(1)

Although a buyer is entitled to rely on a seller's assurances, once put on notice he should not be allowed to wait indefinitely for a defect to materialize before revoking acceptance, but has a duty to conduct his own inspection within a reasonable time to discover defects and revoke acceptance before a substantial change in the condition of the goods occurs; therefore, where the buyer of a thoroughbred brood mare is put on notice of the possibility of a defect in the mare three months after he purchased her when she spontaneously aborts twin foals, he cannot revoke his acceptance of her three years later. Chernick v. Casares (Ky.App. 1988) 759 S.W.2d 832.

In action by truck buyer against dealer seeking rescission of sales contract and damages for breach of express and implied warranties, genuine issue of material fact existed as to whether revocation of acceptance of truck was made within reasonable time, precluding summary judgment. Bell v. Louisville Motors, Inc. (Ky.App. 1978) 573 S.W.2d 351. Judgment ⚷ 181(29)

The nature of the property purchased is a factor in determining whether the contract was rescinded within a reasonable time. Chaplin v. Bessire & Co. (Ky. 1962) 361 S.W.2d 293.

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Purchaser who bought mare on January 15, 1974, who was informed on February 6 that the mare had aborted a dead foal on that day, who was then informed that the mare, rather than having been barren in the previous year, had slipped a foal in that year, and who, on February 11, 1974, wrote letters indicating that the sale should be null and void to both seller of the horse and sales director for organization which conducted auction at which the horse was purchased made revocation of sale within a reasonable time. Keck v. Wacker (E.D.Ky. 1976) 413 F.Supp. 1377. Sales ⚷ 126(1)

4. Substantial impairment of value

The purchase of a new car is a major investment for most people, and in view of the millions of dollars spent every year by automobile vendors to persuade people to purchase their products and the great expectations created and reinforced regarding the dependability and safety of the cars, it is not unreasonable to require the vendor to deliver all or substantially all of that which has been promised; therefore, a material issue of fact exists whether a metallic grinding noise which occurs when a new car is stopped on a steep incline substantially impairs the value of the car to its purchaser, precluding summary judgment for the seller of the car in the buyer's action alleging a revocation of acceptance of the car. Capitol Cadillac Olds, Inc. v. Roberts (Ky. 1991) 813 S.W.2d 287.

KRS § 355.2-608, KY ST § 355.2-608

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H

Supreme Court of Kentucky.

Jeffrey **ALEXANDER** Appellant,
v.
S & M MOTORS, INC., d/b/a the Lexus Store of Lexington, Appellee.
Ken-Ray Motors, Appellant,
v.
Wanda Childers and Don A. Pisacano, Appellees.

Nos. 1998-SC-0896-DG, 1998-SC-0951-DG.

June 15, 2000.
Rehearing Denied Oct. 26, 2000.

Purchaser filed suit against car dealership, alleging that he was defrauded. The Circuit Court entered judgment on jury verdict in favor of purchaser, but denied purchaser's motion for attorney fees under Kentucky Consumer Protection Act (KCPA). Purchaser appealed. The Court of Appeals, No. 1998-SC-0896-DG, affirmed. In another case, purchaser file suit against car dealership, alleging fraudulent misrepresentation and violation of KCPA. The Circuit Court entered judgment on jury verdict in favor or purchaser, but denied purchaser award of attorney fees incurred either in preparation for trial or during course of trial. Purchaser appealed. The Court of Appeals, No. 1998-SC-0951-DG, reversed and remanded for reconsideration of issue of attorney fees and litigation costs. After granting discretionary review, the Supreme Court, Johnstone, J., held: (1) statutory provision pertaining to award of attorney fees in action brought under KCPA, authorized, but did not mandate, an award of attorney fees and costs to prevailing party; and (2) circuit court could deny purchaser award of attorney fees.

Affirmed in part and reversed in part.

Stumbo, J., concurred in part and dissented in part by separate opinion, in which Graves and Keller, JJ., joined.

West Headnotes

[1] Consumer Protection ⚷42
92Hk42 Most Cited Cases

Statutory provision pertaining to award of attorney fees in action brought under Kentucky Consumer Protection Act (KCPA), authorized, but did not mandate, an award of attorney fees and costs to prevailing party; whether to award attorney fees was a decision subject to the sound discretion of the trial judge. KRS 367.220(3).

[2] Statutes ⚷227
361k227 Most Cited Cases

When considering the construction of statutes, "may" is permissive, and "shall" is mandatory. KRS 446.010(20).

[3] Consumer Protection ⚷42
92Hk42 Most Cited Cases

When a trial court is considering whether to award attorney fees and costs and/or how much to award in action brought under Kentucky Consumer Protection Act (KCPA), the trial court's decision should be guided by the purpose and the intent of providing an award of attorney fees and costs under the act. KRS 367.220.

[4] Consumer Protection ⚷42
92Hk42 Most Cited Cases

Permitting an additional recovery of attorney fees and litigation costs to prevailing party in action brought under Kentucky Consumer Protection Act (KCPA) is intended to compensate the prevailing party for the expense of bringing an action under the statute and to provide attorneys with incentive for representing litigants who assert claims which serve an ultimate public purpose. KRS 367.220.

[5] Consumer Protection ⚷42
92Hk42 Most Cited Cases

Trial court could deny purchaser award of attorney

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fees in action brought under Kentucky Consumer Protection Act (KCPA), where amount of attorney fees due as a result of representation was less than punitive damage award, plaintiff was not made less than whole by jury's verdict, denial of an award for attorney fees did not prevent plaintiff's attorney from making a reasonable return on his efforts, and denial of attorney fees would not deter others aggrieved by violations of the KCPA from bringing suit in future or attorneys from representing them. KRS 367.220.

[6] Consumer Protection ⚷42
92Hk42 Most Cited Cases

Trial court's polar star when considering a motion for attorney fees under the Kentucky Consumer Protection Act (KCPA) is keeping the courthouse door open for those aggrieved by violations of the act. KRS 367.220.

***304** Don A. Pisacano, Stites & Harbison, Lexington, Counsel for Appellant, Jeffrey Alexander.

Paul" Skip" Gaines, Stewart C. Burch, Frankfort, Counsel for Appellee, S & M Motors.

Jimmy Dale Williams, Richmond, Counsel for Appellant, Ken-Ray Motors.

Don A. Pisacano, Stites & Harbison, Lexington, Counsel for Appellees, Wanda Childers and Don A. Pisacano.

JOHNSTONE, Justice.

The issue presented in each of these cases involves a question of first impression concerning the award of attorney fees under the Kentucky Consumer Protection Act (KCPA), KRS 367.220(3). We granted discretionary review to resolve a split of authority in the Kentucky Court of Appeals. We hold that the award of attorney fees under the statute is discretionary with the trial court.

We begin with a brief discussion of the pertinent facts of each case.

ALEXANDER V. S & M MOTORS, INC.

On November 29, 1993, Jeffery Alexander purchased a vehicle from S & M Motors, which represented that the vehicle had not been damaged, that it only had one prior owner, and that it was a "Certified Lexus Pre-Owned Car." Approximately one year later, Alexander discovered that the vehicle had sustained heavy damage prior to the date of purchase. Alexander subsequently filed suit against S & M alleging that he was defrauded. In the suit, he sought recovery of his purchase price and punitive damages. The matter proceeded to trial, and a unanimous jury awarded Alexander $6,000 in compensatory damages and $75,000 in punitive damages. However, the trial court denied Alexander's motion for attorney fees under the KCPA, and Alexander appealed this ruling. The Court of Appeals affirmed the trial court.

KEN-RAY MOTORS V. CHILDERS

Wanda Childers purchased a used vehicle from Ken-Ray Motors in May, 1994. Childers began having problems with the vehicle within the first hour of purchase. She continued to have problems with the vehicle and ultimately filed a claim against Ken-Ray in November, 1994. In the complaint she alleged, *inter alia,* fraudulent misrepresentation and violation of the Kentucky Consumer Protection Act (KCPA), KRS 367.010 *et seq.* A jury trial was held concerning these two issues on January 27, 1997. The trial resulted in a unanimous jury verdict which awarded Childers $6,748.89 in compensatory damages and $25,000 in punitive damages. The award of damages was based on the jury's finding that Ken-Ray committed fraud upon Childers, violated the KCPA, and acted with fraud, malice or oppression.

Ken-Ray filed a number of post-judgment motions and Childers filed a motion for attorney fees pursuant to KRS 367.220(3). Childers subsequently filed further motions for additional attorney fees as would be generated from the post-judgment proceedings. The trial court denied all of Ken-Ray's post-judgment motions, and eventually entered an order awarding Childers: (1) the costs necessary ***305** to prepare and bring her cause of action to trial; (2) $128.60 in post-judgment costs; (3) nothing for attorney fees generated in preparation for trial or incurred during trial; and (4) $600 in post-judgment attorney fees. The trial court further ordered that Childers not be

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awarded "any other (additional) costs or attorney fees, as movant has failed to persuade the Court that the additional fees and expenses claimed were necessary." Childers appealed from the portions of this order denying her any award of attorney fees incurred either in preparation for trial or during the course of the trial. The Court of Appeals reversed and remanded to the trial court for reconsideration of the issue of attorney fees and litigation costs.

DISCUSSION

[1] The issue presented in both *Alexander* and *Childers* is whether the trial court abused its discretion in denying attorney fees and costs under KRS 367.220(3), which provides:

> In any action brought by a person under this section, the court *may award,* to the prevailing party, in addition to the relief provided in this section, reasonable attorney's fees and costs.

(Emphasis added).

[2] Not only have Kentucky courts long construed "may" to be a permissive word, rather than a mandatory word, but our legislature has given guidance in this regard. When considering the construction of statutes, KRS 446.010(20) provides that "may" is permissive, and "shall" is mandatory.

Chief Justice Lambert recently noted in *White v. Check Holders, Inc.,* Ky., 996 S.W.2d 496, 497 (1999):

> This Court's duty in construing statutes is to ascertain and give effect to the intent of the General Assembly. *Beckham v. Board of Education,* Ky., 873 S.W.2d 575, 577 (1994). When the words of a statute "are clear and unambiguous and express the legislative intent, there is no room for construction or interpretation and the statute must be given its effect as written." *McCracken County Fiscal Court v. Graves,* Ky., 885 S.W.2d 307, 309 (1994).

We, therefore, read the statute to authorize, but not mandate, an award of attorney fees and costs in an action brought under the Kentucky Consumer Protection Act. Of course, whether to award such is a decision subject to the sound discretion of the trial judge.

[3][4] When a trial court is considering whether to award attorney fees and costs and/or how much to award, the trial court's decision should be guided by the purpose and the intent of providing an award of attorney fees and costs under the act. As Judge Knox, writing for the appellate panel in *Childers,* ably explained:

> Permitting an additional recovery of attorney fees and litigation costs is intended to compensate the prevailing party for the expense of bringing an action under the statute. A further aim is to provide attorneys with incentive for representing litigants who assert claims which serve an ultimate public purpose (*i.e.,* a deterrent to conduct resulting in unfair trade practices which perpetrate fraud and deception upon the public).
>
> In many, if not most, consumer protection cases, the monetary value [of the underlying claim] is typically low. Should the court focus strictly on the dollar value of the ultimate award when considering attorney fees and costs, the intended remedial goal of the statute would be thwarted, if not entirely defeated. Simply put, if, in these cases, attorney fees and costs do not provide a reasonable return, it will be economically impossible for attorneys to represent likely litigants. Thus, practically speaking, the door to the courthouse will be closed to all potential parties excepting those with either a strong probability of substantial damages, or those with sufficient economic resources to personally afford financing the expense of litigation. ***306** Such a situation would indeed be ironic, since it is precisely those with ordinary consumer complaints, who cannot afford to pay attorney fees, for whom these remedial acts are designed.

Childers v. Ken-Ray Motors, Ky.App., 1998 WL 381342, 97-CA-1496-MR, July 10, 1998.

[5][6] Thus, a trial court's polar star when considering a motion for attorney fees under the KCPA is keeping the courthouse door open for those aggrieved by violations of the act. In both cases at bar, neither trial courts' ruling concerning attorney fees penalized either plaintiff for bringing a claim under the act. Nor does either ruling establish a precedent which closes the courthouse for future plaintiffs or makes the door more difficult to open.

The jury awarded Childers $6,748.89 in compensatory damages and $25,000 in punitive damages. The compensatory damages represented the maximum amount that could be awarded under

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the instructions. Childers' attorney submitted an affidavit in support of Childers' motion for attorney fees. According to the affidavit, the amount of attorney fees due as a result of the representation of Childers was $24,965.23 based on a rate of $120 an hour, which, consequently, was just a few dollars less than the punitive damage award. The punitive damage award prevented Childers' favorable judgment from being turned into a Pyrrhic victory. That is, even after factoring in attorney fees and litigation costs, Childers was not made less than whole by the jury's verdict. Further, the denial of an award for attorney fees in this case did not prevent Childers' attorney from making a reasonable return on his efforts. Finally, we do not believe that the denial of attorney fees in Childers' case will deter others aggrieved by violations of the KCPA from bringing suit in the future or attorneys from representing them.

The jury awarded Alexander $6,000 in compensatory damages and $75,000 in punitive damages. Alexander's counsel sought $26,594.50 in attorney fees, which the trial court found to be reasonable. The argument that the trial court abused its discretion in denying attorney fees and costs to Alexander is less compelling under the relevant facts of his case than under the relevant facts of Childers' case.

For the reasons set forth above, we hereby affirm the Court of Appeals in *Alexander v. S & M Motors, Inc.* (1998-SC-0896-DG) and reverse the Court of Appeals in *Ken-Ray Motors v. Childers* (1998-SC-0951-DG).

LAMBERT, C.J.; COOPER and WINTERSHEIMER, JJ., concur.

STUMBO, J., concurs in part and dissents in part by separate opinion, in which GRAVES and KELLER, JJ., join.

STUMBO, Justice, Concurring in Part and Dissenting in Part.

Although I agree with the legal reasoning of the majority opinion, I disagree with the result it reaches and therefore must dissent in part. I agree with that much of the majority's analysis which interprets the Kentucky Consumer Protection Act, KRS 367.220(3) as authorizing, but not requiring, the award of attorney fees to the prevailing party in a suit brought pursuant to the Act. However, I believe the trial courts in both cases herein failed to thoroughly consider all relevant factors when considering the plaintiffs' requests for attorney fees, and, consequently, their denial of attorney fees was an abuse of discretion. I believe Judge Knox's opinion for the Court of Appeals in the *Childers* case articulately and thoroughly sets forth the factors a trial court should consider when considering a request for attorney fees under the KCPA:

> [T]he intent of [KRS 367.220(3)] is analogous to KRS 344.450 which provides for the allowance of attorney fees and costs arising from a successful prosecution for a violation of the Kentucky Civil Rights Act, KRS 344.010 *et seq.*
> In this regard, ***307***Meyers v. Chapman Printing Co., Inc.*, Ky., 840 S.W.2d 814 (1992) remains the seminal case regarding the calculation of reasonable attorney fees as permitted by KRS 344.450.
> ....
> [In *Meyers*, the Kentucky Supreme Court stated] that "the court should not undertake to adopt some arbitrary proportionate relationship between the amount of attorney fees awarded and the amount of damages awarded." *Meyers*, 840 S.W.2d at 825-26. We believe identical reasoning is applicable under the KCPA.
> With respect to civil rights grievances, the accepted method of calculating attorney fees is that set forth in *Hensley v. Eckerhart*, 461 U.S. 424, 103 S.Ct. 1933, 76 L.Ed.2d 40 (1983), as adopted by the *Meyers* Court. The *Hensley/Meyers* analysis provides that attorney fees should be ascertained by multiplying counsel's reasonable hours by a reasonable hourly rate to produce a "lodestar" figure. This lodestar figure may then be adjusted to account for any special factors particular to the individual litigation. *Meyers*, 840 S.W.2d at 826.
> Special factors the court will want to consider in making any adjustment to the lodestar figure include: (1) amount and character of services rendered; (2) labor, time and trouble involved; (3) nature and importance of the litigation in

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which the services were rendered; (4) responsibility imposed; (5) the amount of money or value of the property affected by the controversy, or involved in the employment; (6) skill and professional character and standing of the attorneys; and, (8) the results secured. *Boden v. Boden,* Ky., 268 S.W.2d 632, 633 (1954) (citing *Axton v. Vance,* 207 Ky. 580, 269 S.W. 534 (1925)). These factors have long been regarded as applicable through the decisional law of Kentucky. *Commonwealth v. Lavit,* Ky., 882 S.W.2d 678, 680 (1994) (calculation of fees for private attorney who acted as public defender); *Daniels v. May,* Ky., 467 S.W.2d 372, 374 (1971) (attorney fees allowed for services rendered in civil litigation extending over four years); *Itschner v. Itschner,* Ky., 455 S.W.2d 54, 56 (1970) (award of attorney fees in dissolution action); *Stubblefield v. Stubblefield,* Ky., 327 S.W.2d 24, 26 (1959) (same); *Brown v. Fulton, Hubbard & Hubbard,* Ky.App., 817 S.W.2d 899, 901 (1991) (attorney fee charged for defending client against criminal charges); *Citizens Fidelity Bank & Trust Co. v. Harvin,* Ky.App., 550 S.W.2d 569, 570 (1977) (award of attorney fee for sale of real estate that was subject of action for specific performance).

In my opinion, considering all the proper factors set forth by Judge Knox, and given the services rendered by both plaintiff attorneys and the results realized from said services, the trial courts below should reconsider their refusal to award attorney fees. The trial courts' failure to allow any fee for time spent actually litigating the case and all hourly services leading up thereto is inconsistent with the finding (implicit in *Alexander,* explicit in *Childers*) that the jury's award of both compensatory and punitive damages was supported by the evidence and not the result of passion or prejudice, and that the amount of the compensatory and punitive damages were not excessive. Thus, in my view, the trial courts below either abused their discretion or failed to use it at all. I therefore would remand both cases to the trial courts for reconsideration of the plaintiffs' request for attorney fees in view of all the relevant factors set forth above.

GRAVES and KELLER, JJ., join.

28 S.W.3d 303

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C

Court of Appeals of Kentucky.

Buddy James SMITH, Appellant,
v.
GENERAL MOTORS CORPORATION, and
Royal Oaks Chevrolet-Cadillac, Inc., Appellees.

No. 1997-CA-002295-MR.

Oct. 16, 1998.

Buyer of "new" van that stalled at highway speeds sued dealership and manufacturer for fraud, breach of warranty, and violation of Consumer Protection Act. The McCracken Circuit Court, James R. Daniels, J., granted summary judgment for defendants. Buyer appealed. The Court of Appeals, Miller, J., held that: (1) dealership had statutory and common law duty to disclose to buyer material pre-sale defects and repairs; (2) genuine issue of fact existed as to whether pre-sale repairs to radiator and servicing for engine performance problems totalling $323.33 constituted material repairs and defects precluded summary judgment for dealership on fraud claim; (3) genuine issue of fact as to whether sale of van as "new" without disclosure of pre-sale history was a false, misleading, or deceptive act precluded summary judgment for defendants on Consumer Protection Act claim; and (4) genuine issue of fact as to whether van's stalling was material defect rendering vehicle unmerchantable precluded summary judgment on **breach** of **implied warranty** of **merchantability** claim.

Reversed and remanded.

West Headnotes

[1] Judgment ⚷181(2)
228k181(2) Most Cited Cases

Summary judgment is proper only when there exists no material issue of fact and movant is entitled to judgment as a matter of law.

[2] Fraud ⚷16
184k16 Most Cited Cases

To establish an actionable case of fraud based upon suppression of a fact, plaintiff must demonstrate (1) that defendant had a duty to disclose a material fact, (2) that defendant failed to disclose same, (3) that defendant's failure to disclose the material fact induced him to act, and (4) that he suffered actual damages therefrom.

[3] Fraud ⚷17
184k17 Most Cited Cases

Duty to disclose may arise from a fiduciary relationship, from a partial disclosure of information, or from particular circumstances such as where one party to a contract has superior knowledge and is relied upon to disclose same.

[4] Consumer Protection ⚷9
92Hk9 Most Cited Cases

[4] Fraud ⚷17
184k17 Most Cited Cases

New vehicle dealership, which had made over $300 of pre-sale repairs to "new" van, had statutory and common law duty to disclose to buyer material pre-sale defects and repairs. KRS 186A.540, 190.071(1)(e); KRS 190.010(23) (1995).

[5] Judgment ⚷181(29)
228k181(29) Most Cited Cases

Genuine issue of fact existed as to whether new vehicle dealership's pre-sale repairs to "new" van's radiator and servicing for engine performance problems totalling $323.33 constituted material repairs and defects, thereby precluding summary judgment for dealership in buyer's fraud action based on failure to disclose van's pre-sale history brought after van stalled at highway speeds. KRS 186A.540, 190.071(1)(e); KRS 190.010(23) (1995)
.

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[6] Consumer Protection ⚷9
92Hk9 Most Cited Cases

New motor vehicle dealers have statutory duty to disclose material facts to customers while in the course of conducting business. KRS 190.071(1)(e).

[7] Consumer Protection ⚷9
92Hk9 Most Cited Cases

Licensed dealer's duty under Damaged Motor Vehicles Act to disclose repairs exceeding $300 includes any motor vehicle repairs over $300, be they mechanical, body, or otherwise. KRS 186A.540.

[8] Judgment ⚷181(29)
228k181(29) Most Cited Cases

Genuine issue of fact existed as to whether sale of van as "new" without disclosure of van's pre-sale repairs and defects constituted false, misleading, or deceptive act, thereby precluding summary judgment for new vehicle dealership and manufacturer in buyer's action for violation of Consumer Protection Act. KRS 367.170.

[9] Judgment ⚷181(29)
228k181(29) Most Cited Cases

Genuine issue of fact as to whether new van's stalling at highway speeds was material defect rendering vehicle unmerchantable precluded summary judgment for dealership and manufacturer in buyer's action for **breach** of **implied warranty** of **merchantability.** KRS 355.2-314(1).

[10] Sales ⚷441(3)
343k441(3) Most Cited Cases

Defect may be proved by a sufficient quantum of circumstantial evidence for purposes of **breach** of **implied warranty** of **merchantability** claim. KRS 355.2- 314(1).

***128** Thomas L. Osborne, C. Thomas Miller, Paducah, for Appellant.

Donald Craig York, Louisville, for Appellee/GM.

John C. Whitfield, Madisonville, for Appellee/Royal Oaks Chevrolet.

Before HUDDLESTON, KNOPF, and MILLER, JJ.

OPINION

MILLER, Judge.

Buddy James Smith brings this appeal from a summary judgment (Ky. R. Civ.Proc.(CR) 56) of the McCracken Circuit Court entered April 24, 1997. We reverse and remand.

On or about December 15, 1994, Buddy James Smith (Smith) purchased a new GMC van from co-appellee, Royal Oaks Chevrolet-Cadillac, Inc. (Royal Oaks), in Paducah, Kentucky. His employer paid for the vehicle as a retirement gift. During the first 4,800 miles, the van "stalled" three times on interstate roads while traveling at highway speed. In June, 1995, Smith took the van to Royal Oaks complaining of the stalling incidents. Royal Oaks examined the vehicle and was unable to find a defect. Smith was advised to keep driving the van. About one month later, he complained to co-appellee, General ***129** Motors Corporation (General Motors). He requested both Royal Oaks and General Motors to sign statements that the vehicle was safe for use. Each declined. Being unsatisfied with these responses, Smith returned the van to Royal Oaks.

On November 7, 1995, Smith filed suit against Royal Oaks and General Motors, alleging breach of warranty under the sales provision of our Uniform Commercial Code (UCC)(codified in Ky.Rev.Stat. (KRS) 355.2-101--355.2-725) and violation of our Consumer Protection Act (codified in KRS 367.110 - 367.360). In the course of discovery, Smith learned that Royal Oaks had made pre-sale repairs to the van. In March 1994, some nine months before Smith acquired the van, repairs were made to the radiator. At the time, the odometer reading was eight miles. In August of the same year, the van was serviced for engine performance problems, which included "[dying] at highway speeds." [FN1] At this time, the odometer reading was forty-five miles. These repairs totaled $323.33. Royal Oaks did not advise Smith of the vehicle's service history prior to his taking possession of same. Upon learning said history, Smith amended his complaint to allege fraud. On April 24, 1997, the McCracken

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Circuit Court entered summary judgment dismissing Smith's complaint in its entirety. This appeal followed.

FN1. During discovery, it was learned that other General Motor's vans had experienced stalling problems.

Certain facts are not in dispute. The van was sold as a new vehicle by Royal Oaks, GM's franchised dealer. As such, it was accompanied by the General Motors' new vehicle warranty and, likewise, afforded all protection of the law relative to the sale of new vehicles.

FRAUD CLAIM AGAINST ROYAL OAKS

Smith contends that the circuit court committed reversible error by entering summary judgment upon his claim of fraud. We agree. On this claim, we are of the opinion that Smith established sufficient facts to preclude summary judgment as to Royal Oaks' failure to disclose the van's pre-sale history. [FN2]

FN2. At oral argument, Smith informed the Court that the fraud claim would be directed only against Royal Oaks.

[1][2] Summary judgment is proper only when there exists no material issue of fact and movant is entitled to judgment as a matter of law. *Steelvest, Inc. v. Scansteel Service Center, Inc.*, Ky., 807 S.W.2d 476 (1991). To establish an actionable case of fraud based upon suppression of a fact, Smith must demonstrate (1) that Royal Oaks had a duty to disclose a material fact, (2) that Royal Oaks failed to disclose same, (3) that Royal Oaks' failure to disclose the material fact induced him to act, and (4) that he suffered actual damages therefrom. *See Faulkner Drilling Company, Inc. v. Gross*, Ky.App., 943 S.W.2d 634 (1997), and *Wahba v. Don Corlett Motors, Inc.*, Ky.App., 573 S.W.2d 357 (1978). Royal Oaks asserts, however, there existed no duty upon it to disclose the pre-sale history of the van.

[3][4][5] It is, of course, well established that mere silence is not fraudulent absent a duty to disclose. *Hall v. Carter*, Ky., 324 S.W.2d 410 (1959). A duty to disclose may arise from a fiduciary relationship, from a partial disclosure of information, or from particular circumstances such as where one party to a contract has superior knowledge and is relied upon to disclose same. *See Bryant v. Troutman*, Ky., 287 S.W.2d 918 (1956); *Dennis v. Thomson*, 240 Ky. 727, 43 S.W.2d 18 (1931); and *Faulkner*, 943 S.W.2d at 634. Considering Royal Oaks' superior knowledge and Smith's reliance thereupon, we are of the opinion there arose, as a matter of law, a duty upon Royal Oaks to disclose **material defects** and **repairs** known to it. We believe issues of fact exist as to whether the van's pre-sale history of repairs and defects would be considered material to a reasonable person. *See Faulkner*, 943 S.W.2d at 634. We therefore conclude that material issues of fact exist as to Smith's common law fraud claim, thus precluding summary judgment.

[6] We additionally think statutory provisions exist that imposed upon Royal Oaks a duty to disclose the van's pre-sale history. One such statute is KRS 190.071(1)(e), set ***130** forth in KRS Chapter 190, "Motor Vehicle Sales." KRS 190.071(1)(e) reads as follows:

> (1) It shall be a violation of this section for any new motor vehicle dealer:
>
> ...
>
> (e) **To use false or fraudulent representations in connection with the operation of the new motor vehicle dealership**. (Emphasis added.)

"Fraud," in the above context, is defined in KRS 190.010(23) as

> "**a misrepresentation in any manner**, whether intentionally false or due to gross negligence, of a material fact; a promise or representation not made in good faith; or **an intentional failure to disclose material fact**." (Emphases added.)

Considering this definition of fraud, we believe KRS 190.071(1)(e) imposes an affirmative duty upon new motor vehicle dealers to disclose material facts to customers while in the course of conducting business. We further believe that failure to so inform the customers may constitute fraud. We are buttressed in our interpretation of same by KRS 190.015 wherein the Legislature declared its public policy underlying Chapter 190:

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190.015. Public policy declared.
The Legislature finds and declares that the distribution and sale of vehicles within this state vitally affects the general economy of the state and the public interest and the public welfare, and that in order to promote the public interest and public welfare, ... it is necessary to regulate and license vehicle manufacturers, distributors ... distributor representatives, and to regulate and license dealers of vehicles doing business in this state, in order **to prevent frauds, impositions, and other abuses upon its citizens**.... (Emphasis added.)

Upon the forgoing, we are of the opinion that KRS 190.071(1)(e) imposed upon Royal Oaks a duty to disclose such material pre-sale repairs and defects known to it and that issues of fact exist as to whether the van's pre-sale repairs and defects were material. *See Faulkner,* 943 S.W.2d at 634.

[7] We are also persuaded by Smith's argument that KRS 186A.540 imposed an affirmative duty upon Royal Oaks to disclose repairs exceeding $300.00. That statute is found in the "Damaged Motor Vehicles" Act (KRS 186A.500-550) and states as follows:

An individual or a dealer required to be licensed pursuant to KRS Chapter 190 shall disclose *all damages* to a motor vehicle which result in repairs or repair estimates that exceed three hundred dollars ($300) and that occur while the motor vehicle is in his possession and prior to delivery to a purchaser. Disclosure shall be in writing and shall require the purchaser's signature acknowledging the disclosure of damages. (Emphasis added.)

Royal Oaks urges this Court to adopt a narrow interpretation of the above statute so that it includes only "body" damage to motor vehicles. We decline to do so. We believe said statute should be broadly interpreted to include any motor vehicle repairs over $300.00, be they mechanical, body, or otherwise. We view such broad interpretation as mandated by the legislative purpose of the "Damaged Motor Vehicles" Act:

186A.500. Legislative finding.
The General Assembly finds that purchasers when buying vehicles are entitled **to know if the vehicle has sustained prior severe damage**.... (Emphasis added.)

As the van's cumulative repair work exceeded $300.00, we think KRS 186A.540 imposed a duty upon Royal Oaks to disclose the repairs.

In sum, we are persuaded there existed both a common law and statutory basis for imposition of a duty upon Royal Oaks to disclose material pre-sale repairs and defects of the van and that issues of fact exist to preclude summary judgment thereupon.

CONSUMER PROTECTION CLAIM AGAINST ROYAL OAKS AND GENERAL MOTORS

[8] Upon the aforementioned grounds, we likewise perceive that Smith should not have suffered summary judgment upon his claim that failure to disclose the van's pre-sale history constituted a false, misleading and/or deceptive trade practice under the Consumer Protection Act. KRS 367.170. *Cf. *131 Ford Motor Company v. Mayes,* Ky.App., 575 S.W.2d 480 (1978)(holding that Ford Motor Company's failure to repair or replace a defective vehicle constituted an unfair trade practice under the Consumer Protection Act). We believe this claim should proceed against both Royal Oaks and General Motors. We note that "false", "misleading", and "deceptive" are defined in terms generally understood and perceived by the public. *Cf. Dare To Be Great, Inc. v. Commonwealth,* Ky., 511 S.W.2d 224 (1974). Certainly, a fact-finder might reasonably conclude that the sale of the van as "new" without disclosure of its pre-sale history constituted a false, misleading or deceptive act. Thus, we believe summary judgment upon this issue was improper.

BREACH OF WARRANTY CLAIM AGAINST ROYAL OAKS AND GENERAL MOTORS

We now turn to the consideration of Smith's breach of warranty claim against Royal Oaks and General Motors. KRS 355.2-314(1), a provision of our UCC, implies a warranty of **merchantability** in all contracts of sale. If goods are defective, they may, of course, be rejected. KRS 355.2-602. If a defect is not discovered until after acceptance, however, a revocation of the acceptance may be effected, and the buyer may have "the same rights and duties with regard to the goods ... as if he had rejected them." KRS 355.2- 608(3). In the case at hand, Smith accepted the van, together with all the rights afforded him under the UCC. When he experienced

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stalling at highway speeds, he gave appellees prompt and ample opportunity to correct same. KRS 355.2-608. They gave him no assurance, but suggested that he continue utilizing the vehicle under what he perceived to be extraordinary risk. Unsatisfied with the proffered remedy, Smith revoked his acceptance by delivering the van to the dealer. *See Mayes,* 575 S.W.2d at 480.

[9] The appellees, as did the circuit court, believe it incumbent upon Smith to prove by direct evidence a specific defect. In their briefs and at oral argument, the appellees relied upon *Briner v. General Motors Corporation,* Ky., 461 S.W.2d 99 (1971), for this proposition. In *Briner,* the appellant was injured in an automobile accident. She instituted an action against the manufacturer of the automobile, General Motors Corporation, and the dealer/seller, Universal. The bases of the action were "manufacturer's liability and negligent repair." *Id.* at 100. Essentially, the appellant claimed that a defect existed in the steering system of the vehicle causing her to veer across the centerline and strike another automobile and that such defect was the **proximate cause** of the accident. It is crucial to note that the appellant in *Briner* had the burden of proving not only the existence of a defect but, more importantly, that such defect **caused** the accident. Indeed, the *Briner* Court pointed out that "[t]here was no direct proof of the existence of a defective mechanical condition **existing at the time of the accident which could have caused it**." (Emphasis added.) *Id.* at 101. The Court recognized that such "causal relationship" may be proved by circumstantial evidence but thereafter invoked the well-founded rule of law that such relationship may not be proved by an inference which is itself based upon an inference. The following is the Court's ratiocination:

> To justify a finding of liability on Universal's part would require a jury first to infer a breakdown in the steering mechanism attributable to a defect. Secondly, it would be required to further infer that, had Universal made different inspections and tests it would have discovered and corrected the condition which ultimately caused plaintiff's car to veer to the left. This is piling inference upon inference, which leads to speculation....

[10] ...

As said in *Le Sage v. Pitts*, 311 Ky. 155, 223 S.W.2d 347, 352 (1949):

> "An inference may be drawn from a clearly established fact, but, if the conclusion is drawn upon a fact dependent for proof of its existence upon a prior inference, the evidentiary fact is too remote to support the conclusion."

Id. at 101-102. The *Briner* Court simply held that inference of a "causal relationship" was impermissible as it was based upon inference of a defective condition. Such are ***132** not the circumstances in the case at hand. As no accident occurred, Smith need not prove a "causal relationship." The reasoning of *Briner* is inapposite to the case at hand. Smith invokes but a single inference in his attempt to prove a defective condition. We view such as clearly permissible. We think it only necessary for Smith to prove that the van stalled. Such is evidence of a defective condition. A defect may be proved by a sufficient quantum of circumstantial evidence. Indeed, it has been observed that "[i]t matters not that the evidence be circumstantial for as Thoreau put it 'Some circumstantial evidence is very strong, as when you find a trout in the milk.' " *Embs v. Pepsi-Cola Bottling Company of Lexington, Kentucky, Inc.*, Ky., 528 S.W.2d 703, 706 (1975). Considering the van's uncontroverted prior history of stalling, the witnessing of said stalling by several others besides Smith, and the documented stalling of other General Motors' vans, we liken the weight of circumstantial evidence herein to that of the proverbial "trout in the milk."

In sum, we are convinced that the record presents a material issue of fact as to whether the van's stalling was a material defect rendering the vehicle unmerchantable. Under the doctrine announced in *Steelvest,* 807 S.W.2d at 476, we are therefore of the opinion that the summary judgment upon the breach of warranty claim was inappropriate.

Conclusion

We think summary judgment was improperly granted on Smith's claims of fraud, violation of the Consumer Protection Act, and breach of warranty.

For the foregoing reasons, the judgment of the McCracken Circuit Court is reversed, and this cause is remanded for proceedings consistent with this opinion.

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ANDERSON CIRCUIT COURT
CIVIL BRANCH

JAMES AND JANE CHILTON — PLAINTIFFS

VS. — **JURY INSTRUCTIONS** — NO. 95-CI-225

BLUE GRASS CHRYSLER-PLYMOUTH, INC. — DEFENDANT/ THIRD-PARTY PLAINTIFF

VS.

CHRYSLER CORPORATION — THIRD-PARTY DEFENDANT

* * * * *

Come the Plaintiffs, Jim and Jane Chilton, by counsel, and submit the following proposed jury instructions.

Respectfully submitted,

STITES & HARBISON

Don A. Pisacano
C. Kennan Wethington
2300 Lexington Financial Center
250 West Main Street
Lexington, Kentucky 40507-1758

ATTORNEY FOR PLAINTIFFS

CERTIFICATE OF SERVICE

This is to certify that the foregoing has been served by hand delivering a true copy thereof to:

Jon Woodall, Esq.
McBrayer, McGinnis, Leslie & Kirkland
163 West Short Street, Suite 300
Lexington, Kentucky 40507

Brian Goldwasser, Esq.
Reminger & Reminger Co., L.P.A.
Federated Building, Suite 1690
7 West 7th St.
Cincinnati, OH 45202

on this the 21st day of January, 1998.

_____
ATTORNEY FOR PLAINTIFFS

INSTRUCTION NO. 1

Immediately upon retiring to the jury room, you should elect one of your number as Foreperson.

Nine or more of your number must agree in order to answer any of the questions or make any of the determinations required by these Instructions. The nine or more who agree upon one, however, need not be the same jurors who agree upon another.

If all twelve of you agree on the answer to all of the questions and determinations to which you are required to respond, the foreperson alone can sign for you.

Each answer or response on which the verdict is not unanimous must be signed by the nine or more of you who agree.

(Please proceed to Instruction No. 2)

INSTRUCTION NO. 2

Revocation of Acceptance

It was Blue Grass Chrysler-Plymouth, Inc.'s duty to sell Jim and Jane Chilton a "new" car or car that was free of any non-conformity, if:

(a) the non-conformity was not readily discoverable by the Chiltons at the time they bought the car, and

(b) the Chiltons notified Blue Grass Chrysler-Plymouth, Inc. of the defect within a reasonable time after they discovered or should have discovered the defect.

"Non-conformity" means a defect which substantially impairs the value of the car to the purchasers, Jim and Jane Chilton.

Question No. 2-1

Do you believe from the evidence that Blue Grass Chrysler-Plymouth, Inc. breached this duty owed to the Chiltons?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

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(Please proceed to Instruction No. 3)

INSTRUCTION NO. 3

Under the Kentucky Consumer Protection Act, it is unlawful for Blue Grass Chrysler-Plymouth, Inc. to engage in any unfair, false, misleading, or deceptive act or practice in conducting its business.

Question No. 3-1

Do you believe from the evidence that Blue Grass Chrysler-Plymouth, Inc. in its sale of the car to the Chiltons violated the Consumer Protection Act as described above?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

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JURORS WHO AGREE, IF NOT UNANIMOUS

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(Please proceed to Instruction No. 4)

INSTRUCTION NO. 4

Fraudulent Misrepresentation

You will find for Jim and Jane Chilton against Blue Grass Chrysler-Plymouth, Inc. on the issue of fraudulent misrepresentation if you are satisfied by clear and convincing evidence as follows:

that before Jim and Jane Chilton purchased the car from Blue Grass Chrysler-Plymouth, Inc., Blue Grass Chrysler-Plymouth, Inc., its employees, or representatives communicated to the Chiltons that they were buying a new car;

that Blue Grass Chrysler-Plymouth, Inc., its employees or representatives, intended for the Chiltons to rely on the truth of the statement in subsection (1) above in deciding to buy the car;

that the Chiltons did, in fact, rely on the statement in subsection (1) above as being true in deciding to buy the car;

that, in fact, the car was not new;

that when Blue Grass Chrysler-Plymouth, Inc.'s employees or representatives made such statement, they either knew the statement was not true, or acted in reckless disregard for whether it was true or not, or concealed the truth as to the condition of the car;

AND

that had Jim and Jane Chilton known the truth about the statement in paragraph (1), they would not have purchased the car.

Otherwise, you will find for Blue Grass Chrysler-Plymouth, Inc.

Question No. 4-1

Do you find from the evidence that Blue Grass Chrysler-Plymouth, Inc. made a fraudulent misrepresentation as described above in the sale of the car to Jim and Jane Chilton?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

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JURORS WHO AGREE, IF NOT UNANIMOUS

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(Please proceed to Instruction No. 5)

INSTRUCTION NO. 5

Omission of a Material Fact/Concealment of the Truth

You will find for Jim and Jane Chilton against Blue Grass Chrysler-Plymouth, Inc. if you are satisfied from the evidence as follows:

(1) that before Jim and Jane Chilton purchased the car, Blue Grass Chrysler-Plymouth, Inc. and its employees failed to tell them:

that the car had previous body damage;

OR

the car had been repainted or repaired; OR

the car had damage to the front end and front driver's side door.

(2) that such information would have been material in the Chiltons' decision to purchase the car, and that had one or more of these facts been disclosed to the Chiltons, they would not have bought the car;

(3) that Jim and Jane Chilton could not, through reasonable inspection, discover the omitted facts stated in paragraph (1);

AND

(4) that Blue Grass Chrysler-Plymouth, Inc. knew that the car had been previously damaged OR repaired OR repainted, OR acted in reckless disregard for whether or not the car had such defects.

Question No. 5-1

Do you believe from the evidence presented that Blue Grass Chrysler-Plymouth, Inc. failed to disclose a material fact as described in paragraph (1) of this Instruction in the sale of the car to Jim and Jane Chilton?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

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(Please proceed to Instruction No. 6)

INSTRUCTION NO. 6

If you answered "No" to Question Nos. 2-1, 3-1, 4-1, and 5-1, you have found in favor of Blue Grass Chrysler-Plymouth, Inc. and may return to the courtroom.

If you answered "Yes" to one or more of Questions 2-1, 3-1, 4-1, and 5-1, please proceed to the next instruction.

INSTRUCTION NO. 7

If you answered "Yes" to Question Nos. 2-1, 3-1, 4-1, or 5-1, you will award Jim and Jane Chilton a sum of money that will fairly and reasonably compensate them for such financial loss or losses as you are satisfied from the evidence that they incurred as a direct result of the misrepresentations, violations, omissions, or breaches of Blue Grass Chrysler-Plymouth, Inc.:

1. Purchase price of the car, including tax, license, and processing fee, not to exceed $17,914.03. $_____

2. Interest payments on their loan for the car, not to exceed $514.00. $_____

3. Loss of use of this motor vehicle since April 1996 to present, not to exceed $5,880.00. $_____

(Please Proceed to Instruction No. 8)

INSTRUCTION NO. 8

If you are further satisfied from the evidence that Blue Grass Chrysler-Plymouth, Inc. acted toward Jim and Jane Chilton with fraud, oppression, or malice, or other conduct demonstrating a reckless disregard toward the lives, safety or property of the Chiltons, you may at your discretion award punitive damages against Blue Grass Chrysler-Plymouth, Inc. in addition to the damages awarded under Instruction 7.

"Punitive damages" means damages other than compensatory damages and nominal damages awarded against a person or company to punish and to discourage that person or company, and other persons or companies, from similar conduct in the future.

"Fraud" means an intentional misrepresentation, deceit, or concealment of material fact known to Blue Grass Chrysler-Plymouth, Inc. and made with the intention of causing injury to Jim and Jane Chilton.

"Oppression" means conduct that was specifically intended by Blue Grass Chrysler-Plymouth, Inc. to subject Jim and Jane Chilton to cruel and unjust hardship; and

"Malice" means (a) conduct that was specifically intended by Blue Grass Chrysler-Plymouth, Inc. to cause tangible or intangible injury to Jim and Jane Chilton, OR (b) conduct that was carried out by Blue Grass Chrysler-Plymouth, Inc. with a flagrant indifference to Jim and Jane Chiltons' rights with subjective awareness that such conduct would result in harm.

Question No. 8-1

Do you believe from the evidence that Blue Grass Chrysler-Plymouth, Inc. committed fraud or acted with oppression or malice?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

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_____

Question No. 8-2

Do you believe from the evidence that Blue Grass Chrysler-Plymouth, Inc. acted toward Jim and Jane Chilton with reckless disregard for the lives, safety, and property of the Chiltons?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

_____

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If you award punitive damages, in determining the amount thereof you should consider one or more of the following factors:

the likelihood at the time of such misconduct by Blue Grass Chrysler-Plymouth, Inc. that serious harm would arise from it;

the degree of Blue Grass Chrysler-Plymouth, Inc.'s awareness of that likelihood;

the profitability of the misconduct to Blue Grass Chrysler-Plymouth, Inc.;

the duration of the misconduct and any concealment of it by Blue Grass Chrysler-Plymouth, Inc.;

AND

the actions by Blue Grass Chrysler-Plymouth, Inc. to remedy the misconduct once it became known to it.

If you award punitive damages, you will state the amount separately from the sum or sums awarded under Instruction No. 9.

Does the jury award punitive damages against Blue Grass Chrysler-Plymouth, Inc.?

Yes _____ No _____

If your answer is "Yes," what amount of punitive damages do you award Jim and Jane Chilton? $_____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

_____

_____

_____

_____

(You may return to the Courtroom.)

FAYETTE CIRCUIT COURT
CIVIL BRANCH
FOURTH DIVISION

CHRIS WASHINGTON JUL 28 1995 PLAINTIFF

v. **PROPOSED JURY INSTRUCTIONS** NO. 94-CI-2741

BLUE GRASS CHRYSLER-PLYMOUTH, INC. DEFENDANT

* * * * * * * *

Comes the Plaintiff, Chris Washington, by counsel, and submits the following proposed jury instructions.

STITES & HARBISON

DON A. PISACANO
2300 LEXINGTON FINANCIAL CENTER
250 WEST MAIN STREET
LEXINGTON, KENTUCKY 40507-1758
TELEPHONE: 606-226-2300
FAX: 606-253-9144
ATTORNEY FOR PLAINTIFF

Served by delivering
a true copy to:

Matthew W. Breetz, Esq.
McBrayer, McGinnis, Leslie & Kirkland
163 West Short Street, Suite 300
Lexington, Kentucky 40507

on this 28th day of July, 1995.

ATTORNEY FOR PLAINTIFF

INSTRUCTION NO. 1

(a) Immediately upon retiring to the jury room, you should elect one of your number as Foreperson.

(b) Nine or more of your number must agree in order to answer any of the questions or make any of the determinations required by these Instructions. The nine or more who agree upon one, however, need not be the same jurors who agree upon another.

(c) If all twelve of you agree on the answer to all of the questions and determinations to which you are required to respond, the foreperson alone can sign for you.

(d) Each answer or response on which the verdict is not unanimous must be signed by the nine or more of you who agree.

(Please proceed to Instruction No. 2)

INSTRUCTION NO. 2

The Court has already determined and instructed you that Blue Grass Chrysler-Plymouth has breached both an express warranty and an implied warranty in the sale of a 1993 Pontiac Sunbird to plaintiff, Chris Washington. You shall now decide from the evidence what sum of money will fairly compensate Chris Washington for each of the following elements:

A.	Price of the contract	$_____
B.	Damage to his personal credit	$_____
C.	Damage suffered from the loss of use of the motor vehicle for 16 months	$_____
D.	Damage for his loss of employment opportunities	$_____
E.	Damage to his reputation in the business community	$_____
F.	Damage for his mental and emotional distress and anguish	$_____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

_____

_____

_____

_____

_____

_____

_____

_____

_____

(Please Proceed to Instruction No. 3)

INSTRUCTION NO. 3

Under the Kentucky Revised Statute 367, known as the Consumer Protection Act, it is unlawful for any business to engage in unfair, false, misleading, or deceptive acts or practices.

Question No. 3-1

Do you believe from the evidence that Blue Grass Chrysler-Plymouth in its sale of the 1993 Pontiac Sunbird and the Extended Service Warranty to Chris Washington violated any portion of the Consumer Protection Act as cited above?

YES_____ NO_____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

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(Please proceed to Instruction No. 4)

INSTRUCTION NO. 4

"Fraud" means an intentional misrepresentation, deceit, omission of a material fact, or concealment of a material fact known to the Defendant and made with the knowledge that the misrepresentation, deceit, omission or concealment would be relied upon by the Plaintiff to his detriment and would in all probability cause injury to the Plaintiff.

QUESTION NO. 4-1

Do you believe from the evidence that Blue Grass Chrysler-Plymouth in its sale of the 1993 Pontiac Sunbird and Extended Service Warranty to Chris Washington committed fraud?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

_____
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(If you answered "Yes" to Question No. 4-1, please proceed to Instruction No. 5. If you answered "No" to Question No. 4-1, you may return to the Courtroom.)

INSTRUCTION NO. 5

If you answered "Yes" to Question No. 4-1 or if you are further satisfied from the evidence that the Defendant, Blue Grass Chrysler-Plymouth acted toward Chris Washington with oppression or malice, you may at your discretion award punitive damages against Blue Grass Chrysler-Plymouth in addition to the damages awarded under Instruction 2.

As used in this Instruction: "Oppression" means conduct that was specifically intended by Blue Grass Chrysler-Plymouth to subject Chris Washington to cruel and unjust hardship; and

"Malice" means (a) conduct that was specifically intended by Blue Grass Chrysler-Plymouth to cause tangible or intangible injury to Chris Washington, OR (b) conduct that was carried out by Blue Grass Chrysler-Plymouth with both a flagrant indifference to Chris Washington's rights AND a subjective awareness that such conduct would result in harm.

If you award punitive damages, in determining the amount thereof you should consider the following factors:

(a) the likelihood at the time of such misconduct by Blue Grass Chrysler-Plymouth that serious harm would arise from it;

(b) the degree of Blue Grass Chrysler-Plymouth's awareness of that likelihood;

(c) the profitability of the misconduct to Blue Grass Chrysler-Plymouth;

(d) the duration of the misconduct (and any concealment of it) by Blue Grass Chrysler-Plymouth;

AND

(e) the actions by Blue Grass Chrysler-Plymouth to remedy the misconduct once it became known to it.

If you award punitive damages, you will state the amount separately from the sum or sums awarded under Instruction 2.

Punitive Damages $_____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

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(You may return to the Courtroom.)

FAYETTE CIRCUIT COURT
CIVIL BRANCH
FOURTH DIVISION

CHRIS WASHINGTON PLAINTIFF

v. **PROPOSED JURY INSTRUCTIONS** NO. 94-CI-2741

BLUE GRASS CHRYSLER-PLYMOUTH, INC. DEFENDANT

* * * * * * * *

Comes the Plaintiff, Chris Washington, by counsel, and submits the following proposed jury instructions.

Respectfully submitted,

STITES & HARBISON

_____

Don A. Pisacano
2300 Lexington Financial Center
250 West Main Street
Lexington, Kentucky 40507-1758

ATTORNEY FOR PLAINTIFF

CERTIFICATE OF SERVICE

This is to certify that the foregoing has been served by mailing a true copy thereof to:

Matthew W. Breetz, Esq.
McBrayer, McGinnis, Leslie & Kirkland
163 West Short Street, Suite 300
Lexington, Kentucky 40507

on this the _____ day of August, 1995.

_____

ATTORNEY FOR PLAINTIFF

INSTRUCTION NO. 1

1. Immediately upon retiring to the jury room, you should elect one of your number as Foreperson.

2. Nine or more of your number must agree in order to answer any of the questions or make any of the determinations required by these Instructions. The nine or more who agree upon one, however, need not be the same jurors who agree upon another.

3. If all twelve of you agree on the answer to all of the questions and determinations to which you are required to respond, the foreperson alone can sign for you.

4. Each answer or response on which the verdict is not unanimous must be signed by the nine or more of you who agree.

(Please proceed to Instruction No. 2)

INSTRUCTION NO. 2

The Court has already determined and instructed you that Blue Grass Chrysler-Plymouth has breached both an express warranty and an implied warranty in the sale of a 1993 Pontiac Sunbird to Plaintiff, Chris Washington. You shall now decide from the evidence what sum of money will fairly compensate Chris Washington as follows:

The difference in the value of the car as warranted at the time of sale	$_____
minus (-)	
The actual value of the car at the time of sale	$_____
Actual damage	$_____
Add to actual damage the amount required to restore the vehicle to its actual value at the time of engine failure	$_____
Total actual damages, not to exceed $_____	$_____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

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(Please Proceed to Instruction No. 3)

INSTRUCTION NO. 2A.

It was Blue Grass Chrysler's duty to sell Chris Washington a car that was free of any non-conformity, if such non-conformity was not readily discoverable by Chris Washington at the time he bought the car.

"Non-conformity" means a failure to conform with an express or implied warranty which substantial . . .

"Non-conformity" means a defect which substantially impairs the value of the car to the purchaser, Chris Washington.

Do you believe from the evidence that Blue Grass Chrysler breached this duty owed to Chris Washington?

Yes _____ No _____

(Please proceed to Instruction No. 4)

Foreperson (if unanimous)

Jurors who agree if not unanimous

INSTRUCTION NO. 4

Under the Kentucky Revised Statute 367, known as the Consumer Protection Act, it is unlawful for any business to engage in unfair, false, misleading, or deceptive acts or practices in conducting its business.

Question No. 4-1

Do you believe from the evidence that Blue Grass Chrysler-Plymouth in its sale of the 1993 Pontiac Sunbird and the Extended Service Warranty to Chris Washington violated the Consumer Protection Act as described above?

Yes _____ No _____

FOREPERSON, IF UNANIMOUS

_____

JURORS WHO AGREE, IF NOT UNANIMOUS

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(Please proceed to Instruction No. 5)

INSTRUCTION NO. 5

"Fraud" means an intentional misrepresentation, deceit, omission of a material fact, or concealment of a material fact known to the Defendant and made with the knowledge that the misrepresentation, deceit, omission or concealment would be relied upon by the Plaintiff to his detriment and would in all probability cause injury to the Plaintiff.

INSTRUCTION NO. 5A

You will find for Chris Washington against Blue Grass Chrysler-Plymouth on the issue of fraudulent misrepresentation if you are satisfied from the evidence as follows:

(1) that before Chris Washington purchased the car from Blue Grass Chrysler-Plymouth, that Blue Grass Chrysler-Plymouth's employees told him:

(a) the car was not previously salvaged and rebuilt

OR

(b) the car was previously owned by a woman who could not afford the payments

OR

(c) the service contract he purchased from Blue Grass Chrysler-Plymouth would cover repairs to the car he purchased.

(2) that Blue Grass Chrysler-Plymouth and its employees intended for Chris Washington to rely on the truth of one or more of the statements in (1) above in deciding to buy the car;

(3) that Chris Washington did, in fact, rely on one or more of the statements in subsection (1) above as being true and otherwise would not have purchased the car;

(4) that, in fact, one, two, or all three of those statements in subsection (1) were not true;

AND

(5) that having purchased the car, Chris Washington suffered financial loss or losses that he would not have suffered if the statement or statements made to him by Blue Grass Chrysler-Plymouth and its employees had been true.

Otherwise, you will find for Blue Grass Chrysler-Plymouth.

QUESTION 5-1

Do you find from the evidence that Blue Grass Chrysler Plymouth committed a fraudulent misrepresentation as described above in the sale of the 1993 Plymouth Sunbird or Extended Servic Warranty to Chris Washington?

Yes ✓ _____ No _____

Foreperson (if unanimous)

Juror 1 who if Not Unanimous

INSTRUCTION NO. 5B

You will find for Chris Washington against Blue Grass Chrysler-Plymouth, if you are satisfied from the evidence as follows:

(1) that before Chris Washington purchased the car from Blue Grass Chrysler-Plymouth, that Blue Grass Chrysler-Plymouth and its employees failed to tell him:

(a) the car was previously salvaged and rebuilt;

OR

(b) the car was formerly an Avis Rent-A-Car;

OR

(c) the service contract he purchased from Blue Grass Chrysler-Plymouth was worthless.

(2) that such statements were material in Chris Washington's decision to purchase his car, and that he, in fact, would not have purchased the car had the above facts been disclosed to him;

(3) that Chris Washington could not, through reasonable inspection, discover the omitted facts stated in paragraph (1);

(4) that Blue Grass Chrysler-Plymouth and its employees had knowledge of the facts set forth in paragraph (1);

AND

(6) that Blue Grass Chrysler-Plymouth intentionally withheld or failed to disclose these facts from Chris Washington.

Question No. 5-2

Based on the foregoing, do you believe from the evidence presented that Blue Grass Chrysler-Plymouth committed a fraudulent~~ly~~ omission or described about in the sale of the 1993 Plymouth Sunbird or Extended Service Warranty to Chris Washington?

Yes _____ No _____

Foreperson (If unanimous) _____

Jurors, who agree if not unanimous

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INSTRUCTION NO. 6

If you answered "Yes" to Question No. 3, 4, 5-1, or 5-2 you will award him a sum of money that will fairly and reasonably compensate him for such financial loss or losses as you are satisfied from the evidence that he incurred as a direct result of the misrepresentations or omissions made to him by Blue Grass Chrysler-Plymouth.

1. Purchase price of the contract, not to exceed $11,078.00. $_____

2. Expenses for loan transaction, not to exceed $86.10. $_____

3. ~~Interest paid on loan, not to exceed $178.93.~~ $_____

4. Insurance payments for six months, not to exceed $_____. $_____

5. Loss of use of a motor vehicle since April 1994 to present (seventeen months). $_____

6. Inconvenience and mental anguish, to include damage to credit, stress of legal proceedings, and loss of employment. $_____

(Please Proceed to Instruction No. 7)

INSTRUCTION NO. 7

If you answered "Yes" to Question No. 5-1 or 5-2 or if you are further satisfied from the evidence that the Defendant, Blue Grass Chrysler-Plymouth acted toward Chris Washington with oppression or malice, you may at your discretion award punitive damages against Blue Grass Chrysler-Plymouth in addition to the damages awarded under Instruction 2.

As used in this Instruction: "Oppression" means conduct that was specifically intended by Blue Grass Chrysler-Plymouth to subject Chris Washington to cruel and unjust hardship; and

"Malice" means (a) conduct that was specifically intended by Blue Grass Chrysler-Plymouth to cause tangible or intangible injury to Chris Washington, OR (b) conduct that was carried out by Blue Grass Chrysler-Plymouth with both a flagrant indifference to Chris Washington's rights AND a subjective awareness that such conduct would result in harm.

"Punitive damages" means damages other than compensatory damages and nominal damages awarded against a person or company to punish and to discourage that person or company and others from simliar conduct in the future.

If you award punitive damages, in determining the amount thereof you should consider the following factors:

(1) the likelihood at the time of such misconduct by Blue Grass Chrysler-Plymouth that serious harm would arise from it;

(2) the degree of Blue Grass Chrysler-Plymouth's awareness of that likelihood;

(3) the profitability of the misconduct to Blue Grass Chrysler-Plymouth;

(4) the duration of the misconduct (and any concealment of it) by Blue Grass Chrysler-Plymouth;

AND

(5) the actions by Blue Grass Chrysler-Plymouth to remedy the misconduct once it became known to it.

If you award punitive damages, you will state the amount separately from the sum or sums awarded under Instruction 2 or 6.

Does the jury award punitive damages under Instruction No. ?,?

Yes _____ No _____

If your answer is "Yes," what amount of punitive damages do you award Chris Washington? $_____

FOREPERSON, IF UNANIMOUS

JURORS WHO AGREE, IF NOT UNANIMOUS

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(You may return to the Courtroom.)

TELEMARKETING—CRITICAL ISSUES UPDATE

Todd E. Leatherman
Consumer Protection Division
Office of the Attorney General
Frankfort, Kentucky

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SECTION E

TELEMARKETING—CRITICAL ISSUES UPDATE

I. 1991 TELEPHONE CONSUMER PROTECTION ACT ("TCPA")
47 U.S.C. § 227 ..... E-1

II. TCPA IMPLEMENTING REGULATIONS
47 CFR 64.1200; 47 CFR 68.318 ..... E-11

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358 F.3D 1228 (COLO. 2004) E-75

I. 1991 TELEPHONE CONSUMER PROTECTION ACT ("TCPA")

47 U.S.C. § 227

Sec. 227. - Restrictions on use of telephone equipment

(a) Definitions

As used in this section -

(1)

The term "automatic telephone dialing system" means equipment which has the capacity -

(A)

to store or produce telephone numbers to be called, using a random or sequential number generator; and

(B)

to dial such numbers.

(2)

The term "telephone facsimile machine" means equipment which has the capacity

(A)

to transcribe text or images, or both, from paper into an electronic signal and to transmit that signal over a regular telephone line, or

(B)

to transcribe text or images (or both) from an electronic signal received over a regular telephone line onto paper.

(3)

The term "telephone solicitation" means the initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person, but such term does not include a call or message

(A)

to any person with that person's prior express invitation or permission,

(B)

to any person with whom the caller has an established business relationship, or

(C)

by a tax exempt nonprofit organization.

(4)

The term "unsolicited advertisement" means any material advertising the commercial availability or quality of any property, goods, or services which is transmitted to any person without that person's prior express invitation or permission.

(b) Restrictions on use of automated telephone equipment

(1) Prohibitions

It shall be unlawful for any person within the United States -

(A)

to make any call (other than a call made for emergency purposes or made with the prior express consent of the called party) using any automatic telephone dialing system or an artificial or prerecorded voice -

(i)
to any emergency telephone line (including any "911" line and any emergency line of a hospital, medical physician or service office, health care facility, poison control center, or fire protection or law enforcement agency);

(ii)
to the telephone line of any guest room or patient room of a hospital, health care facility, elderly home, or similar establishment; or

(iii)
to any telephone number assigned to a paging service, cellular telephone service, specialized mobile radio service, or other radio common carrier service, or any service for which the called party is charged for the call;

(B)
to initiate any telephone call to any residential telephone line using an artificial or prerecorded voice to deliver a message without the prior express consent of the called party, unless the call is initiated for emergency purposes or is exempted by rule or order by the Commission under paragraph (2)(B);

(C)
to use any telephone facsimile machine, computer, or other device to send an unsolicited advertisement to a telephone facsimile machine; or

(D)
to use an automatic telephone dialing system in such a way that two or more telephone lines of a multi-line business are engaged simultaneously.

(2) Regulations; exemptions and other provisions
The Commission shall prescribe regulations to implement the requirements of this subsection. In implementing the requirements of this subsection, the Commission -

(A)
shall consider prescribing regulations to allow businesses to avoid receiving calls made using an artificial or prerecorded voice to which they have not given their prior express consent;

(B)
may, by rule or order, exempt from the requirements of paragraph (1)(B) of this subsection, subject to such conditions as the Commission may prescribe -

(i)
calls that are not made for a commercial purpose; and

(ii)
such classes or categories of calls made for commercial purposes as the Commission determines -

(I)
will not adversely affect the privacy rights that this section is intended to protect; and

(II)
do not include the transmission of any unsolicited advertisement; and

(C)

may, by rule or order, exempt from the requirements of paragraph (1)(A)(iii) of this subsection calls to a telephone number assigned to a cellular telephone service that are not charged to the called party, subject to such conditions as the Commission may prescribe as necessary in the interest of the privacy rights this section is intended to protect.

(3) Private right of action

A person or entity may, if otherwise permitted by the laws or rules of court of a State, bring in an appropriate court of that State -

(A)

an action based on a violation of this subsection or the regulations prescribed under this subsection to enjoin such violation,

(B)

an action to recover for actual monetary loss from such a violation, or to receive $500 in damages for each such violation, whichever is greater, or

(C)

both such actions.

If the court finds that the defendant willfully or knowingly violated this subsection or the regulations prescribed under this subsection, the court may, in its discretion, increase the amount of the award to an amount equal to not more than 3 times the amount available under subparagraph (B) of this paragraph.

(c) Protection of subscriber privacy rights

(1) Rulemaking proceeding required

Within 120 days after December 20, 1991, the Commission shall initiate a rulemaking proceeding concerning the need to protect residential telephone subscribers' privacy rights to avoid receiving telephone solicitations to which they object. The proceeding shall -

(A)

compare and evaluate alternative methods and procedures (including the use of electronic databases, telephone network technologies, special directory markings, industry-based or company-specific "do not call" systems, and any other alternatives, individually or in combination) for their effectiveness in protecting such privacy rights, and in terms of their cost and other advantages and disadvantages;

(B)

evaluate the categories of public and private entities that would have the capacity to establish and administer such methods and procedures;

(C)

consider whether different methods and procedures may apply for local telephone solicitations, such as local telephone solicitations of small businesses or holders of second class mail permits;

(D)

consider whether there is a need for additional Commission authority to further restrict telephone solicitations, including those calls exempted under subsection (a)(3) of this section, and, if such a finding is made and supported by the record, propose specific restrictions to the Congress; and

(E)

develop proposed regulations to implement the methods and procedures that the Commission determines are most effective and efficient to accomplish the purposes of this section.

(2) Regulations

Not later than 9 months after December 20, 1991, the Commission shall conclude the rulemaking proceeding initiated under paragraph (1) and shall prescribe regulations to implement methods and procedures for protecting the privacy rights described in such paragraph in an efficient, effective, and economic manner and without the imposition of any additional charge to telephone subscribers.

(3) Use of database permitted

The regulations required by paragraph (2) may require the establishment and operation of a single national database to compile a list of telephone numbers of residential subscribers who object to receiving telephone solicitations, and to make that compiled list and parts thereof available for purchase. If the Commission determines to require such a database, such regulations shall -

(A)

specify a method by which the Commission will select an entity to administer such database;

(B)

require each common carrier providing telephone exchange service, in accordance with regulations prescribed by the Commission, to inform subscribers for telephone exchange service of the opportunity to provide notification, in accordance with regulations established under this paragraph, that such subscriber objects to receiving telephone solicitations;

(C)

specify the methods by which each telephone subscriber shall be informed, by the common carrier that provides local exchange service to that subscriber, of

(i)

the subscriber's right to give or revoke a notification of an objection under subparagraph (A), and

(ii)

the methods by which such right may be exercised by the subscriber;

(D)

specify the methods by which such objections shall be collected and added to the database;

(E)

prohibit any residential subscriber from being charged for giving or revoking such notification or for being included in a database compiled under this section;

(F)

prohibit any person from making or transmitting a telephone solicitation to the telephone number of any subscriber included in such database;

(G)

specify

(i)
the methods by which any person desiring to make or transmit telephone solicitations will obtain access to the database, by area code or local exchange prefix, as required to avoid calling the telephone numbers of subscribers included in such database; and

(ii)
the costs to be recovered from such persons;

(H)
specify the methods for recovering, from persons accessing such database, the costs involved in identifying, collecting, updating, disseminating, and selling, and other activities relating to, the operations of the database that are incurred by the entities carrying out those activities;

(I)
specify the frequency with which such database will be updated and specify the method by which such updating will take effect for purposes of compliance with the regulations prescribed under this subsection;

(J)
be designed to enable States to use the database mechanism selected by the Commission for purposes of administering or enforcing State law;

(K)
prohibit the use of such database for any purpose other than compliance with the requirements of this section and any such State law and specify methods for protection of the privacy rights of persons whose numbers are included in such database; and

(L)
require each common carrier providing services to any person for the purpose of making telephone solicitations to notify such person of the requirements of this section and the regulations thereunder.

(4) Considerations required for use of database method
If the Commission determines to require the database mechanism described in paragraph (3), the Commission shall -

(A)
in developing procedures for gaining access to the database, consider the different needs of telemarketers conducting business on a national, regional, State, or local level;

(B)
develop a fee schedule or price structure for recouping the cost of such database that recognizes such differences and -

(i)
reflect the relative costs of providing a national, regional, State, or local list of phone numbers of subscribers who object to receiving telephone solicitations;

(ii)
reflect the relative costs of providing such lists on paper or electronic media; and

(iii)
not place an unreasonable financial burden on small businesses; and

(C)

consider

(i)

whether the needs of telemarketers operating on a local basis could be met through special markings of area white pages directories, and

(ii)

if such directories are needed as an adjunct to database lists prepared by area code and local exchange prefix.

(5) Private right of action

A person who has received more than one telephone call within any 12-month period by or on behalf of the same entity in violation of the regulations prescribed under this subsection may, if otherwise permitted by the laws or rules of court of a State bring in an appropriate court of that State -

(A)

an action based on a violation of the regulations prescribed under this subsection to enjoin such violation,

(B)

an action to recover for actual monetary loss from such a violation, or to receive up to $500 in damages for each such violation, whichever is greater, or

(C)

both such actions.

It shall be an affirmative defense in any action brought under this paragraph that the defendant has established and implemented, with due care, reasonable practices and procedures to effectively prevent telephone solicitations in violation of the regulations prescribed under this subsection. If the court finds that the defendant willfully or knowingly violated the regulations prescribed under this subsection, the court may, in its discretion, increase the amount of the award to an amount equal to not more than 3 times the amount available under subparagraph (B) of this paragraph.

(6) Relation to subsection (b)

The provisions of this subsection shall not be construed to permit a communication prohibited by subsection (b) of this section.

(d) Technical and procedural standards

(1) Prohibition

It shall be unlawful for any person within the United States -

(A)

to initiate any communication using a telephone facsimile machine, or to make any telephone call using any automatic telephone dialing system, that does not comply with the technical and procedural standards prescribed under this subsection, or to use any telephone facsimile machine or automatic telephone dialing system in a manner that does not comply with such standards; or

(B)

to use a computer or other electronic device to send any message via a telephone facsimile machine unless such person clearly marks, in a margin at the top or bottom of each transmitted page of the message or on the first page of the transmission, the date and time it is sent and an identification of the business, other entity, or individual sending the message and the telephone

number of the sending machine or of such business, other entity, or individual.

(2) Telephone facsimile machines

The Commission shall revise the regulations setting technical and procedural standards for telephone facsimile machines to require that any such machine which is manufactured after one year after December 20, 1991, clearly marks, in a margin at the top or bottom of each transmitted page or on the first page of each transmission, the date and time sent, an identification of the business, other entity, or individual sending the message, and the telephone number of the sending machine or of such business, other entity, or individual.

(3) Artificial or prerecorded voice systems

The Commission shall prescribe technical and procedural standards for systems that are used to transmit any artificial or prerecorded voice message via telephone. Such standards shall require that -

(A)

all artificial or prerecorded telephone messages

(i)

shall, at the beginning of the message, state clearly the identity of the business, individual, or other entity initiating the call, and

(ii)

shall, during or after the message, state clearly the telephone number or address of such business, other entity, or individual; and

(B)

any such system will automatically release the called party's line within 5 seconds of the time notification is transmitted to the system that the called party has hung up, to allow the called party's line to be used to make or receive other calls.

(e) Effect on State law

(1) State law not preempted

Except for the standards prescribed under subsection (d) of this section and subject to paragraph (2) of this subsection, nothing in this section or in the regulations prescribed under this section shall preempt any State law that imposes more restrictive intrastate requirements or regulations on, or which prohibits -

(A)

the use of telephone facsimile machines or other electronic devices to send unsolicited advertisements;

(B)

the use of automatic telephone dialing systems;

(C)

the use of artificial or prerecorded voice messages; or

(D)

the making of telephone solicitations.

(2) State use of databases

If, pursuant to subsection (c)(3) of this section, the Commission requires the establishment of a single national database of telephone numbers of subscribers who object to receiving telephone solicitations, a State or local authority may not, in its regulation of telephone solicitations, require the use of any database, list, or listing system that does not

include the part of such single national database that relates to such State.

(f) Actions by States

(1) Authority of States

Whenever the attorney general of a State, or an official or agency designated by a State, has reason to believe that any person has engaged or is engaging in a pattern or practice of telephone calls or other transmissions to residents of that State in violation of this section or the regulations prescribed under this section, the State may bring a civil action on behalf of its residents to enjoin such calls, an action to recover for actual monetary loss or receive $500 in damages for each violation, or both such actions. If the court finds the defendant willfully or knowingly violated such regulations, the court may, in its discretion, increase the amount of the award to an amount equal to not more than 3 times the amount available under the preceding sentence.

(2) Exclusive jurisdiction of Federal courts

The district courts of the United States, the United States courts of any territory, and the District Court of the United States for the District of Columbia shall have exclusive jurisdiction over all civil actions brought under this subsection. Upon proper application, such courts shall also have jurisdiction to issue writs of mandamus, or orders affording like relief, commanding the defendant to comply with the provisions of this section or regulations prescribed under this section, including the requirement that the defendant take such action as is necessary to remove the danger of such violation. Upon a proper showing, a permanent or temporary injunction or restraining order shall be granted without bond.

(3) Rights of Commission

The State shall serve prior written notice of any such civil action upon the Commission and provide the Commission with a copy of its complaint, except in any case where such prior notice is not feasible, in which case the State shall serve such notice immediately upon instituting such action. The Commission shall have the right

(A)

to intervene in the action,

(B)

upon so intervening, to be heard on all matters arising therein, and

(C)

to file petitions for appeal.

(4) Venue; service of process

Any civil action brought under this subsection in a district court of the United States may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or wherein the violation occurred or is occurring, and process in such cases may be served in any district in which the defendant is an inhabitant or where the defendant may be found.

(5) Investigatory powers

For purposes of bringing any civil action under this subsection, nothing in this section shall prevent the attorney general of a State, or an official or agency designated by a State, from exercising the powers conferred on the attorney general or such official by the laws of such State to conduct investigations or to administer oaths or affirmations or to compel the

attendance of witnesses or the production of documentary and other evidence.

(6) Effect on State court proceedings

Nothing contained in this subsection shall be construed to prohibit an authorized State official from proceeding in State court on the basis of an alleged violation of any general civil or criminal statute of such State.

(7) Limitation

Whenever the Commission has instituted a civil action for violation of regulations prescribed under this section, no State may, during the pendency of such action instituted by the Commission, subsequently institute a civil action against any defendant named in the Commission's complaint for any violation as alleged in the Commission's complaint.

(8) "Attorney general" defined

As used in this subsection, the term "attorney general" means the chief legal officer of a State

II. TCPA IMPLEMENTING REGULATIONS

the carrier provides materially false or incomplete information in its FCC Form 499-A or otherwise fails to comply with paragraphs (a), (b), and (c) of this section.

(f) *Imposition of fine.* After notice and opportunity to respond, the Commission may impose a fine on a carrier that is subject to the registration requirement pursuant to paragraph (a) of this section if that carrier fails to submit an FCC Form 499-A in accordance with paragraphs (a), (b), and (c) of this section.

(g) *Changes in information.* A carrier must notify the Commission of any changes to the information provided pursuant to paragraph (b) of this section within no more than one week of the change. Carriers may satisfy this requirement by filing the relevant portion of FCC Form 499-A in accordance with the Instructions to such form.

(h) *Duty to confirm registration of other carriers.* The Commission shall make available to the public a comprehensive listing of registrants and the information that they have provided pursuant to paragraph (b) of this section. A telecommunications carrier providing telecommunications service for resale shall have an affirmative duty to ascertain whether a potential carrier-customer (*i.e.*, reseller) that is subject to the registration requirement pursuant to paragraph (a) of this section has filed an FCC Form 499-A with the Commission prior to offering service to that carrier-customer. After notice and opportunity to respond, the Commission may impose a fine on a carrier for failure to confirm the registration status of a potential carrier-customer before providing that carrier-customer with service.

[66 FR 12894, Mar. 1, 2001]

Subpart L—Restrictions on Telemarketing and Telephone Solicitation

§64.1200 Delivery restrictions.

(a) No person or entity may:

(1) Initiate any telephone call (other than a call made for emergency purposes or made with the prior express consent of the called party) using an automatic telephone dialing system or an artificial or prerecorded voice,

(i) To any emergency telephone line, including any 911 line and any emergency line of a hospital, medical physician or service office, health care facility, poison control center, or fire protection or law enforcement agency;

(ii) To the telephone line of any guest room or patient room of a hospital, health care facility, elderly home, or similar establishment; or

(iii) To any telephone number assigned to a paging service, cellular telephone service, specialized mobile radio service, or other radio common carrier service, or any service for which the called party is charged for the call.

(2) Initiate any telephone call to any residential line using an artificial or prerecorded voice to deliver a message without the prior express consent of the called party, unless the call,

(i) Is made for emergency purposes,

(ii) Is not made for a commercial purpose,

(iii) Is made for a commercial purpose but does not include or introduce an unsolicited advertisement or constitute a telephone solicitation,

(iv) Is made to any person with whom the caller has an established business relationship at the time the call is made, or

(v) Is made by or on behalf of a tax-exempt nonprofit organization.

(3) Use a telephone facsimile machine, computer, or other device to send an unsolicited advertisement to a telephone facsimile machine,

(i) For purposes of paragraph (a)(3) of this section, a facsimile advertisement is not "unsolicited" if the recipient has granted the sender prior express invitation or permission to deliver the advertisement, as evidenced by a signed, written statement that includes the facsimile number to which any advertisements may be sent and clearly indicates the recipient's consent to receive such facsimile advertisements from the sender.

(ii) A facsimile broadcaster will be liable for violations of paragraph (a)(3) of this section if it demonstrates a high degree of involvement in, or actual notice of, the unlawful activity and fails

to take steps to prevent such facsimile transmissions.

(4) Use an automatic telephone dialing system in such a way that two or more telephone lines of a multi-line business are engaged simultaneously.

(5) Disconnect an unanswered telemarketing call prior to at least 15 seconds or four (4) rings.

(6) Abandon more than three percent of all telemarketing calls that are answered live by a person, measured over a 30-day period. A call is "abandoned" if it is not connected to a live sales representative within two (2) seconds of the called person's completed greeting. Whenever a sales representative is not available to speak with the person answering the call, that person must receive, within two (2) seconds after the called person's completed greeting, a prerecorded identification message that states only the name and telephone number of the business, entity, or individual on whose behalf the call was placed, and that the call was for "telemarketing purposes." The telephone number so provided must permit any individual to make a do-not-call request during regular business hours for the duration of the telemarketing campaign. The telephone number may not be a 900 number or any other number for which charges exceed local or long distance transmission charges. The seller or telemarketer must maintain records establishing compliance with paragraph (a)(6) of this section.

(i) A call for telemarketing purposes that delivers an artificial or prerecorded voice message to a residential telephone line that is assigned to a person who either has granted prior express consent for the call to be made or has an established business relationship with the caller shall not be considered an abandoned call if the message begins within two (2) seconds of the called person's completed greeting.

(ii) Calls made by or on behalf of tax-exempt nonprofit organizations are not covered by paragraph (a)(6) of this section.

(7) Use any technology to dial any telephone number for the purpose of determining whether the line is a facsimile or voice line.

(b) All artificial or prerecorded telephone messages shall:

(1) At the beginning of the message, state clearly the identity of the business, individual, or other entity that is responsible for initiating the call. If a business is responsible for initiating the call, the name under which the entity is registered to conduct business with the State Corporation Commission (or comparable regulatory authority) must be stated, and

(2) During or after the message, state clearly the telephone number (other than that of the autodialer or prerecorded message player that placed the call) of such business, other entity, or individual. The telephone number provided may not be a 900 number or any other number for which charges exceed local or long distance transmission charges. For telemarketing messages to residential telephone subscribers, such telephone number must permit any individual to make a do-not-call request during regular business hours for the duration of the telemarketing campaign.

(c) No person or entity shall initiate any telephone solicitation, as defined in paragraph (f)(9) of this section, to:

(1) Any residential telephone subscriber before the hour of 8 a.m. or after 9 p.m. (local time at the called party's location), or

(2) A residential telephone subscriber who has registered his or her telephone number on the national do-not-call registry of persons who do not wish to receive telephone solicitations that is maintained by the federal government. Such do-not-call registrations must be honored for a period of 5 years. Any person or entity making telephone solicitations (or on whose behalf telephone solicitations are made) will not be liable for violating this requirement if:

(i) It can demonstrate that the violation is the result of error and that as part of its routine business practice, it meets the following standards:

(A) *Written procedures.* It has established and implemented written procedures to comply with the national do-not-call rules;

(B) *Training of personnel.* It has trained its personnel, and any entity assisting in its compliance, in procedures established pursuant to the national do-not-call rules;

(C) *Recording.* It has maintained and recorded a list of telephone numbers that the seller may not contact;

(D) *Accessing the national do-not-call database.* It uses a process to prevent telephone solicitations to any telephone number on any list established pursuant to the do-not-call rules, employing a version of the national do-not-call registry obtained from the administrator of the registry no more than three months prior to the date any call is made, and maintains records documenting this process; and

(E) *Purchasing the national do-not-call database.* It uses a process to ensure that it does not sell, rent, lease, purchase or use the national do-not-call database, or any part thereof, for any purpose except compliance with this section and any such state or federal law to prevent telephone solicitations to telephone numbers registered on the national database. It purchases access to the relevant do-not-call data from the administrator of the national database and does not participate in any arrangement to share the cost of accessing the national database, including any arrangement with telemarketers who may not divide the costs to access the national database among various client sellers; or

(ii) It has obtained the subscriber's prior express invitation or permission. Such permission must be evidenced by a signed, written agreement between the consumer and seller which states that the consumer agrees to be contacted by this seller and includes the telephone number to which the calls may be placed; or

(iii) The telemarketer making the call has a personal relationship with the recipient of the call.

(d) No person or entity shall initiate any call for telemarketing purposes to a residential telephone subscriber unless such person or entity has instituted procedures for maintaining a list of persons who request not to receive telemarketing calls made by or on behalf of that person or entity. The procedures instituted must meet the following minimum standards:

(1) *Written policy.* Persons or entities making calls for telemarketing purposes must have a written policy, available upon demand, for maintaining a do-not-call list.

(2) *Training of personnel engaged in telemarketing.* Personnel engaged in any aspect of telemarketing must be informed and trained in the existence and use of the do-not-call list.

(3) *Recording, disclosure of do-not-call requests.* If a person or entity making a call for telemarketing purposes (or on whose behalf such a call is made) receives a request from a residential telephone subscriber not to receive calls from that person or entity, the person or entity must record the request and place the subscriber's name, if provided, and telephone number on the do-not-call list at the time the request is made. Persons or entities making calls for telemarketing purposes (or on whose behalf such calls are made) must honor a residential subscriber's do-not-call request within a reasonable time from the date such request is made. This period may not exceed thirty days from the date of such request. If such requests are recorded or maintained by a party other than the person or entity on whose behalf the telemarketing call is made, the person or entity on whose behalf the telemarketing call is made will be liable for any failures to honor the do-not-call request. A person or entity making a call for telemarketing purposes must obtain a consumer's prior express permission to share or forward the consumer's request not to be called to a party other than the person or entity on whose behalf a telemarketing call is made or an affiliated entity.

(4) *Identification of sellers and telemarketers.* A person or entity making a call for telemarketing purposes must provide the called party with the name of the individual caller, the name of the person or entity on whose behalf the call is being made, and a telephone number or address at which the person or entity may be contacted. The telephone number provided may not be a 900 number or any other number for which charges exceed local or long distance transmission charges.

(5) *Affiliated persons or entities.* In the absence of a specific request by the subscriber to the contrary, a residential subscriber's do-not-call request shall apply to the particular business

entity making the call (or on whose behalf a call is made), and will not apply to affiliated entities unless the consumer reasonably would expect them to be included given the identification of the caller and the product being advertised.

(6) *Maintenance of do-not-call lists.* A person or entity making calls for telemarketing purposes must maintain a record of a caller's request not to receive further telemarketing calls. A do-not-call request must be honored for 5 years from the time the request is made.

(7) Tax-exempt nonprofit organizations are not required to comply with 64.1200(d).

(e) The rules set forth in paragraph (c) and (d) of this section are applicable to any person or entity making telephone solicitations or telemarketing calls to wireless telephone numbers to the extent described in the Commission's Report and Order, CG Docket No. 02-278, FCC 03-153, "Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991."

(f) As used in this section:

(1) The terms *automatic telephone dialing system* and *autodialer* mean equipment which has the capacity to store or produce telephone numbers to be called using a random or sequential number generator and to dial such numbers.

(2) The term *emergency purposes* means calls made necessary in any situation affecting the health and safety of consumers.

(3) The term *established business relationship* means a prior or existing relationship formed by a voluntary two-way communication between a person or entity and a residential subscriber with or without an exchange of consideration, on the basis of the subscriber's purchase or transaction with the entity within the eighteen (18) months immediately preceding the date of the telephone call or on the basis of the subscriber's inquiry or application regarding products or services offered by the entity within the three months immediately preceding the date of the call, which relationship has not been previously terminated by either party.

(i) The subscriber's seller-specific do-not-call request, as set forth in paragraph (d)(3) of this section, terminates an established business relationship for purposes of telemarketing and telephone solicitation even if the subscriber continues to do business with the seller.

(ii) The subscriber's established business relationship with a particular business entity does not extend to affiliated entities unless the subscriber would reasonably expect them to be included given the nature and type of goods or services offered by the affiliate and the identity of the affiliate.

(4) The term *facsimile broadcaster* means a person or entity that transmits messages to telephone facsimile machines on behalf of another person or entity for a fee.

(5) The term *seller* means the person or entity on whose behalf a telephone call or message is initiated for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person.

(6) The term *telemarketer* means the person or entity that initiates a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person.

(7) The term *telemarketing* means the initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person.

(8) The term *telephone facsimile machine* means equipment which has the capacity to transcribe text or images, or both, from paper into an electronic signal and to transmit that signal over a regular telephone line, or to transcribe text or images (or both) from an electronic signal received over a regular telephone line onto paper.

(9) The term *telephone solicitation* means the initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person, but such term does not include a call or message:

(i) To any person with that person's prior express invitation or permission;

(ii) To any person with whom the caller has an established business relationship; or

(iii) By or on behalf of a tax-exempt nonprofit organization.

(10) The term *unsolicited advertisement* means any material advertising the commercial availability or quality of any property, goods, or services which is transmitted to any person without that person's prior express invitation or permission.

(11) The term *personal relationship* means any family member, friend, or acquaintance of the telemarketer making the call.

(g) Beginning January 1, 2004, common carriers shall:

(1) When providing local exchange service, provide an annual notice, via an insert in the subscriber's bill, of the right to give or revoke a notification of an objection to receiving telephone solicitations pursuant to the national do-not-call database maintained by the federal government and the methods by which such rights may be exercised by the subscriber. The notice must be clear and conspicuous and include, at a minimum, the Internet address and toll-free number that residential telephone subscribers may use to register on the national database.

(2) When providing service to any person or entity for the purpose of making telephone solicitations, make a one-time notification to such person or entity of the national do-not-call requirements, including, at a minimum, citation to 47 CFR 64.1200 and 16 CFR 310. Failure to receive such notification will not serve as a defense to any person or entity making telephone solicitations from violations of this section.

(h) The administrator of the national do-not-call registry that is maintained by the federal government shall make the telephone numbers in the database available to the States so that a State may use the telephone numbers that relate to such State as part of any database, list or listing system maintained by such State for the regulation of telephone solicitations.

[68 FR 44177, July 25, 2003]

EFFECTIVE DATE NOTE: At 68 FR 44177, July 25, 2003, §64.1200 was revised. Paragraph (a)(3)(i) will become effective Jan. 1, 2005.

§64.1201 Restrictions on billing name and address disclosure.

(a) As used in this section:

(1) The term *billing name and address* means the name and address provided to a local exchange company by each of its local exchange customers to which the local exchange company directs bills for its services.

(2) The term "telecommunications service provider" means interexchange carriers, operator service providers, enhanced service providers, and any other provider of interstate telecommunications services.

(3) The term *authorized billing agent* means a third party hired by a telecommunications service provider to perform billing and collection services for the telecommunications service provider.

(4) The term *bulk basis* means billing name and address information for all the local exchange service subscribers of a local exchange carrier.

(5) The term *LEC joint use card* means a calling card bearing an account number assigned by a local exchange carrier, used for the services of the local exchange carrier and a designated interexchange carrier, and validated by access to data maintained by the local exchange carrier.

(b) No local exchange carrier providing billing name and address shall disclose billing name and address information to any party other than a telecommunications service provider or an authorized billing and collection agent of a telecommunications service provider.

(c)(1) No telecommunications service provider or authorized billing and collection agent of a telecommunications service provider shall use billing name and address information for any purpose other than the following:

(i) Billing customers for using telecommunications services of that service provider and collecting amounts due;

(ii) Any purpose associated with the "equal access" requirement of *United States* v. *AT&T* 552 F.Supp. 131 (D.D.C. 1982); and

caused to pass through a proper on-hook transition in order to minimize the likelihood of damage to individuals with normal hearing.

(g) These incorporations by reference of paragraph 4.1.2 (including table 4.4) of American National Standards Institute (ANSI) Standard ANSI/EIA-470-A-1987 and paragraph 4.3.2 of ANSI/EIA/TIA-579-1991 were approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies of these publications may be purchased from the American National Standards Institute (ANSI), Sales Department, 11 West 42nd Street, 13th Floor, New York, NY 10036, (212) 642-4900. Copies also may be inspected during normal business hours at the following locations: Consumer and Governmental Affairs Bureau, Reference Information Center, Federal Communications Commission, 445 12th Street, SW, Washington, DC 20554; and Office of the Federal Register, 800 N. Capitol Street, NW., Suite 700, Washington, DC.

[61 FR 42187, Aug. 14, 1996, as amended at 64 FR 60726, Nov. 8, 1999; 67 FR 13229, Mar. 21, 2002]

§ 68.318 Additional limitations.

(a) *General.* Registered terminal equipment for connection to those services discussed below must incorporate the specified features.

(b) *Registered terminal equipment with automatic dialing capability.* (1) Automatic dialing to any individual number is limited to two successive attempts. Automatic dialing equipment which employ means for detecting both busy and reorder signals shall be permitted an additional 13 attempts if a busy or reorder signal is encountered on each attempt. The dialer shall be unable to re-attempt a call to the same number for at least 60 minutes following either the second or fifteenth successive attempt, whichever applies, unless the dialer is reactivated by either manual or external means. This rule does not apply to manually activated dialers that dial a number once following each activation.

NOTE TO PARAGRAPH (b)(1): Emergency alarm dialers and dialers under external computer control are exempt from these requirements.

(2) If means are employed for detecting both busy and reorder signals, the automatic dialing equipment shall return to its on-hook state within 15 seconds after detection of a busy or reorder signal.

(3) If the called party does not answer, the automatic dialer shall return to the on-hook state within 60 seconds of completion of dialing.

(4) If the called party answers, and the calling equipment does not detect a compatible terminal equipment at the called end, then the automatic dialing equipment shall be limited to one additional call which is answered. The automatic dialing equipment shall comply with paragraphs (b)(1), (b)(2), and (b)(3) of this section for additional call attempts that are not answered.

(5) Sequential dialers shall dial only once to any individual number before proceeding to dial another number.

(6) Network addressing signals shall be transmitted no earlier than:

(i) 70 ms after receipt of dial tone at the network demarcation point; or

(ii) 600 ms after automatically going off-hook (for single line equipment that does not use dial tone detectors); or

(iii) 70 ms after receipt of CO ground start at the network demarcation point.

(c) *Line seizure by automatic telephone dialing systems.* Automatic telephone dialing systems which deliver a recorded message to the called party must release the called party's telephone line within 5 seconds of the time notification is transmitted to the system that the called party has hung up, to allow the called party's line to be used to make or receive other calls.

(d) *Telephone facsimile machines; Identification of the sender of the message.* It shall be unlawful for any person within the United States to use a computer or other electronic device to send any message via a telephone facsimile machine unless such person clearly marks, in a margin at the top or bottom of each transmitted page of the message or on the first page of the transmission, the date and time it is sent and an identification of the business, other entity, or individual sending the message and the telephone number of the sending machine or of

such business, other entity, or individual. If a facsimile broadcaster demonstrates a high degree of involvement in the sender's facsimile messages, such as supplying the numbers to which a message is sent, that broadcaster's name, under which it is registered to conduct business with the State Corporation Commission (or comparable regulatory authority), must be identified on the facsimile, along with the sender's name. Telephone facsimile machines manufactured on and after December 20, 1992, must clearly mark such identifying information on each transmitted page.

(e) *Requirement that registered equipment allow access to common carriers.* Any equipment or software manufactured or imported on or after April 17, 1992, and installed by any aggregator shall be technologically capable of providing consumers with access to interstate providers of operator services through the use of equal access codes. The terms used in this paragraph shall have meanings defined in §64.708 of this chapter (47 CFR 64.708).

[62 FR 61691, Nov. 19, 1997, as amended at 68 FR 44179, July 25, 2003]

§68.320 Supplier's Declaration of Conformity.

(a) Supplier's Declaration of Conformity is a procedure where the responsible party, as defined in §68.3, makes measurements or takes other necessary steps to ensure that the terminal equipment complies with the appropriate technical standards.

(b) The Supplier's Declaration of Conformity attaches to all items subsequently marketed by the responsible party which are identical, within the variation that can be expected to arise as a result of quantity production techniques, to the sample tested and found acceptable by the responsible party.

(c) The Supplier's Declaration of Conformity signifies that the responsible party has determined that the equipment has been shown to comply with the applicable technical criteria if no unauthorized change is made in the equipment and if the equipment is properly maintained and operated.

(d) The responsible party, if different from the manufacturer, may upon receiving a written statement from the manufacturer that the equipment complies with the appropriate technical criteria, rely on the manufacturer or independent testing agency to determine compliance. Any records that the Administrative Council for Terminal Attachments requires the responsible party to maintain shall be in the English language and shall be made available to the Commission upon a request.

(e) No person shall use or make reference to a Supplier's Declaration of Conformity in a deceptive or misleading manner or to convey the impression that such a Supplier's Declaration of Conformity reflects more than a determination by the responsible party that the device or product has been shown to be capable of complying with the applicable technical criteria published by the Administrative Council of Terminal Attachments.

[66 FR 7585, Jan. 24, 2001]

§68.321 Location of responsible party.

The responsible party for a Supplier's Declaration of Conformity must designate an agent for service of process that is physically located within the United States.

[67 FR 57182, Sept. 9, 2002]

§68.322 Changes in name, address, ownership or control of responsible party.

(a) The responsible party for a Supplier's Declaration of Conformity may license or otherwise authorize a second party to manufacture the equipment covered by the Supplier's Declaration of Conformity provided that the responsible party shall continue to be responsible to the Commission for ensuring that the equipment produced pursuant to such an agreement remains compliant with the appropriate standards.

(b) In the case of transactions affecting the responsible party of a Supplier's Declaration of Conformity, such as a transfer of control or sale to another company, mergers, or transfer of manufacturing rights, the successor entity shall become the responsible party.

[66 FR 7586, Jan. 24, 2001]

III. 1994 TELEMARKETING CONSUMER FRAUD AND ABUSE PREVENTION ACT ("TELEMARKETING ACT")

15 U.S.C. §§ 6101 et seq.

Sec. 6101. - Findings

The Congress makes the following findings:

(1)

Telemarketing differs from other sales activities in that it can be carried out by sellers across State lines without direct contact with the consumer. Telemarketers also can be very mobile, easily moving from State to State.

(2)

Interstate telemarketing fraud has become a problem of such magnitude that the resources of the Federal Trade Commission are not sufficient to ensure adequate consumer protection from such fraud.

(3)

Consumers and others are estimated to lose $40 billion a year in telemarketing fraud.

(4)

Consumers are victimized by other forms of telemarketing deception and abuse.

(5)

Consequently, Congress should enact legislation that will offer consumers necessary protection from telemarketing deception and abuse

Sec. 6102. - Telemarketing rules

(a) In general

(1)

The Commission shall prescribe rules prohibiting deceptive telemarketing acts or practices and other abusive telemarketing acts or practices.

(2)

The Commission shall include in such rules respecting deceptive telemarketing acts or practices a definition of deceptive telemarketing acts or practices which shall include fraudulent charitable solicitations, and which may include acts or practices of entities or individuals that assist or facilitate deceptive telemarketing, including credit card laundering.

(3)

The Commission shall include in such rules respecting other abusive telemarketing acts or practices -

(A)

a requirement that telemarketers may not undertake a pattern of unsolicited telephone calls which the reasonable consumer would consider coercive or abusive of such consumer's right to privacy,

(B)

restrictions on the hours of the day and night when unsolicited telephone calls can be made to consumers,

(C)

a requirement that any person engaged in telemarketing for the sale of goods or services shall promptly and clearly disclose to the person receiving the call that the purpose of the call is to sell goods or services and make such other disclosures as the Commission deems appropriate, including the nature and price of the goods and services; and

(D)

a requirement that any person engaged in telemarketing for the solicitation of charitable contributions, donations, or gifts of money or any other thing of value, shall promptly and clearly disclose to the person receiving the call that the purpose of the call is to solicit charitable contributions, donations, or gifts, and make such other disclosures as the Commission considers appropriate, including the name and mailing address of the charitable organization on behalf of which the solicitation is made.

In prescribing the rules described in this paragraph, the Commission shall also consider recordkeeping requirements.

(b) Rulemaking

The Commission shall prescribe the rules under subsection (a) of this section within 365 days after August 16, 1994. Such rules shall be prescribed in accordance with section 553 of title 5.

(c) Enforcement

Any violation of any rule prescribed under subsection (a) of this section shall be treated as a violation of a rule under section 57a of this title regarding unfair or deceptive acts or practices.

(d) Securities and Exchange Commission rules

(1) Promulgation

(A) In general

Except as provided in subparagraph (B), not later than 6 months after the effective date of rules promulgated by the Federal Trade Commission under subsection (a) of this section, the Securities and Exchange Commission shall promulgate, or require any national securities exchange or registered securities association to promulgate, rules substantially similar to such rules to prohibit deceptive and other abusive telemarketing acts or practices by persons described in paragraph (2).

(B) Exception

The Securities and Exchange Commission is not required to promulgate a rule under subparagraph (A) if it determines that -

(i)

Federal securities laws or rules adopted by the Securities and Exchange Commission thereunder provide protection from deceptive and other abusive telemarketing by persons described in paragraph (2) substantially similar to that provided by rules promulgated by the Federal Trade Commission under subsection (a) of this section; or

(ii)

such a rule promulgated by the Securities and Exchange Commission is not necessary or appropriate in the public interest, or for the protection of investors, or would be inconsistent with the maintenance of fair and orderly markets.

If the Securities and Exchange Commission determines that an exception described in clause (i) or (ii) applies, the Securities and Exchange Commission shall publish in the Federal Register its determination with the reasons for it.

(2) Application

(A) In general

The rules promulgated by the Securities and Exchange Commission under paragraph (1)(A) shall apply to a broker, dealer, transfer agent, municipal securities dealer, municipal securities broker, government securities broker, government securities dealer, investment adviser or investment company, or any individual associated with a broker, dealer, transfer agent, municipal securities dealer, municipal securities broker, government securities broker, government securities dealer, investment adviser or investment company. The rules promulgated by the Federal Trade Commission under subsection (a) of this section shall not apply to persons described in the preceding sentence.

(B) Definitions

For purposes of subparagraph (A) -

(i)

the terms "broker", "dealer", "transfer agent", "municipal securities dealer", "municipal securities broker", "government securities broker", and "government securities dealer" have the meanings given such terms by paragraphs (4), (5), (25), (30), (31), (43), and (44) of section 78c(a) of this title;

(ii)

the term "investment adviser" has the meaning given such term by section 80b-2(a)(11) of this title; and

(iii)

the term "investment company" has the meaning given such term by section 80a-3(a) of this title.

(e) Commodity Futures Trading Commission rules

(1) Application

The rules promulgated by the Federal Trade Commission under subsection (a) of this section shall not apply to persons described in section 9b(1) of title 7.

(2) Omitted

Sec. 6103. - Actions by States

(a) In general

Whenever an attorney general of any State has reason to believe that the interests of the residents of that State have been or are being threatened or adversely affected because any person has engaged or is engaging in a pattern or practice of telemarketing which violates any rule of the Commission under section 6102 of this title, the State, as parens patriae, may bring a civil action on behalf of its residents in an appropriate district court of the United States to enjoin such telemarketing, to enforce compliance with such rule of the Commission, to obtain damages, restitution, or other compensation on behalf of residents of such State, or to obtain such further and other relief as the court may deem appropriate.

(b) Notice

The State shall serve prior written notice of any civil action under subsection (a) or (f)(2) of this section upon the Commission and provide the Commission with a copy of its complaint, except that if it is not feasible for the State to provide such prior notice, the State shall serve such notice immediately upon instituting such action. Upon receiving a notice respecting a civil action, the Commission shall have the right

(1)

to intervene in such action,

(2)

upon so intervening, to be heard on all matters arising therein, and

(3)

to file petitions for appeal.

(c) Construction

For purposes of bringing any civil action under subsection (a) of this section, nothing in this chapter shall prevent an attorney general from exercising the powers conferred on the attorney general by the laws of such State to conduct investigations or to administer oaths or affirmations or to compel the attendance of witnesses or the production of documentary and other evidence.

(d) Actions by Commission

Whenever a civil action has been instituted by or on behalf of the Commission for violation of any rule prescribed under section 6102 of this title, no State may, during the pendency of such action instituted by or on behalf of the Commission, institute a civil action under subsection (a) or (f)(2) of this section against any defendant named in the complaint in such action for violation of any rule as alleged in such complaint.

(e) Venue; service of process

Any civil action brought under subsection (a) of this section in a district court of the United States may be brought in the district in which the defendant is found, is an inhabitant, or transacts business or wherever venue is proper under section 1391 of title 28. Process in such an action may be served in any district in which the defendant is an inhabitant or in which the defendant may be found.

(f) Actions by other State officials

(1)

Nothing contained in this section shall prohibit an authorized State official from proceeding in State court on the basis of an alleged violation of any civil or criminal statute of such State.

(2)

In addition to actions brought by an attorney general of a State under subsection (a) of this section, such an action may be brought by officers of such State who are authorized by the State to bring actions in such State on behalf of its residents

Sec. 6104. - Actions by private persons

(a) In general

Any person adversely affected by any pattern or practice of telemarketing which violates any rule of the Commission under section 6102 of this title, or an authorized person acting on such person's behalf, may, within 3 years after discovery of the violation, bring a civil action in an appropriate district court of the United States against a person who has engaged or is engaging in such

pattern or practice of telemarketing if the amount in controversy exceeds the sum or value of $50,000 in actual damages for each person adversely affected by such telemarketing. Such an action may be brought to enjoin such telemarketing, to enforce compliance with any rule of the Commission under section 6102 of this title, to obtain damages, or to obtain such further and other relief as the court may deem appropriate.

(b) Notice

The plaintiff shall serve prior written notice of the action upon the Commission and provide the Commission with a copy of its complaint, except in any case where such prior notice is not feasible, in which case the person shall serve such notice immediately upon instituting such action. The Commission shall have the right

(A)

to intervene in the action,

(B)

upon so intervening, to be heard on all matters arising therein, and

(C)

to file petitions for appeal.

(c) Action by Commission

Whenever a civil action has been instituted by or on behalf of the Commission for violation of any rule prescribed under section 6102 of this title, no person may, during the pendency of such action instituted by or on behalf of the Commission, institute a civil action against any defendant named in the complaint in such action for violation of any rule as alleged in such complaint.

(d) Cost and fees

The court, in issuing any final order in any action brought under subsection (a) of this section, may award costs of suit and reasonable fees for attorneys and expert witnesses to the prevailing party.

(e) Construction

Nothing in this section shall restrict any right which any person may have under any statute or common law.

(f) Venue; service of process

Any civil action brought under subsection (a) of this section in a district court of the United States may be brought in the district in which the defendant is found, is an inhabitant, or transacts business or wherever venue is proper under section 1391 of title 28. Process in such an action may be served in any district in which the defendant is an inhabitant or in which the defendant may be found

Sec. 6105. - Administration and applicability of chapter

(a) In general

Except as otherwise provided in sections 6102(d), 6102(e), 6103, and 6104 of this title, this chapter shall be enforced by the Commission under the Federal Trade Commission Act (15 U.S.C. 41 et seq.). Consequently, no activity which is outside the jurisdiction of that Act shall be affected by this chapter.

(b) Actions by Commission

The Commission shall prevent any person from violating a rule of the Commission under section 6102 of this title in the same manner, by the same means, and with the same jurisdiction, powers, and duties as though all applicable terms and provisions of the Federal Trade Commission Act (15

U.S.C. 41 et seq.) were incorporated into and made a part of this chapter. Any person who violates such rule shall be subject to the penalties and entitled to the privileges and immunities provided in the Federal Trade Commission Act in the same manner, by the same means, and with the same jurisdiction, power, and duties as though all applicable terms and provisions of the Federal Trade Commission Act were incorporated into and made a part of this chapter.

(c) Effect on other laws

Nothing contained in this chapter shall be construed to limit the authority of the Commission under any other provision of law

Sec. 6106. - Definitions

For purposes of this chapter:

(1)

The term "attorney general" means the chief legal officer of a State.

(2)

The term "Commission" means the Federal Trade Commission.

(3)

The term "State" means any State of the United States, the District of Columbia, Puerto Rico, the Northern Mariana Islands, and any territory or possession of the United States.

(4)

The term "telemarketing" means a plan, program, or campaign which is conducted to induce purchases of goods or services, or a charitable contribution, donation, or gift of money or any other thing of value, by use of one or more telephones and which involves more than one interstate telephone call. The term does not include the solicitation of sales through the mailing of a catalog which -

(A)

contains a written description, or illustration of the goods or services offered for sale,

(B)

includes the business address of the seller,

(C)

includes multiple pages of written material or illustrations, and

(D)

has been issued not less frequently than once a year,

where the person making the solicitation does not solicit customers by telephone but only receives calls initiated by customers in response to the catalog and during those calls takes orders only without further solicitation

Sec. 6107. - Enforcement of orders

(a) General authority

Subject to subsections (b) and (c) of this section, the Federal Trade Commission may bring a criminal contempt action for violations of orders of the Commission obtained in cases brought under section 53(b) of this title.

(b) Appointment

An action authorized by subsection (a) of this section may be brought by the Federal Trade Commission only after, and pursuant to, the appointment by the

Attorney General of an attorney employed by the Commission, as a special assistant United States Attorney.

(c) Request for appointment

(1) Appointment upon request or motion

A special assistant United States Attorney may be appointed under subsection (b) of this section upon the request of the Federal Trade Commission or the court which has entered the order for which contempt is sought or upon the Attorney General's own motion.

(2) Timing

The Attorney General shall act upon any request made under paragraph (1) within 45 days of the receipt of the request.

(d) Termination of authority

The authority of the Federal Trade Commission to bring a criminal contempt action under subsection (a) of this section expires 2 years after the date of the first promulgation of rules under section 6102 of this title. The expiration of such authority shall have no effect on an action brought before the expiration date

Sec. 6108. - Review

Upon the expiration of 5 years following the date of the first promulgation of rules under section 6102 of this title, the Commission shall review the implementation of this chapter and its effect on deceptive telemarketing acts or practices and report the results of the review to the Congress

IV. TELEMARKETING SALES RULE

Additional Information

DEPARTMENT OF ENERGY (DOE)

For more information about AFVs, contact DOE's National Alternative Fuels Hotline, **1-800-423-1DOE**, and ask for its free brochure.

NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION (NHTSA)

For more information about vehicle safety, contact NHTSA's Auto Safety Hotline, **1-800-424-9393**.

The information on this label is required by the Federal Trade Commission, 16 CFR Part 309

Figure 8

PART 310—TELEMARKETING SALES RULE

Sec.

310.1 Scope of regulations in this part.
310.2 Definitions.
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310.4 Abusive telemarketing acts or practices.
310.5 Recordkeeping requirements.
310.6 Exemptions.
310.7 Actions by states and private persons.
310.8 Fee for access to "do-not-call" registry.
310.9 Severability.

AUTHORITY: 15 U.S.C. 6101–6108.

SOURCE: 68 FR 4669, Jan. 29, 2003, unless otherwise noted.

§ 310.1 Scope of regulations in this part.

This part implements the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. 6101-6108, as amended.

§ 310.2 Definitions.

(a) *Acquirer* means a business organization, financial institution, or an agent of a business organization or financial institution that has authority from an organization that operates or licenses a credit card system to authorize merchants to accept, transmit, or process payment by credit card through the credit card system for money, goods or services, or anything else of value.

(b) *Attorney General* means the chief legal officer of a state.

(c) *Billing information* means any data that enables any person to access a customer's or donor's account, such as a credit card, checking, savings, share or similar account, utility bill, mortgage loan account, or debit card.

(d) *Caller identification service* means a service that allows a telephone subscriber to have the telephone number, and, where available, name of the calling party transmitted contemporaneously with the telephone call, and displayed on a device in or connected to the subscriber's telephone.

(e) *Cardholder* means a person to whom a credit card is issued or who is authorized to use a credit card on behalf of or in addition to the person to whom the credit card is issued.

(f) *Charitable contribution* means any donation or gift of money or any other thing of value.

(g) *Commission* means the Federal Trade Commission.

(h) *Credit* means the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.

(i) *Credit card* means any card, plate, coupon book, or other credit device existing for the purpose of obtaining money, property, labor, or services on credit.

(j) *Credit card sales draft* means any record or evidence of a credit card transaction.

(k) *Credit card system* means any method or procedure used to process credit card transactions involving credit cards issued or licensed by the operator of that system.

(l) *Customer* means any person who is or may be required to pay for goods or services offered through telemarketing.

(m) *Donor* means any person solicited to make a charitable contribution.

(n) *Established business relationship* means a relationship between a seller and a consumer based on:

(1) the consumer's purchase, rental, or lease of the seller's goods or services or a financial transaction between the consumer and seller, within the eighteen (18) months immediately preceding the date of a telemarketing call; or

(2) the consumer's inquiry or application regarding a product or service offered by the seller, within the three (3) months immediately preceding the date of a telemarketing call.

(o) *Free-to-pay conversion* means, in an offer or agreement to sell or provide any goods or services, a provision under which a customer receives a product or service for free for an initial period and will incur an obligation to pay for the product or service if he or she does not take affirmative action to cancel before the end of that period.

(p) *Investment opportunity* means anything, tangible or intangible, that is offered, offered for sale, sold, or traded based wholly or in part on representations, either express or implied, about past, present, or future income, profit, or appreciation.

(q) *Material* means likely to affect a person's choice of, or conduct regarding, goods or services or a charitable contribution.

(r) *Merchant* means a person who is authorized under a written contract with an acquirer to honor or accept credit cards, or to transmit or process for payment credit card payments, for the purchase of goods or services or a charitable contribution.

(s) *Merchant agreement* means a written contract between a merchant and an acquirer to honor or accept credit cards, or to transmit or process for payment credit card payments, for the purchase of goods or services or a charitable contribution.

(t) *Negative option feature* means, in an offer or agreement to sell or provide any goods or services, a provision under which the customer's silence or failure to take an affirmative action to reject goods or services or to cancel the agreement is interpreted by the seller as acceptance of the offer.

(u) *Outbound telephone call* means a telephone call initiated by a telemarketer to induce the purchase of goods or services or to solicit a charitable contribution.

(v) *Person* means any individual, group, unincorporated association, limited or general partnership, corporation, or other business entity.

(w) *Preacquired account information* means any information that enables a seller or telemarketer to cause a charge to be placed against a customer's or donor's account without obtaining the account number directly from the customer or donor during the telemarketing transaction pursuant to which the account will be charged.

(x) *Prize* means anything offered, or purportedly offered, and given, or purportedly given, to a person by chance.

For purposes of this definition, chance exists if a person is guaranteed to receive an item and, at the time of the offer or purported offer, the telemarketer does not identify the specific item that the person will receive.

(y) *Prize promotion* means:

(1) A sweepstakes or other game of chance; or

(2) An oral or written express or implied representation that a person has won, has been selected to receive, or may be eligible to receive a prize or purported prize.

(z) *Seller* means any person who, in connection with a telemarketing transaction, provides, offers to provide, or arranges for others to provide goods or services to the customer in exchange for consideration.

(aa) *State* means any state of the United States, the District of Columbia, Puerto Rico, the Northern Mariana Islands, and any territory or possession of the United States.

(bb) *Telemarketer* means any person who, in connection with telemarketing, initiates or receives telephone calls to or from a customer or donor.

(cc) *Telemarketing* means a plan, program, or campaign which is conducted to induce the purchase of goods or services or a charitable contribution, by use of one or more telephones and which involves more than one interstate telephone call. The term does not include the solicitation of sales through the mailing of a catalog which: contains a written description or illustration of the goods or services offered for sale; includes the business address of the seller; includes multiple pages of written material or illustrations; and has been issued not less frequently than once a year, when the person making the solicitation does not solicit customers by telephone but only receives calls initiated by customers in response to the catalog and during those calls takes orders only without further solicitation. For purposes of the previous sentence, the term "further solicitation" does not include providing the customer with information about, or attempting to sell, any other item included in the same catalog which prompted the customer's call or in a substantially similar catalog.

(dd) *Upselling* means soliciting the purchase of goods or services following an initial transaction during a single telephone call. The upsell is a separate telemarketing transaction, not a continuation of the initial transaction. An "external upsell" is a solicitation made by or on behalf of a seller different from the seller in the initial transaction, regardless of whether the initial transaction and the subsequent solicitation are made by the same telemarketer. An "internal upsell" is a solicitation made by or on behalf of the same seller as in the initial transaction, regardless of whether the initial transaction and subsequent solicitation are made by the same telemarketer.

§ 310.3 Deceptive telemarketing acts or practices.

(a) *Prohibited deceptive telemarketing acts or practices.* It is a deceptive telemarketing act or practice and a violation of this Rule for any seller or telemarketer to engage in the following conduct:

(1) Before a customer pays[1] for goods or services offered, failing to disclose truthfully, in a clear and conspicuous manner, the following material information:

(i) The total costs to purchase, receive, or use, and the quantity of, any goods or services that are the subject of the sales offer;[2]

(ii) All material restrictions, limitations, or conditions to purchase, receive, or use the goods or services that are the subject of the sales offer;

(iii) If the seller has a policy of not making refunds, cancellations, exchanges, or repurchases, a statement informing the customer that this is the

[1] When a seller or telemarketer uses, or directs a customer to use, a courier to transport payment, the seller or telemarketer must make the disclosures required by § 310.3(a)(1) before sending a courier to pick up payment or authorization for payment, or directing a customer to have a courier pick up payment or authorization for payment.

[2] For offers of consumer credit products subject to the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, and Regulation Z, 12 CFR 226, compliance with the disclosure requirements under the Truth in Lending Act and Regulation Z shall constitute compliance with § 310.3(a)(1)(i) of this Rule.

seller's policy; or, if the seller or telemarketer makes a representation about a refund, cancellation, exchange, or repurchase policy, a statement of all material terms and conditions of such policy;

(iv) In any prize promotion, the odds of being able to receive the prize, and, if the odds are not calculable in advance, the factors used in calculating the odds; that no purchase or payment is required to win a prize or to participate in a prize promotion and that any purchase or payment will not increase the person's chances of winning; and the no-purchase/no-payment method of participating in the prize promotion with either instructions on how to participate or an address or local or toll-free telephone number to which customers may write or call for information on how to participate;

(v) All material costs or conditions to receive or redeem a prize that is the subject of the prize promotion;

(vi) In the sale of any goods or services represented to protect, insure, or otherwise limit a customer's liability in the event of unauthorized use of the customer's credit card, the limits on a cardholder's liability for unauthorized use of a credit card pursuant to 15 U.S.C. 1643; and

(vii) If the offer includes a negative option feature, all material terms and conditions of the negative option feature, including, but not limited to, the fact that the customer's account will be charged unless the customer takes an affirmative action to avoid the charge(s), the date(s) the charge(s) will be submitted for payment, and the specific steps the customer must take to avoid the charge(s).

(2) Misrepresenting, directly or by implication, in the sale of goods or services any of the following material information:

(i) The total costs to purchase, receive, or use, and the quantity of, any goods or services that are the subject of a sales offer;

(ii) Any material restriction, limitation, or condition to purchase, receive, or use goods or services that are the subject of a sales offer;

(iii) Any material aspect of the performance, efficacy, nature, or central characteristics of goods or services that are the subject of a sales offer;

(iv) Any material aspect of the nature or terms of the seller's refund, cancellation, exchange, or repurchase policies;

(v) Any material aspect of a prize promotion including, but not limited to, the odds of being able to receive a prize, the nature or value of a prize, or that a purchase or payment is required to win a prize or to participate in a prize promotion;

(vi) Any material aspect of an investment opportunity including, but not limited to, risk, liquidity, earnings potential, or profitability;

(vii) A seller's or telemarketer's affiliation with, or endorsement or sponsorship by, any person or government entity;

(viii) That any customer needs offered goods or services to provide protections a customer already has pursuant to 15 U.S.C. 1643; or

(ix) Any material aspect of a negative option feature including, but not limited to, the fact that the customer's account will be charged unless the customer takes an affirmative action to avoid the charge(s), the date(s) the charge(s) will be submitted for payment, and the specific steps the customer must take to avoid the charge(s).

(3) Causing billing information to be submitted for payment, or collecting or attempting to collect payment for goods or services or a charitable contribution, directly or indirectly, without the customer's or donor's express verifiable authorization, except when the method of payment used is a credit card subject to protections of the Truth in Lending Act and Regulation Z,[3] or a debit card subject to the protections of the Electronic Fund Transfer Act and Regulation E.[4] Such authorization shall be deemed verifiable if any of the following means is employed:

[3] Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, and Regulation Z, 12 CFR part 226.

[4] Electronic Fund Transfer Act, 15 U.S.C. 1693 *et seq.*, and Regulation E, 12 CFR part 205.

(i) Express written authorization by the customer or donor, which includes the customer's or donor's signature;[5]

(ii) Express oral authorization which is audio-recorded and made available upon request to the customer or donor, and the customer's or donor's bank or other billing entity, and which evidences clearly both the customer's or donor's authorization of payment for the goods or services or charitable contribution that are the subject of the telemarketing transaction and the customer's or donor's receipt of all of the following information:

(A) The number of debits, charges, or payments (if more than one);

(B) The date(s) the debit(s), charge(s), or payment(s) will be submitted for payment;

(C) The amount(s) of the debit(s), charge(s), or payment(s);

(D) The customer's or donor's name;

(E) The customer's or donor's billing information, identified with sufficient specificity such that the customer or donor understands what account will be used to collect payment for the goods or services or charitable contribution that are the subject of the telemarketing transaction;

(F) A telephone number for customer or donor inquiry that is answered during normal business hours; and

(G) The date of the customer's or donor's oral authorization; or

(iii) Written confirmation of the transaction, identified in a clear and conspicuous manner as such on the outside of the envelope, sent to the customer or donor via first class mail prior to the submission for payment of the customer's or donor's billing information, and that includes all of the information contained in §§310.3(a)(3)(ii)(A)-(G) and a clear and conspicuous statement of the procedures by which the customer or donor can obtain a refund from the seller or telemarketer or charitable organization in the event the confirmation is inaccurate; *provided*, however, that this means of authorization shall not be deemed verifiable in instances in which goods or services are offered in a transaction involving a free-to-pay conversion and preacquired account information.

(4) Making a false or misleading statement to induce any person to pay for goods or services or to induce a charitable contribution.

(b) *Assisting and facilitating.* It is a deceptive telemarketing act or practice and a violation of this Rule for a person to provide substantial assistance or support to any seller or telemarketer when that person knows or consciously avoids knowing that the seller or telemarketer is engaged in any act or practice that violates §§310.3(a), (c) or (d), or §310.4 of this Rule.

(c) *Credit card laundering.* Except as expressly permitted by the applicable credit card system, it is a deceptive telemarketing act or practice and a violation of this Rule for:

(1) A merchant to present to or deposit into, or cause another to present to or deposit into, the credit card system for payment, a credit card sales draft generated by a telemarketing transaction that is not the result of a telemarketing credit card transaction between the cardholder and the merchant;

(2) Any person to employ, solicit, or otherwise cause a merchant, or an employee, representative, or agent of the merchant, to present to or deposit into the credit card system for payment, a credit card sales draft generated by a telemarketing transaction that is not the result of a telemarketing credit card transaction between the cardholder and the merchant; or

(3) Any person to obtain access to the credit card system through the use of a business relationship or an affiliation with a merchant, when such access is not authorized by the merchant agreement or the applicable credit card system.

(d) *Prohibited deceptive acts or practices in the solicitation of charitable contributions.* It is a fraudulent charitable solicitation, a deceptive telemarketing act or practice, and a violation of this Rule for any telemarketer soliciting charitable contributions to misrepresent, directly or by implication, any of the following material information:

[5] For purposes of this Rule, the term "signature" shall include an electronic or digital form of signature, to the extent that such form of signature is recognized as a valid signature under applicable federal law or state contract law.

(1) The nature, purpose, or mission of any entity on behalf of which a charitable contribution is being requested;

(2) That any charitable contribution is tax deductible in whole or in part;

(3) The purpose for which any charitable contribution will be used;

(4) The percentage or amount of any charitable contribution that will go to a charitable organization or to any particular charitable program;

(5) Any material aspect of a prize promotion including, but not limited to: the odds of being able to receive a prize; the nature or value of a prize; or that a charitable contribution is required to win a prize or to participate in a prize promotion; or

(6) A charitable organization's or telemarketer's affiliation with, or endorsement or sponsorship by, any person or government entity.

§310.4 Abusive telemarketing acts or practices.

(a) *Abusive conduct generally.* It is an abusive telemarketing act or practice and a violation of this Rule for any seller or telemarketer to engage in the following conduct:

(1) Threats, intimidation, or the use of profane or obscene language;

(2) Requesting or receiving payment of any fee or consideration for goods or services represented to remove derogatory information from, or improve, a person's credit history, credit record, or credit rating until:

(i) The time frame in which the seller has represented all of the goods or services will be provided to that person has expired; and

(ii) The seller has provided the person with documentation in the form of a consumer report from a consumer reporting agency demonstrating that the promised results have been achieved, such report having been issued more than six months after the results were achieved. Nothing in this Rule should be construed to affect the requirement in the Fair Credit Reporting Act, 15 U.S.C. 1681, that a consumer report may only be obtained for a specified permissible purpose;

(3) Requesting or receiving payment of any fee or consideration from a person for goods or services represented to recover or otherwise assist in the return of money or any other item of value paid for by, or promised to, that person in a previous telemarketing transaction, until seven (7) business days after such money or other item is delivered to that person. This provision shall not apply to goods or services provided to a person by a licensed attorney;

(4) Requesting or receiving payment of any fee or consideration in advance of obtaining a loan or other extension of credit when the seller or telemarketer has guaranteed or represented a high likelihood of success in obtaining or arranging a loan or other extension of credit for a person;

(5) Disclosing or receiving, for consideration, unencrypted consumer account numbers for use in telemarketing; *provided,* however, that this paragraph shall not apply to the disclosure or receipt of a customer's or donor's billing information to process a payment for goods or services or a charitable contribution pursuant to a transaction;

(6) Causing billing information to be submitted for payment, directly or indirectly, without the express informed consent of the customer or donor. In any telemarketing transaction, the seller or telemarketer must obtain the express informed consent of the customer or donor to be charged for the goods or services or charitable contribution and to be charged using the identified account. In any telemarketing transaction involving preacquired account information, the requirements in paragraphs (a)(6)(i) through (ii) of this section must be met to evidence express informed consent.

(i) In any telemarketing transaction involving preacquired account information and a free-to-pay conversion feature, the seller or telemarketer must:

(A) obtain from the customer, at a minimum, the last four (4) digits of the account number to be charged;

(B) obtain from the customer his or her express agreement to be charged for the goods or services and to be charged using the account number pursuant to paragraph (a)(6)(i)(A) of this section; and,

(C) make and maintain an audio recording of the entire telemarketing transaction.

(ii) In any other telemarketing transaction involving preacquired account information not described in paragraph (a)(6)(i) of this section, the seller or telemarketer must:

(A) at a minimum, identify the account to be charged with sufficient specificity for the customer or donor to understand what account will be charged; and

(B) obtain from the customer or donor his or her express agreement to be charged for the goods or services and to be charged using the account number identified pursuant to paragraph (a)(6)(ii)(A) of this section; or

(7) Failing to transmit or cause to be transmitted the telephone number, and, when made available by the telemarketer's carrier, the name of the telemarketer, to any caller identification service in use by a recipient of a telemarketing call; *provided* that it shall not be a violation to substitute (for the name and phone number used in, or billed for, making the call) the name of the seller or charitable organization on behalf of which a telemarketing call is placed, and the seller's or charitable organization's customer or donor service telephone number, which is answered during regular business hours.

(b) *Pattern of calls.* (1) It is an abusive telemarketing act or practice and a violation of this Rule for a telemarketer to engage in, or for a seller to cause a telemarketer to engage in, the following conduct:

(i) Causing any telephone to ring, or engaging any person in telephone conversation, repeatedly or continuously with intent to annoy, abuse, or harass any person at the called number;

(ii) Denying or interfering in any way, directly or indirectly, with a person's right to be placed on any registry of names and/or telephone numbers of persons who do not wish to receive outbound telephone calls established to comply with §310.4(b)(1)(iii);

(iii) Initiating any outbound telephone call to a person when:

(A) that person previously has stated that he or she does not wish to receive an outbound telephone call made by or on behalf of the seller whose goods or services are being offered or made on behalf of the charitable organization for which a charitable contribution is being solicited; or

(B) that person's telephone number is on the "do-not-call" registry, maintained by the Commission, of persons who do not wish to receive outbound telephone calls to induce the purchase of goods or services unless the seller

(*i*) has obtained the express agreement, in writing, of such person to place calls to that person. Such written agreement shall clearly evidence such person's authorization that calls made by or on behalf of a specific party may be placed to that person, and shall include the telephone number to which the calls may be placed and the signature[6] of that person; or

(*ii*) has an established business relationship with such person, and that person has not stated that he or she does not wish to receive outbound telephone calls under paragraph (b)(1)(iii)(A) of this section; or

(iv) Abandoning any outbound telephone call. An outbound telephone call is "abandoned" under this section if a person answers it and the telemarketer does not connect the call to a sales representative within two (2) seconds of the person's completed greeting.

(2) It is an abusive telemarketing act or practice and a violation of this Rule for any person to sell, rent, lease, purchase, or use any list established to comply with §310.4(b)(1)(iii)(A), or maintained by the Commission pursuant to §310.4(b)(1)(iii)(B), for any purpose except compliance with the provisions of this Rule or otherwise to prevent telephone calls to telephone numbers on such lists.

(3) A seller or telemarketer will not be liable for violating §310.4(b)(1)(ii) and (iii) if it can demonstrate that, as part of the seller's or telemarketer's routine business practice:

(i) It has established and implemented written procedures to comply with §310.4(b)(1)(ii) and (iii);

(ii) It has trained its personnel, and any entity assisting in its compliance,

[6] For purposes of this Rule, the term "signature" shall include an electronic or digital form of signature, to the extent that such form of signature is recognized as a valid signature under applicable federal law or state contract law.

in the procedures established pursuant to §310.4(b)(3)(i);

(iii) The seller, or a telemarketer or another person acting on behalf of the seller or charitable organization, has maintained and recorded a list of telephone numbers the seller or charitable organization may not contact, in compliance with §310.4(b)(1)(iii)(A);

(iv) The seller or a telemarketer uses a process to prevent telemarketing to any telephone number on any list established pursuant to §§310.4(b)(3)(iii) or 310.4(b)(1)(iii)(B), employing a version of the "do-not-call" registry obtained from the Commission no more than three (3) months prior to the date any call is made, and maintains records documenting this process;

(v) The seller or a telemarketer or another person acting on behalf of the seller or charitable organization, monitors and enforces compliance with the procedures established pursuant to §310.4(b)(3)(i); and

(vi) Any subsequent call otherwise violating §310.4(b)(1)(ii) or (iii) is the result of error.

(4) A seller or telemarketer will not be liable for violating 310.4(b)(1)(iv) if:

(i) the seller or telemarketer employs technology that ensures abandonment of no more than three (3) percent of all calls answered by a person, measured per day per calling campaign;

(ii) the seller or telemarketer, for each telemarketing call placed, allows the telephone to ring for at least fifteen (15) seconds or four (4) rings before disconnecting an unanswered call;

(iii) whenever a sales representative is not available to speak with the person answering the call within two (2) seconds after the person's completed greeting, the seller or telemarketer promptly plays a recorded message that states the name and telephone number of the seller on whose behalf the call was placed[7]; and

(iv) the seller or telemarketer, in accordance with §310.5(b)-(d), retains records establishing compliance with §310.4(b)(4)(i)-(iii).

[7] This provision does not affect any seller's or telemarketer's obligation to comply with relevant state and federal laws, including but not limited to the TCPA, 47 U.S.C. 227, and 47 CFR part 64.1200.

(c) *Calling time restrictions.* Without the prior consent of a person, it is an abusive telemarketing act or practice and a violation of this Rule for a telemarketer to engage in outbound telephone calls to a person's residence at any time other than between 8:00 a.m. and 9:00 p.m. local time at the called person's location.

(d) *Required oral disclosures in the sale of goods or services.* It is an abusive telemarketing act or practice and a violation of this Rule for a telemarketer in an outbound telephone call or internal or external upsell to induce the purchase of goods or services to fail to disclose truthfully, promptly, and in a clear and conspicuous manner to the person receiving the call, the following information:

(1) The identity of the seller;

(2) That the purpose of the call is to sell goods or services;

(3) The nature of the goods or services; and

(4) That no purchase or payment is necessary to be able to win a prize or participate in a prize promotion if a prize promotion is offered and that any purchase or payment will not increase the person's chances of winning. This disclosure must be made before or in conjunction with the description of the prize to the person called. If requested by that person, the telemarketer must disclose the no-purchase/no-payment entry method for the prize promotion; *provided,* however, that, in any internal upsell for the sale of goods or services, the seller or telemarketer must provide the disclosures listed in this section only to the extent that the information in the upsell differs from the disclosures provided in the initial telemarketing transaction.

(e) *Required oral disclosures in charitable solicitations.* It is an abusive telemarketing act or practice and a violation of this Rule for a telemarketer, in an outbound telephone call to induce a charitable contribution, to fail to disclose truthfully, promptly, and in a clear and conspicuous manner to the person receiving the call, the following information:

(1) The identity of the charitable organization on behalf of which the request is being made; and

(2) That the purpose of the call is to solicit a charitable contribution.

§ 310.5 Recordkeeping requirements.

(a) Any seller or telemarketer shall keep, for a period of 24 months from the date the record is produced, the following records relating to its telemarketing activities:

(1) All substantially different advertising, brochures, telemarketing scripts, and promotional materials;

(2) The name and last known address of each prize recipient and the prize awarded for prizes that are represented, directly or by implication, to have a value of $25.00 or more;

(3) The name and last known address of each customer, the goods or services purchased, the date such goods or services were shipped or provided, and the amount paid by the customer for the goods or services;[8]

(4) The name, any fictitious name used, the last known home address and telephone number, and the job title(s) for all current and former employees directly involved in telephone sales or solicitations; *provided*, however, that if the seller or telemarketer permits fictitious names to be used by employees, each fictitious name must be traceable to only one specific employee; and

(5) All verifiable authorizations or records of express informed consent or express agreement required to be provided or received under this Rule.

(b) A seller or telemarketer may keep the records required by § 310.5(a) in any form, and in the same manner, format, or place as they keep such records in the ordinary course of business. Failure to keep all records required by § 310.5(a) shall be a violation of this Rule.

(c) The seller and the telemarketer calling on behalf of the seller may, by written agreement, allocate responsibility between themselves for the recordkeeping required by this Section. When a seller and telemarketer have entered into such an agreement, the terms of that agreement shall govern, and the seller or telemarketer, as the case may be, need not keep records that duplicate those of the other. If the agreement is unclear as to who must maintain any required record(s), or if no such agreement exists, the seller shall be responsible for complying with §§ 310.5(a)(1)-(3) and (5); the telemarketer shall be responsible for complying with § 310.5(a)(4).

(d) In the event of any dissolution or termination of the seller's or telemarketer's business, the principal of that seller or telemarketer shall maintain all records as required under this Section. In the event of any sale, assignment, or other change in ownership of the seller's or telemarketer's business, the successor business shall maintain all records required under this Section.

§ 310.6 Exemptions.

(a) Solicitations to induce charitable contributions via outbound telephone calls are not covered by § 310.4(b)(1)(iii)(B) of this Rule.

(b) The following acts or practices are exempt from this Rule:

(1) The sale of pay-per-call services subject to the Commission's Rule entitled "Trade Regulation Rule Pursuant to the Telephone Disclosure and Dispute Resolution Act of 1992," 16 CFR Part 308, *provided*, however, that this exemption does not apply to the requirements of §§ 310.4(a)(1), (a)(7), (b), and (c);

(2) The sale of franchises subject to the Commission's Rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures," ("Franchise Rule") 16 CFR Part 436, *provided*, however, that this exemption does not apply to the requirements of §§ 310.4(a)(1), (a)(7), (b), and (c);

(3) Telephone calls in which the sale of goods or services or charitable solicitation is not completed, and payment or authorization of payment is not required, until after a face-to-face sales or donation presentation by the seller or charitable organization, *provided*, however, that this exemption does not apply to the requirements of §§ 310.4(a)(1), (a)(7), (b), and (c);

[8] For offers of consumer credit products subject to the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, and Regulation Z, 12 CFR 226, compliance with the recordkeeping requirements under the Truth in Lending Act, and Regulation Z, shall constitute compliance with § 310.5(a)(3) of this Rule.

(4) Telephone calls initiated by a customer or donor that are not the result of any solicitation by a seller, charitable organization, or telemarketer, *provided*, however, that this exemption does not apply to any instances of upselling included in such telephone calls;

(5) Telephone calls initiated by a customer or donor in response to an advertisement through any medium, other than direct mail solicitation, *provided*, however, that this exemption does not apply to calls initiated by a customer or donor in response to an advertisement relating to investment opportunities, business opportunities other than business arrangements covered by the Franchise Rule, or advertisements involving goods or services described in §§310.3(a)(1)(vi) or 310.4(a)(2)-(4); or to any instances of upselling included in such telephone calls;

(6) Telephone calls initiated by a customer or donor in response to a direct mail solicitation, including solicitations via the U.S. Postal Service, facsimile transmission, electronic mail, and other similar methods of delivery in which a solicitation is directed to specific address(es) or person(s), that clearly, conspicuously, and truthfully discloses all material information listed in §310.3(a)(1) of this Rule, for any goods or services offered in the direct mail solicitation, and that contains no material misrepresentation regarding any item contained in §310.3(d) of this Rule for any requested charitable contribution; *provided*, however, that this exemption does not apply to calls initiated by a customer in response to a direct mail solicitation relating to prize promotions, investment opportunities, business opportunities other than business arrangements covered by the Franchise Rule, or goods or services described in §§310.3(a)(1)(vi) or 310.4(a)(2)-(4); or to any instances of upselling included in such telephone calls; and

(7) Telephone calls between a telemarketer and any business, except calls to induce the retail sale of nondurable office or cleaning supplies; *provided*, however, that §310.4(b)(1)(iii)(B) and §310.5 of this Rule shall not apply to sellers or telemarketers of nondurable office or cleaning supplies.

§310.7 Actions by states and private persons.

(a) Any attorney general or other officer of a state authorized by the state to bring an action under the Telemarketing and Consumer Fraud and Abuse Prevention Act, and any private person who brings an action under that Act, shall serve written notice of its action on the Commission, if feasible, prior to its initiating an action under this Rule. The notice shall be sent to the Office of the Director, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580, and shall include a copy of the state's or private person's complaint and any other pleadings to be filed with the court. If prior notice is not feasible, the state or private person shall serve the Commission with the required notice immediately upon instituting its action.

(b) Nothing contained in this Section shall prohibit any attorney general or other authorized state official from proceeding in state court on the basis of an alleged violation of any civil or criminal statute of such state.

§310.8 Fee for access to the National Do Not Call Registry.

(a) It is a violation of this Rule for any seller to initiate, or cause any telemarketer to initiate, an outbound telephone call to any person whose telephone number is within a given area code unless such seller, either directly or through another person, first has paid the annual fee, required by §310.8(c), for access to telephone numbers within that area code that are included in the National Do Not Call Registry maintained by the Commission under §310.4(b)(1)(iii)(B); *provided*, however, that such payment is not necessary if the seller initiates, or causes a telemarketer to initiate, calls solely to persons pursuant to §§310.4(b)(1)(iii)(B)(*i*) or (*ii*), and the seller does not access the National Do Not Call Registry for any other purpose.

(b) It is a violation of this Rule for any telemarketer, on behalf of any seller, to initiate an outbound telephone call to any person whose telephone number is within a given area code unless that seller, either directly or

through another person, first has paid the annual fee, required by § 310.8(c), for access to the telephone numbers within that area code that are included in the National Do Not Call Registry; *provided*, however, that such payment is not necessary if the seller initiates, or causes a telemarketer to initiate, calls solely to persons pursuant to §§ 310.4(b)(1)(iii)(B)(*i*) or (*ii*), and the seller does not access the National Do Not Call Registry for any other purpose.

(c) The annual fee, which must be paid by any person prior to obtaining access to the National Do Not Call Registry, is $25 per area code of data accessed, up to a maximum of $7,375; *provided*, however, that there shall be no charge for the first five area codes of data accessed by any person, and *provided further*, that there shall be no charge to any person engaging in or causing others to engage in outbound telephone calls to consumers and who is accessing the National Do Not Call Registry without being required under this Rule, 47 CFR 64.1200, or any other federal law. Any person accessing the National Do Not Call Registry may not participate in any arrangement to share the cost of accessing the registry, including any arrangement with any telemarketer or service provider to divide the costs to access the registry among various clients of that telemarketer or service provider.

(d) After a person, either directly or through another person, pays the fees set forth in § 310.8(c), the person will be provided a unique account number which will allow that person to access the registry data for the selected area codes at any time for twelve months following the first day of the month in which the person paid the fee ("the annual period"). To obtain access to additional area codes of data during the first six months of the annual period, the person must first pay $25 for each additional area code of data not initially selected. To obtain access to additional area codes of data during the second six months of the annual period, the person must first pay $15 for each additional area code of data not initially selected. The payment of the additional fee will permit the person to access the additional area codes of data for the remainder of the annual period.

(e) Access to the National Do Not Call Registry is limited to telemarketers, sellers, others engaged in or causing others to engage in telephone calls to consumers, service providers acting on behalf of such persons, and any government agency that has law enforcement authority. Prior to accessing the National Do Not Call Registry, a person must provide the identifying information required by the operator of the registry to collect the fee, and must certify, under penalty of law, that the person is accessing the registry solely to comply with the provisions of this Rule or to otherwise prevent telephone calls to telephone numbers on the registry. If the person is accessing the registry on behalf of sellers, that person also must identify each of the sellers on whose behalf it is accessing the registry, must provide each seller's unique account number for access to the national registry, and must certify, under penalty of law, that the sellers will be using the information gathered from the registry solely to comply with the provisions of this Rule or otherwise to prevent telephone calls to telephone numbers on the registry.

[68 FR 45144, July 31, 2003]

§ 310.9 Severability.

The provisions of this Rule are separate and severable from one another. If any provision is stayed or determined to be invalid, it is the Commission's intention that the remaining provisions shall continue in effect.

PART 311—TEST PROCEDURES AND LABELING STANDARDS FOR RECYCLED OIL

Sec.

311.1 Definitions.
311.2 Stayed or invalid parts.
311.3 Preemption.
311.4 Testing.
311.5 Labeling.
311.6 Prohibited acts.

AUTHORITY: 42 U.S.C. 6363(d).

SOURCE: 60 FR 55421, Oct. 31, 1995, unless otherwise noted.

V. KENTUCKY TELEMARKETING ACT

367.46951 Definitions for KRS 367.46951 to 367.46999.

As used in KRS 367.46951 to 367.46999 and 367.990, unless the context otherwise requires:

(1) "Telephone solicitation" means:

(a) A live or recorded communication sent by a telephone or message sent by a facsimile machine to a residential, mobile, or telephone paging device telephone number, including a call made by an automatic dialing or recorded message device, for the purpose of:

1. Soliciting a sale of consumer goods or services, offering an investment, business, or employment opportunity, or offering a consumer loan to the person called;
2. Obtaining information that will or may be used for the solicitation of a sale of consumer goods or services, the offering of an investment, business, or employment opportunity, or the offering of a consumer loan to the person called;
3. Offering the person called a prize, gift, or anything else of value, if payment of money or other consideration is required in order to receive the prize or gift, including the purchase of other merchandise or services or the payment of any processing fees, delivery charges, shipping and handling fees, or other fees or charges; or
4. Offering the person called a prize, gift, or other incentive to attend a sales presentation for consumer goods or services, an investment or business opportunity, or a consumer loan; or

(b) A live or recorded communication sent by telephone, facsimile machine, mobile telephone, or telephone paging device in response to inquiries generated by unrequested notifications sent by the merchant to persons who have not previously purchased goods or services from the merchant or telemarketer or who have not previously requested credit from the merchant, to a prospective purchaser if the merchant or telemarketer represents or implies to the recipient of the notification that any of the following applies:

1. That the recipient has in any manner been specially selected to receive the notification or the offer contained in the notification;
2. That the recipient will receive a prize or gift if the recipient calls the merchant or telemarketer; or
3. That if the recipient buys one (1) or more items from the merchant or telemarketer, the recipient will also receive additional or other items of the same or a different type at no additional cost or for less than the regular price of the items;

(2) "Telephone solicitation" does not mean the following:

(a) A telephone call made in response to an express request of a person called, unless the request was made during a prior telephone solicitation;

(b) A telephone call made to the debtor or a party to the contract in connection with the payment or performance of an existing debt or contract, the payment or performance of which has not been completed at the time of the call;

(c) A telephone call to any person with whom the telemarketer or merchant has a prior or existing business relationship, including but not limited to the solicitation of contracts for the maintenance or repair of items previously purchased from the person making the solicitation or on whose behalf the solicitation is made;

(d) A telephone call made by the following:

1. A merchant or telemarketer located in Kentucky to a location outside of the Commonwealth of Kentucky;

2. A telephone call made by one (1) merchant to another;

(3) "Consumer goods or services" means goods, services, or interests in real property used by natural persons primarily for personal, family, or household purposes;

(4) "Consumer loan" means any extension of credit, including credit cards and other forms of revolving credit, to a natural person primarily for the purposes of purchasing consumer goods or services or for paying existing personal, family, or household debts;

(5) "Consumer" means a natural person who receives a telephone solicitation;

(6) "Legal name of the merchant" means the real name of the merchant, as defined in KRS 365.015(1), or the assumed name of the merchant for which all proper certificates have been filed pursuant to KRS 365.015;

(7) "Merchant" means the individual or business entity offering the consumer goods or services, an investment, business, or employment opportunity, or a consumer loan;

(8) "Caller" or "sales person" means the individual making the call or operating the automatic dialing or recorded message device and causing the call to be made;

(9) "Division" means the Consumer Protection Division of the Office of the Attorney General;

(10) "Automated calling equipment" means any device or combination of devices used to select or dial telephone numbers and to deliver recorded messages to those numbers without the use of a live operator;

(11) "Telemarketer" means any person who under contract with a merchant or in connection with a telephone solicitation initiates or receives telephone calls to or from a consumer of goods and services. A telemarketer includes but is not limited to any such person that is an owner, operator, officer, director, or partner to the management activities of a business;

(12) "Publicly traded corporation" means an issuer or subsidiary of an issuer that has a class of securities which is:

(a) Subject to Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. sec. 78l) and which is registered or exempt from registration under paragraph (A), (B), (C), (E), (F), (G), or (H) of subsection (g)(2) of that section;

(b) Listed on the New York Stock Exchange, the American Stock Exchange, or the NASDAQ National Market System; or

(c) A reported security within the meaning of subparagraph (4) of Regulation Section 240.11Aa3-1.(a) under the Securities Exchange Act of 1934. A subsidiary of an issuer that qualifies for exemption under this paragraph shall not itself be exempt unless at least sixty percent (60%) of the voting power of its shares is owned by the qualifying issuer;

(13) "Telemarketing company" means a company whose primary business is to engage in telephone solicitation; and

(14) "Zero call" list means a list containing the telephone numbers of the individuals that indicate their preference not to receive telephone solicitations.

Effective: July 15, 2002

History: Amended 2002 Ky. Acts ch. 21, sec. 1, effective July 15, 2002. -- Amended 1998 Ky. Acts ch. 426, sec. 573, effective July 15, 1998; and ch. 581, sec. 1, effective July 15, 1998. -- Created 1994 Ky. Acts ch. 302, sec. 1, effective July 15, 1994; and ch. 463, sec. 1, effective July 15, 1994.

Legislative Research Commission (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46953 Requirements for making telephone solicitation.

A caller making a telephone solicitation shall:

(1) Immediately upon making contact by telephone with the consumer, state his actual name, the merchant's legal name, a telephone number or address at which the merchant may be contacted, and the town or city and state where the caller is physically located;

(2) Within the first thirty (30) seconds of the call, identify the goods, services, interest in real estate, investment or business opportunity, or type of credit being offered and inquire whether the consumer is interested in listening to a sales presentation; and

(3) Immediately discontinue the solicitation if the consumer responds in the negative.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 302, sec. 2, effective July 15, 1994; and ch. 463, sec. 2, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46955 Prohibited telephone solicitation acts and practices.

It is a prohibited telephone solicitation act or practice and a violation of KRS 367.46951 to 367.46999 for any person making a telephone solicitation to engage in the following conduct:

(1) Advertising or representing that registration as a telemarketer equals an endorsement or approval by any government or governmental agency;

(2) Requesting a fee in advance to remove derogatory information from or improve a person's credit history or credit record;

(3) Requesting or receiving a payment in advance from a person to recover or otherwise aid in the return of money or any other item lost by the consumer in a prior telephone solicitation transaction;

(4) Requesting or receiving payment of any fee or consideration in advance of obtaining a loan or other extension of credit when the telemarketing company has guaranteed or represented a high likelihood of success in obtaining or arranging a loan or other extension of credit for a person;

(5) Obtaining or submitting for payment a check, draft, or other form of negotiable paper drawn on a person's checking, savings, or bond or other account without the consumer's express written authorization, or charging a credit card account or making electronic transfer of funds except in conformity with KRS 367.46963;

(6) Procuring the services of any professional delivery, courier, or other pickup service to obtain immediate receipt or possession of a consumer's payment, unless the goods are delivered with the opportunity to inspect before any payment is collected;

(7) Assisting, supporting, or providing substantial assistance to any telemarketer when the telemarketing company knew or should have known that the telemarketer was engaged in any act or practice prohibited under this section;

(8) Making a telephone solicitation to anyone under eighteen (18) years of age. When making a telephone solicitation the telemarketer shall inquire as to whether the person is eighteen (18) years of age or older and the answer shall be presumed to be correct;

(9) Utilizing any method to block or otherwise circumvent the use of a caller identification service when placing an unsolicited telephone solicitation call;

(10) Directing or permitting employees to use a fictitious name or not to use their name while making a telephone solicitation;

(11) Threatening, intimidating, or using profane or obscene language;

(12) Causing the telephone to ring more than thirty (30) seconds in an intended telephone solicitation;

(13) Engaging any person repeatedly or continuously with behavior a reasonable person would deem to be annoying, abusive, or harassing;

(14) Initiating a telephone solicitation call to a person, when that person has stated previously that he or she does not wish to receive solicitation calls from that seller;

(15) (a) Making or causing to be made an unsolicited telephone solicitation call if the residential number for that telephone appears in the current publication of the

zero call list maintained by the Office of the Attorney General, Division of Consumer Protection. Any holder of a residential telephone number may notify the division and be placed on a zero call list indicating the wish not to receive unsolicited telephone solicitation calls by notification to the division. The telephone numbers of persons requesting to be on the zero call list shall remain on the list until the person rescinds his or her name from the list.

(b) The zero call list shall be updated, published, and distributed on a quarterly basis in electronic and hard copy and may be made available in other formats at the discretion of the division. After the publication of the list each quarter each telemarketing company, telemarketer, and merchant shall be deemed to be on notice not to solicit any person whose telephone number appears on the list. The list shall be made available to requesters either on a statewide or county by county basis;

(16) Making telephone solicitations to a person's residence at any time other than between 10 a.m. - 9 p.m. local time, at the called person's location;

(17) Selling or making available for economic gain any information revealed during a telephone solicitation without the express written consent of the consumer;

(18) Making a telephone solicitation to any residential telephone using an artificial or prerecorded voice to deliver a message, unless the call is initiated for emergency purposes by schools regulated by the Kentucky Department of Education or the call is made with the prior express consent of the called party; or

(19) Engaging in any unfair, false, misleading, or deceptive practice or act as part of a telephone solicitation.

Effective: July 15, 2002

History: Amended 2002 Ky. Acts ch. 21, sec. 2, effective July 15, 2002. -- Created 1998 Ky. Acts ch. 581, sec. 3, effective July 15, 1998.

Legislative Research Commission Note (07/15/2002). Under the authority of KRS 7.136, the Reviser of Statutes has corrected a clearly erroneous statutory reference in subsection (5) of this section as enacted in 2002 Ky. Acts ch. 21, sec. 2, by changing "KRS 367.46953" to "KRS 367.46963."

367.46957 Contract or agreement voidable by consumer if resulting from nonconforming telephone solicitation.

A contract or agreement made as a result of a telephone solicitation violating KRS 367.46951 to 367.46999 is voidable by the consumer for any reason at any time and shall not be enforced against the consumer.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 302, sec. 3, effective July 15, 1994; and ch. 463, sec. 3, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46961 Cancellation of contract not reduced to writing -- Exception.

(1) Unless the contract is reduced to writing in compliance with subsection (4) of this section, a consumer may cancel a contract made as a result of a telephone solicitation and obtain a full refund of all money paid, by returning the goods, if any, undamaged and unused, or canceling services within the later of:

(a) Fourteen (14) calendar days following receipt of the goods; or

(b) Fourteen (14) calendar days following receipt of two (2) copies of a written notice of cancellation rights containing the following language in no less than ten (10) point, bold-faced type:

NOTICE OF CANCELLATION RIGHTS

BECAUSE YOU AGREED TO BUY THESE GOODS (or services or other appropriate description) AS A RESULT OF AN UNSOLICITED TELEPHONE CALL, KENTUCKY LAW GIVES YOU FOURTEEN (14) DAYS TO CANCEL YOUR AGREEMENT WITH US. IF YOU WANT TO CANCEL, YOU MUST SIGN YOUR NAME BELOW AND RETURN A COPY OF THIS NOTICE, TOGETHER WITH ANY GOODS YOU HAVE RECEIVED, SO THEY ARE POSTMARKED NO LATER THAN MIDNIGHT OF THE FOURTEENTH DAY FOLLOWING THE DATE YOU RECEIVED THE GOODS OR AGREED TO THE SERVICES, OR THE FOURTEENTH DAY FOLLOWING THE DATE YOU RECEIVED THIS NOTICE, WHICHEVER IS LATER. THE NOTICE AND GOODS MUST BE ADDRESSED AS FOLLOWS:

(Name and address of Merchant)

I want to cancel my agreement to purchase.

_____

(Signature)

_____

(Name of Consumer - Printed)

_____

(Address of Consumer - Printed)

_____

(Address - City, State, Zip)

_____

(Date)

(2) The consumer shall be deemed to have complied with subsection (1) of this section if the cancellation notice and goods, if any, are returned to the merchant and are postmarked by midnight of the fourteenth day.

(3) The merchant shall process the refund due any consumer within thirty (30) days of receiving the merchandise returned by the consumer or the written cancellation provided in subsection (1) of this section.

(4) The cancellation period provided in subsection (1) of this section shall not apply to a written contract signed by the consumer that:

(a) Complies with all applicable federal and state laws and regulations:

(b) Contains a description of the goods, services, investment or business opportunity, extension of credit, or interest in realty matching the description used in the telephone solicitation;

(c) Contains the name, address, and telephone number of the merchant, the total price of the contract, including any finance or interest charges, and a detailed description of the goods, services, credit, or interest in realty being offered;

(d) Contains all oral or written representations made to the consumer in connection with the transaction; and

(e) Sets out in at least ten (10) point, bold-face type, immediately preceding the signature, the following statement:

YOU ARE NOT OBLIGATED TO PAY ANY
MONEY UNLESS YOU SIGN THIS CONTRACT
AND RETURN IT TO THE MERCHANT.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 302, sec. 4, effective July 15, 1994; and ch. 463, sec. 4, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46963 Requirements to be met before accepting payment from or charging consumer.

No caller or merchant making or causing to be made a telephone solicitation shall request or accept payment from a consumer or make or submit any charge to the consumer's credit or bank account until either:

(1) The merchant receives from the consumer a signed copy of a written contract complying with KRS 367.46961(4); or

(2) The cancellation period provided in KRS 367.46961(1) has expired, and the consumer has not exercised his right to cancel.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 302, sec. 5, effective July 15, 1994; and ch. 463, sec. 5, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46967 Violation as unfair or deceptive trade practice -- Powers of Attorney General.

(1) A violation by a telemarketing company, telemarketer, caller, or merchant of KRS 367.46951 to 367.46999 shall constitute an unfair, false, misleading, or deceptive act or practice in the conduct of trade or commerce in violation of KRS 367.170.

(2) All of the remedies, powers, and duties provided for the Attorney General by KRS 367.190 to 367.300 and the penalties provided in KRS 367.990, relating to acts and practices violating KRS 367.170 shall apply with equal force and effect to acts and practices declared unlawful by KRS 367.46951 to 367.46999.

(3) Nothing in KRS 367.46951 to 367.46999 shall be construed to limit or restrict the exercise of powers or the performance of the duties of the Attorney General authorized under any other provision of law.

Effective: July 15, 2002

History: Amended 2002 Ky. Acts ch. 21, sec. 7, effective July 15, 2002. -- Created 1994 Ky. Acts ch. 302, sec. 6, effective July 15, 1994; and ch. 463, sec. 6, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46971 Registration of telemarketing companies doing business in this state -- Filing fee -- Renewal -- Addendum -- Written confirmation of receipt of filing -- Posting of registration statement.

(1) At least ten (10) days prior to doing business in this state, a telemarketing company shall file with the division the information described below and pay a filing fee of three hundred dollars ($300). A telemarketing company shall be deemed to do business in this state if the telemarketing company solicits prospective purchasers from locations in this state or solicits prospective purchasers who are located in this state. The information required by this section shall be submitted on a form provided by the Attorney General and shall be verified by a declaration signed by each principal of the telemarketing company, under penalty of perjury. The declaration shall specify the date and location of signing. Information submitted pursuant to KRS 367.46951 to 367.46999 shall be clearly identified and appended to the filing.

(2) Registration of a telemarketing company shall be valid for one (1) year from the effective date thereof and may be renewed annually by making the filing required by this section and paying a filing fee of fifty dollars ($50).

(3) If, prior to expiration of a telemarketing company's annual registration, there is a material change in the information required by KRS 367.46951 to 367.46999, the telemarketing company shall, within ten (10) days, file an addendum updating the information with the division. However, changes in salespersons soliciting on behalf of a telemarketing company shall be updated by filing addenda, if necessary, in quarterly intervals computed from the effective date of registration. The addendum shall include the required information for all salespersons currently soliciting or having solicited on behalf of the telemarketing company at any time during the period between the filing of the registration, or the last addendum, and the current addendum, and shall include information on salespersons no longer soliciting for the telemarketing company as of the date of the filing of the current addendum.

(4) Upon receiving the filing and the filing fee pursuant to this section, the division shall send the telemarketing company a written confirmation of receipt of the filing. If the telemarketing company has more than one (1) business location, the written confirmation shall be sent to the telemarketing company's principal business location as identified in the telemarketing company's filing in sufficient numbers so that the telemarketing company can meet the requirements of this subsection. Within ten (10) days of receipt of the confirmation, the telemarketing company shall post in a conspicuous place at each of the telemarketing company's business locations within this state a copy of the entire registration statement which has been filed with the division. Until confirmation of receipt of filing is received and posted, the telemarketing company shall post in a conspicuous place at each of the telemarketing company's business locations within this state a copy of the first page of the registration form sent to the department. The telemarketing company shall also post in close proximity to either the confirmation of receipt of filing or the first page of the submitted registration form the name of the individual in charge of each location from which the telemarketing company does business in this state.

Effective: July 15, 2002

History: Amended 2002 Ky. Acts ch. 21, sec. 3, effective July 15, 2002. -- Created 1994 Ky. Acts ch. 302, sec. 7, effective July 15, 1994; and ch. 463, sec. 7, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46973 Contents of filing.

Each filing pursuant to KRS 367.46971 shall contain the following information:

(1) The name or names of the merchant, including the name under which the merchant is doing or intends to do business, if different from the name of the merchant, and the name of any parent or affiliated organization that will engage in business transactions with purchasers relating to sales solicited by the merchant, or that accepts responsibility for statements made by, or acts of, the merchant relating to sales solicited by the merchant;

(2) The merchant's business form and place of organization and, if the merchant is a corporation, a copy of its articles of incorporation and bylaws and amendments to those, or, if a partnership, a copy of the partnership agreement, or if operating under a fictitious business name, the location where the fictitious name has been registered, along with a copy of the registration documents. The same information shall be included for any parent or affiliated organization disclosed pursuant to subsection (1) of this section;

(3) The complete street address of all locations designating the principal location from which the merchant will be conducting business. If the principal business location of the merchant is not in this state, then the merchant shall also designate which of its locations within this state is its main location;

(4) A listing of all telephone numbers to be used by the merchant and the address where each telephone using each of these telephone numbers is located;

(5) The name of and the office held by the merchant's officers, directors, trustees, general and limited partners, sole proprietor, and owners and the names of persons having management responsibilities in the merchant's business activities;

(6) The principal residence, the date of birth, and the driver's license number and state of issuance of each person named pursuant to subsection (5) of this section;

(7) The name and principal residence of each person the merchant leaves in charge at each location in which the merchant does business in this state, and the business location at which each of these persons is in charge;

(8) A statement, meeting the requirements of this subsection, as to both the merchant, whether a corporation, partnership, firm, association, joint venture, or any other type of business entity and as to any person identified pursuant to subsection (5) or (7) of this section who:

   (a) Has been convicted of a felony or a misdemeanor involving a violation of this article, or fraud, theft, embezzlement, fraudulent conversion, or misappropriation of property. For purposes of this paragraph, a plea of nolo contendere shall be considered a conviction;

   (b) Has had entered against him a final judgment or order in a civil or administrative action, including a stipulated judgment or order, if the complaint or petition in the civil or administrative action alleged acts constituting a violation of KRS 367.46951 to 367.46999, fraud, theft, embezzlement, fraudulent conversion, or misappropriation of property, the use of untrue or

misleading representations in an attempt to sell or dispose of real or personal property, or the use of unfair, unlawful, or deceptive business practices;

(c) Is subject to an injunction or restrictive court order relating to business activity as the result of an action brought by a federal, state, or local public agency or unit of that agency, including, but not limited to, an action affecting any vocational license; or

(d) Has during the previous seven (7) tax years filed in bankruptcy, been adjudged a bankrupt, been reorganized due to insolvency, or been a principal, director, officer, trustee, general or limited partner, or had management responsibilities of any other corporation, partnership, joint venture, or business entity that has so filed or was so adjudicated or reorganized, during or within one (1) year after the period that the person held that position.

The statement required by paragraphs (a), (b), and (c) of this subsection shall identify the merchant or person, the court or administrative agency rendering the conviction, judgment, or order, the docket number of the matter, the date of the conviction, judgment, or order, and the name of the governmental agency, if any, that brought the action resulting in the conviction, judgment, or order. For purposes of paragraph (d) of this section, the statement required shall include the name and location of the merchant or person filing in bankruptcy, adjudged a bankrupt, or reorganized due to insolvency, and shall include the date thereof, the court which exercised jurisdiction, and the docket number of the matter;

(9) A list of the names, driver's license numbers and states of issuance, principal residence addresses, and telephone numbers of salespersons who solicit on behalf of the merchant, and any names the salesperson uses while soliciting;

(10) A description of the items the merchant is offering for sale and a copy of all sales scripts the merchant requires salespersons to use when soliciting prospective purchasers. If no sales script is required to be used, a statement to that effect shall be included;

(11) A copy of all sales information and literature including, but not limited to, scripts, outlines, instructions, and information regarding how to conduct telephonic sales, sample introductions, sample closings, product information, and contest or premium-award information provided by the merchant to salespersons or of which the merchant informs salespersons, and a copy of all written materials the merchant sends to any prospective or actual purchaser;

(12) (a) If the merchant represents or implies, or directs salespersons to represent or imply, to purchasers that the purchaser will receive certain specific items, including a certificate of any type which the purchaser must redeem to obtain the item described in the certificate, or one (1) or more items among designated items, whether the items are denominated as gifts, premiums, bonuses, prizes, or otherwise, the filing shall include the following:

1. A list of the items offered;

2. The actual value or worth of each item described to prospective purchasers and the basis for the valuation; and

3. The price paid by the merchant to its supplier for each of these items and the name, address, and telephone number of each item's supplier;

(b) If the purchaser is to receive fewer than all of the items described by the merchant, the filing shall include the following:

1. The manner in which the merchant decides which item each prospective purchaser is to receive;
2. The odds a single prospective purchaser has of receiving each described item;
3. The name and address of each recipient who has, during the preceding twelve (12) months, or if the merchant has not been in business that long, during the period the merchant has been in business, received the item having the greatest value and the item with the smallest odds of being received; and
4. All rules, regulations, terms, and conditions a prospective purchaser must meet in order to receive the item; and

(13) If the merchant is offering an investment, business, or employment opportunity, the filing shall include the following:

(a) The number of consumers or investors who have participated to date;

(b) The actual experience of the consumers or investors as measured by standards used in the sales presentations; and

(c) If the opportunity is so recent that no actual performance experience exists, that fact shall be disclosed in all sales presentations, and no other representation of performance shall be made in sales presentations.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 302, sec. 8, effective July 15, 1994; and ch. 463, sec. 8, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46977 Disclosure requirements for sale presentations.

(1) If the merchant or telemarketer represents or implies that the consumer will receive a prize, award, or similar item of value from a number of such prizes or awards, all sales presentations shall include the actual number of individuals who have received the item having the greatest value, a description of the item, the market value of the item, the number of prizes to be awarded, the conditions to receive the item, the odds of winning, the statement that no purchase is necessary to win the prize or to participate in the promotion, and the actual number of individuals who have received the item with the least value within the preceding twelve (12) months or since the merchant or telemarketer has been in business if less than twelve (12) months.

(2) If the merchant or telemarketer is offering real estate, an investment, business, or employment opportunity, the sales presentation shall include the following:

(a) The number of consumers or investors who have participated to date;

(b) The actual experience of the consumers or investors as measured by the standards used in the sales presentations; and

(c) The price of the real estate or investment;

(d) The location of the real estate or investment;

(e) Regarding an investment or business opportunity, the reasonable likelihood of success and a notice of the risk; and

(f) If the opportunity is so recent that no actual performance experience exists, that fact shall be disclosed in all sales presentations, and no other representation of performance shall be made in sales presentations.

(3) If the sales presentation includes representations of prices below those usually charged for items, the sales presentation shall include the name of the manufacturer, importer, or supplier of such items and the locations within the merchant's or telemarketer's calling state or this state at which the items are offered at usual prices. If the item has never been sold in the merchant's or telemarketer's calling state or this state no representation of usual selling price shall be made.

(4) If presenting information on merchandise or service, the total cost of the goods or services that are the subject of the call shall be given.

(5) If any restrictions, limitations, or conditions for the purchase or investment exist, these shall be disclosed during the telephone sales presentation.

(6) Terms for refunds, cancellation, exchange, or repurchase of the subject of the sales presentation shall be disclosed during the telephone sales presentation.

Effective: July 15, 1998

History: Amended 1998 Ky. Acts ch. 581, sec. 2, effective July 15, 1998. -- Created 1994 Ky. Acts ch. 302, sec. 9, effective July 15, 1994; and ch. 463, sec. 9, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46981 Bond required for telemarketing companies -- Notification to Attorney General of promotion offering premium.

(1) Every telemarketing company shall maintain a bond issued by a surety company admitted to do business in this state. The bond shall be in the amount of fifty thousand dollars ($50,000) in favor of the Attorney General for the benefit of any person suffering injury or loss by reason of any violation of KRS 367.46951 to 367.46999 to be paid under the terms of any order of a court of competent jurisdiction obtained by the Attorney General, as a result of any violation of KRS 367.46951 to 367.46999. A copy of the bond shall be filed with the division.

(2) At least ten (10) days prior to the inception of any promotion offering a premium with an actual market value or advertised value of five hundred dollars ($500) or more, the telemarketing company shall notify the Attorney General in writing of the details of the promotion, describing the premium and its current market value, the value at which it is advertised or held out to the customer, the date the premium shall be awarded, and the conditions under which the award shall be made. The telemarketing company shall maintain an additional bond for the greater of the current total market value or the advertised value of the premiums held out or advertised to be available to a purchaser or recipient. A copy of the bond shall be filed with the division. The bond, or a portion of it necessary to cover the cost of the award, shall be forfeited if the premium is not awarded to a bona fide customer within thirty (30) days of the date disclosed as the time of award or the time otherwise required by law. The proceeds of the bond shall be paid to any person suffering injury or loss by reason of any violation of KRS 367.46951 to 367.46999 or shall be paid pursuant to the terms of any order of a court of competent jurisdiction obtained by the Attorney General, Commonwealth's attorney, or county attorney as a result of any violation of KRS 367.46951 to 367.46999. The bond shall be maintained until the telemarketing company files with the Attorney General proof that the premium was awarded.

Effective: July 15, 2002

History: Amended 2002 Ky. Acts ch. 21, sec. 4, effective July 15, 2002. -- Created 1994 Ky. Acts ch. 302, sec. 10, effective July 15, 1994; and ch. 463, sec. 10, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46983 Authority for administrative regulations.

The Attorney General may promulgate administrative regulations necessary for the proper administration and enforcement of KRS 367.46951 to 367.46999.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 302, sec. 11, effective July 15, 1994; and ch. 463, sec. 11, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46987 Person using electronic equipment for solicitation deemed to have accepted Kentucky law.

Any merchant, caller, or other person who uses electronic equipment within this Commonwealth for purposes of telephone solicitation shall, as a condition of that use, be deemed to have accepted the provisions of KRS 367.46951 to 367.46999 and of KRS Chapter 526.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 302, sec. 12, effective July 15, 1994; and ch. 463, sec. 12, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

367.46993 Telemarketer prohibited from contacting credit card issuer to obtain account number -- Issuer prohibited from providing account number.

(1) A telemarketer shall not contact a credit card issuer, in writing or by telephone, facsimile, computer, or by any other means, for the purpose of obtaining a consumer's credit card account number.

(2) A credit card issuer shall not provide a consumer's credit card account number to a telemarketer.

Effective: July 15, 2002

History: Created 2002 Ky. Acts ch. 18, sec. 1, effective July 15, 2002.

367.46994 Zero call list -- Registration -- Administrative regulations -- Availability of information on list -- Consumer education pamphlet.

(1) Any person may apply to the Office of the Attorney General, Division of Consumer Protection, to have his or her residential telephone number listed on the zero call list. The Office of the Attorney General shall provide automated telephone dial-in registration and shall collect only the home phone number from the applicant deemed to be required to administer the zero call list. The Office of the Attorney General shall promulgate administrative regulations to:

(a) Provide for automatic telephone number referral from the incumbent local exchange carrier or the competitive local exchange carrier to the Office of the Attorney General for the purpose of updating the zero call list to reflect an applicant's change of address or an applicant's termination of telephone service; and

(b) Develop, modify, or administer the zero call list in such a way as to permit interface with any national registry established by the Federal Trade Commission or the Federal Communications Commission for the purpose of including in Kentucky's zero call list that part of the national database that relates to the Commonwealth or release to the national registry applicants on the zero call list that indicate a preference to be listed on a national registry.

(2) The Attorney General shall place the residential telephone number provided by the applicant on the list. The Attorney General may update the information on the list as provided in subsection (1) of this section, but shall not remove the information unless requested to do so in writing by the applicant, or upon receiving notice that the given telephone number is no longer held in the name of the applicant.

(3) Persons whose telephone numbers appear on the zero call list shall not receive telephone solicitations except in accordance with the provisions of KRS 367.46951 to 367.46999.

(4) Any person that applies to the Office of the Attorney General to be placed on the zero call list shall be informed about how to add his or her name or telephone number to company-specific and industry-wide no solicitation call lists, including those lists provided by the Direct Marketing Association (DMA) and the Telephone Preference Service (TPS).

(5) Information contained in a database established for the purpose of administering the zero call list shall be used only for the purpose of implementing the zero call program in conformance with KRS 367.46951 to 367.46999.

(6) The zero call list shall be available at no cost to any merchant or telemarketing company that is required to consult the list. In addition to the formats described in KRS 367.46955(15), the list shall be made available in a format for electronic download from the Internet Web page of the Office of the Attorney General. The Attorney General shall make the electronic list available in a format that is searchable by area code and by local exchange. The electronic format shall be arranged with the last four digits of the telephone numbers in ascending order. The electronic list shall also be searchable by individual number and shall be downloadable in at least five (5)

of the most common commercially available data management program formats. Hard copies of the zero call list shall be arranged by area code and local exchange with the last four digits in ascending order. The Office of the Attorney General shall develop procedures to assure that:

(a) The merchant or telemarketing company requesting the list shall maintain the confidentiality of the information on the list; and

(b) The merchant or telemarketing company shall use the list only for the purpose of preventing telephone solicitation calls to persons whose telephone numbers appear on the list.

(7) The Kentucky Public Service Commission shall produce a consumer education pamphlet that:

(a) Describes the changes made in the year 2002 to Kentucky's telemarketing laws including the creation of the zero call list;

(b) Describes the consumer's rights and responsibilities regarding the receipt of telephone solicitation;

(c) Explains how consumers can apply to be placed on the zero call list and on any federal do not call registry established by the Federal Communications Commission or the Federal Trade Commission;

(d) Explains how to apply to be placed on company-specific and industrywide no solicitation calls list, including those lists provided by the Direct Marketing Association (DMA) and the Telephone Preference Service (TPS); and

(e) Describes how a consumer can file a complaint if the consumer receives calls after being placed on the zero call list.

(8) At least once a year, the Public Service Commission shall require that the pamphlet be included in the billing inserts of the telephone companies under the Public Service Commission's jurisdiction.

Effective: July 15, 2002

History: Created 2002 Ky. Acts ch. 21, sec. 5, effective July 15, 2002.

367.46995 Claims alleging calls made to persons on zero call list -- Defenses.

(1) Any claim or action alleging the making of a call to a person on the zero call list in violation of KRS 367.46955 shall be in writing and verified by the claimant.

(2) In any action or claim alleging the making of a call to a person on the zero call list, it shall be a defense that the defendant obtains the current zero call list in a timely manner and makes reasonable efforts to avoid calling persons whose telephone numbers appear on the list.

(3) It shall be a defense in any action or proceeding brought under KRS 367.46951 to 367.46999 that the defendant has established and implemented, with due care, reasonable practices and procedures to prevent telephone solicitations in violation of KRS 367.46951 to 367.46999.

Effective: July 15, 2002

History: Created 2002 Ky. Acts ch. 21, sec. 6, effective July 15, 2002.

367.46999 Penalty for violation -- Concurrent enforcement powers of Attorney General.

Any person, including, but not limited to, a merchant, a telemarketer, a salesperson, agent or representative of the merchant, or an independent contractor, who knowingly violates any provision of KRS 367.46951 to 367.46999 or engages in any act, practice, or course of business which operates or would operate as fraud or deceit upon any person in connection with a sale shall be guilty of a Class D felony, except that any person who violates KRS 367.46955(7) to (16) shall be guilty of a Class B misdemeanor for the first offense and a Class A misdemeanor for any subsequent offense. The Office of the Attorney General shall have concurrent enforcement powers as to such felonies and misdemeanors.

Effective: July 15, 1998

History: Amended 1998 Ky. Acts ch. 581, sec. 4, effective July 15, 1998. -- Created 1994 Ky. Acts ch. 302, sec. 14, effective July 15, 1994; and ch. 463, sec. 14, effective July 15, 1994.

Legislative Research Commission Note (7/15/94). This statute was created by 1994 Ky. Acts chs. 302 and 463, which are substantively identical and have been codified together. Minor variations have been resolved by giving precedence to Acts ch. 463 which was enacted last.

VI. KENTUCKY TELEMARKETING REGULATIONS

40 KAR 2:070. Procedure for registration of telemarketing companies.

RELATES TO: KRS 367.46971, 367.46973, 367.46981

STATUTORY AUTHORITY: KRS 15.180, 367.46983

NECESSITY, FUNCTION, AND CONFORMITY: KRS 367.46983 authorizes the Attorney General to promulgate administrative regulations required to enforce KRS 367.46951 to 367.46999 governing the sales of goods and services to Kentucky consumers by use of telephone solicitations. This administrative regulation establishes procedures for the registration of telemarketing companies governed by the provisions of KRS 367.46951 to 367.46999.

Section 1. Registration. (1)(a) Registration, or a renewal of registration, for telephone solicitation pursuant to KRS 367.46971 shall be made on the "Commonwealth of Kentucky Telemarketing Company Registration Statement". Each telemarketing company shall register by:

1. Completing the information required by the "Commonwealth of Kentucky Telemarketing Company Registration Statement"; and

2. Paying fees required by KRS 367.46971.

(b) At the time of filing the "Commonwealth of Kentucky Telemarketing Company Registration Statement", a telemarketing company shall file:

1. "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company Consent for Service "; and

2. One (1) of the following bond forms:

a. "Commonwealth of Kentucky, Office of the Attorney General, Bond for Telemarketing Company "; or

b. "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company Premium Surety Bond".

(2) A registration may be withdrawn prior to approval by submitting a written request that the application be withdrawn.

(3) If, upon receipt, the division determines that the materials filed by the telemarketing company do not contain all information required by KRS 367.46971, 367.46973 and 367.46981 or this administrative regulation, the division shall notify the telemarketing company in writing, specifying the information that was not completed in the registration statement or bond form. The registration shall not be completed until an amended filing is received by the division that contains all information required by KRS 367.46971, 367.46973 and 367.46981 or this administrative regulation. Upon receipt of the completed registration materials, the division shall provide a written confirmation of receipt of the completed filing.

Section 2. (1) A change in the information specified in this subsection shall be considered a material change that a telemarketing company shall file in an addendum to the original or annual registration:

(a) A change relating to information in an original or annual filing required by KRS 367.46971(3) or 367.46973(11), (12), and (13);

(b) An addition or deletion of factual matter that differs from the factual matter contained in a telemarketing company's original filing; or

(c) An association with an officer, director, trustee, general or limited partner, sole proprietor, owner, or person having management responsibility in an applicant's business, or other person specified by KRS 367.46973(5) and (7), who, after a telemarketing company's original filing:

1. Has committed an act or offense specified by KRS 367.46973(8)(a);

2. Is subject to a final judgment or order specified by KRS 367.46973(8)(b) and (c);

3. Has filed in bankruptcy or been adjudged as bankrupt as specified by KRS 367.46973(8)(d).

(2) Information filed pursuant to subsection (1) of this section shall contain the information required by 367.46973(8).

(3)(a) A change in information required pursuant to this section shall be filed on "Commonwealth of Kentucky Telemarketing Company Registration Statement".

(b) Information required pursuant to this section shall be filed with the division.

Section 3. Incorporation by Reference. (1) The following material is incorporated by reference:

(a) "Commonwealth of Kentucky Telemarketing Company Registration Statement", Form Ts-1, 2002;

(b) "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company, Consent For Service, Form Ts-2, 2002;

(c) "Commonwealth of Kentucky, Office of the Attorney General, Bond for Telemarketing Company ", Form Ts-4, 2002; and

(d) "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company Premium Surety Bond", Form Ts-5, 2002.

(2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at the Office of the Attorney General, 1024 Capital Center Drive, Frankfort Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m. (21 Ky.R. 688; Am. 1283; eff. 10-12-94; 25 Ky.R. 1098; 1581; eff. 1-19-99; 29 Ky.R. 1298; 2075; eff 2-16-03.)

40 KAR 2:050. Hearing procedures.

RELATES TO: KRS 367.461, 367.463, 367.465, 367.467, 367.469

STATUTORY AUTHORITY: KRS 15.180, 367.150(4), 367.469

NECESSITY, FUNCTION, AND CONFORMITY: This administrative regulation establishes the procedures for conducting a hearing by the Office of the Attorney General to revoke a permit to use automated dialing equipment in the Commonwealth of Kentucky.

Section 1. Hearings related to denials of applications or revocations of permits shall be governed by the provisions of this administrative regulation.

Section 2. Denial and revocation actions shall be heard by:

(1) An Assistant Attorney General; or

(2) A hearing examiner employed by the Department of Law as a hearing officer.

Section 3. An applicant or permittee shall have the right to:

(1) Be present;

(2) Be heard at the hearing;

(3) Be represented by legal counsel;

(4) Present evidence;

(5) Cross-examine witnesses presented by the attorney prosecuting the matter before the hearing officer; and

(6) Make both opening and closing statements.

Section 4. Prehearing Disclosure of Evidence. (1) A permittee shall have the right to:

(a) Inspect the investigative file relating to a revocation action;

(b) Represent himself, or be represented by counsel; and

(c) Inspect tangible evidence in the possession of the hearing officer or the department.

(2) An appointment for examination of a file or other evidence shall be made:

(a) Upon reasonable notice;

(b) During and for regular office hours; and

(c) For a time convenient to all parties.

(3) At least ten (10) days prior to the scheduled hearing date, the permittee shall furnish to the Office of the Attorney General:

(a) Copies of documents he intends to introduce; and

(b) Produce for inspection tangible evidence within his possession or control that he intends to introduce.

(4) Upon timely written notice, he shall produce such other information requested by the hearing officer.

(5)(a) At least ten (10) days prior to the scheduled hearing date the permittee shall file with the hearing officer a written response to the specific allegations contained in the notice of charges.

(b) The hearing officer may for good cause permit the late filing of a response.

(6)(a) After disclosure has been completed each party shall remain under an obligation to disclose any new or additional items of evidence which may come to its attention. Such additional disclosure shall take place as soon as practicable.

(b) Failure to disclose may result in the exclusion of the new evidence or testimony from the hearing.

Section 5. Order of Proceeding. (1) The hearing officer shall call the meeting to order and shall identify the parties to the action and the persons present. The hearing officer shall rule upon any objections or motions. Opening statements shall be made, with the attorney prosecuting the allegations of the complaint proceeding first. Either side may waive opening statement.

(2) The taking of proof shall commence with the calling of witnesses on behalf of the attorney prosecuting the matter before the hearing officer. Witnesses shall be examined first by the attorney prosecuting the allegations of the complaint, then by the permittee or that person's attorney, and finally by the hearing officer. Rebuttal examination of witnesses shall proceed in the same order. Documents or other items may be introduced into evidence as appropriate.

(3) Upon conclusion of the case for the attorney prosecuting the matter before the hearing officer, the permittee shall call its witnesses. Witnesses shall be examined first by the permittee or that person's attorney, then by the attorney prosecuting the allegations of the complaint, and finally by the hearing officer. Rebuttal examination of those witnesses shall proceed in the same order. Documents or other evidence may be introduced as appropriate.

(4) The hearing officer shall be responsible for enforcing the general rules of conduct and decorum and expediting the hearing by keeping the testimony and exhibits relevant to the complaint.

Section 6. Evidence. (1) Formal rules of evidence shall not apply.

(2) A hearing officer shall exclude evidence that is:

(a) Irrelevant;

(b) Immaterial;

(c) Unduly repetitious; or

(d) Excludable on:

1. Constitutional or statutory grounds; or

2. The basis of evidentiary privilege recognized in the courts of the Commonwealth.

(3) Testimony or other evidence shall be admitted if it is:

(a) Based on facts; and

(b) Commonly relied upon by reasonably prudent persons.

(4)(a) Evidence shall not be excluded solely because it is hearsay.

(b) Hearsay evidence, including affidavits, may be admitted for the purpose of supplementing relevant evidence.

(5) A hearing officer may admit party or witness testimony taken by deposition if:

(a) A party or witness is unable to attend through no fault of his own; and

(b) The opposing party has had a full opportunity to cross-examine the party or witness.

(6) Evidence may be received in written form if it will:

(a) Expedite the hearing; and

(b) Not substantially prejudice the interests of a party.

(7)(a) A copy or an excerpt of documentary evidence may be received.

(b) Upon request, a party shall be permitted to compare the copy or excerpt with the original.

(8) Official notice shall be taken of:

(a) A fact that would be judicially noticed in the courts of the Commonwealth;

(b) The record of other proceedings before the Office of the Attorney General;

(c) Technical or scientific matters within the specialized knowledge of the Office of the Attorney General;

(d) Pursuant to the provisions of KRS Chapter 13A, codes or standards that have been adopted by:

1. An agency of the United States, the Commonwealth, or another state; or

2. A nationally recognized organization or association.

(9) Tangible items may be received into evidence the hearing officer is satisfied that the item is:

(a) What it is represented to be; and

(b) In substantially the same condition as it was at the time of the events under consideration.

Section 7. (1) Upon the conclusion of the hearing, the hearing officer shall render a decision in writing with copies to all parties.

(2)(a) The decision of the hearing officer shall be reviewed by the Attorney General.

(b) The Attorney General shall:

1. Approve the decision; or

2. Modify the decision; or

3. Remand to the hearing officer for further action. (19 Ky.R. 535; Am. 1064; eff. 11-9-92.)

40 KAR 2:070. Procedure for registration of telemarketing companies.

RELATES TO: KRS 367.46971, 367.46973, 367.46981

STATUTORY AUTHORITY: KRS 15.180, 367.46983

NECESSITY, FUNCTION, AND CONFORMITY: KRS 367.46983 authorizes the Attorney General to promulgate administrative regulations required to enforce KRS 367.46951 to 367.46999 governing the sales of goods and services to Kentucky consumers by use of telephone solicitations. This administrative regulation establishes procedures for the registration of telemarketing companies governed by the provisions of KRS 367.46951 to 367.46999.

Section 1. Registration. (1)(a) Registration, or a renewal of registration, for telephone solicitation pursuant to KRS 367.46971 shall be made on the "Commonwealth of Kentucky Telemarketing Company Registration Statement". Each telemarketing company shall register by:

1. Completing the information required by the "Commonwealth of Kentucky Telemarketing Company Registration Statement"; and

2. Paying fees required by KRS 367.46971.

(b) At the time of filing the "Commonwealth of Kentucky Telemarketing Company Registration Statement", a telemarketing company shall file:

1. "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company Consent for Service "; and

2. One (1) of the following bond forms:

a. "Commonwealth of Kentucky, Office of the Attorney General, Bond for Telemarketing Company "; or

b. "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company Premium Surety Bond".

(2) A registration may be withdrawn prior to approval by submitting a written request that the application be withdrawn.

(3) If, upon receipt, the division determines that the materials filed by the telemarketing company do not contain all information required by KRS 367.46971, 367.46973 and 367.46981 or this administrative regulation, the division shall notify the telemarketing company in writing, specifying the information that was not completed in the registration statement or bond form. The registration shall not be completed until an amended filing is received by the division that contains all information required by KRS 367.46971, 367.46973 and 367.46981 or this administrative regulation. Upon receipt of the completed registration materials, the division shall provide a written confirmation of receipt of the completed filing.

Section 2. (1) A change in the information specified in this subsection shall be considered a material change that a telemarketing company shall file in an addendum to the original or annual registration:

(a) A change relating to information in an original or annual filing required by KRS 367.46971(3) or 367.46973(11), (12), and (13);

(b) An addition or deletion of factual matter that differs from the factual matter contained in a telemarketing company's original filing; or

(c) An association with an officer, director, trustee, general or limited partner, sole proprietor, owner, or person having management responsibility in an applicant's business, or other person specified by KRS 367.46973(5) and (7), who, after a telemarketing company's original filing:

1. Has committed an act or offense specified by KRS 367.46973(8)(a);

2. Is subject to a final judgment or order specified by KRS 367.46973(8)(b) and (c);

3. Has filed in bankruptcy or been adjudged as bankrupt as specified by KRS 367.46973(8)(d).

(2) Information filed pursuant to subsection (1) of this section shall contain the information required by 367.46973(8).

(3)(a) A change in information required pursuant to this section shall be filed on "Commonwealth of Kentucky Telemarketing Company Registration Statement".

(b) Information required pursuant to this section shall be filed with the division.

Section 3. Incorporation by Reference. (1) The following material is incorporated by reference:

(a) "Commonwealth of Kentucky Telemarketing Company Registration Statement", Form Ts-1, 2002;

(b) "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company, Consent For Service, Form Ts-2, 2002;

(c) "Commonwealth of Kentucky, Office of the Attorney General, Bond for Telemarketing Company ", Form Ts-4, 2002; and

(d) "Commonwealth of Kentucky, Office of the Attorney General, Telemarketing Company Premium Surety Bond", Form Ts-5, 2002.

(2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at the Office of the Attorney General, 1024 Capital Center Drive, Frankfort Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m. (21 Ky.R. 688; Am. 1283; eff. 10-12-94; 25 Ky.R. 1098; 1581; eff. 1-19-99; 29 Ky.R. 1298; 2075; eff 2-16-03.)

40 KAR 2:075. Commonwealth of Kentucky Zero Call List.

RELATES TO: KRS 367.150, 367.170, 367.46951(14), 367.46955(15), 367.46971, 367.46973, 367.46981

STATUTORY AUTHORITY: KRS 15.180, 367.46983

NECESSITY, FUNCTION, AND CONFORMITY: KRS 367.46983 authorizes the Attorney General to promulgate administrative regulations required to enforce KRS 367.46951 to 367.46999 governing the sales of goods and services to Kentucky consumers by use of telephone solicitations. KRS 367.46955(15) establishes the right of consumers to be placed on the "Commonwealth of Kentucky Zero Call List". This administrative regulation establishes requirements relating to the "Commonwealth of Kentucky Zero Call List".

Section 1. Placement on the "Commonwealth of Kentucky Zero Call List". In accordance with KRS 367.46955(15)(a), a person who wishes to be placed on the "Commonwealth of Kentucky Zero Call List" shall enroll on the Zero Call List by:

(1) Notifying the division either orally or in writing that the person wishes to be placed on the Zero Call List and providing the person's residential telephone number;

(2) Calling an automated telephone dial-in registration number established by the division and providing the person's residential telephone number; or

(3) Accessing the division's website at www.kycall0.com and entering the person's residential telephone number.

Section 2. Publication. (1) Quarterly publication schedule. The Zero Call List shall be published according to the following schedule:

(a) The first quarter shall be effective January 15-April 14, and it shall be published on December 15;

(b) The second quarter shall be effective April 15-July 14, and it shall be published on March 15;

(c) The third quarter shall be effective July 15-October 14, and it shall be published on June 15; and

(d) The fourth quarter shall be effective October 15-January 14, and it shall be published on September 15.

(2) The Zero Call List shall be:

(a) Available in accordance with Section 4 of this administrative regulation;

(b) Published on the Internet at web site address www.kycall0.com; and

(c) Available in electronic and hard copy. A request for an electronic or hard copy of the Zero Call List shall require a minimum of five (5) business days notice to the division.

Section 3. Deadline for Telephone Numbers' Inclusion in Next Quarterly Publication of Zero Call List. The telephone numbers of properly completed requests for registration on the Zero Call List shall become part of the Zero Call List in the calendar quarter following the deadline for receipt of registration requests according to the following schedule:

Receipt Deadline	Calendar Quarter
November 15th	January 15 – April 14
February 15th	April 15 – July 14
May 15th	July 15 – October 14
August 15th	October 15 – January 14

Section 4. Application for "Commonwealth of Kentucky Zero Call List". (1) A telemarketing company or merchant subject to the provisions of KRS 367.46951 to 367.46999 shall apply for a copy of the "Commonwealth of Kentucky Zero Call List" on an "Application for Telemarketing 'Zero Call' List".

(2) A telemarketing company or merchant shall provide the following information:

(a) The quarter or year for which a list is requested;

(b) Whether the request is for Internet access to the list, electronic copy or hard copy;

(c) The name and title of the person requesting the information; and

(d) The name, telephone number, and complete address of the merchant or telemarketing company.

(3) Before a telemarketing company or merchant may obtain a copy of the Zero Call List, it shall sign a written confidentiality agreement prepared by the Office of the Attorney General that:

(a) Prohibits disclosure of information contained on the Zero Call List;

(b) Restricts use of the Zero Call List exclusively for the purpose of compliance with KRS 367.46951-367.46999; and

(c) Prohibits the transfer of the copy of the Zero Call List to any person or entity who has not completed and signed a written "Application for Telemarketing "Zero Call" List", form TS-8, and filed it with the division.

(4) Each "Application for Telemarketing "Zero Call" List shall expire on June 14 of each year. Each telemarketing company and merchant conducting telephone solicitations to Kentucky residential telephone numbers shall be required to complete a new "Application for Telemarketing "Zero Call" List which shall include an update of the information requested on the form, if applicable. The division shall issue a new user name and password each year for each applicant.

Section 5. Incorporation by Reference. (1) "Application for Telemarketing 'Zero Call' List", Form Ts-8, November, 2002, is incorporated by reference.

(2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at the Office of the Attorney General, 1024 Capital Center Drive, Frankfort Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m. (25 Ky.R. 1263; Am. 1582; eff. 1-19-99; 29 Ky.R. 489; 1284; 1518; eff. 12-18-02.)

40 KAR 2:076. Complaint procedure for telephone solicitations.

RELATES TO: KRS 367.170, 367.46955, 367.46971, 367.46973, 367.46981, 367.46995

STATUTORY AUTHORITY: KRS 15.180, 367.46983

NECESSITY, FUNCTION, AND CONFORMITY: KRS 367.46983 authorizes the Attorney General to promulgate administrative regulations required to enforce KRS 367.46951 to 367.46999 governing the sales of goods and services to Kentucky consumers by use of telephone solicitations. KRS 367.46951(2)(c) excludes from the definition of "telephone solicitation" a telephone call to a person who has a prior or existing business relationship with the telemarketer or merchant. KRS 367.46955 establishes prohibited telephone solicitation acts or practices. KRS 367.46995 requires that a claim or action alleging a violation of KRS 367.46955 be in writing and verified by the claimant. This administrative regulation establishes the procedure for filing a complaint (prior to a claim or action) and lists the factors used to determine if a prior or existing business relationship exists.

Section 1. A complaint relating to a violation of KRS 367.46955 shall be filed with the division in the following manner:

(1) An oral complaint made either by telephone or in person giving a statement of facts;

(2) A written complaint giving a statement of the facts;

(3) A written complaint filed on "Telemarketing Complaint Form"; or

(4) A complaint filed electronically using the Internet Telemarketing Complaint Form on the Kentucky Attorney General's web site.

Section 2. Incorporation by Reference. (1) The following material is incorporated by reference:

(a) "Telemarketing Complaint Form", Form TS-9, November 2002; and

(b) "Internet Telemarketing Complaint Form", TS-10, November 2002.

(2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at the Office of the Attorney General, 1024 Capital Center Drive, Frankfort Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m. (25 Ky.R. 1265; Am. 1584; eff. 1-19-99; 29 Ky.R. 492; 1286; 1520; eff. 12-18-02.)

40 KAR 2:077. Update of zero call list.

RELATES TO: KRS 367.46955, 367.46994(1)(a)

STATUTORY AUTHORITY: KRS 15.180, 367.46983, 367.46994(1)(a)

NECESSITY, FUNCTION, AND CONFORMITY: KRS 367.46994(1)(a) provides that the Attorney General shall promulgate administrative regulations to provide for automatic telephone number referral from the incumbent local exchange carrier or the competitive local exchange carrier to the Office of the Attorney General for the purpose of updating the zero call list to reflect an applicant's change of address or an applicant's termination of telephone service. This administrative regulation establishes the requirements for updating the zero call list by local exchange carriers and competitive local exchange carriers.

Section 1. Deadlines for Receipt of Update Information. (1) The zero call list shall be updated by each local exchange carrier or competitive local exchange carrier providing telephone service to Kentucky consumers.

(2) On November 15th, February 15th, May 15th and August 15th of each year, each local exchange carrier or competitive local exchange carrier shall forward to the Office of the Attorney General the update information described in Section 3 of this administrative regulation.

Section 2. Protocol for Transfer of Update Information. (1) Each local exchange carrier or competitive local exchange carrier shall be issued a user name and password to transfer the update information.

(2) At the time of the issuance of the password, the Attorney General's Office shall provide technical instructions regarding the data transfer.

(3) A local exchange carrier or competitive local exchange carrier shall transfer this information using File Transfer Protocol to a secure file server specified by the Attorney General's Office.

Section 3. Information Update Options. A local exchange carrier or competitive local exchange carrier shall furnish the update information to the Attorney General's office by:

(1) Forwarding an electronic file containing the names and telephone numbers of their customers that are on the zero call list; or

(2) Forwarding an electronic file containing the names and telephone numbers of all of their customers. (29 Ky.R. 1424; Am. 2076; eff. 2-16-03.)

40 KAR 2:078. Interface with federal database.

RELATES TO: KRS 367.46955, 367.46994(1)(b)

STATUTORY AUTHORITY: KRS 15.180, 367.46983, 367.46994(1)(b)

NECESSITY, FUNCTION, AND CONFORMITY: KRS 367.46994(1)(b) provides that the Attorney General shall promulgate administrative regulations to develop, modify or administer the zero call list in such a way as to permit interface with any national registry established by the Federal Trade Commission or the Federal Communications Commission for the purpose of including in Kentucky's zero call list that part of the national database that relates to the Commonwealth or release to the national registry applicants on the zero call list that indicate a preference to be listed on a national registry. This administrative regulation establishes the requirements for interfacing with the federal database.

Section 1. The Attorney General shall:

(1) Include in Kentucky's Zero Call List that part of the National Do Not Call Registry that relates to the Commonwealth, as provided by the administrator of the National Do Not Call Registry; and

(2) On a quarterly basis electronically transfer to the administrator of the National Do Not Call Registry the residential telephone number of all applicants on the zero call list that indicate a preference to be listed on the National Do Not Call Registry. (29 Ky.R. 1425; Am. 2657; eff. 5-15-03.)

VII. MAINSTREAM MARKETING SERVICES, INC. V. F.T.C.

FILED
United States Court of Appeals
Tenth Circuit

FEB 17 2004

PATRICK FISHER
Clerk

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

MAINSTREAM MARKETING SERVICES, INC., a Colorado corporation; TMG MARKETING, INC., a Colorado corporation; AMERICAN TELESERVICES ASSOCIATION,

Plaintiffs-Appellees,

v.

FEDERAL TRADE COMMISSION,

Defendant-Appellant,

No. 03-1429

Before **SEYMOUR, EBEL** and **HENRY**, Circuit Judges.

EBEL, Circuit Judge.

The four cases consolidated in this appeal involve challenges to the national do-not-call registry, which allows individuals to register their phone numbers on a national "do-not-call list" and prohibits most commercial telemarketers from calling the numbers on that list. The primary issue in this case is whether the First Amendment prevents the government from establishing an opt-in telemarketing regulation that provides a mechanism for consumers to restrict commercial sales calls but does not provide a similar mechanism to limit charitable or political calls.[1] We hold that the do-not-call registry is a valid commercial speech regulation because it directly advances the government's important interests in safeguarding personal privacy and reducing the danger of telemarketing abuse without burdening an excessive amount of speech. In other words, there is a reasonable fit between the do-not-call regulations and the government's reasons for enacting them.

As we discuss below in greater detail, four key aspects of the do-not-call registry convince us that it is consistent with First Amendment requirements. First, the list restricts only core commercial speech – i.e., commercial sales calls.[2] Second, the do-not-call registry targets speech that invades the privacy of the home, a personal sanctuary that enjoys a unique status in our constitutional jurisprudence. See Frisby v. Schultz, 487 U.S. 474, 484 (1988). Third, the do-not-call registry is an opt-in program that puts the choice of whether or not to restrict commercial calls entirely in the hands of consumers. Fourth, the do-not-call registry materially furthers the government's interests in combating the danger of abusive telemarketing and preventing the invasion of consumer privacy, blocking a significant number of the calls that cause these problems. Under these circumstances, we conclude that the requirements of the First Amendment are satisfied.

A number of additional features of the national do-not-call registry, although not dispositive, further demonstrate that the list is consistent with the First Amendment rights of commercial speakers. The challenged

[1] The telemarketers also marshal attacks on the fees they must pay to access the national do-not-call registry and to the regulations' exception for commercial callers who have an established business relationship with the consumer. We address those alternative arguments in parts IV(A) and IV(B) below. Finally, in part IV(C), we discuss the FTC's statutory authority to enact its national do-not-call regulations.

[2] We express no opinion as to whether the do-not-call registry would be constitutional if it applied to political and charitable callers.

regulations do not hinder any business' ability to contact consumers by other means, such as through direct mailings or other forms of advertising. Moreover, they give consumers a number of different options to avoid calls they do not want to receive. Namely, consumers who wish to restrict some but not all commercial sales calls can do so by using company-specific do-not-call lists or by granting some businesses express permission to call.[3] In addition, the government chose to offer consumers broader options to restrict commercial sales calls than charitable and political calls after finding that commercial calls were more intrusive and posed a greater danger of consumer abuse. The government also had evidence that the less restrictive company-specific do-not-call list did not solve the problems caused by commercial telemarketing, but it had no comparable evidence with respect to charitable and political fundraising.

The national do-not-call registry offers consumers a tool with which they can protect their homes against intrusions that Congress has determined to be particularly invasive. Just as a consumer can avoid door-to-door peddlers by placing a "No Solicitation" sign in his or her front yard, the do-not-call registry lets consumers avoid unwanted sales pitches that invade the home via telephone, if they choose to do so. We are convinced that the First Amendment does not prevent the government from giving consumers this option.

I. BACKGROUND

In 2003, two federal agencies – the Federal Trade Commission (FTC) and the Federal Communications Commission (FCC) – promulgated rules that together created the national do-not-call registry. See 16 C.F.R. § 310.4(b)(1)(iii)(B) (FTC rule); 47 C.F.R. § 64.1200(c)(2) (FCC rule).[4] The national do-not-call registry is a list containing the personal telephone numbers of telephone subscribers who have voluntarily indicated that they do not wish to receive unsolicited calls from commercial telemarketers.[5] Commercial telemarketers are generally prohibited from calling phone numbers that have been placed on the do-not-call registry, and they must pay an annual fee to access the numbers on the registry so that they can delete those numbers from their telephone solicitation lists. So far, consumers have registered more than 50 million phone numbers on the national do-not-call registry.

The national do-not-call registry's restrictions apply only to telemarketing calls made by or on behalf of sellers of goods or services, and not to charitable or political fundraising calls. 16 C.F.R. §§ 310.4(b)(1)(iii)(B), 310.6(a); 47 C.F.R. §§ 64.1200(c)(2), 64.1200(f)(9).[6] Additionally, a seller may call consumers who have signed up for the national registry if it has an established business relationship with the consumer or if the consumer has given that seller express written permission to call. 16 C.F.R. § 310.4(b)(1)(iii)(B)(i-ii); 47 C.F.R. § 64.1200(f)(9)(i-ii).[7]

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[3] The company-specific do-not-call regulations require that a company must respect a consumer's request not to receive calls from or on behalf of that particular business. See 16 C.F.R. § 310.4(b)(1)(iii)(A); 47 C.F.R. § 64.1200(d)(3).

[4] Congress has directed the FCC to coordinate its efforts with the FTC in order to maximize consistency between the agencies' do-not-call regulations. Do-Not-Call Implementation Act, Pub. L. No. 108-10, 117 Stat. 557 (2003). Although the FTC and FCC rules are consistent in most respects, there are some situations in which a telemarketer could be subject to do-not-call restrictions under one agency's rule but exempt under the other's. See Federal Trade Commission, Report to Congress Pursuant to the Do Not Call Implementation Act on Regulatory Coordination in Federal Telemarketing Laws (2003); Federal Communications Commission, Report on Regulatory Coordination (2003). In the interest of simplicity, and because any inconsistencies between the two rules do not affect our constitutional analysis, we generally refer to both agencies' do-not-call provisions as a single regulatory measure (the do-not-call registry). When we mean to discuss the FTC rule or the FCC rule in particular, we do so explicitly.

[5] Consumers can register their personal phone numbers for the do-not-call list either by phone or online.

[6] There has been some confusion throughout this litigation with respect to how to define the term "telemarketing." Compare Telemarketing and Consumer Fraud and Abuse Prevention Act of 1994, Pub. L. No. 103-297, 108 Stat. 1545 at §§ 7 (1994) ("Telemarketing Act") (defining "telemarketing" as calls "conducted to induce purchases of goods or services") with Mainstream Mktg. Servs., Inc. v. FTC, 283 F.Supp. 2d 1151, 1154 (D. Colo. 2003) (describing "telemarketing" as the practice of "soliciting sales and donations" conducted by businesses, charities, political organizations, and others). Unless otherwise indicated, we use the term "telemarketing" to refer to commercial sales calls made to induce purchases of goods or services (not charitable or political fundraising) consistent with Congress' definition in the Telemarketing Act.

[7] The "established business relationship" exception allows businesses to call customers with whom they have conducted a financial transaction or to whom they have sold, rented, or leased goods or services within 18 months of the telephone call. 47 C.F.R. § 64.1200(f)(3); Telemarketing Sales Rule, Statement of Basis and Purpose, 68 Fed. Reg. 4580, 4591 (Jan. 29, 2003). Additionally, sellers can call consumers on the national do-not-call registry within three months after the consumer makes an inquiry or application. 47 C.F.R § 64.1200(f)(3). A seller who has an established business relationship with a consumer is still bound to comply with the company-specific rules if the consumer requests not to be called. Id. at § 64.1200(f)(3)(i).

Telemarketers generally have three months from the date on which a consumer signs up for the registry to remove the consumer's phone number from their call lists. 16 C.F.R. § 310.4(b)(3)(iv); 47 C.F.R. § 64.1200(c)(2)(i)(D). Consumer registrations remain valid for five years, and phone numbers that are disconnected or reassigned will be periodically removed from the registry. 47 C.F.R § 1200(c)(2); Telemarketing Sales Rule, Statement of Basis and Purpose, 68 Fed. Reg. 4580, 4640 (Jan. 29, 2003).

The national do-not-call registry is the product of a regulatory effort dating back to 1991 aimed at protecting the privacy rights of consumers and curbing the risk of telemarketing abuse. See generally FTC v. Mainstream Mktg. Servs., Inc., 345 F.3d 850, 857-58 (10th Cir. 2003). In the Telephone Consumer Protection Act of 1991 ("TCPA") – under which the FCC enacted its do-not-call rules – Congress found that for many consumers telemarketing sales calls constitute an intrusive invasion of privacy. See Pub. L. No. 102-243, 105 Stat. 2394 at § 2 (1991). Moreover, the TCPA's legislative history cited statistical data indicating that "most unwanted telephone solicitations are commercial in nature" and that "unwanted commercial calls are a far bigger problem than unsolicited calls from political or charitable organizations." H.R. Rep. No. 102-317 at 16 (1991). The TCPA therefore authorized the FCC to establish a national database of consumers who object to receiving "telephone solicitations," which the act defined as commercial sales calls. Pub. L. No. 102-243, 105 Stat. 2394 at § 3.[8]

Furthermore, in the Telemarketing and Consumer Fraud and Abuse Prevention Act of 1994 ("Telemarketing Act") – under which the FTC enacted its do-not-call rules – Congress found that consumers lose an estimated $40 billion each year due to telemarketing fraud. See Pub. L. No. 103-297, 108 Stat. 1545 at § 2 (1994). Therefore, Congress authorized the FTC to prohibit sales calls that a reasonable consumer would consider coercive or abusive of his or her right to privacy. Id. at § 3.

The FCC and FTC initially sought to accomplish the goals of the TCPA and the Telemarketing Act by adopting company-specific do-not-call lists, requiring sellers to maintain lists of consumers who have requested not to be called by that particular solicitor, and requiring telemarketers to honor those requests. See Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991, Report and Order, 7 FCC Rcd. 8752 at ¶ 23-24 (Sept. 17, 1992); Telemarketing Sales Rule, Statement of Basis and Purpose, 60 Fed. Reg. 43842, 43854-55 (Aug. 23, 1995). Yet in enacting the national do-not-call registry, the agencies concluded that the company-specific lists had failed to achieve Congress' objectives. See Telemarketing Sales Rule, Statement of Basis and Purpose, 68 Fed Reg. 4580, 4629, 4631 (Jan. 29, 2003); Rules and Regulations Implementing the Telephone Consumer Protection Act (TCPA) of 1991, 68 Fed. Reg. 44144, 44144-45 (July 25, 2003). Among other shortfalls, the agencies explained that the large number of possible telephone solicitors made it burdensome for consumers to assert their rights under the company-specific rules, and that commercial telemarketers often ignored consumers' requests not to be called. 68 Fed. Reg. at 4629. Accordingly, the agencies decided to keep the company-specific rules as an option available to consumers, but to supplement them with the national do-not-call registry. Id.; 68 Fed. Reg. at 44144.

In this appeal we have consolidated four cases challenging various aspects of the national do-not-call registry.[9] Cases Nos. 03-1429, 03-6258 and 03-9571 involve First Amendment attacks on the do-not-call list and its registry fees. We address these issues in parts III and IV(A) respectively. Case No. 03-9594 involves a challenge to the FCC rule's established business relationship exception on administrative law grounds. We address this issue in part IV(B). Finally, in part IV(C), we address the alternative argument that the FTC lacked statutory authority to enact its do-not-call regulations, an argument that the district court relied upon in case No. 03-6258. We conclude that all of the telemarketers' challenges lack merit and we uphold the do-not-call list in its entirety.

II. STANDARD OF REVIEW

[8] The TCPA defines a "telephone solicitation" as a "telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services," excluding, inter alia, calls from tax exempt nonprofit organizations. Pub. L. No. 103-297, 108 Stat. 1545 at § 3.

[9] Case No. 03-1429 reaches us on appeal from the District of Colorado, which held that the FTC's do-not-call rules were unconstitutional on First Amendment grounds. In that case, the district court enjoined the FTC from implementing the do-not-call registry. We stayed that injunction, pending our review on the merits, in FTC v. Mainstream Mktg. Servs., Inc., 345 F.3d 850 (10th Cir. 2003). Case No. 03-6258 reaches us on appeal from the Western District of Oklahoma, which held that the FTC lacked the statutory authority to enact its do-not-call rules. In that case, the court also approved certain unrelated aspects of the Telemarketing Sales Rule, and the portions of its decision addressing those issues are not before us on appeal. In cases No. 03-9571 and No. 03-9594, we review the FCC order directly pursuant to 47 U.S.C. § 402(a) and 28 U.S.C. § 2342.

The constitutionality of the national do-not-call registry and its fees under the First Amendment are questions of law we review de novo. See Phelan v. Laramie County Cmty. Coll. Bd. of Trs., 235 F.3d 1243, 1246 (10th Cir. 2000). We review whether the FCC's decision to include an established business relationship exception violated the Administrative Procedure Act under the arbitrary and capricious standard. See Friends of the Bow v. Thompson, 124 F.3d 1210, 1215 (10th Cir. 1997). Finally, we review de novo a district court's decision that an agency lacked authority under the controlling statute to act, keeping in mind that the courts owe deference to a federal agency's interpretation of a statute it administers. See Southern Utah Wilderness Alliance v. Dabney, 222 F.3d 819, 824 (10th Cir. 2000) (citing Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842-43 (1984)).

III. FIRST AMENDMENT ANALYSIS

The national do-not-call registry's telemarketing restrictions apply only to commercial speech. Like most commercial speech regulations, the do-not-call rules draw a line between commercial and non-commercial speech on the basis of content. See Metromedia, Inc. v. City of San Diego, 453 U.S. 490, 504 n.11 (1981) ("If commercial speech is to be distinguished, it must be distinguished by its content."); Bates v. State Bar of Ariz., 433 U.S. 350, 363 (1977) (same). In reviewing commercial speech regulations, we apply the Central Hudson test. Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y., 447 U.S. 557, 566 (1980); see also City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 416, 429-30 (1993) (noting that the challenged law drew content-based distinctions between commercial and non-commercial speech and applying more lenient scrutiny under Central Hudson); Florida Bar v. Went For It, Inc., 515 U.S. 618, 634-35 (1995) ("This case ... concerns pure commercial advertising, for which we have always reserved a lesser degree of protection under the First Amendment."); Lanphere & Urbaniak v. Colorado, 21 F.3d 1508, 1513 (10th Cir. 1994) (content-based regulations disadvantaging commercial speech are reviewed pursuant to the lesser degree of First Amendment protection provided in Central Hudson).

Central Hudson established a three-part test governing First Amendment challenges to regulations restricting non-misleading commercial speech that relates to lawful activity. First, the government must assert a substantial interest to be achieved by the regulation. Central Hudson, 447 U.S. at 564. Second, the regulation must directly advance that governmental interest, meaning that it must do more than provide "only ineffective or remote support for the government's purpose." Id. Third, although the regulation need not be the least restrictive measure available, it must be narrowly tailored not to restrict more speech than necessary. See id.; Board of Trs. of the State Univ. of N.Y. v. Fox, 492 U.S. 469, 480 (1989). Together, these final two factors require that there be a reasonable fit between the government's objectives and the means it chooses to accomplish those ends. United States v. Edge Broad. Co., 509 U.S. 418, 427-28 (1993).

The government bears the burden of asserting one or more substantial governmental interests and demonstrating a reasonable fit between those interests and the challenged regulation. Utah Licensed Beverage Ass'n v. Leavitt, 256 F.3d 1061, 1069 (10th Cir. 2001). The government is not limited in the evidence it may use to meet its burden. For example, a commercial speech regulation may be justified by anecdotes, history, consensus, or simple common sense. Went For It, 515 U.S. at 628. Yet we may not take it upon ourselves to supplant the interests put forward by the state with our own ideas of what goals the challenged laws might serve. Edenfield v. Fane, 507 U.S. 761, 768 (1993).

A. Governmental Interests

The government asserts that the do-not-call regulations are justified by its interests in 1) protecting the privacy of individuals in their homes, and 2) protecting consumers against the risk of fraudulent and abusive solicitation. See 68 Fed. Reg. 44144; 68 Fed. Reg. at 4635. Both of these justifications are undisputedly substantial governmental interests.

In Rowan v. United States Post Office Dep't, the Supreme Court upheld the right of a homeowner to restrict material that could be mailed to his or her house. 397 U.S. 728 (1970). The Court emphasized the importance of individual privacy, particularly in the context of the home, stating that "the ancient concept that 'a man's home is his castle' into which 'not even the king may enter' has lost none of its vitality." Id. at 737. In Frisby v. Schultz, the Court again stressed the unique nature of the home and recognized that "the State's interest in protecting the well-being, tranquility, and privacy of the home is certainly of the highest order in a free and civilized society." 487 U.S. 474, 484 (1988) (quoting Carey v. Brown, 447 U.S. 455, 471 (1980)). As the Court held in Frisby:

> One important aspect of residential privacy is protection of the unwilling listener. ... [A] special benefit of the privacy all citizens enjoy within their own walls, which the State may legislate to protect, is an ability to avoid intrusions. Thus, we have repeatedly held that individuals are not required to welcome unwanted speech into their own homes and that the government may protect this freedom.

Id. at 484-85 (citations omitted). Likewise, in Hill v. Colorado, the Court called the unwilling listener's interest in avoiding unwanted communication part of the broader right to be let alone that Justice Brandeis described as "the right most valued by civilized men." 530 U.S. 703, 716-17 (2000) (quoting Olmstead v. United States, 277 U.S. 438, 478 (1928) (Brandeis, J., dissenting)). The Court added that the right to avoid unwanted speech has special force in the context of the home. Id.; see also FCC v. Pacifica Found., 438 U.S. 726, 748 (1978) ("[I]n the privacy of the home ... the individual's right to be left alone plainly outweighs the First Amendment rights of an intruder.").

Additionally, the Supreme Court has recognized that the government has a substantial interest in preventing abusive and coercive sales practices. Edenfield v. Fane, 507 U.S. 761, 768-69 (1993) ("[T]he First Amendment ... does not prohibit the State from insuring that the stream of commercial information flow[s] cleanly as well as freely.") (quoting Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 771-72 (1976)).

B. Reasonable Fit

A reasonable fit exists between the do-not-call rules and the government's privacy and consumer protection interests if the regulation directly advances those interests and is narrowly tailored. See Central Hudson, 447 U.S. at 564-65. In this context, the "narrowly tailored" standard does not require that the government's response to protect substantial interests be the least restrictive measure available. All that is required is a proportional response. Board of Trs. of State Univ. of N.Y. v. Fox, 492 U.S. 469, 480 (1989).

In other words, the national do-not-call registry is valid if it is designed to provide effective support for the government's purposes and if the government did not suppress an excessive amount of speech when substantially narrower restrictions would have worked just as well. See Central Hudson, 447 U.S. at 564-65. These criteria are plainly established in this case. The do-not-call registry directly advances the government's interests by effectively blocking a significant number of the calls that cause the problems the government sought to redress. It is narrowly tailored because its opt-in character ensures that it does not inhibit any speech directed at the home of a willing listener.

1. Effectiveness

The telemarketers assert that the do-not-call registry is unconstitutionally underinclusive because it does not apply to charitable and political callers. First Amendment challenges based on underinclusiveness face an uphill battle in the commercial speech context. As a general rule, the First Amendment does not require that the government regulate all aspects of a problem before it can make progress on any front. United States v. Edge Broad. Co., 509 U.S. 418, 434 (1993). "Within the bounds of the general protection provided by the Constitution to commercial speech, we allow room for legislative judgments." Id. The underinclusiveness of a commercial speech regulation is relevant only if it renders the regulatory framework so irrational that it fails materially to advance the aims that it was purportedly designed to further. See Rubin v. Coors Brewing Co., 514 U.S. 476, 489 (1995); see also Central Hudson, 447 U.S. at 564 ("If a regulation "provides only ineffective or remote support for the government's purpose" it cannot be said to bear a reasonable fit with that purported objective). Cf. City of Ladue v. Gilleo, 512 U.S. 43, 51 (1994) (underinclusiveness provides a basis for a First Amendment claim when it constitutes an "attempt to give one side of a debatable public question an advantage in expressing its views to the people").

In Rubin, for example, the Supreme Court struck down a law prohibiting brewers from putting the alcohol content of their product on beer labels, purportedly in an effort to discourage "strength wars." 514 U.S. at 478. However, the law allowed advertisements disclosing the alcohol content of beers, allowed sellers of wines and spirits to disclose alcohol content on labels (and even required such disclosure for certain wines), and allowed brewers to signal high alcohol content by using the term "malt liquor." Id. at 488-89. Under these circumstances, the Court concluded that there was little chance that the beer label rule would materially deter strength wars in light of the "irrationality of this unique and puzzling regulatory framework." Id. at 489.

Likewise, in City of Cincinnati v. Discovery Network, the Court struck down a law prohibiting commercial newsracks on public property, purportedly in order to promote the safety and attractive appearance of its streets and sidewalks. 507 U.S. 410, 412 (1993). However, the ban applied to only 62 of the 1,500 to 2,000 newsracks in the city, thus addressing only a "minute" and "paltry" share of the problem. Id. at 417-18. Moreover, the challenged

ordinance was not enacted in an effort to address problems posed by newsracks, but was actually an "outdated prohibition against the distribution of any commercial handbills on public property ... enacted long before any concern about newsracks developed." Id. For these reasons, the Court held in part II of that opinion that "the city did not establish the reasonable fit we require." Id. at 417-18.

Yet so long as a commercial speech regulation materially furthers its objectives, underinclusiveness is not fatal under Central Hudson. For example, in Edge Broadcasting the Supreme Court approved a regulation that prohibited broadcasters in North Carolina (which did not permit lotteries) from broadcasting lottery advertisements on the radio, even as applied to a broadcaster located near the border of Virginia (where lotteries were legal) whose audience consisted of 92.2 percent Virginians. 509 U.S. 418, 423-24, 431-33 (1993). The Court found it determinative that the regulation prevented lottery ads from reaching about 127,000 North Carolina residents (7.8 percent of Edge's listeners):[10]

> It could hardly be denied ... that these facts, standing alone, would clearly show that applying the statutory restriction to Edge would directly serve the statutory purpose of supporting North Carolina's antigambling policy.... [T]his result could hardly be called either "ineffective," "remote," or "conditional." Nor could it be called only "limited incremental support" for the Government interest.

Id. at 432 (citations omitted). The Court rejected Edge's argument that the regulations banning lottery advertising by in-state radio failed materially to advance the government's interests because North Carolina residents were already inundated with lottery advertising from other sources, such as Virginia radio and television programs. Id. at 434-35. "[T]he Government may be said to advance its purpose by substantially reducing lottery advertising, even where it is not wholly eradicated." Id. at 434; see also Metromedia, Inc. v. City of San Diego, 453 U.S. 490, 511 (1981) ("[P]rohibition of offsite advertising is directly related to the stated objectives of traffic safety and esthetics. This is not altered by the fact that the ordinance is underinclusive because it permits onsite advertising.").

As discussed above, the national do-not-call registry is designed to reduce intrusions into personal privacy and the risk of telemarketing fraud and abuse that accompany unwanted telephone solicitation. The registry directly advances those goals. So far, more than 50 million telephone numbers have been registered on the do-not-call list, and the do-not-call regulations protect these households from receiving most unwanted telemarketing calls. According to the telemarketers' own estimate, 2.64 telemarketing calls per week – or more than 137 calls annually – were directed at an average consumer before the do-not-call list came into effect. Cf. 68 Fed. Reg. at 44152 (discussing the five-fold increase in the total number of telemarketing calls between 1991 and 2003). Accordingly, absent the do-not-call registry, telemarketers would call those consumers who have already signed up for the registry an estimated total of 6.85 billion times each year.

To be sure, the do-not-call list will not block all of these calls. Nevertheless, it will prohibit a substantial number of them, making it difficult to fathom how the registry could be called an "ineffective" means of stopping invasive or abusive calls, or a regulation that "furnish[es] only speculative or marginal support" for the government's interests. See also id. (noting the effectiveness of state do-not-call lists in reducing unwanted telemarketing calls).[11]

Furthermore, the do-not-call list prohibits not only a significant number of commercial sales calls, but also a significant percentage of all calls causing the problems that Congress sought to address (whether commercial, charitable or political). The record demonstrates that a substantial share of all solicitation calls will be governed by the do-not-call rules. See H.R. Rep. No. 102-317, at 16 (1991) ("[M]ost unwanted telephone solicitations are commercial in nature."); 68 Fed. Reg. at 44153-54 (the high volume and unexpected nature of commercial calls subject to the national do-not-call registry makes those calls more problematic than nonprofit calls and solicitations based on established business relationships).

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[10] In the North Carolina counties Edge served, its broadcasts accounted for about 11 percent of all radio listening. Edge Broad., 509 U.S. at 431-32.

[11] It is unclear from the record exactly how many telemarketing calls will be blocked by the do-not-call regulations. Most significantly, we have not been provided with data as to how many of these unsolicited sales calls would be permissible under the established business relationship exception. In applying Central Hudson, however, we are entitled to rely on anecdotal evidence and make the common sense observation that the do-not-call list will apply to a substantial number of telemarketing calls. See Went For It, 515 U.S. at 628; cf. 68 Fed. Reg. at 44153-54 (suggesting that the volume of calls exempted under the established business relationship exception most likely will be relatively low compared to the volume of calls subject to the do-not-call restrictions); 68 Fed. Reg. at 4631 (noting that telemarketers expect to lay off up to half of their employees in response to the do-not-call regulations).

The telemarketers asserted before the FTC that they might have to lay off up to 50 percent of their employees if the national do-not-call registry came into effect. See 68 Fed. Reg. at 4631. It is reasonable to conclude that the telemarketers' planned reduction in force corresponds to a decrease in the amount of calls they will make. Significantly, the percentage of unwanted calls that will be prohibited will be even higher than the percentage of all unsolicited calls blocked by the list. The individuals on the do-not-call list have declared that they do not wish to receive unsolicited commercial telemarketing calls, whereas those who do want to continue receiving such calls will not register. Cf. 68 Fed. Reg. at 4632 (under the national do-not-call regulations, "telemarketers would reduce time spent calling consumers who do not want to receive telemarketing calls and would be able to focus their calls only on those who do not object").

Finally, the type of unsolicited calls that the do-not-call list does prohibit – commercial sales calls – is the type that Congress, the FTC and the FCC have all determined to be most to blame for the problems the government is seeking to redress. According to the legislative history accompanying the TCPA, "[c]omplaint statistics show that unwanted commercial calls are a far bigger problem than unsolicited calls from political or charitable organizations." H.R. Rep. No. 102-317, at 16 (1991) (noting that non-commercial calls were less intrusive to consumers' privacy because they are more expected and because there is a lower volume of such calls); see also 68 Fed. Reg. at 44153. Similarly, the FCC determined that calls from solicitors with an established business relationship with the recipient are less problematic than other commercial calls. 68 Fed. Reg. at 44154 ("Consumers are more likely to anticipate contacts from companies with whom they have an existing relationship and the volume of such calls will most likely be lower.").

Additionally, the FTC has found that commercial callers are more likely than non-commercial callers to engage in deceptive and abusive practices. 68 Fed. Reg. at 4637 ("When a pure commercial transaction is at stake, callers have an incentive to engage in all the things that telemarketers are hated for. But non-commercial speech is a different matter."). Specifically, the FTC concluded that in charitable and political calls, a significant purpose of the call is to sell a cause, not merely to receive a donation, and that non-commercial callers thus have stronger incentives not to alienate the people they call or to engage in abusive and deceptive practices. Id.; cf. Village of Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 632 (1980) ("[B]ecause charitable solicitation does more than inform private economic decisions and is not primarily concerned with providing information about the characteristics and costs of goods and services, it is not dealt with as a variety of purely commercial speech."). The speech regulated by the do-not-call list is therefore the speech most likely to cause the problems the government sought to alleviate in enacting that list, further demonstrating that the regulation directly advances the government's interests.

In sum, the do-not-call list directly advances the government's interests – reducing intrusions upon consumer privacy and the risk of fraud or abuse – by restricting a substantial number (and also a substantial percentage) of the calls that cause these problems. Unlike the regulations struck down in Rubin and Discovery Network, the do-not-call list is not so underinclusive that it fails materially to advance the government's goals.

2. Narrow Tailoring

Although the least restrictive means test is not the test to be used in the commercial speech context, commercial speech regulations do at least have to be "narrowly tailored" and provide a "reasonable fit" between the problem and the solution. Whether or not there are "numerous and obvious less-burdensome alternatives" is a relevant consideration in our narrow tailoring analysis. Went For It, 515 U.S. at 632. A law is narrowly tailored if it "promotes a substantial government interest that would be achieved less effectively absent the regulation." Ward v. Rock Against Racism, 491 U.S. 781, 799 (1989). Accordingly, we consider whether there are numerous and obvious alternatives that would restrict less speech and would serve the government's interest as effectively as the challenged law. See Central Hudson, 447 U.S. at 565; Edge Broad., 509 U.S. at 430.

We hold that the national do-not-call registry is narrowly tailored because it does not over-regulate protected speech; rather, it restricts only calls that are targeted at unwilling recipients. Cf. Frisby v. Schultz, 487 U.S. 474, 485 (1988) ("There simply is no right to force speech into the home of an unwilling listener."); Rowan v. United States Post Office Dep't, 397 U.S. 728, 738 (1970) ("We therefore categorically reject the argument that a vendor has a right under the Constitution or otherwise to send unwanted material into the home of another."). The do-not-call registry prohibits only telemarketing calls aimed at consumers who have affirmatively indicated that they do not want to receive such calls and for whom such calls would constitute an invasion of privacy. See Hill v. Colorado, 530 U.S. 703, 716-17 (2000) (the right of privacy includes an unwilling listener's interest in avoiding unwanted communication).

The Supreme Court has repeatedly held that speech restrictions based on private choice (i.e. – an opt-in feature) are less restrictive than laws that prohibit speech directly. In Rowan, for example, the Court approved a law

under which an individual could require a mailer to stop all future mailings if he or she received advertisements that he or she believed to be erotically arousing or sexually provocative. 397 U.S. at 729-30, 738. Although it was the government that empowered individuals to avoid materials they considered provocative, the Court emphasized that the mailer's right to communicate was circumscribed only by an affirmative act of a householder. Id. at 738. "Congress has erected a wall – or more accurately permits a citizen to erect a wall – that no advertiser may penetrate without his acquiescence. ... The asserted right of a mailer, we repeat, stops at the outer boundary of every person's domain." Id.

Likewise, in rejecting direct prohibitions of speech (even fully protected speech), the Supreme Court has often reasoned that an opt-in regulation would have been a less restrictive alternative. In Martin v. City of Struthers, the Court struck down a city ordinance prohibiting door-to-door canvassing, noting that the government's interest could have been achieved in a less restrictive manner by giving householders the choice of whether or not to receive visitors. 319 U.S. 141, 147-49 (1943) ("[T]he decision as to whether distributers of literature may lawfully call at a home ... belongs ... with the homeowner himself. A city can punish those who call at a home in defiance of the previously expressed will of the occupant.").[12] More recently, in Watchtower Bible & Tract Soc'y of N.Y., Inc. v. Village of Stratton, the Court struck down a permit requirement for door-to-door advocacy, while noting that another section of the ordinance allowing residents to post "No Solicitation" signs provided ample protection for the unwilling listener. 536 U.S. 150, 153, 168-69 (2002); see also Village of Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 639 (1980) ("[T]he provision permitting homeowners to bar solicitors from their property by posting signs reading 'No Solicitors or Peddlers Invited' suggests the availability of less intrusive and more effective measures to protect privacy.") (citations omitted).

The idea that an opt-in regulation is less restrictive than a direct prohibition of speech applies not only to traditional door-to-door solicitation, but also to regulations seeking to protect the privacy of the home from unwanted intrusions via telephone, television, or the Internet. See United States v. Playboy Entm't Group, Inc., 529 U.S. 803, 815 (2000) (opt-in targeted blocking of offensive television programming "enables the Government to support parental authority without affecting the First Amendment interests of speakers and willing listeners.... Simply put, targeted blocking is less restrictive than banning...."); cf. Reno v. ACLU, 521 U.S. 844, 860, 879 (1997) (striking down an absolute prohibition against making certain sexually explicit material available to minors on the Internet on the grounds that it curtailed the speech of adults, contrasting that regulation with the alternative of facilitating parental control of such material).

Like the do-not-mail regulation approved in Rowan, the national do-not-call registry does not itself prohibit any speech. Instead, it merely "permits a citizen to erect a wall ... that no advertiser may penetrate without his acquiescence." See Rowan, 397 U.S. at 738. Almost by definition, the do-not-call regulations only block calls that would constitute unwanted intrusions into the privacy of consumers who have signed up for the list. Moreover, it allows consumers who feel susceptible to telephone fraud or abuse to ensure that most commercial callers will not have an opportunity to victimize them. Under the circumstances we address in this case, we conclude that the do-not-call registry's opt-in feature renders it a narrowly tailored commercial speech regulation.

The do-not-call registry's narrow tailoring is further demonstrated by the fact that it presents both sellers and consumers with a number of options to make and receive sales offers. From the seller's perspective, the do-not-call registry restricts only one avenue by which solicitors can communicate with consumers who have registered for the list. In particular, the do-not-call regulations do not prevent businesses from corresponding with potential customers by mail or by means of advertising through other media. Cf. Florida Bar v. Went For It, Inc., 515 U.S. 618, 633-34 (1995) (holding a 30-day post-accident ban on attorney solicitations narrowly tailored, finding it relevant that ample alternative channels for advertising legal services were available).

From the consumer's perspective, the do-not-call rules provide a number of different options allowing consumers to dictate what telemarketing calls they wish to receive and what calls they wish to avoid. Consumers who would like to receive some commercial sales calls but not others can sign up for the national do-not-call registry but give written permission to call to those businesses from whom they wish to receive offers. See 16 C.F.R. § 310.4(b)(1)(iii)(B)(*i*); 47 C.F.R. § 64.1200(f)(9)(i). Alternatively, they may decline to sign up on the national registry but make company-specific do-not-call requests with those particular businesses from whom they do not wish to receive calls. See 16 C.F.R. § 310.4(b)(1)(iii)(A); 47 C.F.R. § 64.1200(d)(3). Therefore, under the current regulations, consumers choose between two default rules – either that telemarketers may call or that they

[12] The Court in Martin suggested that one kind of regulation of home solicitation that would pass constitutional muster would be a regulation "which would make it an offense for any person to ring the bell of a householder who has appropriately indicated that he is unwilling to be disturbed." 319 U.S. at 148.

may not. Then, consumers may make company-specific modifications to either of these default rules as they see fit, either granting particular sellers permission to call or blocking calls from certain sellers.

Finally, none of the telemarketers' proposed alternatives would serve the government's interests as effectively as the national do-not-call list. Primarily, the telemarketers suggest that company-specific rules effectively protected consumers. Yet as the FTC found, "[t]he record in this matter overwhelmingly shows the contrary ... it shows that the company-specific approach is seriously inadequate to protect consumers' privacy from an abusive pattern of calls placed by a seller or telemarketer." 68 Fed. Reg. at 4631.

First, the company-specific approach proved to be extremely burdensome to consumers, who had to repeat their do-not-call requests to every solicitor who called. Id. at 4629. In effect, this system gave solicitors one free chance to call each consumer, although many consumers find even an initial unsolicited sales call abusive and invasive of privacy. Id. at 4629-30; cf. FCC v. Pacifica Found., 438 U.S. 726, 748-49 (1978) ("To say that one may avoid further offense by turning off the radio when he hears indecent language is like saying that the remedy for an assault is to run away after the first blow. One may hang up on an indecent phone call, but that option does not ... avoid a harm that has already taken place."). Second, the government's experience under the company-specific rules demonstrated that commercial solicitors often ignored consumers' requests to be placed on their company-specific lists. 68 Fed. Reg. at 4629. Third, consumers have no way to verify whether their numbers have been removed from a solicitor's calling list in response to a company-specific do-not-call request. Id. Finally, company-specific rules are difficult to enforce because they require consumers to bear the evidentiary burden of keeping lists detailing which telemarketers have called them and what do-not-call requests they have made. Id.

The telemarketers' objection that the company-specific approach should have been more vigorously marketed to consumers is unavailing because the flaws the FTC identified are inherent in the company-specific rule. More consumer education simply could not have cured the ineffectiveness of the former system. Similarly, even if we were to agree with the telemarketers' argument that violations of the company-specific list were not adequately enforced, the national do-not-call program improves upon failures of the company-specific approach that were not caused by any lack of enforcement. Unlike the national registry, the company-specific approach gave a vast number of potential solicitors one shot at each unwilling consumer and was significantly more difficult for consumers to use. Moreover, the national do-not-call registry will be easier to enforce than the company-specific rules because there will generally be no dispute as to whether a certain telemarketer is prohibited from calling a particular number.

Finally, the telemarketers argue that it would have been less restrictive to let consumers rely on technological alternatives – such as caller ID, call rejection services, and electronic devices designed to block unwanted calls. Each of these alternatives puts the cost of avoiding unwanted telemarketing calls on consumers. Furthermore, as the FCC found, "[a]lthough technology has improved to assist consumers in blocking unwanted calls, it has also evolved in such a way as to assist telemarketers in making greater numbers of calls and even circumventing such blocking technologies." 68 Fed. Reg. at 44147. Forcing consumers to compete in a technological arms race with the telemarketing industry is not an equally effective alternative to the do-not-call registry.

In sum, the do-not-call registry is narrowly tailored to restrict only speech that contributes to the problems the government seeks to redress, namely the intrusion into personal privacy and the risk of fraud and abuse caused by telephone calls that consumers do not welcome into their homes. No calls are restricted unless the recipient has affirmatively declared that he or she does not wish to receive them. Moreover, telemarketers still have the ability to contact consumers in other ways, and consumers have a number of different options in determining what telemarketing calls they will receive. Finally, there are not numerous and obvious less-burdensome alternatives that would restrict less speech while accomplishing the government's objectives equally as well.

C. Discovery Network

As should be clear from the foregoing discussion, the telemarketers' reliance on Discovery Network is misplaced. In Discovery Network, the Supreme Court applied Central Hudson to strike down a municipal policy directly prohibiting freestanding commercial newsracks on public property. 507 U.S. at 412, 416. It concluded that the regulation – which did not similarly restrict non-commercial newsracks – did not bear a reasonable fit to the city's interests in promoting safety and the attractive appearance of the city's public areas. Id. at 412, 417. In particular, the Court emphasized that 1) the regulation applied to only a "minute" and "paltry" share of the total number of newsracks in the city, id. at 418, and 2) the regulation's distinction between commercial and non-commercial speech bore "no relationship whatsoever to the particular interests that the city has asserted." Id. at 424 (emphasis in original).

The trifling number of newsracks regulated in Discovery Network suggested that the policy did not materially advance the city's interests, and this aspect of the regulation was not justified by evidence demonstrating

that despite their small numbers the commercial newsracks disproportionately caused the problems the city sought to remedy. The Court held, in essence, that a regulation that has only a minimal impact on the identified problem cannot be saved simply because it targets only commercial speech, which occupies a lower place in our First Amendment jurisprudence. The Court concluded that the "low value" of commercial speech was "an insufficient justification for the discrimination against respondents' use of newsracks that are no more harmful than the permitted newsracks, and have only a minimal impact on the overall number of newsracks on the city's sidewalks." Id. at 418 (emphasis added). Under a straight-forward application of Central Hudson, the Court struck down the city's newsrack ordinance because it failed directly to advance the city's interests.

Both of the factors the Court emphasized in Discovery Network are absent in our case. First, while the regulation in Discovery Network applied only to a minute and paltry number of newsracks, the do-not-call registry blocks a substantial amount of unwanted telemarketing calls. See supra part III(B)(1). Second, while the distinction between commercial and non-commercial speech in Discovery Network bore no relationship whatsoever to the city's asserted interests, the do-not-call registry's commercial/non-commercial distinction was based on findings that commercial telephone solicitation was significantly more problematic than charitable or political fundraising calls. Id.; see also FTC v. Mainstream Mktg Servs., Inc., 345 F.3d 850, 856-60 (10th Cir. 2003). Additionally, the government had evidence that other alternatives (company-specific restrictions) failed in the commercial context, but had no comparable experience involving the failure of company-specific restrictions with respect to charitable or political callers. See supra part III(B)(2); 68 Fed. Reg. at 4637.

D. Summary

For the reasons discussed above, the government has asserted substantial interests to be served by the do-not-call registry (privacy and consumer protection), the do-not-call registry will directly advance those interests by banning a substantial amount of unwanted telemarketing calls, and the regulation is narrowly tailored because its opt-in feature ensures that it does not restrict any speech directed at a willing listener. In other words, the do-not-call registry bears a reasonable fit with the purposes the government sought to advance. Therefore, it is consistent with the limits the First Amendment imposes on laws restricting commercial speech.[13]

IV. OTHER ISSUES

The telemarketers also challenge various other aspects of the do-not-call registry. In turn, we consider 1) whether the fees telemarketers must pay to access the registry are constitutional, 2) whether it was arbitrary and capricious for the FCC to approve the established business relationship exception, and 3) whether the FTC had statutory authority to enact its do-not-call rules.[14]

A. The Do-Not-Call Registry Fees

To obtain the phone numbers of consumers who have signed up for the national do-not-call registry, telemarketers must pay a modest annual access fee determined by the FTC. Currently, the fee is $25 per area code of data, except that the first five area codes are provided free of charge and the maximum annual fee is capped at $7,375. 16 C.F.R. § 310.8(c). The telemarketers argue that this fee unconstitutionally imposes a revenue tax on protected speech. We disagree.

It is well-established that the First Amendment protects against the imposition of charges, such as a license taxes, for the enjoyment of free speech rights. Murdock v. Pennsylvania, 319 U.S. 105, 113-14 (1943). Nevertheless, the government is permitted to exact a fee in order to defray the cost of legitimate regulations, even though such a fee incidentally burdens speech. See id. at 114 n.8. In Murdock, for example, the Court struck down an ordinance that required Jehovah's Witnesses to pay licensing fees in order to distribute religious materials door-to-door, explaining that the regulation was "not a nominal fee imposed as a regulatory measure to defray the

[13] Our conclusion is consistent with other circuits' decisions approving similar telecommunications regulations. See Missouri v. American Blast Fax, Inc., 323 F.3d 649 (8th Cir. 2003) (upholding TCPA regulation prohibiting unsolicited commercial fax advertising); Destination Ventures, Ltd., v. FCC, 46 F.3d 54 (9th Cir. 1995) (same); Moser v. FCC, 46 F.3d 970, 972-75 (9th Cir. 1995) (upholding ban on prerecorded commercial telemarketing).

[14] The telemarketers' challenge to the do-not-call registry fees was raised below in case No. 03-1429, although the district court did not reach this issue. The challenge to the FCC's established business relationship exception has been raised only in case No. 03-9594, in which we review the FCC action directly. The telemarketers' challenge to the FTC's statutory authority to enact its do-not-call regulations was raised below in case Nos. 03-1429 and 03-6258. In case No. 03-1429, the district court declined to reach this issue; in case No. 03-6258, the district court held that the FTC lacked statutory authority.

expenses of policing the activities in question." Id. at 106, 113-14. The Court employed the same reasoning in Cox v. New Hampshire, upholding license fees of up to $300 to take part in a parade or procession because the fee was held "to be not a revenue tax, but one to meet the expense incident to the administration of the act and to the maintenance of public order in the matter licensed." 312 U.S. 569, 570-71, 576-77 (1941).

Accordingly, we recently approved the Utah Charitable Solicitations Act – which requires charitable fundraisers to register with the state and pay $250 for a permit – because that fee offsets increased regulatory costs associated with the act. American Target Adver., Inc. v. Giani, 199 F.3d 1241, 1246, 1248-49 (10th Cir. 2000). We held that "a regulatory fee may be constitutional only if it serves a 'legitimate state interest'" and that defraying the costs of a regulation aimed at protecting citizens from fraud is legitimate. Id. at 1248-49. Such fees may be imposed to defray both administrative expenses (such as processing and licensing costs) and the cost of enforcing the regulations. National Awareness Found. v. Abrams, 50 F.3d 1159, 1166 (2d Cir. 1995) ("[E]nforcement power is necessary to ensure that the purposes of [the regulations] are served.").

The Do-Not-Call Implementation Act authorized the FTC to collect fees for fiscal years 2003 to 2007, requiring that "[s]uch amounts shall be available for expenditure only to offset the costs of activities and services related to the implementation and enforcement of the Telemarketing Sales Rule, and other activities resulting from such implementation and enforcement." Pub. L No. 108-10, 117 Stat. 557 at § 2 (2003). In enacting the fees regulation, the FTC stated it was authorized only "to assess fees sufficient to cover the costs of implementing and enforcing the do-not-call provisions of the Amended TSR." Telemarketing Sales Rule Fees, 68 Fed. Reg. 45134, 45141 (July 31, 2003). The FTC estimated the costs of implementing and enforcing the national do-not-call registry at $18.1 million for fiscal year 2003. Id.

The record conclusively demonstrates that the do-not-call registry fees are to be used only to pay for expenses incident to the administration of the do-not-call registry, as required by Murdock and Giani. The FTC explained that the costs of the do-not-call registry fall into three major categories. First are the actual costs of developing and operating the national registry, such as the costs of handling consumer registration and complaints, transferring information from state lists to the registry, ensuring telemarketer access to the registry, and managing law enforcement access to appropriate information. Id. Second are the costs of enforcement efforts, such as domestic and international law enforcement initiatives to identify and challenge alleged violators, and consumer and business education efforts. Id. Third are the increased costs of agency infrastructure and administration, including changes in information technology structural support necessary to handle anticipated increases in consumer complaints and requests from law enforcement agencies for access to such complaints. Id. The FTC decided upon the $25 per area code fee in order to ensure that it would collect the amount necessary to defray these costs.[15]

Therefore, we hold that the registry fees are a permissible regulatory measure designed to offset projected expenses incident to the administration and enforcement of the national do-not-call list, not an unconstitutional revenue tax.

B. The Established Business Relationship Exception

The telemarketers next argue that the FCC's established business relationship exception is arbitrary and capricious in violation of the Administrative Procedure Act. See 5 U.S.C. § 706. In particular, they contend that the FCC failed to give appropriate consideration to the anti-competitive effect that this exception may have on telecommunications markets. We conclude that the FCC did in fact address this concern, and that the FCC's exception for established business relationships is not arbitrary and capricious under the APA.

The arbitrary and capricious standard of review is a narrow one, and we are not empowered to substitute our own judgment for that of the administrative agency. City of Albuquerque v. Browner, 97 F.3d 415, 424 (10th Cir. 1996). "Generally, an agency decision will be considered arbitrary and capricious if 'the agency had relied on factors which Congress had not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.'" Friends of the Bow v. Thompson, 124 F.3d 1210, 1215 (10th Cir. 1997) (quoting Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co., 463 U.S. 29, 43 (1983)).

[15] First, the FTC estimated that about 10,000 telemarketing firms would seek access to the list, and that the average telemarketer would pay to obtain about 73 area codes of data. 68 Fed. Reg. at 45141. Under those estimates, the expenses incident to the list would amount to about $25 per area code provided, excluding those that would be provided free of charge. Recognizing that its fee schedule is based on estimated figures, the FTC also emphasized that these fees would need to be reexamined periodically and adjusted to reflect the FTC's actual experience in operating the registry. Id. at 45141-42.

The Telecommunications Act of 1996, 47 U.S.C. § 251 et. seq., required local telephone monopolies to make their facilities and services available to competitors for negotiated or arbitrated prices, and directed the FCC to establish regulations to advance local competition. The FCC enacted its do-not-call rules under different statutory authority, the TCPA, which specifically authorized the FCC to establish a national database of residential telephone subscribers who object to receiving telephone solicitations. See 47 U.S.C. § 227(c)(3).

When an agency is charged to enforce overlapping and at times inconsistent policies, it cannot act single-mindedly in furtherance of one of those policies while wholly ignoring the other. Southern S.S. Co. v. NLRB, 316 U.S. 31, 46-47 (1942); McLean Trucking Co. v. United States, 321 U.S. 67, 80 (1944).

The FCC rule sufficiently addresses the telemarketers' concerns about the established business relationship exception. In its notice of rulemaking, the FCC asked for comments on the anti-competitive effect this exception might have on the telecommunications industry. See 68 Fed. Reg. at 44159. The FCC received responses indicating that such an exception would favor incumbent telephone service providers who would be able to market new services to their larger customer base. Id. at 44159-60. Also, the FCC noted some respondents' concerns that this anti-competitive effect would be particularly strong because telephone solicitations are currently the primary mechanism for selling telecommunications services. Id. at 44159. The FCC then considered several proposed ways in which such an anti-competitive effect could be mitigated, rejecting each of them.

First, the FCC considered a proposal to narrow the established business relationship exemption so that no telecommunications company could call its customers to advertise different services. Id. at 44160. However, the FCC cited comments in its administrative record emphasizing the importance of "flexibility in communicating with ... customers not only about their current services, but also to discuss available alternative services or products." Id. Accordingly, the FCC concluded that limiting telecommunications companies' ability to market new goods or services to existing customers would not be in the public interest. Id.

Second, the FCC considered a proposal that the Commission revise the definition of established business relationship so that all providers of telecommunications services would be deemed to have such a relationship with all consumers, even if they had not in fact had any preexisting business connections. Id. Third, it considered an alternative proposal that the definition of established business relationship be revised to exclude companies who have historically been dominant or monopoly service providers, at least until such time as the new entrants to the telecommunications industry sufficiently penetrated the market. Id. The FCC concluded that these proposals would not adequately fulfill Congress' mandate to protect residential telephone subscribers' privacy rights to avoid telemarketing calls to which they object: "To permit common carriers to call consumers with whom they have no existing relationships and who have expressed a desire not to be called by registering with the national do-not-call list, would likely confuse consumers and interfere with their ability to manage and monitor the telemarketing calls they receive." Id.

The FCC then explained the factors it believed would limit the established business relationship exception's anti-competitive effect. First, it noted that all providers of telecommunications services – incumbent carriers and new competitors alike – may contact competitors' customers who have not signed up for the national do-not-call registry. Id. Second, consumers who have signed up for the do-not-call registry still have the ability to place their carrier on a company-specific do-not-call list, thereby overriding the established business relationship exception. Id. Finally, the FCC emphasized that telecommunications providers are still free to use other means of marketing their products to consumers, such as direct mailings. Id.

The FCC's rule demonstrates that the agency did not simply ignore the potential anti-competitive effect of the established business relationship exception or its duties under the Telecommunications Act. Rather, the FCC analyzed the possible effects that this exception may have on the telecommunications industry and explained why it believed its rule would minimize any adverse consequences. When an agency has made a reasoned policy decision, "we are not empowered to substitute our judgment for that of the [agency]" under the arbitrary and capricious standard of review. Browner, 97 F.3d at 424. The FCC did not act in an arbitrary and capricious manner in adopting the established business relationship exception, and we decline the telemarketers' invitation to displace the FCC's policy judgment.

C. The FTC's Statutory Authority

In case No. 03-6258, the district court held that the FTC lacked statutory authority to enact the do-not-call registry. In the Telemarketing Act, Congress authorized the FTC to "prescribe rules prohibiting deceptive telemarketing acts or practices and other abusive telemarketing acts or practices." Pub. L. 103-297, 108 Stat. 1545 at § 3. More specifically, Congress directed the FTC to include "a requirement that telemarketers may not undertake a pattern of unsolicited telephone calls which the reasonable consumer would consider coercive or abusive of such consumer's right to privacy." Id. The FTC's conclusion that this language authorized it to enact the national do-not-call registry is entitled to deference under the familiar test outlined in Chevron, U.S.A., Inc. v. Natural Resources Defense Council. 467 U.S. 837, 842-43 (1984).[16] In light of this deference, we conclude that the FTC did have statutory authority to promulgate its do-not-call regulations because the agency's view that the Telemarketing Act authorized it to enact those rules is at least a permissible construction of that statute.

Moreover, even if some doubt once existed, Congress erased it through subsequent legislation. See North Haven Bd. of Educ. v. Bell, 456 U.S. 512, 535 (1982) ("Where an agency's statutory construction has been fully brought to the attention of the public and the Congress, and the latter has not sought to alter that interpretation although it has amended the statute in other respects, then presumably the legislative intent has been correctly discerned."); Schism v. United States, 316 F.3d 1259, 1289 (Fed. Cir. 2002) ("Congress may ratify agency conduct 'giving the force of law to official action unauthorized when taken.'") (citing Swayne & Hoyt v. United States, 300 U.S. 297, 302 (1937)). In the Do-Not-Call Implementation Act, Congress directed the FCC and FTC to maximize consistency between their respective do-not-call rules and authorized the FTC to collect do-not-call registry fees to offset the administrative costs of the regulations. Pub. L. 108-10, 117 Stat. 557 at §§ 2-3. Furthermore, in response to the district court's decision in case No. 03-6258, Congress expressly ratified the FTC's do-not-call regulations. An Act to Ratify the Authority of the Federal Trade Commission to Establish a Do-Not-Call Registry, Pub. L. 108-82, 117 Stat 1006 (2003). The FTC's statutory authority is now unmistakably clear.

V. CONCLUSION

We hold that 1) the do-not-call list is a valid commercial speech regulation under Central Hudson because it directly advances substantial governmental interests and is narrowly tailored; 2) the registry fees telemarketers must pay to access the list are a permissible measure designed to defray the cost of legitimate government regulation; 3) it was not arbitrary and capricious for the FCC to adopt the established business relationship exception; and 4) the FTC has statutory authority to establish and implement the national do-not-call registry.

The judgments below in cases 03-1429 and 03-6258 are REVERSED with respect to the questions presented in this appeal, and the petitions for review in cases 03-9571 and 03-9594 are DENIED.

[16] In reviewing an agency's construction of a statute it administers, we first ask whether Congress has directly spoken to the precise question at issue. If so, that is the end of the matter and Congress' intent controls. If the statute is silent or ambiguous with respect to this issue, our inquiry is limited to whether the agency's interpretation is a permissible construction of the statute. Chevron, 467 U.S. at 842-43.

COLLECTION LAW ISSUES AND PRACTICE

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SECTION F

COLLECTION LAW ISSUES AND PRACTICE

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I. Introduction

This chapter will focus on presenting a general overview of various defenses and potential counterclaims available to a debtor's lawyer and strategies to litigate collection cases. Many of the topics discussed below are treated in more detail in other chapters. *See e.g., infra*, Chapter 10. This chapter is meant to familiarize the debtor's attorney with some useful tools in representing the debtor.

Representing the defendant in collection cases presents special challenges for attorneys. In many cases debtors have a variety of legal defenses to collection actions. It is essential that the attorney for the debtor conduct an in depth interview with the client and review all the documents related to the case in a search for a defense or counterclaim. It is especially important for the private practitioner to review those claims and defenses that allow for payment of fees to the prevailing party.

Most of the federal consumer protection legislation contains provisions for mandatory payment of attorney fees to the prevailing consumer. There is generally a bad faith component to awarding fees against the consumer. Some of the federal laws and the Kentucky Consumer Protection Act give a court discretion to award fees. Attorney fees may even be available where statute of limitations on the debtor's claim has passed when the claim is raised only as a set-off under the doctrine of equitable recoupment. *Empire Finance Co. of Louisville, Inc. v. Ewing*, 558 S.W.2d 619 (Ky. Ct. App. 1977).

It is not infrequent in a debtor's attorney's practice to find individuals who are being sued for debts arising from high pressure sales tactics, such as time-share resort interests, health spa memberships, and unscrupulous home remodeling contractors. All too often, elderly, low-income, or uneducated debtors who have one asset—their home—run afoul of the "blue suede shoe" men and women of the home remodeling industry. Some contractors will use such high-pressure sales tactics as blank contracts and then launder the contracts by sale to an unrelated lender. The contract price may be grossly disproportionate to the work done, or the work is shoddy or sometimes not even performed. The debtors may refuse to make payments or not be able to afford payments and thus find themselves embroiled in a foreclosure suit. There has been an increase in the number of foreclosures resulting from an array of predatory lending practices.

Another large source of consumer debt is the deficiency suit brought by automobile dealers or their financing arms. Typically, the lowest income group must purchase cars at inflated costs and high interest rates. When the vehicle breaks down prior to full payment of the installment loan, as so often occurs, the vehicle is repossessed and sold at auction for a minuscule amount that does not begin to cover the debt.

Class actions, pursuant to Rule 23 of the Kentucky and Federal Rules of Civil Procedure, are another means of allowing low-income debtors to assert their rights if the creditor's actions are systemic, but this topic is outside of the scope of this handbook.

II. Default Judgments

The debtor's attorney should not automatically be deterred by a recently entered default judgment. Unfortunately, many of these clients do not understand the legal significance of the lawsuit, or there are other crises in their lives (e.g., illness, divorce, loss of transportation, etc.) that cause them to disregard the lawsuit until their wages are garnished or a lien is placed on their home. Often, this is the spur to seeking legal assistance.

Kentucky law permits setting aside a default judgment. Kentucky Rule of Civil Procedure ("Civil Rule" or "CR") 55.02 allows a default judgment to be set aside "(f)or good cause shown" in accordance with Civil Rule 60.02. Civil Rule 60.02 permits the court to relieve a party from final judgment upon the finding of one of the following grounds: (a) mistake, inadvertence, surprise or excusable neglect; (b) newly discovered evidence; (c) perjury or falsified evidence; (d) fraud affecting the proceedings; (e) the judgment is void; or (f) any other reason of an extraordinary nature justifying relief. Civil Rule 60.02 requires that the motion to set aside a default judgement be made within a reasonable time and provides a one year limit on bringing a motion based upon grounds (a), (b), or (c).

The court in *S.R. Blanton Dev. Co. v. Investors Realty and Management Co.,* 819 S.W.2d 727 (Ky. Ct. App. 1991), set out the factors to consider in deciding whether to set aside a default judgment: "(1) valid excuse for default, (2) meritorious defense, and (3) absence of prejudice to the other party." The valid excuse and meritorious defense factors are fairly self-explanatory. It is important to note that the prejudice suffered by the plaintiff must be more than simply the prejudice of having opposition to its complaint, and it must be more than mere delay in obtaining a judgment. "To establish prejudice, the plaintiff must show that the delay will result in the loss of evidence, increased difficulties in discovery, or greater opportunities for fraud and collusion." *Berthelsen v. Kane*, 907 F.2d 617 (6th Cir. 1990).

Many defendants will claim that they were never served with a summons, but generally speaking, a review of the court file will indicate that service was made. This is not to say that occasionally there is insufficient service–where, for instance, the summons is delivered to the wrong family member. "Kentucky follows a strict adherence to the rule of 'in-hand service of process.'" *R.F. Burton and Burton Tower Company v. Dowell Division of Dow Chemical Company*, 471 S.W.2d 708, 710 (Ky. 1971) (citation omitted). However, the debtor must present clear and convincing evidence to overcome the record of a properly served summons. *Nicholson v. Thomas*, 277 Ky. 760, 127 S.W.2d 155 (1939).

The trial court has great discretion is determining whether the judgment should be set-aside. From a practical point of view, the attorney, in determining whether it is worthwhile attempting this motion, should have a sympathetic client with a strong defense, and the judgment should be fairly recent. If the judgment cannot be set-aside, a bankruptcy may be the only alternative to stop a garnishment or foreclosure.

III. Venue

Generally speaking, a collection action should be brought where the defendant resides. KRS 452.480 states that transitory actions not specifically covered by another section are to be filed in the county where the defendant resides. In *Cash v. E'town Furniture*, 363 S.W.2d 102 (Ky. Ct. App. 1962), the court held that a default judgment is void where the defendant is not a resident of the county nor served in the county of the action. However, in *Goodwin Brothers v. Preferred Risk Mut. Ins. Co.*, 410 S.W.2d 714 (Ky. 1967), the court upheld a default judgment against an impleaded non-resident third party.

The Fair Debt Collection Practices Act requires that a debt collector must bring suit in the place where the contract was signed or where the debtor resides at the commencement of the action. 15 U.S.C. § 1692(i).

IV. Exemptions

There may be occasions when the debtor is likely to be permanently "judgment proof," and there may be little reason to contest the debt or file bankruptcy. Some of the more important debtor assets from which judgment creditors may not seek to satisfy their judgment are the following exemptions:

- household furnishings;

- jewelry;
- personal clothing and ornaments up to $3,000;
- one motor vehicle and its necessary accessories, including one spare tire up to $2,500 (KRS 427.010(1));
- a homestead or burial plot worth up to $5,000 (KRS 427.060);
- various pensions;
- retirement benefits and individual retirement accounts (KRS 61.690, KRS 161.700, KRS 427.120, KRS 427.125);
- unlimited public assistance payments (KRS 205.220);
- Social Security benefits (42 U.S.C. § 407); and
- SSI (42 U.S.C. § 1383(d)(1)).

In addition, KRS 427.010(2) and 15 U.S.C. § 1673 limit the garnishment of wages to the extent of 30 times minimum wage or 75% (net), whichever leaves the debtor with more.

Pensions and Social Security may be used, with some limitations, for child support and maintenance obligations. The same exception does not apply to SSI, although the amount of the SSI payment can be used to calculate the amount of child support due from the non-custodial parent. KRS 403.212.

The Earned Income Tax Credit ("EITC"), codified at 26 U.S.C. § 32 of the Internal Revenue Code, was found by Kentucky bankruptcy courts to be exempt from a creditor's attachment or execution as a public assistance payment. *In re Brown*, 186 B.R. 224 (Bankr. W.D. Ky. 1995); *In re Goldsberry*, 142 B.R. 158 (Bankr. E.D. Ky. 1992). However, in the case of *In re Duvall*, 281 B.R. 646 (Bankr. W.D. Ky. 2002), two of the bankruptcy judges in the Western District of Kentucky Bankruptcy Court renounced *In re Brown*. It is likely that the decision of *In re Duvall* will be appealed.

The Federal Child Tax Credit ("FCTC"), codified at 26 U.S.C. § 24, was found not to be exempt. *In re Beltz*, 263 B.R. 525 (Bankr. E.D. Ky. 2001). The *Beltz* court distinguished the EITC and the FCTC, reasoning that, unlike the EITC, the primary purpose of the FCTC is not to provide tax relief to low income families but primarily to benefit middle class Americans.

In spite of the exemptions, debtors may find that their bank accounts have been garnished and that they will need to go to court to have the money returned. A simple procedure has been established for the debtor to fill out an affidavit with the circuit clerk and be given a court date to bring in proof that the funds are exempt. Even this process may be beyond the capabilities of a number of elderly, disabled or unsophisticated debtors such that legal assistance is required to reclaim these crucial funds. When contacted by the debtor's attorney, some collection attorneys will return the funds if provided with proof of the exemption. Otherwise, the debtor will need to appear at the court date that is assigned by the clerk to prove to the court that the funds taken are exempt.

The debtor should be advised to have the exempt sources of income direct-deposited into a bank account and never to mix money from any other source in the same account. This simplifies the proof process, although the Kentucky Supreme Court has held that the exemption is not lost when mixed with other money if it can be traced. *Matthews v. Lewis*, 617 S.W.2d 43 (Ky. 1981). As a safety precaution, debtors may wish to keep these funds in a different financial institution than one to which they owe money. The issue of whether a bank setoff of exempt funds is prohibited to the same extent as a garnishment or

attachment has not been decided in this jurisdiction. However, the majority of courts that have examined this issue elsewhere have found that setoff is prohibited. *See, e.g., Tom v. First American Credit Union*, 151 F.3d 1289 (10th Cir. 1998); *Marengo v. First Mass. Bank*, 152 F. Supp. 2d 92 (D. Mass 2001). However, the Ninth Circuit Court of Appeals has held to the contrary. *Lopez v. Wash. Mut. Bank*, 2002 U.S. App. LEXIS 15658, 2002 WL 1792494 (9th Cir. 2002).

V. Consumer Remedies

During the 1970s and 1980s, consumer activism gave rise to a host of state and federal laws that provide consumers with potential counterclaims and defenses.

A. Equal Credit Opportunity Act

The Equal Credit Opportunity Act ("ECOA"), codified at 15 U.S.C. §§ 1691-1691f and Part 202 of the Code of Federal Regulations apply specifically to the right to consumer credit and the procedural safeguards involved in preserving these rights and prohibit discrimination in the extension of credit based on race, color, religion, national origin, gender, marital status, or age. One particularly helpful provision of the ECOA is the requirement that the creditor (as that term is defined in the ECOA, which can include arrangers of credit) must provide specific written reasons for the denial of credit. Of course, there are exceptions, and the attorney must review the ECOA in its entirety. This situation may arise where the debtor's credit application (usually involving a car purchase) has been shopped to a number of different creditors.

For more on the ECOA, *see infra*, Sections [10.64] through [10.71] and [10.112].

B. Fair Credit Reporting Act

The Fair Credit Reporting Act ("FCRA"), codified at 15 U.S.C. §§ 1681- 1681u, prohibits reporting of inaccurate or obsolete credit information and provides an individual the right to dispute the accuracy of a credit report. Inaccurate information can give rise to damage actions by consumers against consumer reporting agencies and furnishers of information.

The FCRA was amended in 1996 to add significant new remedies against the furnishers of inaccurate information, who were previously not covered by the FCRA. The furnisher of information now has a duty to correct and update the information and also must note when that information has been disputed. Furnishers must also participate in reinvestigation of disputed information. The liability of furnishers is generally not for providing the bad information but for failing to correct it following a consumer dispute. The FCRA requires the creditor to follow-up an original report with notice that the debt is disputed, and it must note that the information has been disputed in all future reports. Attorneys should have their clients review their credit reports for compliance with this section, especially where the consumer has legally cancelled a transaction and stopped payment because of a seller's breach.

The FCRA also protects consumers from the unauthorized use of their credit reports. The FCRA enumerates the permissible purposes to obtain a credit report. If not specifically permitted, it is prohibited. For example, it is not permissible to obtain a credit report on the debtor's spouse or another third person unless the consumer is relying on the third party's income and the third party is also liable on the account. Collecting judgments is a permissible use, but litigation itself is not a permissible purpose. In *Duncan v. Handmaker*, 149 F.3d 424 (6th Cir. 1998), the attorney defending a mortgage company in a negligence suit brought by consumers had no permissible purpose in accessing the plaintiffs' report; the business transaction underlying the suit did not extend to the litigation of the negligence claim.

Because credit bureaus may report accurate information, the debtors' credit record may remain blemished with a history of late payments even after a suit is resolved in their favor. It is good practice for the attorney, as part of any settlement agreement, to include a requirement that the negative information be eliminated or that the account information be deleted entirely. Consumers should be advised to check their reports periodically to be sure that the information has not been reinserted.

For more information on the FCRA, *see infra*, Sections [10.55] through [10.63].

C. Credit Repair Organizations Act

The Credit Repair Organizations Act ("CROA") was also signed into law in 1996 as part of the Omnibus Consolidated Appropriations Act. Pub. L. No. 104-208, § 2451. It applies to contracts entered into beginning on March 30, 1997. The CROA was enacted to regulate the activities of credit repair clinics that promise, for a fee, to improve a consumer's credit record.

Under this act, no credit repair services can be provided until three days after a written contract is signed. The contract must disclose certain information, including the total of all fees due, the timing and nature of all services and the three-day right to cancel. The credit repair organization must also provide, on a separate document, disclosure of consumer rights to self-help. Misleading statements or advice is prohibited. The repair organization is prohibited from receiving payment until service is fully performed. Creative consumer attorneys have successfully used the CROA against car dealers and others who make promises of improving the plaintiff's credit record by purchasing with credit.

D. Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act ("FDCPA") applies only to debt collectors: any person whose principal business is collecting debts or any person who regularly collects debts owed to another.

The FDCPA does not exclude attorneys, although the nature and amount of collection activities required for an attorney to be considered a debt collector has been the subject of much litigation. In *Schroyer v. Frankel*, 197 F.3d 1170 (6th Cir. 1999), the Sixth Circuit Court of Appeals held that "for a court to find that an attorney or law firm 'regularly' collects debts for purposes of the FDCPA, a plaintiff must show that the attorney or law firm collects debts as a matter of course for its clients or for some clients, or collects debts as a substantial, but not principal, part of his or its general law practice." In that case, the court found that the firm was not a debt collector because collection cases made up only two percent of the firm's business and it did not employ individuals full-time for the purpose of collecting debts.

Although the FDCPA generally excludes creditors collecting their own debts, the debtor's attorney may be able to pursue an action through tort law or the Kentucky Consumer Protection Act. A Kentucky Attorney General opinion states, "although the FDCPA applies only to third party debt collectors, it serves as a guideline for determining what is an unfair, false, misleading, or deceptive practice in violation of the Kentucky Consumer Protection Act, KRS 367.170." 1983 Ky. Op. Att'y Gen. 2-161, Ky. OAG 83-121, 1983 WL 166379 (Ky. A.G.).

The FDCPA prohibits a number of specific activities, such as: communications at unusual or inconvenient times; contacts with consumers following a letter to cease collection attempts; communication with third parties, such as friends, neighbors, boss, etc.; harassing, oppressive and abusive conduct; and a number of other acts.

The FDCPA also provides debt collectors with various statutory obligations as well. The initial communication sent to a consumer must contain:

- the amount of the debt;
- the creditor's name;
- a statement that unless the consumer disputes the validity of the debt within thirty days of receipt of the notice, the debt collector will assume the debt to be valid;
- a statement that if the consumer does dispute the debt in writing within thirty days, the debt collector will obtain verification of the debt or a copy of the judgment; and
- a statement that, upon the consumer's written request, the debt collector will provide the consumer with the name and address of the original creditor, if different from that of the current creditor.

The debt collector must also disclose on all communications that it is for the purpose of collecting a debt and all information will be used for that purpose. The debtor's attorney should obtain a detailed history from the client and, if possible, copies of all communications with the debtor.

For more on the FDCPA, *see infra*, Sections [10.138] through [10.146].

E. Credit Practice Rule

The Federal Trade Commission's ("FTC") credit practice rule, found at 16 C.F.R. Part 444, states that it is an unfair act or practice for a lender or retail installment seller directly or indirectly to take or receive from a consumer an obligation that contains a cognovit or confession of judgment, waives or limits exemptions, contains an assignment of wages (with exceptions), or contains a nonpossessory security interest in household goods other than a purchase money security interest. Although there is no private right of action to enforce violations of this rule, the practitioner can allege that these prohibited acts also violate the Kentucky Consumer Protection Act's prohibition of unfair acts and practices. KRS Chapter 367.

For more on the FTC credit practice rule, *see infra*, Sections [10.72] through [10.77].

F. Door-to-Door Sales Rule

The FTC's home solicitation rule, located at 16 C.F.R. Part 429, requires disclosure in written form of a three-day right of rescission in the event of a home door-to-door transaction. The Kentucky law concerning door-to-door sales, KRS 367.410, gives an individual three days to cancel the purchase of an item costing more than $25. There is an exemption for individuals or companies that sell insurance or goods provided in an emergency at the request of the buyer. If the consumer agrees to purchase a good at the seller's place of business and the completion of the business transaction occurs in the buyer's home, the three-day right of rescission evaporates. Notably, if a buyer requests that a seller appear at his home, this request will not necessarily relieve the seller of any obligation under this statute.

For more on FTC and Kentucky home solicitation provisions, *see infra*, Sections [10.46] through [10.50] and [10.111].

G. Odometer Statutes

The Federal Odometer Act, 49 U.S.C. §§ 32701-32711, was recodified in 1994 and additional changes were made in 1996 and 1998. The governing regulations can be found at 49 C.F.R. §§ 580.1-580.17. This act prohibits odometer tampering and, with certain exceptions, mandates the disclosure of mileage on the title document. Automobile dealers rarely show the purchasers the actual title document as

required, and if the purchasers can prove intent to defraud, they have a cause of action for which they can receive three times actual damages or $1,500, whichever is the greater, plus costs and attorney fees. The title document can provide important information to the purchaser, such as the identity of the previous owner and notice of title brands, such as flood damage and prior wrecks.

Kentucky's odometer statute is found at KRS 190.260 through 190.320 and KRS 190.990 (4). It also entitles the buyer to three times the actual damage or $1,500, whichever is greater, plus attorney fees and court costs for tampering or knowingly giving a false disclosure with intent to defraud.

H. Federal Truth in Lending Act

The Federal Truth in Lending Act ("TILA"), 15 U.S.C. §§ 1601 – 1615, primarily regulates the disclosure of information, and not the amount of interest that may be charged. The purpose of TILA is to require that disclosures be made in a way that allows for intelligent comparison. For this reason, the consumer must be provided with a copy of the disclosures to review prior to signing. The Official Staff Commentary to Section 226.17 states "it is not sufficient for the creditor merely to show the consumer the document containing the disclosures before the consumer signs and becomes obligated. The consumer must be free to take possession of and review the document in its entirety before signing." The disclosures must be given prior to consummation in a form that the consumer may keep.

TILA provides for damages, costs, and attorney fees for certain violations and, in some situations, rescission of the transaction–a very powerful tool. The accompanying regulations, known as Regulation Z, are found at 12 C.F.R. Part 226. The act regulates both open-end credit, such as revolving credit cards, and closed-end credit (e.g., the typical car loan).

In this day of computers, large creditors rarely make mathematical errors. Most mistakes that occur will be from the small "buy-here pay-here" car dealers and from creditors failing to include certain extra charges (hidden interest) as part of the finance charge. TILA and the regulations thereunder are quite specific about what may be excluded from the finance charge. Creditors' motivation for keeping as many charges as possible out of the finance charge is to make the annual percentage rate appear as low as possible. The debtor's attorney should check the math and carefully scrutinize credit insurance and other fees and costs charged to the consumer. For more information on TILA, *see infra*, Sections [10.37] and [10.78] through [10.112].

TILA allows rescission where the creditor takes a security interest in the debtor's residence. The debtor can rescind for any reason within three business days of entering the transaction. The debtor can also rescind for up to three years if a material TILA violation is discovered. For more information on TILA rescission, *see infra*, Sections [10.78] through [10.112].

In 1994 Congress passed the Home Ownership and Equity Protection Act ("HOEPA"), which gives additional protection to debtors entering into certain closed-end home equity loans. HOEPA kicks in if the annual percentage rate is over an amount based upon Treasury bond rates or if the fees and costs are over 8% of the amount of the loan. HOEPA violations also provide the debtor with enhanced damages and attorney's fees. For more on HOEPA, see infra, Sections [10.113] through [10.120].

I. Consumer Leasing Act

The Consumer Leasing Act ("CLA") is part of the Truth in Lending Act. The accompanying regulations are known as Regulation M and are found at 12 C.F.R. Part 213. The CLA only applies to leases longer than four months and where the contract obligation does not exceed $25,000. This act requires that certain lease disclosures be made in a particular way. There are different rules for leases signed on January 1, 1998 and after. More consumers are obtaining vehicles by lease, and they are often shocked to learn that when they return the vehicle prior to the end of the lease there are enormous charges.

The CLA, in addition to the disclosure requirements, also includes substantive regulation of the early termination charge, which must not be "unreasonable."

J. Magnuson-Moss Warranty Act

The Magnuson-Moss Warranty Act ("Magnuson-Moss") does not require that warranties be given, but it regulates the content, the disclosure and the duties of those who choose to sell or provide warranties and extended service contracts. The act is found at 15 U.S.C. §§ 2301-2312, and the FTC's governing regulations are located at 16 C.F.R. Subchapter G, Parts 700-703. Of particular significance to the consumer's attorney in an auto deficiency case is Magnuson-Moss' prohibition of disclaimers of implied warranties when the dealer sells a service contract. The seller may limit but may not completely disclaim implied warranties. Therefore, the dealer may not sell the vehicle "AS IS", which, in addition to a possible Magnuson-Moss violation, restores the purchaser's rights to assert a breach of the implied warranty claim. The question remains unresolved as to whether a dealer who sells the service contract of another is subject to this restriction. A violation entitles the consumer to actual damages; there are no statutory damages. Attorney fees to the prevailing consumer are discretionary and not mandatory.

For more on Magnuson-Moss, *see infra*, Section [10.53].

K. Kentucky Consumer Protection Act

The expanded consumer activism of the 1970s and 1980s has also given rise to a plethora of remedies under the Kentucky Consumer Protection Act ("KCPA"), found at KRS 367.010 through KRS 367.993. This chapter of the Kentucky statutes was passed to protect the public interest and well being of both the consumer and the ethical vendors in the state.

In addition to the discussion on the KCPA in this chapter in Sections [2.16] through [2.26], *see also infra*, Sections [10.1] through [10.22] and [10.110].

1. Right of Action

KRS 367.220 gives the consumer the right to bring an action in circuit court for relief. The KCPA provides, in part:

> Any person who purchases or leases goods or services primarily for personal, family or household purposes and thereby suffers any ascertainable loss of money or property, real or personal, as a result of the use or employment by another person of a method, act or practice declared unlawful by KRS 367.170, may bring an action under the Rules of Civil Procedure in the Circuit Court in which the seller or lessor resides or has his principal place of business or is doing business, or in the Circuit Court in which the purchaser or lessee of goods or services resides, or where the transaction in question occurred, to recover actual damages. The court may, in its discretion, award actual damages and may provide such equitable relief, as it deems necessary or proper. Nothing in this subsection shall be construed to limit a person's right to seek punitive damages where appropriate.

KRS 367.220(1). The consumer's lawyer should note that the jurisdiction for original cases lies in circuit court, although a counterclaim or defense may also lie in district court.

The Kentucky Attorney General also has the authority to bring actions on behalf of defrauded consumers to seek restitution on their behalf. *Com. ex rel Beshear v. ABC Pest Control*, 621 S.W. 2d 705 (Ky. Ct. App. 1981). The utility of an Attorney General's action that results in a permanent injunction or judgment is made evident under KRS 367.220, which provides:

(4) Any permanent injunction, judgment or order of the court made under KRS 367.190 shall be prima facie evidence in an action brought under this section that the respondent used or employed a method, act or practice declared unlawful by KRS 367.170.

(5) Any person bringing an action under this section must bring such action within one (1) year after any action of the Attorney General has been terminated or within two (2) years after the violation of KRS 367.170, whichever is later.

Therefore, it follows that the debtor would have a defense to collection activity if the Kentucky Attorney General has been granted an injunction. In defending any collection case against a "regulated" plaintiff (health spas, buying clubs, etc.), it would behoove the debtor's lawyer to check with the Kentucky Attorney General's Consumer Protection Division to see if the Commonwealth may have brought, or is contemplating, an action.

2. Prohibited Acts

KRS 367.170 declares unlawful, "unfair, false, misleading, or deceptive acts or practices in the conduct of any trade or commerce." The definition of "unfair" is "unconscionable." The consumer's attorney should review the acts and practices found wrongful by the FTC and by analogy argue that they also violate the KCPA.

3. Scope

The definition of "trade" and "commerce" is very broad: "the advertising, offering for sale, or distribution of any services and any property, tangible or intangible, real, personal or mixed, and any other article, commodity, or thing of value, and shall include any trade or commerce directly or indirectly affecting the people of this Commonwealth." KRS 367.110(2). Since there are no statutory exclusions as to the scope of coverage, insurance, banking and other credit activities are covered as well, although the courts have limited the KCPA's application in certain circumstances. *Capitol Cadillac Olds. Inc. v. Roberts*, 813 S.W.2d 287 (Ky. 1991) (not every failure to perform a contract is necessarily a violation of the KCPA; there must be something unfair, false, misleading or deceptive or an element of intentional or gross negligence); *Miles v. Shauntee*, 664 S.W.2d 512 (Ky. 1983) (a violation of the housing code by itself did not constitute a violation of the KCPA); *Craig v. Keene*, 32 S.W.3d 90 (Ky. Ct. App. 2000) (KCPA does not apply to individual real estate transactions); *Curry v. Cincinnati Equitable Insurance Co.*, 834 S.W.2d. 701 (Ky. Ct. App. 1992) (KCPA is preempted by ERISA).

4. Buying Club Memberships

Under KRS 367.397 a customer may cancel buying club memberships by giving written notice at any time before midnight of the thirtieth business day following the date on which membership was attained. In addition, the same statute provides, in pertinent part, that:

(a) ...Such cancellation shall be without liability on the part of the member and shall entitle the member to a refund of the entire consideration paid for the contract; or

(b) ...Such cancellation shall be on a pro rata daily basis, the member being responsible only for that portion of the contract consideration representing the time elapsed on the contract and being entitled to a refund of that portion of the fee representing the days remaining on the contract at date of cancellation. If the contract duration is for the life of the member, the daily value shall be determined by standard actuarial tables.

KRS 367.397(1).

Cancellation rights are non-waivable. The members' right to cancel must be disclosed in 14-point type and in the above language. Until the club complies with this notice requirement, the customer may cancel and receive a full refund. KRS 367.399(2).

5. Home Solicitation Sales

KRS 367.410 through 367.450 regulates home solicitation sales and largely tracks the FTC regulation on home solicitation sales, 16 C.F.R. § 429.1. The seller must give to the buyer a notice of right to cancel.

Until the seller complies with the statute, the buyer may cancel. KRS 367.430(3). Former Attorney General Chris Gorman stated in an opinion that in home solicitation sales that are a combined sales/credit transaction, "the three-day right to cancel does not begin to run until the date that the credit contract is signed and the consumer is given the credit disclosures required by the federal Truth-in-Lending Act." 1992-1993 Ky. Op. Atty. Gen. 2-63, Ky. OAG 92-41, 1992 WL 540962 (Ky. A.G.).

6. Recreation and Retirement Land Sales

KRS 367.470 through 367.486 regulates recreation and retirement land sales. The seller must post a bond (KRS 367.474(1)) or escrow 50% of the sales receipts (KRS 367.474(3)). The buyer has five days to cancel the agreement, calculated from receipt of a mandatory notice.

7. Mobile Home Sales

KRS 367.710 through 367.775 regulates the sale of mobile homes. KRS 367.715 creates a presumption of nonmerchantability when:

> Any mobile home that, within the first twelve (12) months after delivery to the owner has a defect which cost the owner at least four percent (4%) of the purchase price to repair and which requires repair or replacement on three (3) separate occasions. . . .

Strict notice requirements are set up by KRS 367.725, which requires certified mail, return receipt requested within ten (10) days of the defect. If there is non-compliance by the manufacturer, the consumer has an action for the price of the mobile home. KRS 367.750.

8. Defective New Cars ("Lemon Law")

Kentucky's "lemon law" coverage is found at KRS 367.840 through 367.846, and gives the purchaser (for purchases after July 15, 1986) or lessee (for leases after July 15, 1998) of a new car the right to replacement or refund at the consumer's option if, after a reasonable number of attempts, the manufacturer is unable to repair a defect that "substantially impairs the use, value, or safety of the motor vehicle." The manufacturer is entitled to " a reasonable allowance for the buyer's use of the vehicle" when the refund remedy is chosen. The cut-off period is 12,000 miles or twelve months from delivery, whichever is earlier. The purchaser must send written notification of the defect to the manufacturer. The statute also requires the use of an informal dispute resolution system prior to litigation. *See also infra*, Section [10.54].

9. Rental-Purchase Agreements

KRS 367.976 through 367.985 regulates the rent-to-own business. Many low income consumers pay exorbitant amounts of money to acquire goods in this manner. The KCPA primarily provides for

specific disclosures of cost and payment information to the consumer, but it also substantively regulates some areas, such as termination and reinstatement.

10. Others

There are additional specific Kentucky statutes related to health spas, telephone solicitations, subscriptions, negative option plans, charitable solicitations, sales of business opportunities, pyramid sales, cremation, and pre-need funeral services and burial contracts. If any of these sections are applicable, the debtor's attorney should check the statute for details.

L. Check Cashing

In 1998 the legislature enacted statutes regulating the check cashing industry–also known as pay day lenders. KRS Chapter 368. Typically, a low income person needing money writes a post-dated check that covers the amount of the loan and fee. On "pay day" the check can be redeemed by full payment, or the check-casher may extend the time for an additional fee. Prior to the statutory enactment, the interest on these loans was running, in some cases, as much as 800% and more.

In *Hamilton v. York*, 987 F. Supp. 953 (E.D. Ky. 1997), the United States District Court held that these transactions were not excluded from Kentucky's usury statutes. In *White v. Check Holders, Inc.*, 996 S.W.2d 496 (Ky. 1999), the Kentucky Supreme Court agreed, holding that transactions that took place prior to enactment of Chapter 368 amendments (April 1998) were not protected from usury and RICO laws.

The statutes now protect the check-cashing company if it stays within the still very high allowable limits: $15 per $100 check per fourteen days. However, there are certain protections for the consumer—the most important of which may be the prohibition on convicting or threatening to prosecute a borrower under the "cold check" laws. This information must be conspicuously displayed at the business site.

M. Uniform Commercial Code – Article 9

One source of aid for debtors facing a large deficiency following the repossession of a vehicle is found in the notice and resale requirements of Article 9 of the Uniform Commercial Code, which were revised effective July 1, 2001. The debtor's attorney must check the statutory requirements of KRS 355.9-611 and 355.9-614 to determine if the client received all the proper notices. For instance, the secured party must provide consumers a notice prior to disposition that, in addition to the specifics of the proposed sale of the collateral, also informs the consumer how surpluses or deficiencies are handled and provides contact information on how to obtain additional information.

KRS 355.9-610(2) is of particular importance; it mandates that "(e)very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable." The burden is on the secured party to prove commercial reasonableness and reasonable notice. *Holt v. Peoples Bank of Mt. Washington*, 814 S.W.2d 568, 571 (Ky. 1991). A great disproportionate difference between the value of collateral and the amount realized at the sale of the collateral creates a presumption of commercial unreasonableness. *School Supply Co., Inc. v. First National Bank of Louisville*, 685 S.W.2d 200 (Ky. Ct. App. 1985). "(A)s a general rule the question of what is 'commercially reasonable' is a question of fact, not a question of law." *McCoy v. American Fidelity Bank & Trust Co.*, 715 S.W.2d 228 (Ky. 1986) (this case questioned that aspect of the *School Supply Co.*, where it was found that this issue was a question of law).

VI. Bankruptcy

When all else fails to protect the consumer from loss of home or garnishment of wages, a bankruptcy may be necessary. Congress has been on the verge of substantially changing the Bankruptcy Code as it relates to individual debtors, and by the time of the printing of this handbook, major changes may have occurred.

There are two kinds of bankruptcy that the average consumer debtor will normally consider, Chapter 7 (a liquidation) and Chapter 13 (a reorganization). However, a Chapter 11 filing may also be relevant for an individual debtor who is in business or may have unsecured debts exceeding the statutory maximum for a Chapter 13. *See* 11 U.S.C. § 109(e). The shortcoming of a Chapter 11 case is the lack of a co-debtor stay, which is available in Chapter 13 under 11 U.S.C. § 1301. However, by the filing of a Chapter 11 personally, with a similar reorganization plan as in the corporate Chapter 11, the debtor may be able to preserve his or her business and personal assets.

There is little doubt that there is a "tilt" toward Chapter 13 in the Bankruptcy Code, i.e., a legislative effort to push debtors to use this chapter by the provision of more "debtor-friendly" provisions. First, there are the expanded discharge provisions found in 11 U.S.C. § 1322. Generally, unless there is a violation of the good faith requirements under 11 U.S.C. § 1328, most debts can be discharged. The most important exceptions are debts that mature after the life of the plan, chiefly mortgages, taxes and child support.

Often, the choice of filing a Chapter 13 instead of a Chapter 7 is a matter of personal pride as well as a consideration of the type of debts and assets. Most consumer debtors profess that they wish to pay their bills, but their economic life has been wrecked by circumstances. The debtor may be paying his or her bills but making no progress because of high interest rates. Collection activity, either through court-generated garnishments or out-of-court activity, may push the debtor into bankruptcy.

A. Chapter 7

The classic Chapter 7 client is a laid off worker with a high debt load of credit cards or a debtor with no medical insurance and high medical bills. There are few guidelines for who is eligible for a Chapter 7, other than the prohibition against serial filings found in 11 U.S.C. § 109(g).

There are two creditor responses to a debtor in Chapter 7: (1) a non-dischargeability petition under 11 U.S.C. § 523 or (2) a request for a denial of discharge pursuant to 11 U.S.C. § 727. Only individuals may be granted a discharge. 11 U.S.C. § 727(a). The exceptions to discharge or designations of non-dischargeable debts are easily explained to the average debtor as being public policy debts and are set forth at length at 11 U.S.C. § 523.

Some of the most common non-dischargeable debts are taxes. 11 U.S.C. § 523(a)(1). However, income taxes due three years from the date the return is due *are* dischargeable; for example, taxes can be discharged for 2002 after April 15, 2006. Other non-dischargeable debts include debts arising through fraud in obtaining credit, other fraud or defalcation, and willful and malicious injury.

Although Section 523(a)(3) of the Bankruptcy Code bars from discharge any debts that are not listed by the debtor, an otherwise dischargeable debt which is omitted from the debtor's schedules in a Chapter 7 no-asset case is discharged anyway. *Zirnhelt v. Madaj (In re Madaj),* 149 F.3d 467 (6th Cir 1998).

11 U.S.C. § 523(a)(5) mandates that support or alimony is non-dischargeable. "An award that is designated as support by the state court and that has certain indicia of a support obligation (along with any

others that the state support statute considers) should be conclusively presumed to be a support obligation by the bankruptcy court." *Sorah v. Sorah (In re Sorah)*, 163 F.3d 397 (6th Cir. 1998)

11 USC § 523(a)(15) makes property settlements from divorce non-dischargeable unless the debtor cannot afford to pay without hardship or the benefit of the discharge to the debtor outweighs the detrimental consequences to the creditor-spouse.

Student loans are non-dischargeable under 11 U.S.C. § 523(a)(8), except in the case of undue hardship. In *Tennessee Student Assistance Corp. v. Hornsby (In re Hornsby),* 144 F.3d 433 (6th Cir. 1998), the court of appeals reversed the bankruptcy court's decision because it had failed to conduct "a meaningful multi-factor evaluation in determining whether undue hardship existed: it failed to examine debtors' expenses, the extent to which debtors' discretionary income could be applied to their student loans, and the debtors' monthly budget surplus." The appellate court also held that the bankruptcy courts have the power to fashion an equitable remedy short of discharging debtors' entire student loans.

B. Chapter 13

Filing a Chapter 13 bankruptcy allows the debtor to pay debt out of future income while preserving the debtor's assets. However, the debtor must have a regular source of income. Debtors may need to file a Chapter 13 if they are time-barred from filing a Chapter 7, if they have assets above the exemption limits or if there are non-dischargeability issues. For a Chapter 13 plan to extend past 36 months, the debtor needs a verified motion to extend the plan. The courts freely grant the extension since the reason usually given is to fully repay the unsecured creditors.

Rules for the United States Bankruptcy Court for the Western District of Kentucky require that the debtor immediately begin his or her plan payments by paying the proposed payments to his or her attorney's escrow account and that the debtor maintain regular mortgage payments in a foreclosure situation. Notably, the attorney should contract with the debtor to keep all or a portion of the escrow payments for a fee should the plan not be confirmed. Many debtors simply disappear. Having money in escrow can save the debtor's counsel from a money-losing situation.

Local rules generally require attorneys to check the proofs of claim on file in the clerk's office the day before the Section 341 (creditors) meeting. This allows speedier disposition of cases and allows counsel to identify any problems.

More detailed information on bankruptcy can be found in Chapter 9 of this handbook.

INSURANCE ISSUES IN CONSUMER LAW

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SECTION G

INSURANCE ISSUES IN CONSUMER LAW

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I. POST CLAIM UNDERWRITING

The claim for disability or life insurance seemed outrageous. Sure, the insured had died. But he had died told seven lies on the application. He signed his name at the bottom, and all the health questions were checked "No." He told us he was a picture of health, yet he was receiving Social Security Disability for diabetes and asthma and had just been diagnosed with cancer six months before he signed the application. The insurance company will simply rescind the policy, refund the premium and no attorney in his right mind will agree to represent this man's estate.

A simple case of insurance fraud? Perhaps. But consider the following scenario that unfolds all too frequently when people buy insurance:

An elderly couple living in rural Kentucky had just finished watching the Kentucky Wildcats win another game when there was a knock on the front door. Not expecting any company, the husband grabbed his cane and hobbled to the door while his wife slowly walked to the back bedroom to make herself more presentable to the unannounced visitor. At the door stands a well-dressed man carrying a briefcase. He is one of the finest and most successful salesmen of the Great American Insurance Company.

Before the salesman leaves, he has succeeded in yet another sale, his twelfth of the day. The disabled couple is very happy. They now have something they have desperately wanted for years, but could not obtain. They now have life insurance. It is "guaranteed." Consequently, according to the salesman, there was no need to read all the fine print of the application.

The salesman is happy too. He has made thirteen sales today and his fifty-five (55) percent commission will pay for his children's orthodontic care. He calls his boss from his cell phone to report the good sales. The company executives are also happy because they have $18,000.00 of premium dollars coming in for them to invest in the raging stock market. The company is having one of its best years ever.

A few miles across town, a similar scenario unfolds. A single woman is sitting in the local car dealership. She is about to buy a shiny red sports car. She is uncertain of the price, but understands clearly the amount of the monthly payment. The price does not really matter because she can make the $340.00 monthly payment. She does not have to worry if she loses her job because of an injury. The salesman threw in a disability policy. She is very happy.

The car salesman is equally happy because the disability premium of $2200.00 has generated a sixty (60) percent commission for him. It is all included in the financing so it does not seem very expensive. He slides in front of her the "Truth in Lending Disclosures," the installment contract and the insurance application. Like every other customer, she signs them without reading.

The car dealer reports to the disability insurance company regarding the sales for that week. They likewise are pleased at the thousands of premium dollars, which are pouring in from the car dealerships. The company's profits have doubled, especially since they eliminated the cumbersome and expensive underwriting department. The insurance company vice president leans back in his chair, smiling to himself. He is pleased that sales are at an all time high. Amazingly, claims are at their lowest in ten

years, despite the elimination of the underwriting department. After all, the insurance company vice president thinks, underwriting is really a waste of time. Since we sell thousands of policies and only a few ever file claims, there is no need to worry about all of the policies. We only need to be concerned about the policies once a claim is filed. That is when we do our underwriting now. It is so brilliant, he thinks to himself, that we now have ten claims people doing the work that 100 people used to do in the underwriting department. And best yet, we hardly ever have to pay claims because we can always find a misrepresentation on the applications. If these people are too stupid to read what they sign, then why should he have any sympathy for them?

What is wrong with these pictures? Before an insurance company issues a policy of insurance, the underwriting department should conduct a thorough investigation as to the insurability of each prospective insured, using all information reported on the application. Relegating the function of conducting an investigation as to the insurability of the applicant to the claims department after a claim has arisen is improper "post claim underwriting."

Of course, there is nothing improper with an investigation to uncover fraud or misrepresentation in an application. However, improper post claim underwriting in connection with life and disability insurance typically occurs in two ways when an insurance company receives information on, or regarding, an application for insurance suggesting an adverse medical condition and issues a policy without conducting a thorough medical investigation or any medical investigation at all. Second, the company may directly or indirectly encourage the soliciting agents to not get any

adverse medical information. After the claim is reported, the company then conducts an exhaustive investigation for the purpose of finding a basis for rescinding the policy based on misrepresentation. This is an insidious practice which defeats the very purpose of insurance for the policyholder, protection against covered loss.

Obviously improper post claim underwriting is very profitable. Every applicant is accepted and pays a premium. Then, after it is too late for the injured or deceased applicant to obtain substitute insurance, the claim is filed and the policy is, for the first time, underwritten. The policy is then voided. If the application had information on it which would have required an investigation, then it is certainly unfair for that investigation to occur only to those policyholders who file claims.

In this way an insurance company can receive premiums from everyone, but will never have to pay a claim for any of the non-qualifying policyholders. Yet as to those otherwise non-qualifying policyholders who never file a claim, the insurance company makes a "pure" profit without any risk. Many times the insurance company will obtain an attending physician's statement (code "APS") from the applicant's family physician. These APS statements are typically scant on information which might have a bearing on the applicant's health. Then when a claim is filed, the insurance company will ask for all of the complete medical records and find a preexisting condition, undisclosed on the APS, that, in the company's opinion, would have compelled them to reject the application had they known this information earlier.

Rescission is a failure of the whole purpose of insurance and should never be regarded as routine. If rescission is a routine practice, that means the company's basic method of doing business and underwriting is flawed and needs correcting.

There is virtually no law in the state of Kentucky on post claim underwriting. However, the Mississippi Supreme Court declared:

> To allow (the insurer) to "sandbag" and gloss over its investigation of (the insured's) medical history at the time of evaluating the underwriting risk, then comb intensively for five months his prior records after a claim is made, 'looking for a defense' (even based on a condition unrelated to his benefit claim) and then deny coverage 'in good faith' is to invite manifest abuse of the public in such relationships. Under such circumstances, punitive damage awards provide the public with its best protection from such abuse of this relationship between insurance and insurer.
> Reserve Life Ins. Co. v. McGee, Miss., 444 So.2d 803 (1983).

See also Lewis v. Equity National Insurance Co., Miss. 637 So.2d 183 (1984) and Hildebrand v. Franklin Life Insurance Co., Ill., 455 N.E.2d 553 (1983).

California has actually enacted a statute prohibiting post claim underwriting. Section 10384 of the California Insurance Code provides as follows:

> No insurer issuing or providing any policy of disability insurance covering hospital, medical or surgical expenses shall engage in the practice of post claims underwriting. For the purposes of this section, 'post claims underwriting" means the rescinding, canceling or limiting of a policy or certificate due to the insurer's failure to complete medical underwriting and resolve all reasonable questions arising from written information submitted on or with an application before issuing the policy or certificate.

A Wyoming Court in White v. Continental General Ins. Co., 831 F. Supp. 1545 (D. Wyo. 1993), a case involving four plaintiffs who purchased health insurance from

Continental General Ins. Co. (Continental), disapproved of the practice of post claim underwriting. In this case, each plaintiff filled out an application and then responded to questions from one of the defendant's underwriters in order to obtain the insurance. The questions on the application, and the questions asked by the underwriter were all the underwriting done by Continental. After the plaintiffs made their claims, however, Continental's underwriters were able to find some type of preexisting condition that would enable Continental to rescind the policies.

The Court denied Continental's motion for summary judgment, based on the plaintiffs' evidence Continental engaged on post claim underwriting saying:

> In his opposition, White contends that he raised a genuine issue of fact on his point. His main assertion in support of his claim of bad faith is that Continental engages in the practice of what is referred to as "post claim underwriting," and that this is prima facie evidence of the absence of a reasonable basis for denying to pay benefits under the policy. White submitted evidence that standard industry practice is for the insurer to do a comprehensive investigation before agreeing to insure a person. White alleges that Continental did not conduct a thorough underwriting until after it had issued him a policy. He further alleges that Continental would heavily scrutinize the insured's application only after a claim was submitted by the insured. At that time, Continental would then request medical records and examine the files with a fine-toothed comb to see if a pre-existing condition that would allow it to refuse to pay out the claim.
> 813 F. Supp. at 1555-1556.

In another case, Barrera v. State Farm Mutual Auto Ins. Co., Cal. 456 P.2d 674 (1969), the California Supreme Court said, "An automobile liability insurer must undertake a reasonable investigation of the insured's insurability within a reasonable

period of time from the acceptance of the application and the issuance of the policy." The California court avidly condemned the practice of post claim underwriting in the automobile liability insurance business.

The North Dakota Supreme Court has also condemned the practice of post claim underwriting. In Ingalls v. Paul Revere Life Ins. Group, N.D., 561 N.W.2d 273, the plaintiff won a jury verdict based on claims for breach of contract, bad faith, and fraud for the defendant's refusal to pay disability benefits under the insurance policy. While affirming the jury verdict, the Court concluded there was sufficient evidence of fraud based on expert testimony that an insurer has engaged in post claim underwriting when "instead of looking to pay the claim, it began to look for all things in the application that [it] might be able to dig up that would allow [it] to rescind the policy." Id. at 283.

Numerous cases have condemned this practice of "post-claim underwriting." See *e.g.* State Farm Mutual Automobile Ins. Co. v. Wood, 483 P.2d 892 (Utah 1971); Gardner v. League Life Ins. Co., 210 N.W.2d 897, 898 (Mich. Ct. App. 1973); Allstate Ins. Co. v. Sullam, 76 Misc.2d 87, 349 N.Y.S.2d 550, 569-70 (N.Y. Sup. Ct. 1973); St. Joseph's Hosp. v. Reserve Life Ins., 742 P.2d 808, 815 (Ariz. 1987); Meyer v. Blue Cross & Blue Shield, 500 N.W.2d 150, 153 (Minn. Ct. App. 1993); Krauss v. Manhattan Life Ins. Co., 700 F.2d 870, 872 (2d Cir. 1983); Bernstein v. Nationwide Mutual Ins. Co., 458 F.2d 506, 510 (2d Cir. 1972); Bank of Oklahoma, N.A. v. Verex Assurance, Inc., 1991 U.S. App. LEXIS 31132 (10th Cir. 1991); Stanford v. Veterans Life Ins. Co., 1994 U.S. Dist. LEXIS 21172 (N.D. Miss. 1994).

CONCLUSION

Frequently, people sign insurance applications without reading them. Almost always, the questions are read, or paraphrased, by a soliciting agent many times in a very hurried fashion with no intent or goal to obtain accurate information regarding past health conditions, etc. If this practice is condoned, either indirectly or directly by the insurance company and the insurance company has a policy of doing no underwriting, the entire purpose of insurance is defeated. These practices should be challenged whenever a company goes to great lengths, after a claim is filed, to find grounds for rescission.

Every company should investigate claims thoroughly and reject claims of true misrepresentation. However, whether an inaccuracy on a written application constitutes a misrepresentation, requires consideration of the entire circumstances surrounding the application process.

II. RESCISSION OF HEALTH INSURANCE CONTRACTS - NEW RULE!

Health insurance carriers may sometimes contend that they are entitled to rescind the Plaintiffs' health plan for a material misrepresentation, even if made unintentionally, under the general rescission statute set forth in KRS 304.14-110 regarding rescission of insurance policies. However, the application of that general statute to Health Plans was altered by the subsequent enactment of a more specific statute KRS 304.17A-240 which prohibits a health insurer from discontinuing a health benefit plan unless there is intentional misrepresentation of material fact or fraud.

The two statutes provide as follows:

> KRS 304.14-110: Misrepresentations, omissions, and incorrect statements shall not prevent a recovery under the policy or contract unless either:
> (1) Fraudulent; or
> (2) Material either to the acceptance of the risk, or to the hazard assumed by the insurer; or
> (3) The insurer in good faith would either not have issued the policy or contract, or would not have issued it at the same premium rate, or would not have issued a policy or contract in as large an amount, or would not have provided coverage with respect to the hazard resulting in the loss, if the true facts had been made known to the insurer as required either by the application for the policy or contract or otherwise. This subsection shall not apply to applications taken for workers' compensation insurance coverage.
>
> KRS 304.17A-240: (1) Except as provided in this section, an insurer shall renew or continue in force a health benefit plan at the option of the insured.
> (2) An insurer may nonrenew, cancel, or discontinue a health benefit plan based only on one (1) or more of the following:
> (a) The insured has failed to pay premiums or contributions in accordance with the terms of the plan or the insurer has not received timely premium payments;

(b) The insured has performed an act or practice that constitutes fraud or made an intentional misrepresentation of material fact under the terms of the coverage;

(c) The insured has engaged in intentional and abusive noncompliance with material provisions of the health benefit plan. 1998 c 496, section 6, eff. 4-10-98.

A. THE PLAIN MEANING OF BOTH KRS 304.17A-240 AND KRS 304.14-110 PRECLUDES RESCINDING HEALTH PLANS UNLESS THE MISREPRESENTATION IS INTENTIONAL.

The legislature has promulgated basic rules of statutory construction and interpretation with the following commandment: "All statutes of this state shall be liberally construed with a view to promote their objects and carry out the intent of the legislature... All words and phrases shall be construed according to the common and approved usage of language...." KRS 446.080(1), (4). See also Withers v. University of Kentucky, Ky., 939 S.W.2d 340, 345 (1997). Also, "under the rule of liberal construction, the words employed in the statute must be given their ordinary meaning." Commonwealth v. Shivley, Ky., 814 S.W.2d 572, 573 (1991).[1] Applying the above principles, KRS 304.17A-240 and KRS 304.14-110 cannot be read in a manner which will allow a health insurance company to rescind a policy unless it proves the much more difficult fact of a intentional misrepresentation.

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[1] See also Layne v. Newberg, Ky., 841 S.W.2d 181, 183 (1992) ("[U]nder general rules of statutory construction, we may not interpret a statute at variance with its stated language."); Coy v. Metropolitan Property and Cas. Ins. Co., Ky. App., 920 S.W.2d 73 (1995) ("Statutory language must be accorded its literal meaning unless to do so would lead to an absurd or wholly unreasonable result."); Lincoln County Fiscal Court v. Dept. of Pub. Advocacy Com. of Ky., Ky., 794 S.W.2d 162, 163 (1990) ("Where the words of the statute are clear and unambiguous and express the legislative intent, there is no room for construction or interpretation and the statute must be given its effect as written."); Turner v. Turner, Ky. App., 908 S.W.2d 124, 125 (1995); Regional Jail Authority v. Tackett, Ky., 770 S.W.2d 225, 229 (1989) ("Where there is no ambiguity in a statute there is no need to resort to the rules of statutory construction in interpreting it. The words of the statute are simply accorded their commonly understood meaning."); Alliant Health System v. Kentucky Unemployment Ins. Com'n, Ky. App., 912 S.W.2d 452, 454 (1995) ("Where there is no specific statutory definition, we must construe the words of the statute within their common usage.").

Foremost, the plain meaning of KRS 304.17A-240, enacted in 1998, sets forth the only grounds permitting an insurer's nonrenewal, cancellation, or discontinuance of a health plan. The statute provides in part:

> (1) Except as provided in this section, an insurer shall renew or continue in force a health benefit plan at the option of the insured.
> (2) An insurer may nonrenew, cancel, or discontinue a health benefit plan based only on one (1) or more of the following:
> (a) The insured has failed to pay premiums or contributions in accordance with the terms of the plan or the insurer has not received timely premium payments;
> (b) The insured has performed an act or practice that constitutes fraud or made an intentional misrepresentation of material fact under the terms of the coverage;
> (c) The insured has engaged in intentional and abusive noncompliance with material provisions of the health benefit plan;

KRS 304.17A-240 (emphasis added). First, KRS 304.17A-240(1) provides an affirmative commandment that "an insurer shall renew or continue in force a health benefit plan at the option of the insured." (emphasis added). Thus, unless an exception provided in section (2) is met, then the insured is entitled to have the health benefit plan renewed or continued in force at his or her option. For example, if "[t]he insured has performed an act or practice that constitutes fraud or made an intentional misrepresentation of material fact under the terms of the coverage," then "[a]n insurer may nonrenew, cancel, or discontinue a health benefit plan." KRS 304.17A-240(2)(b) (emphasis added).

Note also the content of the "outline of Coverage" that was given to the client. This is a document that may be required under state law and summarizes the coverage.

Many times the "outline of Coverage," or even the policy itself, specifically states that "The policy will remain in force at the option of the insured, except for the following reasons... there is fraud or intentional material misrepresentation made by or with the knowledge of any insured applying for this coverage..."

1. *KRS 304.14-110 is not applicable to health plans having been superceded by the later, and more specific statute, 17A-240.*

Furthermore, "[i]t is... the well-established rule that a literal construction of the statute will not be applied when such construction would defeat the purpose of the statute, and the intention the Legislature had in mind when enacting it." Commonwealth ex rel. Martin v. Tom Moore Distillery Co., Ky., 152 S.W.2d 962, 965 (1939). A plain reading of KRS 304.17A-240 indicates that the purpose of the statute is to protect the contractual rights of a health plan insured. The right to continued health insurance coverage is guaranteed, once the policy is issued, unless the insured commits "fraud" or makes "an intentional misrepresentation of material fact under the terms of the coverage." KRS 304.17A-240 (emphasis added). To apply KRS 304.14-110 to a health plan, and to allow complete rescission when there is no proof of intentional misrepresentation, would defeat the purpose of KRS 304.17A-240. Consequently, although the literal construction of KRS 304.14-110 does not contain a scienter requirement, the plain meaning and its purpose would only be served by applying it consistently with KRS 304.17A-240 and requiring either "fraud" or "intentional misrepresentation of material fact" to allow rescission.

B. NO APPARENT CONFLICT EXISTS BETWEEN KRS 304.17A-240 AND KRS 304.14-110; THUS, THE STANDARD SET FORTH IN KRS 304.17A-240 APPLIES.

As noted supra, applying the plain meaning of KRS 304.17A-240 and KRS 304.14-110 does not result in a conflict.

To begin with, "[i]n construing a statute, the courts must consider 'the intended purpose of the statute--the reason and spirit of the statute--and the mischief intended to be remedied.'" Commonwealth. v. Kash, Ky. App., 967 S.W.2d 37, 43-44 (1997) (quoting City of Louisville v. Helman, Ky., 253 S.W.2d 598, 600 (1952)). The legislative purpose of both statutes is to protect parties' contractual rights and prevent fraud. This legislative purpose must be maintained in the interpretation of these statutes.

With the above in mind, it is important to note that "[a]ll statutes are presumed to be enacted for the furtherance of a purpose on the part of the legislature and should be construed so as to accomplish that end rather than to render them nugatory." Commonwealth ex rel. Martin v. Tom Moore Distillery Co., Ky., 152 S.W.2d 962, 967 (1939). KRS 304.17A-240, as noted supra, protects an insured's right to continual insurance coverage unless the insured commits "fraud" or "an intentional misrepresentation of material fact. Courts must refrain from construing a statute in a manner which will effectively abolish it. Commonwealth v. Wirth, Ky., 936 S.W.2d 78, 84 (1996).

C. ALTERNATIVELY, EVEN IF AN APPARENT CONFLICT DOES EXIST BETWEEN KRS 304.17A-240 AND KRS 304.14-110, THE STANDARD SET FORTH IN KRS 304.17A-240 STILL APPLIES.

The Court in Combs v. Hubb Coal Corp., Ky., 934 S.W.2d 250 (1996), provided the proper analysis for interpreting and applying apparently conflicting statutes. The Court held:

> We start with the well-established premise that in construing legislative enactments, courts "should look to the letter and spirit of the statute, viewing it as a whole...." City of Owensboro v. Noffsinger, Ky., 280 S.W.2d 517, 519 (1955). Where there is apparent conflict between sections of a statute, courts must endeavor to harmonize its interpretation so as to give effect to both. Kentucky Insurance Guaranty Association v. NREPC, Ky.App., 885 S.W.2d 315 (1994). In so doing, the reviewing court must attempt to construe the statute in such a manner that "no part of it is meaningless or ineffectual." Brooks v. Meyers, Ky., 279 S.W.2d 764, 766 (1955). Finally, we are required to observe the directive set out in Commonwealth of Kentucky, Transportation Cabinet v. Tarter, Ky.App., 802 S.W.2d 944 (1990), that each section is to be construed in accord with the statute as a whole.

Combs v. Hubb Coal Corp., 934 S.W.2d 250, 252-53. In the event that KRS 304.17A-240 and KRS 304.14-110 are construed as to be conflicting, then KRS 304.17A-240 controls and applies here because it is both a more specific piece of legislation and a more recent promulgation from the legislature.

First, KRS 304.14-110 concerns insurance contracts in general. On the other hand, KRS 304.17A-240 specifically deals with health insurance and health benefit plans. In the case at hand, the contract at issue is one providing a health benefit plan. The Kentucky Supreme Court has held "that where two statutes concern the same or similar subject matter, the specific shall prevail over the general." Withers v. University of Kentucky, Ky., 939 S.W.2d 340, 345 (1997). Similarly, the Kentucky Court of Appeals dealt with an apparent conflict between statutes in Preston v. Floyd/Johnson County

Pilots Ass'n, Blackburn, Belhasen, Wells, Short, Latta, City of Prestonsburg, Paintsville/Prestonsburg Airport Bd., Ky.App., 867 S.W.2d 474 (1993). There the Court reasoned, "[w]here two statutes are in apparent conflict, and their inconsistencies cannot be reconciled, 'the one containing express and positive language relating to the particular subject should take precedence over a provision dealing with a matter in general terms.'" Preston, 867 S.W.2d at 475 (citation omitted). With this rationale in mind, the Court held, "[s]ince KRS 183.132 specifically addresses the appointment of air board members, it must control over the general provisions of Chapter 83A." Id. Thus, since KRS 304.17A-240 is more specific and expressly provides an insured's entitlement to continuous health insurance coverage, it must prevail when in an apparent conflict with KRS 304.14-110, a more general statute.

Second, KRS 304.14-110 was enacted in 1970, but its latest amendment occurred in 1994. On the other hand, KRS 304.17A-240 was enacted in 1998 and amended by 2002 Kentucky Acts Chapters 249 and 251. Thus, KRS 304.17A-240 represents a more recent promulgation of public policy. "If the two statutes are repugnant to each other, the later statute must prevail, as it is the latest expression of the legislative will." Head v. Commonwealth, Ky., 165 Ky. 603, 177 S.W. 731, 733 (1915). KRS 304.17A-240 is clearly a later statute and a later expression of the legislative will. Thus, in case of a statutory conflict with KRS 304.14-110, KRS 304.17A-240 must prevail.

CONCLUSION

While the plain meaning of both KRS 304.17A-240 and KRS 304.14-110 evinces a legislative intent to protect parties' contractual rights. However, the plain meaning of

both statutes at issue supports an interpretation that is consistent with both statutory schemes and preserves the legislative intent. Thus, the plain meaning of both KRS 304.14-110 and KRS 304.17A-240 require that a health insurance carrier prove either "fraud" or "an intentional misrepresentation of material fact" before permitting a health insurance carrier to rescind a contract. Alternatively, to the extent the statutes appear conflicting and harmonization of the two seemingly conflicting statutes is not possible, the more recent or more specific statute, KRS 304.17A-240, shall supercede the older or more general statute, KRS 304.14-110.

III. THE CONSUMER PROTECTION ACT - PROTECTING PURCHASERS OF USED CARS - OR PROTECTING CLIENTS AND PATIENTS TOO?

Treat them fairly. Be truthful with them and do not mislead them. If you do, and it causes damage, they can sue you and they can recover attorney's fees. They are the consumers. But who is "you?" The consumer protection act, codified in KRS 367-170 provides that any "unfair, false, misleading, or deceptive acts or practice in the conduct of any trade or commerce" is declared unlawful. It is a very powerful and underutilized tool. Typically, it is thought of as avenue for recovery for that naïve consumer who gets ripped off by a used car salesman. Its use has been expanded in Kentucky to include an insurance contract. But what about clients of lawyers? What about medical patients? Can they sue under the Consumer Protection Act. It appears the answer is yes. The statute closely mirrors the Federal Trade Commission Act (FTC Act).[2] The act also protects the public from abuses arising in the course of competitive trade. Lawyers have been held liable for unfair and deceptive business practices under state consumer protection laws in the state of Washington. See Short v. Demopolis, 691 P.2d 163 (Wash. 1989).

The state of Washington has also held a physician liable under the Unfair and Deceptive Trade Practices Act. In Quimby v. Fine, 724 P.2d 403, 406, a physician substituted a procedure during a tubal ligation surgery without the patient's consent. Since she was not advised of the risk and alternatives, she sued ten months later when she gave birth to a child with multiple birth defects. She sued for both negligence and

[2] 15 U.S.C. § 45 (1994).

unfair and deceptive trade practices. The Court held that the negligence claim was not within the scope of the Consumer Protection Act, but his failure to fully disclose accurate medical information could form the basis of an unfair and deceptive trade practice claim. The Court's reasoning was based on the entrepreneurial activities of the doctor's trade or business would fall within the scope of the act. The Court defined entrepreneurial aspects of the practice of medicine to include anything that "will increase profits and volume of patients." Id. at 406.

Texas has also allowed a claim against a physician under the Deceptive Trade Practice Act. In Chapman v. Wilson, 826 S.W. 2d 214, 215 (Tex. Ct. App. 1992), a dentist made false statements regarding his expertise in wisdom tooth extraction and the use of general anesthesia. The Court held that since the dentist had made false and misleading statements, the patient could claim a violation of the Texas Deceptive Trade Practices Act.

Later, Texas extended the Chapman decision in Sorokolit v. Rhodes, 889 S.W.2d 239 (Tex. 1994). Before performing a breast augmentation surgery, a physician had guaranteed the patient that she would look exactly like a photograph the physician had showed her. The Court held that the claim against the physician for unfair and deceptive trade practices was based upon deception and not a breach of the medical standard of care, thus the Consumer Protection Act could be utilized in the lawsuit. Critical to the analysis was the deceptive practice was intended to increase patient volume and profit. In both cases, the conduct did not actually deceive the patients

involved, but the business methods used had a tendency or capacity to deceive which is a requirement under the Unfair and Deceptive Trade Practice Laws.

Some states have specifically excluded physicians from coverage under their Consumer Protection Acts. Ohio has such an exemption.[3] The Pennsylvania Courts have held just the opposite of Texas and Washington. In Gatten v. Merzi, a patient sued her doctor, alleging violations of the state consumer protection law after undergoing unsuccessful weight loss surgery. The Court refused to allow the action, reasoning that an unfair and deceptive trade practice claim against a medical doctor would render all physicians "absolute guarantors of medical results." In Gatten, the plaintiff did not consider or argue entrepreneurial aspects of the practice of medicine as the basis of a consumer protection claim. However, in Chalfin v. Beverly Enterprises, Inc., a federal district court in Pennsylvania ruled that the Unfair Trade Practices and Consumer Protection laws did apply to health care providers. In this case, the law was applied to a nursing home which had provided health services to a Medicaid patient. The court found that the nursing home's act of evicting a patient after it had agreed to care for her, in order to substitute a higher paying patient, could constitute a claim under the Deceptive Trade Practice Act.

There is not much case law on this matter. Kentucky Attorney General opinions would apply the act to an audiologist, a psychotherapist and a drug retailer. Thus, most appellant courts in most states have not had the opportunity to consider whether consumer protection laws would apply to the entrepreneurial aspects of the learned

[3] Ohio Rev. Code Ann. § 1345.01(a)(Anderson 1994).

professions, both law and medicine. However, the Kentucky Consumer Protection gives no hint at exempting professions from the scope of the act. Certainly, in this day and age of high competition for dollars from HMOs and competition between lawyers, it is certainly feasible for patients, and clients, to be deceived into courses of action which they would not otherwise take. Like it or not, the professions have become entrepreneurial enterprises. Consumers, including patients and clients, would benefit from knowing that all businesses, including the learned practices of medicine and law must abide by the same standard. No business should be exempt from treating consumers fairly.

IV. BAD FAITH HANDLING OF PIP -DAMAGES LIMITED TO INTEREST AND ATTORNEY'S FEES (FOR NOW)

A recent Kentucky Court of Appeals' decision has introduced an interesting twist to the Unfair Claims Settlement Practices Act (UCSPA). In Phoenix Healthcare of Kentucky, L.L.C. v. Kentucky Farm Bureau Mut. Ins. Co., Ky.App., 120 S.W.3d 726 (2003), the Court of Appeals held that KRS §§ 304.39-210 and -220 of the Motor Vehicle Reparations Act (MVRA) provided the "exclusive remedy" for the late payment or failure to pay the insured's basic reparation (PIP) benefits. The holding reaches an equitable result for this particular case, but unfortunately creates broad sweeping precedent that tilts the legal landscape of the UCSPA too far. Close review of this opinion demonstrates why our law professors taught us "bad facts make bad law."

In Phoenix, Dr. Hays performed an MRI on the insured, Ms. Jones, after she was injured in a motor vehicle accident. Kentucky Farm Bureau was the insurer and a basic reparation obligor to Ms. Jones. Phoenix Healthcare of Kentucky ("Phoenix") was the billing agent and assignee in regard to billing and receiving payments for MRIs performed by Dr. Hays.

On March 14, 2002, Phoenix mailed an invoice to Farm Bureau for $3,790 for the MRI. As expected (given the size of the bill) Farm Bureau sent notice that the payment was being withheld pending a peer review. While Farm Bureau conducted its peer review, it proceeded to pay other PIP bills submitted by other providers. Consequently, when Farm Bureau decided, eight days later, to pay the MRI bill, most of the $10,000 in PIP benefits had been disbursed, and Farm Bureau only made a partial payment of

$2,345.95, which totally exhausted the $10,000 in benefits. The insured, Ms. Jones, received her full benefit of $10,000 in PIP benefits. She apparently had no complaint with Farm Bureau. The only one complaining was a medical provider, Phoenix Healthcare, because the delay caused by the peer review left Phoenix Healthcare "out in the cold because (Farm Bureau) had no more PIP benefits to pay out."[4] Essentially, Farm Bureau, at worst, was two weeks late in making payment to Phoenix. Neither the opinion nor any of the briefs discuss why an MRI would cost $3,790. Phoenix sought punitive damages against Farm Bureau, even though Farm Bureau had paid out its entire contractual obligation of $10,000, claiming that Farm Bureau had acted recklessly in paying other medical providers and that it should have placed a "hold" on all payments while it conducted its peer review of Phoenix's MRI bill of $3,790.

It would be extremely difficult to infer recklessness under this set of facts, because the duties of Farm Bureau to pay PIP claims timely apply to all medical providers and the insured. To argue that Farm Bureau should delay payment on other claims, while it exercises its right to review Phoenix Healthcare's MRI bill, would necessarily subject the insurer to claims by other providers of delay. Likewise, for Farm Bureau to <u>not</u> investigate the propriety of a $3,790 MRI bill, without an appropriate review, could subject Farm Bureau to a claim by the insured that her limited $10,000 in PIP benefits had been squandered needlessly, leaving other medical providers unpaid. In essence, the claims handling conduct of Farm Bureau was obviously far better than the proposed conduct urged by the plaintiff.

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[4] Reply Brief of Phoenix Healthcare pp. 3-4.

One cannot determine whether the Floyd Circuit Court or the Kentucky Court of Appeals was influenced by the obvious flaws in Phoenix Healthcare's argument, but certainly these facts did nothing to inspire the judiciary to acknowledge a remedy for punitive damages against Farm Bureau. The Court of Appeals' opinion essentially precludes any causes of action under the UCSPA against a PIP insurance carrier for compensatory and punitive damages for failure to pay PIP benefits in good faith, the remedy for violations being limited to interest and attorney's fees.

The record in Phoenix Healthcare indicates that the appellant did not file a motion for reconsideration, or a motion for discretionary review.[5] Thus, the opinion in Phoenix Healthcare became final and was published as precedent. Thus, its holding may not be the final answer to this important issue. This article will address arguments not mentioned in the parties' briefs or the opinion.

In support of its opinion, the Court reasoned: "It is well settled that '[w]here the statute both declares the unlawful act and specifies the civil remedy available to the aggrieved party, the aggrieved party is limited to the remedy provided by the statute.'" Id. (quoting Grzyb v. Evans, Ky., 700 S.W.2d 399, 401 (1985)). The Court also distinguished the case at hand from State Farm Mutual Auto. Ins. Co. v. Reeder, Ky., 763 S.W.2d 116 (1988) by noting:

> [I]n Reeder, the court specifically held that KRS 446.070 does not authorize a private cause of action for the violation of a statute if the statute itself specifies a civil remedy available to the aggrieved party. In Reeder, unlike the case at hand,

[5] The record indicates that Phoenix Healthcare changed attorneys midway in the appeal.

> the statute at issue did not provide a civil remedy and accordingly KRS 446.070 applied to the matter. (Id. at 727).

Significantly, the Motor Vehicle Reparations Act ("MVRA") contains no "exclusive remedy" provisions that would apply to the 15 enumerated duties set forth in the UCSPA. The Phoenix decision would remove PIP carriers from regulation by the entire Kentucky Insurance Code (KRS Chapter 304, which encompasses the UCSPA and the MVRA), by ensuring that PIP claims are controlled by only part of that Code. However, as the Kentucky Supreme Court recognized in Farmland Mutual Ins. Co. v. Johnson, Ky., 36 S.W.3d 368 (2000):

> The KUCSPA is part of a large statutory scheme entitled, the "Insurance Code." The Insurance Code regulates the insurance industry, and an insurance company derives its right to do business in Kentucky from the Code. The Code and the UCSPA within it relate to a class encompassing **all insurance companies doing business in Kentucky** that are regulated by the Kentucky Insurance Commissioner. **Thus the statute does not relate to only particular persons or things in that class.**

Id. at 380 (Emphasis added). Consequently, it is clear that the Kentucky Insurance Code is intended to apply *in toto* to all insurance carriers.

In support of its decision, the Court in Phoenix cites to the Kentucky Supreme Court's decision in The Travelers Indemnity Co. v. Reker, Ky., 100 S.W.3d 756 (2003), in which the Court held that suits for insurance bad faith under the UCSPA were not available against workers' compensation insurers because of the "exclusive remedy" provision of the Workers' Compensation Act, KRS § 342.690(1), despite the enactment of KRS § 342.267 and the existence of KRS § 446.070. What separates the Workers'

Compensation Act from the Kentucky Insurance Code, however, is that the latter does not contain an exclusivity provision remotely analogous to the one contained in KRS § 342.690.

The first sentence of KRS § 342.690(1) states as follows:

> If an employer secures payment of compensation as required by this chapter, the liability of such employer under this chapter shall be exclusive and in place of all other liability of such employer to the employee, his legal representative, husband or wife, parents, dependents, next of kin, and anyone otherwise entitled to recover damages from such employer at law or in admiralty on account of such injury or death.

The fourth sentence of KRS § 342.690(1) further reads:

> The exemption from liability given an employer by this section shall also extend to such employer's carrier, and to all employees, officers, or directors of such employer or carrier, provided the exemption from liability given an employee, officer or director of an employer or carrier shall not apply in any case where the injury or death is proximately caused by the willful and unprovoked physical aggression of such employee, officer or director.

An exclusive remedy provision this clear and explicit is not contained in the MVRA.

Indeed, the Supreme Court expressly recognized in Reker that the Kentucky Insurance Code "does not include an 'exclusive remedy' provision prohibiting private causes of action for its violation." Id. at 763. Moreover, as noted by the Court, the Kentucky Insurance Code is a statutory scheme that—unlike the Workers' Compensation Act—does not contain interrelated statutes providing civil remedies for an insurer's bad faith. Id.; see also Farmland Mut. Ins. Co., 36 S.W.3d at 380.

Furthermore, the Code does not include a specific statutory provision explicitly prohibiting private civil actions against insurance carriers. Id.

The Court in Phoenix also failed to discuss Kentucky Farm Bureau Mut. Ins. Co. v. Troxell, Ky., 959 S.W.2d 82 (1997), in which the Kentucky Supreme Court implicitly recognized that a claim for lost wages under PIP could support a claim for punitive damages for insurance bad faith and unfair claims settlement practices. In Troxell, the plaintiff brought suit for recovery of UM and PIP benefits, as well as a cause of action for bad faith. The jury returned a verdict in favor of the plaintiff for $3000 in PIP lost wages and $775,000 in punitive damages. On appeal, the Court recognized that the plaintiff's "claims for bad faith and unfair claims settlement practices were premised on both UM and lost wage theories." Id. at 85. However, because the Court found that the plaintiff presented insufficient evidence of lost wages, and because the jury's justification for punitive damages could not be specifically ascertained (that is, it could have been partially based on the unproven element of lost wages), the Court remanded the case for another bad faith trial. Id. Thus, the Supreme Court was not troubled that a claim for lost wages under PIP could support a claim for punitive damages for bad faith claims handling.

Furthermore, there is no law suggesting that the MVRA and the UCSPA cannot be simultaneously applicable. The Kentucky Court of Appeals also held in Phoenix that, "[b]ecause KRS 304.39-210 specifically applies to late payments of basic reparation benefits, as opposed to the more general language of KRS 304.12-230 and -235," the former statute precludes recovery under the USCPA or for punitive damages in a case

involving basic reparations benefits. As an initial matter, it should be noted that the Court must harmonize the law so as to give effect to all statutes, if possible. See Allen v. McClendon, Ky., 967 S.W.2d 1, 3 (1998). With this in mind, there is no inherent conflict between the MVRA and the UCSPA that would necessitate deciding whether to use a "specific" or "general" statute. See Reker, 100 S.W.3d at 763 (stating that it is necessary for a specific provision to take precedence over a general provision only "when [the] two statutes are in conflict").

Moreover, in FB Ins. Co. v. Jones, Ky. App., 864 S.W.2d 926 (1993), the Kentucky Court of Appeals addressed the contention, supported by Gryzb v. Evans, Ky., 700 S.W.2d 399 (1985), that the passage of KRS § 304.12-235 precluded further suits under the UCSPA via KRS § 446.070. The Court concluded that "KRS 304.12-230 and KRS 304.12-235 are different statutes which address different kinds of culpable behavior..." "KRS 304.12-235 appears to be intended as a prod to prevent laxity in the adjustment of claims. KRS 304.12-230, however, speaks out against more egregious behavior." Id. at 929. This decision was reached even though KRS § 304.12-235(2) provides a penalty of 12% per annum interest for a "[failure] to make a good faith attempt to settle a claim within the time prescribed."

Similarly, KRS § 304.39-210(2) allows for a penalty of 12% per annum for overdue payments and 18% per annum for a delay without reasonable foundation. While this language is comparable to KRS § 304.12-235, it explicitly prohibits suits under the UCSPA, nor does it speak to the same type of conduct that is prohibited by the UCSPA.

Furthermore, a bad faith lawsuit requires different proof than 304.39-210:

> [A]n insured must prove three elements in order to prevail against an insurance company for alleged refusal in bad faith to pay the insured's claim: (1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed....

Wittmer v. Jones, Ky., 864 S.W.2d 885, 890 (1993) (quoting Federal Kemper Ins. Co. v. Hornback, Ky., 711 S.W.2d 844, 846-47 (1986) (Liebson, J., dissenting)). The requirement of showing intent or reckless disregard in a bad faith action is different from the requirement in KRS § 304.39-210 that only a lack of reasonable foundation for delay be shown.

The Court notes that State Farm Mut. Auto. Ins. Co. v. Reeder, Ky., 763 S.W.2d 116 (1998) and Grzyb v. Evans hold that "[w]here the statute both declares the unlawful act and specifies the civil remedy available to the aggrieved party, the aggrieved party is limited to the remedy provided by the statute." Reeder, 763 S.W.2d at 118; Grzyb, 700 S.W.2d at 401. The PIP remedies, contained in KRS §§ 304.39-210 and -220, however, only speak to "overdue payments" or overdue payments resulting from "delay ... without reasonable foundation." They do not speak to any of the enumerated violations set forth in the UCSPA, nor do they speak to the heightened requirements for showing bad faith. Consequently, it is unclear how these statutes provide civil remedies for violations of the UCSPA in PIP cases, the Court held in Phoenix.

This particularly holds true when one considers that KRS § 304.12-235, part of the UCSPA, provides for interest and attorney's fees for "delay[s] without reasonable

foundation" and failures "to make a good faith attempt to settle a claim." This statute, contained in the UCSPA, does not prohibit the bringing of claims for punitive damage causes of action—as this Court held in FB Ins. Co. v. Jones—it would appear to be just as reasonable that KRS 304.39-210 and -220 do not prohibit such causes of action.

In conclusion, as the Kentucky Supreme Court made clear in State Farm Mut. Ins. Co. v. Reeder, Ky., 763 S.W.2d 116, 118 (1988): "[The UCSPA] is intended to protect the public from unfair trade practices and fraud. It should be liberally construed so as to effectuate its purpose." Indeed, "this Court's duty in construing statutes is to ascertain and give effect to the intent of the General Assembly." White v. Check Holders, Inc., Ky., 996 S.W.2d 496 (1999). Making the UCSPA inapplicable to basic reparation benefit carriers, even when those carriers are engaged in conduct not anticipated by the MVRA, is entirely antithetical to the idea that insurers hold a fiduciary duty to their insureds. Moreover, it is entirely antithetical to the policy and purpose behind the MVRA itself. See KRS § 304.39-010.

V. PIP CARRIERS MUST HAVE "GOOD CAUSE" FOR REQUESTING AN IME.

It is clear from the facts of this case that PIP carrier lacked "good cause" for the IME. KRS 304.39-270(1) states as follows:

> If the mental or physical condition of a person is material to a claim for past or future basic or added reparation benefits, the reparation obligor may petition the circuit court for an order directing the person to submit to a mental or physical examination by a physician. Upon notice to the person to be examined and all persons having an interest, the court may make the order for good cause shown. The order shall specify the time, place, manner, conditions, scope of the examination, and the physician by whom it is to be made.

Although the language of this statute seems to indicate that an insurer is not required to seek a court order before requesting an IME, it also implicitly suggests that an insurer must have "good cause" for requesting that an insured submit to such an examination. Given the policies behind Kentucky's no-fault insurance scheme, such an inference makes sense. This conclusion is also bolstered by language in Miller v. U.S. Fidelity & Guar. Co., Ky.App., 909 S.W.2d 339, 343 (1995) ("As we have noted, the insurer is not entitled to an independent medical examination upon demand.").

Here, PIP carrier's "good cause" for an examination of Plaintiff is that (a) he allegedly had told them when reporting the accident that he was not hurt, or (b) and that he did not seek any treatment for "several" weeks before reporting his injuries.

Consequently, PIP carrier's "good cause" for seeking an IME can be boiled down to a suspicion based upon questionably accurate information. In Miller v. U.S. Fidelity & Guar. Co., the Kentucky Court of Appeals held that the "mere suspicion" of an insurer does not constitute the necessary "good cause" for a basic reparation benefits IME. The

Court found that the "general averments" of an employee of an insurer were not enough to constitute "good cause." Id. at 342. Instead, the Court cited State Farm Ins. Co. v. Swantner, 594 A.2d 316 (Pa. Super. Ct. 1991) (case attached), for the principle that "good cause" for an IME could be shown by such steps as submitting an insured's medical records to peer review evaluation or by requesting that a treating physician supplement his medical reports in order to address an insurer's specific concerns. Id. Here, of course, PIP carrier sought an IME without having **any** of Plaintiff's medical records and did not ask the treating physicians to address any of its concerns. Consequently, the examination should never have taken place at all, as PIP carrier had no justification for it as a matter of law.

The Kentucky General Assembly has explicitly recognized the importance of basic reparation benefits in the system of insurance set forth by the Motor Vehicle Reparations Act. KRS 304.39-010 states that one of its primary purposes is "[t]o encourage prompt medical treatment and rehabilitation of the motor vehicle accident victim by providing for prompt payment of needed medical care and rehabilitation." KRS 304.39-010(3). Moreover, the General Assembly has specifically acknowledged a "right to basic reparation benefits," which is reinforced by a statutorily mandated presumption "that any medical bill submitted [to obtain those benefits] is reasonable." KRS 304.39-030(1); KRS 304.39-020(5)(a). Kentucky courts have further recognized that no-fault insurance is "remedial in nature and thus will be broadly construed to carry out its beneficial purpose of providing compensation for persons injured by

automobiles." Blue Cross & Blue Shield of Ky. v. Baxter, Ky.App., 713 S.W.2d 478, 480 (1986) (citation omitted).

Consequently, it is clear that an insurer should not deny or withdraw basic reparation benefits lightly. Indeed, other jurisdictions that have dealt with the policy behind their no-fault insurance provisions have stated this proposition more forcefully. For example, the Supreme Court of New Jersey has held that its statute "must be read, whenever possible, to promote **prompt** payment to **all** injured persons for **all** of their losses." Benyola v. Allstate Ins. Co., 568 A.2d 134, 137 (1990) (citation omitted) (case attached).

PIP carrier may assert that it did not need "good cause" for an IME because Plaintiff consented to the examination. However, PIP carrier's own PIP log illustrates that Plaintiff gave his "consent" only after he was told that if he did not, PIP carrier would force him to be examined via a court order. Of course, PIP carrier neglected to tell Plaintiff that it could only force him to be examined if it had "good cause" for the examination, thereby implicitly suggesting that he ultimately would be examined even if he did not agree to do so willingly. By this conduct, PIP carrier took advantage of KRS 304.39-270's allowance for court-ordered examinations in issuing its ultimatum to Plaintiff, but it refused to inform him of the "good cause" requirement for such a court order.

In effect, PIP carrier took advantage of its superior leverage and coerced Plaintiff into "consenting" to an examination for which it had no justification. In doing so, it presumably hoped to avoid the "good cause" requirement of KRS 304.39-270, given that

it had absolutely no evidence to show good cause for an IME. KRS 304.39-270 is an avenue for IME's that protects claimants from unsubstantiated requests for such examinations. By using the threat of a court order as a sword to coerce an insured into an examination to which it would not otherwise be entitled, PIP carrier has flouted and warped the purpose of the statute entirely. Accordingly, any "consent" to an IME obtained from Plaintiff by PIP carrier should be disregarded as a matter of law.

VI. CONDITIONING RELEASE OF BAD FAITH CLAIMS UPON PAYMENT OF AN UNDERLYING CLAIM -NOT A GOOD IDEA.

The client arrives in your office needing assistance in pursuing a typical insurance claim. Perhaps it is an injury claim, or perhaps it is a property damage claim. In either case, a tortfeasor caused damage to your client, and you proceed to successfully negotiate a settlement with the third party's insurance carrier, Tag Along Insurance Company of America.

The settlement check arrives in your office with a standard preprinted release. You scan it quickly as you prepare the settlement documents and have your secretary write the escrow account deposit slips and checks. But something in the release catches your eye and strikes you as being wrong: not only will your client be releasing all claims against the tortfeasor, he also will be releasing all claims against the third-party insurance carrier.

Out of an abundance of caution, you call your law school insurance professor (who told all of her students to call if they had any questions). You pose the question: Why does your client need to release the insurance company? She tells you that, in Kentucky, there is no direct action that your client could file against a third-party insurance carrier, as carriers are merely required to indemnify the liability of the tortfeasor. However, she reminds you that your client may have a potential cause of action against the third-party carrier for insurance bad faith. You then remember that Kentucky—like a number of other jurisdictions—has recognized the availability of a

third-party bad faith lawsuit by a claimant against a tortfeasor's liability insurance company for violations of the Unfair Claims Settlement Practices Act ("UCSPA").[6]

With this information in hand, you are now in a quandary. If your client releases a cause of action that he never asserted, and for which he received no compensation, you could be facing a potential legal malpractice suit. Accordingly, you correctly conclude that you must inform him of this potential cause of action and get his consent before releasing it. But then another thought occurs—why should you release the insurance company in the first place? Your client has asserted no claim for USCPA violations in this case. The bargain that you made was only for the tortfeasor's liability.

You discuss the matter with the insurance adjuster, and he tells you that, in his twenty years as an adjuster, no one has ever disputed releasing the insurance company. The insurance company always gets released and it is always a condition of the settlement. You are told that if you want the money, you have to release the insurance company—otherwise there is no deal.

What has happened here and what does it mean? For starters, by insisting on its release and conditioning settlement on that release—even when no claims have been made against it—the insurance company has arguably committed an act of bad faith, both towards its insured and towards the third-party claimant. Although there is a dearth of case law on this particular issue, there are cases from other jurisdictions that support this position.

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[6] State Farm v. Reeder, Ky., 763 S.W.2d 116 (1988).

For example, in Isaac v. State Farm Mut. Auto. Ins. Co.,[7] a first-party bad faith case, the South Dakota Supreme Court was faced with a situation where the insurance company conditioned its offer of $100,000 upon the plaintiff's release of her bad faith claim. In addressing the issue of punitive damages, the court remarked:

> There is evidence supporting the trial court's position that State Farm acted in reckless disregard of the rights of Isaac. Included in the actions taken by State Farm evidencing this reckless disregard is the fact that when State Farm did offer their policy limits of $100,000, the offer was conditioned on a release by Isaac of any bad faith claim that she may have with respect to State Farm's handling of the claim. Clear and convincing evidence existed to form a reasonable basis to present the issue of punitive damages to the jury.[8]

The South Dakota Supreme Court reaffirmed this position in Harter v. Plains Ins. Co., Inc.,[9] and the Eighth Circuit Court of Appeals recognized and followed both decisions in Athey v. Farmers Ins. Exchange.[10]

In a more recent case, National Insurance Association v. Sockwell,[11] the Supreme Court of Alabama was faced with a similar scenario. In addressing the appropriateness of a $600,000 punitive damage award, the court—citing the trial court's post-trial order—particularly noted the insurance carrier's efforts to obtain a "2-for-1" release from its insured:

> Perhaps the most reprehensible conduct was committed by the defendant's claims supervisor, Kathy West, who [was the defendant's representative] at trial. West testified that upon receipt of this lawsuit in March 1999, she reviewed the

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[7] Isaac v. State Farm Mut. Auto. Ins. Co., 522 N.W.2d 752 (S.D. 1994).
[8] Id. at 61.
[9] Harter v. Plains Ins. Co., Inc., 579 N.W.2d 625, 634 (S.D. 1998).
[10] Athey v. Farmers Ins. Exchange, 234 F.3d 357, 362 (8th Cir. 2000).
[11] National Insurance Association v. Sockwell, No. 1001627, 2002 WL 399041 (Ala. Mar. 15, 2002).

> claim file prepared by Patrice Hawthorne and immediately concluded that the claim had been improperly denied, and should have been paid. Nevertheless, testimony from the attorneys who were handling Sockwell's claim at that time indicated West made an offer of $41,000, and expressly conditioned payment of Sockwell's underinsured motorist claim upon her release and dismissal of the bad faith claim. Such a conditioned offer, when West knew the claim was due to be paid, is evidence of another, separate act of bad faith.[12]

Based, in large part, on this evidence, the court affirmed the punitive damage award.

While these cases all specifically involve traditional first-party bad faith situations, their reasoning holds up when applied to other bad faith scenarios under Kentucky law. For example, by conditioning settlement of a claim against its insured upon release of any claims against it, an insurance company could find itself in breach of the implied covenant to exercise good faith in protecting its insured from an excess judgment, as set forth in Grundy v. Manchester Ins. and Indem. Co. (Grundy I).[13] In essence, the company would be gambling with the policyholder's money by demanding a release that—more likely than not—the insured has no idea is being sought. This emphasis on self-interest—at the possible risk of exposing the insured to an excess verdict—creates an inherent conflict of interest that should be disclosed to a policyholder, and it exposes the company to a potential common law bad faith suit where none had existed before.

Furthermore, conditioning settlement upon insurer release—particularly where no bad faith case has been asserted previously—almost certainly constitutes a violation

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[12] Id. at *24.

[13] Grundy v. Manchester Ins. and Indem. Co., Ky., 425 S.W.2d 735 (1968).

of the UCSPA, opening the insurer up to a potential bad faith suit by the third-party claimant. Most notably, such action would appear to violate KRS 304.12-230(6), which states that an insurer has committed an unfair claims settlement practice by "[n]ot attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear." Using settlement of an underlying claim as leverage to dispose of an actual or potential bad faith claim could not be a clearer example of this type of inappropriate behavior.

As a practical matter, an insurance company has no right to condition settlement upon release of a bad faith claim because this issue undoubtedly did not come up during settlement negotiations. Why should it? Settlement of a liability insurance tort case involves a claimant reaching a resolution with a tortfeasor who happens to be a beneficiary of an insurance contract with an insurance carrier. The focus on any settlement discussions would necessarily be on the underlying merits of the tort claim, with the insurer only aiding in its policyholder's defense and indemnifying him for any damages. The insurer's own conduct in handling the claim is a matter that is distinct and separate from whether its policyholder is tortiously at fault for the incident in question. Accordingly, considerations about the insurance company's behavior and any liability for that behavior should never enter into that company's mindset when it comes to settling or evaluating an underlying claim. Why, then, should an insurance carrier be allowed to obtain a release of bad faith claims whenever it settles a liability claim on behalf of its insured when it wasn't bargained for and rightfully wasn't an issue in the first place?

In most cases, this stance is more of a matter of principle than anything else. Unlike the hypothetical that begin this article, rarely, if ever, will an insurance adjuster pull a settlement offer off of the table once you explain to her why you don't release third-party insurers. However, consistently and firmly refusing to release third-party insurers in these cases fulfills a broader purpose by reinforcing their duty to act promptly and in good faith. If every claimant could be leveraged, via settlement, into releasing the third-party insurance company, there never would be any third-party bad faith causes of action brought against insurance companies, no matter how egregious their conduct. This would render the legal duty of good faith as to third-party carriers virtually meaningless. However, refusing to release bad faith claims encourages good faith behavior throughout the entire claims process—up to and including settlement.

VII. RATES FOR CREDIT LIFE AND DISABILITY ARE SET BY STATUTE

Credit life and health insurance are unique among the various types of insurance sold in Kentucky in that the maximum rates that may be used to compute premiums for credit insurance are explicitly set forth by the General Assembly in KRS 304.19-380. Unlike other types of insurance, determining the "reasonableness" of a credit insurance rate has not been left to the discretion of the Department of Insurance; rather, the General Assembly has made it very clear that credit insurance rates "shall not exceed" those rates set forth by statute. See KRS 304.19-080(3)(a); see also KRS 304.19-080(7) ("The foregoing rates and procedures are deemed to be legislative prerogatives and shall not be subject to administrative or executive change or modification."). The credit Life or disability carrier exceeded the rates set forth by KRS 304.19-080(3) and the rate formula it filed with the Kentucky Department of Insurance. Consequently, it overcharged the Consumer on their credit life premium.

To understand this rate violation, one must first understand the terminology of credit life insurance. The product sold by credit Life or disability carrier to the Consumer was truncated, single premium net payoff debt credit life insurance. It was "truncated" because the life insurance coverage only covered the first 60 months of a much longer 300-month loan. The product was "single premium" because the premium for the entire 60 months of coverage was paid up front and financed as part of the Consumer' loan. The product was "net payoff" because the amount of coverage at any time during the first 60 months of the loan was equal to the amount necessary to pay off the loan.

Here, there are two (2) errors in premium calculation on the part of Credit disability carrier. The first error was obvious at the time the Complaint was filed—Credit disability carrier charged a premium in excess of the maximum statutory rate. However, based upon the affidavits tendered by the actuaries of Credit disability carrier, it has become clear that a second error was made—Credit disability carrier used a "rate factor" for premium calculation well in excess of the "rate factor" produced by the formula filed with and approved by the Kentucky Department of Insurance. Plaintiff will address each of these errors in turn.

A. CORRECT CALCULATION OF PREMIUM UNDER MAXIMUM STATUTORY RATE

Because the type of insurance here is credit life net debt, the maximum amount of premium that can be charged for such insurance is calculated using the monthly outstanding balance *prima facie* rate set forth in KRS 304.19-080(3)(a)(3).[14] The *prima facie* rate for credit life net debt is therefore $0.92 per $1000 of outstanding balance.[15] With single premium net payoff credit life insurance, the coverage purchased is just sufficient to payoff the remaining principal on the loan. Since the remaining principal declines with each month's loan payment, the total amount of coverage is the sum of the remaining principal in each month of the loan. The premium is calculated by

[14] KRS 304.19-080(3)(a)(3) reads as follows: A premium payable monthly at the rate of ninety-two cents ($0.92) per one thousand dollars ($1,000) of outstanding unpaid insured indebtedness ... will be deemed the actuarial equivalent of the foregoing rates."

[15] This rate is used instead of the rate set forth in KRS 304.19-080(3)(a)(1) ("For decreasing term credit life insurance, a single premium of sixty cents ($0.60) per annum per one hundred dollars ($100) of scheduled indebtedness ....") because (3)(a)(1) applies only to credit life gross debt. The Consumer' policy involved credit life net debt, so the rate set forth in (3)(a)(3) applies here. Although both are *prima facie* rates promulgated by the General Assembly, they are considered to be "actuarially equivalent" because they are considered to be equal after adjustment for differences in exposure base.

multiplying the amount of coverage in each month by the monthly outstanding balance ("MOB") credit life rate and then summing the monthly premiums. Stated differently, a single premium net payoff credit life premium calculation is simply the sum of the MOB premiums for each of the months of coverage.

In the book, Credit Life and Disability Insurance, the author wrote:

> In almost all net payoff regulations, the MOB rate is specified as level for all loan terms. The single premium for each term must be calculated by computer using the generalized formula:
>
> $$SP_n = 1/10 \times (MOB) \times \sum_{t=1}^{n} (\text{In force})_t$$

GARY FAGG, CREDIT LIFE AND DISABILITY INSURANCE 171 (2nd prtg. 1994) Kentucky credit insurance statutes clearly indicate that $0.92 per $1,000 of outstanding insured indebtedness is the maximum MOB rate allowed to be used by a credit life insurer. KRS 304.19-080(3)(a) provides, in part, as follows:

> (a) Credit life insurance. The premium rates set forth hereunder, **or actuarially equivalent**, shall not exceed:
>
> 1. For decreasing term credit life insurance, a single premium of sixty cents ($0.60) per annum per one hundred dollars ($100) of scheduled indebtedness, or sixty-five cents ($0.65) per annum per one hundred dollars ($100) of scheduled indebtedness if dismemberment benefits are included in the policy.
>
> 3. **A premium payable monthly at the rate of ninety-two cents ($0.92) per one thousand dollars ($1,000) of outstanding unpaid insured indebtedness** or one dollar ($1) per one thousand dollars ($1,000) of outstanding unpaid insured indebtedness if dismemberment benefits are included in the policy, **will be deemed the actuarial equivalent of the foregoing rates.**

(Emphasis added).

The single premium net payoff credit life insurance premium for an installment loan of the type here is calculated by summing the MOB credit life premiums for all of the months that the credit life insurance coverage is in force. In the case of the Consumer loan and credit insurance, the term of the loan was 300 months, but the term of the credit insurance coverage was only 60 months. It should be noted by this Court, however, that the initial amount of coverage sold by Credit disability carrier ($31,853.00) is the sum of the amount of the loan before credit insurance ($30,000.00) plus the amount of the credit life insurance premium ($1,853.00). The credit life insurance was financed, so the initial amount of the loan and the initial amount of net payoff credit life coverage was $31,853.00. However, if the $0.92 maximum MOB rate had been used in the premium calculation, the credit life premium would have been less than $1,853.00 and the amount of insurance coverage would also have been less accordingly.

The correct credit life insurance premium for the Consumer's loan (of $30,000.00 before a credit insurance premium was added to the amount borrowed and financed) should have been calculated as **$1,726.99** under the maximum statutory MOB rate. Accordingly, the total amount of the loan should have been only $31,726.99—not $31,853.00

A MOB rate of $0.9832 is required to produce the premium of $1,853.00 charged Mr. Consumer by Credit disability carrier. This rate is, of course, substantially higher than the $0.92 maximum statutory rate set forth in KRS 304.19-080(3)(a)(3).

B. ADDITIONAL DAMAGES

The cost to the Consumer' from overpaying for credit insurance is more than the amount of the premium that they were overcharged. Because the premium was financed, the damages suffered by the Consumer also include the interest (e.g., finance charges) paid on the overcharged portion of the financed premium. The damages also include the loss of the use of those funds, which could have been producing investment income for the Consumer. To prevent Credit disability carrier from benefiting from its illegal practices, this Court should require Credit disability carrier to pay the Consumer the amount of the overcharge, the finance charges associated with the overcharge, and interest on the overcharge plus interest on the sum of the overcharge plus associated finance charges at the same rate earned by Credit disability carrier during this period.

VIII. CREDIT LIFE- REFUND OF UNEARNED PREMIUM

Many times, the premium charged for life coverage, sold in connection with a loan, is paid "up front" in full for a five-year premium. There is no difference in the monthly rate of the premium. Thus, if the insured dies before the end of the term, partial refund is due for the unused and unearned period of time that remains on the term of the insurance contract.

KRS 304.19-090 states, in part, as follows:

> (2) Each individual policy or group certificate shall provide that **in the event of termination of the insurance prior to the scheduled maturity date of the indebtedness, any refund of an amount paid by the debtor for insurance shall be paid or credited promptly to the person entitled thereto**.... The formula to be used in computing such refund shall be filed with and approved by the commissioner.

(Emphasis added). In accordance with this requirement, the life insurance contract sold to the Consumers will specifically provides that, upon termination, "[a]ny unearned premium will be: 1. paid or credited to The Insured; and 2. computed by the formula on file and approved by the Insurance Commissioner To be clear about what constitutes "termination," the contract may spell out seven events that end the term:

> **Term of insurance:** The term of this insurance shall begin on the Effective Date. **The term shall end on the sooner of the**:
> 1. scheduled maturity date of the debt; or
> 2. expiration date shown in the Schedule; or
> 3. end of the maximum term shown in the Schedule; or
> 4. date the debt is repaid, renewed, or refinanced; or
> 5. **date of death**; or
> 6. date a scheduled payment is more than 90 days late and the loan is foreclosed; or
> 7. date of repossession.

(Emphasis added). Despite these statutory and contractual requirements, however, Credit disability carriers does not refund any unearned portion of the multi-year premium upon death.

According to the group master policy form filed with the Kentucky DOI, the refund method to be used for net payoff decreasing life coverage is the "actuarial method," also known as the "Rule of Anticipation." (Group Master Policy, attached as Exhibit 7, at page 6). The refund by the Rule of Anticipation method is the premium for the remaining term of coverage, calculated using the same insurance rate and loan terms as the original premium. Accordingly, the appropriate refund by the Rule of Anticipation is **$857.30**, calculated by adding the MOB premiums for months 33 through 60 of coverage .

IX. CASE LAW OF BAD FAITH IN KENTUCKY.*

A. THE TURBULENT 80'S - BIRTH, DEATH AND THEN REBIRTH

B. DEFINING BAD FAITH

C. TYPES OF BAD FAITH

1. *Excess Verdict Against the Insured –Failure to Settle within Policy Limits*
2. *First Party Bad Faith - Failure to pay insured*
3. *Statutory Third Party Bad Faith (UCSPA)*
4.. *Other Statutory Basis for Bad Faith*
5. *Consumer Protection Act Violation*

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X. STATUTES AFFECTING DUTY OF GOOD FAITH*

A. THE UNFAIR CLAIMS SETTLEMENT PRACTICES ACT (304.12-230)
B. THE CONSUMER PROTECTION ACT KRS 367.170, 367.220
C. KENTUCKY'S PRIVATE ACTION STATUTE KRS 446.070
D. INSURANCE FRAUD ACT KRS 304.47-20
E. MISCELLANEOUS INSURANCE STATUTES
F. RICO 18 USC § 1961

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HOUSING ISSUES OF CONCERN TO THE CONSUMER LAW PRACTITIONER

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SECTION H

HOUSING ISSUES OF CONCERN TO THE CONSUMER LAW PRACTITIONER

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INTRODUCTION

The "American Dream" has long included in its definition the ownership of a home. Many times home ownership for a number of reasons is out of reach for many Americans. Therefore, renting and rental agreements creating a landlord/tenant relationship are the housing options for many citizens. This chapter will discuss various aspects of consumer law which have been proven to be issues for both the home owner and the tenant alike.

There are numerous issues confronting the consumer, whether in buying a home or renting an apartment. The issues run the gambit of substandard housing to denial of housing due to discriminatory motives. Also at issue is the type of housing and to what rights is one entitled to who enters into the housing agreement. This chapter will attempt to address the issues included in rental housing, a mobile home or a stationary residence.

I. WARRANTY OF HABITABILITY

At the outset it must be mentioned that Kentucky does not recognize the doctrine of Warranty of Habitability. This was of most recently affirmed in the case of Miles v. Shauntee, Ky., 664 S.W.2d 512 (1983). The case arose when Ethal Miles filed a counterclaim against her action for defective conditions existing in her rental housing.

In Miles v. Shantee the Supreme Court discussed the Common Law of the application of caveat emptor to leaseholds. The Court recognized exception to caveat emptor and placed the burden on the landlord to disclose a dangerous condition to a tenant. If the Landlord conceals the dangerous condition he could be held liable for injuries sustained by the tenants, servants or guests. Holzhouser v. Sheeny 127 Ky. 28, 104 S.W.1034 (1907). In Miles the Court refused to find that the landlord/tenant

relationship created an implied warranty of habitability. The Court accepted the long standing rule that a tenant "takes premises as he finds them". *Citing* Milby v. Mears, Ky. App., 580 S.W.2d 724, 728 (1979) and Whitehouse v. Lorch, Ky. 347 S.W.2d 512 (1961). The Court also rejected the very creative legal argument that the landlord renting substandard housing constitutes an "unfair, false, misleading or deceptive acts or practices" in violation of the KRS 367.170 more commonly known as the Kentucky Consumer Protection Act. The Court found the landlord's breach to make repairs to the unit did not constitute an unfair, false or misleading practice under the Consumer Protection Act. Therefore, the creative and frontal attack on the Commonwealth's archaic reliance on "caveat emptor" in terms of safe and habitable housing fell short.

Where does that leave tenants in addressing concerns about the condition of rental property? Certainly, units must comply with local housing codes and regulations in municipalities that have adopted code requirements. The tenants in public housing have a warranty of habitability by virtue of their status. However, the potential tenants in rural areas where there are no housing codes may rent anything from a landlord at their own peril. Understanding caveat emptor and its application it would seem to work counter to the mandate stated in 1938 that all Americans have a right to live in "safe, sanitary and decent housing".

II. HOUSING DISCRIMINATION

In 1964 with the passage of the Civil Rights Act of 1964 Congress outlawed discrimination based on race, sex, national origin, age, color and religion in employment and public accommodations. What is noticeably absent from the list of what came to be called the "protected classes" was discrimination in housing. This oversight brought to

the forefront in the late 1960's when the segregated communities of Detroit, Washington D.C. and Los Angeles as well as other cities across the Nation erupted in racial violence.

Not stating that racial unrest was solely caused by the segregated housing and lack of housing opportunities for minorities to move out of the inner cities would be a simplistic reason for what we know as a complex problem. Nevertheless in April 1968, Congress passed the Fair Housing Act (FHA) (42 U.S.C. §3601-3619), Title VIII of the Civil Rights Act of 1968. The Fair Housing Act prohibited discrimination based on race, color, religion and national origin in most housing transactions. The Act was amended to add sex, handicap and familial status in 1974. What is noticeably absent as a protected class under the FHA is age. While the FHA has been used to attack practices of limiting access to individuals of advanced age it is many times utilized in the context of disability (handicap) discrimination.

A second significant event occurred 1968 when the Supreme Court decided in Jones v. Alfred G. Mayer Co., 392 U.S. 409, 88 S.Ct. 2186 (1968). In Jones the Court held that the Civil Rights Act of 1866 prohibited probate as well as public racial discrimination in housing. The passage of the FHA and the Jones decision allowed protected classes the opportunity to move out of segregated settings and into areas that were once off limits.

The FHA was passed again in 1988 by Congress. The most significant facts of the 1988 Act was the change in the enforcement procedures of the Act. The Act required that all states receiving housing monies from the government have their own FHA Housing Act or substantially equivalent laws or run the risk of loosing Federal dollars.

Kentucky passed the Fair Housing Act, which is codified in KRS 344.600 et. seq. in 1994.

The FHA and the Kentucky equivalent defined a discriminatory housing practice as any act that is unlawful under these sections 42 USC §3604, §3605, §3606 and §3617.

Discriminatory practices include advertising, failure to rent, sell, steeling, redlining and disparate treatment in terms and conditions of tenancy or ownership and accessibility issues. The FHA is a consumer friendly statute, which allows a recourse to the consumer in search of safe, and adequate housing.

The prospective tenant or buyer is many times ignorant to signs of discrimination, i.e. the prospective tenant being informed that the unit had been rented when they arrived a few minutes after the call or the prospective tenant being told that they may be more comfortable in another part of the community. Advertising by the landlord has been found to violate the FHA. "Adult Community" "Quiet Area" or even more obvious "no children" have been found to violate the Act with no surprise. The issues of steering by real estate agents, insurance redlining, predatory lending have all been found to violate the FHA.

A particular area that has proven problematic for the landlord, but of great assistance to the individual within the disabilities community, are the accessibility standards adopted by the FHA and KRS 344. The statute's phrase "otherwise make available" has been used by a qualified tenant with a disability to force a landlord to address issues of parking spaces, recreation facilities, cleaning services that any disabled tenant would enjoy by virtue of the tenancy.

The area of accommodating the qualified tenant with a disability and the cost that may be incurred because of the obligation has been subject to litigation from almost the passage of the law. The consumer must be aware that the coverage of the FHA extends for the qualified tenant with a disability to "children, parents, friends, spouses, roommates, patients, sub-tenants or other associates who have disabilities". Additionally, advocacy groups who want to provide housing opportunities for qualified persons with disabilities have standing to sue if their efforts are blocked or interfered. Assoc. of Retarded Citizens v. Dallas, 19 F.3d 241 (5th Cir. 1994). City of Edmonds v. Oxford House, 514 U.S. 725 (1995).

The FHA is a powerful tool for the prospective consumer in search of safe adequate housing. The anti-discrimination statute guarantees at least equal opportunity to all individuals to rent or purchase a home. The substantive parties of the FHA and KRS 344.600 et. seq. include:

1) Coverage.

   A. Definition – The FHA and the Kentucky equivalent defined a discriminatory housing practice as any act that is unlawful under these sections 42 USC 3604(a) §3604, §3605, §3606 and §3617.

   B. FHA Prohibits discriminatory transactions having to do with dwellings. "Dwellings" include any building occupied or intended to be occupied as a residence or land sold with intent to construct dwelling. *See.* United States v. Hughes Memorial Home 396 F. Supp. 544 (W.D.V.a. 1975) and United States v. Columbus Country Club 915 F2d 577 (3d Cir. 1990). Case which extends

coverage to nursing homes, retirement communities, college dormitories, resident hotels, group homes and recreational time properties.

C. Exemptions – FHA offers seven exemptions. The seven include owner's sale or rental of single family home, owner occupied buildings with no more than four units; religious organizations private clubs; occupancy standards; older persons exempted from familial discrimination.

D. Otherwise make unavailable and Traditional Discrimination 42 USC 3604 (a) and (f)(1) KRS 344.

1) Traditional discrimination;

2) Steering;

3) Zoning ex. group homes;

E. Discriminatory Terms and Conditions 42 USC 3609(b) and KRS 344.

1) Sex discrimination;

2) Children and Playgrounds;

3) Rent;

4) Service and Facilities;

5) Discriminatory Advertisements and Notices and Statements 42 USC 3604(c);

6) False Representations of Non-Availability 42 USC 3604(d);

7) Blockbusting 42 USC 3604(e);

8) Financing and Related Transactions 42 USC 3605;

9) Access to Brokerage Services 42 USC 3606;

10) Coercion, intimidation, threats and interference.

2) Enforcement

A. Administrative

1) HUD;

2) Kentucky Commission on Human Rights;

3) Local HAP agencies;

4) Private FHIP agencies.

B. One year Statute of Limitations to file Administration Court action pursuant to KRS 344 and a two year statute of limitations.

III. PRIVATE RESIDENTIAL LANDLORD TENANT LAW

While the American Dream of owning one's home has long been a politically adopted dream the reality is that majority of consumers are renters. Majority of tenants are unaware of their rights and obligations as a tenant. Just as well many landlords are unaware of their responsibilities to the tenant.

Kentucky landlord/tenant law is a mixture of haves and have nots. Many cities have passed the Uniform landlord/tenant Act which provides added protection to the tenant and landlords. Many localities still operate without URLTA and the rights of the tenant/consumer suffer.

IV. ESTABLISHMENT OF LANDLORD/TENANT RELATIONSHIP

The lease signed by the landlord and tenant creates a legal relationship outlining the obligation of both parties. The principals of contract law apply to the leases. However, a "please purchase agreement may very well fall outside of the landlord/tenant law. For example:

A. Establishing Existence of Tenancy

1) Testimony of oral agreement;

2) Introduction into evidence of written lease;

3) Is there a landlord/tenant relationship?

   a) Sebastian v. Floyd, 585 S.W.2d 381 (Ky. 1979), held that when an installment land contract is used as a means of financing the purchased of property, the vendor's interest, being bare legal title, is to be treated as a lien on the property to secure payment, requiring a vendor to seek a judicial sale of the property upon the purchaser's default. *See* Gamble v. Bryant, 599 S.W.2d 472 (Ky. App. 1980.

   b) Emmons v. Madden, 781 S.W.2d 529 (Ky. App. 1989), held that lawsuit by purchaser against vendor alleging that vendor has conveyed property to purchaser and agreed to deliver possession at time of closing but had not vacated property was not a forcible detainer action over which district court has subject matter jurisdicion.

Many times upon argument, the District Court in a forcible retainer action will dismiss the landlord's action requiring him instead to file a foreclosure action in Circuit Court. Not only will the foreclosure action delay the removal of the occupier/buyer of the property it will also allow the occupier/buyer all equitable defenses allowed under the Civil Rules.

B. The written lease can not be unconscionable.

   a) Landlord can not charge late fees in an exorbitant note.

   b) Landlord can not place unreasonable borders on a tenant for any reason.

c) Landlord can enforce occupancy standards on a landlord as long as not discriminatory.

C. Renewal of Lease

a) Lease is good for the terms stated in lease.

Example- year to year, month to month, week to week

b) Lease not renewed but hold over tenant is a "month to month" lease *See* Clay v. Terrill 670 S.W.2d 492 (Ky. App. 1984).

V. TERMINATION OF LEASE

A. Lease provisions should state how a lease should be terminated by either party.

B. Early Termination of Lease

a) Good cause.

b) Mitigation by landlord.

C. Notice to terminate lease.

1) Non URLTA.

a) KRS 383.195 requires one months notice in writing to terminate tenancy at will or by sufferance.

b) But... Pack v. Feuchtenburger, 22 S.W2d 914 (Ky. 1930), interpreting predecessor to KRS 383.195, Reck and Riehl v. Caulfield, 112 S.W. 843 (Ky. 1908), David V. Hall, 6 Ky. 444 (1884), stated that the one month notice to vacate must run until the next periodic rental date (example: rent is due on the 5th of the month, notice to vacate given on January 22 must run until March 5, not just February 21.)

c) AND ... Goodwin v. Beutel, 256 S.W.2d 532 (Ky. 1953), interpreting predecessor to KRS 383.195, stated that non-payment of rent by tenant at will is not a forfeiture of the tenancy, therefore it did not preclude tenant from raising the defense that statutory one month's written notice requiring tenant to vacate was not given by landlord.

See Clay v. Terrell, 670 S.W.2d 492 (Ky. App. 1984).

d) KRS 383.160 provides that no notice is necessary if:

1) An action is commenced within 90 days of the expiration of the lease if the tenancy was for a year or more and was set to expire on a date certain. If no action is commenced within that time then the term is automatically extended for a period of one year form the original date of the expiration of the tenancy.

2) An action is commenced within 30 days of the expiration of the lease if the tenancy was for less than a year and was set to expire on a date certain. If no action is commenced within that time then the term is automatically extended for a period of 60 days from the original date of the expiration of the tenancy.

3) *See* Masterson v. DeHart Paint & Varnish Co., 843 S.W.2d 332 (Ky. 1992).

e) Waiver of notice has been upheld in Stoll Oil Refining Company v. Pierce, 337 S.W.2d 263 (Ky. 1960). This case involved a commercial lease. Many judges this that it is an unconscionable assertion, and provision should be held unenforceable in a residential setting. Strength of bargaining positions should

be a relevant item. But See Aetna Oil Coampany v. Robertson, 258 S.W.2d 464 (Ky. 1953).

f) Service of notice preferably is to be hand delivered personally to tenant. Strongly suggest notice requirements of URLTA be followed. See KRS 383.560. But see 51 C.J.S. Landlord and Tenant Section 150(6); 50 Am. Jur. 2d Landlord and Tenant, Section 1213.

2) URLTA

a) Notice to vacate must be hand delivered to tenant or mailed by register or certified mail. KRS 383.560(3)(c), with some exceptions noted.

b) Time period for eviction must be stated on notice.

1) Non-payment of rent – seven day notice with right to cure. KRS 383.660(2).

2) Material noncompliance with rental agreement fourteen day notice. KRS 383.660(1).

3) Periodic tenancy – seven day notice for week-to-week tenancy. KRS 383.695(1); 30 day notice from periodic rental date for month-to-month tenancy. (like Pack). KRS 383.695(2).

4) Tenancy begun upon the termination of a written lease. KRS 383.695(3).

a) Waiver of statuary notice in a lease is prohibited. KRS 383.570.

b) The party who is relying on the URLTA municipal ordinance must introduce certified copy into evidence. Judicial notice will not be taken of ordinances of local governments. Butler v. Louisville and Jefferson County Board of Zoning Adjustment and Appeals, 224 S.W.2d 658 (Ky. 1949). There is a

limited exception to this rule that makes ordinances of a first-class city subject to judicial notice. KRS 383.080.

D. Eviction Proceedings KRS 383.660.

1) Time period for eviction must be stated on notice.

   a) Non-payment of rent – seven day notice with right to cure. KRS 383.660(2).

   b) Material noncompliance with rental agreement fourteen day notice. KRS 383.660(1).

   c) Periodic tenancy – seven day notice for week-to-week tenancy. KRS 383.695(1); 30 day notice from periodic rental date for month-to-month tenancy. (like Pack). KRS 383.695(2).

   d) Tenancy begun upon the termination of a written lease. KRS 383.695(2).

2) KRS 383 states that the Defendant in forcible detainer must be provided at least three days notice of the eviction hearing.

3) Eviction is a summary proceeding possession of properly in question is the only issue Judge or Jury will decide. KRS 383.540 confers jurisdiction or District Court on Issues under URLTA.

   A. Back rent or damages not collectible in forcible detainer actions.

   B. Jury trial permitted KRS 383.210(2) but no discovery allowed.

      1) Must be unanimous verdict.

      2) If jury is ruling on Tenant's counterclaim additionally must be unanimous.

      3) Effect of July decision:

         (a) If in favor of tenant/landlord's eviction petitioner is dismissed

(b) In favor of landlord the tenant has only seven (7) days to appeal the decision.

4) Appeal

A. Seven (7) days to appeal the decision to Circuit Court KRS 383.255(1).

B. Deposit rent into Court as it becomes due. See Fickey v. Cross Creek LTD 700 S.W.2d 807 Ky. App. (1985).

C. Right of first Appeal from Circuit Court Ky. Constitution § 115.

5) Writ of Restitution KRS 383.245 Sheriff or Constable will not remove tenant's belongings landlord or authorized agent must remove belongings to the street.

A. Landlord could be liable for conversion action if takes tenant's property without notice or order.

B. District of rent abolished KRS 383.680.

6) Acceptance of rent after termination notice given.

A. URLTA. KRS 383.675. Acceptance of rent with knowledge of default by tenant constitutes a waiver of the landlord's right to termination the rental agreement for that breach.

B. Non-URLTA.

1) Acceptance of rent for a period following the proposed termination date operates as a waiver of the termination notice requiting that a new notice be issued before an FED action can be maintained. *See* Daily v. Kelly, 200 S.W.2d 114 (Ky. 1946); Rich v. Rose, 99 S.W. 953 (Ky. 1907); 51 C.J.S. Landlord and Tenant Section 150(7), where it is noted that "a

notice to vacate the premises on a designated day is waived by acceptance of rent for a tenure and use beyond that date."

2) Citizens Fidelity Bank & Trust Co. v. Norfleet, 252 S.W.2d 54 (Ky. 1952); Cities Service Oil Co. v. Taylor, 45 S.W.2d 1039(Ky. 1932) held that a ground of forfeiture is waived by acceptance of rent with knowledge of the ground, unless circumstances are shown to rebut the presumption arising from such a situation.

3) However, Sherrill v. Harlan Theater Company, Inc., 75 S.W.2d 775 (Ky. 1934) and Pettitte v. Smith, 87 S.W.2d 945 (Ky. 1935), arguably hold that such acceptance of rent waives the forfeiture only if it was based on non-payment of rent.

4) 51 C.J.S. Landlord and Tenant Section 150(7) states that notice also will be waived by the issuance of a new notice.

5) 12A Ky. Digest Landlord and Tenant Section 112(2); 50 Am.Jur.2d Landlord and Tenant Section 1215 and 1216; 120 ALR 561.

6) Jurisdiction.

   a) Arguably the district court does not have jurisdiction over the issues in an eviction where the major question is whether or not the lease has been violated. If the eviction is premised upon violation of the term so a lease, then it is arguable that the issue of whether or not here has been a violation first must be decided by the circuit court. KRS 383.540 confers jurisdiction on the district court to hear those matters which arise under URLTA. It is not as clear that the district court has

jurisdiction to hear URLTA jurisdiction. Once the circuit court determines there has been a violation of the terms of the lease then a proper notice may be given and an FED commenced upon the expiration of the notice.

b) In an eviction proceeding, the district court does not have jurisdiction to enter orders relating to back rent or damages. It has authority only to enter a judgement on the issue of restitution and costs. (Exception at KRS 383.645).

7) Retaliatory Eviction

a) URLTA

1) A landlord may not retaliate by increasing rent or decreasing services or by bringing an action for possession after the tenant has complained to the landlord or the tenant has become a member of a tenant's group. KRS 383.705(1).

2) Remedies. KRS 383.705(2). Tenant entitled to remedies provided in KRS 383.655, recovery of possession or termination of rental agreement and, in other case, recover an amount not more than three (3) months periodic rent and a <u>reasonable attorney's fee</u>. If the rental agreement is terminated the landlord must return prepaid rent.

3) Exceptions. KRS 383.705(3). (a) Tenant's lack of reasonable care resulting in building/housing code violations; (b) Tenant in default on rent; (c) Compliance with the applicable building/housing code

requires alteration, remodeling or demolition which deprives the tenant of the use of dwelling unit.

b) Non-URLTA

1) It is possible to urge, even in non-URLTA jurisdictions, that retaliatory evictions should not only be discouraged but prohibited as against public policy. *See* 40 ALR 3d 753, concerning retaliatory eviction of tenant for reporting landlord's violation of laws. Analogies may be drawn from the law being developed in the area of wrongful discharge. For instance, an eviction should be prohibited as against public policy when it can be proved that it is the result of the tenant's exercise of a statutory right or the consequence of the tenant's refusal to break the law. *See* Grzyb v. Evans, 700 S.W.2d 399 (Ky. 1985), for an introduction to wrongful discharge law in Kentucky.

2) It is also possible to urge that evictions carried out for illegal purposes should not be allowed. For instance, KRS 344.360 and 344.362 prohibits discrimination in housing. Consider also the Fair Housing Amendments Act of 1988.

VI. MOBILE HOME ISSUES

Mobile Homes are the residence of choice for many Kentucky resident. Mobile Homes sales often resemble that of a car sales in comparison to a fixed housing sale. The Mobile home sale is fact specific as to any violation of the law.

A. Client usually visits a Mobile Home Dealership and is shown around. During the visit the following will occur:

1) Oral representation about home.

2) Oral representation about financing.

3) Preparation of credit application.

4) Buyer agrees on home and financing.

5) Watch "Bait and Switch" possibility.

B. Purchase Order Signed.

1) Order may contain...

a) Disclaimer of express or implied warranties.

b) Provisions limiting venue of litigation.

c) Provisions lowering statute of limitations.

May include other information such as price, down payment, trade in allowance, finance charges, payment schedule, balance.

NOTE: The purchase order is not a Truth-In-Lending (TILA) disclosure statement.

C. Return of Consumer to sign a retail sales installment and contract security agreement. RISA).

1. RISA may include:

a) Venue limitations.

b) One year statute of limitations.

c) Disclaimers of Warranties.

d) Disclosures requited by TILA and Kentucky Installment Sales Contract Act of KRS 371.210 et.seq.

e) Manufacturers warranty.

f) Arbitration Agreement.

g) Loan origination fee, check the "RISA" to see if the loan origination fees comply with Federal Depository Institution. The regulation and Monetary Control Act of 1982 (DIDA) 15 U.S.C. § 1735f-7(a). 12 CFR Sec. 590.

h) Beware of taxable terms.

i) Delivery and Dealer Responsibilities.

j) Discovery and notification of Defects.

A. ACTIONS AVAILABLE TO CONSUMER

The consumer/buyer may assert many claims against the Mobile Home Manufacturer and Seller. Common Law negligence and negligence per se resulting from violations of manufacturers Housing Code, 12 CFR Part 3282. The regulations set standards for construction of manufacturing housing. Other causes of Action include:

Against the Manufacturer:

1) Mobile Home Sales Act KRS 367.710 et. seq.

   a) Applies to original purchaser and manufacturers only.

   b) Defect within the first 12 months which costs 4% of the purchase price to repair and which requires three separate repairs, will be presumed unmerchantable. KRS 367.715.

   c) Buyer must notify manufacturer of the defect by certified mail within ten days following establishment of the defect with copy to dealer.

d) Within ten days manufacturer must examine and notify the owner in writing that no defect exists, or that the defect was caused by someone other than the manufacturer, or that the manufacturer will make the home merchantable.

e) The manufacturer must provide equivalent accommodations during repair.

f) If statutory remedies fail, consumer may bring action for price plus attorney fees.

g) KRS 367.760 is the only part of the Mobile Home Sales Act that applies to the dealer. It requires that any dealer, manufacturer, or wholesaler making a repair on a new mobile home prior to delivery must state in writing to the owner the nature of the defect repaired and the cause of the damage. Use in conjunction with KRS 446.0701 to create a negligence per se cause of action.

2) Consumer Protection Act KRS 367. The consumer can allege an unfair deceptive and unconscionable trade practice when a manufacturer asserts a warranty limitation limiting the buyer's remedies to repair and/or replace defective parts. If successful the consumer/buyer can recover damages courts and attorney fees. Ford Motor Company v. Mays 575 S.W.2d 480 Ky. App. (1979).

3) Magnuson Moss Warranty Act. 15 U.S.C. 2301-2312 16 CFR 700 et.seq.

a) The Act applies to tangible personal property normally used for personal, family or household use manufactured after July 4, 1975, when in connection with the product a written warranty is given, or within 90 days of the sale, a supplier sells a service contract on the product.

b) The Act contains both substantive rights and disclosure requirements. The consumer can recover damages caused by both, but no statutory penalties are

provided.

c) The Act contains disclosure requirements that mandate that all terms, limitations and conditions of warranties must be fully and conspicuously disclosed in simple readily understood language.

d) Allows consumers to recover damages including attorney fees for breach of any written warranty, implied warranty, service contract, or disclosure requirement of the act. See 15 USC Sec. 2310(d)(1).

e) UCC implied warranties in Kentucky only apply to the dealers as no privacy with manufacturers. See Williams v. Fulmer 695 S.W.2d 411 (Ky. 1985).

B. CLAIMS AGAINST DEALER

1) Regulation under UCC: KRS 355.2 602, KRS 355.2 508 and KRS 355.2-601.

a) Buyer can reject for any non-conformity to the contract UCC adopts "mirror image rule".

b) Reject must occur with in reasonable time.

c) Buyer must notify seller of rejection and should be specific.

d) Seller has right to care non-formality.

e) Seller must notify buyer of intent to care within reasonable time-if seller facts to care within reasonable time rejection is effective.

f) Buyer may retain goods but not alter goods.

g) Buyer's right of rejection and revocation of acceptance is not affected by disclaimers of implied warranties Capital Cadillac Olds, Inc. v. Roberts 813 Ky., S.W.2d 287 (1991).

2) Revocation of Acceptance.

a) Non-conformity must substantially impair value of goods.

b) Buyer must notify seller of revocation of acceptance with in reasonable time. Kentucky Courts appear to hold that the seller has the same right to care as in the rejection context. See Ford v. Meyers 575 S.W.2d 480 (Ky. App. 1928). Cherwick v. Carares 759 S.W.2d 832 (Ky. App. 1982).

c) Non-conformity to the contract rejection of revocation of acceptance are available for any non-conformity to contract. Implied warranty of merchantability (KRS 355.314); Implied warrant of fitness for a particular purpose (KRS 355.2315); Non-conformity credit, late delivery failure to install properly are examples of non-conformities to be contracted.

d) Damages

1) Incidental and consequential damages are available to buyer who successfully rejects or revokes acceptances. KRS 355.2715.

2) Buyer may recover for any non-conformity, determined in any manner that is reasonable.

3) Breach of Warranty.

4) Problems with Disclaimers.

(a) See Capital Cadillac Olds v. Roberts. 813 S.W.2d 287.

(b) Plead fraud.

(c) Plead Consumer Protection Act unfair and deceptive.

(d) Unconscionably.

(e) Magnetron Moss Warranty Act.

(f) Disclaimer not conspicuous. See General Motors Acceptance Corp. v. Grad 501 N.E.2d 68 (1985).

3) Fraud

a) Elements "(a) material representation, (b) which is false, (c) known to be false or made recklessly, (d) made with inducement to be acted upon, (e) acted with reliance thereon, and (f) causing injury." WAHBA v. Don Corlett Motors, Inc. 573 S.W.2d 357, 359 (Ky. App. 1978).

b) Must be proved by "clear and convincing evidence".

c) Reception as unfair practices under KRS 367.110.

d) Breach of obligation of good faith.

e) All UCC remedies are available for fraud or material misrepresentation KRS 355.2721.

f) Negligence claims.

g) Consumer Credit Claims (TILA, RISA, or Kentucky Installment Sales Contract Act KRS 371.210 et.seq.

4. "Holder Rule".

The claims against the holder (bank) or mortgage company, etc.) . See FTC Holder Rule at 16 CFR 433.1. The Holder rule notice reads as follows:

NOTICE

> Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder.

a) Meaning: The debtor can affirmatively recover all sums paid to anyone under the contract and can offset all amounts remaining owed under the contract.

b) Consumer may sue under the "holder rule" Ford Motor Credit Company v. Morgan 536 N.E.2d 587 (Mass 1989); Resolution Trust Corp. v. Cook 840 S.W.2d 42 (Tex. App. 1992); Eichen v. Scott Housing System 630 Fed. Supp. 1962 (M.D. Ala. 1986); Ailett v. City Finance Co. 391 S.O.2d 896 (Ca. 1980); Thomas v. Ford Motor Credit Comp. 429 A2d 277 (M.D. App. 1981).

C. Claims Unique to Mobile Homes

1) B Seal "Habitability Claims and certain consumer claims.

   a) B-Seal Claims KRS 227.550(3) means a seal issued pursuant to KRS 227.600(3).

   b) KRS 227.600(3) "Class B Seal" means a seal issued pursuant to subsection (3) of KRS 227.600.

   KRS 227.660(3) Any dealer who has acquired a used manufactured home, mobile home, or recreational vehicle without a seal shall apply to the office for a Class B Seal by submitted an affidavit that the unit has been brought up to or meets reasonable standards established by the board for used manufactured homes, mobile homes, or recreational vehicles. Those manufactured homes or mobile homes taken in trade must be re-inspected and certified. A numbered Class B seal shall be affixed by the dealer to the unit prior to sale. A seal will not be required if such dealer submits an affidavit that the unit will not be resold for use as such by the public. A dealer shall not transport or install a manufactured or mobile home which is to be used for residential purposes which does not have a class A or Class B seal.

   See administrative regulations relevant to "B Seal" at 815 KAR 25:040-090.

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