KIRKLAND & ELLIS LLP

ALERT

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Ninth Circuit Expands the Obligations of Companies Using Consumer Credit Reports

On August 4, 2005, a panel of the United States Court of Appeals for the Ninth Circuit in *Reynolds v. Hartford Financial Services Group, Inc.*, — F.3d —, No. 03-35695 (9th Cir. Aug. 4, 2005), issued a decision that could dramatically change the way your company complies with the Fair Credit Reporting Act ("FCRA"), if the Ninth Circuit's decision is not reconsidered or reversed. *Reynolds* requires that insurance companies provide an "adverse action" notice to a consumer who does not receive the *best available rate* based on credit information. Any company that uses consumer credit reports for insurance, credit, or employment decisions should review its compliance procedures in light of *Reynolds*. The penalties for non-compliance are significant.

Background: The Fair Credit Reporting Act

The FCRA requires persons who use consumer credit reports to make decisions about applicants for insurance, credit, or employment to provide "notice" to the consumer of any "adverse action" based in whole or in part on credit information. 15 U.S.C. § 1681m(a).[1]

With regard to insurance, "adverse action" means "a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of insurance." *Id.* § 1681a(k)(1)(B)(i). With regard to credit, "adverse action" means "a denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the amount or on substantially the terms requested." *Id.* §§ 1681a(k)(1)(A), 1691(d)(6). With regard to employment, "adverse action" means "a denial of employment or any other decision for employment purposes [including promotion, reassignment, or retention] that adversely affects any current or prospective employee." *Id.* §§ 1681a(k)(1)(B)(ii), 1681a(h).

[1] Under the FCRA, anyone who takes "adverse action" on the basis of a consumer report must "provide oral, written, or electronic notice of the adverse action to the consumer." *Id.* § 1681m(a)(1). The notice must provide the name, address, and telephone number of the consumer reporting agency that provided the report, a statement that the agency did not make the adverse decision and is not able to explain it to the consumer, a statement setting forth the consumer's right to obtain a free disclosure of the consumer's file from the agency, and a statement setting forth the consumer's right to dispute directly with the agency the accuracy or completeness of any information in the report. *Id.* § 1681m(a)(2)-(3).

Anyone who "willfully fails to comply" with the notice requirement is liable to the affected consumer for actual damages or for statutory damages "of not less than $100 and not more than $1,000," as well as punitive damages, attorney's fees, and costs. 15 U.S.C. § 1681n. But the FCRA has an important available defense: a person can avoid liability upon proof that "reasonable procedures" were maintained to assure compliance. *Id.* § 1681m(c).

Private plaintiffs and the Federal Trade Commission can enforce the FCRA, and both have recovered substantial damages and penalties for FCRA violations. Recently, for example, Sprint entered into a consent decree with the FTC, agreeing to pay over $1 million in civil penalties for failing to notify applicants for telephone service of "adverse actions" taken against them based on credit information. *United States v. Sprint Corp.*, No. 4:04CV361 (N.D. Fla. 2004).

Reynolds' Expansion of FCRA Obligations

In *Reynolds*, the trial court ruled that the FCRA does not apply to first time applicants who are not offered the company's best insurance rate. The trial judge reasoned that the FCRA applies only to an applicant who is denied insurance or to an existing policyholder whose rate is later increased due to credit information.

On appeal, the Ninth Circuit reversed. It held: "The Act requires that an insurance company send the consumer an adverse action notice whenever a higher rate is charged because of credit information it obtains, regardless of whether the rate is contained in an initial policy or an extension or renewal of a policy and regardless of whether the company has previously charged the consumer a lower rate." *Reynolds*, slip op. at 10035.

The Ninth Circuit made three related rulings that further expand a person's obligations under the FCRA. First, it ruled that the "FCRA's adverse action notice requirement applies whenever a consumer would have received a lower rate for insurance had his credit information been more favorable, regardless of whether his credit rating is above or below average." *Id.* Second, the court held that charging more for insurance because "no credit information or insufficient credit information is available constitutes an adverse action." *Id.* Third, it ruled that "when a consumer applies for insurance with a family of companies and is charged a higher rate for insurance because of his credit report, two or more companies within that family may be jointly and severally liable." *Id.* In particular, joint and several liability may be extended to any company that declines to insure the applicant, makes a decision as to which company should insure the applicant, decides the higher rate to be charged, or issues the higher priced policy.[2]

Implications of _Reynolds_

Although the Ninth Circuit acknowledged that it was addressing issues of "first impression" in *Reynolds*, slip op. at 10045, it ignored the profound and broad-ranging effects that its decision could have on so many businesses.

Most notably, *Reynolds* will likely change the way insurance companies handle consumers' initial policy applications. Before *Reynolds*, some companies believed that they were not obligated to provide an adverse action notice to a consumer who obtained a policy, but perhaps not on the best available terms. Now, to comply with *Reynolds*, an adverse action notice will have to be sent to any applicant who, based on credit information, does not receive the company's best available terms — even where the applicant has an average or no credit rating.

In addition, *Reynolds* will likely change the way affiliated insurance companies handle consumers' policy applications. Before *Reynolds*, some companies believed that they were not obligated to provide an adverse action notice to a consumer who was successfully referred to an affiliated company handling higher risk consumers on less favorable terms. Now, to comply with *Reynolds*, an adverse action notice will have to be sent to any applicant who, based on credit information, does not qualify for a policy and instead is referred to an affiliate.

The sweeping effects of *Reynolds* will likely carry over to credit and employment decisions. Credit applicants who, based on credit information, do not obtain the best available terms may claim a FCRA violation if they do not receive an adverse action notice. Likewise, job applicants who, based on credit information, do not obtain the best available terms of employment may claim a FCRA violation if they do not receive an adverse action notice. Current employees who, based on credit information, are not promoted, reassigned, or retained on the best available terms may claim a FCRA violation if they do not receive an adverse action notice.

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2 The Ninth Circuit resolved two other issues in *Reynolds*. It held that "to comply with FCRA's notice requirement, a company must, *inter alia*, communicate to the consumer that an adverse action based on a consumer report was taken, describe the action, specify the effect of the action upon the consumer, and identify the party or parties taking the action." *Id.* It also ruled that a company is liable for a willful violation of the FCRA if it "'knowingly and intentionally committed an act in conscious disregard for the rights of others.'" *Id.* at 10036.

Indeed, the possible list of *Reynolds*-created FCRA violations could go on and on, and some companies undoubtedly will find themselves at the mercy of clever plaintiffs' lawyers.

Some Practical Considerations

If your company uses consumer credit reports in the insurance, credit, or employment contexts, it is advisable to review your existing policies and procedures in the wake of *Reynolds*. It may be that your company is in full compliance with the obligations imposed by the FCRA. Or, it may be that your company needs to make some adjustments to come into compliance or to reduce its risks and potential exposure.

Here are some important questions to ask:

- Is your company's use of consumer credit reports fully authorized by the FCRA?
- In the insurance context, is your company notifying consumers whenever it takes an "adverse action" based on credit information, including denying or canceling insurance, increasing any charge for insurance, or reducing or otherwise making an unfavorable change in the terms of coverage or amount of any insurance?
- In the credit context, is your company notifying consumers whenever it takes an "adverse action" based on credit information, including denying or revoking credit, changing the terms of an existing credit arrangement, or refusing to grant credit in substantially the amount or substantially on the terms requested?
- In the employment context, is your company notifying prospective and current employees whenever it takes an "adverse action" based on credit information, including denying employment or adversely evaluating any employee for promotion, reassignment, or retention?
- Do the form and substance of your company's "adverse action" notices comply with the FCRA?
- Do the company's affiliates have any obligations under the FCRA? If so, are they (and your company) discharging them properly?

Finally, it is prudent for your company to: (1) have a written compliance policy; (2) monitor the effectiveness of your compliance program; (3) train employees who are responsible for FCRA compliance; (4) make adjustments to the compliance program based on any problems that occur; and (5) have a written record of your compliance efforts. If any employee inadvertently makes a mistake, your company does not want to be held liable for damages and other penalties. Your company's written record of compliance efforts will help defend against any charges of "willful" violations.

Should you have any questions about the matters addressed in this Alert or need assistance in implementing an effective compliance program, please contact the following author or the Kirkland attorney you normally contact.

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