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Safeco Insurance Co. of America v. Burr: U.S. Supreme Court Clarifies Standard of Liability Under Fair Credit Reporting Act

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In a mixed ruling for users of consumer credit reports, yesterday the United States Supreme Court resolved a dispute arising from the terms "adverse action" and "willful" in the Fair Credit Reporting Act ("FCRA"). In companion cases before the Supreme Court, class action plaintiffs alleged that defendant insurance companies had violated FCRA by failing to send adverse action notices after using consumer credit report information in setting anything but the lowest possible rates for initial purchasers of insurance. According to plaintiffs, the failure to send the notices was a willful violation of FCRA requiring the companies to pay statutory damages of $100 to $1,000 per class member. The Supreme Court resolved an unsettled issue for insurers by holding that companies that use consumer credit information in setting rates for initial purchasers of insurance must provide an adverse action notice to a consumer only when the rate charged is higher than it would have been if the consumer's credit report had not been considered. The Court rejected the notion that an adverse action notice is required for all consumers who receive less than the best possible rate or policy. The Supreme Court also resolved a circuit split regarding "willful" FCRA violations by holding that a "willful" violation of FCRA may be established by proving "reckless disregard" of the statute. The Supreme Court's rejection of an "actual knowledge" standard of liability makes it easier for plaintiffs to recover statutory and punitive damages under FCRA.

BACKGROUND

Since the late 1990's, insurance companies have used consumer credit reports to set various types of insurance premiums. FCRA requires an insurer that uses a consumer's credit report to notify the consumer whenever an "adverse action" occurs based in whole or in part on any information contained in the consumer credit report. 15 U.S.C. § 1681m(a). An adverse action is defined as "a denial or cancellation of" or "an increase in any charge for" insurance. 15 U.S.C. § 1681a(k)(1)(B)(i). A negligent failure to provide the statutory notice can result in liability for actual damages; a "willful" failure can give rise to liability for actual damages or statutory damages ranging from $100 to $1000 per violation as well as punitive damages. 15 U.S.C. §§ 1681o(a), 1681n(a).

Consumer class action litigation has arisen over whether FCRA adverse action notices are required in connection with the initial purchase of insurance. Some insurers have taken the position that they need not send FCRA notices to initial purchasers of insurance because there is no "denial" "cancellation" or "increase in any charge" for insurance in that context. Others have provided adverse action notices to initial applicants where the substitution of a neutral credit score for that consumer's actual score would have resulted in a lower rate or more favorable terms and conditions in an insurance policy. Insurance consumer plaintiffs have challenged both approaches, arguing that FCRA requires notice to *all* applicants who receive anything but the lowest rates as a consequence of their credit report, and that the failure to give such notice constitutes a willful violation of FRCA.

In *Reynolds v. Hartford Financial Services Group, Inc.* and *Spano v. Safeco Insurance Co. of America*, the Court of Appeals for the Ninth Circuit held that an adverse action has occurred and notice is required in all circumstances where a consumer would have received a lower rate if the consumer had a better credit score. The Ninth Circuit also held that an insurer "willfully" fails to comply with FCRA where it acts with "reckless disregard" for the rights of a consumer. According to the Ninth Circuit, "reckless disregard" includes a "deliberate failure to determine the extent of [a company's] obligations," "reliance on creative layering that provides indefensible answers," or reliance on "implausible interpretations." In adopting a "reckless disregard" standard, the court split with several other circuit courts that define "willful" as a "knowing and intentional" FCRA violation.

THE SUPREME COURT DECISION

On June 4, 2007, in an opinion authored by Justice Souter, the Supreme Court reversed the Ninth Circuit's interpretation of FCRA, settling the question of whether an initial purchaser of insurance can suffer an adverse action subject to the notice requirements of FCRA and defining the term "willful" under FCRA.

The Supreme Court held that an initial purchaser of insurance can suffer an adverse action subject to the notice requirements of FCRA where the rate offered by the insurer to the consumer is "based in whole or in part on" the information contained in the consumer credit report, and the rate offered is higher than the rate the consumer would have received had the company not considered the consumer's credit report. In other words, for FCRA's notice requirements to be triggered, the report must be a "but for" or "necessary" cause of the premium increase. Where the credit report "has no identifiable effect on the rate," on the other hand, "the consumer has no immediately practical reason to worry about it" and there is no reason to require notice, as "both the company and the consumer are just where they would have been if the company had never seen the report." The Supreme Court reasoned that this benchmark best comported with Congressional intent to require notice only when the effect of the consumer report is "to put the consumer in a worse position than other relevant facts would have decreed anyway," as opposed to a different approach addressing the "theoretical question whether the consumer would have gotten a better rate with perfect credit." The Supreme Court rejected the plaintiffs' demand to use perfect credit as a benchmark, as this standard would require "slews" of adverse action notices that would "mean just about nothing" to the recipient, and "go the way of junk mail."

Resolving a split in the circuit courts, the Supreme Court also held that a showing of "reckless disregard" is sufficient to demonstrate a "willful" violation of FCRA, and that "actual knowledge" is not required to prove a violation. In so holding, the Court stated that "a company subject to FCRA does not act in reckless disregard of it unless the action is not only a violation under a reasonable reading of the statute's terms, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless." Addressing the underlying conduct before it, the Supreme Court found that one insurer may have violated FCRA, but had not acted recklessly when it determined (wrongly) that initial rates offered to consumers were not subject to FCRA's notice requirements. According to the Supreme Court, "[g]iven the dearth of guidance and the less-than-pellucid statutory text, [the insurer's] reading [of FCRA's notice requirements] was not objectively unreasonable, and so falls well short of raising the unjustifiably high risk of violating the statute necessary for reckless liability."

IMPLICATIONS

Following yesterday's decision, insurers need only provide adverse action notices to consumers under FCRA where the rates charged are higher or the policies offered are less favorable than what would have been charged or offered if the consumer's credit report had not been considered, a determination which may be made by reference to a "neutral" credit score. The Supreme Court has thus now lent its imprimatur to a practice many insurers have already adopted.

Yesterday's decision also serves as a warning about non-compliance under FCRA. The potential risks of non-compliance have increased. By establishing a "reckless disregard" standard to prove a "willful" violation of FCRA, the Supreme Court may have broadened exposure to statutory damages for a wide class of companies that use credit reports. FCRA, unlike other consumer credit statutes, has no damages cap for class actions. With damages of $100 to $1000 per class member for "willful" violations of FCRA and the possible imposition of punitive damages, even a medium-sized class action suit can lead to significant liability.

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