ALASKA LEGISLATURE COMMITTEE FILES, 2003-2004 8672
11193 SENATE JUDICIARY

RAND INSTITUTE FOR CIVIL JUSTICE
RESEARCH | BRIEF

July 1996

How Big Is the Price Tag for Excess Auto Injury Claims?

Although the nationwide accident rate has been falling steadily, the cost of personal injury automobile insurance has grown at a breathtaking rate over the last two decades, leaving the average driver with a bill for basic coverage in 1990 that was two and a half times higher than the bill for the same coverage in 1980. Because every state requires some form of personal injury insurance, these stiff increases are burdensome for everyone, and especially so for low-income populations. The high costs of coverage also probably swell the ranks of those who drive without coverage.

Many believe that excess claims are a major contributor to rising insurance costs, but to date there has been no comprehensive evidence to support or refute this view. A recent Institute for Civil Justice study, *The Costs of Excess Medical Claims for Automobile Personal Injuries*, takes the first rigorous look at the pattern and cost of excess automobile medical claiming across the states. Authors Steve Carroll, Allan Abrahamse, and Mary Vaiana found that about one-third of the automobile injury medical costs submitted to insurers appear to be excess.

Access to General Damages Provides Incentive to Excess Claiming

In the study, the term *excess medical claiming* includes claims based on staged or nonexistent accidents, claims by people involved in real accidents for nonexistent injuries, and buildup of claims for real injuries. To develop an estimate of how much excess claiming occurs nationwide--in contrast to individual instances of fraud identified in a sting operation--the researchers take an indirect approach.

First, they analyze the incentives to submit inflated or invented claims for various types of injuries provided by different insurance systems:

- Under the tort liability system--the set of legal rules governing compensation for automobile injuries in about three-quarters of the states--an injured individual may seek compensation for both the economic loss incurred as a result of that injury (e.g., medical costs) and for noneconomic losses or general damages--hurts such as "pain and suffering" not directly measured in dollars.

- In 1988, when the data used in this study were collected, eleven states had adopted dollar threshold no-fault insurance systems, under which an automobile accident victim is allowed to seek compensation for general damages only if his or her medical costs exceed a specified amount.

- Florida, Michigan, and New York had adopted verbal no-fault systems. In these states the law contains an explicit list of injuries--usually quite serious--for which an accident victim is allowed

to seek general damages.

The availability of general damages and the fact that they are usually calculated as some multiple of economic losses provide the incentive to submit claims for nonexistent injuries and to build medical costs.

Characteristics of Injuries also Affect Ability to Exaggerate Claims

The opportunity for exaggeration is also influenced by the nature of the injuries themselves. The researchers distinguish soft injuries, such as sprains and strains, from hard or objectively verifiable injuries, such as fractures and loss of limbs. Examining the incentives embedded in the insurance systems and the ease or difficulty of exaggerating injuries, they predicted what patterns of excess claiming for injuries might occur.

Testing Analytic Predictions

The authors draw on a large database of individual closed claims developed in previous ICJ research to test these analytical predictions. Their results support the predictions about the extent of excess claiming that will occur in certain insurance environments.

Figure 1 illustrates their findings. It shows the number of soft injury claims per hard injury claim in every state. The horizontal black line indicates the average value for Michigan and New York, which is used as a baseline in the study. (Certain features of Florida's verbal no-fault system precluded its inclusion in the baseline.)

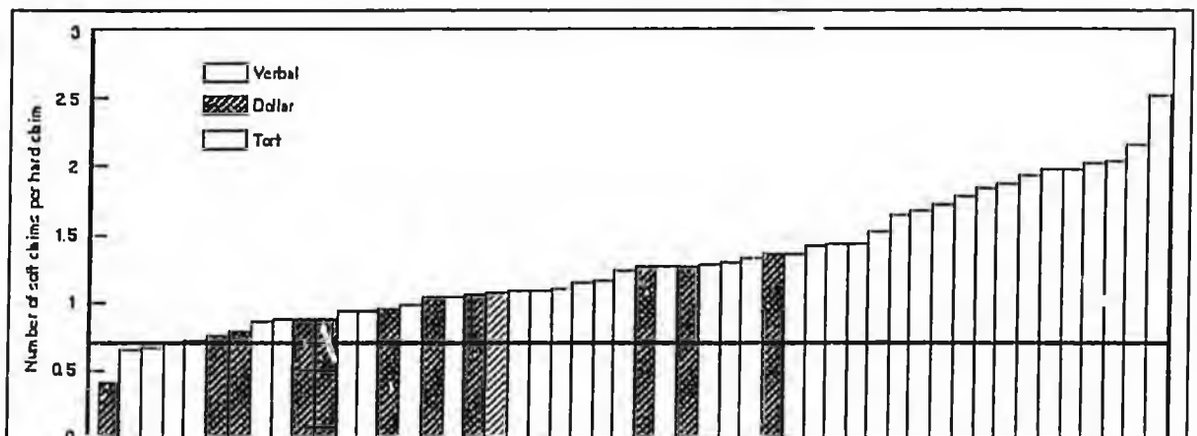

Figure 1--Claims Above Michigan/New York Baseline Suggest Extent of Claims for Nonexistent Soft Injuries

Claims for nonexistent soft injuries in the verbal threshold no-fault states should be rare because this insurance system provides no access to general damages unless the injury is one of those explicitly specified by the law. In addition, the economic barriers to an accident victim's access to medical care in these states are as low as, or lower than, in any other. Michigan and New York offer first-party auto

insurance with no deductible or coinsurance, very high benefit levels, and prohibitions on rate increases based on claiming. Thus, more than in other insurance environments, accident victims are likely to claim whatever medical care they need. Assuming that hard claims are almost always valid, the ratio of soft to hard claims in Michigan and New York suggests the relative frequency of these injuries in automobile accidents.

Soft injury claimants will obtain general damages in dollar no-fault states if the medical claim can be pushed over the threshold; thus the possibility of general damages offers an incentive to claim nonexistent soft injuries in these states. The eleven dollar no-fault states in Figure 1 are scattered, and ten have ratios above the baseline. But all cluster toward the lower end of the distribution.

Because general damages can be obtained for even a small medical claim in the tort states, the study predicted that comparatively more claims for nonexistent soft injuries would occur in these states. The result: Only one of the 36 tort states falls below the baseline. And the 35 tort states that have comparatively high ratios of soft to hard injury claims tend to cluster toward the high end of the distribution. All of the highest 18 states in Figure 1 are tort states.

The study uses the extent to which the ratio of soft claims to hard claims in each state exceeds the corresponding ratio for Michigan and New York as the measure of the degree to which claims are being submitted for nonexistent soft injuries in that state.

The study goes on to analyze the amount of medical costs claimed on either soft or hard claims, using methods similar to those described above to estimate the degree to which accident victims are building costs on real injury claims to leverage larger insurance settlements.

Figure 2 provides an example of the analysis. It shows the distributions of medical costs for soft injury claims in Hawaii, a dollar threshold state, and New York. Dollar threshold states provide strong incentives to build costs on soft injury claims because pushing the claim over the threshold allows access to general damages. The vertical line in the figure shows Hawaii's threshold. The average cost of a soft injury claim in each state is adjusted for interstate differences in medical costs and treatment patterns. The horizontal axis in the figure is a logarithmic scale so that equal intervals show equal percentage differences.

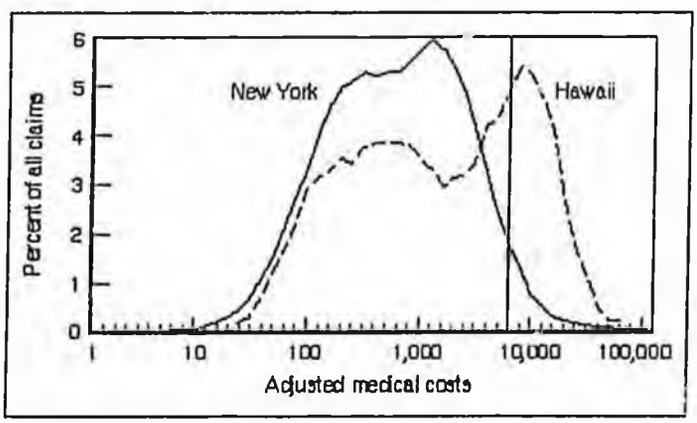

Figure 2--Hawaii's Distribution of Medical Costs for Soft Injury Claims Peaks Just Past Dollar Threshold

The distribution of medical costs in New York rises quickly, peaks, and then drops off sharply to the right. The large majority of soft injury claims are for relatively small medical costs. New York has very

few soft injury claims for medical costs that exceed Hawaii's threshold.

Hawaii's distribution also rises sharply, then flattens out. It begins to decline at a relatively low level of medical costs, then turns up again and rises sharply through the threshold. The Hawaii distribution peaks above the threshold, and finally falls off.

A substantial fraction of Hawaii's soft injury claims are for medical costs above the threshold. Compared with New York, the distribution of adjusted medical costs in Hawaii is shifted substantially to the right, as one would predict given the incentives built into the state's insurance system.

The Price Tag for Excess Claiming

The researchers use their empirical analysis of the extent of excess claiming to estimate that between 34 and 40 percent of the automobile injury medical costs submitted to insurers appear to be excess. In 1994, these questionable medical claims would have added roughly $13 to $16 billion to the nation's total automobile insurance bill, or about $100, on average, per policy. These excess claims also stimulated $4 billion in excess health care consumption.

Policy Direction

There are no easy solutions to the problem of excess claiming, but the study suggests one possible policy direction: Break the connection between medical costs and general damages. Ways to accomplish this include

- Modifying our insurance systems. (Verbal no-fault systems appear to eliminate the incentives that drive excess claiming for soft injuries, while dollar no-fault systems appear to exacerbate them.)
- Establishing a schedule for general damages based on the nature of the injury, as in disability policies.
- Changing the rule governing admissibility of medical cost information in courts. Modifying this rule could reduce the incentive to inflate that figure.

RAND research briefs summarize research that has been more fully documented elsewhere. This research brief describes work done in the Institute for Civil Justice and published as *The Costs of Excess Medical Claims for Automobile Personal Injuries*, by Stephen Carroll, Allan Abrahamse, and Mary Vaiana, RAND DB-139-ICJ, 25 pp., $6.00, ISBN: 0-8330-1649-0, which is available from National Book Network (Telephone: 800-462-6420; FAX: 301-459-2118) or from RAND on the Internet (order@rand.org). RAND is a nonprofit institution that helps improve public policy through research and analysis; its publications do not necessarily reflect the opinions or policies of its research sponsors.

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STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY, Appellant, v. STACEY LAWRENCE SR., and TOBITHA LAWRENCE,
26 P.3d 1074; 2001 Alas. LEXIS 82
Supreme Court No. S-8915, No. 5429
July 13, 2001, Decided
SUPREME COURT OF ALASKA
Before: Matthews, Chief Justice, Eastaugh, Fabe, Bryner, and Carpeneti, Justices.

Disposition State Farm has waived its arguments that the Lawrence parents do not qualify for separate policy limits because the Lawrence parents did not suffer "bodily injury" and because the Lawrences do not meet their policies' requirement of having been "in the same accident" as their son. Accordingly, we AFFIRMED the superior court's ruling that the Lawrence parents' NIED claims qualify for policy limits separate from those received by their son. Because the Lawrences' liability policies cover them for their own punitive damages, because the policies suggest that they cover the punitive damages of an underinsured tortfeasor, and because public policy does not forbid this result, we also AFFIRMED the superior court's ruling that the Lawrences' UM/UIM provisions provide coverage for the punitive damages of an underinsured tortfeasor.40

40 Because we affirm both of the superior court's rulings in favor of the Lawrences, we also affirm the superior court's award of attorneys' fees and costs to the Lawrences.

Counsel Paul W. Waggoner, Waggoner Law Office, Anchorage, and Earl M. Sutherland, Reed McClure, Seattle, for Appellant.

Jonathon A. Katcher, Pope & Katcher, Anchorage, for Appellees.

Opinion

Editorial Information: Prior History

Appeal from the Superior Court of the State of Alaska, Third Judicial District, Anchorage, Brian C. Shortell, Judge. Superior Court No. 3AN-96-7929 CI.

Opinion by: CARPENETI

CARPENETI, Justice.

I. *INTRODUCTION*

Stacey Lawrence, Jr. was seriously injured in a car accident caused by an underinsured motorist. Lawrence exhausted the "Each Person" limits of the uninsured/underinsured motorist (UM/UIM) provisions of his family's State Farm Mutual Automobile Insurance Co. policies. His parents then sought to collect separate policy limits under the "Each Accident" provision of their UM/UIM provisions, for both negligent infliction of emotional distress (NIED) and punitive damages for the intentional act of the underinsured tortfeasor. On motions for summary judgment, the superior court ruled that (1) the Lawrence parents' NIED claims qualify for separate policy limits; and (2) the Lawrences' UM/UIM provisions provide coverage for punitive damages against an underinsured tortfeasor. Because State Farm has waived all of the arguments that could show that the Lawrence

Jr.'s bodily injury claims. As such, the Lawrences argued that Wohltmann's "Each Accident" limits applied. State Farm disputed this contention.

The parties then entered into a Stipulation and Order, pursuant to which Stacey Jr. settled his claims against Wohltmann for one "Each Person" policy limit, plus supplemental payments. In addition, Stacey Jr. recovered the "Each Person" policy limits on each of the UM/UIM provisions in the Lawrences' policies, thereby exhausting the "Each Person" policy limits of both Wohltmann's and the Lawrences' policies.

As part of the stipulation, the Lawrence parents agreed to dismiss their NIED claims against Wohltmann. The parents and State Farm agreed, however, that the parents could pursue their NIED claims against the Lawrences' own State Farm UM/UIM provisions.

The Lawrence parents then moved for declaratory judgment on two issues: (1) whether their NIED claims qualify for policy limits under their UM/UIM provisions that are separate from the policy limits received by their son; and (2) whether their UM/UIM provisions cover them for the punitive damages of an underinsured motorist. The parents argued that both questions should be answered in the affirmative. State Farm brought a cross-motion for summary judgment on both of these issues, arguing that both questions should be answered in the negative.

After oral argument, Superior Court Judge Brian C. Shortell ruled in favor of the Lawrences on both issues and awarded them attorney's fees and costs. State Farm appeals.**1**

III. *STANDARD OF REVIEW*

This appeal raises questions of contract interpretation and statutory construction. We substitute our own judgment on questions pertaining to the interpretation of a contract.**2** We resolve questions of statutory construction *de novo* by applying our independent judgment.**3** In doing so, we "adopt the rule of law that is most persuasive in light of precedent, reason, and policy."**4**

IV. *DISCUSSION*

This appeal presents two issues: (1) whether the superior court correctly ruled that the Lawrence parents' NIED claims qualify for UM/UIM policy limits that are separate from the UM/UIM policy limits that Stacey Jr. received for his injuries; and (2) whether the superior court correctly ruled that the UM/UIM provisions in the Lawrence parents' policies cover them for the punitive damages of an underinsured motorist. Both issues present us with questions of first impression.

A. *The Superior Court Did Not Err in Ruling that the Lawrence Parents' NIED Claims Qualify for Separate Policy Limits.*

The superior court ruled that the Lawrence parents' NIED claims qualify for policy limits that are separate from the policy limits Stacey Jr. received for his bodily injuries. We agree.

The UM/UIM provision of the Lawrences' policies provide that

> The amount of coverage for *bodily injury* is shown on the declarations page under "Limits of Liability - U - Bodily Injury, Each Person, Each Accident". Under "Each Person" is the amount of coverage for all damages due to *bodily injury* to one *person*. "*Bodily injury* to one *person*" includes all injury and damages to others resulting from this bodily *injury*. Under "Bodily Injury -- Each Accident" is the total amount of coverage, subject to the amount shown under "Each Person", for all damages due to *bodily injury* to two or more *persons* in the same accident.
>
> The Lawrences' policies define "bodily injury" as "bodily injury to a *person* and sickness, disease or death which results from it."

In *Crabtree v. State Farm Insurance Co.*,**5** the Supreme Court of Louisiana interpreted State Farm policy language that is virtually identical to the language at issue here.**6** That case involved a husband

injury" if those persons were injured "in the same accident."**17**

We find the Louisiana Supreme Court's reasoning to be persuasive. Given the wording of State Farm's "Each Accident" provision, it is objectively reasonable for State Farm insureds to expect that two or more persons who suffer bodily injury in the same accident would be entitled to separate policy limits. Since we honor the objectively reasonable expectations of insureds regarding the terms of insurance contracts,**18** we reject State Farm's interpretation of the policy language at issue.

3. *The Lawrences are not subject to single policy limits on the grounds that the Lawrence parents' claims are akin to claims for loss of consortium.*

State Farm also argues that the individual "Each Person" limits apply because the Lawrence parents' claims are essentially claims for loss of consortium. This argument is unpersuasive.

Other courts have rejected arguments equating emotional distress and loss of consortium.**19** We agree with those courts. Unlike claims for loss of consortium, claims for emotional distress concern injuries that the claimants have suffered directly, rather than derivative injuries that resulted from an injury to another.**20**

Even if we considered the Lawrence parents' claims to be akin to claims for loss of consortium, State Farm would not necessarily prevail on the separate policy limits issue. As noted above, the dispositive questions in interpreting this aspect of the Lawrences' policies are whether the Lawrence parents suffered "bodily injury," and whether such "bodily injury" was suffered "in the same accident" that injured their son.**21** State Farm has waived its arguments pertaining to these questions. **22**

Because State Farm has waived the arguments that, if successful, would show that the Lawrence parents do not qualify for separate policy limits under the terms of the UM/UIM provisions in their policies, we affirm the superior court's ruling that the Lawrence parents' claims of NIED qualify for policy limits separate from those that their son received for his bodily injuries.**23**

B. *The Lawrences' State Farm Policies Cover Them for Punitive Damages that They Are Legally Entitled to Collect from an Underinsured Motorist.*

The superior court ruled that the UM/UIM provisions in the Lawrences' policies cover them for punitive damages that they would be legally entitled to collect from an underinsured motorist. We agree.

1. *Because the Lawrences' liability policies provide coverage for punitive damages for which the Lawrences themselves may be liable, the Lawrences' UM/UIM provisions provide coverage for punitive damages incurred by an underinsured tortfeasor.*

a. *In Alaska, automobile insurance companies must provide UM/UIM coverage that mirrors an insured's liability coverage.*

In *State Farm Mutual Automobile Insurance Co. v. Harrington*,**24** we considered AS 21.89.020(c), which describes the UM/UIM coverage that insurance companies offering automobile liability insurance must offer to insureds.**25** We stated that "the evident purpose of section 020(c)(1) is to provide for the insured, as an injured claimant, the same benefit level as that provided by the insured to those asserting claims against the insured."**26** Therefore, automobile insurance companies must offer insureds UM/UIM coverage that mirrors the insureds' liability coverage.**27** If State Farm has failed to provide such coverage, its UM/UIM provisions will be reformed to conform with the statutory requirements.**28** Therefore, if the Lawrences' liability policies cover them for punitive damages for which they may be liable, the UM/UIM provisions in their policies must also cover them for the punitive damages that they are legally entitled to collect from an underinsured tortfeasor.**29**

b. *The Lawrences' liability policy covers them for punitive damages for which they may be liable.*

The Lawrences' liability policies do not specifically exclude coverage for punitive damages. Rather,

by the policy. We have stated that the purpose of punitive damages is to punish and deter;**37** State Farm argues that punitive damages should not be available here because it has engaged in no wrongdoing, and an award of punitive damages would not punish the tortfeasor or deter others like him. This argument is unpersuasive.

Under the Lawrences' liability coverage, there is no question that State Farm would be liable for punitive damages awarded against the Lawrences.**38** But coverage for the Lawrences' liability for punitive damages is no different analytically from coverage for an uninsured motorist's intentional or reckless torts. Thus, State Farm's argument proves too much. Its suggestion that the Lawrences' liability policies should also not provide coverage for punitive damages is clearly wrong.

The question here ultimately turns not on policy but on what the parties contracted for. The Lawrences essentially bought liability coverage for underinsured motorists who injured them. The terms of that coverage included protection for punitive damages awards from an underinsured motorist. Since that is the coverage they contracted for, there is no reason that they should not obtain it.

In sum, the Lawrences' UM/UIM provisions provide coverage for punitive damages because the Lawrences' liability policies provide such coverage, because the Lawrences' policies suggest that they include coverage for the punitive damages of an underinsured tortfeasor, and because public policy does not forbid this result.**39**

V. *CONCLUSION*

State Farm has waived its arguments that the Lawrence parents do not qualify for separate policy limits because the Lawrence parents did not suffer "bodily injury" and because the Lawrences do not meet their policies' requirement of having been "in the same accident" as their son. Accordingly, we AFFIRM the superior court's ruling that the Lawrence parents' NIED claims qualify for policy limits separate from those received by their son. Because the Lawrences' liability policies cover them for their own punitive damages, because the policies suggest that they cover the punitive damages of an underinsured tortfeasor, and because public policy does not forbid this result, we also AFFIRM the superior court's ruling that the Lawrences' UM/UIM provisions provide coverage for the punitive damages of an underinsured tortfeasor.**40**

Footnotes

Footnotes

1 After this appeal is decided, remaining factual disputes will be referred to arbitration.

2 *See Alaska Hous. Fin. Corp. v. Salvucci*, 950 P.2d 1116, 1119 (Alaska 1997).

3 *See Progressive Ins. Co. v. Simmons*, 953 P.2d 510, 512 (Alaska 1998) (citing *Deal v. Kearney*, 851 P.2d 1353, 1356 n.4 (Alaska 1993)).

4 *Id.* (internal quotation marks omitted) (quoting *Guin v. Ha*, 591 P.2d 1281, 1284 n.6 (Alaska 1979)).

5 632 So. 2d 736 (La. 1994).

6 *See id.* at 739 (quoting the policy language).

7 *See id.* at 738.

8 *See id.*

9 *Id.*

10 *See id.* at 745.

29 This conclusion is buttressed by a comparison of AS 21.89.020(c) , which *Harrington* is based upon, and the broader language of AS 28.20.440 . In *Lavender v. State Farm Mutual Auto. Ins. Co.*, 828 F.2d 1517 (11th Cir. 1987), the Eleventh Circuit distinguished between a Mississippi statute that required coverage of accidents with uninsured motorists "*for* bodily damage" (similar to AS 21.89.020(c)) and an Alabama statute requiring coverage "*because* of bodily damage" (similar to AS 28.20.440). The court said that the Alabama statute extended uninsured motorist coverage over punitive damages, but that the Mississippi statute did not. *Id.* at 1518. Without expressly adopting the analysis in *Lavender*, we recognize that no such distinction is necessary in this case because our statutes contain both the "for bodily damage" (AS 21.89.020(c)) and "because of bodily damage" (AS 28.20.440(a)(3)) formulations with regard to uninsured motorists. And where two insurance statutes partially overlap, the statute requiring broader coverage governs. *See Progressive Ins. Co. v. Simmons*, 953 P.2d 510, 522 (Alaska 1998).

30 *See* AS 09.17.020(b) .

31 684 P.2d 861 (Alaska 1984).

32 *Id.* at 862 (quoting the policy language).

33 *See id.* at 862-63.

34 *See Grace v. Insurance Co. of N. Am.*, 944 P.2d 460, 467 n.15 (Alaska 1997) (citing *U.S. Fire Ins. Co. v. Colver*, 600 P.2d 1, 3 (Alaska 1979)).

35 This section provides that if State Farm and the insured cannot agree on an amount due, the claim shall be decided by arbitration upon written request of one of the parties. It goes on to state that "the arbitrators shall not award punitive damages or other noncompensatory damages."

36 *See Jones v. Horace Mann Ins. Co.*, 937 P.2d 1360, 1362 n.3 (Alaska 1997).

37 *See Providence Wash. Ins. Co. v. City of Valdez*, 684 P.2d 861, 863 (Alaska 1984).

38 *See supra* Part IV.B.1.b.

39 State Farm advances other policy arguments against allowing an award of punitive damages in this case. For example, it argues that punitive damages should not be allowed here because this would lead to higher insurance prices for people like the Lawrences, and that allowing punitive damages here is akin to allowing them against the estate of a deceased tortfeasor. We reject these arguments.

40 Because we affirm both of the superior court's rulings in favor of the Lawrences, we also affirm the superior court's award of attorneys' fees and costs to the Lawrences.

WILLIAM SCOTT HOLDERNESS, Appellant, v. STATE FARM FIRE AND CASUALTY COMPANY and STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY, Appellees.
24 P.3d 1235; 2001 Alas. LEXIS 77
Supreme Court No. S-8939, No. 5425
June 22, 2001, Decided
SUPREME COURT OF ALASKA
Before: Matthews, Chief Justice, Eastaugh, Fabe, Bryner, and Carpeneti, Justices.

Disposition We AFFIRMED in part and REVERSED in part the superior court's order granting partial judgment, and REMANDED for further proceedings consistent with this decision.

Counsel David Karl Gross, Law Offices of Murphy L. Clark, Anchorage, for Appellant.

James M. Powell, Kimberlee A. Colbo, and Ronald H. Bussey, Hughes Thorsness Powell Huddleston & Bauman, LLC, Anchorage, for Appellees.

Opinion

Editorial Information: Prior History

Appeal from the Superior Court of the State of Alaska, Third Judicial District, Anchorage, Karen L. Hunt, Judge. Superior Court No. 3AN-94-9277 CI.

Opinion by: BRYNER

BRYNER, Justice.

I. *INTRODUCTION*

Dr. William Holderness's car was struck from behind while he was driving from home to the hospital to perform surgery. He was severely injured and ultimately sued his insurers (collectively State Farm). This appeal, from an order partially dismissing Holderness's suit, raises two central questions. The first is whether Holderness's personal umbrella liability policy qualifies as automobile liability insurance under Alaska's insurance code. If so, our precedent requires that the policy's underinsured motorist coverage include prejudgment interest and attorney's fees. We conclude that the umbrella policy is automobile liability insurance. The second question is whether the accident was covered by the general liability policy of Alaska Podiatry Associates, a medical corporation of which Holderness was an executive officer. We conclude that the accident was not covered by the general liability policy because Holderness's duties as an executive officer of Alaska Podiatry Associates did not include commuting to work.

II. *FACTS AND PROCEEDINGS*

While Holderness was driving to Anchorage to perform surgery on January 20, 1994, another motorist hit his car from behind, causing him serious and permanent injuries. The driver who hit Holderness was underinsured.

State Farm paid Holderness the $ 2,000,000 facial limit of his personal liability umbrella policy, but refused to pay him prejudgment interest and Civil Rule 82 attorney's fees in excess of that amount. Holderness argued below that his umbrella policy qualified as automobile insurance under AS 21.89.020 and triggered reformation of the policy to include prejudgment interest and attorney's fees under *Harrington*. The superior court disagreed, ruling that umbrella policies are not automobile insurance under AS 21.89.020 and, accordingly, that *Harrington* does not apply.

Alaska Statute 21.89.020(c) requires insurers to offer underinsured motorist coverage in amounts equal to the limits purchased for liability coverage. The statute provides, in relevant part:

An insurance company offering automobile liability insurance in this state for bodily injury or death shall, initially and at each renewal, offer coverage prescribed in AS 28.20.440 and 28.20.445 or AS 28.22 for the protection of the persons insured under the policy who are legally entitled to recover damages for bodily injury or death from owners or operators of uninsured or underinsured motor vehicles. . . . Coverage required to be offered under this section must include the following options:

(1) policy limits equal to the limits voluntarily purchased to cover the liability of the person insured for bodily injury or death[.][**7**]

Our cases have interpreted this provision to mean that if an automobile liability policy fails to include equal liability and underinsured motorist coverage, the policy must be reformed to make the underinsured motorist coverage "equal to the limits voluntarily purchased" for liability.**8** In *Harrington*, we specifically considered whether a policy reformed to provide such underinsured motorist coverage must also include attorney's fees and prejudgment interest in addition to the policy's facial limits, as would be required in a case involving liability coverage.**9** We held that underinsured motorist coverage must include those additional amounts.**10** Noting that we had interpreted "policy limits" similarly in other contexts, we found this interpretation consistent with the underlying goal of AS 21.89.020(c) : "to provide for the insured . . . the same benefit level as that provided by the insured to those asserting claims against the insured."**11**

Here, we must decide whether *Harrington* applies to Holderness's umbrella policy. We based our decision in *Harrington* on AS 21.89.020(c) , which, by its own terms, only applies to "automobile liability insurance." While subsection (c) of AS 21.89.020 does not define "automobile liability insurance," subsection (a) of the same provision sets forth a core definition, describing an automobile liability policy as one "that insures an owner or operator of a motor vehicle against loss resulting from liability for bodily injury or death, or for property injury or destruction, or both."**12** Accordingly, we apply this definition in determining whether subsection (c)'s requirement of equal liability and underinsured motorist coverage applies to Holderness's umbrella policy.

Holderness's umbrella policy expressly covers losses arising from his liability for personal injury or property damage in excess of the limits covered by his underlying State Farm policies:

If you are legally obligated to pay damages for a **loss**, we will pay your **net loss** minus the **retained limit**. Our payment will not exceed the amount shown on the **Declarations** as Policy Limits - Coverage L - Personal Liability.**[13]**

> The umbrella policy defines a "loss" as "an accident that results in personal injury or property damage during the policy period." "Net loss" is the total of the damages the insured must pay for the loss and the reasonable expenses incurred in settling or trying the case. The "retained limit" is the amount the insured or the underlying insurance must pay before the umbrella policy begins to pay. The policy additionally covers "expenses we incur and costs taxed against you in suits we defend," including attorney's fees,**14** as well as "prejudgment interest awarded against you on that part of the judgment we pay under Coverage L."

Although the umbrella policy might have been phrased to exclude coverage for liability stemming from

from prescribing general compliance with applicable provisions of the AMAIA, AS 21.89.020(c)(1) commands that underinsured motorist coverage offered under section .020 "include . . . policy limits equal to the limits voluntarily purchased to cover . . . liability." And as we have already indicated, AS 21.89.020(a) describes automobile liability broadly enough to include umbrella policies like the State Farm policy at issue here. Accordingly, the AMAIA's internal exemption for umbrella policies fails to reach these externally imposed coverage requirements of the insurance code.

We find further support for this conclusion when we consider how the insurance code and the AMAIA interact with a third statutory regime, the MVSRA. We described this interaction in *Progressive Insurance Co. v. Simmons*.**23** We noted in *Simmons* that the "AMAIA's coverage limits generally parallel those of the MVSRA;" while these two acts "coexist as components of the Alaska Uniform Vehicle Code," they "are not coextensive."**24** Thus, we observed, the AMAIA "supplements, but does not supplant, the MVSRA."**25** Concerning the insurance code, we separately noted that the original version of AS 21.89.020 "required that all policies issued in the state meet the content requirements imposed by the MVSRA" and "expressly referred to subsection 28.20.440(b)(3) of the MVSRA, which required uninsured motor vehicle coverage. "**26** We thus recognized that, "although the MVSRA has never been a mandatory insurance law, as of 1968 the act's policy content requirements became mandatory for all policies written in the state."**27**

We further observed in *Simmons* that, upon enactment of the AMAIA in 1989, AS 21.89.020 's language incorporating the content requirements of the MVSRA was amended to include a reference to the AMAIA.**28** Given that AS 21.89.020(c) now incorporates the content requirements of both the MVSRA and the AMAIA, which are generally parallel but not coextensive, we went on to ask, "How should this language be interpreted where the contents of policies required under the mandatory act differ from the content requirements of the MVSRA? "**29** Answering this question, we interpreted AS 21.89.020(c) to demand primary compliance with the MVSRA unless the AMAIA imposes broader requirements:

> In our view, this language means that all policies in the state must continue to conform to the content requirements of the MVSRA, and that if the content requirements of the mandatory act are broader than those of the MVSRA, those requirements must also be complied with as to persons covered by the mandatory act.**[30]**

In the present case, the content requirements of the MVSRA and the AMAIA stand in conflict: the MVSRA contains no equivalent to the categorical exclusion of umbrella policies set out in the AMAIA's 28.22.121(b).**31** In this respect, the MVSRA provides for broader coverage than the AMAIA. Thus, under *Simmons*, even assuming that AS 21.89.020(c) did not independently mandate equal liability and underinsured motorist coverage, the subsection's incorporation of the MVSRA's comparable content requirements**32** would prevail over its incorporation of the AMAIA's umbrella policy exclusion.

For these reasons, we hold that the superior court erred in concluding that AS 28.22.121(b) excludes Holderness's umbrella policy from being treated as an automobile liability policy under AS 21.89.020(a) and from being reformed, under *Harrington*, to provide equal liability and underinsured motorist coverage, as prescribed by AS 21.89.020(c) .

C. Coverage Under the Alaska Podiatry Associates Business Liability Policy

At the time of the accident, Holderness was insured under a business liability policy held by Alaska Podiatry Associates for those acts he undertook "with respect to [his] duties as [an executive] officer[]." The liability section of the policy covers "those sums that the insured becomes legally obligated to pay as damages because of bodily injury, property damage, personal injury or advertising injury to which this insurance applies." Although the "Business Liability Exclusions" section of the policy specifically excludes coverage for injuries arising out of an insured's use of an automobile, the same section states an exception to this exclusion that results in coverage for liability arising from use of a non-company-owned auto:

In *Martin v. United States Fidelity & Guaranty Co.*,**33** the Supreme Court of Missouri, holding that a policy's use of the term "duties as your officers" was ambiguous, resolved the ambiguity by concluding that the term could include a non-managerial duty, such as fitting a pipe flange, if that duty was one of the executive officer's actual responsibilities.**34** By contrast, in *Creel v. Louisiana Pest Control Insurance, Inc.*,**35** the Court of Appeal of Louisiana construed similar policy language narrowly, to include only managerial duties; but the court based its decision on the trial testimony of Ray's Pest Control's president, who specifically described his responsibilities as president to be limited to "attending and participating in corporate meetings, the hiring and firing of personnel, handling financial dealings, and making corporate decisions."**36** Noting that Ray's president had been on his way to spray a house for pests when the accident occurred, the court concluded that he was not an insured at the time of the accident.**37**

Read together, *Martin* and *Creel* suggest that, absent a narrower definition of "duties of office," when a policy extends coverage to executive officers acting "with respect to their duties as . . . officers," the coverage should be construed to include all work-related activities performed by executive officers -- whether menial or managerial -- unless case-specific evidence establishes that an officer actually undertook to perform a narrower range of duties in that capacity.

Here, no record evidence suggests that Holderness's role as an executive officer of Alaska Podiatry Associates was actually limited to managerial or purely "executive" functions. Accordingly, we reject State Farm's contention that Holderness was necessarily acting outside the scope of his duties as an executive officer at the time of the accident merely because he was not performing managerial functions.

But this conclusion does not resolve the issue specifically presented here. The superior court's ruling did not focus on whether Holderness was performing uniquely "executive" functions at the time of the accident; instead, the ruling more broadly concluded that driving to work falls outside the scope of any kind of work-related activity: "Holderness has raised no factual issue that he was involved in anything other than a completely ordinary commute to work." As the court's ruling recognizes, Alaska follows the general rule that going to work and coming home fall outside the scope of employment.**38** Although the "going-and-coming" rule allows for exceptions on certain occasions -- as when special errands call a worker away from work**39** or force the worker to take an unusually dangerous route to work**40** -- the record presents no evidence suggesting that Holderness was responding to any unique or special demands when he left home for the hospital on the day of the accident.**41** Nor does the record contain any case-specific evidence indicating that Alaska Podiatry Associates actually considered commuting to work to be an integral aspect of Holderness's duties as an executive officer. Absent such evidence, we conclude, the superior court properly ruled that Holderness "was not performing his duties as an executive officer and was not covered by the [Alaska Podiatry Associates] policy."

D. *Dismissal of Contract Claims*

This appeal is before us on a Civil Rule 54(b) partial judgment dismissing all of Holderness's "contract claims" with prejudice. Holderness argues that this judgment was too broad because it could be interpreted to block a contractual claim that he has asserted separately -- his still pending claim that State Farm violated AS 21.89.020(e) by failing to obtain his written waiver of underinsured motorist coverage.

But the superior court's partial summary judgment dismissed Holderness's contract claims "inaccordance with" its order regarding the "Policy Limits Issues." The policy limits order did not consider or purport to decide the validity of Holderness's contract claim for violations of AS 21.89.020(e) 's waiver provision. We thus interpret the superior court's subsequent entry of partial summary judgment to be similarly limited, and we conclude that the judgment does not bar Holderness from pursuing his separate claim for violation of AS 21.89.020(e) .

9 *See Harrington*, 918 P.2d at 1025-26.

10 *See id.*

11 *Id.* at 1026.

12 AS 21.89.020(a) provides:

An automobile liability policy that insures an owner or operator of a motor vehicle against loss resulting fromliability for bodily injury or death, or for property injury or destruction, or both, that is sold in the state, must contain limits in at least the amount prescribed for a motor vehicle liability policy in AS 28.20.440 or AS 28.22.101 .

13 The emphases in the quoted passage appear in the original policy, which emphasizes words to indicate that they are specifically defined in the policy. In the remaining references, this emphasis is omitted, except where necessary for clarity.

14 *Cf. Kenai Peninsula Borough v. Port Graham Corp.*, 871 P.2d 1135, 1141 (Alaska 1994); *Schultz v. Travelers Indem. Co.*, 754 P.2d 265, 267 (Alaska 1988).

15 AS 21.89.020(a) .

16 AS 28.22.

17 AS 28.20.

18 AS 21.89.020(c) .

19 AS 28.22.121(b) . The full text of AS 28.22.121 reads:

Excess of additional coverage. (a) A policy that grants the coverage required for a motor vehicle liability policy may also grant lawful coverage in excess of or in addition to the coverage specified for a policy and the excess or additional coverage is not subject to the provisions of this chapter. With respect to a policy that grants excess or additional coverage, the term "motor vehicle liability policy" applies only to that part of the coverage that is required by this chapter.

(b) A policy is excluded from the application of this chapter if the automobile or motor vehicle liability coverage is provided only on an excess or umbrella basis.

20 *See* AS 28.22.101 .

21 For instance, AS 28.22.101(d) requires that motor vehicle liability policies governed by the AMAIA "must provide coverage in the United States or Canada." Under the exclusion for umbrella policies in AS 28.22.121(b) , an insured might buy umbrella coverage for a more restricted geographical area.

22 AS 28.22.121(b) (emphasis added).

23 953 P.2d 510, 520-22 (Alaska 1998).

24 *Id.* at 520-21.

25 *Id.* at 521.

26 *Id.* at 520.

27 *Id.*

28 *See id.* at 522. Specifically, we stated:

Finally, prior to the mandatory insurance act of 1989, AS 21.89.020(c) read as follows:

HB

339

REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

MEMORANDUM

DATE: April 28, 2004

TO: Senator Ralph Seekins
Chairman, Senate Judiciary Committee

FROM: Representative Kevin Meyer

RE: CS HB 339 (JUD) Trade Practices: Free Trial/Opt-Out Plans

At your earliest convenience, please schedule CS HB 339 (JUD) Trade Practices: Free Trial/Opt-Out Plans for a hearing in the Senate Judiciary Committee.

CS HB 339 (JUD) prohibits the use of opt-out marketing plans and free trial periods, unless the seller fulfills certain requirements and makes specific disclosures to the consumer regarding consumer obligations for accepting goods or services under an opt-out marketing plan or a free trial period.

Thank you for your time and consideration of this request.

Email: Representative_Kevin_Meyer@legis.state.ak.us • **Toll Free:** (866) 465-4945
Session: State Capitol, Juneau, Alaska 99801-1182 • Phone: (907) 465-4945 Fax: (907) 465-3476
Interim: 716 W. 4th Ave., Anchorage, Alaska 99501-2133 • Phone: (907) 269-0199 Fax: (907) 269-0197

REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

MEMORANDUM

DATE: May 1, 2004

TO: Senator Ralph Seekins
Chairman, Senate Judiciary Committee

FROM: Representative Kevin Meyer

RE: Blank Committee Substitute for HB 339

I would like the members of the Senate Judiciary Committee to consider the accompanying blank senate committee substitute for HB 339 (version 23-LS1265\B), in lieu of the original bill.

The following amendments were incorporated into the blank senate committee substitute:

Page 2, line 1:
Delete: subparagraph (2)
Insert: new subparagraph (2)

(2) a description of all charges that will be imposed after the free trial period ends, including whether billing will include charges for shipping and handling, and, if the offer, promotion, or advertising is made by telephone, the amount of the shipping and handling charges;

Page 2, line 8:
Delete: subsection (d)
Insert: new subsection (d)

(d) A consumer who receives goods or services for a free trial period may

(1) at any time during the free trial period, return the goods or cancel the services without any further obligation to the seller;

(2) within 30 days after the free trial period ends, return the goods or services for a full refund of the charges, or a partial refund for the unused portion of the goods or services.

Page 2, line 11:
Delete: subsection (e)

Page 2, line 22
Delete: subsection (f)

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Session: State Capitol, Juneau, Alaska 99801-1182 • Phone: (907) 465-4945 Fax: (907) 465-3476
Interim: 716 W. 4th Ave., Anchorage, Alaska 99501-2133 • Phone: (907) 269-0199 Fax: (907) 269-0197

Re-letter the remaining subsections accordingly.

Page 3, line 27
Delete: subsection (e)
Insert: new subsection (e)

(e) In this section,

(1) "opt-out marketing plan"

(A) means an arrangement under which a seller provides, without the buyer's express verifiable consent, a notice to a buyer that identifies goods or services that the seller intends to provide to the buyer and to charge the buyer for, unless, by a specific date or within a specific time frame, the buyer notifies the seller not to provide the goods or services;

(B) does not include a prenotification negative option plan that is regulated by and complies with 16 C.F.R. 425;

(2) "seller" includes a person who engages in the business of selling, contracting for the sale of, or arranging for the sale of goods or services.

23-LS1265\B
Bannister
4/30/04

SENATE CS FOR CS FOR HOUSE BILL NO. 339( )

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - SECOND SESSION

BY

Offered:
Referred:

Sponsor(s): REPRESENTATIVES MEYER, Dahlstrom, Anderson, Gara, Holm, McGuire, Wolf, Kerttula, Seaton, Lynn, Crawford

A BILL

FOR AN ACT ENTITLED

"An Act relating to opt-out marketing plans for sales, to free trial periods for goods or services, and to acts that are unlawful as unfair trade practices."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

*** Section 1.** AS 45.45 is amended by adding new sections to read:

Sec. 45.45.920. Free trial period. (a) Notwithstanding a provision in AS 45.02 to the contrary, a seller may not offer, promote, advertise, or provide a consumer with goods or services for a free trial period unless the seller complies with all the conditions of this section.

(b) When offering, promoting, or advertising consumer goods or services for a free trial period, a seller shall clearly and conspicuously disclose all material terms and conditions of the free trial period, including

(1) all material restrictions, limitations, terms, and conditions of the free trial period, including any obligation by the consumer to purchase a minimum quantity of goods or services after the free trial period ends;

L

(2) a description of all charges that will be imposed after the free trial period ends, including whether billing will include charges for shipping and handling, and, if the offer, promotion, or advertising is made by telephone, the amount of the shipping and handling charges;

(3) a description of the consumer's right to cancel; and

(4) any other obligations the consumer assumes by accepting or using the goods or services during the free trial period.

(c) Before providing goods or services to a consumer for a free trial period, a seller shall obtain express verifiable consent from the consumer to the free trial period.

(d) A consumer who receives goods or services for a free trial period may

(1) at any time during the free trial period, return the goods or cancel the services without further obligation to the seller;

(2) within 30 days after the free trial period ends, return the goods or cancel the services for a full refund of the charges, if any, or a partial refund for the unused portion of the goods or services.

(e) This section does not apply to a seller who provides goods or services to a consumer for free if the consumer does not assume any obligation by accepting the free goods or services.

(f) This section does not apply to

(1) a telephonic seller who is registered under AS 45.63 and who complies with AS 45.63; or

(2) a prenotification negative option plan that is regulated by 16 C.F.R. 425 and that complies with 16 C.F.R. 425.

(g) In this section, "seller" means a person who engages in the business of selling, contracting for the sale, arranging for the sale of, or arranging for a free trial period for goods or services.

Sec. 45.45.930. Opt-out marketing plans. (a) Notwithstanding a provision in AS 45.02 to the contrary, a seller may not use an opt-out marketing plan to sell goods or services unless the seller complies with all of the provisions of this section.

(b) Before using an opt-out marketing plan, a seller shall obtain express verifiable consent from the buyer that confirms that the buyer agrees to the use of the

plan. The seller shall provide the following information before obtaining the consent:

(1) a description of the material terms and conditions of the plan, including a description of the goods or services that will be offered;

(2) that the buyer's account will be charged unless the buyer takes an affirmative action to avoid the charge;

(3) the date the charge will be submitted for payment; and

(4) the specific steps the buyer must take to avoid the charge.

(c) A seller who charges a buyer for goods or services under an opt-out marketing plan has the burden of proving that the buyer provided the express verifiable consent required by (b) of this section and was given the disclosures required by (b) of this section.

(d) This section does not apply to a telephonic seller who is registered under AS 45.63 and who complies with AS 45.63.

(e) In this section,

(1) "opt-out marketing plan"

(A) means an arrangement under which a seller provides, without the buyer's express verifiable consent, a notice to a buyer that identifies goods or services that the seller intends to provide to the buyer and to charge the buyer for, unless, by a specific date or within a specific time frame, the buyer notifies the seller not to provide the goods or services;

(B) does not include a prenotification negative option plan that is regulated by and complies with 16 C.F.R. 425;

(2) "seller" includes a person who engages in the business of selling, contracting for the sale of, or arranging for the sale of goods or services.

*** Sec. 2.** AS 45.50.471(b) is amended by adding new paragraphs to read:

(47) violating AS 45.45.920 (free trial period);

(48) violating AS 45.45.930 (opt-out marketing plans).

REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

SPONSOR STATEMENT

CS HB 339 (JUD)

"An Act relating to opt-out marketing plans for sales, to free trial periods for goods or services, and to acts that are unlawful as unfair trade practices."

CS HB 339(JUD) prohibits the use of opt-out marketing plans and free trial periods, to sell goods or services, unless specific requirements and disclosures are made to the consumer.

Under CS HB 339(JUD), an opt-out marketing plan is defined as an arrangement under which a seller provides an announcement to a buyer that identifies goods or services that the seller intends to provide to the buyer, unless, by a specific date or within a specific time frame, the buyer notifies the seller not to provide the goods or services. Essentially, an opt-out marketing plan requires the consumer to take action to avoid initial or continuing charges. Some businesses see the use of opt-out marketing plans as a successful marketing ploy; enabling a business to get a product out to a critical number of people, without fully disclosing the terms of the plan, and receiving compensation through unwilling and/or uneducated consumers.

Free trial periods are also a great way to try new products or services without making a long-term commitment to a membership, subscription, or extended service contract. However, consumers should always receive adequate information concerning the extent of the free trial period, and what obligations are required of them.

CS HB 339 (JUD) establishes clear guidelines for businesses to follow that do not result in consumer deception. The required disclosures under CS HB 339 (JUD) include: providing information pertaining to charges, how charges are calculated and collected, a description of the consumer's right to cancel, and any and all consumer obligations.

Over the past two years, complaints to the Federal Trade Commission (FTC) about unordered merchandise has increased by nearly 60%. Opt-out marketing plans and free trial period scams account for a significant amount of all new reports. Consumers are also turning to state Attorney General Offices' to complain of unfair and deceptive trade practices by businesses engaging in these plans. Over the past year, there have been a number of high-profile cases, where the State has intervened on behalf of Alaskans.

CS HB 339 (JUD) removes uncertainty in Alaska statutes of what the role and the responsibility is of businesses in protecting consumers and their interests, when using free trial periods and opt-out marketing plans. Businesses will be required to disclose all material terms of these plans, ensuring that the consumer can make the best decision possible to accept goods or services through these introductory type offers.

Last Updated: April 1, 2004

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FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 339(L&C)
(H) Publish Date: 2/5/04

Revision Date/Time (Note if correction):
Dept. Affected: LAW
Title "An Act relating to negative option plans for sales, to charges for goods or services..."
RDU Civil
Component Commercial & Fair Business
Sponsor Representative Meyer
Requester House Labor & Commerce
Component No.

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

Prepared by: Kathryn A. Daughhetee, Director
Phone 465-3673
Division Administrative Services
Date/Time 2/1/04 2:16 PM
Approved by: Kathryn Daughhetee for Gregg D. Renkes, Attorney General
Date 2/1/2004
Agency Department of Law

(Revised 12/2003 OMB)

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: CSHB 339(L&C)
(H) Publish Date: 2/5/04

Revision Date/Time (Note if correction):
Dept. Affected: DCED
Title: Trade Practices
RDU: Banking, Securities & Corp (115)
Component: Banking, Securities & Corp
Sponsor: Representative Meyer
Requester: Labor & Commerce
Component No.: 1233

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation has no impact on the operations of the Department.

Prepared by: Mark Davis, Director — Phone (907) 465-2521
Division: Banking, Securities & Corporations — Date/Time 2/2/04 1:56 PM
Approved by: Edgar Blatchford, Commissioner — Date 2/2/2004
Agency: Department of Community & Economic Development

(Revised 9/2003 OMB)

AS 45.50.471 Unlawful acts and practices

(a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of trade or commerce are declared to be unlawful.

(b) The terms "unfair methods of competition" and "unfair or deceptive acts or practices" include, but are not limited to, the following acts:

(1) fraudulently conveying or transferring goods or services by representing them to be those of another;

(2) falsely representing or designating the geographic origin of goods or services;

(3) causing a likelihood of confusion or misunderstanding as to the source, sponsorship, or approval, or another person's affiliation, connection, or association with or certification of goods or services;

(4) representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities that they do not have or that a person has a sponsorship, approval, status, affiliation, or connection that the person does not have;

(5) representing that goods are original or new if they are deteriorated, altered, reconditioned, reclaimed, used, secondhand, or seconds;

(6) representing that goods or services are of a particular standard, quality, or grade, or that goods are of a particular style or model, if they are of another;

(7) disparaging the goods, services, or business of another by false or misleading representation of fact;

(8) advertising goods or services with intent not to sell them as advertised;

(9) advertising goods or services with intent not to supply reasonable expectable public demand, unless the advertisement prominently discloses a limitation of quantity;

(10) making false or misleading statements of fact concerning the reasons for, existence of, or amounts of price reductions;

(11) engaging in any other conduct creating a likelihood of confusion or of misunderstanding and which misleads, deceives or damages a buyer or a competitor in connection with the sale or advertisement of goods or services;

(12) using or employing deception, fraud, false pretense, false promise, misrepresentation, or knowingly concealing, suppressing, or omitting a material fact with intent that others rely upon the concealment, suppression or omission in

connection with the sale or advertisement of goods or services whether or not a person has in fact been misled, deceived or damaged;

(13) failing to deliver to the customer at the time of an installment sale of goods or services, a written order, contract, or receipt setting out the name and address of the seller and the name and address of the organization that the seller represents, and all of the terms and conditions of the sale, including a description of the goods or services, which shall be stated in readable, clear, and unambiguous language;

(14) representing that an agreement confers or involves rights, remedies or obligations which it does not confer or involve, or which are prohibited by law;

(15) knowingly making false or misleading statements concerning the need for parts, replacement, or repair service;

(16) misrepresenting the authority of a salesman, representative or agent to negotiate the final terms of a consumer transaction;

(17) basing a charge for repair in whole or in part on a guaranty or warranty rather than on the actual value of the actual repairs made or work to be performed on the item without stating separately the charges for the work and the charge for the guaranty or warranty, if any;

(18) disconnecting, turning back or resetting the odometer of a vehicle to reduce the number of miles indicated;

(19) using a chain referral sales plan by inducing or attempting to induce a consumer to enter into a contract by offering a rebate, discount, commission, or other consideration, contingent upon the happening of a future event, on the condition that the consumer either sells, or gives information or assistance for the purpose of leading to a sale by the seller of the same or related goods;

(20) selling or offering to sell a right of participation in a chain distributor scheme;

(21) selling, falsely representing or advertising meat, fish or poultry which has been frozen as fresh food;

(22) failing to comply with AS 45.02.350 ;

(23) failing to comply with AS 45.45.130 - 45.45.240;

(24) counseling, consulting or arranging for future services relating to the disposition of a body upon death whereby certain personal property, not including cemetery lots and markers, will be furnished or the professional services of a funeral director or embalmer will be furnished, unless the person receiving money or property deposits the money or property, and money or property is received, within five days of its receipt, in a trust in a financial institution whose deposits are insured by an instrumentality of the federal government designating the institution as the trustee as

a separate trust in the name only of the person on whose behalf the arrangements are made with a provision that the money or property may only be applied to the purchase of designated merchandise or services and should the money or property deposited and any accrued interest not be used for the purposes intended on the death of the person on whose behalf the arrangements are made, all money or property in the trust shall become part of that person's estate; upon demand by the person on whose behalf the arrangements are made, all money or property in the trust including accrued interest, shall be paid to that person; this paragraph does not prohibit the charging of a separate fee for consultation, counseling or arrangement services if the fee is disclosed to the person making the arrangement; any arrangement under this paragraph which would constitute a contract of insurance under AS 21 is subject to the provisions of AS 21;

(25) failing to comply with the terms of AS 45.50.800 - 45.50.850 (Alaska Gasoline Products Leasing Act);

(26) failing to comply with AS 45.30 relating to mobile home warranties and mobile home parks;

(27) failing to comply with AS 14.48.060 (b)(13);

(28) dealing in hearing aids and failing to comply with AS 08.55;

(29) violating AS 45.45.910 (a), (b), or (c);

(30) failing to comply with AS 45.50.473 ;

(31) violating the provisions of AS 45.45.400 ;

(32) knowingly selling a reproduction of a piece of art or handicraft that was made by a resident of the state unless the reproduction is clearly labeled as a reproduction; in this paragraph, "reproduction" means a copy of an original if the copy is

(A) substantially the same as the original; and

(B) not made by the person who made the original;

(33) violating AS 08.66 (motor vehicle dealers);

(34) violating AS 08.66.200 - 08.66.350 (motor vehicle buyers' agents);

(35) violating AS 45.63 (telephonic solicitations);

(36) violating AS 45.68 (charitable solicitations);

(37) violating AS 45.50.474 (on board promotions);

(38) referring a person to a dentist or a dental practice that has paid or will pay a fee for the referral unless the person making the referral discloses at the time the referral is made that the dentist or dental practice has paid or will pay a fee based on the referral;

(39) advertising that a person can receive a referral to a dentist or a dental practice without disclosing in the advertising that the dentist or dental practice to which the person is referred has paid or will pay a fee based on the referral if, in fact, the dentist or dental practice to which the person is referred has paid or will pay a fee based on the referral;

(40) violating AS 45.50.477 (a) - (c);

(41) failing to comply with AS 45.50.475 ;

(42) violating AS 45.35 (lease-purchase agreements);

(43) violating AS 45.25.400 - 45.25.590 (motor vehicle dealer practices);

(44) violating AS 45.66 (sale of business opportunities);

(45) violating AS 08.18.023 (b) or 08.18.152;

(46) violating AS 45.50.479 (limitations on electronic mail).

(c) The unlawful acts and practices listed in (b) of this section are in addition to and do not limit the types of unlawful acts and practices actionable at common law or under other state statutes.

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AARP Alaska

April 22, 2004

The Honorable Con Bunde, Chair
Senate Labor and Commerce Committee
Alaska State Capitol, Room 506
Juneau, Alaska 99801-1182

HB 339 (Meyer)—Support

On behalf of the Alaska members of AARP, we recommend you and your colleagues on the Senate Labor and Commerce Committee support HB 339, authored by Representative Kevin Meyer and co-sponsored by ten of his House colleagues representing both parties.

The intent of HB 339 is to protect Alaska consumers from inappropriate sales practices by which consumers must opt-out of a provision or it is automatically included in the sales agreement. HB 339 will prohibit the use of opt-out marketing plans and free trial periods to sell goods or services, unless specific requirements and disclosures are made to the consumer.

Many older persons have been victims of poor and inappropriate marketing practices, including a variety of opt-out proposals. HB 339 will go a long way in consumer protection and warrants the support of you and your Committee colleagues.

AARP recommends an "AYE" vote on HB 339.

Should you have any questions about our position, please feel free to contact Marie Darlin, Coordinator of the AARP Capital City Task Force (907-586-3637), Patrick Luby, AARP Advocacy Director (907-762-3314) or me (907-245-5259).

Thank you for your consideration.
Sincerely,

Marguerite Stetson

Marguerite Stetson
AARP State Coordinator for Advocacy
3009 Northwood Street
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CC: Vice-Chair Ralph Seekins
Senator Gary Stevens
Senator Bettye Davis
Senator Hollis French
Marie Darlin
Patrick Luby

Electronic Code of Federal Regulations

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THIS DATA CURRENT AS OF THE FEDERAL REGISTER DATED SEPTEMBER 8, 2003

16 CFR - CHAPTER I - PART 425

View Part

§ 425.1 The rule.

(a) In connection with the sale, offering for sale, or distribution of goods and merchandise in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice, for a seller in connection with the use of any negative option plan to fail to comply with the following requirements:

(1) Promotional material shall clearly and conspicuously disclose the material terms of the plan, including:

(i) That aspect of the plan under which the subscriber must notify the seller, in the manner provided for by the seller, if he does not wish to purchase the selection;

(ii) Any obligation assumed by the subscriber to purchase a minimum quantity of merchandise;

(iii) The right of a contract-complete subscriber to cancel his membership at any time;

(iv) Whether billing charges will include an amount for postage and handling;

(v) A disclosure indicating that the subscriber will be provided with at least ten (10) days in which to mail any form, contained in or accompanying an announcement identifying the selection, to the seller;

(vi) A disclosure that the seller will credit the return of any selections sent to a subscriber, and guarantee to the Postal Service or the subscriber postage to return such selections to the seller when the announcement and form are not received by the subscriber in time to afford him at least ten (10) days in which to mail his form to the seller;

(vii) The frequency with which the announcements and forms will be sent to the subscriber and the maximum number of announcements and forms which will be sent to him during a 12-month period.

(2) Prior to sending any selection, the seller shall mail to its subscribers, within the time specified by paragraph (a)(3) of this section:

(i) An announcement identifying the selection;

(ii) A form, contained in or accompanying the announcement, clearly and conspicuously disclosing that the

subscriber will receive the selection identified in the announcement unless he instructs the seller that he does not want the selection, designating a procedure by which the form may be used for the purpose of enabling the subscriber so to instruct the seller, and specifying either the return date or the mailing date.

(3) The seller shall mail the announcement and form either at least twenty (20) days prior to the return date or at least fifteen (15) days prior to the mailing date, or provide a mailing date at least ten (10) days after receipt by the subscriber, provided, however, that whichever system the seller chooses for mailing the announcement and form, such system must provide the subscriber with at least ten (10) days in which to mail his form.

(b) In connection with the sale or distribution of goods and merchandise in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, it shall constitute an unfair or deceptive act or practice for a seller in connection with the use of any negative option plan to:

(1) Refuse to credit, for the full invoiced amount thereof, the return of any selection sent to a subscriber, and to guarantee to the Postal Service or the subscriber postage adequate to return such selection to the seller, when:

(i) The selection is sent to a subscriber whose form indicating that he does not want to receive the selection was received by the seller by the return date or was mailed by the subscriber by the mailing date;

(ii) Such form is received by the seller after the return date, but has been mailed by the subscriber and postmarked at least 3 days prior to the return date;

(iii) Prior to the date of shipment of such selection, the seller has received from a contract-complete subscriber, a written notice of cancellation of membership adequately identifying the subscriber; however, this provision is applicable only to the first selection sent to a canceling contract-complete subscriber after the seller has received written notice of cancellation. After the first selection shipment, all selection shipments thereafter are deemed to be unordered merchandise pursuant to section 3009 of the Postal Reorganization Act of 1970, as adopted by the Federal Trade Commission in its public notice, dated September 11, 1970;

(iv) The announcement and form are not received by the subscriber in time to afford him at least ten (10) days in which to mail his form.

(2) Fail to notify a subscriber known by the seller to be within any of the circumstances set forth in paragraphs (b)(1)(i) through (iv) of this section, that if the subscriber elects, the subscriber may return the selection with return postage guaranteed and receive a credit to his account.

(3) Refuse to ship within 4 weeks after receipt of an order merchandise due subscribers as introductory and bonus merchandise, unless the seller is unable to deliver the merchandise originally offered due to unanticipated circumstances beyond the seller's control and promptly makes a reasonably equivalent alternative offer. However, where the subscriber refuses to accept alternatively offered introductory merchandise, but instead insists upon termination of his membership due to the seller's failure to provide the subscriber with his originally requested introductory merchandise, or any portion thereof, the seller must comply with the subscriber's request for cancellation of membership, provided the subscriber returns to the seller any introductory merchandise which already may have been sent him.

(4) Fail to terminate promptly the membership of a properly identified contract-complete subscriber upon his written request.

(5) Ship, without the express consent of the subscriber, substituted merchandise for that ordered by the subscriber.

(c) For the purposes of this part:

(1) *Negative option plan* refers to a contractual plan or arrangement under which a seller periodically sends to subscribers an announcement which identifies merchandise (other than annual supplements to previously acquired merchandise) it proposes to send to subscribers to such plan, and the subscribers thereafter receive and are billed for the merchandise identified in each such announcement, unless by a date or within a time specified by the seller with respect to each such announcement the subscribers, in conformity with the provisions of such plan, instruct the seller not to send the identified merchandise.

(2) *Subscriber* means any person who has agreed to receive the benefits of, and assume the obligations entailed in, membership in any negative option plan and whose membership in such negative option plan has been approved and accepted by the seller.

(3) *Contract-complete subscriber* refers to a subscriber who has purchased the minimum quantity of merchandise required by the terms of membership in a negative option plan.

(4) *Promotional material* refers to an advertisement containing or accompanying any device or material which a prospective subscriber sends to the seller to request acceptance or enrollment in a negative option plan.

(5) *Selection* refers to the merchandise identified by a seller under any negative option plan as the merchandise which the subscriber will receive and be billed for, unless by the date, or within the period specified by the seller, the subscriber instructs the seller not to send such merchandise.

(6) *Announcement* refers to any material sent by a seller using a negative option plan in which the selection is identified and offered to subscribers.

(7) *Form* refers to any form which the subscriber returns to the seller to instruct the seller not to send the selection.

(8) *Return date* refers to a date specified by a seller using a negative option plan as the date by which a form must be received by the seller to prevent shipment of the selection.

(9) *Mailing date* refers to the time specified by a seller using a negative option plan as the time by or within which a form must be mailed by a subscriber to prevent shipment of the selection. (38 Stat. 717, as amended; 15 U.S.C. 41-58)

[38 FR 4896; Feb. 22, 1973; 38 FR 6991, Mar. 15, 1973, as amended at 63 FR 44562, Aug. 20, 1998]

Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

For Release: November 1, 2001

FTC Testimony Details Deceptive Negative Option Marketing and the Deceptive Sale of Credit and Credit Card-Related Services

The Federal Trade Commission's recent enforcement action against deceptive negative option marketing programs as well as Commission actions involving credit card sales and credit card loss protection services were detailed today in testimony before the House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit.

The testimony, presented by Elaine Kolish, Associate Director of FTC's Bureau of Consumer Protection's Division of Enforcement, included information about the Commission's recent crackdown against a group of buying clubs, including Triad Discount Buying Service, Inc., its related companies, and their operator, Ira Smolev, for failure to disclose, or to disclose adequately, the terms of negative option or "free trial" offers. "Negative option marketing is particularly troubling," Kolish explained, "when marketers, as they did in the *Smolev* case, already have consumers' credit card or billing account information and can easily charge consumers' accounts without their permission or when marketers fail to disclose that consumers' credit card numbers will be transferred to another company and charged unless consumers call to cancel."

Kolish also presented examples of FTC's aggressive challenges against deceptive marketing of credit and credit card-related services. The testimony cited the October 18, 2001 FTC filing of nine cases, most of which involved the alleged deceptive telemarketing of "guaranteed loans," worthless credit card protection services, and "protection" from identity theft, and additional cases challenging the deceptive telemarketing of major credit cards, such as VISA and MasterCard.

Included in the testimony was information about the numerous consumer education publications the Commission has disseminated to help consumers protect themselves. Among the publications mentioned were: "Prenotification Negative Option Plans;" "Trial Offers: The Deal is in the Details;" "Gold and Platinum Cards;" "Secured Credit Card Marketing Scams;" and "FTC Consumer Alert! Credit Card Loss Protection Offers: They're the Real Steal." Kolish urged consumers who may have had their credit card numbers transferred or charged without their knowledge or consent to report their experiences by filing a complaint with the FTC in writing, online at www.ftc.gov, or by calling the FTC's toll-free number, 1-877- FTC - HELP. "Consumer reports are essential to our investigations," said Kolish, "as information about where such practices are occurring and which companies are engaging in them is critical to effective state and federal law enforcement efforts."

FTC publications mentioned in the testimony are available at www.ftc.gov.

Related Documents:

Prenotification Negative Option Plans

Trial Offers: The Deal is in the DetailsPrenotification Negative Option Plans

Gold and Platinum Cards

Secured Credit Card Marketing Scams

FTC Consumer Alert! Credit Card Loss Protection Offers: They're the Real Steal

Prepared Statement of the Federal Trade Commission Concerning Its Recent Enforcement Action Against Ira Smolev, Triad, and Related Parties

Text of the Commission Testimony

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Copies of the testimony are available from the FTC's Web site at http://www.ftc.gov and also from the FTC's Consumer Response Center, Room 130, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. The FTC works for the consumer to prevent fraudulent, deceptive and

unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint, or to get free information on any of 150 consumer topics, call toll-free, 1-877-FTC-HELP (1-877-382-4357), or use the complaint form at www.ftc.gov. The FTC enters Internet, telemarketing, identity theft and other fraud-related complaints into Consumer Sentinel, a secure, online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

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(FTC File No. 992-3255)

(http://www.ftc.gov/opa/2001/11/kolish.htm)

PREPARED STATEMENT
OF THE FEDERAL TRADE COMMISSION

Before the

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
UNITED STATES HOUSE OF REPRESENTATIVES

Washington, D.C.

November 1, 2001

I. Introduction

Mr. Chairman and members of the Committee, I am Elaine Kolish, Associate Director of the Bureau of Consumer Protection's Division of Enforcement at the Federal Trade Commission.[1] I am pleased to have this opportunity to provide information concerning the Commission's recent enforcement action against Ira Smolev, Triad, and related parties.[2] That case was brought as part of the Commission's crackdown on deceptive negative option marketing programs that fail to disclose, or to disclose adequately, the terms of negative option or "free trial" offers. These practices have resulted in consumers being charged or billed for goods and services without authorization.[3] Negative option marketing is particularly troubling when marketers, as they did in the *Smolev* case, already have consumers' credit card or billing account information and can easily charge consumers' accounts without their permission or when marketers fail to disclose that consumers' credit card numbers will be transferred to another company and charged unless consumers call to cancel.

This testimony describes the *Smolev* case and other recent Commission actions involving deceptive negative option marketing and the deceptive sale of credit cards and credit card loss protection services. In addition, this statement describes FTC consumer education materials designed, for example, to help consumers understand negative option offers and minimize the risk of having their billing information transferred or used without their knowledge or consent.

II. Background

The FTC is the federal government's primary consumer protection agency. Congress has directed the FTC, under the FTC Act, to take action against "unfair or deceptive acts or practices" in almost all sectors of our economy and to promote vigorous competition in the marketplace.[4] As part of our activity, the Commission monitors complaints about all types of negative option marketing. Although the number of complaints in this general area has been increasing, one of the specific segments with a particularly dramatic increase in complaints is buying clubs. Buying clubs provide members with specified benefits over a period of time, including, for example, discounts on goods, health services, and legal services. From 1998 to 2000, buying clubs jumped from the 26th to the 11th most frequently complained about subject in the FTC's Consumer Sentinel complaint database. Thus, this area has attracted increased FTC attention, as well as the attention of the State Attorneys General.

III. *Smolev/Triad* Case and Negative Option Marketing

On October 24, 2001, the FTC announced that a group of buying clubs including Triad Discount Buying Service, inc., its related companies and their operator, Ira Smolev, will pay more than $9 million to settle charges brought by the FTC and State Attorneys General that the defendants misled consumers into accepting trial buying club memberships and obtained consumers' credit card account numbers without the consumers' knowledge or authorization from telemarketers pitching the buying clubs. [5] Consumers then were enrolled in the clubs and charged up to $96 in yearly membership fees. Of the amount to be paid, $8.3 million is earmarked for consumer restitution, and $750,000 will cover state investigative costs. The multi-state investigation, which

was led by Florida and Missouri, resulted in more than 40 states' entering into the settlement agreement.

From 1996 to 2000, the Triad companies contracted with numerous independent telemarketers to "upsell"[6] the Triad buying clubs. The telemarketers generally marketed their own products and services through outbound calls or inbound calls in response to advertising, direct mail, or infomercials. After customers purchased products or services from these telemarketers and provided their credit card numbers for payment, the telemarketers promoted a 30-day free trial in the Triad buying club as a thank-you for purchasing the telemarketers' products or services. The Commission's complaint alleges that the telemarketing scripts did not disclose or disclose sufficiently that consumers had to call the defendants and cancel their membership before the end of the trial period to avoid being automatically enrolled as a member and charged an annual fee. In addition, consumers were unaware that their credit card numbers were being transferred from the telemarketer they called to Triad.

In addition to providing monetary relief, the Triad Order requires Ira Smolev and the Triad companies to drastically revise their marketing practices to prevent future deception. The Order prohibits them from misrepresenting "free" offers of goods or services and from failing to disclose any obligations placed on consumers who accept trial offers. The Order also prohibits them from: (1) obtaining consumers' billing information, including credit card account numbers and unique identifying information, from third parties without the consumers' express authorization; (2) disseminating the information (with a few narrow exceptions, such as to process an authorized charge); and (3) signing up new members or renewing existing memberships without express, verifiable authorization from the consumer.[7]

In addition to the FTC and state actions against Triad, since 1999 several states have taken enforcement action against three other buying club marketers, Damark International,[8] MemberWorks[9] and Brand Direct Marketing ("BDM"),[10] based on their marketing practices. These matters involved alleged practices like those at issue in the *Smolev* matter.

The FTC and State Attorneys General are continuing to investigate other companies that are engaged in negative option marketing, including offers for buying clubs, that may be misleading to consumers. Past FTC cases have involved book offers,[11] website services,[12] and Internet services,[13] among others. On October 4, during remarks at the 2001 Privacy Conference in Cleveland, Ohio,[14] FTC Chairman Muris announced that, as part of the FTC's review of the Telemarketing Sales Rule, he will recommend consideration of amendments to address abuses concerning pre-acquired account information to ensure that this type of information is not used to bill consumers for goods or services they did not want.[15]

IV. Actions Involving Credit Card Sales and Credit Card Loss Protection Services

The FTC has aggressively challenged deceptive marketing of credit and credit card-related services. Most recently, on October 18, 2001, the FTC announced the filing of nine cases, most of which involve the alleged deceptive telemarketing of "guaranteed loans," worthless credit card protection services, and "protection" from identity theft.[16]

The FTC has brought cases challenging the deceptive marketing by telemarketers of major credit cards, such as VISA and MasterCard. For example, in January 2001, the Commission obtained a settlement with American Consumer Membership Services, Inc. and its principal resolving charges that they deceptively telemarketed offers of pre-approved, guaranteed VISA or MasterCard credit cards for a $69 fee to consumers with credit problems. Instead of the promised cards, consumers received vouchers, coupons, and other offers, and occasionally credit card applications with lists of banks to which they could apply for a credit card. Applying for these credit cards often required additional bank fees of as much as $150. The settlement bans the defendants from engaging in any telemarketing, or in the advertising, marketing, or sale of credit cards, loans or other extensions of credit. In addition, it requires the payment of over $40,000 in consumer redress.[17] In other similar cases, the FTC alleged that the companies misrepresented that consumers whose credit cards are lost or stolen are at risk for unlimited charges, when in fact under the Truth-in-Lending Act consumers are not responsible for any unauthorized credit card charges over $50, and major credit card companies typically waive this fee too.

V. Consumer Education

To help consumers protect themselves, the Commission has widely disseminated numerous consumer education publications.[18] To help consumers understand negative option and trial offers and reduce the risk of having their credit card numbers transferred or charged without authorization, the Commission has issued two publications - "Prenotification Negative Option Plans" and "Trial Offers: The Deal is in the Details." The FTC also has issued consumer education materials addressing the deceptive marketing of gold credit cards and credit card loss protection programs, including "Gold and Platinum Cards;" "Secured Credit Card Marketing Scams;" and "FTC Consumer Alert! Credit Card Loss Protection Offers: They're the Real Steal." We hope that consumers who may have had their credit card numbers transferred or charged without their knowledge or consent will report their experiences by filing a complaint with the FTC. Consumers who feel that they have been defrauded can file complaints with the FTC in writing, online at www.ftc.gov, or by calling the FTC's toll-free number, 1-877- FTC HELP. Information about where such practices are occurring and which companies are engaging in them is critical to effective state and federal law enforcement efforts.[19]

VI. Conclusion

The Commission appreciates the opportunity provided by the Subcommittee to describe our efforts to tackle the deceptive marketing of negative option and free trial offers and the improper transfer or misuse of consumers' billing information, as well as other deceptive practices involving the sale of credit cards and credit card loss protection services.

Endnotes:

1. The views expressed in this statement represent the views of the Commission. My oral statement and responses to any questions you may have are my own, and do not necessarily represent the views of the Commission or of any individual Commissioner.

2. *FTC v. Ira Smolev*, No. 01-8922 CIV ZLOCH (S.D. Fla.) (filed Oct. 23, 2001).

3. A negative option is any type of sales term, contract provision, or buying plan that requires an affirmative action on the consumer's part to prevent a sale from taking place. This type of marketing is legal as long as the seller clearly discloses all the material terms and conditions up front and the consumer accepts the offer.

4. The FTC has broad law enforcement responsibilities under the FTC Act, 15 U.S.C. § 41 *et seq.* The statute provides the agency with jurisdiction over most of the economy. Certain entities, such as depository institutions and common carriers, are wholly or partially exempt from FTC jurisdiction, as is the business of insurance. In addition to the FTC Act, the FTC has enforcement responsibilities under more than 40 statutes.

5. The press release and related documents are available at www.ftc.gov/opa/2001/10/triad.htm . Specifically, the complaint alleges that defendants misrepresented that: (1) consumers who agree to the offer of a 30-day trial membership incur no obligation to take any action to avoid having their credit cards charged for the membership; (2) consumers agreed to accept the trial memberships, or agreed to purchase memberships, for which defendants charged them; and (3) only the cost of the products purchased from defendants' third-party telemarketers would be charged to the consumers' credit card accounts and no other charges to the accounts would be made without the consumers' further express authorization. The complaint also alleges that defendants failed to disclose or to disclose adequately that a consumer who fails to contact defendants within 30 days and cancel the membership is automatically enrolled as a member and charged an annual fee, and that the member is charged a renewal fee each subsequent year unless the member cancels the membership. In addition, it alleges that defendants, directly and through their third-party telemarketers, failed to disclose that the consumers' financial information is turned over to defendants, who charge the consumer's credit card for the membership. Finally, the complaint alleges that defendants violated the Telemarketing Sales Rule ("TSR") by not disclosing material terms and conditions of the offers up front.

6 Upselling is the practice of marketing additional products after a consumer has agreed to purchase a different product. In this case, for example, two sellers entered into a joint marketing agreement to offer products or services during the same telephone call. The first seller telemarketed its own products or services. After consumers provided financial information to pay for their orders, the first seller offered the second seller's products or services.

7. The Order also enjoins violations of the Telemarketing Sales Rule, and requires Ira Smolev and the Triad companies to retain a third party monitor to oversee their future business operations and report to the FTC. Finally, the Order requires Ira Smolev to maintain a $1.5 million escrow account before he markets goods or services to the general public or assists others engaging in telemarketing.

8. In 1999, Minnesota obtained an Assurance of Discontinuance from Damark International to resolve allegations that it deceived consumers by offering a free trial membership in its buying clubs without disclosing that consumers must affirmatively act to cancel the membership within 30 days to avoid a credit card charge.

9. At least four states -- Minnesota, New York, Nebraska, and California -- have obtained either an Assurance of Voluntary Compliance ("AVC") or a court settlement with MemberWorks. Nebraska obtained an AVC in February 2001 that applies

nationwide. The AVC requires MemberWorks to provide refunds to consumers alleging unauthorized charges and includes detailed conduct provisions applicable to MemberWorks' marketing of membership programs.

10. In August 2000, BDM agreed to be bound by a federal court order resolving allegations that BDM violated the TSR and state consumer protection laws. *State of Connecticut and State of Washington v. Brand Direct Marketing, Inc.*, No. 300CV1456-GLG (D. Conn., Aug. 9, 2000). The states filed this action in federal court to enforce the TSR pursuant to the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. §6101 *et seq.* The states have authority to bring such TSR enforcement actions under 15 U.S.C. § 6103(a). Pursuant to this Order, BDM paid $1.9 million in penalties, fees and consumer education funds, and about $11 million in restitution. In addition, BDM is required to make specific disclosures about its ability to directly charge consumers' credit cards. Finally, the order requires BDM to improve its cancellation, automatic renewal, and refund procedures.

11. For example, the Commission recently obtained a consent decree against a book company for allegedly violating the Prenotification Plan Negative Option Rule, 16 C.F.R. Part 425, the TSR, and the Unordered Merchandise Statute, 39 U.S.C. § 3009. *FTC v. Creative Publishing Int'l, Inc.*, No. 01-945 (DWF/AJB) (D. Minn. May 30, 2001). That case involved allegations that consumers were not told all the terms and conditions of the plan they were unwittingly signed up for when they agreed to receive a book on a free preview basis. Those consumers who paid for the book were sent notices, without their authorization, that other books would be sent to them unless they cancelled.

12. *See e.g., FTC v. Shared Network Services, LLC*, No. CIV. S-99-1087 WBS JFM (E.D. Cal.); *FTC v. Wazzu Corp.*, No. SACV-99-762-AHS (C.D. Cal.); and *FTC v. U.S. Republic Communications, Inc.*, No. 4:99-CV-3657 (S.D. Tex.). The defendants in these cases represented that small businesses would have an opportunity to review website services for a 30-day trial period before being charged for the services. The defendants made it nearly impossible for businesses to cancel, however, by failing to provide information about how to contact the defendants or by providing that information weeks after the telemarketing call.

13. In 1998, the Commission challenged the free trial-period marketing practices of three Internet Service Providers ("ISPs"). The Commission alleged that the ISPs failed to disclose adequately that consumers who do not cancel free Internet services during a 30-day trial period would incur charges on their credit cards (the consumers provided their credit card numbers to the ISPs to initiate the free trial periods). The consent orders require the ISPs to disclose clearly and prominently any obligation to cancel the service in order to avoid being charged, and to provide at least one reasonable means of canceling. *See America Online, Inc.*, No. C-3787, *Prodigy Servs. Corp.*, No. C-3788, and *CompuServe, Inc.*, No. C-3789 (Mar. 16, 1998).

14. Chairman Muris' remarks can be found at www.ftc.gov/speeches/muris/privisp1002.htm.

15. 16 C.F.R. Part 310. As with any rulemaking, the Commission will carefully consider the record developed during the proceeding before making a final decision.

16. The press release announcing the "Ditch the Pitch" cases is at www.ftc.gov/opa/2001/10/ditch.htm.

17. *FTC v. American Consumer Membership Services, Inc.*, No. 99 CV 1206 (N.D.N.Y.) (complaint filed Aug. 5, 1999).

18. These publications are available at www.ftc.gov/bcp/conline/pubs.

19. Recently issued voluntary self-regulatory guidelines also may help address and prevent deception and consumer confusion over negative option marketing practices, as well as the use of pre-acquired account information. On October 14, 2001, the Electronic Retailing Association's board approved industry self-regulatory guidelines that address negative option marketing (called advance consent marketing by the industry), made compliance with them a condition of membership, and advised members not to do business with other companies not adhering to the guidelines. In addition, the Magazine Publishers Association and companies such as Time-Life have formally adopted the guidelines, and it appears that other companies and associations also may do so. These guidelines explain the disclosures that are required for various types of negative option marketing (*e.g.*, automatic renewals, free trial offers) and advise sellers "to be sensitive to the privacy concerns of consumers and regulators in connection with the use and disclosure of consumers' account billing information." The guidelines further provide that "sellers and their agents and their service providers should not transfer a consumer's account billing information to any unaffiliated third party other than a billing or processing agent without the consumer's express authorization." We are hopeful that as the self-regulatory guidelines become more widely known and adopted, they will have a significant impact on industry practices and reduce consumer confusion and complaints about negative option marketing techniques. The guidelines are available at www.retailing.org.

Prenotification Negative Option Plans

You see the ads on TV, in magazine and newspaper inserts, and on the Internet: "5 Books for $1," "10 CDs for FREE," or "4 Videos for 49¢ each." By joining some of the clubs that are offering these deals, you may become a member of a "prenotification negative option plan." That means you are agreeing to receive merchandise automatically unless you tell the club not to send it.

How Prenotification Plans Work

Often, you can join a plan simply by accepting an introductory offer of some merchandise, often at a discounted price. Then, you pay full price for additional merchandise.

Joining a plan means you agree to the plan's sales method as long as you're a member. As a plan member, you will receive periodic announcements describing merchandise that you can buy. These announcements are important because the merchandise is sent to you automatically unless you return the form rejecting the offer within the specified time.

Each time you receive an announcement, you have two choices:

> A. If you want the merchandise, do nothing. It will be sent automatically. Some plans require you to pay for the merchandise when you get it. Other plans send the merchandise "on approval,"which means you can try it for a specified period. If you return the merchandise, you don't have to pay for it.
>
> OR
>
> B. If you don't want the merchandise, you must say so and return the rejection form included with the announcement within a specified time, usually 10 days. Make sure you follow the instructions on the form. Some plans also let you use the rejection form to order other merchandise.

The Prenotification Negative Option Rule

The Federal Trade Commission enforces the Prenotification Negative Option Rule. The Rule requires companies to give you information about their plans, clearly and conspicuously, in any promotional materials that consumers can use to enroll. If the sales presentation for a plan is made orally, say on the phone, the terms and conditions still must be disclosed clearly and conspicuously during the presentation. For example, companies must tell you:

- whether there's a minimum purchase obligation;
- how and when you can cancel your membership;
- how many announcements and rejection forms you'll receive each year, and how often you'll receive them;

- how to reject merchandise;
- the deadline for returning the rejection form to avoid shipment of the merchandise; and
- whether billing charges include postage and handling.

Minimum Purchase Obligations and Canceling Memberships

Some plans require that you buy a certain amount of merchandise at the club's regular prices. If that's the case, the minimum purchase obligation must be disclosed clearly and conspicuously. Once you've satisfied the minimum purchase requirements, you can cancel your membership. If the club has no minimum purchase obligation, you can cancel your membership any time.

If you want to cancel your membership, send your request in writing. The company must cancel your membership promptly. If the company sends additional merchandise after receiving your written cancellation notice, you need to return the first item that is sent. You may consider any additional shipments as unordered merchandise and keep them as a gift.

However, to avoid dunning notices, it's best to tell the company that you're no longer a member each and every time you receive unordered merchandise. You can do that by sending the company a copy of your cancellation letter.

Announcements and Rejection Forms

The company must tell you how often and how many announcements and rejection forms you'll receive each year and how often you will receive them. The company also must tell you whether billing charges for each item include postage and handling.

The rejection form comes with, or is a part of, the announcement. In some plans, the rejection form can be used to decline merchandise and to choose a different item. The announcement must give you at least 10 days to decide if you want the merchandise and mail back the form. The form includes a "return date" B the date the form must be received by the company, **or** a "mailing date" B the date you must mail the form to the company. No matter which date the company uses, you have at least 10 days to respond.

If you don't get at least 10 days, and you receive an unwanted shipment, you can return the merchandise to the company for a full credit to your account. The company must pay for the return postage.

Bonus Merchandise

To attract new members, some companies advertise special introductory offers, like "5 Books for $1." By law, a company must ship the merchandise within 30 days of receiving your order. If the merchandise can't be shipped within that time, the company may offer you an equivalent alternative. If you don't want the alternative, you can cancel your membership. The company must honor your cancellation request, as long as you return the

introductory merchandise.

Another Type of Clubs or Plans

Some book, CD or video clubs may involve membership in another type of plan called a "Continuity plan." "Continuity plans" automatically send merchandise or provide services until you tell them to stop, without sending an announcement or a rejection form before each shipment. While these plans are **not** covered under the FTC's Prenotification Negative Option Rule, basic consumer protection principles apply: Sellers must give consumers information about the plan's terms and conditions, clearly and conspicuously, in their promotional materials.

Some continuity plans provide an "approval" period so you can check out the merchandise and decide whether to keep it and pay for it. Many programs selling collectibles, like stamps or coins, work this way. Other continuity plans require you to pay for merchandise when you receive it.

Protect Yourself

Before you agree to any prenotification plan:

Read the terms and conditions of the plan carefully so you understand the obligations of membership before you join.

Compare costs. The introductory merchandise may be substantially discounted but you may be required to buy additional merchandise at the club's regular prices and to pay shipping and handling on those purchases. Do the math to compare the club's prices and the shipping charges against those of other sellers.

Keep copies of plan documentation that explain the terms and conditions of the plan and the rejection forms you return to the seller. It's also a good idea to keep documentation of the date you mailed the rejection forms.

Check out the seller. Contact your local consumer protection agency or the Better Business Bureau to find out if they have any complaints on file. A record of complaints may indicate questionable practices, but a lack of complaints doesn't necessarily mean that the seller is without problems. Unscrupulous businesses or business people often change names and locations to hide complaint histories.

Where to Complain

If you have a problem with your plan, try to resolve it with the seller first. If you're dissatisfied with the response, contact your local Better Business Bureau or local consumer protection agency.

You also may file a complaint with the FTC.

The FTC works for the consumer to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint or to get free information on consumer issues, visit www.ftc.gov or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. The FTC enters Internet, telemarketing, identity theft and other fraud-related complaints into Consumer Sentinel, a secure, online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

FEDERAL TRADE COMMISSION	FOR THE CONSUMER
1-877-FTC-HELP	www.ftc.gov

May 2001

Trial Offers: The Deal Is in the Details

Chances are you've gotten offers to try a product or service through a "free trial." Companies use these offers to sell a variety of items, from books and CDs to videos, magazines, hosiery and Internet access. But as part of a trial offer, a company also must tell you if any conditions are attached to the deal.

The Federal Trade Commission (FTC) carefully monitors the marketing practices in this area and offers this information to help you make wise purchasing decisions. Be a savvy consumer: read the fine print and ask questions. Trial offers can be a great way to try new products or services without making a long-term commitment to a membership, subscription or extended service contract. But by accepting the free trial offer, you may be agreeing to buy additional products and services - if you don't cancel.

What Does "No Risks or Obligations" Really Mean?

A company may claim its free trial offer has no risk or obligation for the consumer. And that may be true, but only if you take timely action to avoid future obligations. For example, you may have to contact the company to cancel **during the trial period** to avoid receiving additional goods or services or to pay for what you've already received. By not canceling, you may be agreeing to let the company enroll you in a membership, subscription or service contract, and to charge the fees to your credit card.

How Conditional Trial Offers Work

Here are a few examples of conditional free trial offers:

- A company offers you an introductory package of free books, CDs or videos. If you accept the offer, you may be agreeing to enroll in a club that will send you the products and bill you **until you cancel**.
- A company offers you the first three issues of a magazine for free. Unless you cancel **after** receiving the third issue, you may be agreeing to a one-year subscription that is automatically renewed each year.
- A company offers you free Internet service for 30 days or 700 hours, whichever comes first (30 days = 720 hours). Unless you cancel **within** the 30-day period or **after** you use the 700 hours, you may be agreeing to pay for continuous Internet service.
- A company offers you a free pair of pantyhose. By accepting the offer, you may be agreeing to receive a second pair as well. You also may be agreeing that, if you keep and pay for the second pair, the company may ship you a third pair. This may continue **until** you tell the company to cancel your account.

Make Sure You Know Who's Selling What

Sometimes, you call a company for one reason and at the end of the transaction, you may be told about a trial offer that another company is offering. This is called upselling. If you receive such an offer, pay close attention to the terms and conditions. Make sure you understand **who** you're dealing with and **what** you're agreeing to. By accepting the trial offer, you may be agreeing to let the company you called in the first place give your credit card account information to another seller.

If you don't cancel **during** the trial period, your credit card may be charged by the second seller for the product or service offered for the trial period. If you don't recognize the seller, you may think the charge is an unauthorized transaction. In fact, by accepting the trial offer, you may have agreed to pay if you didn't cancel **before** the trial period ended.

It's The Law

According to the law, companies must clearly and prominently disclose the "material" terms of their trial offers before you give your consent. Material terms may include:

- the fact that by accepting the trial offer, you're actually agreeing to be enrolled in a membership, subscription or service contract or paying for additional products and services if you don't cancel **within** the trial period;
- how much time you have to cancel before you incur charges;
- the cost or range of costs of goods or services you'll receive if you don't cancel during the trial period;
- how to cancel **during** the trial period;
- whether you'll be charged a non-refundable membership fee if you don't cancel **within** the trial period;
- whether fees will be charged automatically to the credit card you used to buy other goods or services.

Protect Yourself

Trial offers are promoted through all kinds of media: newspaper and magazine ads, TV and radio commercials, direct mail, and the phone and Internet. In print ads and offers, the material terms may appear in fine print as a footnote at the bottom of a page, or on the back of the offer. Read the whole offer carefully before you decide whether it's a good deal for you. When offers are made orally - whether by radio, TV or on the phone - listen carefully to the message. If you don't understand the details, ask the caller to repeat the terms and conditions as many times as it takes until you get it. If you're not satisfied with the responses, consider taking your business elsewhere. Never give in to pressure to agree to a deal.

Here are some questions you may want to ask the seller:

- Is the free trial offer related to a membership, subscription or extended service

contract?

- Do I have to contact the company to avoid receiving more merchandise or services? If so, how much time do I have? What is my deadline?
- Who do I contact to cancel? How do I cancel? By letter? By phone? By email?
- Will I get other products with the free item? If so, will I have to pay for them or send them back if I don't want them? How long do I have to decide before incurring a charge?
- How do I stop getting additional merchandise or services?
- Is there a membership fee? If so, is it refundable?
- Will you automatically bill my credit card for anything?
- Who is offering the trial - you or another company? What is the name and address of the company?

Where to Complain

If you have a problem with a trial offer, try to resolve it with the seller first. If you're dissatisfied with the response, contact your local Better Business Bureau or local consumer protection agency.

You also may file a complaint with the FTC. The FTC works for the consumer to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint, or to get free information on any of 150 consumer topics, call toll-free, 1-877-FTC-HELP (1-877-382-4357), or use the complaint form at www.ftc.gov. The FTC enters Internet, telemarketing, identity theft and other fraud-related complaints into Consumer Sentinel, a secure, online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

The FTC works for the consumer to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint or to get free information on consumer issues, visit www.ftc.gov or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. The FTC enters Internet, telemarketing, identity theft and other fraud-related complaints into Consumer Sentinel, a secure, online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

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July 2001

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Web posted Thursday, May 8, 2003

Wireless feature requires opt-out from customers

ANCHORAGE (AP) ‹ ACS Wireless and MTA Wireless both recently added voice-activated dialing to their calling features, and are offering it free to customers for a trial period.

The tricky part, known as opt-out marketing, means if customers ignore the offer, they will end up paying $2 a month for it.

The practice is perfectly legal, according to the Federal Communications Commission, the agency that regulates wireless telephone companies. Cell phone companies can add calling features to customers' existing service plans and require them to opt-out of them as long as they clearly disclose the terms in writing and notify customers.

The add-on feature at issue allows customers to simply speak the name of the person being called rather than dial the number.

ACS Wireless, which introduced its Voice Connect service in early March, has twice sent out fliers tucked into monthly bills, notifying its 82,000 subscribers that they would automatically be billed for the new service unless they canceled it, according to Mary Anne Pease, a spokeswoman for the Anchorage-based company.

ACS is a unit of Alaska Communications Systems, which also provides local and long-distance phone service as well as Internet access.

ACS also did two mass mailings, sending postcards to customers advising them about the service and the need to opt out if they didn't want it, Pease said.

But Helen Clough, an ACS Wireless customer in Juneau, said she never saw the bill stuffers. And she nearly pitched the postcard in the trash because she thought it was junk mail.

On the outside of the card is a picture of an ACS Wireless phone with floppy dog ears and a tail. To the right of the picture it says, ŒŒStay? Want to keep Voice Connect? It's

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					1	2
3	4	5	6	7	8	9
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your choice."

Inside is more information about the Voice Connect service and a postage-paid form to mail if you want to opt out.

ŒŒIt's totally deceptive," Clough said. ŒŒThere's nothing on the outside to indicate that money's involved."

MTA Wireless also has sent bill stuffers to its roughly 8,000 customers from Talkeetna to Eagle River, as well as a letter describing the service, which it calls Talk to Me VoiceDial, company spokeswoman Jackie Whitstine said.

MTA Wireless is a unit of Matanuska Telephone Association, which also provides regular phone and Internet service.

The letter, mailed in a regular MTA envelope, also includes an opt-out form that can be mailed back with your next phone bill.

Both companies are providing the service in partnership with an outfit called Preferred Voice, which supplies the computer hardware, software and billing systems that make it work. Neither ACS nor MTA is bearing any of those costs. Dallas-based Preferred Voice takes a cut of the fees for the service.

Mary Merritt, Preferred Voice's vice president of finance, said the company requires most of its customers to use opt-out marketing.

ŒŒIt's so we get a return on the investment in our technology," she said.

The free trial period for ACS Wireless' voice-activated dialing service is over at the end of May. June 14 will be the end of MTA's free-use period.


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Like it or not, you may be paying for wireless feature

VOICE-ACTIVATED DIALING: Customers must tell ACS, MTA they don't want it.

By RICHARD RICHTMYER
Anchorage Daily News
(Published: May 2, 2003)

It may look like more junk mail from your cell phone company, but if you toss it away without looking at it, you might unwittingly be signing up and paying for a calling feature you don't want.

ACS Wireless and MTA Wireless both recently added voice-activated dialing to their calling features, making it available to all their customers free for a trial period. But at the end of the trial period, the onus is on customers to notify the company if they don't want to pay $2 a month for the new feature, not if they do.

That practice, known as opt-out marketing, is perfectly legal, according to the Federal Communications Commission, the agency that regulates wireless telephone companies.

As long as they clearly disclose the terms in writing and notify customers in a timely fashion, cell phone companies may add calling features to their customers' existing service plans and require them to opt out if they don't want them, an agency spokeswoman said.

The add-on feature at issue allows customers to simply speak the name of the person being called rather than dial the number.

ACS Wireless, which introduced its Voice Connect service in early March, has twice sent out "bill stuffers" -- fliers tucked in with the monthly bill -- notifying its 82,000 subscribers throughout the state that they would automatically be billed for the new service unless they canceled it, according to Mary Anne Pease, a spokeswoman for the Anchorage-based company. ACS is a unit of Alaska Communications Systems, which also provides local and long-distance phone service as well as Internet access.

ACS also did two mass mailings, sending postcards to customers advising them about the service and the need to opt out if they didn't want it, Pease said.

But Helen Clough, an ACS Wireless customer in Juneau, said she never saw the bill stuffers. And she nearly pitched the postcard in the trash because on the surface, she thought it looked like junk mail.

On the outside of the card is a picture of an ACS Wireless phone with floppy dog ears and a tail. To the right of the picture it says, "Stay? Want to keep Voice Connect? It's your choice."

You have to break a seal to open the card. Inside are more information about the Voice Connect service and a postage-paid form to mail if you want to opt out.

"It's totally deceptive," Clough said. "There's nothing on the outside to indicate that money's involved. It's like it was specifically designed so that you wouldn't see it."

MTA Wireless also has sent bill stuffers to its roughly 8,000 customers from Talkeetna to Eagle River, as well as a letter describing the service, which it calls Talk to Me VoiceDial, company spokeswoman

Jackie Whitstine said.

MTA Wireless is a unit of Matanuska Telephone Association, which also provides regular phone and Internet service.

The letter, mailed in a regular MTA envelope, also includes an opt-out form that can be mailed back with your next phone bill.

Both companies are providing the service in partnership with an outfit called Preferred Voice, which supplies the computer hardware, software and billing systems that make it work. Neither ACS nor MTA is bearing any of those costs. Dallas-based Preferred Voice takes a cut of the fees for the service.

Mary Merritt, Preferred Voice's vice president of finance, said the company requires most of its customers to use opt-out marketing.

"It's so we get a return on the investment in our technology," she said.

The technology is expensive to deploy, and without a critical number of customers it wouldn't pay for itself, she said.

ACS believes customers will like the feature if only they'll try it, Pease said. As is often true with new technology, getting people to sample it can be a challenge. That's why ACS decided to give customers a free trial, she said.

Wireless companies that choose not to go with the opt-out plan have to make a large, upfront payment and agree to make fixed monthly payments to Preferred Voice, according to Merritt.

"It would have required a huge investment on their part, which might have prevented them from providing the service at all," she said.

This was the first time ACS has used opt-out marketing, and it caused enough of a backlash among customers to make it the last, according to Pease.

"The intent was to get new technology out into the marketplace, not to get people to pay for something they don't want to use," she said. "This is not the way we'll be introducing new features in the future."

The free trial period for ACS Wireless' voice-activated dialing service is over at the end of May. On Wednesday, Pease said the only way to avoid the $2 a month fee is to contact ACS and opt out. But on Thursday she said only customers who have tried Voice Connect will need to opt out to avoid the fee. Those who have not used it will not be billed, she said.

MTA used the opt-out method recently when it introduced a service used to screen out junk e-mail. The company will continue to use the technique but will do so judiciously, Whitstine said.

"We feel like it's still a very valuable method for us, but we want to be very careful in what features we deploy like this," she said.

June 14 will be the end of MTA's free-use period, and all customers, whether they tried the voice dialing feature or not, will need to opt out if they don't want it, Whitstine said.

At the end of this month, the company will send a second letter reminding customers that they must opt out if they don't want the service. It will be delivered in an envelope with the words "Important Account Information" printed on the front, Whitstine said.

MTA also will offer up to six months' credit to customers who neglect to opt out because they were

not aware that they had to, she said.

Daily News reporter Richard Richtmyer can be reached at rrichtmyer@adn.com or 257-4344.

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State of Alaska

Department of Law

Gregg D. Renkes
Attorney General
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Juneau, Alaska 99811

NEWS RELEASE

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FOR IMMEDIATE RELEASE: October 28, 2003

STATE FILES SUIT AGAINST ACS FOR UNFAIR BUSINESS PRACTICES

(Juneau, AK) – Attorney General Gregg Renkes filed a complaint against ACS Wireless and its holding company, ACS Communications, Inc. for violations of Alaska Consumer Protection Act in connection with ACS' promotion of its "Voice Connect" wireless product earlier this year.

ACS promoted the new service through a "negative option" or "opt out" campaign, which required customers to notify the company if they did not want it. The company automatically billed customers $2.00 if they failed to notify ACS that they did not want "Voice Connect" by the required deadline. The charge continued each month until the customer cancelled the plan.

"Consumers should never have to pay for a product or service not expressly requested by the consumer," said Attorney General Gregg Renkes. "These types of marketing tactics are inherently deceptive and open the door for a variety of consumer abuses. We want to make it clear that this kind of marketing will not be tolerated in Alaska."

The state's complaint asks the court to prohibit ACS from engaging in this kind of opt-out marketing in the future. It also asks the court to make ACS give refunds to consumers who were signed-up for "Voice Connect" as a result of this marketing tactic and pay the state civil penalties of $5,000 for each consumer who was a target of this conduct.

Alaska Communications Systems Group, Inc. (ACS) provides long distance and facilities-based local telephone, wireless, data, network, and Internet services throughout Alaska. The Anchorage-based company serves residents in 74 communities throughout the state, including Anchorage, Fairbanks, Juneau, Kenai/Soldotna, Kodiak, and Sitka. It sells services to three-fourths of the state's population.

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Free trial offers: Are they actually good deals?

By AL TOBIN
Better Business Bureau

Free trial offers are used by many companies to sell everything from books to CDs, from magazines to Internet access. Trial offers can be a great way to try out new products or services without making a long-term commitment. You should be aware, however, that by accepting a free trial offer, you might be agreeing to buy additional products and services, *if* you do not cancel within a specified period of time.

Trial offers can be a great way to try out new products or services without making a long-term commitment. You should be aware, however, that by accepting a free trial offer, you might be agreeing to buy additional products and services if you do not cancel within a specified period of time.

Before you accept a free trial offer, be sure you know what your obligations will be. For example you may have to contact the company to cancel *during the trial period* to avoid receiving goods or services or to avoid paying for what you have already received. By not canceling, you may be agreeing to let the company enroll you in a membership, subscription or service contract, and to charge the fees to your credit card.

Pay close attention to the "material" terms advertisers use. According to the law, companies must clearly and prominently disclose the material terms of their trail offers *before* you give your consent. Material terms may include:

• how much time you have to cancel before you incur charges;

• the fact that by accepting the trial offer, you are actually agreeing to be enrolled in a membership, subscription or service contract or agreeing to pay for additional products and services if you do not cancel within the trial period;

• the cost or range of costs of goods or services you will receive if you do not cancel during the trial period;

• how to cancel during the trial period;

• whether you will be charged a non-refundable membership fee if you do not cancel within the trial period; and,

• whether fees will be charged automatically to the credit card you used to buy other goods or services.

Trial offers are promoted through all types of media: newspaper and magazine ads, TV and radio commercials, direct mail, and the phone and Internet. In print ad offers, the material terms may appear in fine print as a footnote at the bottom of a page, or on the back of the offer. To protect yourself, read the entire offer carefully before you decide whether it is a good deal for you. When offers are made orally – whether by radio, TV or on the phone – listen carefully to the message. If you do not understand the details, ask the caller to repeat the terms and conditions as many times as it takes until you understand. Or, ask them to send you the terms and conditions in writing. Never give-in to pressure to agree to a deal.

The BBB, along with the Federal Trade Commission, suggest you ask the following questions:

• Is the free trial offer related to a membership, subscription or extended service contract?

• Do I have to contact the company to avoid receiving more merchandise or services?

• Who do I contact to cancel?

• Will I receive other

page 32 please

Free trial offers . . .

continued from page 26

products with the free item? If so, will I have to pay for them or send them back if I do not want them? How long do I have to decide before incurring a charge?

• Is there a membership fee? If so, is it refundable?

• Will you automatically bill my credit card for anything?

• Who is offering the trial – you or another company? What is the name and address of the company?

If you have a problem with a trial offer, try to resolve it with the seller first. If you are dissatisfied with the response, contact the Better Business Bureau (www.bbb.org), Federal Trade Commission (www.ftc.gov) or your local consumer protection agency.

Al Tobin is chief executive officer for Better Business Bureau of Alaska, Inc.

The Post and Courier
CHARLESTON.Net

FTC gets complaints of negative options gone wild

BY DAVID S. HILZENRATH
The Washington Post

Timothy Cain of Rochester, N.Y., said he was trying to simplify his Christmas shopping last winter when he visited the Web site of "Girls Gone Wild" and bought a pair of videos for his brother for $9.99 plus shipping. He was incensed, though, when additional videos started arriving monthly, along with $24.98 in charges on his credit card.

Unwittingly, he had purchased a subscription, Cain said, a fact that was "hidden" in the Web site.

The videos' producer, Mantra Films Inc., uses an increasingly common marketing strategy known as a "negative option," which requires the consumer to take action to avoid continuing charges. The video series, in which spring break revelers expose themselves for roving cameras, has become a hot seller.

Negative options can be a convenience for consumers, but they are also "ripe for abuse," said Reilly Dolan, assistant director for enforcement in the Federal Trade Commission's bureau of consumer protection. Over the past two years, complaints to the FTC about unordered merchandise have increased by 60 percent, and negative-option marketing accounts for a significant part of that, he said.

Cain filed a complaint with the Better Business Bureau, one of 843 grievances about Mantra filed over the past three years, according to William Mitchell, president of the BBB chapter in the Los Angeles area, where Mantra is based.

The Experian credit reporting bureau's ConsumerInfo.com subsidiary has been the subject of 960 complaints to the BBB over the same time period, Mitchell said, and the bureau revoked ConsumerInfo.com's membership in 2001 when it refused to improve disclosures.

The related FreeCreditReport.com site offers a "FREE credit report in seconds" and adds: "So what's the catch? There isn't one!" But many consumers who took advantage of the offer didn't realize they were enrolling in a credit monitoring service until the annual $79.95 charge showed up on their credit card statements, a BBB report said.

Under federal consumer protection standards, marketers must disclose significant terms of a transaction in a "clear and conspicuous" fashion. "Whether a disclosure meets this standard is measured by its performance -- that is, how consumers actually perceive and understand the disclosure within the context of the entire ad," an FTC guidance says.

The "Girls Gone Wild" subscription feature is discussed deep in a "Terms and Conditions" section of the videos' Web site, and it is possible to order the merchandise without ever seeing that text.

"I think it's extremely misleading," said the BBB's Mitchell. "It's fairly obvious that the whole thing is set up to rope people into this automatic reorder program and then of course make it difficult to extricate yourself from that situation."

Asked recently why the company doesn't disclose the terms more conspicuously, Mantra spokesman Bill Horn said, "We are going to evaluate it, and we're sure to make some changes.

"While Mantra feels that the monthly subscription service aspect of Web-based ordering is clear for consumers, you have made some interesting points about how some consumers may be confused or may choose not to read the terms of the sale," Horn said.

The FTC occasionally takes action against companies for inadequate disclosure of negative options. In 1997, it accused America Online of failing to make clear that consumers would automatically be charged for continuing service if they didn't cancel before their free trials ended. AOL settled the case by agreeing to make clearer disclosures.

Last November, the FTC alleged that marketers of books such as "Best of Martha Stewart" and "Southern Living Christmas" failed to properly disclose the negative-option feature of offers made through mail and phone solicitations. Oxmoor House and its parent, Southern Progress Corp., agreed to pay penalties of $500,000 to settle an FTC complaint.

The company agreed to change the wording in its offers, but Southern Progress spokeswoman Laura Hardin said there was "nothing legally wrong with the way we market the books."

The subscription aspect of the ConsumerInfo.com program is explained in small print under the heading "Privacy Policy Notice" after the consumer fills out two screens of ordering information.

Why isn't the disclosure displayed up front on the site? "You can't put everything on one page," Experian spokesman Donald Girard replied. "I think the font type would be so small that you would not really get the message across very clearly."

The terms are more prominently displayed on another Experian Web site

advertising similar services.

ConsumerInfo.com, which has 1.2 million subscribers, takes the complaints seriously and resolves most of them quickly, Girard said.

As for Mantra, Horn said, the number of complaints about "Girls Gone Wild" doesn't show a huge percentage of unhappy customers, considering the millions of videos sold annually.

In a December television interview, Mantra founder and Chief Executive Joseph Francis, 30, said the company had sold "tens of millions" of videos "and sales have been in the hundreds of millions."

Despite his frustration with the company, Cain expressed admiration for its money-making power. "It's a thing of beauty if you look at it from the other side," he said. "It's just very rigged in their favor."

Mantra said Cain had to return the goods to get his money back, but would not refund the $4.99 shipping and handling charge.

On Mantra's online order form, the "Agree to Terms" box is automatically checked -- as a convenience, Horn said. Only by clicking on the word "Terms" would the consumer see them. Section 8A of the terms says, "Certain products offered by Mantra consist of a subscription," but the site does not explicitly say which ones.

Elsewhere on the site are references to a "MONTHLY PREVIEW PROGRAM" with the notation "CANCEL ANY TIME," but Horn agreed those references alone don't explain the negative option, and one could place an order without ever seeing them.

A BBB report on Mantra suggested recipients of unordered merchandise dispute unauthorized charges with their credit card issuer.

The report also noted that, under federal law, consumers are entitled to keep unordered merchandise without paying for it.

Click here to return to story:
http://charleston.net/stories/051203/bus_12marketing.shtml

HB

340

REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

MEMORANDUM

DATE: March 24, 2004

TO: Senator Ralph Seekins
Chairman, Senate Judiciary Committee

FROM: Representative Kevin Meyer

RE: CS HB 340 (JUD)am Dam Construction Claims

At your earliest convenience, please schedule CS HB 340 (JUD)am Damages in Construction Claims for a hearing in the Senate Judiciary Committee.

CS HB 340 (JUD)am places a limit on the damages that can be awarded in a construction defect lawsuit to the actual cost of fixing the defect and other closely related costs.

CS HB 340 (JUD)am provides that the limitation on damages does not apply if the defect was caused by gross negligence or reckless or intentional misconduct by the construction professional.

Thank you for your time and consideration of this request.

Email: Representative_Kevin_Meyer@legis.state.ak.us • Toll Free: (866) 465-4945
Session: State Capitol, Juneau, Alaska 99801-1182 • Phone: (907) 465-4945 Fax: (907) 465-3476
Interim: 716 W. 4th Ave., Anchorage, Alaska 99501-2133 • Phone: (907) 269-0199 Fax: (907) 269-0197

REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

SPONSOR STATEMENT

CS HB 340 (JUD)am

"An Act relating to damages in an action for a defect in the design, construction, and remodeling of certain dwellings; and providing for an effective date."

CS HB 340(JUD)am Damages in Construction Claims places a limit on the damages that can be awarded in a construction defect lawsuit to the actual cost of fixing the defect and other closely related costs. This bill does not apply to, limit, or otherwise affect lawsuits alleging personal injury or wrongful death resulting from construction defects.

Beginning in 2001, a disturbing trend among insurance carriers developed that is impacting the housing industry nationwide, but particularly in Alaska. Construction professionals are paying significantly higher insurance premiums for statutorily required general liability insurance. Under AS 08.18, a contractor must file with the State of Alaska satisfactory evidence that the applicant has public liability and property damage insurance covering the applicant's contracting operations in this state.

Coupled with the rising costs in mandatory insurance, contractors and subcontractors are also facing a decline in policy availability and number of insurance carriers in the state of Alaska. If a construction professional is able to find affordable insurance, often the policy is limited in coverage, and generally excludes coverage for any claims arising out of a construction defect.

The cause of these difficulties is the increase in construction defect litigation. Insurance carriers are passing expenses incurred due to these lawsuits on to construction professionals in the form of increased premiums. Insurance carriers are pulling out of the Alaska residential construction market, thus making it difficult to obtain required liability insurance.

CS HB 340(JUD)am provides a working solution to the cost of general liability insurance and availability of quality insurance providers in Alaska. By establishing a limit on the amount of damages that may be recovered in a construction defect lawsuit, insurance carriers can see that Alaska is working towards establishing a less risky insurance environment. The passage of CS HB 340(JUD)am will create an incentive for national carriers to return to Alaska and provide construction professionals with a break in the cost of mandated insurance.

Last Updated: February 19, 2004

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REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

SECTIONAL ANALYSIS

CS HB 340 (JUD)am

"An Act relating to damages in an action for a defect in the design, construction, and remodeling of certain dwellings; and providing for an effective date."

Section 1: Provides that a homebuilder must provide notice of limitations to a homebuyer under AS 09.45.893(c).

Section 2: Repeals and reenacts AS 09.45.895. Provides that a construction defect lawsuit covered under AS 09.45.881-09.45.899, is limited to the following damages:

1. The reasonable cost of repairs to cure the defect or actual damages caused by the construction defect;
2. The reasonable temporary housing expenses, if any, during the repair of the defect;
3. The reduction in market value, if any, caused by the construction defect; and
4. The reasonable and necessary attorney fees and costs.

Provides that the limitation on damages does not apply if the defect was caused by gross negligence or reckless or intentional misconduct by the construction professional.

Section 3: Applicability

Section 4: Effective Date

Last Updated: February 19, 2004

Email: Representative_Kevin_Meyer@legis.state.ak.us • Toll Free: (866) 465-4945
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REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

MEMORANDUM

DATE: March 24, 2004

TO: Senator Ralph Seekins
Chairman, Senate Judiciary Committee

FROM: Representative Kevin Meyer

RE: CS HB 340 (JUD)am Dam: Construction Claims

HB 340 was amended on the House Floor. The House of Representatives adopted the following changes:

Page 1, line 27:
After: "attorney fees"
Insert: "and costs."
Explanation: This amendment was accepted so that it was clear that any costs associated with an attorney and courts may be awarded and not limited.

Page 3, line 3:
After: "satisfy the claim"
Delete: "or"
Insert: ", or any amount the claimant is required to repay under the terms of the homeowner's warranty contract or homeowner's insurance policy"
Explanation: It is not unusual for a homeowner's policy to include a subrogation clause. A subrogation clause requires a policyholder to repay the insurance company the amount that the insurance company gave the policyholder after a claim was filed and damages were awarded in an action brought forth by the homeowner.

Currently in statute, the court was required to deduct the amount, if any, the claimant had received from the insurance company after filing a claim. This amendment provides that if a homeowner has a subrogation clause on their homeowner's insurance policy, and a court awards damages, then the court may not deduct from the award the amount the homeowner received from the insurance company.

There were no additional changes to CS HB 340 (JUD)am in the Senate Labor and Commerce Committee.

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FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 340(L&C)
(H) Publish Date: 1/26/04

Revision Date/Time (Note if correction):
Dept. Affected: DCED
Title: Damages In Construction Claims
RDU: Occupational Licensing (117)
Component: Occupational Licensing
Sponsor: Representative Meyer
Requester: Labor & Commerce
Component No.: 2360

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation relates to claims and court actions for defects in the design, construction, and remodeling of certain dwellings, and limits when certain court actions may be brought; it has no impact on the Department.

Prepared by: Rick Urion, Director — Phone (907) 465-2538
Division: Occupational Licensing — Date/Time 1/21/04 12:29 PM
Approved by: Edgar Blatchford, Commissioner — Date 1/21/2004
Agency: Department of Community & Economic Development

AS 09.45.893. Notice required in contract.

(c) The notice required by (a) of this section must be conspicuous and must be in substantially the following form:

ALASKA LAW AT AS 09.45.881-09.45.899 CONTAINS IMPORTANT REQUIREMENTS THAT YOU MUST FOLLOW BEFORE YOU MAY FILE A COURT ACTION FOR DEFECTIVE DESIGN, CONSTRUCTION, OR REMODELING AGAINST THE DESIGNER, BUILDER, OR REMODELER OF YOUR HOME. WITHIN ONE YEAR OF THE DISCOVERY OF A DESIGN, CONSTRUCTION, OR REMODELING DEFECT, BEFORE YOU FILE A COURT ACTION, YOU MUST DELIVER TO THE DESIGNER, BUILDER, OR REMODELER A WRITTEN NOTICE OF ANY DESIGN, CONSTRUCTION, OR REMODELING CONDITIONS YOU ALLEGE ARE DEFECTIVE IN ORDER TO PROVIDE YOUR DESIGNER, BUILDER, OR REMODELER WITH THE OPPORTUNITY TO MAKE AN OFFER TO REPAIR OR PAY FOR THE DEFECTS. YOU ARE NOT OBLIGATED TO ACCEPT ANY OFFER MADE BY THE DESIGNER, BUILDER, OR REMODELER. THERE ARE STRICT DEADLINES AND PROCEDURES UNDER STATE LAW, AND FAILURE TO FOLLOW THEM MAY AFFECT YOUR RIGHT TO FILE A COURT ACTION.

AS 09.45.895. Collateral sources. In an action under AS 09.45.881-09.45.899, a court shall deduct from the compensation awarded to a claimant any compensation paid to the claimant under a homeowner's warranty contract or a homeowner's insurance policy as compensation for the defects that are the subject of the action. The amount of this deduction does not include any compensation paid by the construction professional to the claimant to satisfy the claim or any compensation paid under an insurance policy issued to the construction professional to satisfy the claim.

NAHB
NATIONAL ASSOCIATION OF HOME BUILDERS

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CIVIL JUSTICE REFORM

Civil Justice Reform is needed to counter the detrimental impact that increased costs of litigation have had on the housing industry. Civil Justice Reform has several key components, including class action reform and state notice & opportunity to repair laws. With respect to class actions, High Production Builders and affiliate members may be subject to class action lawsuits in the context of a product defect case. Class action lawsuits are subject to widespread abuse by trial attorneys and individual plaintiffs, resulting in costly and unfair settlements, skyrocketing insurance premiums, and unreasonable attorneys fees, with little benefit to consumers. The state notice & opportunity to repair laws create a system that requires homeowners to notify builders of alleged construction defects before commencing litigation. The process gives builders the opportunity to inspect the defects and offer to repair the defects or to settle the claim via monetary payment. The legislation's intent is to resolve disputes between builders and consumers without having to resort to time consuming and costly litigation.

On June 12, 2003 the House approved H.R. 1115, the "Class Action Fairness Act of 2003." The bill was approved by a vote of 253 to 170, with 32 Democrats voting for the legislation. NAHB sent a letter to the entire House in support of the bill and placed calls to Democrats who were undecided on the day of the vote. One amendment was adopted by voice vote on the House floor. The amendment broadens the category of class action cases that would remain in state court. The amendment was a compromise that mirrored an amendment authored by Senator Diane Feinstein (D-CA) and adopted by the Senate Judiciary Committee during its mark up of the Senate version of the class action bill. The adoption of the amendment increases the chance that the bill will move through the Senate and be passed into law. Supporters of the bill claim that reform is needed to curb the trend of "forum shopping," a practice in which class action cases are being filed in state courts that are known for awarding large settlements.

Provisions of the amendment adopted on the House floor:

- Raises the aggregate amount in controversy required for federal court jurisdiction from $2 million to $5 million.
- If less than one-third of the plaintiffs are citizens of the same state, the case is automatically eligible for federal court jurisdiction under the new diversity rules in this bill.
- If between one-third and two-thirds of the plaintiffs are citizens of the same state as the primary defendants, the federal courts have the discretion, after weighing five factors, to determine if the case is appropriately of a local character and return intrastate class actions to state court.
- If more than two-thirds of the plaintiffs are citizens of the same state, the case remains in state court and is not subject to the new rules contained in this bill.
- If there are fewer than 100 plaintiffs, the case remains in state court.

The amendment substantially changed the reach of the original bill. NAHB is currently assessing the amendment, and its impact on our members, in anticipation of the Senate's review of the bill.

Senate Majority Leader Bill Frist (R-TN) has indicated that he is planning to bring class action reform legislation to the Senate floor for a vote sometime in this Fall. S. 274, the "Class Action Fairness Act of 2003", was reported out of the Senate Judiciary Committee in April. The bill is similar to the House passed class action bill, H.R. 1115.

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NAHB
National Association of Home Builders

Civil Justice Reform

NAHB worked with a consultant to gather data to help identify the underlying liability problems facing the building industry and to develop potential solutions that may address these problems. Further, a review was conducted of the constitutionality/legality and political feasibility of various tort reform options. This information enabled NAHB to develop and adopt a resolution on civil justice (tort) reform at the 2003 Spring Board of Directors meeting.

Efforts this year to advance Notice & Opportunity to Repair legislation have scored notable success, with 12 states passing new laws and others still considering them. As of October 20, 2003 notice and opportunity to repair legislation has been signed into law in 2003 by the governors of twelve states (Alaska, Colorado, Florida, Idaho, Indiana, Kansas, Kentucky, Montana, Nevada, Oregon, South Carolina, and West Virginia). Texas' major construction reform bill, which adds to their existing dispute resolution process, was signed by the governor on June 20. The new law includes building standards, which eliminates existing implied warranties, but creates a specific statutory warranty of habitability. NOR bills are still active in several states.

NAHB continues to work with national organizations of elected and appointed public officials that are considering reform of the nation's tort liability system.

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NAHB Web Resources

www.nahb.org

Civil Justice Reform

Alaska State Chamber of Commerce

2004 Position

Amend the Tort Laws and Regulations

The Alaska State Chamber of Commerce supports amending tort laws and regulations to reduce the number of wasteful law suits and exorbitant settlements and awards that cause insurance rates to climb and businesses to become less competitive in Alaska.

INSURANCE JOURNAL
The Property Casualty Magazine

AIA Says Colo. Bill Provides Relief from Construction Defect Lawsuits

April 22, 2002

A bill making its way through the Colorado House would limit the damages available for civil actions arising out of construction defects and should be enacted as quickly as possible, according to the Alliance of American Insurers.

An amended version of the bill (HB 1398) passed in committee earlier this month. It would require a claimant to file a list of construction defects, limit civil damages, prohibit non-economic damages except for bodily injury or wrongful death and prevent suits for negligence where a building violation has been alleged unless the claimant can show actual loss or damages. Claimants would be entitled to reasonable costs of repairs and temporary housing, the reduction of market value, reasonable value of loss, reasonable attorney fees, additional costs incurred including expert fees and interest as permitted by law.

The introduced version of the bill applied to residential construction defect claims. However, the amended version eliminates the word "residential," extending the bill to all construction defect claims.

"This is a good bill because it is aimed at reducing the costs of construction defect litigation, which may help provide some relief to insurers and construction professionals in Colorado," Sarah White, a policy manager in the Alliance's property/casualty department.

Colorado is one of several states tackling the problem construction defect lawsuits are causing, she noted. "Washington Gov. Gary Locke (D) recently signed into law SB 6049, which establishes an alternative dispute resolution procedure, giving aggrieved parties other options besides litigation in these situations."

Construction defect lawsuits are a growing problem for contractors in many western states. Because of the increased amount of expensive litigation, insurers have either stopped writing policies to cover contractors, or have been forced to price the policies at rates up to 10 times higher than prior coverage.

"The issue of construction defect lawsuits is of major concern to our industry," White remarked. "Courts have been struggling with the definition of what constitutes a construction defect and whether or not they fall within the coverage of commercial general liability (CGL) policies. We believe CGL policies weren't intended as warranties.

"Many lawyers see this as another class-action shopping spree, and they are suing every contractor and subcontractor they can find, trying to get insurers to foot the bill. I've seen reports of one case that involved 20 contractors and 50 lawyers that ran for 22 weeks. The courts have been inundated by these lawsuits."

URL: www.insurancejournal.com/news/newswire/west/2002/04/22/17507.htm

LAS VEGAS REVIEW-JOURNAL • reviewjournal.com

Tuesday, July 02, 2002

INSURANCE CRISIS: Builders voice concerns

Defect lawsuits blamed for rise in coverage costs

By HUBBLE SMITH
REVIEW-JOURNAL

Hundreds of trade contractors Monday blamed an increase in frivolous construction defect litigation for an "insurance crisis" that threatens to cripple Nevada's home building industry.

"This situation has gripped the industry for several years and continues to get worse," said Steve Hill, president of Silver State Materials and chairman of the Coalition for Fairness in Construction, a group that was recently formed to lobby for legislative reform.

Hill was one of several hundred contractors who jammed the Sawyer State Building Monday to testify, via videoconference, before Nevada Insurance Commissioner Alice Molasky-Arman about the availability and cost of construction liability insurance.

More industry officials attended the hearings in Carson City.

The crisis is driving up the median price of a new home in Las Vegas, which is currently at $187,000 and expected to top $200,000 by the end of the year. Home builders estimate that 1,400 potential buyers are priced out of the market for every $1,000 increase in price.

Additionally, Hill said, with construction jobs accounting for about 10 percent of Nevada's work force, the state can expect to see a rise in unemployment if this issue isn't resolved.

Robert Lewis, whose family has built 25,000 homes in Las Vegas since 1961, said one of the reasons he sold his company to KB Home in 1999 was the "hostile environment" for home builders resulting from construction defect litigation and the inability to get insurance.

"I always viewed insurance as a necessity to do business," he said. "Agents may have sold me more insurance than I needed, but it provided our company and our customers comfort and ease of mind."

Lewis said insurance coverage, when available, was not only expensive but

often limited. And instead of having choices, it became a take-it-or-leave-it proposition.

"I really don't blame the carriers since they too have become a victim of our litigious society," he said.

Bruce King, president of Pete King drywall and painting in Las Vegas and Arizona, testified that his insurance rates have gone from $161,000 a year in 1999 to $1.4 million that he expects to pay in August.

"Some people say it's because of September 11, but these insurance companies are not only raising their rates, they're leaving the state of Nevada," King said.

Builders would receive four to eight rate quotes just two to three years ago, whereas today they're lucky to get one or two quotes, said Mark Tomlinson, president of the Southern Nevada Home Builders Association.

Molasky-Arman said she's aware of the shortage, and has been sending out notices to beware of insurance companies that are not authorized to do business in Nevada. She said one has already been discovered.

Many things are feeding construction defect litigation, said Paul Wilkins, a building official in charge of permits and inspections for the city of Las Vegas.

"We expect homeowners, if there's a problem, to call up a contractor and they'll come out and fix it," he said. "There are some contractors where a customer calls and gets routed to customer service and they never get back to them."

Then there's the sheer volume of construction activity in Las Vegas. Over the past eight to nine years, Wilkins said construction valuation permits have exceeded $1 billion a year.

"So that's going to attract a lot of people, all kinds of people," he said, suggesting the high volume of construction activity is probably attracting some lower-quality contractors and builders.

Insurance company representatives generally agreed with the contractors, saying rising premiums are primarily a result of settlements in construction defect cases.

"Insurance companies are basically saying we need to define what a construction defect is and how a policy is supposed to respond," said Rod Leavitt, owner of Leavitt Insurance Agency in Las Vegas.

For example, he asked, if a toilet doesn't sit straight and rocks back and forth, is that a defect or just a maintenance problem?

"A lot of things that were never contemplated to be covered by insurance, the legal society is calling it a defect," he said.

Nancy Quon, a construction defect attorney with the firm Mainor & Harris, said Monday's hearing was an attempt by the construction industry to dovetail with what's happening in medical malpractice insurance.

"It was merely an attempt to catch the Legislature's ear," she said. "A lot of this talk about the right to repair .... there was already legislation on the books that allowed them to do that, but they didn't take advantage of it."

This story is located at:
http://www.reviewjournal.com/lvrj_home/2002/Jul-02-Tue-2002/business/19098091.html

Industry Under Siege:

Contractors Face Greater Cost, Less Choice for Insurance

by Joe Wheeler

From The Construction Zone: July 2000

Nevada's contractors face increasing costs and less choice of insurance carriers for their general liability insurance thanks to construction defect lawsuits.

Cheryl Justin, branch manager of Comstock Insurance, said that construction defects are a national problem, and that insurance companies are looking harder at southern Nevada risks. One insurer, Hawkeye, has chosen to non-renew most kinds of residential subcontractors, while other insurance companies are excluding contractors who build condominiums.

"What happening is that with residential general contractors, or "paper" generals, it's becoming more difficult to find coverage for them," Justin said. "They are ultimately responsible for the work of all the subs, and if they've had any construction defect cases, it's hard to write them."

Federated Insurance is a well known insurer who still writes subcontractors who do residential construction. Rates have gone up and those who do work on condos will face much more scrutiny in underwriting. So far, Nevada isn't so bad, according to Justin. "We still have good insurance markets."

How long that lasts is a guess. Another problem facing contractors is the quality of the insurance companies willing to write construction risks. "There's a lot of companies who will write coverage," Justin said. "It's just that the companies may not be financially strong or the coverage is reduced."

Tom Wheeler, vice president of marketing for Nevada Contractors Insurance, said that construction defect loss control needs to begin with the project. Documentation of every phase of construction may answer questions of quality asked years later.

"*NCI* is just starting to offer products like general liability that expose the company to these types of suits," Wheeler said. "We want to make sure our insureds are practicing effective loss control, which means preparing to defend allegations of construction defects."

Contractors must also be aware of changes made to coverage at renewal, according to Comstock Insurance's Justin. Coverage changes could include provisions that leave a contractor on his own if he's sued for a construction defect.

"There are some companies who exclude subsidence," Justin said. "If it's determined that subsidence is the problem, there's no coverage." One of the largest defect settlement on record, $21 million, involved subsidence issues in North Las Vegas. Based on that, "It's important that contractors understand the exclusions in their policy," Justin said.

Exclusions can be changed at renewal. If a contractor is not careful, his policy may leave him exposed to settling a lawsuit using his own resources. At a recent seminar on construction defects, attorney Scott Rasmussen said that the average case takes two years to settle and the highest cost may not be the settlement, but the legal fees. If the contractor's policy excludes coverage, the contractor pays those costs.

Although a construction defect lawsuit may take two to three years to resolve, time is not on the contractor's side. The insurance company "reserves" an amount of money for the settlement as soon as the lawsuit is filed. That "reserve amount" is credited against the contractor's loss ratio from that point on. When the policy comes up for renewal, the rates go up according to the total amount paid in actual claims and the amount "reserved."

According to attorney Rasmussen, the settlement amount does not reflect the actual cost of the case. If a construction defect case settles for approximately $20,000 to $30,000 for a subcontractor, the cost would be much higher when legal fees are factored in. A case that takes two years to resolve will have an additional $60,000 to $70,000 in fees.

Such settlements and fees can give a contractor a "negative" loss ratio, meaning that the insurance company paid out more money than collected in premiums. This puts the contractor at the highest level for renewal - *if* that insurer chooses to renew at all.

"There's going to be a lot of business owners who will have to get other coverage," Cheryl Justin said. "Until the legislature changes the law to let money go to repairs and not to attorneys, this is how it's going to be."

Back to Main Page

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Industry Under Siege:

Defect Claims Impact Insurance

Division of Insurance Survey Shows Less Coverage, Higher Rates

by Joe Wheeler

From The Construction Zone: March 2001

Nevada's Division of Insurance conducted a survey of contractors, insurance companies, and insurance agencies to access the availability and affordability of insurance.

The results depict an insurance market with, "A limiting of coverage by the carriers, coupled with an increase in rates and premiums for residential developers and contractors."

The survey form was sent to 1000 construction companies, 203 insurance agencies, and 544 insurance companies in August, the results tabulated over time.

Of the construction companies surveyed, not all those who got the survey chose to respond. Those who did were asked to answer questions such as, "Are you having any difficulties procuring construction defect coverage in Nevada?"

The answers reflected that insurance is getting more expensive, that carriers are discontinuing coverage for condos and town homes, that some carriers are canceling policies or non-renewing them, and that contractors are losing customers due to restrictions placed upon them by insurance carriers.

Contractors are passing the higher cost on to their customers, according to one response. The increased insurance cost will be passed on to buyers, and some potential home buyers (especially the first time buyer), will not be able to afford a home.

A builder reported that the construction defect claims process goes awry from the beginning. Citing that insurance companies either give him a new or inexperienced attorney to represent his case, or an attorney who is just "going through the motions" with the plaintiff's attorneys. What really rankled the contractor was the chummy, "coffee club" atmosphere that exists between defense and plaintiff attorneys. They all seem to know one another, he said, the contractor being the only one not part of the club. "This can be seen at nearly every stage of litigation and it is simply a crime, in my estimation."

The most common claims for defects experienced by contractors are for condos, wind damage and subsidence issues. One contractor reacted bitterly to "boiler plate" defect lists that include items that do not even exist at the sites named in the claim. He said, "...As a homebuilder, I am guilty until proven innocent."

Insurance agencies responded that the trend in premiums is for increases, most of the respondents saying that premium increases were 15 percent or higher. New restrictions have multiplied into a laundry list of excluded coverages and excluded activities. Montrose exclusions are common, as are multi-family housing exclusions, condos and town home exclusions.

Agents are finding it harder to place coverage for framing, concrete and drywall contractors, or anyone that has more than 20 home starts a year. Another side of the issue is that while coverage has gotten more restricted, and more complicated, the agents feel that the contractors understand it less and less.

Of the 221 insurance carriers that participated in the DOI's survey, 193 of them had not written construction risk coverage in the last four years, 17 were still writing coverage (many with restrictions or exclusions), and 11 carriers had stopped writing contractors altogether.

Back to Main Page

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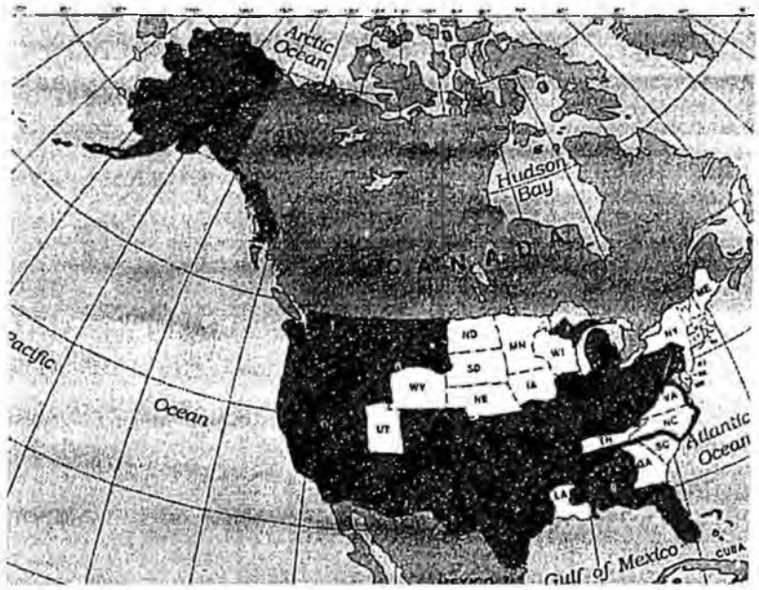
SECOND CHANCES

Thirteen more states pass laws giving builders the right to fix defects in new homes.



With the ink barely dry on many right-to-repair laws, it's too early to say how much they will ultimately help builders struggling against construction-defect trends and spiraling insurance costs.

But early responses are promising. "We've gotten a favorable reaction from the insurance industry," says Clayton Traylor, senior staff vice president of construction, codes and standards (state and local operations) at the National Association of Home Builders (NAHB). "The real bounce for the insurance guys is that something is different...they're looking at the probability that there will be fewer [construction defect] cases going into the court system."

Builders and others hope that will be the case, especially in the thirteen states that passed laws in 2003, giving builders the right to fix any defects in homes before being sued. At press time, Pennsylvania was also considering such a bill.

Among the 17 states with such legislation in place, the NAHB likes the laws in Colorado and Texas best. Colorado limits the amount and type of damages builders must pay in construction-defect suits, while Texas provides for self-policing through a nine-member panel that has the power to set mandatory residential construction performance standards. These state standards should eliminate much of the wrangling of construction-defect litigation by making it easier for people in Texas to decide whether or not a new home's imperfections is truly a defect. "In other states, a construction defect is in the eye of the beholder," Traylor says. "In Texas, these standards are adopted by statute, so they have the force of the law."

Next year, builders hope to pass right-to-repair laws in Arkansas, Illinois, Mississippi, New Mexico, and Oklahoma, where bills made progress last year.

**17 states currently have right-to-repair laws on the books. Eight are considering such legislation.*

Taken from: *Builder Magazine*
December 2003
Page 98

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Insurance Crisis

guide for a challenging market

What goes up must come down, right? In the midst of an all-around economic downtime, this seems the case, but the real question builders are asking is, will these rising insurance premiums ever come down?

"The economy is cyclical," Joel Gregoire of Lockton Affinity says, and right now, it's a hard market. Prior to the general liability issue, growth was the hot topic. Now with layoffs and closings, the economy has taken a natural growth control," recalls Rob Nanfelt, government affairs director for the Colorado Association of Home Builders. Insurers are dropping out of the market, while those that are staying are raising their prices and limiting essential coverage. What can a builder do to combat this blow? The first step to resolving this problem is to define the crisis; the second, is to identify the possible solutions.

CRISIS

The high price for general liability unfortunately puts builders out of business because they can't afford the premiums. "If a small residential builder only puts out a few homes a year, unless they are high-end projects, it's hard to charge enough to cover the cost, so they can't stay in business," Gregoire says.

Why are premiums on the rise? Many factors have been in motion contributing to the difficulty of keeping premiums low, while getting important coverage.

According to Colleen King, a speaker at the 2003 International Builders' Show (IBS) from a carrier that specializes in builder insurance, "The investment market is changing. Insurers aren't getting high returns on paid premiums." With interest rates decreasing, insurers are also losing out on gains, "passing this cost on to the builder." In addition, catastrophes have been more prevalent; for example, the insurance industry has paid out billions of dollars with Sept. 11, King explains, not to mention a string of natural disasters: floods, hurricanes, earthquakes. "You may be asking how this affects you? Look at it like this — when, insurance pays out a loss, it affects everyone."

In the immediate forefront of this crisis, construction defect litigation has hit every state and poses a constant threat to all general liability providers. "In the residential market, insurance losses are horrendous. Insurance carriers are drawing out from residential construction due to poor underwriting losses, which means [insurers] are paying out more in losses than they're taking in with premiums," reports Bruce Harrell, CEO of HBW Insurance Services.

He continues that these providers choose not to deal with the problem, but rather leave the industry altogether. "The problem with certificates of insurance is that it is nearly impossible to accurately predict the potential losses. Reinsurers don't predict risk and insurance carriers can't figure out the amount to charge over 10 years," Gregoire says. This unpredictability drives insurers to leave the market to make money where good predictions can be made, like workers' compensation, he adds.

Exclusions and endorsements

Meanwhile, having wised up to the potential for huge losses and soliciting lawyers, the few insurers remaining are actually eliminating critical coverage from general liability policies on issues such as soil movement and mold. Carriers have exercised their right to exclude likely "incidents" from general liability coverage. Patrick Wielinski of Cokinos, Bosien & Young says in his article, *The Changing Landscape of Coverage Disputes Over Defective Work Claims* (March 2000; www.IRIM.com), that exclusions, targeted specifically at business risks, have done little to affect the basic coverage under the policy. The exclusion simply amounts to a restatement of basic concepts relating to the definition of "property damage."

"In terms of insurance coverage disputes, this phenom-

enon has resulted in a de-emphasis of the traditional property damage exclusions as a basis to deny coverage for defective work claims," Wielinski notes.

Builders who have had coverage in the past are not shielded from this trend. Upon renewal of contracts, endorsements and exclusions can be added, removing the coverage a builder once had from his policy. Clifford J. Shapiro, partner and chair of the construction law group at Sachnoff & Weaver, Ltd. in Chicago, advises that it is key to be careful when renewing policies to ensure that a builder is well covered or at least aware of the coverage they've been given. Shapiro notes that the reality of a tight market is obvious when a general contractor renews his/her insurance; it's likely that he or she will leave with a higher rate and less coverage.

Standard policies have more frequently been including endorsements, or written changes in policy stating certain terms, that legally become part of the policy, Shapiro explains. "These offer an insurer the right to change a policy in conjunction with what the market can bear on renewal," he says.

If these additions fall through the cracks, which can be the case with smaller companies who don't have an in-house risk management team, and a claim is filed, the builder learns about these changes the hard way, Shapiro adds. Once a renewal notice is signed, it is a binding contract, he says, so it is pertinent that a builder has a broker, an attorney or a third party look over the policy before it is signed. "Be aware of what you're buying," Shapiro asserts.

Wise additions to internal practices

So what can a builder do to keep insurance premiums low and receive good coverage? In the face of this crisis there are no quick fixes; however, there are ways you can improve your business to make yourself more attractive to insurers.

One of the big challenges you will face, Harrell points out, is the difficulty in determining legal liability for builders and contractors. Unfortunately for builders, the insurance industry operates on this principle.

"Your general liability policy is designed to protect you from any legal liability brought against you," Harrell says. "If insurers can't determine when this starts and ends, the industry generally leaves because they need a dollar amount in order to turn a profit." The builder must implement change in his practices to set the stage for credibility, reassuring the providers they can invest in you, he adds.

First, you must prove that you are a reliable client. "It is your responsibility to prove to the underwriter that you are better than other builders because you are fighting for the same coverage," explains Bruce Thompson, senior loss control consultant at Lockton Insurance and a presenter at IBS.

The ways things are going, Harrell says, you must be responsible for implementing a risk management program, step up and define your legal liability.

Documentation procedures

Gregoire says that as a builder, a quality assurance program is essential with step-by-step plans and an audit program. "Go out with construction managers and train them how to look for potential construction defects," he says. "Have written programs in place, go over them with a carrier and broker, making sure you're doing things right before anything happens." Thompson suggests working with the NAHB, your broker, your attorney and other builders to see what they're doing; ask for their help.

Shapiro recommends a third-party job oversight engineer to lend credibility to your documentation. The oversight engineer serves to watch over and document the project through its various stages. Although smaller firms may not be able to afford this, keeping proper documentation throughout will still be beneficial if an occurrence arises, Shapiro says.

The NAHB Research Center (NAHBRC) gives these pointers for quality assurance documentation in its *Quality Assurance System for Wood Framing Contractors* manual. In the event a construction defect claim is brought against your firm, you should have such documentation to support your work and your product. The NAHBRC suggests that within the firm, an appointed employee must ensure that records are retained for a minimum of three years.

The following records must be retained:
- Job specifications
- Completed inspection forms
- Records of nonconformances
- Warranty service and repair records

Contracts, including:
- Builder-trade contracts
- Purchase contracts

Quality management records, including:
- Training and test records
- Preventive action records, quality system audits and review records
- All quality manual versions
- Builder satisfaction surveys

Beneficial wording

The Hartford Loss Control Department, one of the nation's

largest investment and insurance companies, recommends these options in the Product Liability Risk Transfer Techniques portion of its Technical Information Paper Series.

Certificates of Insurance. These certificates state the essential provisions of your policy, exerting the existence and limits of your coverage. The loss control department suggests the policy be insured by a reputable domestic insurer and cover comprehensive general liability, product liability and workers' compensation. Also, make sure the policy limits are equal to or greater than your own, and you are named as the certificate holder.

Waivers of Subrogation. In the event of an incident, an insurer has the right to attempt to recover some of its losses if they feel the builder was at fault. Waivers of Subrogation prevent such a lawsuit. The builder would need to have this waiver from the other party's insurer prior to any loss; it is an endorsement to the insurance policy issued to the other party. Shapiro points out that although these are common practice, they do raise complex issues. In some cases, the waiver can prevent builders from pursuing other lawsuits. For example, if an insurer picks up half the cost of a claim and a builder the other half, but the subcontractor was at fault, the builder would be bound by the waiver, unable to regain losses from the subcontractor.

Hold Harmless Agreements. This is a legally binding contract by which the other party agrees to hold you harmless for any liability arising out of their work, including liability for claims that would not be covered by insurance. Such parties include vendors, contractors and subcontractors. This agreement must be in writing and must clearly state the homeowner's responsibility to indemnify you against liability of loss or damage. The agreement should have no time limitations or be cancelable without sufficient notice.

Prevention

The best way to keep the confidence of your insurer and your premiums low is by preventing incidents before they occur.

Subcontractors. Shapiro recommends that as a builder, you must make sure you're working with a reputable subcontractor who signs agreements with precise warranty and indemnification wording. Any of the inclusions listed are worthless if you're not dealing with a good, reliable subcontractor. "The best protection for construction defects is to go with the best subcontractor you can afford," Shapiro advises.

"The courts buy into the illusionary belief that contractors should be able to control the quality of their work, even though that work may have been performed by one of many subcontractors on a complex construction project. Any defective work claim would therefore fall under the contractor's risk of doing business," Wielinski says. "After a project is complete, it becomes your project — the subcontractor is exempt, and you are responsible," Shapiro warns.

"The courts are not working in our favor; they are ruling that faulty workmanship be paid from the assets of the builder," Harrell states. The insurance industry doesn't have to reimburse you or protect you for coverage eliminated by the court through endorsements, he continues. "You are left exposed; the insurance company is not responsible for you – they won't offer you an attorney if you get sued -- it will come out of your pocket."

However, there are steps you can take to protect yourself and have control over what's happening to your business, Harrell says. (For more information, refer to the *The Liability Game* on page 32.)

Customer Service. With any type of claim, be proactive, Thompson recommends. Being aggressive is cheaper in the long run. "If you catch wind of a possible claim, put your best people on it to find out how things are going. Customer service is important even before a problem. Follow up with your clients and their satisfaction," he says.

The Hartford Loss Control Department suggests that complaint management be dealt with seriously. "In product liability, near misses or complaints can be construed as notice of a defect or problem that could cause harm or damage." It goes to say that complaints offer opportunity. "If handled in a professional manner, complaints represent opportunities for cor-

rection of immediate problems; constructive ideas to improve products; improving services; and modifying promotional material and information."

Planning. Shapiro recommends that a builder take costs into account prior to a claim. "Rather than accrue a loss for repairs, problems should be anticipated, not acknowledged in hindsight." However, if there is a complaint, regardless of whether you fixed it or not, Shapiro warns that you're aware of the potential traps you may encounter. "For example, the notice trap — let's say a problem is brought to your attention, and you fix it but don't report it to your insurer. Then five years down the line, the problem returns and results in a lawsuit. Your insurer can sue you for breach of contract. You'll get dropped and be left to cover the lawyer fees and fix the problem by yourself," he says.

Most policies have notice provisions to report occurrences when a problem first emerges. If you do things behind the backs of your insurer, the insurance company can take you to court saying you breached these notice provisions. Eventually, you will end up with no coverage, paying lawyer fees for both the claim and breach of contract. Shapiro insists that you report incidents to your insurer, it ultimately protects you.

Crucial legislation

Builders are not alone in this crisis. Organizations are working to get legislation passed that will protect the builder from the destruction construction defect claims can have on firms. Such legislation will not only ease the minds of builders, it should bring insurers back to the market.

New legislation has captured the attention of the insurance market. In Colorado, the "notice and opportunity to repair" law, passed in April, contains caps on damages awarded to plaintiff's and noneconomic damages, like pain and suffering, at $250,000. Such legislation is very important to insurers who can now actuate the risk of insuring a builder. Nanfelt explains that American Family Insurance was about to drop its builders' insurance but ceased to pull out with the passing of the bill. He says that "this is remarkable."

However, a citizen ballot is in the works to overturn the bill. "We need to sell and market our stance as a way to measure risk to the insurers and try to ensure that the opposing bill will die," Nanfelt says. "The problem is that it takes time [with insurance companies]. You have the decision makers at a corporate office in other states, looking at the risks — some builders don't have time."

"Ultimately we'd like insurers to come back to the market and offer a product at a reasonable price," Nanfelt explains.

Gregoire suggests that builders contact their legislators to get similar bills passed in their states; builders should also get involved in organizations like the NAHB.

There is hope. Aside from the tips given, "The bottom line is that insurance carriers won't change until construction defects get resolved before the problem," Gregoire says. "All builders must improve the quality of construction before there will be any change."

Let's hope the cliché is reliable and the premiums that do go up, will eventually come down. (For more information on construction defect liability issues, see page 32) ✦

design/build® BUSINESS
A Cygnus Business Media Publication

Fighting A War: It's Time To Be Proactive

Photo: Susie's Photography

A few months ago the state of Colorado followed in the footsteps of other states leading the charge to help protect builders from construction defect litigation, and adopted the "notice and opportunity to repair" legislation.

This new law asks homeowners to notify builders and give them the chance to fix defects before filing a lawsuit.

While this law is a huge step forward in the battle for affordable general liability insurance, the war is not yet over.

Premiums need to become affordable once again, and insurance companies need to offer more coverage rather than create more exclusions. This will only happen when insurance companies can reduce their risk. In order for this to happen, a limit of liability on builders and the homes they build must be established — where does a builder's liability start and where does it end?

Our industry has been in an insurance and liability crisis for far too long, and it's time we start being proactive. The "notice and opportunity to repair" law is the first such measure taken toward a comprehensive solution. It provides caps on damages and limits a plaintiff's recoveries (for the full description, see pg. 36). This legislation has also captured the attention of insurance companies, as some have decided to continue offering coverage in states that have the law.

Only seven states have adopted this law so far, and others have it in the works. But, what's disheartening is that while Colorado builders were feeling some relief with the passing of the bill, a citizen ballot is in the works to overturn the bill. An overturn could be a major setback to resolving the insurance and liability crisis if homeowners in other states take similar action. Insurance companies may decide not to re-enter or worse yet, more may leave; premiums will continue to increase, and builders will continue to be exposed to risk, making a profitable business difficult. Ultimately, the costs will be passed onto the homeowners. (I have to point out: Would the homeowners pushing the overturn in Colorado think differently if they knew that?)

So, what can you do? Get involved. Work with your local builders' association and legislature. Tell your clients why this is important and educate them. This war can only be won when building professionals band together and take a proactive stance.

Jordanna Smida

Spinell HOMES, Inc.

January 16, 2004

Representative Kevin Meyers
Alaska House of Representatives
State Capitol Building
Juneau, Alaska 99811

Subject: HB340, Construction Defect Claims

Dear Representative Meyers:

Thank you for sponsoring HB340, an Act limiting damages for construction defect claims. Residential home builders across the nation – and especially in Alaska – are experiencing a crisis in being able to both obtain and afford general liability insurance.

HB340 will limit the damages that can be awarded for a construction defect claim in a fair and reasonable manner. When it comes to dealing only with the defects that may occur in home construction, it makes good sense for awards to be limited only to the actual damages and their full cost.

Common sense says that a builder should correct and fix the problem – and in fact, almost all problems are resolved by the home owner and the builder working things out. However, civil justice reform is needed to help counter the detrimental impact that increased costs of insurance is having on the housing industry.

Notification and opportunity to repair laws are helping to create a system that requires home owners to notify builders of any problems before litigation is started. HB340 is the next step toward a system that tries to avoid the expense and consequences of lawsuits. We need a process that encourages both parties to arrive at a resolution that fixes the defect.

This letter is to help you, as the sponsor of HB340, show this bill is important for the housing industry. I support HB340, and hope it will pass this Legislative Session.

Thank you.

JAN 2 2 2004

Chuck Spinelli
Spinell Homes, Inc.

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NCP
DESIGN/BUILD, LTD.

January 19, 2004

Representative Kevin Meyers
Alaska State Legislature
State Capitol Building, Room 513
Juneau, Alaska 99811

Dear Rep. Meyers:

My business is facing rising insurance rates that are debilitating, and I see others in the housing industry facing the same problem. I am encouraged to see a bill like House Bill 340.

I am sending you this letter to ask the Legislature to pass HB340.

Like many other builders, my construction company has seen insurance premiums increase over 500% just in the last year. (Other builders say their rates have gone up as much as 2500%.) This is ridiculous! Insurance costs per home are averaging anywhere from $2,500 to $4,000, depending on how many homes a contractor builds.

Insurance costs are not calculated into the amount of the appraisal, which means small to medium size building companies will probably go out of business unless something is done. They simply aren't going to be able to absorb costs this large. Mortgage loans used to pay for home prices are limited by the appraisal, and in most cases lending institutions have underwriting standards for loan-to-value ratios at 95% or even less.

HB340 provides reasonable limitations on awards for construction defect claims. If there is a problem in the construction of a home, everyone is better served if the problem is fixed. By limiting awards to actual damages, this creates a situation where there is always an incentive to simply repair the damage.

If something isn't done to help avoid and limit construction claims and awards, the housing Markey will suffer from the loss of registered contractors - many who have been in business in Alaska for a long time and have solid reputations as good quality builders.

I support HB340 because I would rather fix defects and see a system aimed toward fixing defects and limiting awards to their actual costs.

Thank you for supporting HB 340.

Sincerely,

Claiborne Porter SB

N. Claiborne Porter Jr.
NCP Design/Build

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