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Force-placed insurance and the filed-rate doctrine

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Several years ago, after a major forest fire struck the county in which I live, my homeowners insurer decided to withdraw from the market and stopped renewing policies in my county.

Within days of receiving a nonrenewal notice from my insurer, I received a separate notice from my mortgage lender informing me that it had procured insurance to cover my property.

My first reaction was one of relief — I had (or thought I had) insurance until I could find one of the few insurers willing to underwrite homeowners insurance in my county, which, located in the California foothills, has a heightened risk of forest fires.

On closer inspection, however, it became apparent that the insurance my lender had force-placed on my property looked like a money grab by the lender that was of no benefit to me.

The insurance covered only the lender's mortgage interest in the property. My interest in the property's equity after the lender was paid for a loss was unprotected.

Moreover, the policy provided no protection against liability claims. Most infuriating, the annual premium for this lender force-placed policy, which my lender graciously agreed to fold into the principal balance of my loan, was five times what I was paying for my soon-to-be cancelled policy, which provided much better coverage.

The 11th Circuit's recent decision in *Patel v. Specialized Loan Servicing LLC*, 904 F.3d 1314 (11th Cir. 2018), sheds light on why the premiums on a force-placed insurance are so high and on the more important question of their legality.

Although a majority of the three-judge panel rejected the plaintiffs' challenge to the cost of force-placed insurance, U.S. Circuit Judge Adalberto Jordan's dissent provides a roadmap for plaintiffs in future cases.

FACTUAL BACKGROUND

The plaintiffs in *Patel* were mortgage borrowers who were forced to pay premiums for insurance placed on their properties by mortgage servicers after the borrowers allowed their property insurance to lapse. *Patel* is a consolidated case involving multiple borrowers from Florida and Pennsylvania.

The plaintiffs' complaints did not challenge the right of the servicers to force-place insurance on their properties. Their mortgage contracts expressly authorized the lenders to do so, and the servicers were acting on behalf of the lenders.

Instead, the plaintiffs alleged that their loan servicers and American Security Insurance Co., the largest issuer of force-placed insurance policies in the country, conspired to charge them inflated amounts for the insurance the servicers placed on their properties.

Specifically, the plaintiffs alleged that payment for each force-placed transaction actually involved a series of separate transactions.

First, the borrower's loan servicer paid ASIC for the insurance. Next, the servicer billed the borrower for the full amount charged by ASIC. Finally, ASIC paid the servicers rebates and kickbacks disguised as a fee for placement of coverage or a premium for nonexistent reinsurance of ASIC's risk.

The plaintiffs' lawsuit challenged the servicers' failure to pass the savings on to plaintiffs in the form of reduced charges for reimbursement of the servicers' payments to ASIC.

The suit's contention that the full premium charged by ASIC did not reflect the "cost of insurance" and therefore violated plaintiffs' loan agreements and unjustly enriched the servicers and ASIC was based on the nature of the relationship between ASIC and the servicers and the manner in which ASIC issued force-placed coverage on plaintiffs' properties.

ASIC was the exclusive provider of force-placed insurance for the defendant servicers. As part of this arrangement, ASIC performed much of the work for which the rebates and kickbacks were supposed to compensate the servicers.

Prior to any lapse in the plaintiffs' hazard insurance, ASIC had already issued a master insurance policy to each servicer that covered its entire mortgage-loan portfolio.

ASIC monitored the servicers' loan portfolios for lapses in borrowers' insurance coverage. Once a lapse was identified, ASIC informed the borrower that insurance would be force-placed if voluntary coverage was not obtained.

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If the lapse continued, ASIC issued an insurance certificate, at the borrower's expense, based on the already-existing master policy.

The servicers neither communicated with individual borrowers when their coverage lapsed nor procured replacement coverage. Nor did the servicers assume any of ASIC risks themselves or place any of the risk with reinsurers.

> Having made its *Erie* guess, the 11th Circuit found that the plaintiffs' complaints contained "textbook examples of the sort of claim that previously have been barred by the nonjusticiability principle."

In addition to breach of contract and unjust enrichment, the plaintiffs alleged causes of action against the servicers for violating the federal Truth in Lending Act, 15 U.S.C.A. § 1601; against ASIC for tortious interference with a business relationship; and against both ASIC and the servicers for violating the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C.A. §§ 1962(c) and (d).

The Florida borrowers further alleged causes of action under the Florida Deceptive and Unfair Trade Practices Act, Fla. Stat. Ann. § 501.201.

FILED-RATE DOCTRINE INVOKED

A federal district court in Florida dismissed the lawsuit on the ground that insurance regulators in Florida and Pennsylvania had approved the rates ASIC used to determine premiums for individual borrowers and therefore the filed-rate doctrine barred any challenge to those rates.

Developed in response to efforts by large corporations to obtain better shipping rates than those filed with and approved by the Interstate Commerce Commission, the filed-rate doctrine forbids challenges to the reasonableness of rates approved by administrative agencies.

Courts have invoked the doctrine even where the regulated entity has defrauded an administrative agency to obtain the challenged rate.

Moreover, the doctrine's applicability does not turn on whether the plaintiff is a ratepayer. The fact that the servicers, not plaintiffs, were technically the ratepayers did not preclude invocation of the doctrine.

Two rationales underlie the doctrine: the nondiscrimination principle and the nonjusticiability principle.

The nondiscrimination principle ensures that all ratepayers pay the same rate for the regulated entity's services.

The nonjusticiability principle prevents courts from interfering with the exclusive authority of duly empowered administrative agencies to determine rates.

Importantly, the doctrine applies whenever a lawsuit implicates either principle.

On appeal, the plaintiffs argued that the doctrine has no place in a dispute over whether the loan servicers and the lenders had a contractual right to charge the plaintiffs more than they paid ASIC after accounting for the rebates and kickbacks.

11TH CIRCUIT MAKES '*ERIE* GUESS'

Affirming the trial court, a divided 11th Circuit panel sidestepped the plaintiffs' argument and effectively refused to look beyond the transaction between ASIC and the loan servicers in determining the applicability of the filed-rate doctrine.

The appeals court initially asked whether regulators in Florida and Pennsylvania had authority to determine the reasonableness of ASIC's rates.

If they did, the predicate for deferring to the state's ratemaking decisions was established and the only question remaining was whether the plaintiffs' complaints attacked the reasonableness of ASIC's filed rates.

The court explained that the complaints could attack the filed rates either facially or by challenging the components of the rate approved by state regulators.

The fact that the plaintiffs had no contractual relationship with ASIC and no contractual obligation to pay the lenders and servicers more than their "cost of insurance" was, in the court's view, irrelevant.

If the plaintiffs questioned the validity of the kickback/rebate component of that rate, the filed-rate doctrine precluded liability even though the plaintiffs were not ratepayers.

The regulatory schemes in Florida and Pennsylvania authorized state insurance regulators to disapprove rates that are "excessive, inadequate or unfairly discriminatory."

Although acknowledging the "data points" left uncertainty regarding whether courts in those states would apply the doctrine to the regulatory schemes in question, the 11th Circuit applied state laws, known as making an "*Erie* guess," to conclude that the Florida and Pennsylvania courts would incorporate a defense developed in federal ratemaking and antitrust disputes into disputes over state-regulated insurance rates. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

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The court did so even though it was unable to point to a single instance of the courts of Florida or Pennsylvania applying the filed-rate doctrine under any circumstances.

Having made its *Erie* guess, the court found that the plaintiffs' complaints contained "textbook examples of the sort of claim that previously have been barred by the nonjusticiability principle."

In a section of the complaints titled "The Force-Placed Insurance Scheme," they characterize the servicers as being "incentivized to purchase and force place insurance coverage with *artificially inflated premiums*" (emphasis added by the 11th Circuit).

Elsewhere, they describe themselves as "suffer[ing] damages in the form of *unreasonably high* force-placed insurance premiums" (emphasis added by the 11th Circuit).

Finally, the complaints accused ASIC and the services of colluding to "manipulate the force-placed insurance market" to "artificially inflate the amounts … charge[d] to borrowers" for force-placed insurance.

The court concluded that if the plaintiffs were to prevail on these claims at trial, a jury (or the judge) would substitute its judgment about the reasonableness of ASIC's rates for the judgment of state regulators.

DISSENT

Judge Jordan's dissent vigorously attacks the intellectual underpinnings of the majority's opinion and provides a roadmap for plaintiffs in future cases.

Describing the majority's Erie guess as a "shot in the dark," Judge Jordan chastised the majority for importing a federal common law doctrine derived from federal statutes into the common law of Florida and Pennsylvania without any meaningful guidance from the courts of either state.

He criticized the 2nd U.S. Circuit Court of Appeals' decision in *Rothstein v. Balboa Insurance Co.*, 794 F.3d 256 (2d Cir. 2015), which applied the filed-rate doctrine in the context of force-placed insurance, and pointed to case law in other states in which courts have either rejected the filed-rate doctrine altogether or adopted a much less robust version of the defense.

"The majority's unwarranted assumption that Pennsylvania and Florida would adopt a full-throated version of the federal filed-rate doctrine," he observed, "is not faithful to our notions of federalism."

He instead would have certified the question to the supreme courts of Pennsylvania and Florida and asked whether they have adopted the filed-rate doctrine in some form.

Even assuming arguendo that the federal version of the filed-rate doctrine applies in Florida and Pennsylvania, Judge Jordan would not have dismissed the plaintiffs' lawsuit.

Contrary to the majority, he determined that the doctrine does not bar a breach-of-contract claim that does not directly challenge a filed rate.

Nowhere did the plaintiffs' complaints challenge ASIC's right to charge the lenders and servicers the full amount of the filed rate.

Rather, the plaintiffs challenged how much of the premium the lender/servicer defendants could recover from the plaintiffs under their mortgage contracts — which Judge Jordan pointed out "are entirely distinct from the commercial insurance agreements between the lenders and ASIC."

Those mortgage contracts required the borrowers to reimburse only the "cost" of insurance. If, as the plaintiffs alleged, the lenders/servicers did nothing in exchange for the kickbacks, and ASIC actually performed most of the tasks for which the kickbacks were supposed to compensate the lenders/servicers, the kickbacks reduced the actual cost to the lenders of force-placed insurance.

Judge Adalberto Jordan's dissent vigorously attacks the intellectual underpinnings of the majority's opinion and provides a roadmap for plaintiffs in future cases.

Consequently, the amount recoverable under the mortgage agreements was not the amount billed but the amount billed less any kickbacks or rebates.

Judge Jordan reasoned that the lenders breached the mortgage agreements if they demanded more than the discounted cost actually paid — a question of fact that should have gone to a jury.

Judge Jordan further noted that the filed-rate doctrine applies only if the defendant relying on the doctrine proves that a validly filed rate governs the transaction in question.

Accordingly, the defendants must show that ASIC's rate filings in Florida and Pennsylvania authorized the rebates and kickbacks, Judge Jordan said.

Although the defendants argued that state regulators approved the payment of commissions, Judge Jordan found no evidence in the record to support their assertion.

Finally, even assuming the filed-rate doctrine is the law in Florida and Pennsylvania, and assuming defendants had

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successfully proved ASIC's filed rate permitted rebates and kickbacks, Judge Jordan would have limited the doctrine's protection to ASIC.

He criticized the majority's application of the doctrine to claims against nonregulated entities such as lenders and servicers that happen to touch a regulated rate.

CONCLUSION

As long as federal courts reflexively apply the filed-rate doctrine in force-placed insurance cases, plaintiffs should consider filing their lawsuits in state rather federal courts.

Plaintiffs' foundational theories of liability are breach of contract and violation of state unfair-business-practice statutes, and state courts have concurrent jurisdiction under the federal Truth in Lending Act. So plaintiffs should be able to obtain comparable relief in state court.

Plaintiffs filing in state court should take care to draft their complaints in a manner that avoids removal to federal court under the federal Class Action Fairness Act, 28 U.S.C.A. § 1332.

Class counsel can avoid removal by defining the putative class in a way that brings the action within either CAFA's "local controversy" or "home state controversy" exceptions.

The "local controversy" provision, 28 U.S.C.A. § 1332(d)(4)(A), requires a federal court to decline jurisdiction where:

- More than two-thirds of the members of the proposed plaintiff class are citizens of the state where the action was originally filed.
- At least one "significant" defendant is a citizen of that state.
- Class members' "principal injuries" were incurred there.
- No other class action asserting the same or similar factual allegations has been filed against any of the defendants within the preceding three years.

Under the "home state controversy" exception, 28 U.S.C.A. § 1332(d)(4)(B), a federal court must decline jurisdiction where two-thirds or more of the class members and the "primary" defendants are citizens of the state where the action was originally filed.

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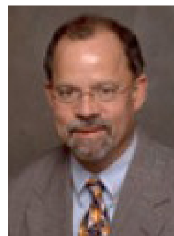
ABOUT THE AUTHOR



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