The Business Suit

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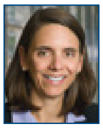

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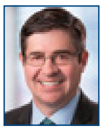

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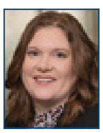

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In This Issue

Committee Notes

Feature Articles

Back to Contents

From the Chair: The Show Must Go On

By Tracey Turnbull

It is early fall, and it already feels like several years have passed since we last gathered in New Orleans at the 2019 Annual Meeting. Despite everything that has been thrown at each of us, we have all persevered and kept going in our own way on our own paths. The Commercial Litigation Committee (CLC) has done the same. We have not done this in a vacuum, but rather with the leadership, encouragement, and guidance of the amazing DRI Executive Committee, Board of Directors, and Law Institute. Typically, in this newsletter we would be looking forward to our committee's program at the Annual Meeting (or this year's planned Summit) and organizing our business meeting and social events. While the COVID-19 crisis took away our opportunity to gather in person at the Summit in Washington, D.C., this October and our Super Conference scheduled in Minneapolis last May, it did not take the spirit and energy of the members of this group.

Recently, Charlie Frazier, the 2020 Program Chair stepped forward to lead us in planning our 2021 Program and finish what he started and almost completed. In case you are wondering, this is no small feat. If you have served as Program Chair for any DRI program you know that while it always looks like things went smoothly at the seminar—they never do. To jump back in and agree to face those challenges again head on is amazing (Peter Lauricella and Liam Felson—I'm just kidding it is easy to be the Program Chair—once the clock strikes Noon on Friday). The CLC's 2021 Super Conference planning has already begun. While some portions of the planned 2020 program will be the same, there will be many opportunities for several new presentations and speakers. If you are interested in speaking or have any ideas for great topics, please let us know.

Planning for CLC's annual seminar is not the only thing that has continued on in the CLC. Throughout the COVID-19 crisis our five SLGs continue to conduct regularly scheduled meetings. These meetings afforded our members an opportunity to stay on top of emerging issues in their respective substantive areas and provided a real opportunity for our members to stay connected. They also afforded new members opportunities to get to know other members and start to make some connections within the Committee. In addition to the SLGs meetings, the CLC has reached out to it members and non-members through the use of new social media platforms. If you are not connected to the DRI Litigation Committee on LinkedIn, you should be. Our CLC LinkedIn group provides yet another forum for our members to share recent legal developments, success stories, new professional associations, promotions, and post other published content with each other. If you are not looking for substantive content, the CLC also has a Facebook page which affords an arena for our members to connect and share information. We owe all credit for the success of these new platforms to our Social Media Chair, Emily Ruzic who tirelessly encouraged regular participation and membership on these platforms. If you would like to join either of these groups, let us know and we will get you connected.

If attending SLG meetings or social media postings are not enough—we added more. After missing our opportunity to gather in person in Minneapolis, the CLC scheduled a virtual Zoom happy hour on the date when our second seminar networking reception was scheduled. This informal gathering included nothing substantive and had no agendas, talking points or deadline reminders. Instead, it was a relaxed check-in where members came together to say hello with a favorite "beverage." In July, the infamous Bourbon SLG hosted its first virtual Zoom "bourbon tasting," which included no standards or requirements—just attendance and any beverage of choice. This "no judgment" social event represented another way for our members to gather and connect.

While most of these different gatherings lasted no more than an hour, they all provided whatever our members needed on that particular day. Renewed or new friendships, camaraderie, a sympathetic ear and laughter. This is what the CLC does. Of course, if you need some guidance on a tricky or new legal issue, recommendations for or feedback on a mediator, arbitrator or expert witness, or local counsel in a particular jurisdiction—the CLC will also be there for you. This is what makes DRI membership priceless. Speaking of DRI membership, Matt Murphy and the entire CLC membership team have consistently carried our flag throughout the pandemic but could use help spreading the word on why membership in the DRI CLC is worthwhile.

The next time you receive a reminder for an SLG meeting or a virtual happy hour invite a colleague, your mentee or friend to join you and meet this group. Whatever happens next in this crazy year, the DRI CLC will carry on and will be there for you.

***Tracey L. Turnbull**, a partner in the Cleveland, Ohio, office of Porter Wright Morris & Arthur LLP, focuses her practice on complex commercial and employment litigation matters. She represents companies and individuals in cases involving contract disputes, covenants not to compete, trade secrets, intellectual property, and product liability claims. Ms. Turnbull is chair of the DRI Commercial Litigation Committee.*

From the Editor

By Jamie Weiss

Like Tracey, typically I am writing about the next opportunity to get together in person with old friends and new through this committee, whether it's at our annual seminar or conference in the spring or the big DRI annual meeting or summit in the fall. Of course, it's unlikely we will get that chance in 2020. But that doesn't mean there are no other opportunities to reap the benefits of membership in DRI and the Commercial Litigation Committee.

While we will not be able to travel to Washington, D.C., in October, DRI is still moving forward with a Virtual Annual Meeting from October 21 to 23. Just a few weeks before the election, this meeting will feature a discussion with political strategists Paul Begala and Michael Murphy, as well as a keynote speech from former deputy attorney general Rod Rosenstein. I urge you all to check it out and register. In addition to these speakers and CLE opportunities, there will also be virtual networking events to connect with other members throughout that week.

As far as this issue of the *Business Suit*, in addition to an update on a recent appellate victory from our member Josh Gayfield and his colleagues, we have *five* amazing feature articles. The first, from Juan Ortega, looks at the question whether mortgage servicers qualify as debt collectors under federal law. The second, from Lynne Ingram and Stephen Wolf discusses questions about the duties of construction managers in several states. The third, from Walter Judge, looks at a recent decision on commercial landlord liability to injuries to a retail tenant's customer. Fourth, Thomas Lyons writes about some recent decisions about wrongful repossession. And last, but not least, regular contributor Mark Olthoff writes about preemption in the financial services industry.

James M. (Jamie) Weiss *is a partner in the litigation group at Ellis & Winters in Raleigh, North Carolina. His practice includes a mix of complex commercial litigation and products liability. That includes matters ranging from trade secrets theft and unfair competition to defending companies following crane and rigging accidents or manufacturers of lighting and plumbing applications. Jamie received his B.A. from the University of Virginia and his J.D. from the Washington University School of Law in St. Louis.*

Recent Appellate Victories

CLC Member **Josh Gayfield** and Megan McGinnis recently secured a noteworthy published opinion from the United States Court of Appeals for the Fourth Circuit. The opinion establishes new law regarding Federal Rule of Evidence 408 and the admissibility of pre-litigation settlement negotiations. The case, in which Miles & Stockbridge represented the redeveloper of a 3,100-acre land parcel east of Baltimore Inner Harbor, arose from a dispute over a former employee's claim to an alleged commission for the resale of the property. At a civil jury trial in the Maryland District Court, Miles & Stockbridge objected to the introduction of certain testimonial evidence key to the plaintiff's case on the basis that it involved an attempt to compromise a disputed claim. While trial court initially allowed the evidence, a unanimous panel of the Fourth Circuit held that the lower court had erred and accordingly vacated the judgment and remanded for a new trial.

Are Mortgage Servicers Debt Collectors Under the FDCPA?

By Juan Ortega

When defaulted borrowers are fighting to keep their home, lawsuits against the lender or mortgage servicer are often filed. One of the many claims asserted against lenders and mortgage servicers is a violation of the Fair Debt Collection Practices Act (FDCPA), the purpose of which is to "eliminate abusive debt collection practices by debt collectors," among others. 15 U.S.C. §1692(e). Generally, a defaulted borrower alleges that his or her mortgage servicer is a "debt collector," and that the mortgage servicer has attempted to collect on the defaulted mortgage loan in a way that violates the FDCPA such as using false, deceptive, or misleading statements in attempting to collect a debt; or using unfair or unconscionable means to collect or attempt to a collect a debt.

If the borrower succeeds on a claim under the FDCPA, the borrower can recover actual damages sustained as a result of the violation, and statutory damages up to $1,000.00. While actual and statutory damages may not be all that much, the borrower can also recover the costs of the action and a reasonable attorney's fee. This fee-shifting provision can be very costly to anyone found to have violated the FDCPA, even for a minor infraction. The attorneys who handle these types of claims are usually allowed to charge premium rates due to the nuanced nature of this area of the law, and the costs of handling this type of case can rise quickly due to the amount of work it takes to prosecute and defend an FDCPA claim. So, if there is a finding of liability under the FDCPA, the violator could easily be on the hook for more than $100,000.00, after paying damages, costs, and attorney's fees for both the opposing counsel and its own lawyers!

However, in order for a defaulted borrower to prevail against a mortgage servicer on a claim for violation of the FDCPA, he or she must plead and ultimately prove three things: "(1) the plaintiff has been 'the object of collection activity arising from consumer debt'; (2) 'the defendant is a debt collector as defined by the FDCPA'; and (3) 'the defendant has engaged in an act or omission prohibited by the FDCPA.'" *See Vazquez v. Prof'l Bureau of Collections of Maryland, Inc.*, 217 F. Supp. 3d 1348, 1351 (M.D. Fla. 2016), *quoting Kennedy v. Nat'l Asset & Risk Mgmt., LLC*, No. 3:13–CV–101–J–12MCR, 2013 WL 5487022, at *2 (M.D. Fla. Sept. 30, 2013). When examining a claim for violation of the FDCPA, one of the first items to determine is whether the defendant is subject to the FDCPA. That is, is the target defendant a "debt collector" as that term is defined in the statute? If the target defendant is not a "debt collector" under the statute, then the statute does not apply, and there can be no liability to the defaulted borrower.

Often, the defaulted borrower will acknowledge in the complaint that the mortgage servicer is, in fact, an entity that serviced the subject mortgage loan. The complaint may also assert that the mortgage servicer is a "debt collector" under the FDCPA, but it would be almost impossible to not acknowledge the fact that the mortgage servicer is indeed a mortgage servicer of the subject loan. Just because a mortgage servicer is called a "debt collector" does not necessarily make it so. The defaulted borrower will still have to prove that the mortgage servicer is a "debt collector."

The FDCPA defines a "debt collector" as "any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another." 15 U.S.C. §1692a(6). This statutory definition generally defines third-party debt collection agencies, those businesses that do nothing but attempt to collect overdue debts, and "[e]veryone agrees that the term embraces the repo man—someone hired by a creditor to collect an outstanding debt." *See Henson v. Santander Consumer USA, Inc.*, 137 S. Ct. 1718, 1720 (2017).

However, "an enforcer of a security interest, such as a [mortgage servicer] foreclosing on mortgage of real property… falls outside the ambit of the FDCPA." *Warren v. Countrywide Home Loans, Inc.,* 342 Fed. App'x. 458, 460 (11th Cir. Aug. 14, 2009) (determining that "the act of foreclosing on a security interest is not debt collection activity for the purposes of the FDCPA."); *see also Brown v. Morris*, 243 Fed. App'x. 31, 35 (5th Cir. June 28, 2007) (recognizing that a foreclosure is not *per se* a debt collection under the FDCPA); *Ho v. ReconTrust Co., N.A.*, 858 F.3d 568, 571-573 (9th Cir. 2017) (enforcement of security interest, without more, does not create collection of a debt subject to the

FDCPA). Thus, the FDCPA "applies only to debt collectors and not to creditors or mortgage servicers" engaging in first party collection efforts. *Carroll v. Bank of America, N.A.*, 2013 WL 1320755, at *4 (N.D. Ga. Mar. 28, 2013); *Janke v. Wells Fargo and Co.*, 805 F. Supp. 2d 1278, 1281 (M.D. Ala. 2011); *see also Todd v. Discover Bank*, 115 So. 3d 167, 171 (Ala. Civ. App. 2012) (noting that the defendant must be a debt collector to be liable under the FDCPA); *Buckentin v. SunTrust Mortg. Corp.*, 928 F. Supp. 2d 1273, 1294 (N.D. Ala. 2013); *Madura v. Lakebridge Condo. Ass'n Inc.*, 382 Fed. App'x 862, 864 (11th Cir. June. 14, 2010).

To be considered a "debt collector" under the statute, a person must meet one of the two definitions set forth therein. Under the first prong, a "debt collector" is one, "who uses any instrumentality of interstate commerce or the mails *in any business the principal purpose of which is the collection of any debts.*" *Carroll*, 2013 WL 1320755 at *4, n.5 (emphasis added). The second prong defines a "debt collector" as one, "who *regularly* collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another." *Id.* (emphasis added); *see also Graveling v. BankUnited N.A.,* 970 F.Supp.2d 1243, 1257 (N.D. Ala. 2013) (a party qualifies as a "debt collector" by using interstate commerce or the mails in operating a business the principal purpose of which is to collect debts, or by regularly attempting to collect debts). For those persons falling under the second prong, the FDCPA provides an exception to the term "debt collector": "[t]he term does not include any person collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity… concerns a debt which was not in default at the time it was obtained by such person…." 15 U.S.C. §1692a(6)(F). When the exception is read with the definition, a "debt collector" under the second prong is one who regularly collects debts, owed or due or asserted to be owed or due another if the debt being collected was in default when acquired. *See Davidson v. Capital One Bank (USA), N.A.*, 44 F.Supp.3d 1230 (N.D. Ga. 2014), *aff'd* 797 F.3d 1309 (11th Cir. 2015). For the FDCPA to apply to a defaulted borrower's claims, it must be determined whether the mortgage servicer falls into either the first or second prong of the definition of a "debt collector," and if neither, then the mortgage servicer has no liability under the FDCPA.

In most cases, the defaulted borrower will allege that because the loan was in default at the time the mortgage servicer began servicing the loan (after an assignment), the servicer is a "debt collector." That alone does not qualify the servicer as a debt collector. Under the definition of "debt collector," several exclusions exist. *See* 15 U.S.C. §1692a(6)(A)-(F). One of the exclusions from the definition of "debt collector" is a person collecting or attempting to collect a debt owed to another to the extent the debt was not in default when it was obtained by the person attempting to collect. *See id. at* §1692a(6)(F)(iii). Put simply, if a debt is obtained by a party that did not originate the debt, and it is not in default when obtained, then the non-originating party is not a "debt collector" if it later attempts to collect. Conversely, if the debt is obtained by a non-originating party and it is in default at the time obtained, then the non-originating party is a "debt collector" for purposes of the statute. Obviously, this exclusion was meant to avoid third-party debt collectors from obtaining defaulted debts to collect by way of an assignment to avoid being labeled a "debt collector." Hence, the defaulted borrower will allege that his or her mortgage loan was in default when the mortgage servicer that foreclosed on the property began servicing the loan so as not to fit within the exclusion of the term "debt collector" found in §1692a(6)(F)(iii). However, the analysis does not end there.

Mortgage Servicers Are Not in Business with the Principal Purpose of Collecting Debts

It would be hard to argue that a mortgage servicer is in any business the principal purpose of which is the collection of debts. Indeed, mortgage servicers handle the day-to-day administration of a mortgage loan, such as processing payments, handling of escrow accounts for taxes and insurance, communicating with investors, and communicating with borrowers. *See* Fed. Hous. Fin. Agency OIG, Second Semiannual Report to the Congress (April 1, 2011 to September 30, 2011), available at https://www.fhfaoig.gov; *see also Powell v. Nationstar Mortgage LLC*, 2016 WL 11198648, *4 (E.D. Tex. 2016) (mortgage servicers handle day-to-day activities of mortgage loans such as collecting and applying payments, and responding to borrowers' questions and correspondence). Based on these accepted descriptions of what a mortgage servicer does, it would be very difficult to argue that a mortgage servicer's principal purpose is the collection of debts. Therefore, it cannot be said that a mortgage servicer meets the first prong definition of a "debt collector" under 15 U.S.C. §1692a(6).

Ineligibility of the Exception Does Not Automatically Qualify a Mortgage Servicer as a Debt Collector Under the Second Prong

Because mortgage servicers do not fit within the first prong definition of a "debt collector," defaulted borrowers usually attempt to classify them as a "debt collector" under the second prong. However, when the facts of a case are considered along with a logical interpretation of the statute, acquisition of a debt in default does not automatically qualify a mortgage servicer as a "debt collector." Rather, "acquiring a debt that was in default at the time simply makes a defendant ineligible for this particular exclusion from the definition of a 'debt collector;' it does not follow from this ineligibility that the defendant satisfies the definition of 'debt collector' that §1692a(6) puts forth or cannot be considered a "creditor" pursuant to §1692a(4)." *See Davidson*, 44 F.Supp.3d at 1239 (quoting *Bradford v. HSBC Mortg. Corp.*, 829 F.Supp.2d 340, 350 n. 21 (E.D. Va.2011)).

Mortgage Servicers Do Not Meet the Definition of "Debt Collector" Under Second Prong

Defaulted borrowers will argue that because the foreclosing mortgage servicer acquired a loan in default, it does not qualify for the exception to the definition of a "debt collector" set forth in 15 U.S.C. §1692a(6)(F); and therefore, the servicer should be considered a "debt collector." However, a careful reading of §1692a(6) shows that mortgage servicers do not meet the definition of "debt collector."

The purpose of the FDCPA is to, "eliminate abusive debt collection practices by debt collectors…." 15 U.S.C. §1692(e). The term "debt collector" was intended to apply to third parties who collect debts for others, not creditors, "who are generally restrained by the desire to protect their good will when collecting past due accounts, independent collectors are likely to have no future contact with the consumer and often are unconcerned with the consumer's opinion of them." *Davidson*, 44 F.Supp.3d at 1235 at n.7. The purpose and intent is to protect consumers from those entities who acquire bad debt solely for the purpose of collecting or attempting to collect money. These are the "debt collectors" the FDCPA is aimed to regulate.

As the Seventh Circuit noted, "[i]f the one who acquired the debt continued to service it, it is acting much like the original creditor that created the debt. On the other hand, if it simply acquires the debt for collection, it is acting more like a debt collector." *Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534, 536 (7th Cir. 2003). Under this logic, an entity who acquires a loan in default but continues to treat it as its own by servicing the loan is not a "debt collector" under the second prong.

This reasoning is in accord with the line of cases that hold a mortgage servicing company is generally not a debt collector. It is also in accord with the second prong definition because an entity that acquires a loan and continues to service it is not regularly collecting money due another. Rather, it is more like a "creditor" which is defined as, "any person who offers or extends credit creating a debt or to whom a debt is owed, but such term does not include any person to the extent that he receives an assignment or transfer of a debt in default *solely* for the purpose of facilitating collection of such debt for another." 15 U.S.C. §1692a(4) (emphasis added). In most cases, even when the mortgage servicer obtains a defaulted loan, the servicer handles the day-to-day administration of the loan, which sometimes even includes assisting the defaulted borrower with efforts to modify the defaulted loan. Such activity can hardly be described as receiving a debt *solely* for the purpose of collecting it.

As stated above, a "debt collector" under the second prong is one who *regularly* collects debts, owed or due or asserted to be owed or *due another* if the debt being collected was in default when acquired. *See Davidson*, 44 F.Supp.3d 1230 (holding that the defendant was not a debt collector subject to FDCPA liability despite fact that plaintiff's account was in default at time of acquisition by defendant). The Eleventh Circuit's holding in *Davidson*, 797 F.3d 1309 (2015), has since been applied to a mortgagee's assignee. *See Arencibia v. Mortgage Guaranty Ins. Corp.*, 659 Fed. Appx. 564 (11th Cir. 2016). In *Arencibia*, the court noted that *Davidson* rejected the argument that the only distinction between a "creditor" not typically subject to the FDCPA (*e.g.*, mortgage servicers) and "debt collectors" is the default status of the loan. *Id*. at 566. In doing so, the court held that an entity that does not meet the statutory definition of a "debt collector" under §1692a(6), as a plaintiff generally alleges, is not a "debt collector" under the FDCPA even if the debt was in default at the time it was acquired. *Id*. at 567 (quoting *Davidson*, 797 F.3d at 1316); *see also Thomas v. U.S. Bank Nat'l Ass'n*, 675 Fed. Appx 892, 898 (11th Cir. 2017).

To establish that a mortgage servicer meets the second prong, defaulted borrowers must put forth evidence that the servicer "regularly" collects debts "due another." Rarely can the borrower establish that the servicer regularly collects debts due another, as opposed to servicing the defaulted mortgage loans. In almost every instance, the mortgage has been assigned to the mortgage servicer; therefore, the servicer is the mortgagee and holds a security interest in the subject property.

It has long been held that the assignee of a mortgage is entitled to receive the money secured by the mortgage. *See, e.g., Kelly v. Carmichael*, 217 Ala. 534, 537, 117 So.

67, 70 (1928). Thus, if the mortgage servicer has been assigned the subject mortgage, hence the assignee of the mortgage and entitled to receive the money, it is collecting money for itself—not some other entity. Furthermore, in those instances where the assignment of mortgage occurs after the loan is in default, it was not transferred or assigned "solely for the purpose of facilitating collection of such debt." This is because the mortgage servicer is handling the day-to-day administration of the loan. Even if all the servicer is going to do is institute a foreclosure process, that alone is not collection of a debt. *See Warren, supra*. Therefore, outside of a very narrow set of specific factual circumstances, mortgage servicers should not be deemed to be "debt collectors" for purposes of the FDCPA, and any claim for violation of the FDCPA should be dismissed, or summary judgment should be granted for the servicer.

In conclusion, mortgage servicers do more than collect money. In fact, the servicer is usually the only entity a mortgage borrower will interact with throughout the life of the loan. The responsibilities of a mortgage servicer include all aspects of the day-to-day administration of the loan. For this reason, borrowers typically think the servicer *is* their lender, not a "debt collection agency." A reasoned and reasonable interpretation of the definition of a "debt collector" supports the conclusion that a mortgage servicer, much like an originating lender, is not a "debt collector" under the FDCPA.

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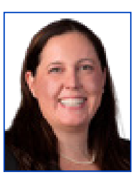
What Is the Duty of a Construction Manager in PA and NY? The Answer Is "Well, It Depends"

By Lynne Ingram and Stephen Wolf




If you work in construction or are generally familiar with the industry, you have likely heard the term "construction manager" (CM). Though the term CM is commonly used, the definition varies from project to project. The Construction Management Association of America (CMAA) defines construction management as the "process of professional management applied to a construction program from conception to completion for the purposes of controlling time, costs, and quality." A CM is hired by the owner to provide oversight in either the design and/or construction phases of a project to deliver the project on time, at or under budget, and to the intent of the design plans.

Construction management typically takes two forms, CM-Agency and CM-At-Risk. CM-Agency is where the CM acts as the agent for the owner and helps the owner manage a project and make decisions regarding that project but is not actually committed to delivering the project on-time and/or on-budget and does not directly hire contractors to perform the work. CM-At-Risk is where the CM is legally responsible for delivering the project on-time and on-budget and directly enters into subcontracts with trades to perform the work.

As discussed further, identifying the duty of a CM depends upon the contract, the scope of their performance in the field, and the jurisdiction.

Pennsylvania

In light of the varying definitions of CM and the different forms CM can take from project to project, Pennsylvania courts have resisted attempts to place a static duty onto CMs. In *Farabaugh v. Pa. Tpk. Comm'n*, the plaintiff suffered a fatal accident while operating a dump truck on a construction project on the Pennsylvania Turnpike and brought suit against several parties, including the CM. 911 A.2d 1264, 1266 (Pa. 2006). Under the terms of its agreement, the CM was "to administer, manager, and oversee construction of several sections of the expressway, including reviewing and monitoring the on-site safety procedures and having the authority to stop work if they perceived a dangerous condition. *Id.* at 1268. The Supreme Court of Pennsylvania acknowledged the diversity of contractual responsibilities for construction managers and, therefore, found it could not create a defined duty for all construction managers. *Id.* at 1281–82.

Because of the differences in contractual responsibilities for construction managers from case to case, the *Farabaugh* Court held, "[W]e decline to provide a rigid definition of a construction manager or impose a correspondingly status duty on all construction managers. Instead, we find it preferable to allow owners and construction managers to define their roles and responsibilities in each contract according to the needs of each project and leaving courts to consider on a case by case basis whether such responsibilities trigger a duty to other workers on the jobsite." *Id*. at 1282.

Once it declined to adopt a rigid duty, the Court looked to the CM's contract, which required it to take an active role assuring safety on site. The contractual duties included developing, maintaining and monitoring a comprehensive project safety/insurance program, interviewing applicants to be the contractors' safety representatives and monitor their performance, and monitoring the contractors' compliance with safety regulations frequently and regularly. *Id*. In light of the CM's contractual responsibilities, the Court in *Farabaugh* held that the CM owed a duty to perform its safety obligations under the contract with the owner so as not to injure the plaintiff. *Id*. at 1283-1284.

In *Cottingham v. Tutor Perini Bldg. Corp*., the U.S. District Court for the Eastern District of Pennsylvania, applying Pennsylvania law, held that the CM did not assume the responsibility to supervise safety at the work site because (1) unlike *Farabaugh*, there was no contract imposing such responsibility; and (2) even if it could be assumed by performance, the plaintiff did not present sufficient evidence that the CM assumed safety oversight. 237 F.Supp.3d 244, 252–53 (E.D. Pa. 2017).

Pennsylvania law makes it clear—the answer as to what duty a CM owes to a worker on a jobsite is "well, it depends" because the courts need to evaluate the contract language to see what safety responsibilities, if any, the CM agreed to perform in its contract. Under this framework, courts give deference to the duties and responsibilities the owner and CM bargain for. However, the downside is that whether or not the CM assumed such responsibilities is determined on a case-by-case basis, which will typically require discovery and therefore will not lend itself to early dismissals.

New York

In addition to permitting ordinary negligence claims, New York codified the Labor Law to provide additional protections to workers. Section 200 of the Labor Law codifies a common law negligence claim and requires employees on construction site to be provided with "reasonable and adequate protection to the lives, health and safety of all persons employed therein or lawfully frequently such places." For a CM to be liable under a section 200 claim, or common law negligence claim, it must be established that the CM "had the opportunity to supervise or control the performance of the work." *Ortega v. Puccia*, 866 N.Y.S.2d 323 (N.Y. App. Div. 2d Dept. 2008); *Narducci v. Manhasset Bay Assocs.*, 727 N.Y.S.2d 37 (N.Y. 2001); *Delahaye v. Saint Anns School,* 836 N.Y.S.2d 233, 236-38 (N.Y. App. Div. 2d Dept. 2007).

In addition to section 200, section 240(1) of the Labor Law, known as the scaffolding law, provides that "[a]ll contractors and owners and their agents… in the erection, demolition, repairing, altering, painting, cleaning or of a building or structure shall furnish or erect, or cause to be furnished or erected for the performance of such labor, scaffolding, hoists, stays, ladders, slings, hangers, blocks, pulleys, braces, irons, ropes, and other devices… as to give proper protection" to such workers.

For §240(1) claims, a construction manager is generally not considered a 'contractor' or 'owner' within the meaning of Labor Law §240(1) or §240 and can only be held responsible if it was delegated the authority and duties of either the general contractor or functioned as an agent of the owner, meaning it had the authority to control or supervise the work being performed. *Domino v. Prof'l Consulting, Inc.*, 869 N.Y.S.2d 224, 226 (N.Y. App. Div. 2d Dept. 2008); *Pino v. Irvington Union Free Sch. Dist.*, 843 N.Y.S.2d 133 (N.Y. App. Div. 2d Dept. 2007); *Lodato v. Greyhawk N. Am., LLC*, 834 N.Y.S.2d 242 (N.Y. App. Div. 2d Dept. 2007). Notably, in New York, a construction manager, as a matter of law, is not a statutory agent of the owner to the construction manager and additional facts are required to support the agency argument. *See Phillips v. Wilmorite, Inc.*, 723 N.Y.S.2d 590 (N.Y. App. Div. 4th Dept. 2001).

Section 241(6) provides another cause of action commonly used in New York construction cases, which provides that "All areas in which construction, excavation or demolition work is being performed shall be so constructed… as

Back to Contents

to provide reasonable and adequate protection and safety to the persons employed therein or lawfully frequenting such places." To prevail on a cause of action pursuant to Labor Law §241(6), "a plaintiff must prove a violation of the Industrial Code that sets forth a specific standard." *See Ross v. Curtis-Palmer Hydro-Elec. Co.*, 601 N.Y.S.2d 49 (N.Y. 1993). Though absolute liability is imposed upon owners and general contractors where a violation of a sufficiently specific section of the Industrial code is demonstrated, in order for a construction manager to be liable under Labor Law §241(6) as a statutory agent of the owner, the owner must have delegated to the construction manager "the authority to supervise or control the injury producing work." *Bateman v. Walbridge Aldinger Co.*, 750 N.Y.S.2d 402, 403 (N.Y. App. Div. 4th Dept. 2002) (citations omitted); *see also Russin v. Louis N. Picciano & Son*, 445 N.Y.S.2d 127 (N.Y. 1981).

The critical questions when evaluating defending a CM in New York is whether the CM supervised or controlled the injury producing work or had the opportunity to do so and/or whether the CM was the statutory agent of the owner or delegated the duties of a general contractor. These questions are all incredibly fact specific and require an in-depth analysis on a case-by-case basis.

Conclusion

Whether you are litigating in Pennsylvania or New York, the duties and liability of a CM depend upon the CM's contract for that project as well as the CM's performance in the field. When representing a CM, attention to the details of the contract documents for the parties on the jobsite, especially the CM and those entities involved in the injury producing work, is critical. In addition, it is important to evaluate any arguments that the CM assumed additional responsibilities not expressly provided for by contract while on the job. Just like the definition of a CM, a CM's legal duties vary from project to project.

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Vermont Court Rules that Commercial Landlord Cannot Be Liable for Injury to Retail Tenant's Invitee Involving Tenant's Operations on Premises

By Walter Judge

In *Mowrey v. Eagle Rutland, LLC, et al.*, Vt. Super. Ct., Docket No. 284-5-18 Rdcv (Aug. 5, 2020), the court held that a non-possessory, arms-length commercial landlord that leased premises to a supermarket could not be liable for a personal injury to a deliveryman on the loading dock, where the lease gave the tenant-supermarket exclusive control over and responsibility for the premises and the injury was related to the supermarket's operations and not to the landlord's mere ownership of the premises. This is a significant decision for commercial landlords, such as shopping plaza owners.

In 2002, the supermarket's predecessor-in-interest (another supermarket) leased the premises from the landlord's predecessor-in-interest. In 2013, the current landlord, Eagle Rutland, acquired the property and at that time both parties affirmed their adherence to the original lease. Like its predecessor-in-interest, Eagle Rutland had no ownership interest in the supermarket nor any role in its operations. It was an unrelated, arms-length landlord.

In 2017, the plaintiff, an employee of a dairy vendor who was delivering product to the supermarket, fell off of an elevated "dock lift" at the back of the premises and was injured. The dock lift is a platform that rises from the pavement level of the loading dock to the level of the cargo floor at the back of the delivery truck so that merchandise can be off-loaded. The plaintiff sued the landlord and the supermarket. As to the landlord, he contended that, as the owner of the premises, it was ultimately responsible for maintaining a safe premises even though it fully leased the premises to the supermarket.

The landlord moved for summary judgment, contending that it owed no duty to the plaintiff under the circumstances.

The lease not only gave the supermarket exclusive control over the premises, it also required the supermarket to maintain the premises, including the loading dock, and to indemnify the landlord for any liability claims arising out of the supermarket's operations on the premises. The only responsibility that the landlord reserved under the lease was to make structural repairs to limited areas of the building that were not involved in the case.

In deciding the landlord's motion to be dismissed from the case, the court analyzed (a) the terms of the lease and (b) longstanding Vermont law on the duties of tenants vs. landlords with respect to the safety of third parties on the premises. It cited a 1917 Vermont Supreme Court decision holding that as between a landlord and a tenant, where the tenant controls the premises, it is normally the tenant's duty to ensure that the premises are safe for those coming onto the property at the tenant's invitation. Thus, the key issue was which party had control over the premises, and, in particular, the loading dock.

Given that the lease gave full control over and responsibility for the premises to the tenant-supermarket, it was the plaintiff's burden to come forward with evidence that, notwithstanding the terms of the lease, the landlord exercised some control or authority over the loading dock. The plaintiff had no such evidence because in fact the landlord exercised no such control or authority. Instead, the plaintiff argued that because under the lease the landlord retained the responsibility for making certain structural repairs to the building, it was therefore responsible for the safety of the loading dock and the dock lift. The court rejected this position as nothing more than the plaintiff's subjective interpretation of the terms of the lease (to which he was not a party). The court found that the lease was unambiguously clear that the tenant-supermarket controlled and was responsible for the premises, including the loading dock. Accordingly, the landlord owed no duty to ensure the safety of the premises as to a vendor of the supermarket and the court granted judgment for the landlord, dismissing the plaintiff's claims against it.

In summary, the issue here was whether a non-possessory commercial landlord owes a duty of safety to the tenant's visitors, merely by virtue of being the owner of the premises. The court held that a commercial landlord who fully leases out the premises, who retains no responsibility for maintaining the premises, and who exercises no control over the tenant's operations, owes no duty of safety to a visitor of the tenant. Accordingly, the deliveryman had no claim against the landlord.

This decision expresses an important principle for commercial landlords who own properties that are used and maintained exclusively by the tenants.

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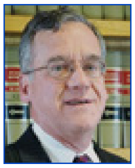
Back to Contents

Wrongful Repossession: A Review of Recent Decisions

By Thomas Lyons



There are essentially two grounds for a "wrongful repossession" claim, so-called: first, the party initiating or performing the repossession is not legally entitled to possession of the property, and second, the repossession is performed in an illegal manner by "breaching the peace," or otherwise. See *Garcia v. Santander Consumer USA Inc.*, No. CV-19-04817-PHX-DLR, 2020 WL 1812037 at *2 (D. Ariz. Apr 9, 2020).

Two "hot" topics with respect to wrongful repossessions are whether there is insurance coverage for such claims and whether police officers involved in repossessions may have violated federal or state law. See, *e.g.*, *Niemeyer v. Williams*, 910 F.Supp.2d 1116 (C.D. Ill. 2012) (denying the City of Peoria summary judgment on plaintiffs' claim that City's practice of turning over impounded vehicles to lienholders violated constitutional rights to due process). Those topics are *not* covered here.

Legal Right to Possession

The creditor's rights to possession may arise under statute, typically Article 9 of the Uniform Commercial Code, or by contract. See, *In re Bolin & Co., LLC*, 437 B.R. 731, 752 (D. Conn. 2010) ("Parties to a security agreement are permitted to waive and vary the rules that the UCC sets with respect to default and repossession, unless those rules are mandatory."). *Krajewski v. Am. Honda Fin. Corp.*, 557 F.Supp.2d 596, 605–07 (E.D. Pa. 2008). In *Krajewski*, the court held that since there was an issue of fact whether the debtor was in default under the contract when police seized the vehicle from debtor's ex-husband (because there were drugs in it), there was also an issue of fact under the UCC.

UCC section 9-602 lists numerous rules that may not be varied by contract, including a creditor's duty to repossess without breaching the peace when proceeding without judicial process. U.C.C. §9-602(6). Nonetheless, under section 9-603(a), the parties may agree what standards shall apply to a determination of whether there has been compliance with Section 9-602 so long at their standards are not "manifestly unreasonable." *Bolin*, 437 B.R. at 752–53. In *Bolin*, the Court held that the debtor jewelry store was in default under its security agreement when it had pawned some of the inventory that constituted security and it had civil judgments entered against it. Accordingly, the creditor was entitled to possession of the jewelry inventory that was its security. 437 B.R. at 755.

In addition, federal statutes may bear on whether a repossession is wrongful. Section 1692(f)(6) of the Fair Debt Collection Practices Act (FDCPA) makes it illegal to dispossess a consumer of property if "there is not present right to possession of the property claimed as collateral through an enforceable security interest." *Richards v. PAR, Inc.*, 954 F.3d 965, 967 (7th Cir. 2020); *Gable v. Universal Acceptance Corp. (WI)*, 338 F.Supp.3d 943, 949 (E.D. Wis. 2018) (quoting *Nadalin v. Auto Recovery Bureau, Inc.*, 169 F.3d 1084, 1085 (7th Cir. 1999) (quoting 15 U.S.C. §1692f(6)(A))).

Whether there is a present right to possession of the property depends on state law. *Gable*, 338 F.Supp.3d at 949. Nonetheless, an allegation that the repossession violated the FDCPA will provide federal jurisdiction over a claim that is otherwise governed entirely by state law. *Gable*, 338 F.Supp.3d at 945.

Some courts have held that §1692(f)(6) applies to repossession companies and repossession "middlemen" as well as to creditors. *Buzzell v. Citizens Auto. Fin., Inc.*, 802 F.Supp.2d 1014, 1021 (D. Minn. 2011) (holding that FDCPA applies to company that creditor hired to arrange for repossession and sale of automobile). The middleman and the repossession agency may be entitled to rely on an express representation by the creditor that it has a present right to possession of the vehicle. *Revering v. Norwest Bank Minn., N.A.*, Civ. No. 99-480/RHK/JMM, 1999 WL 33911360 at *5 (D. Minn. Nov. 30, 1999). However, they cannot assume the creditor has a present right to possession merely from the creditor's request that they repossess the vehicle. *Buzzell*, 802 F.Supp.2d at 1023.

The creditor may not be entitled to repossession under state law, even if the debtor's payment is overdue, if the creditor has previously accepted late payments and has not given the debtor written notice that future payments must be in strict compliance with the promissory note. *Id.* at 1022 (applying Minnesota law). If the creditor has not provided adequate notice, then repossession is wrongful as a matter of law. *Id.* at 1024.

Similarly, the debtor may not be in default even where he had not made timely payments if the creditor has an obligation to seek payment from disability or property insurers when the debtor fails to pay because he has become disabled or because the vehicle has been damaged and the creditor has a right to seek such payments under the contract. *Wiley v. Gen. Motors Acceptance Corp.*, 624 So.2d 518, 521 (Ala. 1993); *Corbin v Regions Bank*, 574 S.E.2d 616, 619 (Ga. App. 2002); *Rogers v. Farmers & Merch. Bank*, 545 S.E.2d 51 (Ga. App. 2001); *Carter v. U.S. Nat'l Bank of Oregon*, 768 P.2d 930 (Or. App. 1989).

Conversely, the creditor may be entitled to possession of the vehicle if the debtor alleges she was defrauded into entering into the contract. *Mayberry v. Ememessay, Inc.*, 201 F.Supp.2d 687, 698-99 (W.D. Va. 2002). In *Mayberry*, the debtor claimed the creditor had represented to her that she was pre-approved for financing. The contract said the sale of the vehicle was dependent on the debtor getting financing. After the debtor took possession of the vehicle, the financing fell through and the creditor repossessed the vehicle. The court said that the debtor's allegations that she was fraudulently led to believe she owned a car that she did not own undermined her allegations that the repossession was wrongful.

Similarly, the debtor may not have an action for conversion of a repossessed car if she never had title to it. *Wilson v. Gen. Motors Acceptance Corp.*, 883 So.2d 56, 68 (Miss. 2004). In *Wilson*, plaintiff's husband had purchased a Mustang before their marriage and listed his sister as a contact person. After the marriage, he died in a car accident involving a different car. Plaintiff's sister-in-law told GMAC it could pick up the car. Plaintiff called GMAC, said she wanted to keep the car, and made a payment on it. She later changed her mind and asked GMAC to pick up the car and refund her payment. GMAC agreed. It repossessed the car, resold it, and asserted a claim for the deficiency against the husband's estate. Plaintiff sued alleging GMAC had converted the car. The Mississippi Supreme Court held that on these facts there was no conversion. *Id.*

Manner of Repossession

Most states hold that the manner of repossession is wrongful if it constitutes a breach of the peace as defined either by statute or common law. However, individual states can have very different statutes or common law. Under Section 9-609 of the Uniform Commercial Code, a creditor may take possession of the collateral: "Without judicial process, if it proceeds without breach of the peace; provided however, in the case of repossession of any motor vehicle without knowledge of the retail buyer, the local police department shall be notified of such repossession within one hour after obtaining such possession." U.C.C. §9-609(b)(2). If the local police are not available, the creditor must provide notice to the state police. *Id.* Section 9-625 provides remedies, including damages, if the secured party fails to comply, although the statutory damages are limited. Section 9-625. However, depending on state law, the U.C.C. may not be an exclusive remedy and other statutory or common law claims and remedies may be available. *Droge v. AAAA Two Star Towing, Inc.*, No. 75206, 2020 WL 3415636 at *11 (Nev. App. June 18, 2020).

Comment 3 to section 9-609 states that what constitutes a breach of the peace is not defined and that the Section leaves that matter "for continuing development by the courts." Some states may define what constitutes a breach of the peace by statute. See, *e.g.*, *Marks v. Motor City*, 265 So.3d 86, 89 (La. App. 2019), quoting Louisiana Revised Statutes, 6:965 ("Oral protest by a debtor to the repossessor against repossession prior to the repossessor seizing control of the collateral shall constitute a breach of the peace by the repossessor."). In *Marks*, the court held there was a breach of the peace where the debtor's attorney called the repossessor during the repossession and objected. *Id.* at 90.

Where states do not define the term by statute, "[n]ot surprisingly, courts struggle to define the term 'breach of the peace' in the context of self-help repossession statutes." *Droge v. AAAA Two Star Towing, Inc.*, 2020 WL 3415636, *5 (Nev. Ct. App. June 18, 2020). The *Droge* court said that most courts do not adopt a definition of the term but, instead, focus on the specific factual circumstances of each case. *Id.* However, the court provided "workable guidelines to assist courts in determining when a breach of the peace occurs." *Id.* It commented:

- A breach of the peace occurs where actual violence or physical resistance is present during a repossession. *Id.* at *6, citing *Callaway v. Whittenton*, 892 So.2d 852, 854, 857 (Ala. 2003); *Cottam v. Heppner*, 777 P.2d 468, 472 (Utah 1989).
- However, violence is not a precondition to a breach of the peace. *Id.*, citing *Chrysler Credit Corp. v. Koontz*, 661 N.E.2d 1171, 1173 (Ill. App. 1996).
- A breach of the peace occurs when the repossession agent crosses physical barriers or destroy personal property during the repossession. *Id.*, citing *Davenport v. Chrysler Credit Corp.*, 818 S.W.2d 23, 29–30 (Tenn. Ct. App. 1991).
- However, a "mere trespass" to remove collateral from a debtor's driveway or from an open area on the debtor's property is not a breach of the peace. *Id.*, citing *Butler*

v. Ford Motor Credit Co., 829 F.2d 568, 569–70 (5th Cir. 1987); *Reno v Gen. Motors Acceptance Corp.*, 378 So.2d 1103, 1103–05 (Ala. 1979).

- A breach of the peace occurs when a repossession occurs while the debtor or a third-party in control of the property is present and objects to the repossession. *Id.*, citing *Hollibush v. Ford Motor Credit Corp.*, 508 N.W.2d 449, 455 (Wisc. Ct. App 1993); *Chapa v. Traciers & Assocs.*, 267 S.W.3d 386, 395 (Tex. Ct. App. 2008).
- A breach of the peace occurs when the repossession "raised a real possibility of immediate violence," even if none occurs. *Id.* at *7, citing *Salisbury Livestock Co. v. Colo. Cent. Credit Unions*, 793 P.2d 470 (Wyo. 1990) (citing *Restatement (Second) of Torts*, §1981 (Am. Law Inst. 1965)).

The *Droge* court recognized there is a benefit to extra-judicial repossessions so long as there is no breach of the peace. *Id*. at *8. It said there was no breach when the repossession is accomplished at a reasonable time and in a reasonable manner. *Id*. Conversely, a breach of the peace happens when the repossession occurs at an unreasonable time or in an unreasonable manner. *Id*. at *9.

Comment 3 makes clear that "courts should hold the secured party responsible for the actions of others taken on the secured party's behalf, including independent contractors engaged by the secured party to take possession of collateral." See, *Droge*, 2020 WL 3415636 at *1, n.1 ("Because a secured party's duty to carry out self-help repossessions is non-delegable, *see* U.C.C. §9-625, cmt. 3… secured parties will be held liable for actions taken on their behalf by agents or independent contractors."). Comment 3 seems to conflict with typical state case common law on liability for the actions of independent contractors. However, many states have statutes that extend liability for the manner of automobile repossessions to the creditor.

Some courts do not require an actual breach of the peace to show that the repossessor violated Section 9-609 during a non-judicial repossession. It is sufficient if the repossessor takes the car over the debtor's unequivocal objection. *Gable*, 338 F.Supp.3d at 949-950, citing *Hollibush*, 179 Wis.2d 799 at 808 (quoting 2 J. White & R. Summers, *Uniform Commercial Code*, §27-6, at 580 (3d ed. 1988)). White and Summers say that: "In most cases, to determine if a breach of the peace has occurred, courts inquire into: (1) whether there was entry by the creditor upon the debtor's premises; and (2) whether the debtor or one acting on his behalf consented to the entry and repossession." *Id.* at 575. There is no breach of the peace where the debtor consents to the repossession. *Bolin*, 437 B.R. at 755–56. Examples of breach of the peace may include when the creditor repossesses by force or threat of force, when the debtor physically protests the repossession while it occurs, or when a police officer's presence is necessary to safely effectuate the taking of collateral. *Bolin*, at 755.

However, other courts require more to establish a breach of the peace. *Johnson v. Credit Acceptance Corp.*, 165 F. Supp. 2d 923, 930 (D. Minn. 2001). In *Johnson*, the court said, "a breach of the peace occurs during a repossession if there is violence or the threat of violence or the commission of an underlying offense." *Id.* It added that in addition to the debtor's objection to the repossession, there was evidence of "a minor physical and verbal altercation" and "loud and abusive language was exchanged." The court held this raised an issue of fact with respect to allegations of both violation of the UCC and a conversion. *Id*. at 930–31.

In *Wilson*, the Mississippi Supreme Court said, "simply going upon the private driveway of the debtor and taking possession of the secured collateral, without more does not constitute a breach of the peace." 883 So.2d at 71 (quoting *Hester v. Bandy*, 627 So.2d 833, 840 (Miss. 1993)). Similarly, repossessing the car from a public place over the objection of the debtor's husband, who was present, was not a breach of the peace. *Id*., citing *Commercial Credit Co. v. Cain*, 1 So.2d 776, 777 (Miss. 1941). The court distinguished *Hester* by saying that the repossessor there attempted a "quick snatch" of the vehicle in the early morning hours, a "tactic which guaranteed generating fright or anger, or both, if discovered in progress by [the debtor]." *Id.* Moreover, the debtor physically resisted the repossession. By contrast, in *Wilson*, the trial court had found there was no credible evidence of any physical altercation during the repossession, no specific threat was made, or even that Wilson had objected to the repossession, and the Mississippi Supreme Court affirmed. *Id.* at 72

A wrongful repossession may give rise to claims under state common law for conversion or for statutory theft. Repossessing a car without judicial authorization and over the objection of the debtor may constitute conversion. *Gable*, 338 F.Supp.3d at 953, citing *Restatement (Second) of Torts*, §222A (1965) (conversion "is an intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other for the full value of the chattel."); *Buzzell*, 802 F.Supp.2d at 1025 ("The sale of unlawfully repossessed property constitutes a conversion."); *Corbin v. Regions Bank*, 574 S.E.2d at 621 (holding a conversion occurred when bank repossessed car without first seeking payment under disability policy applicable to party's contract).

Many states have statutes that provide a civil remedy for damages to people who have been harmed by criminal actions, such as theft. See, *e.g.*, R.I. Gen. Laws §9-1-2. However, this may require proof that the repossessor acted with criminal intent, or at least, maliciously and in intentional disregard of the debtor's rights. *Gable*, 338 F.Supp.3d at 953.

Similarly, there may be state statutes specifically dealing with automobile repossessions, or "baby" FDCPAs, or consumer protection, generally, that may apply to whether the manner of repossession is wrongful. See. *e.g.*, *Hayes v. Find Track Locate, Inc.*, 60 F.Supp.3d 1144 (D. Kan. 2014).

Pursuant to the Federal Arbitration Act, the debtor's claims for wrongful repossession may be subject to arbitration if there is an arbitration provision in the parties' agreement. *McKinzie v. American General Financial Services, Inc.*, 276 P.3d 1082 (Okla. App. 2012).

In sum, there are two major issues counsel must consider in the context of a repossession: did the creditor have a present right to possession and was the manner of repossession lawful?

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A *Madden* Fix: Regulators Codify The "Valid When Made" Doctrine

By Mark Olthoff

Financial institutions do not only make loans, they often are active participants in the secondary market, assigning debt for collection, moving assets from their balance sheets, or transferring loans for securitization. A 2015 case, *Madden v. Midland Funding, LLC,* 786 F.3d 246 (2nd Cir. 2015), created disruption and caused uncertainty in the financial services marketplace when it rejected a longstanding principle recognizing the permissibility of interest rates on transferred loans. Following the *Madden* decision, several stakeholders tried to reverse the effects of the case and codify the "valid when made" doctrine that *Madden* rejected. While Congress was unsuccessful in amending the federal interest statutes, regulators have recently codified the doctrine thus furthering the goals of banks' statutory and regulatory frameworks.

Federal Law Preempts State Law Usury Claims

Federally regulated or insured lenders rely upon statutes for interest rate protections. For example, the National Bank Act (NBA) preempts state law usury claims asserted against national banks. In sections 85 and 86 of the NBA, Congress enacted a federal usury law and created a cause of action for usury claims against national banks. 12 U.S.C. §§85, 86 (national bank preemption); see also 12 U.S.C. §1463(g) (savings association preemption).

Similarly, for insured state banks, the Federal Deposit Insurance Act (FDIA) preempts state usury law where an interest rate is permissible in the insured lender's home state. FDIA Section 27 permits insured state banks to charge interest at the maximum rate permitted by the state where the bank is located and preempts contrary laws of the states where borrowers may live. See 12 U.S.C. §1831d; *Kaur v. World Business Lenders, LLC*, 440 F. Supp. 3d 111 (D. Mass. 2020). These preemption provisions protect national banks and insured state banks from varying state usury laws. Because FDIA section 27 was patterned after NBA section 85 and uses similar language, courts and regulators have consistently construed Section 27 *in pari materia* with Section 85. *Greenwood Trust Co. v. Commonwealth of Mass.*, 971 F.2d 818, 827 (1st Cir. 1992); FDIC General Counsel Opinion No. 11, 63 Fed. Reg. 27282 (May 18, 1998).

But lending is only part of the business of banks. These institutions also participate in secondary market transactions. For example, national banks' authority includes the power to assign loans, which provides banks access to alternative funding sources, improves financial performance ratios, and enables them to meet customer needs more efficiently. *See* 12 U.S.C. §§24 (seventh), 371, 1464; see also 12 CFR §7.4008 and 34.3, 160.3.

Contraction of Federal Preemption: The *Madden* Decision

In *Madden v. Midland Funding, LLC*, the Second Circuit held that the NBA does not preempt a consumer's claims against a debt buyer as assignee of a national bank for allegedly violating state usury law. There, a New York consumer failed to pay her credit card bill and the originating bank sold the delinquent account to a non-bank debt buyer that tried to collect on the debt according to the original credit agreement. The plaintiff filed a putative class action against the debt buyer and its affiliated account servicer alleging that they violated the FDCPA and state usury law by charging and attempting to collect interest at an unlawful rate.

The district court entered judgment for the defendants and denied the plaintiff's motion for class certification, concluding that the NBA preempts any state law usury claim against the defendants. The court cited a string of cases reflecting the holding that courts must look to the originating entity and not the downstream assignee to determine whether NBA preemption applies. The district court also cited cases supporting the common law of assignments which generally provides that a loan made at a lawful rate of interest cannot become usurious because of a later assignment.

On appeal, the Second Circuit reversed, holding that NBA preemption did *not* apply to the non-bank defendants. First, the court found that neither defendant was a national bank, a subsidiary, an agent of a national bank, or acting on behalf of a national bank. Second, the court concluded that applying state usury law to debt buyers would not "significantly interfere" with the originating national bank's ability to exercise its powers under the NBA because it would not prevent a national bank from selling its debts (even though state laws might decrease the amount that a national bank could ask buyers for its delinquent debt or what a debt buyer might pay). *Id.* at 251; see also *Eul v. Transworld Systems*, 2017 WL 1178537, at *6 (N.D. Ill. Mar 30, 2017).

Reading the text of the statute in isolation, the *Madden* court concluded that NBA Section 85—which authorizes national banks to charge interest at the rate permitted by the law of the state in which the national bank is located—does not allow national banks to transfer enforceable rights in the loans they made under their preemptive authority. The preemption question in *Madden* should have been whether the national bank had the right to contract for and collect the rate specified in the original credit agreement, *i.e.,* whether the debt was valid when made. The court concluded that it was. However, it failed to recognize whether, under the law of contract assignment, the credit agreement and collection of interest by the non-bank assignee should have maintained its original intent and structure and did not violate state usury law.

The *Madden* decision has far-reaching ramifications. The secondary market relies on the notion that credit agreements are valid when made to enforce those agreements under the terms agreed upon between the original creditor and borrower. Buyers of defaulted debt, like the defendant in *Madden*, generally will not have the same interest rate authority as the creditors selling such debt. The same is true for securitization vehicles or purchasers of whole loans. The *Madden* decision creates substantial uncertainty and could allow individual state laws to influence the interest rates that national banks charge and the amount such banks can demand in selling their delinquent debt. Unquestionably, this raises the specter of interference or impairment of the powers granted to national banks under the NBA. Secondary market participants may be leery of acquiring defaulted debt or taking assignments in securitization transactions where a national bank's rates (or fees charged as discussed above) could push the debt into a usurious range. This could stall secondary markets for national banks where the debt is otherwise valid because federal law prescribes the rates they may charge.

Denying financial institutions the ability to transfer enforceable rights in the loans they made under their preemptive authority would undermine the purpose of the statutes and deprive the institutions of an important and indispensable component of their federal statutory power to make loans at the rates permitted. The ability to transfer enforceable right in the loans they validly made under the preemptive authority of is also central to the stability and liquidity of the domestic loan markets.

Legislative and Regulatory Efforts to Mitigate *Madden*

Shortly after the Supreme Court denied a petition for writ of certiorari in *Madden*, bills were introduced in Congress to overrule the decision and codify the "valid when made" doctrine. However, those legislative efforts were unsuccessful in amending the NBA or FDIA.

Back to Contents

In turn, the Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC) recognized the mischief that *Madden* had wrought on the financial industry. In November 2019, both agencies proposed regulations to codify the "valid when made" doctrine. On May 29, 2020, the OCC published its final rule. On June 25, 2020, the FDIC published its final rule. In both instances, the rules provide that the interest rate is unaffected by the assignment of the loan contract. A loan that was "valid when made" will not be rendered usurious by a later transfer. Those rules apple to national banks (12 C.F.R. 7. 4001), federal savings associations (12 C.F.R. 160.110) and insured state institutions (12 C.F.R. 331.4):

> 7.4001(e) Transferred Loans. Interest on a loan that is permissible under 12 U.S.C. §85 shall not be affected by the sale, assignment or transfer of the loan.
>
> 160.110(d) Transferred Loans. Interest on a loan that is permissible under 12 U.S.C. §1463(g)(1) shall not be affected by the sale, assignment, or other transfer of the loan.
>
> 331.4(e) Determination of Interest Permissible under section 27. Whether interest on a loan is permissible under section 27 of the [FDIA] is determined as of the date the loan is made. Interest on a loan that is permissible under section 27 of the [FDIA] shall not be affected by a change in state law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan, in whole or in part.

Regarding national banks and thrifts, the new regulations remove a hole in the statute and regulations by re-enforcing the doctrine that a loan which is valid when made is valid in the hands of the transferee. Regarding insured state banks, to eliminate ambiguity and carry out the purpose of Section 27, the regulation makes explicit that the right to assign loans is a component of banks' federal statutory right to make loans at the rates permitted by Section 27. The FDIC's interpretation of Section 27 also follows state banking laws, which typically grant state banks the power to sell or transfer loans and, more generally, to engage in banking activities similar to those listed in the NBA and activities that are incidental to banking.

In the first decision following the issuance of the new regulations, the United States District Court for the District of Colorado applied the new rule and found the assigned promissory note at issue was "valid when made." *In re Rent-Rite SuperKegs West Ltd.,* Slip Op. (D. Colo. Aug. 12, 2020). However, it then remanded the case on the "true lender" issue for additional fact development. Relatedly, several states' attorneys general have filed suit to block both the OCC's and FDIC's regulations. *People of the State of California, et al. v. Federal Deposit Ins. Corp.,* Case No. 4:20-cv-05860 (filed Aug. 20, 2020, N.D. Cal.); *People of the State of California, et al. v. Office of the Comptroller of the Currency,* Case No. 20-cv-5200 (filed July 28, 2020, N.D. Cal.)

Conclusion

The agencies' recently codified rules reflect their positions that federal law established that a national bank or insured state bank may enter into a loan contract, charge interest at the maximum rate permitted in the state where located, and assign the loan with preemption of usury laws intact. The rules further the policy goals and securitizations to access funding sources, manage loan concentrations, improve financial performance ratios, and more efficiently meet customer needs. The tool of the loan assignment would be severely weakened and the market for assignments thinned if assignments were only permitted with third parties that could utilize the same preemption laws and be subject to the same or higher usury caps.

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