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Corporate Law and Practice
Course Handbook Series

24th Annual Consumer Financial Services Institute

Co-Chairs
Alan S. Kaplinsky
John J. Roddy
Julia B. Strickland
Beth E. Terrell

CORPORATE LAW AND PRACTICE
Course Handbook Series
Number B-2473

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New York City, March 25–26, 2019
Hotel Allegro, May 20–21, 2019
San Francisco, December 9–10, 2019

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24th Annual Consumer Financial Services Institute (2019)
March 25-26, New York and Live Webcast
May 20-21, Chicago, Hotel Allegro

AGENDA DAY ONE

Morning Session: 9:00 a.m. to 11:45 a.m.

9:00
Opening Remarks

9:15
Federal Regulators Speak (Part I)

- General
  - Significance of leadership changes at BCFP, FTC, OCC and FDIC
  - Interactions among the federal agencies and with the state agencies
  - Constitutional challenges to the BCFP
  - Agency efforts to promote innovation
  - Handling of consumer complaints
- Regulatory Developments
  - Final BCFP small-dollar lending rule and prepaid account rule
  - Proposed BCFP third-party debt collection rule
  - Proposed BCFP HMDA rule
  - BCFP Trial Disclosure Policy proposal
  - OCC FinTech charter and related developments at the FDIC
  - OCC proposal to revise Community Reinvestment Act regs
  - OCC small-dollar lending guidance and related FDIC developments
  - Update on Madden and "true lender" issues
  - Status of BCFP RFIs
- Enforcement Developments
  - Important consent orders and enforcement litigation during the last year and priorities going forward
- Supervisory Developments
  - Focus of examinations
  - Supervisory highlights
  - The thin line between consumer protection and safety and soundness

NY and Live Webcast: Keith A. Noreika (Co-Moderator), Kelly T. Cochran (Invited), Kristen Donoghue (Invited), Stuart Feldstein, Travis J. Hill, Malini Mithal, Peggy L. Twohig
CHI: Keith A. Noreika (Co-Moderator), Allison Brown, Kelly T. Cochran (Invited), Kristen Donoghue (Invited), Stuart Feldstein, Travis J. Hill (Invited), Malini Mithal

10:15 Networking Break

10:30

Federal Regulators Speak (Part II)

- General
  - Significance of leadership changes at BCFP, FTC, OCC and FDIC
  - Interactions among the federal agencies and with the state agencies
  - Constitutional challenges to the BCFP
  - Agency efforts to promote innovation
  - Handling of consumer complaints
- Regulatory Developments
  - Final BCFP small-dollar lending rule and prepaid account rule
  - Proposed BCFP third-party debt collection rule
  - Proposed BCFP HMDA rule
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11:45 Lunch

Afternoon Session: 12:45 p.m. to 5:00 p.m.

12:45

State Regulatory Activism Update

- Increased coordination through multistate investigation/actions
- Privacy issues
- Automobile sales and finance
- Student lending and servicing
- Mortgage lending and servicing
- Debt collection

NY and Live Webcast: Jane M. Azia, Shennan A. Kavanagh, Philip D. Ziperman
CHI: Susan N. Ellis, Shennan A. Kavanagh, Shannon E. Smith

1:45

Data Security and Privacy Issues

- *Equifax* MDL update and other data breach trends
- Privacy policies – how are Google, Apple, and other "market makers" responding to the current landscape?
- Smart TVs and smart home devices – do their data collection methods give rise to liability?
- State and federal legislative and regulatory update

NY and Live Webcast: Katherine E. McCarron, Andre M. Mura
CHI: Jay Edelson, Katherine E. McCarron

2:45 Networking Break

3:00

Fair Credit Reporting Act/ Debt Collection Issues

- Has the BCFP abandoned these fields?
- Predictions for the BCFP debt collection rulemaking
- Trends in litigation about the scope of the FCRA's coverage—FCRA implications of alternative data and AI models (who is a CRA; how will disputes work with that type of data; disclosure on adverse action and credit bureau disclosures)
- FCRA's new federal right for consumers to implement a security freeze
- Update on public records litigation
- State regulatory and legislative activity with respect to debt collection – first and third party

NY and Live Webcast: Christopher J. Willis, Chi Chi Wu
CHI: E. Michelle Drake, David Seligman, Christopher J. Willis

4:00

The Rapidly Evolving Landscape for FinTech

- The legal challenges facing users of aggregated data and providers of data
- The use of Artificial Intelligence (AI)
- The use of Blockchain, including virtual currency
- The impact of privacy and data security laws
- The legal challenges facing marketplace lenders
- Treasury's FinTech report
- BCFP's Office of Innovation and other sandboxes in the U.S.

NY and Live Webcast: Duncan B. Douglass, Deborah Hoffman, Christopher J. Willis
CHI: Duncan B. Douglass, Joshua Ashley Klayman, Christopher J. Willis

5:00 Adjourn

AGENDA DAY TWO

Morning Session: 9:00 a.m. to 11:45 a.m.

9:00
What's Trending Now: Cutting Edge Consumer Financial Services Updates

- Important consumer issues on the Supreme Court's spring 2019 agenda
- TCPA update: Litigation and regulatory trends
- Developments in personal jurisdiction jurisprudence
- Trump appointed judges and the enforcement of consumer laws
- Best practices throughout the life cycle of consumer financial services products and services

NY and Live Webcast: Jennifer Bennett, Blythe Chandler, Joy Feigenbaum, Arjun P. Rao
CHI: Karla Gilbride, Amy E. Keller, Arjun P. Rao

10:30 Networking Break

10:45
Consumer Advocates Speak

- Preemption as a threat to state regulation of the consumer finance industry
- Tribal lending – cracks in the armor?
- Arbitration update
- Student lending: DOE rules that restrict the "borrower defense" that a school closed or acted illegally

NY and Live Webcast: Jennifer Bennett, Deepak Gupta, Christopher L. Peterson
CHI: Stacy M. Bardo, Karla Gilbride, Matthew Wessler

11:45 Lunch

Afternoon Session: 1:00 p.m. to 3:30 p.m.

1:00

Class Actions and Litigation Update

- Changes to class action standards through jurisprudence and legislation, including the impact of Rule 23 amendments
- Updates on trending class certification issues
- CAFA update, including update as to removal of class action counterclaims
- Important settlement notice and administration considerations
- Renewed attention to California's Unfair Competition Law for "public" claims

NY and Live Webcast: Elizabeth J. Cabraser, Elizabeth L. McKeen

CHI: Elizabeth J. Cabraser, Elizabeth L. McKeen

2:15 Networking Break

2:30

Ethical Issues Unique to the Consumer Space

- Who is the client? Investors? Borrowers? Insurance? The larger public?
- Do the courts have any ethical duties to cultivate non-ideological jurisprudence?
- Professional responsibilities faced when "excessive risk of default" is present
- Cybersecurity policies: Understanding the ethical obligations for in-house counsel
- FDCPA reform efforts and other ethical conundrums on the horizon

NY and Live Webcast: Linda E. Fisher, Christopher L. Peterson

CHI Speakers: Anne P. Ray, Christopher L. Peterson

3:30 Adjourn

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Alan S. Kaplinsky is a senior partner and Practice Leader of the more than 110-person Consumer Financial Services Group at Ballard Spahr LLP which was recently named by Law 360 a Banking Law Practice Group of the year. He devotes his practice exclusively to: (i) counseling financial services companies with respect to bank regulatory and transactional matters, particularly consumer financial services law, and (ii) defending them when they are sued by consumers and governmental enforcement agencies in individual and class action lawsuits. Alan was the first president of the American College of Consumer Financial Services Lawyers, an organization founded in order to honor those lawyers who have made substantial contributions to the development of consumer financial services law. In April of 2016, he received the American College's Lifetime Achievement Award. He is a past chair of the Committee on Consumer Financial Services of the Section of Business Law of the American Bar Association. He has been named as a tier one banking and consumer financial services lawyer in the 2006-2018 editions of *Chambers USA: America's Leading Lawyers for Business*, a directory of America's leading lawyers. In 2015, Alan was named as a "Trailblazer" by the National Law Journal because of his pioneering work related to consumer arbitration provisions. For 24 years, he has annually co-chaired for Practicing Law Institute its Annual Institute on Consumer Financial Services in New York, Chicago and San Francisco. His group recently received the 2018 Readers' Choice Awards from JD Supra, including the Top Firm Award in Banking and Finance. Alan earned Top Author honors in Banking and Finance and was ranked #1 in Class Actions. He was recently awarded the National Law Review's "Go-To Thought Leadership Award in Consumer Finance" for his work on the Firm's Consumer Finance Monitor blog which Alan launched in 2011. Alan recently launched a companion podcast series known as Consumer Finance Monitor.

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John is a partner in Bailey & Glasser's Boston office. His practice is devoted to representing consumers in class actions, challenging unfair and deceptive business practices, and serving as relator's counsel in qui tam "whistleblower" actions. In the last two decades the settlements in cases he has litigated have returned more than $850 million to consumers harmed by marketplace misconduct. John regularly writes and speaks on class action practice and consumer financial services law, and has published dozens of articles on these topics. He is a fellow of the American College of Consumer Financial Services Lawyers, and serves on the Consumer Financial Services Law Report Board of Advisors, the Advisory Board of the Massachusetts Appleseed Foundation, and the National Consumer Law Center Partners Council. He is a member of the National Association of Consumer Advocates and the Volunteer Lawyers Project. John has co-chaired PLI's Annual Consumer Financial Services Institute for the past 17 years.

Julia B. Strickland
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Widely recognized as one of the best litigators in the country, Julia Strickland leads a broad national practice that focuses on the defense of class actions and other complex actions. Ms. Strickland is regularly called by major financial services companies and others when they are confronted with complex issues that put them at substantial economic and reputational risk. She is a member of the firm's Executive Committee, Managing Partner of the Los Angeles office, and head of the firm's national Financial Services Litigation, Regulation and Enforcement Group.

In addition to her experience defending complex and class actions through dispositive motion practice, trial and/or appeal, Ms. Strickland has settled all types of complex and class actions. She is versatile and creative in addressing settlement considerations, both legal and business, and in developing settlement structure options unique to the particular case. She also routinely represents companies in compliance counseling, regulatory proceedings and responding to claims by federal and state regulators and enforcement authorities. Representative clients include JPMorgan Chase, HSBC, TransUnion, Discover, American Express, Citigroup, HSBC, PayPal, BMW Financial Services, Zappos and Synchrony Bank, among others.

Ms. Strickland once again received top honors in *Chambers USA* 2018 with a Band 1 ranking in the Financial Services Regulation: Consumer Finance Litigation–Nationwide category. Ms. Strickland is one of only three attorneys across the country to receive this recognition. She was also selected by *Law360* as a 2017 Banking MVP joining an elite slate of only six lawyers nationally who have distinguished themselves from their peers.

For more than 13 years running, *The Los Angeles Daily Journal* has named Ms. Strickland one of California's "Top Women Lawyers." The *Los Angeles Business Journal* honored Ms. Strickland in their Leader in Law awards, naming her one of their "Lawyers of the Year" for 2016 and 2017, and she was recognized by leading corporate counsel as a member of the BTI Consulting Group's "Client Services All-Stars" for her "uncanny ability to anticipate opposing counsel," as well as being "very customer focused and practical." She has also been repeatedly recognized by *Super Lawyers*, *Benchmark Litigation*, The *Los Angeles Times* and *Best Lawyers*.

Beth E. Terrell
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Beth E. Terrell is a 1995 graduate of University of California, Davis Martin Luther King, Jr. Hall School of Law, Order of the Coif. She is a founding member of Terrell Marshall Law Group PLLC, located in Seattle. Beth's practice focuses on complex litigation, including the prosecution of consumer fraud, defective product, and wage and hour class actions. She has been co-lead counsel on many multi-state and nationwide class actions against Fortune 100 and 500 companies such as Wal-Mart, Microsoft, Best Buy, Sallie Mae, Bank of America, and Capital One. Beth has been awarded an "AV" rating in Martindale Hubbell by her peers, a rating denoting the highest legal ability and ethical standards, and has been recognized as a "Superlawyer." Beth frequently speaks at CLEs and other seminars on issues as diverse as ESI, class actions, and mandatory arbitration, and is active in the bar and community, serving on a number of non-profit boards.

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Ballard Spahr LLP, Selected Blog Posts and Alerts Related to the Panel, Federal Regulators Speak

Submitted by:
Alan S. Kaplinsky

Ballard Spahr LLP

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CFPB finalizes changes to the Prepaid Account Rule and further delays effective date

By **Pavitra Bacon** on January 26, 2018

On January 25, the CFPB **finalized** certain changes to the original **Final Prepaid Rule** (the "Rule") **proposed** last summer. The amended Rule still contains onerous restrictions on credit features and complicated disclosure requirements, but the changes are generally positive for prepaid providers and incorporate feedback from **industry representatives**. Importantly, due to concerns about implementation difficulties, the effective date of the Rule, which was originally October 1, 2017 and **delayed** to April 1, 2018, is now further delayed to **April 1, 2019**.

The changes reverse two controversial aspects of the original Rule, and make several other changes:

- *Error Resolution and Limitation of Liability.* One of the original Rule's most controversial mandates required error resolution and limited liability protections for ***unregistered*** accounts (*e.*, accounts that have not concluded the verification process, accounts where the process is concluded but the consumer's identity could not be verified, and accounts in programs for which there is no such verification process). Acknowledging "financial institutions' fear of fraud losses," the CFPB changed the Rule to no longer require financial institutions to resolve errors or limit consumers' liability for unregistered prepaid accounts until ***after*** a financial institution successfully completes its consumer identification and verification process. Notably, the Rule differs from last year's proposed changes

by not requiring financial institutions to limit liability or resolve errors that occurred prior to verification on accounts that are later successfully verified. If no verification process is available, financial institutions must disclose to consumers the absence of, or limitations on, such protections.

- *Digital Wallets.* The amended Rule also narrows the definition of "business partner" under Regulation Z to clarify the Rule's application to digital wallets and to alleviate burdens for digital wallet providers. Under the amended Rule, business arrangements between prepaid account issuers and issuers of traditional credit cards are excluded from coverage under the Rule's hybrid prepaid-credit card provisions as long as

1. the prepaid card cannot access credit from the credit card account during a prepaid card transaction without written consent to link the two accounts,
2. the acquisition or retention of either account is not conditioned on whether the consumer authorizes such a connection, and
3. the parties do not vary certain terms and conditions based on whether the two accounts are linked.

Deviating from last year's proposal, the Rule now permits digital wallet providers to run negative balances when a covered separate credit feature offered by a business partner is attached to the digital wallet as long as the following requirements are met:

1. the digital wallet cannot access credit from the covered separate credit feature that is offered by its business partner;
2. the digital wallet provider has a general policy and practice of declining transactions that will take the account negative (at least outside of the situations involving incidental credit); and
3. the digital wallet provider generally does not charge credit-related fees.

These changes do not completely exclude digital wallets that can store funds, or person-to-person ("P2P") payment products from the Rule, but it does ease

compliance burdens on digital wallet providers that allow consumers to link their debit and credit cards and to store and access funds.

- *Loyalty, award, and promotional gift cards.* The amended Rule clarifies that loyalty, award, or promotional gift cards that are not marketed to the general public are not covered by the Rule, regardless of whether they provide disclosures under the Gift Card Rule.
- *Unsolicited Issuance.* Regulation E provides that a financial institution may only issue an access device for an account to a consumer on an unsolicited basis in accordance with certain requirements. The original Rule raised questions about how the unsolicited issuance rules applied where the consumer is given no other option but to receive the disbursement via a prepaid account, such as prison release cards, jury duty cards, and certain types of refund cards. The amended Rule provides that, under such facts, the financial institution can comply with the unsolicited issuance rule by informing the consumer that there is no other way to access funds in the prepaid account if the consumer disposes of the access device.
- *Pre-Acquisition Disclosures.* The CFPB finalized changes that provide additional flexibility regarding the pre-acquisition disclosures mandated by the Rule:

1. If there are no alternative means for the consumer to receive funds from a prepaid account (other than a payroll card account or government benefit account), pre-acquisition disclosures may be provided at the time the consumer receives the prepaid account.
2. The original Rule required financial institutions to provide a long form disclosure after a consumer acquires a prepaid account at a retail location. The amended Rule provides that financial institutions may deliver the long form disclosure after acquisition without E-Sign consent, as long as it is not provided inside the prepaid account packaging material, and the financial institution is not otherwise mailing or delivering to the consumer written account-related communications within 30 days of obtaining the consumer's contact information. The amended

Rule does not require a financial institution to provide the long form disclosure if it has not obtained the consumer's contact information.

3. Under the amended Rule, if a financial institution provides pre-acquisition disclosures in writing, and a consumer subsequently completes the acquisition process online or by telephone, the financial institution need not provide the disclosures again electronically or orally.
4. Financial institutions disclosing additional fee types with three or more fee variations are now able to consolidate those variations into two categories and allow those two categories to be disclosed on the short form.
5. The amended Rule clarifies that foreign language pre-acquisition disclosures for payroll card accounts and government benefit accounts are not required where the foreign language is offered by telephone only via a real-time language interpretation service provided by a third party.

- *Submission of Agreements.* To reduce compliance burdens, the amended Rule makes several changes to the original Rule's requirements requiring submission of prepaid account agreements to the CFPB:

1. Issuers may delay submitting a change in the names of other relevant parties to a prepaid account agreement (such as employers for a payroll card agreement) until the earlier of: (a) the time the issuer submits an amended agreement or changes to other identifying information; or (b) May 1 of each year, for any updates to the list of names of other relevant parties that occurred between the issuer's last submission of relevant party information for that agreement and April 1 of that year.
2. Short form and long form disclosures may be provided as separate addenda to the agreement, rather than integrated into the agreement or provided as a single addendum.

With the announcement of these changes, the CFPB provided an **Executive Summary** of the amended Rule, and an **unofficial redline** of the changes.

The preamble to the amended Rule states that the CFPB will submit a report to Congress pursuant to the Congressional Review Act ("CRA") containing the Rule and other required information, and also states that this is ***not*** a major rule under the CRA. Because the Senate **did not previously reject the Prepaid Final Rule** under the CRA, and because the amended Rule contains a lot of concessions to industry participants, we think it's unlikely there will be a significant push for the Rule's rejection.

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Congress disapproves CFPB Bulletin concerning discretionary pricing by auto dealers

By **Alan S. Kaplinsky** & **Christopher J. Willis** on May 8, 2018

We previously **reported** that Congress might have the opportunity to disapprove the CFPB's disparate impact theory of assignee liability for so-called auto dealer "markup" disparities because the CFPB Bulletin describing its theory was determined by the General Accountability Office (GAO) to be a "rule" subject to override under the Congressional Review Act (CRA). Our hope became a reality late this afternoon when the House of Representatives passed, by a bipartisan vote of **234 to 175**, a **joint resolution** stating that Congress:

> "[D]isapproves the rule submitted by the Bureau of Consumer Financial Protection relating to 'Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act' (CFPB Bulletin 2013-02 (March 21, 2013), and printed in the Congressional Record on December 6, 2017, . . . along with a letter of opinion from the [GAO] dated December 5, 2017, that the Bulletin is a rule under the Congressional Review Act), and such rule shall have no force or effect."

The Senate previously passed this joint resolution on April 18, 2018 by a vote of 51 to 47. It has been reported that President Trump will sign the joint resolution into law when it is presented to him for executive action. Like every other legislative measure that is passed by Congress and signed by the President of the United States, the joint resolution of disapproval will be assigned a Public Law number and published in

Statutes at Large. *See, e.g.*, **Pub. L. No. 115-74**, 131 Stat. 1243 (joint resolution disapproving of CFPB rule relating to arbitration agreements).

The Bulletin

The Bulletin is an official guidance document – a species of what one scholar has characterized as **"regulatory dark matter"** – that previewed the Bureau's subsequent ECOA enforcement actions against assignees of automobile retail installment sale contracts ("RISCs"). It set forth the CFPB's views concerning what it characterized as a significant ECOA compliance risk associated with an asserted assignee "policy" of "allowing" dealerships to negotiate the retail annual percentage rate (APR) under *their* RISCs by "marking up" the wholesale buy rate established by a prospective assignee. The Bulletin's intent to establish and prioritize a supervisory and enforcement initiative with respect to the asserted practice was unmistakably clear not only from its text, but also from the tag line in the accompanying press release – "Consumer Financial Protection Bureau to Hold Auto Lenders Accountable for Illegal Discriminatory Markup." Indeed, the blog post that we published on the day the Bulletin was issued was titled "***The CFPB previews its coming auto finance fair lending enforcement actions***" and the associated webinar that we then hosted was titled, appropriately, "*Auto Finance Industry in the CFPB's Crosshairs*."

The CFPB initiative regarding so-called dealer "mark up" was premised upon what we believe may fairly be characterized, in the parlance of ***Inclusive Communities***, as a disparate impact claim that is "abusive" of banks and sales finance companies that acquire RISCs from independent, unaffiliated dealerships, because it is based on a factual and legal theory that is highly suspect, and in particular seeks to establish causation through the use of statistics alone, which *Inclusive Communities* holds is improper. The initiative proved to be highly controversial and became a lightning rod for **media**, industry, and Congressional criticism of the Bureau. The industry criticism is probably best reflected and documented in the AFSA study titled "***Fair Lending: Implications for the Indirect Auto Finance Market***", an Executive Summary of which is available **here**. The congressional criticism included a trilogy of investigative

reports prepared by the House Financial Services Committee Majority Staff titled "***Unsafe at Any Bureaucracy: CFPB Junk Science and Indirect Auto Lending***," **"*Unsafe at Any Bureaucracy, Part II: How the Bureau of Consumer Financial Protection Removed Anti-Fraud Safeguards to Achieve Political Goals*"** and "***Unsafe at Any Bureaucracy, Part III: The CFPB's Vitiated Legal Case Against Auto Lenders***."

We also have written previously about some of the many legal and factual flaws inherent in the approach taken by the Bureau and reflected in the now congressionally-disapproved Bulletin. *See, e.g.*, "***The CFPB Stretches ECOA Past the Breaking Point***," CFPB Monitor (Feb. 21, 2013); ***Auto Finance and Disparate Impact: Substantive Lessons Learned from Class Certification Decisions***," Consumer Fin. Servs. L. Rep., Vol. 18, Issue 21 (May 1, 2015). Indeed, in our blog post dated February 21, 2013 – one month before the issuance of the Bulletin – we noted that "there are several things about potential enforcement actions in this area that make them profoundly unfair, and which should cause the CFPB to refrain from pursuing enforcement based on this flawed theory." Accordingly, it should surprise no one that the Bulletin has become the first guidance document to be disapproved by Congress pursuant to the CRA.

Application of the CRA to the Bulletin

Some **have**, and others undoubtedly will, criticize this use of the CRA and seek to downplay the significance of the adoption of a Public Law disapproving the Bulletin. We take issue with these critiques, and have engaged in some spirited "back and forth" with Professor Adam Levitin at Georgetown Law Center regarding this subject. We previously **replied** to a message that Prof. Levitin sent to one of us on Twitter after the GAO issued its determination that the Bulletin is a "rule" subject to congressional review. More recently, Prof. Levitin posted a *Credit Slips* Blog post titled "***Congressional Review Act Confusion: Indirect Auto Lending Guidance Edition (a/k/a The Fast & the Pointless)***" in which he made various assertions regarding the CRA's applicability to the Bulletin, and the consequences of its

disapproval by Congress (in his opinion, basically none). Since the impact of CRA disapproval of this CFPB Bulletin appears to be the subject of some debate, we wanted to take this opportunity to explain our view about why Congress' action is so significant.

CRA Definition of a "Rule"

In his blog post, Prof. Levitin asserts that the Bulletin in not a "rule" subject to congressional review for various reasons. These reasons include suggestions that the CRA only applies to rules that have "effective dates" because the CRA states that a rule may not "take effect" until the rule and its proposed effective date have been reported to each House of Congress and the Comptroller General pursuant to the CRA. According to Prof. Levitin, this "suggests that the term 'rule' in the CRA means what we normally think of as a 'rule,' and not some technical definition." This argument strikes us as grasping at straws.

While the Bulletin will become the first guidance document to be disapproved pursuant to the CRA, the notion that a guidance document can be a "rule" subject to congressional review is not novel. The GAO previously determined that other guidance documents can be "rules" subject to congressional review. For example, as we **reported** previously, the GAO **determined** that the Interagency Leverage Lending Guidance issued jointly by the federal bank regulatory agencies on March 22, 2013 "is a general statement of policy and is a rule under the CRA." In concluding that the Interagency Leveraged Lending Guidance was a rule subject to the CRA, the GAO relied upon prior GAO opinions (including one issued in 2001) holding that general statements of policy are "rules," decisional law under the Administrative Procedure Act and floor statements made by the principal sponsor during final congressional consideration of the bill that became the CRA as well as analyses of legal commentators. Among other things, the principal sponsor had stated that the types of documents covered by the CRA include "statements of general policy, interpretations of general applicability, and administrative staff manuals and instructions to staff that affect a member of the public." Agencies thus were on

notice that the CRA definition of a "rule" can encompass guidance documents and that this was by design.

With respect to the allusion to a "technical definition" of a "rule," it is the prerogative of Congress to define statutory terms in a manner that is consistent with the achievement of its legislative objectives. The legislative intent was to ensure that elected representatives of the People be afforded an opportunity to disapprove "rules" issued by administrative agencies, including certain guidance documents such as the Bulletin that are an example of administrative overreach. In making its determination, the GAO applied the statutory definition in a straightforward, well-reasoned manner. As for the statutory requirement to include the proposed effective date when reporting a rule to Congress, absent some statutory or regulatory limitation, a guidance document that does not provide for a deferred effective date presumably is effectively immediately. If such a guidance document is a "rule" (other than a "major rule") subject to the CRA, "immediately" presumably should mean the date on which it is reported to each House of Congress and the Comptroller General in compliance with the CRA.

Prof. Levitin further suggests that the Bulletin is not a "rule" because it was not "designed" by the Bureau to "interpret law" or "prescribe . . . policy" and it does not have "future effect" because it is non-binding guidance that has no effect. More specifically, Prof. Levitin asserts that the Bulletin has no future effect because, *inter alia*, it does not affirmatively state that the Bureau will bring enforcement actions in these circumstances, and it does not specifically and affirmatively state a position of the Bureau. According to Prof. Levin, while "[p]erhaps there's an implicit enforcement threat, "it's pretty oblique" and, in his view, the guidance is merely "a sort of 'head's up, there might be compliance issues here that you guys aren't aware of, so here's what you should be thinking." We respectfully submit, however, that it cannot seriously be contended that the Bulletin was not designed by the Bureau to interpret law or prescribe policy and to have future effect. To the contrary, the Bulletin was labeled in the CFPB's own press release as indicating an intent "to Hold Auto Lenders Accountable for Illegal Discriminatory Markup." That does not seem oblique

to us; it is an explicit statement of future enforcement actions which, in fact, the Bureau was pursuing at the time the Bulletin was released and which became public later in 2013.

Administrative agencies periodically issue official guidance documents to communicate their position with respect to regulatory compliance issues. While such documents may be literally non-binding, regulatory agencies do not issue official guidance documents in the hope that they will be disregarded by regulated entities. The regulatory expectation is that entities subject to the regulatory, supervisory and enforcement authorities of the agency will take to heart the views reflected therein. As regulated entities are well aware, the failure to take official guidance documents seriously can have significant adverse regulatory consequences. This is true generally and it was certainly true with respect to the Bulletin.

We fail to understand how the Bulletin could fairly be read as anything other than a statement of policy. As noted previously, the associated CFPB press release included a statement that the Bureau was going "to Hold Auto Lenders Accountable for Illegal Discriminatory Markup." Additionally, the concluding sentence in the Bulletin warned industry participants that "[t]he CFPB will continue to closely review the operations of. . . indirect auto lenders, *utilizing all appropriate regulatory tools to assess whether supervisory, enforcement, or other actions may be necessary* to ensure that the market for auto lending [sic] provides fair, equitable, and nondiscriminatory access to credit for consumers." (emphasis added).

This enforcement threat was, in fact, explicit and there was nothing oblique about it. This threat publicly came to fruition nine months later with what the Bureau press release characterized as "the largest-ever settlement in an auto loan discrimination case" that was "the result of a CFPB examination that began in September 2012." The CFPB press release stated that the associated Consent Order "demonstrates the type of fair lending risk identified in" the Bulletin "explaining that [the Bureau] *would hold indirect auto lenders accountable for unlawful discriminatory pricing*." (emphasis added). Notwithstanding the suggestion to the contrary by Prof. Levitin,

we believe that the irrefutable evidence of the prescriptive nature and future effect of the Bulletin may be found in the Bulletin itself, the associated CFPB press release, various internal CFPB documents posted on the website of the House Financial Services Committee, four public Consent Orders, and in CFPB publications such as *Supervisory Highlights* and Fair Lending Reports of the Bureau. From a big picture perspective, it is abundantly clear that the Bulletin was part of an orchestrated CFPB initiative to effectuate a sea change with respect to the discretionary pricing of retail automotive credit by either eliminating dealer discretion or requiring RISC assignees to impose more restrictive "mark up" limits, perform portfolio-level analyses for "mark up" disparities and promptly remunerate alleged affected consumers if disparities were identified at the portfolio level. The Bulletin says as much when it discusses the approaches RISC assignees should take to manage the asserted ECOA compliance risk.

Implications of Congressional Disapproval

Much undoubtedly will be written about the implications of Congressional disapproval of the Bulletin, and some will suggest, as Prof. Levitin has in the title of his blog post, that it is a "pointless" exercise. We respectfully disagree with this point of view, and believe a federal court would disagree as well if the issue were ever to be litigated.

In our "back and forth" with Prof. Levitin, he suggested that a Congressional override of the Bulletin would represent merely a disapproval of the Bureau's statement of its position. We responded that, in our view, it would also represent a disapproval of the position reflected in the Bulletin pursuant to a Public Law adopted by the elected representatives of the People stating that "such rule shall have no force and effect." It seems to us self-evident that the import of a Public Law disapproving the Bulletin would be a disapproval of the position reflected therein because the "position" is embodied in the "statement" of the position and cannot be disassociated with it. They are, simply stated, indivisible.

So, what exactly is the substantive centerpiece of the Bulletin that Congress today disapproved? It is the notion that a RISC assignee has a "policy" of "allowing" dealerships to negotiate the APRs under *their* RISCs by "marking up" the wholesale buy rate established by a prospective assignee and that disparate impact liability may be predicated upon this "policy" if there are "mark-up" disparities in the portfolio of RISCs acquired by the assignee. One cannot get past the "Background" section of the Bulletin without encountering a reference to supervisory experience of the Bureau confirming that such policies exist and the statement that such discretionary pricing "policies" create a significant risk that they will result in unlawful pricing disparities on a prohibited basis. The Bulletin proceeds to state that an "indirect auto lender that permits dealer markup and compensates dealers on that basis may be liable for these policies and practices if they result in disparities on a prohibit basis." This rule of liability – based on the factual and legal theory set forth in the Bulletin – is the "rule" that Congress has just disapproved.

Viewed from this perspective, if a court is called upon to discern the import of the joint resolution of disapproval in the context of a litigation premised upon this type of disparate impact claim, we are confident that the court will conclude that it represents a repudiation, by Congress, of the substantive centerpiece of the Bulletin.

We hope, however, that no industry participant ever itself in a situation in which it becomes necessary to assert this argument in the context of a CFPB enforcement action. As we suggested previously, if the Bulletin is invalid, and the CFPB cannot reissue a disapproved rule in "substantially the same form" or issue "a new rule that is substantially the same," turning around and applying the substantive centerpiece of the disapproved rule in supervision and enforcement would disregard the clear import of an act of Congress. And it would lead to the most absurd of results – that the CFPB would be forbidden from adopting the "rule" set forth in the Bulletin, but would be free to enforce that "rule" in enforcement actions against industry participants. We think any federal court would find it impossible to swallow this contradiction. But, as noted above, our hope is that an administrative agency that respects its role in a representative democracy should not behave in a manner that

reflects a desire to nullify the clear import of a Congressional resolution disapproving the disparate impact centerpiece of the Bulletin.

Finally, in his *Credit Slips* Blog post, Prof. Levitin asserted that our reference to "grandiose and vague 'will of the People' language . . . is a glaring sign that there's not a good substantive argument" and that we were "falling back" on a legislative intent argument. In this regard, he asserts that we incorrectly assume that a CRA resolution is an affirmative statement of policy and seeks to draw a distinction between an affirmative law requiring 60 votes in the Senate and negative law adopted pursuant to the CRA.

Simply stated, we think it illogical to suggest that a statement of policy can be disapproved without thereby disapproving the substance of the policy that is the subject of the statement. The purported distinction, based upon Senate filibuster rules, between an affirmative law and a negative law strikes us as curious indeed. At the end of the day, a Public Law is, in fact, a law and the only relevant question is, "what is its import?" In **written testimony** submitted to the House Financial Services Committee on July 12, 2015, Prof. Levitin himself observed that a trio of provisions of a proposed Financial CHOICE Act, including one that "would nullify the CFPB's indirect auto lending guidance and impose an onerous process for any future guidance," would "shield discriminatory lenders from legal repercussions."

Additionally, our perspective strikes us entirely consistent with the policy underlying the CRA, which was to give Congress a veto power over administrative rulemaking that can be, and often is, substantive in nature. It seems to us that the perspective articulated by Prof. Levtin leads to a result that leaves an administrative agency whose rule has been disapproved to continue to cling to (and apply) the substance of its disapproved rule in supervision and enforcement. We respectfully submit that the view articulated by Prof. Levitin would have the effect of defeating the central purpose of the CRA.

In sum, although we have enjoyed the engaging “back and forth” with our friend Adam Levitin, it appears that we will have to agree to respectfully disagree. What remains to be seen is whether the academic discussion in which we have been partaking ever becomes something with more practical impact. That will, of course, depend on the CFPB’s future action.

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President Trump signs joint resolution disapproving CFPB Bulletin concerning discretionary pricing by auto dealers

By **Alan S. Kaplinsky** & **Christopher J. Willis** on May 22, 2018

Yesterday afternoon, President Trump signed into law **S.J. Res. 57**, the joint resolution under the Congressional Review Act (CRA) that disapproves the CFPB's Bulletin 2013-2 regarding "Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act." The Government Accountability Office had determined that the Bulletin, which set forth the CFPB's disparate impact theory of assignee liability for so-called auto dealer "markup" disparities, was a "rule" subject to override under the CRA.

The joint resolution was passed by the Senate in April 2018 by a vote of 51 to 27 and by the House earlier this month by a vote of 234 to 175. We recently shared our thoughts on **the implications of Congressional disapproval**.

The CFPB issued a **statement** about the signing that included a statement from Acting Director Mulvaney that referred to the Bulletin as an "initiative that the previous leadership at the Bureau pursued [that] seemed like a solution in search of a problem." Mr. Mulvaney said that "those actions were misguided, and the Congress has corrected them."

The CFPB stated that the resolution's enactment "does more than just undo the Bureau's guidance on indirect auto lending. It also prohibits the Bureau from ever reissuing a substantially similar rule unless specifically authorized to do so by law." Most significantly, the CFPB indicated that it "will be reexamining the requirements of the ECOA" in light of "a recent Supreme Court decision distinguishing between antidiscrimination statutes that refer to the consequences of actions and those that refer only to the intent of the actor" and "the fact that the Bureau is required by statute to enforce federal consumer financial laws consistently."

This is presumably a reference to the Supreme Court decision in *Inclusive Communities* and the fact that the ECOA discrimination proscription does not proscribe discriminatory effects but, rather, speaks solely in terms of discrimination "against any applicant on the basis of" race, national origin and other prohibited bases. As we have observed **previously**, the basis for the *Inclusive Communities* holding with respect to the FHA, which is summarized at the end of Section II of the majority opinion, highlights material differences between the FHA and the ECOA. The distinctions between discrimination statutes that refer to the consequences of actions and those that do not is illustrated vividly by a textual juxtaposition **chart** that appeared in the House Financial Services Committee Majority Staff Report titled "Unsafe at Any Bureaucracy: CFPB Junk Science and Indirect Auto Lending." The Business Lawyer article cited in that report, "*The ECOA Discrimination Proscription and Disparate Impact – Interpreting the Meaning of the Words that Actually Are There*," discusses this issue in further detail. The CFPB's plans to reexamine ECOA requirements could represent an overture to reviewing references to the effects test in Regulation B (which implements the ECOA) and the Regulation B Commentary.

With regard to the Bulletin's status as the first guidance document to be disapproved pursuant to the CRA, the CFPB commented that the resolution's enactment "clarifies that a number of Bureau guidance documents may be considered rules for purposes of the CRA, and therefore the Bureau must submit them for review by Congress." The CFPB indicated that it plans to "confer with Congressional staff and federal agency partners to identify appropriate documents for submission."

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Fifth Circuit agrees to hear challenge to CFPB's constitutionality

By **Barbara S. Mishkin** on April 26, 2018

The U.S. Court of Appeals for the Fifth Circuit **has agreed to hear an interlocutory appeal** challenging the CFPB's constitutionality requested by the defendants in **a lawsuit filed by the CFPB in 2016** that alleges the defendants engaged in abusive, deceptive, and unfair conduct in connection with making certain payday loans, failing to refund overpayments on those loans, and cashing consumers' checks.

Unlike previous cases involving challenges to the CFPB's constitutionality (most notably, *PHH*), the Fifth Circuit case represents the first such challenge in which the CFPB's position will be determined under the leadership of Acting Director Mick Mulvaney rather than former Director Cordray. As a result (and particularly in light of **statements by Mr. Mulvaney** that legislative change is needed to ensure the CFPB Director answers to the President in the exercise of executive authority), it is far from certain that the CFPB will defend its constitutionality before the Fifth Circuit.

On March 21, 2018, the district court **entered an order denying the defendants' motion for judgment on the pleadings**. Citing **the D.C. Circuit's en banc *PHH* decision**, the district court rejected the defendants' argument that the CFPB is unconstitutional based on its single-director-removable-only-for-cause structure. It also rejected the defendants' argument that the CFPB's UDAAP claims violated due

process because the Consumer Financial Protection Act fails to give fair notice of the conduct it proscribes.

The defendants subsequently filed a motion asking the district court to certify for interlocutory review both the question of whether the CFPB's structure is unconstitutional and the question of whether principles of fair notice and due process prevent the CFPB from enforcing the CFPA's UDAAP prohibition without defining the relevant terms. On March 27, the district court **entered an order** in which it granted the defendants' motion only as to the question of the CFPB's constitutionality. Citing **the D.C. Circuit panel decision in *PHH*** that held that the CFPB's structure is unconstitutional and the dissent in the en banc decision disagreeing with the majority's view that the CFPB's structure is constitutional, the district court found there was a substantial ground for difference of opinion on the issue "amongst the jurists in the United States Court of Appeals for the District of Columbia who have considered the issue." With regard to the due process issue, however, the district court found "no substantial ground for difference of opinion as to whether the terms [of the UDAAP prohibition] have been adequately defined by other federal statutes from which Congress borrowed when enacting the [CFPA]."

The defendants' **petition to the Fifth Circuit** asking it to grant interlocutory review of the constitutionality issue **was opposed by the CFPB**, which did not directly address the merits of the defendants' constitutional challenge and instead argued that the issue did not present a "controlling question of law" (one of the requirements for granting an interlocutory appeal in addition to a substantial ground for difference of opinion and that an immediate appeal may materially advance the termination of the case). According to the CFPB, "whatever the abstract merits of Defendants' constitutional argument," because Acting Director Mulvaney is removable at will by the President and ratified the CFPB's decision to bring the lawsuit, any constitutional defect that may have existed with the CFPB's initiation of the lawsuit was cured and the constitutionality of the for-cause removal provision was no longer relevant to the case.

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SDNY, disagreeing with D.C. Circuit, finds CFPB structure unconstitutional and strikes Title X of CFPA in its entirety

By **Alan S. Kaplinsky** & **Theodore R. Flo** on June 21, 2018

On June 21, 2018, Judge Preska of the Southern District of New York ("SDNY") **issued a decision** finding that the CFPB's single-director-removable-only-for-cause structure is unconstitutional. In doing so, the SDNY held that Title X of Dodd-Frank—the title that created the CFPB and established its regulatory, supervisory, and enforcement authority—should be stricken in its entirety.

The SDNY went further in finding that Mulvaney's ratification of the CFPB's decision to bring the lawsuit was inadequate to cure the constitutional deficiencies. The decision was issued in response to the **motion to dismiss** filed by the defendants in the CFPB's and New York Attorney General's case against RD Legal Funding, LLC.

This decision is in direct conflict with the **D.C. Circuit's *en banc* decision in the PHH case**, which held that the CFPB's structure is constitutional. Adopting portions of two dissenting opinions in the *en banc* decision, the SDNY found that, not only is the CFPB's structure unconstitutional, but the proper remedy is to strike all of Title X rather than just its for-cause removal provision.

While the SDNY dismissed the CFPB from the *RD Legal Funding* case, it allowed the New York Attorney General's claims to proceed. Because part of the case remains

active, the CFPB cannot appeal the decision unless the SDNY certifies that there is no reason to delay that appeal under Rule 54(b) of the Federal Rules of Civil Procedure. Assuming such a certification by the SDNY, the CFPB could appeal to the Second Circuit.

We will soon be blogging in further detail about the implications of the SDNY decision.

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D.C. Circuit Rules CFPB's View of RESPA Was Wrong But its Structure is Constitutional

By **Theodore R. Flo** on February 2, 2018

On January 31, 2018, the *en banc* D.C. Circuit handed down its **opinion** in the *PHH v. CFPB* case, **which we've discussed at length**. It held, 7 to 3, that the CFPB's single-director-removable-only-for-cause structure is constitutional but that the CFPB's interpretation of RESPA was wrong.

***En Banc* Court Reinstates Panel's RESPA Ruling**

The *en banc* Court reinstated the RESPA-related portions of the D.C. Circuit's October 2016 **panel decision**. The panel had held that the plain language of RESPA permits captive mortgage re-insurance arrangements like the one at issue in the PHH case, if the mortgage re-insurers are paid no more than the reasonable value of the services they provide. This is consistent with HUD's prior interpretation. For the first time in 2015, in prosecuting the case against PHH, the CFPB announced a new interpretation of RESPA under which captive mortgage reinsurance arrangements were prohibited. The panel rejected this on the ground that the statute unambiguously allows the kinds of payments that the CFPB's 2015 interpretation prohibited.

In remanding the case to the CFPB for further proceedings, the panel had admonished the CFPB by alternatively holding that—even assuming that the CFPB's

interpretation was permitted under any reading of RESPA—the CFPB's attempt to retroactively apply its 2015 interpretation, which departed from HUD's prior interpretation, violated due process. It held that "the CFPB violated due process by retroactively applying that new interpretation to PHH's conduct that occurred before the date of the CFPB's new interpretation." The *en banc* Court cited the panel's due process analysis with approval.

The panel's RESPA decision remanded the case to the CFPB to determine whether PHH violated RESPA under the longstanding interpretation previously articulated by HUD. The *en banc* Court's reinstatement of that aspect of the panel decision led it to order that the case be remanded to the CFPB for further proceedings.

Statute of Limitations Continues to Apply to RESPA Cases Before CFPB

At the administrative stage of the case, the CFPB argued that no statute of limitations applies to *any* CFPB administrative action. The panel soundly rejected that argument, holding that RESPA's three-year statute of limitations applies to any RESPA claims that the CFPB brings, whether administratively or otherwise. That aspect of the panel decision, because it pertains to RESPA, is also reinstated by the *en banc* Court's ruling.

CFPB's Structure Deemed Constitutional

The panel of the D.C. Circuit had also held that the CFPB's structure was unconstitutional because it improperly prevented the President from "tak[ing] Care that the Laws be faithfully executed." Rejecting this holding, the *en banc* Court held that "[w]ide margins separate the validity of an independent CFPB from any unconstitutional effort to attenuate presidential control over core executive functions." In other words, the *en banc* Court found (wrongly, in our view) that it wasn't even a close call.

In reaching this conclusion, the *en banc* Court considered two questions: First, it asked whether the "means" that Congress employed to make the CFPB independent

was permissible? That is, were the independence-creating tools used ones that the Supreme Court approved of, such as for-cause removal or budgetary independence? The *en banc* Court found that the Supreme Court approved each of the "means" Congress used to achieve CFPB "independence" individually. It reasoned then, that those "means" could all be combined in a single agency without running afoul of the U.C. Constitution.

Second, the *en banc* Court asked whether "the nature of the function that Congress vested in the agency calls for that means of independence?" In answer to the second question, the *en banc* Court found it was consistent with historical practice to grant financial regulators like the CFPB such independence.

The *en banc* Court went further, however, and dismissed the panel's other constitutional concerns under the heading "Broader Theories of Unconstitutionality." For example, it rejected the panel's concern that having a powerful unaccountable CFPB Director was a threat to individual liberty. It suggested that such an argument "elevat[ed] regulated entities' liberty over those of the rest of the public." "It remains unexplained why we would assess the challenged removal restriction with reference to the liberty of financial services providers, and not more broadly to the liberty of the individuals and families who are their customers," it said. In doing so, it seems to have forgotten that Dodd-Frank gives the CFPB Director broad powers to go after individuals, "mom and pop" businesses, *and* large "regulated entities."

***Lucia* Issue Regarding ALJ Appointment Not Addressed**

Notably, the *en banc* Court in PHH specifically "decline[d]to reach the separate question whether the ALJ who initially considered this case was appointed consistently with the Appointments Clause." That was the issue in *Lucia*, which we have **blogged about** extensively. In that case, Raymond J. Lucia challenged the manner in which the SEC appointed administrative law judges ("ALJs"), arguing that ALJs are "inferior officers" who must be appointed by the president, a

department head, or the courts under the Appointments Clause of the U.S. Constitution. The **Supreme Court recently agreed to hear** *Lucia*.

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CFPB files appeal with Second Circuit in RD Legal Funding case

By **Alan S. Kaplinsky** on September 17, 2018

As expected, following **Judge Preska's dismissal on September 12** of all of the New York Attorney General's federal and state law claims, the CFPB filed an appeal with the Second Circuit from Judge Preska's June 21 ruling in the RD Legal Funding case in which she held that the CFPB's single-director-removable-only-for-cause structure is unconstitutional, struck the CFPA (Title X of Dodd-Frank) in its entirety, and dismissed the CFPB from the case.

In its **Notice of Appeal** filed on September 14, the CFPB gives notice that it "appeals to the United States Court of Appeals for the Second Circuit from this Court's June 21, 2018 Order (ECF No. 80), as amended by its September 12, 2018 Order (ECF No. 105), dismissing the Bureau's claims against Defendants, and this Court's Judgment (ECF No. 106) entered on September 12, 2018."

Since Judge Preska dismissed all of its claims, the NYAG can also appeal to the Second Circuit. Alternatively, the NYAG can refile its CFPA and state law claims in New York state court (although a state court might stay the case pending a decision by the Second Circuit in the CFPB's appeal, particularly if the NY AG decides to appeal the dismissal of its claim brought under Dodd-Frank Section 1042. If the NYAG appeals the jurisdictional dismissal of its state law claims, then RD Legal

should be able to file a cross-appeal of Judge Preska's June 21 decision ruling on the merits of the state law claims and denying RD Legal's motion to dismiss.

The CFPB's appeal means that the Bureau's constitutionality is now before two circuits, the Second and Fifth Circuits. In April 2018, **the Fifth Circuit agreed to hear All American Check Cashing's interlocutory appeal** from the district court's ruling upholding the CFPB's constitutionality. Also, a **petition for certiorari** was recently filed in the U.S. Supreme Court by State National Bank of Big Spring which, together with two D.C. area non-profit organizations that also joined in the petition, had brought one of the first lawsuits challenging the CFPB's constitutionality.

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NY Attorney General files appeal with Second Circuit in RD Legal Funding case

By **Alan S. Kaplinsky** on October 15, 2018

The New York Attorney General, on October 12, 2018, **filed a notice of an appeal** to the Second Circuit from Judge Preska's **dismissal on September 12, 2018 of all of the NYAG's federal and state law claims**, and her subsequent September 18 order amending the September 12 order to provide that the NYAG's claims under Dodd-Frank Section 1042 **were dismissed "with prejudice**." (Section 1042 authorizes state attorneys general to initiate lawsuits based on UDAAP violations.)

On September 14, **the CFPB filed an appeal with the Second Circuit** from Judge Preska's June 21, 2018 decision, as amended by her September 12 order, in which she ruled that the CFPB's single-director-removable-only-for-cause structure is unconstitutional, struck the CFPA (Title X of Dodd-Frank) in its entirety, and dismissed the CFPB from the case. That was followed on September 25 by RD Legal Funding's **filing of a cross-appeal** with the Second Circuit from **Judge Preska's June 21 decision**, as subsequently amended, in which Judge Preska had ruled that the NYAG had stated federal and state law claims against RD Legal Funding. (Although Judge Preska's various orders resulted in the dismissal of all of the CFPB's and NYAG's claims, RD Legal Funding may have filed the cross-appeal to preserve its ability to challenge Judge Preska's June 21 ruling that the NYAG had stated claims against RD Legal Funding should the Second Circuit conclude that the CFPB's structure is

constitutional or that the structure is unconstitutional but that the proper remedy is to sever the Dodd-Frank for-cause removal provision rather than strike all of Title X.)

The Bureau's constitutionality is now before two circuits, the Second and Fifth Circuits. In April 2018, **the Fifth Circuit agreed to hear All American Check Cashing's interlocutory appeal** from the district court's ruling upholding the CFPB's constitutionality. Also, a **petition for certiorari** was recently filed in the U.S. Supreme Court by State National Bank of Big Spring which, together with two D.C. area non-profit organizations that also joined in the petition, had brought one of the first lawsuits challenging the CFPB's constitutionality.

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Petition for certiorari filed by State National Bank of Big Spring raising constitutional challenge to CFPB

By **Alan S. Kaplinsky** on September 13, 2018

A **petition for certiorari** was filed in the U.S. Supreme Court late last week by State National Bank of Big Spring (SNB) which, together with two D.C. area non-profit organizations that also joined in the petition, had brought one of the first lawsuits challenging the CFPB's constitutionality.

Originally filed in 2012 in D.C. federal district court, the complaint alleged that the CFPB's structure violated the U.S. Constitution's separation of powers. **The district court dismissed for lack of standing** but on appeal, the D.C. Circuit held that the plaintiffs did have standing and remanded the case to the district court. Further proceedings in the case were held in abeyance by the district court pending the outcome of the PHH case in the D.C. Circuit.

Following the D.C. Circuit's en banc *PHH* decision that held the CFPB's structure is constitutional, the district court lifted its abeyance order and, with the parties having agreed that *PHH* foreclosed the district court from ruling in favor of the plaintiffs on their constitutional challenge, entered judgment against the plaintiffs. On June 8, 2018, the D.C Circuit **entered an order summarily affirming the district court's judgment**. Citing its en banc *PHH* decision, the D.C. Circuit order stated that "the merits of the parties' positions are so clear as to warrant summary action."

In their petition for certiorari seeking Supreme Court review of the D.C. Circuit's June 8 order, SNB and the non-profits urge the Supreme Court to grant the petition "to resolve the conflict" between *PHH* and the Fifth Circuit's decision in ***Collins v. Mnuchin***. In *Collins*, the Fifth Circuit ruled that the Federal Housing Finance Agency (FHFA) is unconstitutionally structured because it is excessively insulated from Executive Branch oversight. While stating that it was "mindful" of the D.C. Circuit's en banc *PHH* decision, the Fifth Circuit found that "salient distinctions" between the CFPB's structure and the FHFA's structure dictated different conclusions as to each agency's constitutionality. SNB and the non-profits argue in their petition that "the approaches of the D.C. Circuit and the Fifth Circuit cannot be reconciled."

We continue to follow two other active cases involving challenges to the CFPB's constitutionality that could come before the Supreme Court. In April 2018, the Fifth Circuit agreed to hear **All American Check Cashing's interlocutory appeal** from the district court's ruling upholding the CFPB's constitutionality. In **RD Legal Funding**, Judge Preska of the Southern District of New York is expected to soon enter a Rule 54(b) judgment against the CFPB so that it can file an appeal with the Second Circuit from her June 21 order in which she ruled that the CFPB's structure is unconstitutional and struck all of Title X of Dodd-Frank.

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CFPB to reconsider final payday loan rule

By **Jeremy T. Rosenblum** & **Mark J. Furletti** on January 16, 2018

The CFPB **announced today** that it intends to engage in a rulemaking process to reconsider, pursuant to the Administrative Procedure Act, **its final rule** on Payday, Vehicle Title, and Certain High-Cost Installment Loans (the "Payday Rule"). The announcement fully accords with our expectation that the Payday Rule will never see the light of day in its current form.

If it were to go into effect, the Payday Rule would largely eliminate the availability of payday loans to the public. In this regard, the Payday Rule reflected former CFPB Director Cordray's hostility to payday lending and his **failure to seriously consider how consumers who rely upon the product would be impacted by its elimination**. It was adopted on a crash basis shortly before Director Cordray's resignation and largely disregarded over 1,000,000 comments from consumers articulating the critical *benefits* of payday loans.

To our mind, it was inevitable that Director Cordray's successor would wish to re-evaluate the costs and benefits of the Payday Rule. We think it highly likely that, at the end of the day, the new Director (whether Mick Mulvaney in an acting capacity or the as-yet-to-be-appointed permanent successor to former Director Cordray) will repeal the Payday Rule while he or she considers other options that can preserve the product and limit the potential for consumer injury.

Today's announcement is good news for the millions of consumers who rely upon payday and title loans to meet their financial needs (and, of course, to the payday and title lending industries).

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CFPB issues statement regarding plans to reconsider payday loan rule

By **Jeremy T. Rosenblum** on October 26, 2018

Earlier today, the Bureau of Consumer Financial Protection released a **Public Statement Regarding Payday Rule Reconsideration and Delay of Compliance Date**. Echoing rumors that have been circulating in the industry for several weeks (which we had agreed not to address in our blog), the Statement reads in full as follows:

> The Bureau expects to issue proposed rules in January 2019 that will reconsider the Bureau's rule regarding Payday, Vehicle Title, and Certain High-Cost Installment Loans and address the rule's compliance date. The Bureau will make final decisions regarding the scope of the proposal closer to the issuance of the proposed rules. However, the Bureau is currently planning to propose revisiting only the ability-to-repay provisions and not the payments provisions, in significant part because the ability-to-repay provisions have much greater consequences for both consumers and industry than the payment provisions. The proposals will be published as quickly as practicable consistent with the Administrative Procedure Act and other applicable law.

Of course, the Bureau is correct in observing that the ability-to-repay (ATR) provisions of the Rule "have much greater consequences for both consumers and industry than

the payment provisions." That is because the ATR provisions, if allowed to go into effect, would largely kill the industry and thus deprive millions of consumers of a source of credit they deem essential. Nevertheless, the draconian potential consequences of the ATR provisions do not justify leaving the payment provisions intact. These provisions are unduly complicated. They require hard-to-reach consumers to affirmatively reauthorize lender-initiated payment attempts after two consecutive unsuccessful attempts rather than relying on a simpler and more straightforward notice and opt-out regimen.

Also, while the payment provisions are supposedly designed to prevent excessive NSF fees, as we have pointed out in a comment letter to the Bureau and elsewhere, they treat attempts to initiate payments by debit card, where there is no chance of any NSF fee, the same as other forms of payment that can give rise to NSF fees. This treatment of card payments can only be ascribed to the hostility to high-rate lending characteristic of the former leadership of the Bureau. If the Bureau does nothing else with the Rule's payment provisions, it should certainly correct this wholly indefensible aspect of the Rule.

We note that the Bureau requested an extension until Monday, October 29, **to respond to the preliminary injunction motion** by the Community Financial Services Association and Consumer Service Alliance of Texas. If the Bureau files its response Monday, we will likely have more to report.

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A third bite at the apple: trade groups file lawsuit challenging CFPB payday loan rule

By **Alan S. Kaplinsky** on April 10, 2018

Two trade groups, the Consumer Financial Service Association of America, Ltd. and the Consumer Service Alliance of Texas, have filed a lawsuit against the CFPB in a Texas federal district court challenging the CFPB's final payday/auto title/high-rate installment loan rule (Payday Rule). The plaintiffs seek an order and judgment holding the Payday Rule unlawful and enjoining and setting aside the Payday Rule. The case has been assigned to Judge Lee Yeakel, who was nominated by President George W. Bush in 2003.

The lawsuit appears to be a third bite at the apple in that it represents a third possible route for overturning the Payday Rule. More specifically, the filing appears to reflect industry concern about the viability of overturning the rule through a resolution under the Congressional Review Act (CRA) or the reopening of rulemaking by the CFPB.

The complaint alleges that the Payday Rule is unlawful for the following reasons:

- The CFPB's structure is unconstitutional because of the President's inability to remove the CFPB Director other than for-cause and the funding of the CFPB outside of the normal appropriations process

- The Consumer Financial Protection Act (CFPA) unconstitutionally delegates legislative power to the CFPB by granting it "legislative authority" to prescribe rules identifying as unlawful unfair, deceptive, or abusive acts or practices and not providing "an intelligible principle" that the CFPB must follow in exercising such authority
- The Payday Rule exceeds the CFPB's statutory authority for reasons that include:
    - The Final Rule's identification of unfair and abusive lending practices conflicts with the CFPA limitations on the CFPB's authority to declare an act or practice unfair or abusive
    - The Final Rule violates the CFPB prohibition on the CFPB's establishment of a usury limit because it "determines the legal status of certain covered loans based solely on their interest rates"
    - The CFPB does not have the authority to impose an ability-to-repay requirement on the loans covered by the Payday Rule
- The Payday Rule is arbitrary and capricious in violation of the Administrative Procedure Act (APA) because the CFPB's unfairness and abusive determinations "are unsupported by substantial evidence and reflect a clear error in judgment"
- The CFPB's cost-benefit analysis of the Payday Rule does not satisfy the requirements of the CFPA for such an analysis
- The CFPB failed to satisfy various procedural requirements in promulgating the Payday Rule including:
    - The APA notice and comment rulemaking process because "the history of the rulemaking demonstrates that the Bureau will not consider or evaluate empirical studies or evidence that diverges from the Bureau's pre-determined decision that payday lending and title lending are harmful and must be burdened by draconian regulations"

- The CFPB has "reduced the elaborate rulemaking process to little more than a sham" because it "has largely allowed outside groups opposed to payday lending to drive this rulemaking, and has not adequately disclosed its reliance on these groups"
- The CFPB failed to adequately consider the Payday Rule's impact on small businesses as required by SBREFA
- The CFPB failed to give adequate consideration to the "over one million comments [it received] from consumers who opposed the proposed rule"

Resolutions under the Congressional Review Act (CRA) to override the Payday Rule have been introduced in the **House** and **Senate**. In January 2018, **the CFPB announced** that it intends to engage in a rulemaking process to reconsider the Payday Rule pursuant to the APA. The Payday Rule became "effective"on January 16, 2018. However, the compliance date for the rule's substantive requirements and limits (Sections 1041.2 through 1041.10), compliance program/documentation requirements (Section 1041.12), and prohibition against evasion (Section 1041.13) is August 19, 2019.

It is doubtful that there are 51 votes in the Senate to pass a CRA resolution. Adoption of a new rule through a reopened rulemaking could take too long to accomplish because of the many APA regulatory hoops that the CFPB would have to jump through. In addition, consumer advocacy groups would likely file a lawsuit against the CFPB challenging any new rule.

Perhaps the most important question with respect to the Texas lawsuit is how the CFPB will respond. The CFPB's position under the Trump Administration on the constitutional issues is uncertain. While President Trump wanted the CFPB to be held unconstitutional when Richard Cordray was Director so that he could be removed without cause, the President no longer needs such authority. Moreover, the President might no longer want to have such authority because it would potentially

enable a Democratic President to remove whoever President Trump eventually appoints as Director.

On the other hand, based on Mr. Mulvaney's **recent recommendation** that the CFPA be amended to give the President more control over the Director, some observers believe that the CFPB would agree with the complaint's allegation that the CFPB is unconstitutional. In addition, Mr. Mulvaney's decision to reopen the rulemaking indicates that he has grave concerns about the Payday Rule.

All in all, we believe that the CFPB will likely file an answer to the complaint stating that it agrees with most, if not all, of the complaint's allegations. Should that happen, the plaintiffs would be well-positioned to file a motion for judgment on the pleadings.

A motion for judgment on the pleadings is ordinarily granted when the complaint and answer, by themselves, reveal that there are no material issues of fact to be resolved and that a party is entitled to judgment as a matter of law. However, it is unclear whether the court would be obligated to grant a motion by the plaintiffs for judgment on the pleadings or could exercise independent judgment about the legal issues raised in the lawsuit.

It also seems likely that certain consumer advocacy groups or Democratic state attorneys general will seek to intervene as defendants in order to defend the lawsuit. The plaintiffs (and perhaps the CFPB) would likely oppose such intervention and it is premature at this point to speculate as to how the court would rule on intervention.

While it is also noteworthy that the lawsuit was filed in federal court in Texas rather than in D.C., the reason for the plaintiffs' choice of Texas seems obvious—they needed to initiate the lawsuit in a federal circuit that has not already ruled on their constitutional challenge. The D.C. Circuit has already concluded **in *PHH*** that the CFPB is constitutional. The plaintiffs undoubtedly hope that the Fifth Circuit will decide the constitutional issue differently, thus creating a conflict with the D.C. Circuit that the U.S. Supreme Court would likely resolve. Also, unlike the D.C. Circuit, the Fifth Circuit is known for being one of the more conservative circuits in the country

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Court stays CFPB payday loan rule compliance date

By **Jeremy T. Rosenblum** on November 7, 2018

Yesterday, the court reversed course in the lawsuit filed by two industry trade groups challenging the CFPB's final payday/auto title/high-rate installment loan rule (Payday Rule). On its own initiative, the Texas federal district court **granted a stay of the Payday Rule's August 19, 2019 compliance date** and continued in force its stay of the lawsuit. Unfortunately, the court did not specify a termination date for the stay of the compliance date, as the trade groups and CFPB originally requested. Instead, the compliance date is stayed "pending further order of the court."

To my mind, the court's failure to specify how long the stay of the compliance date will remain in effect leaves the Rule's status hopelessly muddled. The CFPB has stated that **its current plan** is to revisit the Payday Rule's ability-to-repay (ATR) provisions but not its payment provisions. CFPB officials have indicated that the Bureau intends to propose a delay of the Payday Rule's ATR provisions but not the payment provisions. What happens if the CFPB follows through with that plan? When the parties report that development to the court, might the court just lift its stay of the compliance date, without affording lenders additional time to address the payment provisions?

My guess is that the court intends its stay to function like the tolling of a statute of limitations—meaning that, for each day the stay remains in effect, the August 19 compliance deadline is extended for an additional day. But alas, the court's order

does not specify this intent. I hope the parties in the case ask for clarification that the compliance date will be extended day-for-day so long as the stay remains in effect. Alternatively, the CFPB could announce that it will propose a delay in the compliance date for the payment provisions when it moves forward with its rule-making next January.

Unless and until the court and/or the CFPB clarify their intentions, prudent lenders will continue to prepare for the advent of the payment provisions of the Payday Rule. As Ned Stark from The Game of Thrones might say (if he were alive): "August 19 is coming."

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CFPB hints at possible disparate impact rulemaking

By **Christopher J. Willis** on October 18, 2018

On October 17, **the Bureau released its Fall 2018 Rulemaking Agenda**, but it included a surprise for those interested in fair lending. Under the section of the associated blog post entitled "Future Planning" appears the following statement:

"The Bureau is considering future [rulemaking] activity with regard to specific areas of consumer financial law of significant public interest. For example, the Bureau announced in May 2018 that it is reexamining the requirements of the Equal Credit Opportunity Act (ECOA) concerning the disparate impact doctrine in light of recent Supreme Court case law and the Congressional disapproval of a prior Bureau bulletin concerning indirect auto lender compliance with ECOA and its implementing regulations."

This is a very interesting development, because it suggests that the Bureau's "reexamination" of disparate impact may not merely be a matter of informal interpretation or enforcement/supervision priorities, but may become enshrined in a rule (presumably an amendment to Regulation B). If this happens, its effects would likely be more permanent and widespread than a more informal statement of position relating to disparate impact. A rule, once finalized, would presumably:

- remain in effect indefinitely, until altered by another notice-and-comment rulemaking;

- be binding on other federal agencies (like the Department of Justice) and on courts, as an authoritative interpretation of ECOA;
- survive any leadership change at the Bureau, again subject to the rulemaking process being restarted; and
- prevent the Bureau from applying any different standard for disparate impact retroactively upon a change in leadership at the agency.

So, a disparate impact rulemaking could be very significant over the long term. But what direction might such a rulemaking take?

One possibility would be to remove the "effects test" language from Regulation B (§ 1002.6(a)) and state affirmatively that there is no disparate impact theory of liability under ECOA. There is certainly support in the statutory language, and the reasoning of Inclusive Communities, for that result. Indeed, this conclusion was the one highlighted in the House Financial Services Committee's Unsafe at Any Bureaucracy report, including **a chart** that shows the distinctions between ECOA and other federal statutes illustrating that there is no language in ECOA to support a disparate impact theory of liability.

Another idea might be to follow the path of the HUD disparate impact rulemaking under the Fair Housing Act, to carefully define the elements of a disparate impact claim in a way that limits application of the theory to more well-settled situations and which gives appropriate deference to reasonable business justifications. We blogged about the HUD rulemaking most recently **here**.

A third potential would be to flesh out the "robust causality" requirement discussed in *Inclusive Communities* to require significant proof beyond statistical analysis for any disparate impact claim, which again could serve to curb what the Supreme Court labeled "abusive" claims of disparate impact.

We don't know what the Bureau may do in this regard, or whether the foreshadowing of an ECOA rulemaking will actually be carried through to completion, but if it is, it could be a very significant, long-term development for fair lending law.

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CFPB Fall 2018 rulemaking agenda confirms plans to consider rulemaking on “abusiveness” standard

By **Barbara S. Mishkin** on October 17, 2018

The CFPB’s **Fall 2018 rulemaking agenda** has been published by the Office of Information and Regulatory Affairs (OIRA) as part of its Fall 2018 Unified Agenda of Federal Regulatory and Deregulatory Actions. (OIRA is part of the Office of Management and Budget.) It represents the CFPB’s second rulemaking agenda under the Trump Administration and Acting Director Mick Mulvaney’s leadership. **The agenda’s preamble** indicates that the information in the agenda is current as of August 30, 2018 and identifies the regulatory matters that the Bureau “reasonably anticipates having under consideration during the period from October 1, 2018, to September 30, 2019.”

As signaled by Mr. Mulvaney i**n comments made earlier this week**, the preamble indicates that the Bureau is considering “whether rulemaking or other activities may be helpful to further clarify the meaning of ‘abusiveness’ under section 1031 of the Dodd-Frank Act.” Such rulemaking is included on **the CFPB’s list of “long-term actions”** that is part of the unified agenda.

The preamble further states that the future activity being considered by the Bureau includes “reexamining the requirements of the Equal Credit Opportunity Act (ECOA) in light of recent Supreme Court case law and the Congressional disapproval of a prior Bureau bulletin concerning indirect auto lender compliance with ECOA and its

implementing regulations." The preamble references **the CFPB's May 2018 statement** that was issued following such Congressional disapproval in which the CFPB announced that it was reexamining the ECOA requirements. However, unlike the "abusiveness" rulemaking, the ECOA rulemaking is not included on the CFPB's list of long-term actions or otherwise listed in its rulemaking agenda.

With regard to the CFPB's rulemaking to reconsider its final payday/auto title/high-rate installment loan rule (Payday Rule), the Fall 2018 agenda estimates the issuance of a notice of proposed rulemaking (NPRM) in January 2019. (**The Spring 2018 rulemaking agenda** had estimated issuance of a NPRM in February 2019.) The Payday Rule's compliance date is August 19, 2019. In the preamble, the CFPB states that it expects to issue a NRPM "by no later than early 2019 that will address reconsideration of the rule on the merits as well as address changes to its compliance date."

In addition to reconsidering the Payday Rule, the other key rulemaking initiatives listed on the Fall 2018 agenda are:

- Debt Collection. The agenda states that the Bureau "expects to issue [a NPRM] addressing such issues as communication practices and consumer disclosures by spring 2019." It estimates the issuance of a NPRM in March 2019.
- Business Lending Data. Dodd-Frank Section 1071 amended the ECOA to require financial institutions to collect and maintain certain data in connection with credit applications made by women- or minority-owned businesses and small businesses. Such data includes the race, sex, and ethnicity of the principal owners of the business. In May 2017, the CFPB **issued a RFI and a white paper on small business lending** in conjunction with a field hearing on small business lending. In the Spring 2018 agenda, the Section 1071 rulemaking was included in the list of current rulemakings, with an estimated March 2019 date for prerule activities. The Fall 2018 agenda reclassifies the Section 1071 rulemaking as a long-term action item. In the preamble, the CFPB attributes the rulemaking's

new status to the Bureau’s “need to focus additional resources on various HMDA initiatives.”

- HMDA/Regulation C. The CFPB states that it expects to issue final guidance in late 2018 to govern the disclosure of loan-level HMDA data in 2019. However, to address HMDA data disclosure in future years, the CFPB states that it has decided to add a new notice-and-comment rulemaking to its agenda and estimates a May 2019 date for issuance of a NRPM. The agenda estimates a March 2019 date for the CFPB’s issuance of a NRPM “to address some or all” of the issues related to various HMDA projects under consideration, such as revisiting the Bureau’s 2015 HMDA rule and its August 2018 interpretive rule regarding amendments made to HMDA by the Economic Growth, Regulatory Relief, and Consumer Protection Act.

In addition to DFA Section 1071 rulemaking, the key long-term actions items listed in the Fall 2018 agenda are:

- Inherited Regulations. These are the existing regulations that the CFPB inherited from other agencies through the transfer of authorities under the Dodd -Frank Act. The CFPB indicates that it expects to focus its initial review on the subparts of Regulation Z that implement TILA with respect to open-end credit and credit cards in particular. By way of example, the CFPB states that it expects to consider adjusting rules concerning the database of credit card agreements it is required to maintain by the CARD Act “to reduce burden on issuers that submit credit card agreements to the Bureau and make the database more useful for consumers and the general public.” The CFPB states it may launch additional projects after reviewing the responses it received to its RFIs on **the inherited regulations** and **rules issued by the CFPB**.
- Consumer reporting. The Fall 2018 agenda indicates that the Bureau will evaluate potential additional rules or amendments to existing regulations governing consumer reporting, with possible topics for consideration to include

the accuracy of credit reports, including the processes for resolving consumer disputes, identity theft, or other issues.

- Consumer Access to Financial Records. In November 2016, the CFPB **issued a RFI** about market practices related to consumer access to financial information. The Fall 2018 agenda states that the Bureau will continue to monitor market developments and evaluate possible policy responses to issues identified, including potential rulemaking. Possible topics the Bureau might consider include specific acts or practices and consumer disclosures. In addition, the Bureau plans to consider “whether clarifications or adjustments are necessary with respect to existing regulatory structures that may be implicated by current and potential developments in this area.”
- Regulation E Modernization. The Fall 2018 agenda states that the Bureau “will evaluate possible updates to the regulation, including but not limited to how providers of new and innovative products and services comply with regulatory requirements” and that “potential topics for consideration might include disclosure provisions, error resolution provisions, or other issues.”

Three items no longer mentioned in the CFPB’S agenda are overdrafts, “larger participant” rules, and student loan servicing. The CFPB designated these items as “inactive” when it issued its Spring 2018 agenda.

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CFPB suspending routine supervisory examinations for MLA compliance

By **Anthony C. Kaye** on August 14, 2018

On August 10, the **New York Times reported** that Mick Mulvaney, the CFPB Acting Director, intends to dispense with routine supervisory examinations of creditors for violations of the Military Lending Act (MLA). According to the report, Acting Director Mulvaney has argued in a two-page draft change to the CFPB's policies that "proactive oversight is not explicitly laid out in the legislation."

We agree with Acting Director Mulvaney that the CFPB lacks statutory authority to examine creditors for MLA compliance. Sections 1024(b)(1)(A) and 1025(b)(1)(A) of the Consumer Financial Protection Act (CFPA) provide that the CFPB shall conduct examinations of covered persons to assess compliance with the requirements of "Federal consumer financial laws." Section 1002(14) of the CFPA defines the term "Federal consumer financial law" to mean generally the provisions of the CFPA and the "enumerated consumer laws." Section 1002(12) lists the "enumerated consumer laws." There are 18 federal statutes listed in Section 1002(12). Noticeably absent is the MLA.

Although supervisory examinations for MLA compliance are expected to come to a halt, the Times reports that the CFPB will continue to pursue cases against creditors for violations of the 36 percent interest rate cap. (The 36% cap is on the Military Annual Percentage Rate (MAPR), which is an "all-in" APR that includes interest and

other fees such as application fees and annual fees that are not finance charges under Regulation Z.)

While the CFPB does not have statutory authority to examine creditors for MLA compliance, it does have MLA enforcement authority. The MLA authorizes the CFPB to enforce the MLA against the same persons as to whom it has Truth in Lending enforcement authority (i.e. any person subject to TILA.)

The CFPB will also continue to supervise creditors under other consumer protection statutes. According to the Times report, "the rule change came from a top-to-bottom review of the bureau's procedures geared at curtailing what the administration, along with lending industry executives, have criticized as overly aggressive enforcement by the bureau's first director, Richard Cordray."

In place of supervisory examinations, it appears the CFPB will rely exclusively on complaints reported by service members through the CFPB's website and hotlines. Christopher L. Peterson, a University of Utah law professor who participated in the drafting of the Department of Defense's regulations implementing the MLA, observed that enforcement "will go from a proactive system to something that is completely reactive." At the same time, Acting Director Mulvaney is urging Congress to pass legislation amending the MLA to expressly permit supervisory examinations. A spokesman for Mr. Mulvaney, John Czwartacki, stated "we are 100 precent committed to seeing that happens."

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CFPB proposes revisions to trial disclosure policy (as amended on September 19, 2018)

By **Alan S. Kaplinsky** on September 13, 2018

We have revised the blog to more fully discuss the effect of a waiver on potential UDAAP liability.

The CFPB **is proposing significant revisions** to its "Policy to Encourage Trial Disclosure Programs" (TDP Policy), which sets forth the Bureau's standards and procedures for exempting individual companies, on a case-by-case basis, from applicable federal disclosure requirements to allow those companies to test trial disclosures. The revisions are intended to address the TDP Policy's numerous shortcomings, which the Bureau acknowledges "failed to effectively encourage trial disclosure programs: The Bureau did not permit a single such program in the nearly five years since the Policy was issued." (The CFPB **finalized the existing TDP Policy** in October 2013.) Comments on the proposal must be received by October 10, 2018.

The TDP Policy relies on the Bureau's authority under Dodd-Frank Section 1032(e) to permit providers of consumer financial services and products "to conduct a trial program that is limited in time and scope, subject to specified standards and procedures, for the purpose of providing trial disclosures to consumers." The proposal follows Acting Director Mulvaney's **July 2018 appointment of Paul Watkins** to serve as Director of the Bureau's Office of Innovation. Before joining the CFPB, Mr. Watkins was in charge of fintech initiatives in the Arizona Attorney General's

office and led the state's successful efforts to create the first "regulatory sandbox" in the United States which allows new financial technologies and products to be tested in a controlled environment with reduced regulatory risk. In the Bureau's proposal, the TDP Policy is referred to as "the Bureau's Disclosure Sandbox."

As detailed below, the proposal would make several "industry-friendly" changes to the existing TDP Policy. The changes would streamline the application process and reduce the review timeframe, provide procedures for extensions of successful trial disclosure programs, and provide for coordination by the CFPB with sandbox programs offered by other regulators.

The revised TDP Policy's description of the protection from liability provided by a waiver is consistent with how the CFPB previously described such protection in connection with the existing Policy. However, unlike the CFPB's previous description which was only in the Supplementary Information accompanying the existing TDP Policy, the CFPB is proposing to include the description in the text of the revised Policy. It would state:

> For permitted trial disclosure programs, therefore, the Bureau will, for a defined period, deem a participating company to be in compliance with, or exempt from, identified Federal disclosure requirements. As a result of this determination by the Bureau, no basis exists under those provisions for a private suit based on the company's use of the trial disclosure. The same is true with respect to other Federal and State regulators even if they have enforcement authority or supervisory authority as to the enumerated laws for which the Bureau has rulemaking authority. There can be no predicate for an enforcement action by such a regulator that is based on a statutory or regulatory provisions waived by the Bureau. (footnote omitted).

In addition, the proposed TDP policy would provide that, when a waiver is granted, "in the exercise of its discretion, the Bureau will not make supervisory findings or bring a supervisory or enforcement action against the company or companies under

its authority to prevent unfair, abusive, or deceptive acts or practices predicated upon its or their use of the trial disclosures during the waiver period, provided the company engages in good faith, substantial, compliance with the terms of the waiver." Dodd-Frank Section 1032(e) provides that a covered person that receives a CFPB waiver "shall be deemed to be in compliance with, or may be exempted from, a requirement of a rule or an enumerated consumer law."

The "enumerated consumer laws" as defined by Dodd-Frank do not include the CFPA and the proposal indicates that the term "rule" as used in Section 1032(e) includes rules implementing an "enumerated consumer law" and rules implementing the CFPA, including rules promulgated by the CFPB under its authority to prevent UDAAPs or "to enable full, accurate and effective disclosure." Thus, although section 1032(e) does not provide for immunity from a UDAAP claim asserted by the CFPB based on its general authority under the CFPA, the Bureau has indicated that it will refrain from bringing such claims "in the exercise of its discretion." This exercise of discretion fills a gap in the language of section 1032(e) that makes it much more valuable to a company participating in a trial disclosure program. However, since section 1032(e) does not provide immunity under the CFPA's UDAAP provisions, there is a risk that such an action could be brought by a state attorney general or regulator using its authority under Dodd-Frank Section 1042 to file civil actions to enforce the provisions of the CFPA. However, we think a motivated state regulator would be far more likely to invoke its own state UDAP law if it wished to challenge a disclosure made under the CFPB's TDP.

Among the issues not addressed in the proposal are:

- What protection, if any, a waiver would give a company from state law liability. For example, many states have disclosure requirements that incorporate or track federal requirements. It is not clear if such requirements would be preempted for companies receiving a CFPB waiver.
- Whether a company whose waiver is revoked would lose its protection from liability retroactively or from the date that the revocation is effective

- Whether waivers will only be granted in connection with financial products or services that involve technological or other innovations and will not be granted in connection with conventional products or services. Although the Bureau refers to "facilitating innovation in financial products and services through enabling responsible companies to research informative, cost-effective disclosures in test programs," the proposal does not expressly indicate whether the CFPB only intends to give waivers in connection with innovative financial products or services.

The proposal would make the following key revisions to the TDP Policy:

- Bureau assessment of applications for trial disclosure program waivers. The revised TDP Policy would provide that in addition to individual companies, applications can be submitted by a trade association or other group seeking approval to test trial disclosures on a group basis. It would state that an application could include "the elimination of disclosure requirements, modifications to an existing model form or other disclosures, changed delivery mechanisms, or replacement of a model form or existing disclosure requirements with new disclosures or forms." The list of factors considered by the CFPB in assessing an application would be substantially reduced to eliminate factors determined to be redundant or otherwise unnecessary and thereby focus the Bureau's review on "the quality and persuasiveness of the application, especially the extent to which the trial disclosures are likely to be an improvement over existing disclosures, and the extent to which the testing program mitigates risks to consumers." The revised TDP Policy would provide that the Bureau "intends to grant or deny formal, complete applications within 60 days of submission."
- Waiver procedures. In addition to allowing the Bureau to revoke a waiver if a company does not follow the terms of a waiver, the revised Policy would allow the Bureau to revoke a waiver if it determines that a disclosure "is causing a material, adverse, impact on consumer understanding." It would further provide

that the Bureau "intends to require companies to notify the Bureau of material changes in customer service inquiries, complaint patterns, default rates, or other information that should be investigated by the Bureau to determine if the trial disclosures may be causing a material, adverse, impact on consumer understanding." The revised TDP Policy would indicate that the Bureau expects "a two-year testing period...to be appropriate in most cases."

- Waiver extensions. A new section would be added that sets forth the procedures for requesting the extension of a waiver and the factors the Bureau would consider in deciding whether to grant an extension. The revised TDP Policy would provide that "upon the presentation of persuasive test result data," the Bureau expects to grant waiver extensions "for a period at least as long as the period of the original waiver." In the proposal's supplementary information, the CFPB indicates that "to the extent that testers are able to show that trial disclosures succeed in improving upon existing requirements, the Bureau will endeavor to amend disclosure rules accordingly and to permit the use of validated trial disclosures until such amendment is effective." The revised TDP Policy would provide that the Bureau anticipates permitting extensions longer than the period of original waiver when it is considering such an amendment. It would also provide that "during the time period pending a rule amendment," the Bureau "intends to consider means of making the improved disclosure available to other covered entities."
- Coordination with other regulators. A new section would be added that sets forth the Bureau's plans for coordinating the TDP Policy with "state sandbox programs" (which for purposes of the revised TDP Policy would refer to "a regulatory structure where a participant obtains limited or temporary access to a market in exchange for reduced regulatory barriers to entry or reduced regulatory uncertainty." The revised TDP Policy would provide that the Bureau "is interested in entering into agreements with State authorities designed to improve upon existing disclosure requirements by allowing covered persons to test disclosures within the state sandbox." It would state further than the

> Bureau expects in specified circumstances that such covered persons "could receive permission to conduct a trial disclosure program pursuant to the Bureau's agreement with the State authority, rather than through the process [described in the TDP Policy]." The proposal would list the features that the Bureau would want such agreements to contain. (Currently, **Arizona** is the only state that has enacted a "sandbox.")

We hope that the CFPB will next be revisiting its **no-action letter policy** which also has numerous shortcomings that we have criticized. In its **June 2017 report**, the Treasury Department recommended that the CFPB change the requirements for no-action letters to make them less onerous by aligning CFPB policy with "the more effective policies of the SEC, CFTC, and FTC," with specific changes to CFPB requirements to include expanding the scope of the CFPB's policy beyond new products.

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BCFP proposes revisions to no-action letter policy and creation of new product sandbox

By **Alan S. Kaplinsky** & **James Kim** on December 11, 2018

The BCFP has issued **proposed revisions** to its **2016 final policy** on issuing "no-action" letters (NAL), together with a proposal to create a new "BCFP Product Sandbox." Comments must be received on or before February 11, 2019.

Proposed NAL policy revisions. The revisions are intended to address the 2016 policy's many shortcomings. The Bureau observes that the fact that the Bureau has provided **only one NAL under the 2016 policy** "strongly suggests that both the process required to obtain [NALs] and the relief available under the 2016 Policy have not provided firms with sufficient incentives to seek [NALs] from Bureau staff." Through the proposal, the Bureau seeks to "bring certain aspects of the Bureau's [NAL] policy more into alignment with [NAL] programs offered by other Federal regulators."

Key proposed changes to the 2016 policy include the following:

- The 2016 policy states that "it was intended to facilitate consumer access to innovative financial products" and that NALs would not be routinely available and were anticipated to be "provided rarely and on the basis of exceptional circumstances." The proposal would remove such statements.

- The 2016 policy stated that NALs were not binding on the Bureau and indicated that UDAAP-focused NALs were expected to be uncommon. The proposal would revise the policy to state that the Bureau "intends that [an NAL] will include a statement that, subject to good faith, substantial compliance with the terms and conditions of the letter, and in the exercise of its discretion, the Bureau will not make supervisory findings or bring a supervisory or enforcement action against the recipient's offering or providing the described aspects of the product or service under (a) its authority to prevent unfair, deceptive, or abusive acts or practices; or (b) any other identified statutory or regulatory authority within the Bureau's jurisdiction."
- The 2016 policy requires an NAL applicant to provide up to 15 items of information. In contrast, the proposal would reduce such items to up to 7.
- The 2016 policy was accompanied by the Bureau's statement that it did not intend to issue NALs to trade groups on behalf of their members or to a company that was not identified in an application. The revised policy would "invite applications from trade associations, service providers, and other third-parties."
- The 2016 policy contains no discussion of the Bureau's coordination with other regulators in connection with an NAL. The proposal would add a section on "Regulatory Coordination" that discusses the Bureau's interest in coordinating with state regulators that issue similar NALs "that would provide for an alternative means of receiving an [NAL] from the Bureau" and in coordinating more generally with other regulators by "enter[ing] into agreements whenever possible to coordinate relief [under Bureau NALs] with similar forms of relief offered by State, Federal, or international regulators."
- The 2016 policy anticipates that an NAL will have a limited duration. The revised policy would assume no temporal limitation.
- The 2016 policy requires the recipient of an NAL to commit to share data with the Bureau if requested to do so. The proposal would remove that requirement.

- The 2016 policy states that in addition to granting or denying a request for an NAL, the Bureau can decline to grant or deny the request, with or without an explanation. It also lists 10 items for the Bureau to consider when deciding whether to issue an NAL. The proposal would eliminate the 10 items and revise the policy to provide that in deciding whether to issue an NAL, the Bureau "intends to consider the quality and persuasiveness of the application, with particular emphasis on [certain designated information included in the application]." The revised policy would state only that the Bureau "intends to grant or deny" an application within 60 days of when it is complete (which is the same timetable as the 2016 policy).

The proposal would continue the practice of publishing NALs on the Bureau's website and would also allow the Bureau to publish denials after an applicant is given an opportunity to request reconsideration of the denial. (The proposal would add that the Bureau might publish a version or summary of the application "in appropriate cases" and its reasons for denying an NAL application "particularly if it determines that doing so would be in the public interest.") However, the proposal would revise the 2016 policy to add a detailed discussion of the legal limits on the Bureau's ability to disclose confidential commercial or financial information, including supervisory information, and to state that the Bureau "intends to draft [an NAL] in a manner such that confidential information is not disclosed."

The proposal would also require the Bureau to specify in an NAL "the extent to which [it] intends to publicly disclose information about the [NAL]." It would further provide that if an applicant objects to the Bureau's disclosure of certain information and the Bureau insists such information must be publicly disclosed if an NAL is issued, the applicant can withdraw the application.

BCPF Product Sandbox proposal. Neither the Bureau's background discussion nor its proposal clearly explain when an applicant would seek to participate in the sandbox program rather than seek a "standard" NAL. Presumably, the sandbox program is intended to allow participants to test innovative financial products or services without

the need to comply with otherwise applicable or potentially applicable statutory or regulatory requirements. However, there is no indication that the sandbox program is limited to innovative products or services, such as those typically labeled "fintech."

Key features of the sandbox proposal that differ from the NAL policy include the following:

- An applicant admitted to the sandbox program, in addition to receiving no-action relief that is substantially the same as that provided in an NAL letter (i.e. a statement that the Bureau will not make adverse supervisory findings or bring a supervisory or enforcement action under its UDAAP authority or otherwise), will receive two other forms of relief:
    - Approvals, as applicable, under the provisions of theTILA, ECOA, and EFTA that provide a safe harbor from liability in federal or state enforcement actions and private lawsuits for actions taken or omitted in good faith in conformity with Bureau approvals
    - Exemptions granted by Bureau order (i) from statutory or regulatory provisions as to which the Bureau has statutory authority to issue exemptions by order (such as provisions of the ECOA, HOEPA, and FDIA), or (ii) from regulatory provisions as to which the Bureau has general authority to issue exemptions. Such an exemption would provide immunity from federal or state enforcement actions and private lawsuits.
- Sandbox program admission will generally be for a two-year term and participants can apply for extensions.
- The information that applicants must provide includes a description of the data the applicant possesses and/or intends to develop regarding the impact of the product or service on consumers to be shared with the Bureau if the application is granted and a proposed schedule for such sharing.
- A participant must report information about how the offering or providing of the product or service affects "complaint patterns, default rates, or similar metrics

that will enable the Bureau to determine if doing so is causing material, tangible harm to consumers."

- A participant must commit to compensate consumers "for material, quantifiable, economic harm" caused by the participant's offering or providing the product or service within the sandbox program and must commit to sharing data with the Bureau regarding such product or service.
- In addition to publishing specified information about participants on its website, the Bureau intends to publish information about denials of applications, including its reasons for denying an application, after the applicant is given an opportunity to request reconsideration of the denial.

In September 2018, the Bureau **proposed significant revisions** to its "Policy to Encourage Trial Disclosure Programs" (TDP Policy), which sets forth the Bureau's standards and procedures for exempting individual companies, on a case-by-case basis, from applicable federal disclosure requirements to allow those companies to test trial disclosures. That proposal is not referenced in the NAL policy and sandbox proposals.

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Senate confirms Kraninger as CFPB Director

By **Barbara S. Mishkin** on December 6, 2018

This afternoon, by a vote of 50-49, the Senate confirmed Kathy Kraninger as CFPB Director.

Pursuant to the Dodd-Frank Act, the CFPB Director has a five-year term. The approximate 12 months during which Mick Mulvaney has served as Acting Director since former Director Cordray's resignation last November does not count against Ms. Kraninger's five-year term. As a result, Ms. Kraninger could serve as Director for approximately three years of the next four-year Presidential term that begins in January 2021 even if a Democratic President is elected.

There is, however, a "wildcard" that could potentially shorten Ms. Kraninger's tenure, namely the ongoing litigation challenging the CFPB's constitutionality. In September 2018, **a petition for certiorari** was filed in the U.S. Supreme Court by State National Bank of Big Spring which, together with two D.C. area non-profit organizations that also joined in the petition, had brought one of the first lawsuits challenging the CFPB's constitutionality. Following **the D.C. Circuit's en banc *PHH* decision** that held the CFPB's structure is constitutional, the D.C. Circuit, based on *PHH*, summarily affirmed the district court's judgment entered against the plaintiffs. The issue of the CFPB's constitutionality is also currently pending in two circuit courts–the Second Circuit in the **RD Legal Funding** case and the Fifth Circuit in the **All American Check**

Cashing case. In all of these cases, the CFPB's constitutionality has been challenged based on its single-director-removable-only-for-cause structure.

These cases create a strong likelihood of this issue coming before the Supreme Court in the next year or so. If the CFPB's structure is found to be unconstitutional and severing Dodd-Frank's for-cause removal provision is determined to be the appropriate remedy (as the D.C. Circuit determined in its *PHH* panel decision), a Democratic President might have the ability to remove Ms. Kraninger without cause before the end of her five-year term.

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OCC small-dollar lending bulletin: one step forward but one step back?

By **Jeremy T. Rosenblum** on May 24, 2018

The OCC has issued a bulletin (**2018-14**) setting forth core lending principles and policies and practices for short-term, small-dollar installment lending by national banks, federal savings banks, and federal branches and agencies of foreign banks.

In issuing the bulletin, the OCC stated that it "encourages banks to offer responsible short-term, small-dollar installment loans, typically two to 12 months in duration with equal amortizing payments, to help meet the credit needs of consumers." The bulletin is intended "to remind banks of the core lending principles for prudently managing the risks associated with offering short-term, small-dollar installment lending programs."

By way of background, the bulletin notes that in October 2017, the OCC **rescinded its guidance on deposit advance products** because continued compliance with such guidance "would have subjected banks to potentially inconsistent regulatory direction and undue burden as they prepared to comply with the [CFPB's final payday/auto title/high-rate installment loan rule (Payday Rule)."] The guidance had effectively precluded banks subject to OCC supervision from offering deposit advance products. The OCC references the CFPB's plans to reconsider the Payday Rule and states that it intends to work with the CFPB and other stakeholders "to ensure that OCC-supervised banks can responsibly engage in consumer lending,

including lending products covered by the Payday Rule." (**The statement issued by CFPB Acting Director Mulvaney** applauding the OCC bulletin further reinforces our expectation that the CFPB will work with the OCC to change the Payday Rule.)

When the OCC withdrew its prior restrictive deposit advance product guidance, we commented that the OCC appeared to be inviting banks to consider offering the product. The bulletin appears to confirm that the OCC intended to invite the financial institutions it supervises to offer similar products to credit-starved consumers, although it suggests that the products should be even-payment amortizing loans with terms of at least two months. It may or may not be a coincidence that the products the OCC describes would not be subject to the ability-to-repay requirements of the CFPB's Payday Rule (or potentially to *any* requirements of the Payday Rule).

The new guidance lists the policies and practices the OCC expects its supervised institutions to follow, including:

- "Loan amounts and repayment terms that align with eligibility and underwriting criteria and that promote fair treatment and access of applicants. Product structures should support borrower affordability and successful repayment of principal and interest in a reasonable time frame."
- "Analysis that uses internal and external data sources, including deposit activity, to assess a consumer's creditworthiness and to effectively manage credit risk. Such analysis could facilitate sound underwriting for credit offered to consumer who have the ability to repay but who do not meet traditional standards."

While the OCC's encouragement of bank small-dollar lending is a welcome development, the bulletin contains potentially troubling language. The OCC's "reasonable policies and practices specific to short-term, small-dollar installment lending" also include "[l]oan pricing that complies with applicable state laws and reflects overall returns reasonably related to product risks and costs. The OCC *views unfavorably* an entity that partners with a bank with the sole goal of evading a lower

interest rate established under the law of the entities licensing state(s)." (emphasis added). This statement raises at least two concerns:

- The OCC's reference to "[l]oan pricing that complies with applicable state laws" is confused (or likely to cause confusion). *Federal* law (12 U.S.C. Section 85) governs the interest national banks may charge. It authorizes banks to charge the interest allowed by the law of the state where they are located, without regard to the law of any other state. The OCC should clarify that it did not mean to suggest otherwise.
- The OCC's unfavorable view of bank-nonbank partnerships, where the "sole goal [is] evading" state-law rate limits, could be read to call into question a valuable distribution channel for bank loans. While the context is "specific to short-term, small-dollar installment lending," this apparent hostility to bank-model relationships should be of concern to all banks that partner with third parties, including fintech companies, to make loans under Section 85. The statement in question seems at odds with the broad view of federal preemption enunciated by the OCC with respect to the ***Madden* decision**.

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Federal court dismisses second lawsuit challenging OCC fintech company special purpose national bank charter proposal

By **Alan S. Kaplinsky** & **Scott M. Pearson** on May 3, 2018

A D.C. federal district court **has dismissed the lawsuit** filed by the Conference of State Bank Supervisors (CSBS) **in April 2017** challenging the OCC's authority to grant special purpose national bank (SPNB) charters to nondepository fintech companies.

The dismissal follows **the December 2017 dismissal** by a New York federal district court of a lawsuit filed by the New York Department of Financial Services (DFS) that also challenged the OCC's authority to grant SPNB charters. The D.C. court found that the CSBS had failed to establish any injury in fact necessary for Article III standing and that the case was not ripe for judicial review, which were the same grounds on which the New York court dismissed the DFS lawsuit.

In dismissing the CSBS lawsuit, the district court observed that all of the potential injuries identified by the CSBS in its complaint were contingent on whether the OCC charters a fintech company and that a chain of speculative events had to occur before a charter was issued, including the OCC's finalization of the procedures for applying for a SPNB charter and a decision by the OCC to grant a charter to a fintech company. As a result, the CSBS had failed to establish an injury in fact to a CSBS member under the test that a threatened injury was "certainly impending" or under

the test that there was "substantial risk" that such injury would occur. (The court observed that "there was no doubt" if the OCC were to charter a fintech company, "then that national charter would preempt conflicting state laws" and would allow an impacted state to allege an injury in fact.")

With regard to ripeness, the court concluded that the CSBS's claims were neither constitutionally nor prudentially ripe. According to the court, the claims were not constitutionally ripe for the same reason that Article III standing was lacking–namely, the CSBS had not established an injury in fact.

The court also found that the claims were not prudentially ripe. In its view, because "the recent leadership changes at the OCC [make] it particularly speculative to guess whether the OCC will continue down paths considered by a previous Comptroller," the OCC's actions were not yet "sufficiently settled to be fit for review." The court further found that the legal issues presented by the dispute were unfit for review before the OCC had made a decision "to adopt and apply a regulatory scheme to a particular Fintech charter." According to the court, at that point "the agency action will become sufficiently settled and courts will have a more concrete setting to resolve the legal disputes."

Finally, the court found that the CSBS had failed to show that delay in obtaining a decision would cause it hardship, with the court observing that there would be "hardship to the OCC if each minor step towards a potential agency policy were litigated one-by-one as the policy becomes more settled."

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August 3, 2018

OCC to Accept Applications from Fintech Companies Seeking National Bank Charters

by Ballard Spahr's Consumer Financial Services Group

The Office of the Comptroller of the Currency's (OCC) announcement this week that it will begin accepting applications for special purpose national bank (SPNB) charters from financial technology (Fintech) companies represents a major development that provides Fintech companies with the opportunity to take advantage of the benefits of federal preemption available to full-service national banks. Most significantly, the OCC's decision means that obtaining an SPNB charter is now an option for Fintech companies that would be disqualified from obtaining a full-service national bank charter due to their own non-financial activities or those of an affiliate.

On August 28, 2018, from 12 p.m. to 1 p.m. ET, Ballard Spahr will conduct a webinar, "The OCC's Special Purpose National Bank Charter: What Fintech Companies Need to Know." A link to register is available here.

As set forth in a new Policy Statement, it is now the OCC's policy to consider applications for SPNB charters from Fintech companies "that are engaged in the business of banking but do not take deposits." The statement confirms the OCC's authority under the National Bank Act (NBA) to grant the charters and generally describes the chartering standards the OCC will apply and its supervisory expectations for Fintech companies that receive an SPNB charter. The application and decision process is described more fully in a supplement to the OCC's existing Licensing Manual, "Considering Charter Applications from Financial Technology Companies." The supplement describes an SPNB as a bank "that would engage in one or more of the core banking activities of paying checks or lending money, but would not be insured by the Federal Deposit Insurance Corporation (FDIC)."

The supplement discusses:

- the application process, including prefiling communications with the OCC's Office of Innovation and Licensing Department;
- key factors considered by the OCC in reviewing an application, including the qualifications and experience of organizers, managers, and directors, as well as the applicants' business plan, and the SPNB's capital and liquidity, commitment to financial inclusion, and contingency planning;
- the OCC's chartering decision, including conditions of approval; and
- OCC supervision of approved SPNBs.

Below are some items of particular note in the supplement:

- An SPNB's organizers will be expected to propose a minimum level of capital the bank will meet or exceed at all times. If preliminary approval of an SPNB charter is granted, the approval will include a condition specifying the minimum level of capital that the bank must meet or exceed at all times. Organizers will also be expected to describe how the SPNB can be funded and maintain sufficient liquidity under stressed conditions.
- Because it is uninsured, an SPNB, as a condition of charter approval, must have a contingency plan that includes options to sell itself, wind down, or merge with a nonbank affiliate, if necessary.

- Assessments imposed on an SPNB as a condition of charter approval will be modified from those charged to full-service national banks based on factors tailored to the SPNB's business model.
- In considering applications, the OCC will coordinate with other regulators to facilitate consideration of any applications or approvals required by those regulators.
- A pending enforcement action involving a significant supervisory matter may be grounds for denial of an application. If an application is approved for a company that has an obligation to remediate or pay penalties for violations cited by another regulator, the OCC will ensure that the obligation is carried forward and enforced through conditions imposed on a charter approval.

A SPNB charter would allow Fintech companies that engage in lending activities or payment services to enjoy the benefits of federal preemption afforded to full-service national banks under the NBA. (In the supplement, the OCC states that "facilitating payments electronically may be considered the modern equivalent of paying checks.") An SPNB charter would allow such Fintech companies to avoid burdensome state licensing requirements for lending activities and money transmission. They would also be entitled to the NBA's preemption of state consumer financial laws that "prevent[] or substantially interfere[] with the national bank's exercise of its powers."

For Fintech companies engaged in lending activities, an SPNB's entitlement to federal preemption would eliminate the need for a bank partner and the potential for "true lender," *Madden,* and other legal challenges arising from such relationships. In particular, an SPNB would be entitled to the NBA's preemption of state usury laws so that it could export the maximum interest rate allowed in the state where the bank is located and make loans in other states without regard to their usury laws.

Under the Bank Holding Company Act (BHCA), a "bank" is defined as an institution that is an "insured bank" as defined in the Federal Deposit Insurance Act (FDIA) or that both receives "demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others" and makes "commercial loans." The parent company of an SPNB that does not take deposits, but only makes loans, will not be deemed a bank holding company under the BHCA or be subject to Federal Reserve oversight. As a result, the activities in which the parent company could engage would not be restricted by the BHCA. It is uncertain, however, whether the Federal Reserve would assert jurisdiction over, and thereby seek to restrict the activities of, the parent company of an SPNB that offers payments services that are akin to the payment of checks but does not have deposit insurance or take deposits.

SPNBs also would not be subject to the FDIA's provisions applicable to "insured depository institutions" because they would not be required to have deposit insurance. However, in the Policy Statement, the OCC made clear that it would not approve charter applications from Fintech companies that include "financial products and services that have predatory, unfair, or deceptive features or that pose undue risk to consumer protection."

While not discussed in the supplement, it appears that a Fintech company holding an SPNB charter would be required to be a member of the Federal Reserve System and be subject to oversight as a member bank. As a Federal Reserve member, an SPNB would have access to the Federal Reserve discount window and other Federal Reserve services. To become a Federal Reserve member, an SPNB would have to subscribe to the capital stock of the Federal Reserve, a requirement that should not be particularly burdensome. However, since Federal Reserve membership would make the affiliate transaction restrictions of Sections 23A and 23B of the Federal Reserve Act applicable to the SPNB, a Fintech company interested in obtaining an SPNB charter should consider the potential impact of these restrictions.

The OCC's decision to begin accepting SPNB charter applications from nondepository Fintech companies is consistent with the views of the Treasury Department set forth in its report, "Nonbank Financials, Fintech, and Innovation," which was issued the same day as the OCC's announcement. In the report, the Treasury Department endorsed the OCC's proposal to grant the charters and recommended that it finalize the proposal.

The OCC's decision to begin accepting applications, however, is likely to be challenged by state regulators who have opposed the proposal. Lawsuits challenging the OCC's authority to grant SPNB charters to nondepository Fintech companies filed by the Conference of State Bank Supervisors (CSBS) and the New York Department of Financial Services (DFS) were dismissed for lack of standing and ripeness by federal district courts in D.C. and New York respectively. Indeed, the DFS Superintendent released a statement on the day of the OCC's announcement in

which she stated that the OCC's decision to begin accepting the charter applications was "wrongly supported by the Treasury Department" and "is clearly not authorized under the [NBA]." In addition, according to media reports, the OCC's decision has also been criticized by the CSBS President.

It is unclear whether, based on the decisions dismissing the two lawsuits, the OCC's announcement that it will begin accepting applications would be sufficient to allow state regulators to file new lawsuits that would survive a motion to dismiss for lack of standing and ripeness or whether the OCC would first have to approve an application. In its opinion dismissing the DFS complaint, the court noted that the DFS had sent it a letter asking it to require the OCC to promptly notify the DFS "if and when" the OCC decided to accept SPNB charter applications and allow the DFS to reinstate the case and litigate its challenge before an application is approved. The court indicated that it did not have the subject matter jurisdiction necessary to grant the relief requested but indicated that it would be "sensible" for the OCC to provide such notice.

Ballard Spahr's Consumer Financial Services Group is nationally recognized for its guidance in structuring and documenting new consumer financial services products and programs, its experience with the full range of federal and state consumer credit laws, and its skill in litigation defense and avoidance.

The firm's Marketplace Lending Task Force is nationally recognized for counseling marketplace lending businesses in both the consumer and small business spaces. We offer soup-to-nuts guidance, working with startup alternative lenders, long-established market leaders, banks, institutional investors, and others. We document and advise on the structure and strategy of bank, platform, and investor relationships, assist in concluding account servicing arrangements, provide extensive consumer regulatory advice, documentation, and diligence assistance, and help with state licensing. We have been advising clients on the steps involved in obtaining an SPNB charter.

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State regulators file second lawsuit opposing OCC fintech charter

By **Alan S. Kaplinsky** on October 29, 2018

The Conference of State Bank Supervisors (CSBS) **has filed a second lawsuit** in D.C. federal district court to stop the Office of the Comptroller of the Currency (OCC) from issuing special purpose national bank (SPNB) charters to fintech companies. A similar lawsuit was filed last month in a New York federal district court by the New York Department of Financial Services.

The CSBS and **the DFS** had previously filed lawsuits challenging the OCC's authority to grant SPNB charters to fintech companies at a time when the OCC had not yet decided whether it would move forward on its charter proposal. Both lawsuits were dismissed for failing to establish an injury in fact necessary for Article III standing and for lacking ripeness for judicial review. The new lawsuits were filed in response to **the OCC's July 2018 announcement** that it would begin accepting applications for SPNB charters from fintech companies. In its complaint, the CSBS alleges that "things have changed substantially since the Court's decision [dismissing the prior CSBS lawsuit]. The issuance of a [SPNB] charter is now clearly imminent." It further alleges that "upon information and belief, multiple pre-qualified candidates have already decided to apply (and may have already applied)."

The CSBS challenges the OCC's SPNB charter plans in the new lawsuit on the following grounds (which generally track those asserted in the first CSBS lawsuit):

- 12 C.F.R. Section 5.20(e)(1), on which the OCC has relied for its authority to charter a bank that performs a single core banking function—receiving deposits, paying checks, or lending money—is inconsistent with the National Bank Act because the NBA does not allow the OCC to charter entities that do not receive deposits unless they are carrying on a special purpose expressly authorized by Congress.
- Because the OCC has indicated that state law would be preempted as to fintech companies that obtain a SPNB charter, the OCC's plans to issue the charters represent a preemption determination to which notice and comment procedures apply.
- The OCC's plans to issue SPNB charters to fintech companies represent a "rule" that was made without compliance with the Administrative Procedure Act and is an arbitrary and capricious action that does not constitute "reasoned decision making" as required by the APA.
- The OCC's plans to issue SPNB charters to fintech companies, by enabling nonbank charter holders to disregard state law, violate the Tenth Amendment of the U.S. Constitution under which states retain the powers not delegated to the federal government, including the police powers necessary to regulate nonbank providers of financial services and protect consumers and the public interest from unsound and abusive financial practices.

For the reasons **discussed in our blog post** about the second lawsuit filed by the DFS, we expect the OCC's power to issue an SPNB charter will ultimately be withheld.

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The lawsuit filed in September 2018 by the DFS in the U.S. District Court for the Southern District of New York seeking a declaratory judgment that the OCC's decision to accept applications for SPNB charters from non-depository companies exceeds the OCC's powers under the National Bank Act (NBA) represents the second time that DFS has sued the OCC regarding the SPNB charter.

The original lawsuit filed by DFS was dismissed in December 2017 due to lack of ripeness and the absence of a case or controversy. In reaching its decision, the court pointed to statements made by former Acting Comptroller Keith Noreika indicating that while the OCC was continuing to consider its SPNB charter proposal, it had not yet determined its ultimate position. It also noted that Joseph Otting, the new Comptroller, had not yet taken a public position on the charter proposal.

The court concluded that the injuries that DFS alleged would result from the issuance of SPNB charters "would only become sufficiently imminent to confer standing once the OCC makes a final determination that it will issue SPNB charters to fintech companies." Such alleged injuries included the potential for New York-licensed money transmitters to escape New York's regulatory requirements and for their consumers to lose the protections of such requirements as well as DFS's loss of the funding it receives through assessments levied on the New York-licensed financial institutions that would instead obtain SPNB charters.

With regard to ripeness, the court concluded that DFS's claims were neither constitutionally nor prudentially ripe. According to the court, the claims were not constitutionally ripe for the same reason that Article III standing was lacking–namely, the claims were not "actual or imminent" but instead were "conjectural or hypothetical."

The new complaint filed by DFS is almost a carbon copy of its 2017 complaint with minor changes to discuss the OCC's decision to accept applications for SPNB charters and to argue that the decision removes questions of ripeness or standing. The OCC makes the following principal arguments in the new complaint:

- The NBA does not allow the OCC to charter non-depository financial services companies
- The OCC's decision to issue SPNB charters to fintech companies, by enabling non-depository charter holders to disregard state law, violates the Tenth Amendment of the U.S. Constitution under which states retain the powers not delegated to the federal government, including the police power to regulate financial services and products delivered within a state

In defending its authority to charter SPNBs that do not take FDIC-insured deposits, the OCC has relied on 12 C.F.R. Section 5.20(e)(1) which allows the OCC to charter a bank that performs a single core banking function—receiving deposits, paying checks, or lending money. The DFS lawsuit includes a declaration that the OCC lacks authority under the NBA to issue SPNB charters to fintech companies that do not take deposits, a declaration that 12 C.F.R. Section 5.20(e)(1) is null and void because it exceeds the OCC's authority under the NBA, and an injunction prohibiting the OCC from issuing SPNB charters as planned.

We expect that the OCC's power to issue an SPNB charter will ultimately be upheld. In 12 U.S.C. §21, the NBA permits the formation of an association to carry on the business of banking. In 12 U.S.C. §24, subd. 7, a national banking association is empowered "To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of title 62 of the Revised Statutes." The NBA does not state that a national bank must take deposits and the OCC has chartered trust companies that are not deposit-taking institutions.

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OCC seeks comment on modernizing CRA regulatory framework

By **Alan S. Kaplinsky** & **John L. Culhane, Jr.** on August 30, 2018

The Office of the Comptroller of the Currency (OCC) has issued an **advance notice of proposed rulemaking** (ANPR) on which it invites public comment "to solicit ideas for building a new framework to transform or on ways to transform or modernize the regulations that implement the Community Reinvestment Act of 1977 (CRA)." The ANPR follows **the Treasury Department's issuance of a memorandum in April 2018** that made recommendations for modernizing the CRA to reflect the significant organizational and technological change experienced by the U.S. banking industry since the CRA's enactment. The Treasury's memorandum was directed to the primary CRA regulators, consisting of the OCC, the Federal Reserve, and the FDIC. Each of these agencies has individually adopted regulations to implement the CRA. In issuing the ANPR, the OCC becomes the first of the three agencies to move forward on updating its CRA regulations. Comments on the ANPR will be due no later than 75 days after the date it is published in the Federal Register.

The ANPR is intended to respond to stakeholder concerns that (1) the CRA's statutory purpose of encouraging banks, consistent with safety and soundness considerations, to help meet the credit needs of the communities they serve including low- and moderate-income (LMI) areas "is not fully or effectively accomplished through the current regulations," (2) the current CRA regulatory framework "no longer reflects

how many banks and consumers engage in business of banking," and (3) the current CRA regulatory requirements lack "clarity, consistency, and certainty."

Following a discussion of the different methods currently used to evaluate a bank's CRA performance depending on its asset size and business strategy, what is included in a bank's assessment area, and the relationship between a bank's assessment area and its CRA-qualifying activities, the ANPR invites comments on five groups of questions. The questions in the first group are general in nature and solicit comments "on changes to transform or modernize the current CRA regulatory framework." For example, the OCC asks whether the current CRA regulations are "clear and easy to understand" and "applied consistently" and whether the current CRA rating system is "objective, fair, and transparent."

The other four groups of questions are directed at specific topics as follows:

- Revising or transforming the current regulatory approach by implementing either (1) an alternative evaluation method to replace existing performance tests and standards that would "separately evaluate retail or [community development (CD)] activities for all banks, accounting for variations in size, business model, or other factors," and use "updated metrics that take into account information on a bank's performance context, such as the demographic characteristics and the economic and financial condition of specific communities," or (2) "a more transformational approach" that could, through the use of "a metric-based performance measurement system with thresholds or ranges (benchmarks) that correspond to the four statutory CRA ratings," make the process for evaluating a bank's CRA performance more transparent, define "community" more broadly, and expand the activities receiving CRA consideration.
- An updated approach to defining a bank's assessment area under which a bank would continue to receive consideration for CRA-qualifying activities within its branch and deposit-taking ATM footprint and could receive consideration "for

providing these types of beneficial activities in LMI areas outside of [such footprint] and other underserved areas."

- Expanding CRA-qualifying activities through regulatory changes "that could ensure CRA consideration for a broad range of activities supporting community and economic development in banks' CRA performance evaluations, while retaining a focus on LMI populations and areas, and set clear standards for determining whether an activity qualifies for CRA consideration," such as small business loans.
- Updating CRA recordkeeping and reporting requirements under a metric-based framework.

The ANPR concludes with an invitation for "other ideas and options for modernizing the CRA regulatory framework not identified in this ANPR."

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Federal banking agencies issue policy statement on interagency notification of enforcement actions

By **Alan S. Kaplinsky** on June 21, 2018

The federal banking agencies (the Federal Reserve Board, OCC, and FDIC (FBAs)), recently issued a "**Policy Statement on Interagency Notification of Formal Enforcement Actions**" that is intended "to promote notification of, and coordination on, formal enforcement actions among the FBAs at the earliest practicable date." The issuance of the policy statement follows **the DOJ's announcement last month** of a new policy to encourage coordination among the DOJ and other enforcement agencies when imposing multiple penalties for the same conduct to discourage "piling on."

The new policy statement recites that it is not intended as a substitute for routine informal communications among FBAs in advance of an enforcement action, including verbal notification of pending enforcement actions "to officials and staff with supervisory and enforcement responsibility for the affected institution."

The policy statement's key instructions are:

- When an FBA determines that it will take formal enforcement action against a federally-insured depository institution, depository institution holding company, non-bank affiliate, or institution-affiliated party, it should evaluate whether the action involves the interests of another FBA. By way of example, the policy

statement notes that an entity targeted by an FBA for unlawful practices might have significant connections with an institution regulated by another FBA.

- If it is determined that one or more other FBAs have an interest in an enforcement action, the FBA proposing the action should notify the other FBA(s) at the earlier of the FBA's written notification to the targeted entity or when the responsible agency official or group of officials determines that enforcement action is expected to be taken.
- The information shared should be appropriate to allow the other FBA(s) to take necessary action in examining or investigating the entity over which they have jurisdiction
- If two or more FBAs is considering bringing a complementary action, such as an action involving a bank and its parent holding company, those FBAs should coordinate the preparation, processing, presentation, potential penalties, service, and follow-up of the enforcement action.

We view the new policy statement as a very positive development.

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FDIC seeks comments on small-dollar lending

By **Jeremy T. Rosenblum** on November 15, 2018

The FDIC has published a **request for information** (RFI) on small-dollar lending, including "steps the FDIC could take to encourage FDIC-supervised institutions to offer responsible, prudently underwritten small-dollar credit products that are economically viable and address the credit needs of bank customers." (The FDIC supervises state-chartered banks and savings institutions that are not Federal Reserve members.) Comments must be received by January 22, 2019.

In May 2018, the OCC **issued a bulletin** intended to encourage its supervised institutions to offer small-dollar loans. The FDIC's issuance of the RFI signals that the FDIC intends to follow suit.

The RFI requests input on 21 questions dealing with the following topics:

- Consumer demand
- Challenges
- Product features
- Innovation
- Alternatives
- Other considerations

The questions dealing with "Challenges" include one that asks whether there are "any legal, regulatory, or supervisory factors that prevent, restrict, discourage, or disincentivize banks from offering small-dollar credit products." A glaring regulatory impediment to small-dollar lending by FDIC-supervised institutions is the FDIC' s November 2013 **guidance on deposit advance products**, which effectively precludes FDIC-supervised institutions from offering deposit advance products. (In October 2017, just hours after the CFPB released its final rule on payday, vehicle title, and certain high-cost installment loans, **the OCC rescinded** substantially identical guidance on deposit advance products, applicable to national banks and federal savings associations.)

While the OCC's encouragement of small-dollar lending was in one sense a welcome development, the OCC bulletin raised several concerns. As discussed more fully in **our blog post about the bulletin**, those concerns were the bulletin's failure to confirm that the National Bank Act authorizes national banks to charge the interest allowed by the law of the state where they are located, without regard to the law of any other state, as well as the bulletin's unfavorable view of bank-nonbank partnerships.

Unlike the FDIC, the OCC did not issue an RFI in advance of issuing its bulletin. The FDIC's RFI thus serves as an opportunity for commenters to provide input that could result in the FDIC's issuance of guidance that addresses the shortcomings in the OCC bulletin. For example, the RFI asks: "What are the potential benefits and risks related to banks partnering with third parties to offer small-dollar credit?" In addition, it invites comment on the structure of small-dollar credit products offered by FDIC-supervised institutions. Thus, commenters can ask the FDIC to consider structures other than the structure suggested by the OCC bulletin—even-payment amortizing loans with terms of at least two months.

Additionally, and perhaps most significantly, this RFI could serve as a vehicle for the FDIC to confirm that, in a properly structured loan program between a bank and a nonbank marketing and servicing agent, the Federal Deposit Insurance Act

authorizes state-chartered banks to charge the interest allowed by the law of the state where they are located, without regard to the law of any other state, despite "true lender" and *Madden* arguments to the contrary.

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Republican Senators seek action from FDIC to ensure end of Operation Choke Point

By **Barbara S. Mishkin** on November 19, 2018

Thirteen Republican Senators **have sent a letter** to FDIC Chairman Jelena McWilliams urging the FDIC to take action to ensure that lawful businesses are no longer at risk of adverse financial consequences as a result of "Operation Choke Point, and its associated culture and Choke Point-like regulatory actions."

"Operation Choke Point" was a federal enforcement initiative involving various agencies, including the DOJ, OCC, FDIC, and Fed. Initiated in 2012, Operation Choke Point targeted banks serving online payday lenders and other companies that have raised regulatory or "reputational" concerns. In June 2014, the national trade association for the payday lending industry and several payday lenders **initiated a lawsuit in D.C. federal district court** against the FDIC, Fed, and OCC in which they alleged that certain actions taken by the regulators as part of Operation Choke Point violated the Administrative Procedure Act and their due process rights. In September 2018, pursuant to a joint stipulation of dismissal, the Fed was dismissed from the lawsuit. Cross-motions for summary judgment are currently pending before the court.

In their letter, the Senators ask the FDIC if it is the agency's official position "that lawful businesses should not be targeted by the FDIC simply for operating in an industry that a particular administration might disfavor" and "[i]f so, what [the FDIC is] doing to make sure that bank examiners and other FDIC officials are aware of this

policy and have communicated it to regulated institutions?" They also ask whether there were any communications explaining supervisory expectations of "elevated risk" or "high risk" merchants with regulated institutions that would likely qualify as a rule under the Congressional Review Act that were not properly submitted to Congress and what the FDIC is doing to ensure that its staff does not communicate policy in a matter that is inconsistent with the position of the FDIC's Board of Directors.

The letter does not reference the FDIC's **January 2015 Financial Institution Letter** (FIL) entitled "Statement on Providing Banking Services" that attempted to rectify the damage created by Operation Choke Point. In the Statement, the FDIC "encourages institutions to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories of customers, without regard to the risks presented by an individual customer or the financial institution's ability to manage the risk." The Statement followed the FDIC's **July 2014 FIL** in which the FDIC withdrew the list of "risky" merchant categories (such as payday lenders and money transfer networks) that was included in prior guidance on account relationships with third-party payment processors (TPPPs). Consistent with the July 2014 FIL and an October 2013 FIL on TPPP relationships, the 2015 FIL advised banks that they were neither prohibited nor discouraged from providing services to customers operating lawfully, provided they could properly manage customer relationships and effectively mitigate risks. However, unlike the prior FILs, the new FIL expressly acknowledged that "customers within broader customer categories present varying degrees of risk" and should be assessed for risk on a customer-by-customer basis.

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FDIC seeking comment on brokered deposit and interest rate regulations

By **Scott A. Coleman** on December 20, 2018

The FDIC has issued an **Advance Notice of Proposed Rulemaking** (ANPR) seeking comment on its regulatory approach to brokered deposits and interest rate restrictions.

The FDIC's current regulations on brokered deposits and interest rate restrictions are set forth at 12 C.F.R. Section 337.6. Such regulations implement Section 29 of the Federal Deposit Insurance Act which restricts an insured depository institution that is less than well capitalized from soliciting or accepting deposits by or through a "deposit broker." It also imposes restrictions on the interest rate that such institutions can pay on deposits.

The FDIC states in the ANPR that it is undertaking a "comprehensive review[] [of] its brokered deposit and interest rate regulations in light of significant changes in technology, business models, the economic environment, and products since the regulations were adopted." Through the ANPR, the FDIC seeks input on how it "can improve its implementation of Section 29 of the FDI Act, while continuing to protect the safety and soundness of the banking system." The FDIC also seeks input on a series of specific questions, with one set of questions directed at brokered deposits and a second set directed at interest rate restrictions.

In addition to two sections that discuss various issues concerning brokered deposits and interest rate restrictions, the ANPR's Supplementary Information contains a section that reviews the current law and regulations and their history and another section that reviews the history of brokered deposit use by insured institutions, including the impact of the bank failures that occurred during the 1980s, and related research findings. The ANPR also includes two appendices: Appendix 1 providing "descriptive statistics detailing the historical holdings of brokered deposits by bank size and [Prompt Corrective Action] capital classification status" and Appendix 2 providing an updated analysis of core and brokered deposits using data through the end of 2017.

Given the infrequency with which the FDIC has granted waivers to the interest rate restrictions for banks that are deemed less than well capitalized (including banks that have entered into an enforcement action with a capital provision), a reexamination of the brokered deposit rules will be viewed positively by the industry. Further, although a financial institution could use brokered deposits to fund rapid growth, brokered deposits can be a more stable long-term funding source on a financial institution's balance sheet. The industry will benefit if financial institutions can use brokered deposits responsibly without significant limitations to manage liquidity needs and limit interest rate risk.

Responses to the ANPR will be due no later than 90 days after the date of its publication in the Federal Register.

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Republicans take control of FTC

By **Barbara S. Mishkin** on May 2, 2018

With the swearing in of four of the **five newly-confirmed FTC commissioners**, control of the FTC is now in the hands of Republicans.

Yesterday, Joseph Simons, a Republican, was sworn in as FTC Chairman. **Today**, Noah Phillips, a Republican, was sworn in along with Rebecca Slaughter and Rohit Chopra, both Democrats.

Republican Christine Wilson, the fifth newly-confirmed FTC commissioner, was appointed to fill the seat currently held by Maureen Ohlhausen, also a Republican. Ms. Ohlhausen is awaiting Senate confirmation of her nomination by President Trump to serve as a judge on the U.S. Court of Federal Claims. Ms. Wilson will be sworn in when Ms. Ohlhausen leaves the FTC.

We will be closely watching future FTC developments to see the impact of the change to Republican control on the FTC's regulatory and enforcement priorities and initiatives.

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Ballard Spahr LLP
Consumer Finance Monitor
CFPB, Federal Agencies, State Agencies, and Attorneys General

FTC approves appointment of Andrew Smith to head Bureau of Consumer Protection

By **Alan S. Kaplinsky** on May 17, 2018

I was pleased to see **the announcement** yesterday afternoon by FTC Chairman Joseph Simons that the FTC has approved the appointment of Andrew Smith to serve as Director of the agency's Bureau of Consumer Protection, beginning next week.

As I indicated in **my prior blog post**, I have known Andrew for many years going back to his tenure at the FTC earlier in his career and have always felt that Andrew was a very fair-minded attorney who studiously called the shots as he saw them. In addition to bringing his excellent lawyering skills to the FTC, I am confident that Andrew will continue to take an even-handed approach in his new leadership role.

Andrew's appointment was approved by a 3-2 vote, with both Democratic commissioners, **Rohit Chopra** and **Rebecca Slaughter**, voting against his appointment.

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Simpson Thacher & Bartlett LLP, Memorandum, OCC Seeks Comments on Modernizing Community Reinvestment Act Regulations (August 29, 2018)

Submitted by:
Keith A. Noreika

Simpson Thacher & Bartlett LLP

Simpson Thacher

Memorandum

OCC Seeks Comments on Modernizing Community Reinvestment Act Regulations

August 29, 2018

On August 28, the Office of the Comptroller of the Currency ("OCC") released an Advance Notice of Proposed Rulemaking ("ANPR") seeking comment on the best ways to modernize the regulatory framework implementing the Community Reinvestment Act of 1977 ("CRA"). The ANPR follows recent recommendations by the U.S. Treasury Department for the Federal banking agencies to adopt certain reform the CRA regulations.[1] Notably, however, the OCC released the ANPR without being joined by the Board of Governors of the Federal Reserve System or the Federal Deposit Insurance Corporation, which also have responsibility of implementing the CRA. Comptroller Otting has previously stated that he was "hopeful and confident" that the Federal Reserve and FDIC would join the OCC in efforts to reform and modernize the CRA, and an agency spokesperson recently stated that the OCC "will be sharing comments with fellow regulators."

Prior to releasing the ANPR, the OCC reached out to and engaged with over 1,000 stakeholders on the existing CRA framework and whether it is meeting the credit needs of communities, given the changing landscape of the financial services industry and banking. The OCC's goal for issuing this ANPR is to obtain additional public input on how to revise the CRA regulations to encourage more local and nationwide community and economic development—and thus promote economic opportunity—by encouraging banks to lend more to low- and moderate-income ("LMI") areas, small businesses, and other communities in need of financial services.

[1] *See* Memorandum from the U.S. Department of the Treasury to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (April 3, 2018).

To that end, the OCC has invited comments on how to revise CRA regulations to:

- bring greater clarity, consistency, and certainty to the evaluation process, as well as to provide flexibility to accommodate banks with different business strategies;
- develop metrics to increase the objectivity of performance measures;
- update assessment area definitions to accommodate digital lending channels, while retaining a focus on the communities in which bank branches are located;
- clarify and broaden the range of activities supporting community and economic development that qualify for CRA consideration; and
- enhance recordkeeping and reporting requirements under the CRA.

Additional detail regarding each of these topics of consideration is provided below.

1. Revising the Current Performance Evaluation Method

The ANPR invites comment on ways to modify and streamline the existing CRA performance tests, such as by implementing an alternative evaluation method or by increasing and enhancing the use of metrics within the performance tests. The OCC suggested that one such alternative evaluation method could replace the existing performance tests and separately evaluate retail or community development activities for all banks, accounting for variations in size, business model, and other factors. This approach could include updated metrics that take into account information on a bank's performance context, such as the demographic characteristics and the economic and financial conditions of specific communities.

2. Metric-Based Framework

The ANPR indicated that the OCC may consider a "more transformational approach" to the CRA regulatory framework that could include a metric-based performance measurement system with thresholds or benchmarks that correspond to the statutory CRA rating categories. In such a metric-based framework, the dollar value of CRA-qualified activity could be compared to readily available and objective criteria (such as the bank's domestic assets, deposits, or capital from the bank's balance sheet) to calculate a ratio that could correspond to the benchmark established for each rating category. This use of quantitative benchmarks for specific ratings may increase the transparency of how a bank's CRA performance is evaluated and facilitate comparisons of the CRA performance of banks of different sizes and business models. The OCC asked several questions about a potential metric-based framework, including whether additional weight could be given to certain categories of CRA-qualified activity.

3. Redefining Communities and Assessment Areas

Under current CRA regulations, a bank's CRA performance evaluation is based primarily on the CRA-qualifying activities that occur in or serve a bank's assessment areas. Because these assessment areas are limited to the areas surrounding a bank's main office, branch offices, and deposit-taking ATMs, the assessment areas of some banks may not include a substantial portion of the areas in which they conduct activities that would otherwise qualify for CRA consideration.

The ANPR invites comments on ways to update how a bank's community is defined for purposes the CRA. Under an updated approach suggested by the OCC, banks would continue to receive consideration for CRA-qualifying activities within their branch and deposit-taking ATM footprint, but could also receive consideration for providing these types of beneficial activities in LMI areas outside of their branch and deposit-taking ATM footprint and other underserved areas. This approach could allow a bank to include additional areas tied to the bank's business operations (*e.g.*, areas where the bank has a concentration of deposits or loans, non-bank affiliate offices, or loan production offices) in their assessment areas, enabling consideration of CRA-qualifying activities conducted within these areas. This approach would address concerns that the current CRA assessment areas can restrict bank lending or investment in areas of need. Such an expanded view of assessment areas may also accommodate banks that either operate without physical branches or with services that reach far beyond the geographic location of their physical branches. The OCC asked questions about how the current approach for delineating a bank's assessment areas could be upgraded, as well as questions on other approaches, such as weighting activities in certain geographic areas over others and requiring minimum levels of CRA performance in certain areas before activity in other areas could be receive credit.

4. Expanding CRA-Qualifying Activities

In light of concerns expressed by certain stakeholders regarding the need for more clarity as to which community development, small business, lending, and retail service activities will receive CRA consideration, the ANPR invites comment on regulatory changes that could ensure CRA consideration for a broader range of activities supporting community and economic development in banks' CRA performance evaluations, and set clear standards for determining whether an activity qualifies for CRA consideration. The OCC asked several questions about how CRA-qualifying activities would be betted defined to address community needs, including whether certain types of loans and investments or services provided to particular recipients or communities should be presumed to receive CRA consideration. The OCC also asked questions about how CRA regulations should treat certain other activities, including investments in loan-backed securities, financial education or literacy programs, consumer lending, small business lending, among others, and how loan originations should be considered compared to loan purchases.

5. Recordkeeping and Reporting

The ANPR also invites comments on how to modernize CRA regulations to promote transparency and consistency in recordkeeping, reporting, and examination requirements. The OCC recognized in the ANPR that the current regulatory approach "does not facilitate regular tracking, monitoring, and comparisons of levels of CRA performance by banks and other stakeholders." A modernized CRA framework that uses objective reportable metrics would have the advantage of allowing for better tracking by banks of their overall CRA level of performance on a regular, periodic basis. Such reporting could also support comparison among banks, their peer groups, or the entire industry and would support understanding of industry-wide activity and trends. The OCC asked several questions about new recordkeeping and reporting requirements, including the reporting of data using a use of a metric-based approach and the frequency of CRA reporting. The OCC also requested information on the economic impact of, and costs and benefits associated with, any proposed changes to the CRA regulations.

Notably, the ANPR makes no mention of the OCC's recently announced expectations for any entity seeking a new national "fintech" charter to demonstrate a commitment to "financial inclusion."[2] However, the OCC's apparent openness in the ANPR to reconsidering the ways it delineates a bank's community and categorizes CRA-qualifying activities may suggest that the OCC will also be open to innovative approaches to compliance with the "financial inclusion" requirement for fintech charter applicants.

The OCC will be accepting comments for 75 days following the publication of the ANPR.

[2] For additional information regarding the OCC's fintech charter, please see the Firm's memorandum dated August 1, 2018, available here.

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Simpson Thacher & Bartlett LLP,
Memorandum, OCC to Accept Applications
for Federal FinTech Charters
(August 1, 2018)

Submitted by:
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Memorandum

OCC to Accept Applications for Federal FinTech Charters

August 1, 2018

On July 31, the Office of the Comptroller of the Currency (OCC) announced that it will begin accepting applications for limited-purpose national bank charters formed to provide nondepository financial technology, or "fintech," bank products and services.[1] The federal charter will largely allow fintech businesses to operate nationwide under a single set of national standards, without needing to seek state-by-state licenses or joining with brick-and-mortar banks. This announcement follows efforts by prior Comptrollers of the Currency to develop a fintech charter,[2] and coincides with the publication of a report by the U.S. Department of Treasury that encourages the OCC's consideration of applications for fintech charters.[3]

The special purpose charter will be available for newly formed or existing fintech businesses that would engage in one of the "core banking functions" of paying checks or lending money (including activities that the OCC has interpreted to be the modern equivalent of such activities, such as facilitating payments electronically). The fintech charter will not be available to companies seeking to take deposits or obtain FDIC deposit insurance. A company seeking a fintech charter would be required to meet the chartering requirements and standards applicable to all national banks.[4]

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[1] *See* OCC Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters (July 31, 2018); Comptroller's Licensing Manual Supplement: Considering Charter Applications from Financial Technology Company (June 2018).

[2] Keith A. Noreika, Acting Comptroller of the Currency, "Remarks Before Georgetown University's Fintech Week" (October 19, 2017); Thomas J. Curry, Comptroller of the Currency, "Special Purpose National Bank Charters for FinTech Companies" (December 2, 2016); OCC Whitepaper, "Exploring Special Purpose National Bank Charters for Fintech Companies" (December 2016).

[3] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities: Nonbank Financials, FinTech, and Innovation" (July 2018).

[4] The filing procedures for a fintech charter are substantially the same as those that would apply for any other national bank charter application.

In general, as a special purpose national bank, a federally chartered fintech bank would be permitted to engage only in activities that are permissible for national banks, although the OCC would consider on a case-by-case basis the permissibility of a new activity that a company seeking a fintech charter wishes to conduct. In addition, all federal fintech charters will be subject to the same safety and soundness standards that all federally chartered banks must meet, which are tailored by the OCC based on the institution's business model, size, complexity, and risks. Importantly, however, a company could acquire or organize a fintech company operating under this special purpose bank charter without becoming subject to the Bank Holding Company Act.[5]

By obtaining a new fintech special purpose national bank charter, a fintech bank would be organized under, and governed by, the National Bank Act. The corporate organization and structure provisions of the National Bank Act (*e.g.*, classes of shares, voting rights, number of directors, and term of office) would govern the corporate structure of the fintech company.

Once chartered by the OCC, a fintech bank generally would be subject to the same laws, regulations, examination, reporting requirements, and ongoing supervision (including the same "CAMELS" ratings system) as other national banks. Statutes that by their terms apply to national banks, such as legal lending limits and limits on real estate holdings, apply to all special purpose national banks, including fintech firms chartered as uninsured special purpose national banks. Other laws that apply to special purpose banks include the Bank Secrecy Act and other anti-money laundering laws, the economic sanctions administered by the U.S. Department of the Treasury's Office of Foreign Assets Control, and the prohibitions against engaging in unfair or deceptive acts or practices under section 5 of the Federal Trade Commission Act and unfair, deceptive, or abusive acts or practices under section 1036 of the Dodd-Frank Act.

Some statutes, however, apply to a national bank only if it is FDIC-insured and, therefore, would not apply to an uninsured fintech bank. For example, certain provisions in the Federal Deposit Insurance Act, such as safety and soundness standards, retention of records rules, as well as the Community Reinvestment Act, only apply to insured depository institutions. In addition, the provisions in the Federal Deposit Insurance Act governing the receivership of insured depository institutions would not apply to an uninsured fintech bank, although the OCC adopted a rule in 2016 that would establish a framework for the receivership of an uninsured national bank under the receivership provisions in the National Bank Act.[6]

State law would apply to a federally chartered fintech bank in the same way and to the same extent as it applies to a full-service national bank. For example, state laws would not apply to a federally chartered fintech bank if they would require the company to be licensed in order to engage in certain types of activity

[5] *See* 12 U.S.C. § 1841(c)(2)(D). The acquisition of control of a fintech bank would, however, be subject to prior notice to the OCC. *See* 12 C.F.R. § 5.50(e)(2).

[6] *See* 81 Fed. Reg. 92594 (December 20, 2016).

or business. National banks also have authority to lend and offer trust services nationwide subject to a uniform set of rules and authority. Examples of state laws that would generally apply to national banks include state laws on anti-discrimination, fair lending, right to collect debts, taxation, zoning, criminal laws, and torts.

In its announcement of the new fintech charter, the OCC identified several baseline supervisory expectations for any entity seeking a new national fintech charter, including a detailed business plan, governance, capital, liquidity, compliance risk management, financial inclusion, and recovery and resolution planning, as described in more detail below. The OCC strongly encourages prospective applicants for the fintech charter to meet with the OCC prior to filing an application to discuss these baseline expectations in detail and how the expectations (and any others arising from the particular proposal) would apply to their proposed organization.

- *Organizers, Management, and Directors*: The OCC expects organizers, managers and directors to be well qualified, with diverse experience in relevant areas (including at least some members with experience in banking or broader financial services). In addition, the OCC will consider whether the organizers, managers, and directors have other financial and business expertise and experience in highly regulated industries, as well as sufficient technical knowledge, skills, and experience to manage a technology-driven company.
- *Robust Business Plan*: All applicants for a fintech charter must submit a comprehensive business plan to the OCC. The OCC would expect a fintech company seeking a federal charter to clearly articulate why it is seeking a federal charter and provide significant detail about the proposed firm's activities. The business plan should define the market that it plans to serve and the products and services it will offer, and describe the fintech company's risk management framework and internal system of controls. Applicants should also provide a risk assessment with the business plan which, among other things, demonstrates an understanding of risks posed by third-party service providers, cybersecurity, Bank Secrecy Act and anti-money laundering requirements, Office of Foreign Assets Control economic sanctions obligations, consumer protection, and fair lending.
- *Permissibility of Activities*: If the permissibility of an applicant's proposed activities has not previously been established, OCC staff may advise the applicant to request a legal opinion from the OCC's Chief Counsel's Office.
- *Capital and Liquidity*: Federally chartered fintech banks will be subject to the minimum leverage and risk-based capital requirements that apply to all national banks. In addition, fintech charter applicants would be expected to propose a minimum level of capital that the proposed bank would

meet or exceed at all times to account for any off-balance sheet activities.[7] As with capital, minimum and ongoing liquidity for a federally chartered fintech bank would need to be commensurate with the risk and complexity of the proposed activities. A fintech charter applicant would need to demonstrate how it would maintain sufficient capital and liquidity under stressed conditions.

- *Financial Inclusion*: As noted above, only insured depository institutions are subject to the requirements of the Community Reinvestment Act (CRA). However, the OCC would expect any fintech charter applicant to demonstrate a commitment to "financial inclusion" that supports fair access to financial services and fair treatment of customers. To this end, a fintech charter applicant should describe its commitment to financial inclusion in its application, including its proposed goals, approaches, activities, milestones, commitment measures, and metrics for serving the anticipated market and community consistent with its activities, business model, and product and service offerings.

  While the requirements for complying with the CRA are well-developed, the concept of "financial inclusion" is new and may require innovative approaches to compliance, particularly for fintech companies that do not plan to engage in traditional lending activities.

- *Contingency Planning*: The OCC expects a fintech charter applicant to develop a contingency plan to address significant financial stress that could threaten the viability of the bank. Development of a contingency plan during the bank's organization phase will be a condition to preliminary approval for a charter, and the OCC's final approval for a fintech charter will require the bank to implement and adhere to the plan, which must be updated annually or more frequently as needed. Because a federally charted fintech bank would be uninsured, the OCC will require the fintech charter applicant to include in its contingency plan options to sell itself, wind down, or merge with a nonbank affiliate, if necessary.

State banking authorities and the Conference of State Bank Supervisors (CSBS) may resume their efforts to challenge the OCC's statutory authority to grant fintech charters. Separate lawsuits brought by the CSBS and New York State's Department of Financial Services challenging the OCC's authority were previously dismissed earlier in 2018 and 2017, respectively, for lack of ripeness. Following the OCC's announcement, legal challenges may soon be forthcoming.

[7] If the OCC grants a preliminary conditional approval for a fintech charter, that approval would include a condition specifying a minimum capital level the bank must maintain or exceed at all times, which would be established based on quantitative and qualitative factors.

For more information regarding recent developments on the OCC's new fintech charter, please contact any member of the Firm's Financial Institutions Group.

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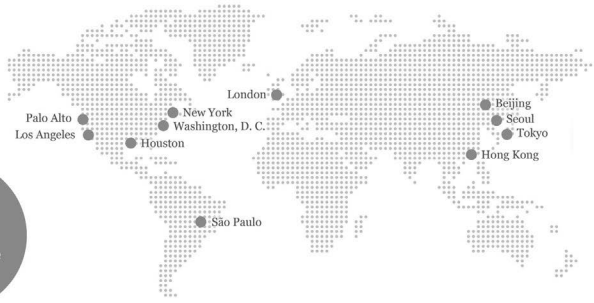
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Simpson Thacher & Bartlett LLP, Memorandum, Treasury Department Issues Recommendations on Reforming the Community Reinvestment Act (April 4, 2018)

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Memorandum

Treasury Department Issues Recommendations on Reforming the Community Reinvestment Act

April 4, 2018

On April 3, 2018, the U.S. Treasury Department issued a report detailing a number of recommendations for reforming and modernizing the Community Reinvestment Act of 1977 ("CRA") framework. The report, which follows through on the commitment made by Treasury in its June 2017 report to the President to review the current CRA framework, includes recommendations for (i) changing the way CRA geographic assessment areas are defined to reflect the changing nature of banking arising from changing technology, customer behavior, and other factors; (ii) improving the CRA performance evaluation criteria to increase the transparency and effectiveness of CRA rating determinations; (iii) harmonizing CRA-related oversight and improving the CRA examination process; and (iv) improving how banks' CRA performance is incentivized to improve the benefit to communities.

The report reflects Treasury's assessments of how the CRA could be improved after soliciting input and meeting with close to 100 stakeholders, representing community and consumer advocates, academics and think tanks, financial institutions, trade associations, and law firms. A number of the recommendations will require specific action by, or significant coordination among, the federal banking agencies charged with administering the CRA, while a small number of recommendations (such as shortening CRA examination cycles for small banks) would require legislative action.

This memorandum provides a high-level summary of Treasury's key recommendations for reforming and modernizing the CRA included in the Treasury report.

Assessment Areas

In general, Treasury recommends revisiting the historic approach of determining the geographic assessment areas within which a bank's regulator will evaluate a bank's record of meeting the credit needs of its

community, in order to account for the current range of alternative channels that exist for accepting deposits and providing banking services.

CRA assessment areas are currently defined to include the geographies surrounding a bank's main office, branches, ATMs, and locations where the bank has originated or purchased a substantial portion of its loans. However, Treasury has found that this definition directs CRA loans, investments, and services in a manner that may exclude a substantial portion of the communities that the banks are effectively serving. Instead, Treasury recommends allowing banks to receive credit not only for CRA activity within their branch and deposit-taking footprint, but also for CRA activity in other low- and moderate-income ("LMI") communities outside of the bank's physical footprint, and in other areas where the bank accepts deposits and does substantial business. This expanded approach may improve the application of CRA requirements to banks using alternative delivery channels, including emerging "branchless" banks.

Examination Clarity and Flexibility

In the course of its review of the CRA framework, Treasury found a number of instances of uncertainty, inconsistency, or lack of flexibility in the CRA examination process. For example, while CRA examination procedures are developed on an interagency basis, each banking agency provides additional guidance to its examiners, and each examiner applies the procedures and guidance differently. In addition, it is often unclear to banks whether certain investments will qualify for CRA credit in light of retroactively applied policy changes, and vague standards for examination criteria can be subject to inconsistent interpretations. Accordingly, Treasury issued the following recommendations to improve transparency in the examination process.

- **Process to Determine CRA Investment Eligibility**. Treasury recommends expanding the types of loans, investments, and services eligible for CRA credit and clarifying the eligibility criteria (including by more clearly aligning CRA regulatory standards and definitions with other regulatory procedures). Further, Treasury believes that banks should be allowed to obtain a limited number of advance determinations regarding the CRA eligibility of specific loans, investments, or services, with any such determinations being made publicly available.
- **Application of Bank Performance Context**. Bank examiners review a broad range of economic, demographic, institution-specific and community-specific information to understand the context in which a bank's CRA performance should be evaluated. While consideration of a bank's performance context allows the CRA process to account for local factors and challenges, Treasury found the establishment of bank performance contexts to be too subjective and inconsistent (in part because examiners responsible for defining performance contexts often do not have the required expertise). Accordingly, Treasury recommends that the banking agencies involve their research and policy staff in developing the performance context in advance of CRA examinations to provide their

expertise on the economic and business environment of the communities where banks are operating.

- **Examination Criteria.** In its meetings with stakeholders and in its own review of examiner guidance, Treasury found substantial uncertainty as to the expectations of regulators and the evaluation criteria used in assigning bank CRA performance ratings. For example, descriptions of the parameters used to weigh and score activities use vague and undefined terms such as "excellent," "substantial," and "extensive." Meanwhile, banks have no clear guidance as to what constitutes a sufficient quantity or "geographic distribution" of CRA-eligible activities.

  Treasury calls for establishing clear criteria for grading CRA loans, investments, and services that incorporate less subjective evaluation techniques. In addition, Treasury recommends establishing a "measurement" of CRA activity that is reportable in a clear and transparent manner, allowing for better assessment of the impact of CRA activities.

- **Overemphasis on Branch Network in the Service Test**. Treasury calls for establishing a modernized, forward-looking approach to the CRA's Service Test with a reduced emphasis on traditional branch-based services, especially in light of the ongoing adoption of alternative delivery channels which have lessened the relevance of physical branches to communities. In addition, the scope of CRA-eligible services should be expanded to promote innovation and address technological advancements.

Examination Process

Treasury recommends that the banking agencies standardize the CRA examination schedules (which may, in some cases, require statutory changes), and provide more CRA ratings since the amount of time that it takes to conduct CRA examinations and to publicly disclose performance evaluations has become excessively long.

CRA Performance

- **CRA Downgrades for Violations of Consumer Protection Laws**. Treasury recommends that the federal banking agencies adopt uniform guidance, similar to the guidance issued by the OCC in October 2017, to clarify the impact evidence of discriminatory or other illegal credit practices can have on CRA ratings. Such uniform guidance should consider whether there is a logical nexus between a bank's CRA rating and evidence of discriminatory or illegal credit practices to ensure that banks are not penalized in their CRA assessments for minor violations or practices unrelated to CRA lending activities. In addition, such guidance should consider remediation efforts undertaken by the bank.

- **Performance Evaluation Delays Due to Consumer Protection Law Investigations**. Under current practice, CRA performance evaluations are often delayed until the CFPB, the Justice Department, or other regulators have completed their investigations and/or taken enforcement

actions under consumer protection laws. Treasury recommends that rather than delaying CRA performance evaluations due to pending consumer protection law investigations or enforcement actions, any evidence of a consumer protection law violation that is discovered after the issuance of a CRA performance evaluation should be considered in the bank's subsequent performance evaluation.

- **Impact of Less-Than-Satisfactory Ratings and Remediation.** A bank's CRA rating may impact the bank's expansionary plans, as regulators are required to take CRA performance into account when evaluating applications for mergers and acquisitions under the Bank Merger Act and Bank Holding Company Act, as well as applications for charter conversions, branch establishment and main office relocations.

  A less-than-satisfactory CRA rating has typically resulted in an automatic denial of such applications. In November 2017, however, the OCC issued new guidance clarifying that while applications from banks with a less-than-satisfactory CRA rating would continue to receive enhanced scrutiny, the CRA rating would not result in an automatic denial of a licensing application. Instead, the OCC will consider how recently the CRA rating was issued, the severity of the less-than-satisfactory rating, the progress made by the bank in addressing the issues underlying the rating, and the effect that approval of the application would have on the bank's ability to meet the credit needs of the communities to be served.

  Treasury recommends that the Federal Reserve and FDIC adopt principles that are generally aligned with those adopted by the OCC for evaluating various applications from banks with a less-than-satisfactory CRA rating. In its report, Treasury indicated that regulators use the application process as an incentive to encourage banks with a less-than-satisfactory rating to commit to engaging in additional CRA-eligible activities in LMI communities.

  Notably, the Treasury report does not suggest any safe-harbor or similar relief for banks with "Outstanding" CRA ratings, or otherwise recommend updates to the public comment process for licensing applications. Under current practice, the receipt of any adverse public CRA comment on a merger or other expansionary application will typically delay application processing significantly (and regulators will often consider public comments received even after the close of the comment period), which has been a source of frustration to banks with exemplary CRA ratings. In 2017, the OCC updated its policy on the review of public comments for licensing filings, clarifying that the OCC will not accept comments after the close of the comment period and will only extend the comment period in extenuating circumstances. However, the Treasury report does not recommend that the Federal Reserve and FDIC adopt policies similar to those adopted by the OCC for reviewing public comments on application filings.

- **Use of Community Benefits Plans**. In response to adverse public comments received in connection with applications for mergers, acquisitions or other expansionary plans, some banks

have entered into "community benefits plans" with prominent community groups to demonstrate the bank's commitment to meeting the convenience and needs of the community. Such plans have been an increasingly common demand from community activists critical of a bank merger, and Treasury recommends that the bank regulators clarify that such plans are not required (although the agencies have already made explicit comments to this effect in recent guidance and approval orders).

However, Treasury believes that regulators should make it clear that a community benefits plan, among other strategies, can be an effective tool for banks with less-than-satisfactory ratings to demonstrate how approval of an application would benefit the communities served.

- **Maintaining a Public CRA File in Bank Branches.** Treasury recommends that CRA regulations be amended to allow banks to store their public CRA files electronically on the bank's website, rather than requiring banks to maintain a physical copy of the public file at the bank's main office and at one branch office in each other state in which the bank is located.

Miscellaneous Items

- **Disparate Treatment of Debt and Equity Investments**. Currently, community development investments are treated differently than community development loans when considered for CRA credit. Loans to qualified entities are counted toward CRA credit only in the year originated, while equity investments in qualified entities are counted toward CRA credit each year that the investment is held. Treasury recommends that community development loans receive the same annual consideration as community development investments.
- **Inclusion of Affiliates in CRA Assessments.** Banks are currently given the option to include the activities of their affiliates for consideration in the bank's CRA performance evaluation. Treasury recommends that the CRA regulators evaluate their approach to affiliates in order to ensure that performance evaluations accurately reflect the CRA-eligible activity of the overall bank and to prevent banks from artificially inflating their CRA performance by strategically deciding whether to include the activities of affiliates in their CRA performance evaluation.
- **Impact of CCAR on CRA Investments.** For banking organizations subject to CCAR, public welfare investments with non-complex structures are generally assigned higher loss projections (and assessed higher capital requirements under CCAR) than public welfare investments with more complex capped loss structures. Because this differing capital treatment may discourage certain types of investments in non-capped loss structures that would otherwise benefit LMI communities, Treasury encourages the banking agencies to review the CCAR treatment of public welfare investments.

- **Nonbanks and CRA**. Although Treasury acknowledges the increasing market share of nonbanks in the market for CRA-eligible loans, Treasury recommends only that regulators continue to monitor the impact of nonbanks on the effectiveness of CRA, calling for more research on the extent to which nonbanks are meeting the credit needs of LMI communities.

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NOTES

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Bureau of Consumer Financial Protection, Supervisory Highlights, Issue 17, Summer 2018 (September 2018)

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1. Introduction

The Bureau of Consumer Financial Protection (Bureau) is committed to a consumer financial marketplace that is free, innovative, competitive, and transparent, where the rights of all parties are protected by the rule of law, and where consumers are free to choose the products and services that best fit their individual needs. To effectively accomplish this, the Bureau remains committed to sharing with the public key findings from its supervisory work to help industry limit risks to consumers and comply with Federal consumer financial law.

The findings included in this report cover examinations in the areas of automobile loan servicing, credit cards, debt collection, mortgage servicing, payday lending, and small business lending that were generally completed between December 2017 and May 2018 (unless otherwise stated).

It is important to keep in mind that institutions are subject only to the requirements of relevant laws and regulations. The information contained in *Supervisory Highlights* is disseminated to help institutions better understand how the Bureau examines institutions for compliance with those requirements. This document does not impose any new or different legal requirements. In addition, the legal violations described in this and previous issues of *Supervisory Highlights* are based on the particular facts and circumstances reviewed by the Bureau as part of its examinations. A conclusion that a legal violation exists on the facts and circumstances described here may not lead to such a finding under different facts and circumstances.

We invite readers with questions or comments about the findings and legal analysis reported in *Supervisory Highlights* to contact us at cfpb_Supervision@cfpb.gov.

2. Supervisory observations

Recent supervisory observations are reported in the areas of automobile loan servicing, credit cards, debt collection, mortgage servicing, payday lending, and, for the first time, small business lending.

2.1 Automobile loan servicing

The Bureau continues to examine auto loan servicing activities, primarily to assess whether servicers have engaged in unfair, deceptive, or abusive acts or practices prohibited by the Consumer Financial Protection Act of 2010 (CFPA). Recent auto loan servicing examinations identified deceptive and unfair acts or practices related to billing statements and wrongful repossessions.

2.1.1 Billing statements showing paid-ahead status after applying insurance proceeds

One or more examinations observed instances in which notes required that insurance proceeds from a total vehicle loss be applied as a one-time payment to the loan with any remaining balance to be collected according to the consumer's regular billing schedule. However, in some instances after consumers experienced a total vehicle loss, the servicers sent billing statements showing that the insurance proceeds had been applied to the loan payments so that the loan was paid ahead and that the next payment on the remaining balance was due many months or years in the future. Servicers then treated consumers who failed to pay by the next month as late and in some cases also reported the negative information to consumer reporting agencies.

The examination found that servicers engaged in a deceptive practice by sending billing statements indicating that consumers did not need to make a payment until a future date when in fact the consumer needed to make a monthly payment.[1] The billing statements

[1] 12 USC 5531, 5536.

contained due dates inconsistent with the note and the servicer's insurance payment application. Such information would mislead reasonable consumers to think they did not need to make the next monthly payment. The misrepresentation is material because it likely affected consumers' conduct with regard to auto loans. Consumers would have been more likely to make a monthly payment if they knew that not doing so would result in a late fee, delinquency notice, or adverse credit reporting. In response to examination findings, the servicers are sending billing statements that accurately reflect the account status of the loan after applying insurance proceeds from a total vehicle loss.

2.1.2 Repossessions

Many auto servicers provide options to consumers to avoid repossession once a loan is delinquent or in default. Servicers may offer formal extension agreements that allow consumers to forbear payments for a certain period of time or may cancel a repossession order once a consumer makes a payment.

One or more recent examinations found that servicers repossessed vehicles after the repossession was supposed to be cancelled. In these instances, the servicers incorrectly coded the account as remaining delinquent or customer service representatives did not timely cancel the repossession order after the consumer's agreement with the servicers to avoid repossession. The examinations identified this as an unfair practice.[2] The practice of wrongfully repossessing vehicles causes substantial injury because it deprives borrowers of the use of their vehicles and potentially leads to additional associated harm, such as lost wages and adverse credit reporting. Such injury is not reasonably avoidable when consumers take action they believed would halt the repossession and there is no additional action the borrower can take to prevent it. Finally, the injury is not outweighed by countervailing benefits to the consumer or to competition. No benefits to competition are apparent from erroneous repossessions. And the expense to better monitor repossession activity is unlikely to be substantial enough to affect institutional operations or pricing. In response to the examination findings, the servicers are stopping the practice, reviewing the accounts of consumers affected by a wrongful repossession, and removing or remediating all

[2] *Id.*

repossession-related fees.

2.2 Credit cards

The Bureau continues to examine the credit card account management operations of one or more supervised entities. Typically, examinations assess advertising and marketing, account origination, account servicing, payments and periodic statements, dispute resolution, and the marketing, sale and servicing of credit card add-on products. With some notable exceptions, the examinations found that supervised entities generally are complying with applicable Federal consumer financial laws.

2.2.1 Periodic re-evaluation of rate increases

Regulation Z, as revised to implement the Card Accountability Responsibility and Disclosure (CARD) Act, requires credit card issuers to periodically re-evaluate consumer credit card accounts subjected to certain increases in the applicable Annual Percentage Rate(s) (APR or rate) to assess whether it is appropriate to reduce the account's APR(s).[3] Issuers must first re-evaluate each such account no later than six months after the rate increase and at least every six months thereafter.[4] In re-evaluating each account, the issuer must apply either (a) the factors on which the rate increase was originally based or (b) the factors the issuer currently considers when determining the APR applicable to similar, new consumer credit card accounts.[5]

One or more examinations between January and July 2018 found that entities: (a) failed to re-evaluate all eligible accounts, (b) failed to consider the appropriate factors when re-evaluating eligible accounts, or (c) failed to appropriately reduce the rates of accounts eligible for rate reduction. In one or more instances, the issuers failed to re-evaluate all eligible accounts because they inadvertently excluded some eligible accounts from the pool of accounts they re-evaluated. In one or more instances, the issuers failed to consider the appropriate factors because they inappropriately conflated re-evaluation factors, among other reasons. In one or

[3] 12 CFR 1026.59(a).

[4] 12 CFR 1026.59(c).

[5] 12 CFR 1026.59(d)(1).

more instances, the issuers failed to appropriately reduce the rates for eligible accounts because they effectively imposed additional criteria for a rate reduction. The issuers have undertaken, or developed plans to undertake, remedial and corrective actions in response to these examination findings.

2.3 Debt collection

The Bureau's Supervision program has authority to examine certain entities that engage in consumer debt collection activities, including nonbanks that are larger participants in the consumer debt collection market. Recent examinations of larger participants identified one or more violations of the Fair Debt Collection Practices Act (FDCPA).[6]

2.3.1 Failure to obtain and mail debt verification before engaging in further collection activities

Section 809(b) of the FDCPA requires a debt collector, upon receipt of a written debt validation request from a consumer, to cease collection of the debt until it obtains verification of the debt and mails it to the consumer.[7] Examinations found that one or more debt collectors routinely failed to mail debt verifications before engaging in further collections activities. Instead, one or more debt collectors forwarded consumer debt validation requests to originating creditors; the creditors then reviewed the debts and mailed responses directly to consumers. One or more debt collectors accepted creditor determinations that the debt was owed by the relevant consumer for the amount claimed without receiving information verifying the debt and without mailing the required verification to consumers. One or more debt collectors then continued collection activities on accounts in violation of section 809(b) of the FDCPA.[8] In response to these examination findings, one or more debt collectors are revising their debt validation policies, procedures, and practices to ensure both that they obtain appropriate verification of the debt

[6] 15 USC 1692–1692p.

[7] 15 USC 1692g(b).

[8] *Id*.

when requested and that they mail the verification to consumers prior to engaging in further collection activities.

2.4 Mortgage servicing

Bureau examinations continue to focus on the loss mitigation process and, in particular, on how servicers handle trial modifications where consumers are paying as agreed. One or more recent mortgage servicing examinations observed unfair acts or practices relating to conversion of trial modifications to permanent status and initiation of foreclosures after consumers accepted loss mitigation offers. Recent examinations also identified unfair acts or practices when institutions charged consumers amounts not authorized by modification agreements or by mortgage notes.

2.4.1 Converting trial modifications to permanent status

Past editions of *Supervisory Highlights* discussed how one or more servicers failed to place consumers who successfully completed trial modifications into permanent modifications in a timely manner.[9] Such delays may harm consumers when interest accrues at a higher non-modified rate or when servicers report consumers as delinquent or still in trial modifications to consumer reporting agencies during the delay. Where a servicer does not provide full financial remediation to the consumer for such a delay, one or more examinations have identified an unfair practice.

One or more recent examinations reviewed the practices of servicers with policies providing for permanent modifications of loans if consumers made four timely trial modification payments. However, for nearly 300 consumers who successfully completed the trial modification, the servicers delayed processing the permanent modification for more than 30 days. During these delays, consumers accrued interest and fees that would not have been accrued if the permanent modification had been processed. The servicers did not remediate all of the affected consumers

[9] *See, e.g.*, Issue 11 of Supervisory Highlights, section 3.2, *available at*, https://www.consumerfinance.gov/documents/509/Mortgage_Servicing_Supervisory_Highlights_11_Final_web_.pdf.

nor did they have policies or procedures for remediating consumers in such circumstances. The servicers attributed the modification delays to insufficient staffing.

As a result, one or more examinations identified an unfair act or practice. Consumers experienced substantial injury that could not be reasonably avoided. The accrued fees and interest that the servicers failed to fully remediate were likely significant because the delays were more than 30 days. And consumers could not reasonably avoid these injuries. They could neither control the processing of their loan modifications nor compel remediation from the servicers. The harm to consumers outweighs the cost to consumers or to competition, given that the servicers acknowledged that the delay was in error and did not indicate that the cost of remediation was burdensome. In response to examination findings, the servicers are fully remediating affected consumers and developing and implementing policies and procedures to timely convert trial modifications to permanent modifications where the consumers have met the trial modification conditions.[10]

In September 2017, examinations also found that one or more servicers mitigated the potential consumer harm associated with trial conversion delays by maintaining communication with consumers during the delay and by proactively remediating individual consumers for the costs associated with the delay after eventually making the consumers' modifications permanent.

2.4.2 Charging consumers unauthorized amounts

One or more examinations found instances in which mortgage servicers charged consumers more than the amounts authorized by their loan modification agreements. The overcharges were caused by data errors affecting the modified loan's starting balance, step-rate and interest-rate changes, deferred interest, and amortization maturity date when the loan was entered into the servicing system. The examinations identified this as an unfair practice.[11] The overcharges resulted in substantial injury to consumers when consumers made payments higher than those stipulated in the modification agreements or when they made payments for a term longer than stipulated in the modification agreements. Consumers could not reasonably avoid this injury,

[10] 12 USC 5531, 5536.

[11] 12 USC 5531, 5536.

which was caused by errors in the servicers' systems. The injury to consumers is not outweighed by any countervailing benefits to consumers or to competition. No benefits to competition are apparent from the systemic errors that resulted in erroneous billing statements. And the expense of instituting validation procedures for loan-modification data is unlikely to be substantial enough to affect institutional operations or pricing. In response to the examination findings, the servicers are remediating affected consumers and correcting loan modification terms in their systems.

2.4.3 Representations regarding initiation of foreclosure

When one or more mortgage servicers approved borrowers for a loss mitigation option on a non-primary residence, the servicers represented to borrowers that the servicers would not initiate foreclosure if the borrower accepted loss mitigation offers in writing or by phone by a specified date. However, the servicers then initiated foreclosure even if borrowers had called or written to accept the loss mitigation offers by that date. Examinations identified this as a deceptive act or practice.

The misrepresentations were likely to mislead borrowers when the servicers expressly indicated that the servicers would not initiate foreclosure proceedings if borrowers accepted the loss mitigation offers. The borrowers' interpretation of the misrepresentations was reasonable in this circumstance, i.e., that the servicers would not initiate foreclosure after the borrowers accepted the loss mitigation offers. The misrepresentations were material because they were likely to prompt borrowers to accept the loss mitigation offers to avoid the initiation of foreclosure proceedings.

2.4.4 Representations regarding foreclosure sales

Examinations observed that when borrowers submitted complete loss mitigation applications less than 37 days from a scheduled foreclosure sale date, one or more servicers sent the borrowers notices indicating that the applications were complete and stating that the servicer(s) would notify the borrowers of the decision on the applications in writing within 30 days. But after sending these notices, the servicers proceeded to conduct the scheduled foreclosure sales without making a decision on the borrowers' loss mitigation applications.

The examinations did not find that this conduct amounted to a legal violation but observed that it could pose a risk of a deceptive practice. The notices could potentially mislead borrowers by

stating that the borrowers would receive a decision on their loss mitigation applications. Borrowers reasonably could take that statement to mean that foreclosure sales would be postponed until a decision was reached.

2.5 Payday lending

The Bureau's Supervision program covers entities that offer or provide payday loans. Examinations of payday lenders identified unfair and deceptive acts or practices as well as violations of Regulation E.[12]

2.5.1 Misleading collection letters

Examinations observed one or more entities engaging in a deceptive act or practice in their collection letters. These entities represented in their letters that they will, or may have no choice but to, repossess consumers' vehicles if the consumers fail to make payments or contact the entities. This was despite the fact that these entities did not have business relationships with any party to repossess vehicles and, as a general matter, did not repossess vehicles. Given these facts, the examination concluded that the net impression of these representations in the context of each letter was to mislead consumers to believe that these entities would repossess or were likely to repossess consumers' vehicles. The representations were material because they were likely to affect the behavior of consumers who were misled. The representations were likely to induce consumers to make payments to these entities, as opposed to allocating their funds toward other expenses. In response to the examination findings, the entity or entities are ensuring that their collection letters do not contain deceptive content.

2.5.2 Debiting consumers' accounts without valid authorization by using account information previously provided for other purposes

Examinations observed one or more entities using debit card numbers or Automated Clearing House (ACH) credentials that consumers had not validly authorized the entities to use to debit funds in connection with a single-payment or installment loan in default. Upon a consumer's

[12] 12 CFR 1005.10(b).

failure to repay the loan obligation as agreed, one or more entities attempted to initiate electronic fund transfers (EFTs) using debit card numbers or ACH credentials that borrowers had identified on authorization forms executed in connection with the defaulted loan at issue. If those attempts were unsuccessful, the entities would then seek to collect balances due and owing via EFTs using debit card numbers or ACH credentials that the borrowers had supplied to the entities for other purposes, such as when obtaining other loans or making one-time payments on other loans or the loan at issue. Through these invalidly authorized EFTs, the entities sought payment of up to the entire amount due on the loan.

The examinations identified these as unfair acts or practices and also, in some cases, as violations of Regulation E. With respect to unfairness, the invalidly authorized debits caused substantial injury in the form of debits that consumers could not anticipate, leading to potential fees. Because the credentials were provided to the entities for other purposes, such as account information consumers provided in previous credit applications, consumers could not anticipate that the entities would use them for the defaulted loan at issue and thus could not reasonably avoid such injury. Finally, the injury was not outweighed by any countervailing benefits to consumers, such as satisfying their debts, or to competition, such as passing on lower costs to consumers derived from easier debt collection. By giving an unfair advantage over other entities that obtain authorization to initiate debits from consumers pursuant to clear and readily understandable terms, the unfair acts or practices likely harmed competition.[13]

With respect to loans for which the consumer entered into preauthorized EFTs that recurred at substantially regular intervals, the examinations identified this practice as a violation of Regulation E, which requires that preauthorized EFTs from a consumer's account be authorized only by a writing signed or similarly authenticated by the consumer.[14] Here, the loan agreements and EFT authorization forms failed to provide clear and readily understandable terms regarding the entities' use of debit card numbers or ACH credentials that consumers provided for other purposes. Accordingly, the entities did not obtain valid preauthorized EFT authorizations for the debits they initiated using debit card numbers or ACH credentials consumers provided for other purposes.

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[13] 12 USC 5531, 5536.

[14] 12 CFR 1005.10(b),

In response to examination findings, the entity or entities are ceasing the violations, remediating borrowers impacted by the invalid EFTs, and revising loan agreement templates and ACH authorization forms.

2.6 Small business lending

The Equal Credit Opportunity Act (ECOA) prohibition against discrimination is not limited to consumer transactions; it also applies to business-purpose credit transactions, including credit extended to small businesses. In 2016 and 2017, the Bureau began conducting supervision work to assess ECOA compliance in institutions' small business lending product lines, focusing in particular on the risks of an ECOA violation in underwriting, pricing, and redlining. The Bureau anticipates an ongoing dialogue with supervised institutions and other stakeholders as the Bureau moves forward with supervision work in small business lending.

2.6.1 Supervisory observations

In the course of conducting ECOA small business lending reviews, Bureau examination teams have observed instances in which one or more financial institutions effectively managed the risks of an ECOA violation in their small business lending programs.

Examinations at one or more institutions observed that the board of directors and management maintained active oversight over the institutions' compliance management system (CMS) framework. Institutions developed and implemented comprehensive risk-focused policies and procedures for small business lending originations and actively addressed the risks of an ECOA violation by conducting periodic reviews of small business lending policies and procedures and by revising those policies and procedures as necessary. Examinations also observed that one or more institutions maintained a record of policy and procedure updates to ensure that they were kept current.

With regard to self-monitoring, one or more institutions implemented small business lending monitoring programs and conducted semi-annual ECOA risk assessments that include assessments of small business lending. In addition, one or more institutions actively monitored pricing-exception practices and volume through a committee.

When examinations included file reviews of manual underwriting overrides at one or more institutions, they found that credit decisions made by the institutions were consistent with the requirements of ECOA, and thus the examinations did not find any violations of ECOA.

At one or more institutions, however, examinations observed that institutions collect and maintain (in useable form) only limited data on small business lending decisions. Limited availability of data could impede an institution's ability to monitor and test for the risks of ECOA violations through statistical analyses.

3. Remedial actions

3.1 Public enforcement actions

The Bureau's supervisory activities resulted in or supported the following public enforcement actions.

3.1.1 Citibank N.A

On June 29, 2018, the Bureau announced an enforcement action against Citibank, N.A., (Citibank or Bank). The Bureau found Citibank violated the Truth in Lending Act (TILA) and its implementing regulation, Regulation Z, by failing to properly periodically re-evaluate and reduce the Annual Percentage Rates (rates) applicable to credit card accounts that had been subject to certain rate increases between 2011 and 2017 and by failing to have in place reasonable written policies and procedures to do so.

In 2016, Citibank initiated a significant compliance review program across its credit cards line of business. That review led to Citibank's self-identifying several deficiencies and errors in its rate re-evaluation methodologies. After the Bank promptly self-disclosed the violations, the Bureau ultimately found through its supervisory process that Citibank violated TILA by failing to reevaluate and reduce the APRs for approximately 1.75 million consumer credit card accounts and thereby imposed on those accounts excess interest charges of $335 million.

Under the terms of the resulting consent order, Citibank was required to correct these practices and pay $335 million in restitution to the impacted consumers.[15] The Bureau did not assess civil money penalties based on a number of factors, including Citibank's self-identifying and self-reporting the violations to the Bureau and its self-initiating remediation to affected consumers.

[15] *See* Citibank Consent Order *available at*, https://www.consumerfinance.gov/about-us/newsroom/bureau-consumer-financial-protection-settles-citibank-na/.

3.1.2 Triton Management Group

On July 19, 2018, the Bureau entered into a consent order with Triton Management Group, Inc., a payday lender that operates in Alabama, Mississippi, and South Carolina under several names including "Always Money" and "Quik Pawn Shop." The Bureau found that Triton violated the CFPA and the disclosure requirements of TILA by failing to properly disclose finance charges associated with their auto title loans in Mississippi. The Bureau also found that Triton used advertisements that failed to disclose the annual percentage rate and other information in violation of TILA. The consent order bars Triton from misrepresenting the costs of its loans and requires Triton to remediate consumers $1,522,298. Based on Triton's inability to pay, it will remediate consumers $500,000.[16]

[16] *See* Triton Management Group Consent Order *available at,* https://www.consumerfinance.gov/about-us/newsroom/bureau-consumer-financial-protection-settles-triton-management-group/.

4. Supervision program developments

4.1 Recent Bureau rules and guidance

4.1.1 Mortgage servicing final rule

On March 8, 2018, the Bureau issued a final rule to help mortgage servicers communicate with certain borrowers facing bankruptcy. The final rule gives mortgage servicers a clearer and more straightforward standard for providing periodic statements to consumers entering or exiting bankruptcy by amending the Bureau's 2016 mortgage servicing rule. Specifically, the final rule provides a clear single-statement exemption for servicers to make the transition, superseding the single-billing-cycle exemption included in the 2016 rule. The effective date for the rule was April 19, 2018.[17]

4.1.2 2017–2018 amendments of the TILA-RESPA integrated disclosure rule

On August 11, 2017, the Bureau published a final rule[18] in the *Federal Register* amending the Federal mortgage disclosure requirements under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) as implemented by Regulation Z (2017 TILA-RESPA Rule). These amendments are intended to provide greater certainty and clarity to the 2013 TILA-RESPA Rule, which went into effect on October 3, 2015. Changes and clarifications in the 2017 TILA-RESPA Rule include creating a tolerance for the total of payments disclosure, clarifying the partial exemption for housing assistance lending, expanding coverage of the disclosure rule to include cooperative units regardless of whether State law considers the units real property or personal property, and clarifying when disclosures may be shared with third

[17] *See* Mortgage Service Rules under the Truth in Lending Act (Regulation Z), 83 Fed. Reg. 10553 (Mar. 8, 2018), https://files.consumerfinance.gov/f/documents/cfpb_mortgage-servicing_final-rule_2018-amendments.pdf.

[18] Amendments to Federal Mortgage Disclosure Requirements under the Truth in Lending Act (Regulation Z), 82 Fed. Reg. 37656 (Aug. 11, 2017).

parties. Additionally, the 2017 TILA-RESPA Rule includes several additional clarifications and technical changes addressing various parts of the 2013 TILA-RESPA Rule, including the calculating cash to close table, construction-to-permanent lending, principal reductions, rounding requirements, and simultaneous second lien loans. The 2017 TILA-RESPA Rule became effective October 10, 2017. However, compliance with the 2017 TILA-RESPA Rule is mandatory only with respect to transactions for which a creditor or mortgage broker receives an application on or after October 1, 2018 (except for compliance with the escrow cancellation notice[19] and compliance with the partial payment policy disclosure requirements,[20] which will become mandatory on October 1, 2018, regardless of when an application was received).

On May 2, 2018, the Bureau published a final rule in the *Federal Register* amending the Federal mortgage disclosure requirements to address when a creditor may use a Closing Disclosure to determine if an estimated closing cost was disclosed in good faith and within tolerance (2018 TILA-RESPA Rule).[21] The 2013 TILA-RESPA Rule in effect as of October 3, 2015 included a timing restriction limiting the use of the Closing Disclosure to reset tolerances to a period relative to the date of consummation, resulting in a creditor's inability to pass through closing cost increases[22] to the consumer in certain limited circumstances. The 2018 TILA-RESPA Rule removes this timing restriction, permitting the use of the Closing Disclosure to establish good faith and reset tolerances regardless of when the Closing Disclosure is provided relative to consummation. The final rule took effect on June 1, 2018.

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[19] 12 CFR 1026.20(e).

[20] 12 CFR 1026.39(d)(5).

[21] Federal Mortgage Disclosure Requirements under the Truth in Lending Act (Regulation Z), 83 Fed. Reg. 19159 (May 2, 2018).

[22] 12 CFR 1026.19(e)(3)(iv).

4.2 Fair lending developments

4.2.1 HMDA implementation and new data submission platform

On December 21, 2017, the Bureau provided the following statement regarding HMDA implementation:

> Recognizing the impending January 1, 2018 effective date of the Bureau's amendments to Regulation C and the significant systems and operational challenges needed to adjust to the revised regulation, for HMDA data collected in 2018 and reported in 2019 the Bureau does not intend to require data resubmission unless data errors are material. Furthermore, the Bureau does not intend to assess penalties with respect to errors in data collected in 2018 and reported in 2019. Collection and submission of the 2018 HMDA data will provide financial institutions an opportunity to identify any gaps in their implementation of amended Regulation C and make improvements in their HMDA CMS for future years. Any examinations of 2018 HMDA data will be diagnostic to help institutions identify compliance weaknesses and will credit good faith compliance efforts. The Bureau intends to engage in a rulemaking to reconsider various aspects of the 2015 HMDA Rule such as the institutional and transactional coverage tests and the rule's discretionary data points. For data collected in 2017, financial institutions will submit their reports in 2018 in accordance with the current Regulation C using the Bureau's HMDA Platform.[23]

On July 5, 2018, the Bureau provided the following statement regarding recent HMDA amendments:

[23] *CFPB Issues Public Statement on Home Mortgage Disclosure Act Compliance* (December 21, 2017), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-public-statement-home-mortgage-disclosure-act-compliance/.

The President signed the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Act) on May 24, 2018, a section of which amends the Home Mortgage Disclosure Act (HMDA). The Act provides partial exemptions for some insured depository institutions and insured credit unions from certain HMDA requirements.[24] The partial exemptions are generally available to insured depository institutions and insured credit unions:

- For closed-end mortgage loans if the institution originated fewer than 500 closed-end mortgage loans in each of the two preceding calendar years.
- For open-end lines of credit if the institution originated fewer than 500 open-end lines of credit in each of the two preceding calendar years.

For closed-end mortgage loans or open-end lines of credit subject to the partial exemptions, the Act states that the "requirements of [HMDA section 304(b)(5) and (6)]" shall not apply. Accordingly, for these transactions, those institutions are exempt from the collection, recording, and reporting requirements for some, but not all, of the data points specified in current Regulation C.

The Bureau expects to provide further guidance soon on the applicability of the Act to HMDA data collected in 2018.[25]

For all institutions filing HMDA data collected in 2018, the Act will not affect the format of the LARs:

- LARs will be formatted according to the previously released 2018 Filing Instructions Guide for HMDA Data Collected in 2018 (2018 FIG).[26]
- If an institution does not report information for a certain data field due to the Act's partial exemptions, the institution will enter an exemption code for the

[24] Pub. L. No. 115-174, section 104(a) (to be codified at 12 USC 2803).

[25] The partial exemptions are not available to insured depository institutions that do not meet certain Community Reinvestment Act performance evaluation rating standards. Guidance will include information on how this provision will be implemented.

[26] https://s3.amazonaws.com/cfpb-hmda-public/prod/help/2018-hmda-fig.pdf.

field specified in a revised 2018 FIG that the Bureau expects to release later this summer.

- All LARs will be submitted to the same HMDA Platform. A beta version of the HMDA Platform for submission of data collected in 2018 will be available later this year for filers to test.

4.2.2 Small business lending review procedures

Each ECOA small business lending review includes a fair lending assessment of the institution's CMS related to small business lending. To conduct this portion of the review, examinations use Module II of the ECOA Baseline Review Modules. CMS reviews include assessments of the institution's board and management oversight, compliance program (policies and procedures, training, monitoring and/or audit, and complaint response), and service provider oversight.

Examinations also use the Interagency Fair Lending Examination Procedures, which have been adopted in the Bureau's Supervision and Examination Manual. In some ECOA small business lending reviews, examination teams may evaluate an institution's fair lending risks and controls related to origination or pricing of small business lending products. Some reviews may include a geographic distribution analysis of small business loan applications, originations, loan officers, or marketing and outreach, in order to assess potential redlining risk.

As with other in-depth ECOA reviews, ECOA small business lending reviews may include statistical analysis of lending data in order to identify fair lending risks and appropriate areas of focus during the examination. Notably, statistical analysis is only one factor taken into account by examination teams that review small business lending for ECOA compliance. Reviews typically include other methodologies to assess compliance, including policy and procedure reviews, interviews with management and staff, and reviews of individual loan files.

4.2.3 FFIEC HMDA examiner transaction testing guidelines effective date

On August 22, 2017, the Federal Financial Institutions Examination Council (FFIEC) members, including the Bureau, announced new FFIEC Home Mortgage Disclosure Act (HMDA)

Examiner Transaction Testing Guidelines for all financial institutions that report HMDA data.[27] The Guidelines apply to the examination of HMDA data collected beginning in 2018, which financial institutions must report to the Bureau by March 1, 2019.[28]

4.2.4 Upstart no-action letter

The Bureau is continuing to monitor Upstart Network, Inc. (Upstart) regarding its compliance with the terms of the no-action letter (NAL) it received from Bureau staff. As part of its request for a NAL, Upstart agreed to conduct ongoing fair lending testing of its underwriting model, notify the Bureau before new variables are considered eligible for use in production, and maintain a robust model-related compliance management system.

In addition to the ongoing fair lending testing discussed above, Upstart agreed as part of its request for a NAL to employ other consumer safeguards. These safeguards, which are described in the application materials posted on the Bureau's website, include ensuring compliance with requirements to provide adverse action notices under Regulation B and the Fair Credit Reporting Act and its implementing regulation, Regulation V, and ensuring that all of its consumer-facing communications are timely, transparent, and clear, and use plain language to convey to consumers the type of information that will be used in underwriting. Upstart has committed to monitoring the effectiveness of all safeguards and sharing the results of its testing, along with other relevant information, with the Bureau during the term of the NAL.

On July 18, 2018, the Bureau announced the creation of its Office of Innovation, to foster consumer-friendly innovation, which is now a key priority for the Bureau. The Office of Innovation is in the process of revising the Bureau's NAL and trial disclosure policies, in order to increase participation by companies seeking to advance new products and services.

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[27] The Guidelines were published by the FFIEC member agencies including the Bureau, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the State Liaison Committee. These new Guidelines are available at https://files.consumerfinance.gov/f/documents/201708_cfpb_ffiec-hmda-examiner-transaction-testing-guidelines.pdf.

[28] For HMDA data collected in 2017 and submitted in 2018, the Bureau will follow the HMDA resubmission guidelines published on October 9, 2013 and available at http://files.consumerfinance.gov/f/201310_cfpb_hmda_resubmission-guidelines_fair-lending.pdf.

5. Conclusion

The Bureau expects that the publication of *Supervisory Highlights* will continue to aid Bureau-supervised entities in their efforts to comply with Federal consumer financial law. The report shares information regarding general supervisory and examination findings (without identifying specific institutions, except in the case of public enforcement actions), communicates operational changes to the program, and provides a convenient and easily accessible resource for information on the Bureau's guidance documents.

NOTES

6

NYAG Year in Review

Submitted by:
Jane M. Azia
Office of the New York State Attorney General

1. ACS EDUCATION SERVICES (CURRENTLY KNOWN AS CONDUENT EDUCATION SERVICES):

The NYAG and Department of Financial Services reached a joint $9 million settlement with ACS Education Services (currently known as Conduent Education Services). The settlement was the first in the country to address claims that a federal student loan servicer steered distressed borrowers away from available income-based repayment plans towards other, more expensive options, thus costing them money and increasing their risk of default. It also addressed for the first time claims that a federal student loan servicer deceived borrowers concerning the availability of Public Service Loan Forgiveness (PSLF), a program that, under certain circumstances, provides forgiveness of student loan debt after a borrower works for ten years in a public-service job. In addition to paying penalties and restitution to injured borrowers, ACS agreed not to service loans for the major federal programs or private loans for the next five years.

The settlement resolved claims against ACS concerning its mishandling of student loan borrowers' accounts, including.

- Steering struggling borrowers into forbearances, a temporary pause in payments, which are only a short-term solution for an inability to pay and usually increase the cost of a loan, instead of directing borrowers to apply for a program that pegs payments to income and family size called Income-Based Repayment (IBR).
- Misleading borrowers by informing them that IBR was their best option despite the introduction of newer, more beneficial repayment options. In order to take advantage of these new options, borrowers would have needed to consolidate their loans into a newer loan program, meaning that they would have been assigned to another servicer.
- Informing borrowers who asked about PSLF that they were not eligible, even though they might have been if they had consolidated their loans.
- Failing to provide borrowers who sought to consolidate their loans the necessary account information, preventing some from doing so for more than three years. These borrowers potentially lost years of qualifying service towards PSLF and access to better repayment programs.
- Failing to process IBR applications in a timely and accurate fashion.
- Requiring some borrowers to reapply for IBR unnecessarily.
- Misallocating payments by borrowers, in some cases costing them additional late fees or interest.

- Making inaccurate reports to credit reporting agencies.
- Failing to inform private-loan borrowers about the possibility of the release of co-signers.
- Overstating the monthly payments owed by some members of the armed forces who were eligible for reductions under the Service-members' Civil Relief Act.
- Charging some borrowers late fees higher than the legal cap.

Available at https://ag.ny.gov/press-release/attorney-general-james-and-superintendent-vullo-announce-9-million-settlement-federal

2. JOINT ACTION WITH FTC AGAINST BUFFALO DEBT COLLECTION OPERATION:

NYAG and FTC filed a joint lawsuit against Buffalo debt collection companies and their principal for engaging in deceptive and abusive debt collection practices. The federal court granted a temporary restraining order freezing the operations' assets, ordered the defendants to comply with the law, and appointed a receiver to take over the corporate entities at the request of the Attorney General's office and the FTC.

The defendants in the case were Robert Heidenreich and six corporations he controls: Campbell Capital LLC; Kahl, Heidenreich, and Nemmer, LLC; Urban, Heidenreich, Melendez, and Associates, LLC; J & V Receivables, LLC; Rich Financial, LLC; and BCH & Associates Ltd.

The complaint alleged that the defendants violated the law by demanding and receiving more money from consumers than actually owed, a practice known in the debt collection industry as "overbiffing." In numerous instances, according to the complaint, consumers agreed to pay more than the defendants' own records indicate consumers owed.

The complaint also alleged that the defendants' collectors pretended to be law enforcement personnel and threatened consumers with arrest unless they make a payment. The collectors also pretended to be attorneys or process servers to try to collect alleged debts by falsely claiming that lawsuits had been filed against consumers.

Available at https://ag.ny.gov/press-release/ag-underwood-announces-court-order-permanently-banning-fraudulent-debt-collectors

3. JOINT ACTION WITH CFPB AGAINST RD LEGAL FUNDING:

The original complaint filed in the S.D.N.Y. alleged that defendants scammed 9/11 heroes and National Football League (NFL) concussion victims out of money intended to cover medical costs, lost income, and other critical needs.

RD Legal offers advances to consumers entitled to payouts from victim compensation funds or lawsuit settlements. The company targeted fund awardees including police, firefighters, paramedics, and others who were first responders to the World Trade Center attack on September 11, 2001. Many of these first responders suffer from cancers and other respiratory illnesses related to their exposure to dust and debris at the attack site, post-traumatic stress disorder, depression, and memory loss. They were awarded money from the Zadroga Fund, established by Congress to assist with needs including mounting medical costs and lost income because of their inability to work. The company also targeted former NFL players who have been diagnosed with neurodegenerative diseases such as Alzheimer's and Parkinson's disease and were entitled to payments from the settlement in a class action lawsuit.

Specifically, the CFPB and NYAG alleged that RD Legal:

- **Lured consumers into costly payouts by lying about the terms of the deal:** Through convoluted contracts, RD Legal misrepresented to consumers what they were being offered. These misrepresentations deceived consumers, interfered with their understanding of the terms, costs, and conditions of the transactions, and prevented them from meaningfully evaluating what was being offered. The products were expensive. For example, one consumer was awarded $65,000 from the Zadroga Fund. While she waited for her full payment from the fund, RD advanced her $18,000. When her award payment from the fund arrived six months later, she had to repay $33,000 to RD Legal – so she paid $15,000 to RD above and beyond the money RD Legal advanced to her.
- **Lied about speeding up the processing of consumers' claims:** RD Legal claimed that it could "cut through red tape" to obtain their anticipated payments from claims administrators faster than would otherwise be possible. In fact, RD Legal had no authority or ability to change when victim compensation or settlement payouts occurred.
- **Deceived consumers about when they would receive the money from RD Legal:** RD Legal misrepresented to consumers when they would receive money from the company. On its website, the company promised that consumers would receive the money within several

days of entering into the contract, but some consumers did not receive money until months after it was promised.

- **Illegally collected money from consumers:** When consumers received their payouts from their actual settlement funds, RD Legal attempted to recover its money from the victims. The complaint alleged that the costly transactions were not valid and enforceable under New York law because they violated the state interest rate cap.
- **Violated New York usury laws:** The complaint also alleged other violations of New York state law, including that these transactions are in fact loans under New York law with usurious interest rates. On many of these loans, RD Legal collected effective interest rates ranging from 18% to over 250%. These interest rates exceed New York's 16% civil usury cap and its 25% criminal usury cap. Under New York law, contracts that charge more than the maximum usury rate are void.

Available at https://ag.ny.gov/press-release/ag-schneiderman-and-consumer-financial-protection-bureau-announce-lawsuit-against-rd

Current Status:

The case was assigned to Judge Preska who issued a 104 page decision finding that the RD agreements were in fact loans and could not be assigned. *CFPB v RD Legal Funding, LLC*, 332 F. Supp. Ed 729 (S.D.N.Y. 2018). She also found that the State had adequately pleading that the loans were usurious. However, she also concluded that the structure of the CFPB under the federal Consumer Financial Protection Act (CFPA) was unconstitutional and that Title X of the CFPA, which provided the authority for both the CFPB and state's federal claims, could not stand. As such, she dismissed the entire complaint, without prejudice to the NYAG filing our state claims in state court. The CFPB and NYAG have filed Notices of Appeal, and RD filed a Notice of Cross-Appeal. New York also refiled the state claims in state court.

4. ACTION AGAINST STUDENT DEBT RELIEF COMPANIES:

Student debt is a major issue facing consumers. New Yorkers' student loan debt is estimated at $86.54 billion, according to a 2017 Consumer Financial Protection Bureau report. In September, the NYAG sued nine student loan debt relief companies, their financing company, and two individuals with leadership roles in several of the companies. The lawsuit alleged that the defendants fraudulently, deceptively, and illegally advertise, market, offer

for sale, sell, and finance student debt relief services to thousands of consumers nationwide, including thousands of New Yorkers.

In particular, the complaint alleges that defendants falsely claim to be affiliated with the federal government, make multiple misrepresentations to induce consumers to enroll in their services, and charge consumers illegal upfront fees and/or usurious interest rates. Defendants typically charge a consumer more than $1,000 for their services, which are available for free through the federal government or the consumer's student loan servicer.

The lawsuit alleges that the student loan debt relief defendants contact borrowers in a number of ways, including through deceptive personalized direct mail solicitations that appear to come from the federal government and deceptive Facebook ads that claim as "breaking news" that certain United States Department of Education ("DOE") programs were recently approved by the federal government, when in fact they were passed years ago.

The lawsuit further alleges that these defendants then rely on "Student Loan Advisors" to sell student loan debt-relief agreements to consumers by phone. Despite holding themselves out as being knowledgeable about student loans, these so-called Student Loan Advisors are in reality telemarketers with no specialized experience or expertise, who sell virtually identical student loan debt-relief agreements to borrowers using the same sales scripts and pitches. Student Loan Advisors repeatedly make false and deceptive misrepresentations to consumers such as:

- telling borrowers that they are from the federal government, are a part of the federal student loan program, are working with the federal student loan program, or are working with a federal student loan servicer – when in fact, they are not affiliated with the federal government or student loan servicers;
- telling borrowers that they cannot enroll in the debt-relief services offered on their own – when in fact, borrowers can work directly with their servicers or use the DOE website to obtain student loan debt-relief services at no additional cost; and
- telling borrowers that they can eliminate their student loan debt by making a number of payments to one of the defendants – when in fact, making these payments will not reduce, let alone eliminate, their student loan debt.

As detailed in the suit, some consumers stop making payments on their loans because they are led to believe that their payments to defendants are paying their student loans. These consumers ultimately owe more on their student loans due to the missed payments.

Defendants typically charge consumers more than $1,000 each for their services. In recent years, defendants have required that consumers enter into financing agreements with defendant Equitable Acceptance Corporation. The lawsuit alleges that these financing agreements typically charge New York consumers 20.99% interest, above the New York civil usury rate cap of 16%. The lawsuit also alleges that defendants violate federal and New York State laws designed to protect consumers from fraudulent credit repair organizations, telemarketers, and consumer credit agreements.

The lawsuit seeks injunctive relief, a declaration that defendants' contracts with borrowers are null and void, restitution, damages, disgorgement, penalties, and costs.

The student loan debt relief companies named in the lawsuit are Debt Resolve, Inc.; Hutton Ventures, LLC; Progress Advocates, LLC; Progress Advocates Group, LLC; Student Advocates, LLC; Student Advocates Group, LLC; Student Advocates Team, LLC; Student Loan Care, LLC; and Student Loan Support LLC (collectively, "student loan relief defendants"). Debt Resolve, Inc., a New York company, is the majority owner of two of the other student loan debt relief entities. The two named individuals are Bruce Bellmare and Stanley E. Freimuth, the current and past CEOs of Debt Resolve, Inc. The financing company named in the lawsuit is Equitable Acceptance Corporation.

Available at https://ag.ny.gov/press-release/ag-underwood-files-suit-against-nine-student-loan-debt-relief-companies-costly-student

5. 50 STATE SETTLEMENT WITH WELLS FARGO:

All 50 states and the District of Columbia entered into a $575 million settlement with Wells Fargo resolving claims that the bank violated state consumer protection laws by (1) opening millions of unauthorized accounts and enrolling customers into online banking services without their knowledge or consent, (2) improperly referring customers for enrollment in third-party renters and life insurance policies, (3) improperly charging auto loan customers for force-placed and unnecessary collateral protection insurance, (4) failing to ensure that customers received refunds of unearned premiums on certain optional auto finance products, and (5) incorrectly charging customers for mortgage rate lock extension fees.

Wells Fargo had identified more than 3.5 million accounts where customer accounts were opened, funds were transferred, credit card applications were filed, and debit cards were issued without the customers' knowledge or consent. The bank also identified 528,000 online bill pay enrollments nationwide that may have resulted from improper sales practices at the

bank. In addition, Wells Fargo improperly submitted more than 6,500 renters insurance and/or simplified term life insurance policy applications and payments from customer accounts without the customers' knowledge or consent.

The states alleged that Wells Fargo imposed aggressive and unrealistic sales goals on bank employees and implemented an incentive compensation program where employees could qualify for credit by selling certain products to customers. The states further alleged that the bank's sales goals and the incentive compensation program created an impetus for employees to engage in improper sales practices in order to satisfy such sales goals and earn financial rewards. Those sales goals became increasingly harder to achieve over time, the states alleged, and employees who failed to meet them faced potential termination and career-hindering criticism from their supervisors.

The states also alleged that Wells Fargo improperly charged premiums, interest, and fees for force-placed collateral protection insurance to more than two million auto financing customers, despite evidence that the customers' regular auto insurance policy was in effect, and despite numerous customer complaints about such unnecessary placements. (Many of those customers may not have suffered financial harm, however, because the policies were cancelled before the customers paid the charges).

Additionally, the states alleged that Wells Fargo failed to ensure that customers received proper refunds of unearned portions of optional Guaranteed Asset/Auto Protection (GAP) products sold as part of motor vehicle financing agreements.

Finally, the states alleged that Wells Fargo improperly charged residential mortgage loan consumers for rate lock extension fees even when the delay was caused by Wells Fargo, a practice contrary to the bank's policy. Wells Fargo has identified and contacted affected consumers and has refunded or agreed to refund over $100 million of such fees. *See* https://www.nytimes.com/2018/12/28/business/wells-fargo-settlement.html.

6. FEDERAL ROLLBACKS – STUDENT LENDING:

New York is an active participant in efforts opposing the federal Department of Education's rollback of student borrower protections, including the Borrower Defense to Repayment and Gainful Employment regulations, and the Department's efforts to preempt state action in the area of student lending and servicing.

Borrower Defense to Repayment: The Borrower Defense to Repayment Rule, which set forth procedures for student borrowers to obtain full or partial discharge of federal student loans as a result of school misconduct, was scheduled to go into effect on July 1, 2017. We were a co-plaintiff with Massachusetts and others in an action challenging the Department of Education's multiple delays of the Borrower Defense to Repayment Rule. *Massachusetts v. DeVos* (D.C. Dist. Randolph Moss, J.) On September 12, the district court granted summary judgment to the States. The Court vacated the Department's delay of the Rule but provided the Department with 30 days to attempt to remedy deficiencies in their earlier action to stay the implementation of the Rule. The Department did not attempt to remedy the deficiencies in the stay. As a result, the Rule went into effect in October 2018. In December 2018, the Department discharged the loans of 15,000 borrowers in compliance with the Rule's "automatic closed school discharge" provision. We also joined states in filing multiple comments opposing the Department's multiple delays and proposed rulemaking to replace the existing rule. *See, e.g.*, https://ag.ny.gov/press-release/attorney-general-underwood-secretary-devos-puts-predatory-profit-schools-ahead.

Gainful Employment Rule: In 2016, the Department of Education also promulgated the Gainful Employment Rule. The Rule was intended to bring accountability and transparency to for-profit schools by, among other things, i) requiring such schools to demonstrate that graduates of their programs meet minimum benchmarks for loan repayment capacity, ii) providing that programs that fail to meet the standard for debt-to earnings ratios risk losing eligibility for federal financial aid; and iii) requiring schools to disclose certain student outcome information directly to prospective students to empower students to make informed decisions when choosing programs. We are part of a coalition of states that filed a lawsuit challenging the Department of Education's unlawful delay and rescission of the rule. We also participated in several comments opposing these actions. *See, e.g.*, https://ag.ny.gov/press-release/attorney-general-underwood-calls-education-secretary-betsy-devos-scrap-plan-eliminate.

Preemption: We have been leading state efforts opposing federal preemption in this area. We have submitted comments to the Department of Education and Congress supporting the states' historic role in protecting students and opposing actions that would preempt the states. *See* https://ag.ny.gov/uploads/student-loan-preemption-letter. We took the lead in drafting an amicus brief in *Student Loan Servicing Alliance v. Taylor*, a:18-cv-00640-PLF (D.C. 2018), a federal challenge to Washington D.C.'s student loan servicer licensing regime. *See* https://ag.ny.gov/press-release/

ag-underwood-leads-bipartisan-amicus-brief-opposing-efforts-undermine-states-role.

7. FEDERAL ROLLBACKS – CFPB:

We have been closely monitoring developments at the federal level to weaken the CFPB or existing consumer protections. We took the lead in opposing The Financial Choice Act, legislation that would have eliminated many of the critical consumer protections implemented as a result of Dodd-Frank. *See* https://ag.ny.gov/press-release/ag-schneiderman-leads-coalition-20-ags-urging-house-reject-anti-consumer-legislation. We also took the lead in drafting comments urging the CFPB to maintain its governmental and public consumer complaint databases, both of which have proven to be invaluable resources in identifying both consumer trends and potential misconduct and providing consumers with the information they need about financial decisions, options in the market place and how to avoid bad actors. *See* https://ag.ny.gov/press-release/ag-underwood-leads-coalition-14-ags-urging-cfpb-retain-public-access-consumer. We have joined a number of other multistate letters and comments, including a letter supporting the broad subpoena and investigatory powers of the CFPB and one calling on the CFPB to continue enforcing federal law to protect against credit discrimination. *See* https://ag.ny.gov/press-release/ag-schneiderman-trump-administration-dont-weaken-cfpbs-investigative-authority; https://ag.ny.gov/press-release/ag-underwood-calls-cfpb-continue-enforcement-federal-law-protect-against-credit.

NOTES

7

Abigail M. Stempson and Philip D. Ziperman, What Are the Key Criteria for State Enforcers When Deciding to Bring an Action in a Data Breach Matter?

Submitted by:
Philip D. Ziperman

Office of the Maryland Attorney General

Prior versions of this outline have been submitted for American Bar Association Consumer Protection conferences in February 2017 and February 2019.

1. VIOLATION OF STATUTE

a. General state consumer protection laws (CPA/UDAP)[1]

- Unfair and/or unconscionable standards
- Misrepresentations
  - Privacy policy or privacy statement
    - Have to comply with affirmative statements
    - Promises not to resell consumer data – consumer lists as property in a bankruptcy estate - e.g. *Borders*[2] and *Radio Shack*[3]
  - Google Safari - "Safari is set by default to block all third-party cookies. If you have not changed those settings, this option effectively accomplishes the same thing as setting the opt-out cookie."[4]
- Implied representations
  - Are you representing that you will take reasonable steps to protect consumers' data by collecting it?
- Material omissions
  - Are you committing material omissions if you are not transparent when collecting data?
  - Considerations:
    - Maintaining consumers' data
    - Length of time
    - Sharing it with third parties
- No requirement to prove harm
  - *Spokeo* – requiring injury-in-fact.
  - Deception theory in public enforcement actions do not have to prove harm
  - But, under an unfairness theory the State must show serious harm to consumers

b. Breach notification laws[5]

c. Personal Information Protection Acts[6]

- Requiring reasonable care when storing personal information
- Making the failure to take reasonable care an unfair or deceptive trade practice
- Data disposal
    - Dumpster diving and public receptacles
        - *Also see* state data disposal laws[7]

d. Attorney general passport programs[8]

- Generally termed an *Identity Theft Passport*, after verifications are made that the person in question is indeed a victim of identity theft, that person is issued a card that can be carried and presented to law enforcement or other individuals who may challenge the person about his/her identity

e. Current Developments – State Laws

- California Consumer Privacy Act of 2018[9]
    - Gives California consumers unprecedented personal data protections and possibly sets the tone for similar legislation in other states
- Vermont Data Broker Law (H.764)
    - Data brokers in Vermont must now disclose what data they collect and allow customers to opt out
- Colorado Privacy Law[10]
    - Requiring reasonable data protection practices to be appropriate to the nature of the personal identifying information and the nature and size of the business and its operations

2. SEVERITY AND SCOPE

a. Data sensitivity

i. Social Security Numbers, health information, biometric data, driver's license number, financial information, information that can damage reputation, etc.

b. Number and type of consumers affected

i. Does the breach affect a large number of the citizens in the enforcer's jurisdiction? Is it nationwide? Is it worldwide?

- Some breaches are so massive such as Equifax-what is an enforcer to do?

ii. Has the breach impacted a particular segment of the population such as children or the elderly?

iii. Is the office receiving complaints?

c. Impact on consumers

i. Has the breach caused losses such as financial, time, effort, jobs, emotional, health, and safety?

ii. Risk of identity theft

d. Is or can the harm be ongoing?

e. Can the compromised information be modified to the detriment of the consumer in addition to it being accessed?

f. How culpable is the entity for the breach?

i. Did the entity report the breach in accordance with state laws?

- To consumers?
- To attorneys general and/or other law enforcement if required?
- Timeliness of notification?

ii. Did the entity take other action to protect consumers immediately?

- Internal investigation?
- Contact criminal law enforcement?
- Hire a forensic expert?

iii. Was a third party involved?

iv. Did the entity try to pay a ransom?

v. Was the breach something that was reasonably preventable?

g. Liability for vendors or third-parties

i. Statutory duty to protect data is non-delegable

3. REMEDIES AVAILABLE

a. Injunctions

- How specific should terms be in tech cases?
  - Easy
    - Reasonable steps to protect consumers' data and if you don't, violating statute
    - Apply critical patches and do so in a reasonable way, including using scanning tools, plus make sure someone is responsible for this process (but often not as simple as applying a patch)
  - Harder
    - More finite issues such as patch management, updating systems, updating corporate governance, scanning tools
    - Are regulators qualified to come up with these? Should they use existing best practices that may be available?
- Should they sunset?

b. Civil penalties

- Most states have consumer protection or data protection acts that list penalties for each violation
- One violation per affected consumer for whom a representation is made

c. Consumer restitution

- Most attorney general settlements have not gotten restitution for consumers and instead include things such as free credit monitoring or freezes
  - Credit monitoring often only lasts for a short period of time, but your social security number lasts for your life-Dark web sellers know this
- Challenge: Some consumers have been impacted by multiple breaches-How do you determine which one is actually the cause?

- Restitution through class actions?
    - Target[11], Home Depot[12], Anthem[13]

d. *Cy Pres*

- Relevant in some matters

e. Attorney's fees/costs

f. Are there ways for the enforcer to address the basic problem other than through investigation/litigation such as public education, legislation, public hearings?

g. Are there alternative remedies available to consumers affected by the breach outside of action by the enforcer?

4. LEGAL VALUE OF THE CASE

a. Likelihood of a favorable result through settlement or litigation

b. If restitution, penalties, or other payments are awarded, are they collectible?

c. Precedential value of the case:

- Impact on the development of consumer law in the state or nationwide
- General or specific deterrent effect
- Stop the deceptive/illegal practice before it becomes widely used by others in the same industry or address a widely used practice
- Protect the public by making it unnecessary for competitors to adopt similar practices because of economic necessity

5. RESOURCES

a. Consumer Protection Divisions

- Assistant Attorneys Generals
- Investigators
- Internal or external experts?

b. Some State AGs have formed ID Theft or Privacy Units[14]

6. EXAMPLES OF AG INVESTIGATIONS/INQUIRIES/LETTERS/ ENFORCEMENT ACTIONS/SETTLEMENTS RELATING TO PRIVACY

a. Investigations/Inquiries/Letters

i. Social Security Administration

- NAAG Letter to the Social Security Administration by 43 Attorneys General, 2018[15]
- Asking the acting commissioner to prioritize the implementation of a new database system that meets requirements in a law recently passed by Congress

ii. Facebook[16]

- NAAG Letter to Facebook by 41 Attorneys General, 2018[17]

iii. Google

- North Carolina, 2018[18]
- NC Press Heading: *Attorney General Josh Stein Asks Google for Answers*

iv. Equifax Inc.[19]

- Letter to Equifax Inc. by 34 Attorneys General, 2017[20]

b. Enforcement actions

i. District of Columbia vs. Facebook[21]

- 2018
- DC Press Heading: *AG Racine Sues Facebook for Failing to Protect Millions of Users' Data*

ii. Multiple States vs. Medical Informatics Engineering, Inc. (MIE) and NoMoreClipboard, LLC[22]

- 2018
- First time state Attorneys General have joined together to pursue a HIPAA-related multistate data breach case in federal court
- Allegations: The company violated provisions of the Health Insurance Portability and Accountability Act (HIPAA) as well as unfair and deceptive practice laws, notice of data

breach statute, and personal information protection laws in 2015 health data breach

iii. Massachusetts vs. Equifax Inc.[23]

- 2017
- MA Press Heading: *AG's Office Alleges Company Failed to Protect Personal Information of Nearly Three Million Massachusetts Residents, Despite Knowing its System Was Vulnerable to Hackers*

iv. Washington vs. Uber Technologies, Inc.[24]

- 2017
- WA Press Heading: *AG Ferguson Files Multi-Million Dollar Lawsuit Against Uber for Failing to Report Massive Data Breach*

c. Settlements

i. EmblemHealth, Inc.[25]

- 2018
- New Jersey
- Allegations: October 2016 breach incident in which EmblemHealth improperly displayed the Medicare Health Insurance Claim Numbers, which mirror individual Social Security numbers, belonging to more than 81,000 policy holders, 6,443 of whom reside in New Jersey

ii. Uber Technologies, Inc.[26]

- 2018
- 50 states & DC
- Allegations: Uber learned in November 2016 that hackers gained access to personal information that it maintains about its drivers, but failed to report the breach in a timely manner

iii. Aetna Inc.

- 2018
- Connecticut[27], District of Columbia[28], New Jersey[29], New York[30], Washington[31]

- Allegations: HIPAA violations resulting from mailings to HIV/AIDS and cardiac patients

iv. Lenovo (United States) Inc.[32]

- 2017
- 32 states
- Allegations: Pre-installation of faulty software on laptop computers sold to consumers that made consumers' personal information vulnerable to hackers

v. Nationwide Mutual Insurance Company & Allied Property & Casualty Insurance Company (subsidiary)[33]

- 2017
- 32 states & DC
- Allegations: 2012 data breach-hackers exploited a vulnerability in the companies' third-party web application hosting software due to failure to apply a critical software patch exposing sensitive personal information of 1.2 million consumers

vi. Target Corporation[34]

- 2017
- 47 states & DC
- Allegations: 2013 data breach-weaknesses in Target's system allowed the attackers to access consumer data

vii. Hilton Domestic Operating Company, Inc., formerly known as Hilton Worldwide, Inc.

- 2017
- Vermont and New York[35]
- Allegations: data security incidents exposed over 350,000 credit card numbers in two separate breaches in 2015-Attorney General Schneiderman's investigation, conducted in collaboration with the Vermont Attorney General's office, revealed that Hilton did not provide consumers with timely notice and did not maintain reasonable data security

viii. SAManage[36]

- 2017
- Vermont
- Allegations: exposure of excel spreadsheet with 660 SSNs, which was not reported

ix. Ruby Corp, Ruby Life, Inc., also doing business as AshleyMadison.com, and ADL Media, Inc.[37]

- 2016
- 13 states, DC, & FTC
- Allegations: 2015 data breach of AshleyMadison.com dating sight allowing access to consumer data plus website had created thousands of fake user profiles, misrepresented the strength of its security, and sold a "Full Delete" option which it did not carry out in all instances

x. Adobe Systems Inc.[38]

- 2016
- 15 states
- Allegations: unauthorized access to Adobe servers containing consumer personal information

xi. Google Inc. (Safari)[39]

- 2013
- 37 states & DC
- Allegations: circumvention of privacy settings

xii. Google Inc. (Street View)[40]

- 2013
- 38 states & DC
- Allegations: collection of personal data of consumers

xiii. TJX Companies, Inc.[41]

- 2009
- 40 states & DC

- Allegations: breach of consumers' personal cardholder information

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1. *See* Alabama Deceptive Trade Practices Act, Ala. Code § 8-19-1 *et seq*.; Alaska's Unfair Trade Practices and Consumer Protection Act, Alaska Stat. 45.50.471 through 561; Am. Samoa Code Ann. §§ 27.0401 through 0406; Am. Samoa Code Ann. 27.0601 through 0616; Am. Samoa Code Ann. 27.0901 through 0905; Am. Samoa Code Ann. 22.1501 through 1504; Am. Samoa Code Ann. 22.1701 through 1711; Arizona Consumer Fraud Act, Ariz. Rev. Stat. § 44-1521 *et seq*.; Deceptive Trade Practices Act, Ark. Code Ann. § 4-88-101 *et seq*.; Cal. Bus. & Prof Code §§ 17200 *et seq*. and 17500 *et seq*.; Colorado Consumer Protection Act, Colo. Rev. Stat. § 6-1-101 *et seq*.; Connecticut Unfair Trade Practices Act, Conn. Gen. Stat. §§ 42-110a *et seq*.; Consumer Fraud Act, Del. Code Ann. tit. 6, §§ 2511 through 2527; Uniform Deceptive Trade Practices Act, Del. Code Ann. tit. 6, §§ 2531 through 2536; District of Columbia Consumer Protection Procedures Act, D.C. Code §§ 28-3901 *et seq*.; Florida Deceptive and Unfair Trade Practices Act, Fla. Stat. Ann. §§ 501.201 through 213; Fair Business Practices Act, Ga. Code Ann. § 10-1-390 *et seq*.; Trade Practices and Consumer Protection, 5 Guam Code Ann. §32101 *et seq*.; Uniform Deceptive Trade Practice Act, Haw. Rev. Stat. § 481A ; Haw. Rev. Stat. § 480-2; Consumer Protection Act, Idaho Code Ann. §§ 48-601 *et seq*.; Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1 *et seq*.; Uniform Deceptive Trade Practices Act, 815 ILCS 510/1 *et seq*.; Deceptive Consumer Sales Act, Ind. Code 24-5-0-5 *et seq*.; Iowa Consumer Fraud Act, Iowa Code § 714.16; Kansas Consumer Protection Act, Kan. Stat. Ann. § 50-623 *et seq*.; Kentucky Consumer Protection Act, Ky. Rev. Stat Ann. § 367.110 *et seq*.; Unfair Trade Practices and Consumer Protection Law, La. Rev. Stat. Ann. 51:1401 *et seq*.; Unfair Trade Practices Act, Me. Rev. Stat. tit. 5 §§ 205-A through 214; Maryland Consumer Protection Act, Md. Code Ann., Com. Law § 13-101 *et seq*.; Mass. Gen. Laws ch. 93A, §§ 2 and 4; Michigan Consumer Protection Act, Mich. Comp. Laws § 445.901 *et seq*.; Minnesota Deceptive Trade Practices Act, Minn. Stat. §§ 325D.43 through 48; Minnesota False Advertising Act, Minn. Stat. § 325F.67; Minnesota Consumer Fraud Act, Minn. Stat. §§ 325F.68 through 70; Minnesota Deceptive Trade Practices Against Senior Citizens or Disabled Persons Act, Minn. Stat. § 325F.71; Miss. Code Ann. 75-24-1 *et seq*.; Merchandising Practices Act, Mo. Rev. Stat. §§ 407.010 *et seq*.; Mont. Code Ann. §§ 30-14-101 *et seq*.; Nebraska Consumer Protection Act, Neb. Rev. Stat. §§ 59-1601 *et seq*.; Uniform Deceptive Trade Practices Act, Neb. Rev. Stat. §§ 87-301 *et seq*.; Deceptive Trade Practices Act, Nev. Rev. Stat. §§ 598.0903 *et seq*.; New Hampshire Consumer Protection Act, N.H. Rev. Stat. Ann. § 358-A; New Jersey Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-1 *et seq*.; New Mexico Unfair Practices Act, N.M. Stat. Ann. §§ 57-12-1 *et seq*.; N.Y. General Business Law Art. §§ 349 through 50, and Executive Law § 63(12); North Carolina Unfair and Deceptive Trade Practices Act, N.C. Gen. Stat. §§ 75-1.1 *et seq*.; Unlawful Sales or Advertising Practices, N.D. Cent. Code § 51-15-01 *et seq*.; Consumer Protection Act, 4 N. Mar. I. Code §§ 5101 *et seq*.; Disaster Price Freeze Act, 4 CMC §§ 5141 *et seq*.; Assistive Technology Warranty Act, 4 CMC §§ 5161 *et seq*.; Alien and Immigrant Consumer Protection Act, 4 CMC §§ 5181 *et seq*.; Unfair Trade Practices 4 CMC §§ 5201 *et seq*.; Ohio Consumer Sales Practices Act, Ohio Rev. Code Ann. §§ 1345.01 *et seq*.; Oklahoma Consumer Protection Act, Okla. Stat. tit. 15 §§ 751 *et seq*.; Oregon Unlawful Trade

Practices Act, Or. Rev. Stat. §§ 646.605 *et seq*.; Pennsylvania Unfair Trade Practices and Consumer Protection Law, 73 Pa. Con. Stat. §§ 201-1 *et seq*.; P.R. Laws Ann. tit. 3, §§ 2101 *et seq*.; Rhode Island Deceptive Trade Practices Act, R.I. Gen. Laws §§ 6-13.1-1 *et seq*.; South Carolina Unfair Trade Practices Act, S.C. Code Ann. §§ 39-5-10 *et seq*.; South Dakota Deceptive Trade Practices and Consumer Protection, S.D. Codified Laws §§ 37-24-1 *et seq*.; Tennessee Consumer Protection Act, Tenn. Code Ann. § 47-18-101 *et seq*.; Texas Deceptive Trade Practices-Consumer Protection Act, Tex. Bus. And Com. Code §§ 17.41 *et seq*.; Utah Consumer Sales Practices Act, Utah Code Ann. §§ 13-11-1, *et seq*.; Consumer Protection Act, Vt. Stat. Ann. tit. 9, §§ 2451 *et seq*.; The Consumer Fraud and Deceptive Business Practices Act, V.I. Code Ann. tit. 12A, § 301 *et seq*.; V.I. Code Ann. tit. 12A § 101 *et seq*.; Virginia Consumer Protection Act, Va. Code Ann. §§ 59.1-196 through 207; Unfair Business Practices/Consumer Protection Act, Wash. Rev. Code §§ 19.86 *et seq*.; West Virginia Consumer Credit and Protection Act, W.Va. Code §46A-1-101 *et seq*.; Wis. Stat. § 100.182; Wis. Stat. § 100.18; Wis. Stat. §100.20; Wyoming Consumer Protection Act, Wyo. Stat. Ann. §§ 40-12-101 *et seq*.

2. https://www.reuters.com/article/us-borders/borders-bn-get-courts-ok-on-14-million-ip-sale-idUSTRE78P5US20110926.
3. https://www.texasattorneygeneral.gov/news/releases/attorney-general-paxton-announces-agreement-to-protect-consumer-privacy-in.
4. https://www.iowaattorneygeneral.gov/newsroom/google-changes-web-browser-privacy-tracking-practices-pays-state-275-000-in-consumer-protection/.
5. *See* Alaska Breach of Security Involving Personal Information statutes, AS 45. 48.0 10-45.48.090l; Arizona Notification of Breach of Security System, A.R. S. § 18-545; Arkansas Disclosure of Security Breaches, Ark. Code Ann. § 4- 110-105; Colorado Consumer Protection Act, Notification of Security Breach § 6-1-716; Connecticut Breach of Security re Computerized Data Containing Personal Information, Conn. Gen. Stat. § 36a-701b; District of Columbia Security Notification Act, D. C. Code § 28-3851, et seq.; Delaware 6 Del.C. § 12B-101, et al.; Florida Information Protection Act, § 50 1. 17 1, Fla. Stat.; Georgia Personal Identity Protection Act, O.C.G.A. § 10-1-910 through 915 - Hawaii Security Breach of Personal Information - Haw. Rev. Stat. Chpt. 487N; Illinois Personal Information Protection Act, 815 ILCS 530/1 et seq.; Indiana Disclosure of Security Breach Act; Indiana Code article 24-4.9; Iowa Personal Information Security Breach Protection Act, Iowa Code § 715C; Kansas K. S. A 50-7a0 1 et al.; Kentucky Rev. Stat. 365.732; Louisiana Database Security Breach Notification Law, La. Rev. Stat. 51: 3071, et seq., and Reporting Requirements, La. Admin. Code tit. 16, pt. 3, § 701.; Maine Notice of Risk to Personal Data Act, 10 M.R. S. § 1346, et seq.; Maryland Personal Information Protection Act, Md. Code Ann., Com. Law § 14-3501, et seq. (20 13 Repl. Vol and 2016 Supp.); Massachusetts Security Breach Law (Mass. Gen. Laws ch. 93H); Michigan Identity Theft Protection Act, Mich. Comp. Laws §§ 445.6 1, et seq.; Minnesota Data Breach Notification Statute, Minn. Stat. § 325E.61; Mississippi Notice of Breach of Security, Miss. Code Ann. § Appendix C. 75-24-29; Missouri Merchandising Practices Act, Section 407.1500, RSMo.; Montana Impediment of Identity Theft Act, Mont. Code Ann. § 30- 14-1704; Nebraska Financial Data Protection and Consumer Notification of Data Security Breach Act of 2006, Neb. Rev. Stat. § 87-801 et seq.; Nevada Rev. Stat. § 603A.220 (located within the Nevada Security of Personal Information Act); New Hampshire RSA 359-C: 19-21; New Jersey Identity Theft Prevention Act, N.J. S.A. 56: 8-16 1 to -166; The New York State Information Security Breach and Notification Act

(General Business Law 899-aa); North Carolina Identity Theft Protection Act, Protection from security breaches, N. C. Gen. Stat. § 75-65; North Dakota C. C. ch. 51-13: Notice of Security Breach for Personal Information; Ohio "Private disclosure of security breach of computerized personal information data", R.C. 1349.19 et seq.; Oklahoma Security Breach Notification Act, 24 O. S. §§ 161 et seq.; Oregon Consumer Identity Theft Protection Act, ORS 646A.600 et seq.; Pennsylvania Breach of Personal Information Notification Act, 73 P. S. §§ 2301, et seq.; Rhode Island Identity Theft Protection Act, R.I. Gen. Laws § 11-49.3-4; The South Carolina Identity Fraud and Identity Theft Protection Act, S.C. Code Ann. § 1-11-490, et seq.; Tennessee Tenn. Code Ann. § 47-18-2107 (within the Tennessee Identity Theft Deterrence Act of 1999, Tenn. Code Ann. §§ 47-18-2101 et seq.); Texas Identify Theft Enforcement and Protection Act, Tex. Bus. & Com. Code Ann. Ch. 521 (West 2015); Utah Protection of Personal Information Act, Utah Code § 13-44-10 1 et seq.; Vermont Security Breach Notice Act, 9 V. S.A. § 2435; Virginia Code § 18.2-186.6; Washington Data Breach Notification Law, RCW 19.255.010; West Virginia WVCCP A, Breach of Security of Consumer Information, W. Va. Code § 46A-2A-10 1, et al.

6. *See* Alaska Personal Information Protection Act, AS 45.48.010 et seq.; Arkansas Personal Information Protection Act, Ark. Code Ann. § 4-110-10 1 et seq.; California Consumer Privacy Act of 2018, AB-375 (effective date January 1, 2020); Colorado Consumer Protection Act, C.R.S. § 6-1-101 et sec., Notification of Security Breach, C.R. S. § 6-1-716; Connecticut Safeguarding of Personal Information, Conn. Gen. Stat. § 42-471; Florida Information Protection Act, § 50 1. 1 71, Fla. Stat.; Georgia Personal Identity Protection Act, O. C.G. A § 10- 1-910 through 915; Hawaii Personal Information Protection -Haw. Rev. Stat. Chpt. 487J; Illinois Personal Information Protection Act, 815 ILCS 530/1 *et seq.*; Indiana Disclosure of Security Breach Act, Indiana Code section 24-4.9-3-3. 5; Kansas Wayne Owen Act, K. S.A. 50-6, 139b; Maryland Personal Information Protection Act, Md. Code Ann., Com. Law § 14-3501, et seq. (2013 Repl. Vol and 2016 Supp.); Massachusetts Standards for the Protection of Personal Information of Residents of the Commonwealth (201 C.M.R. 17.00 et seq.); Minnesota Use of Social Security Numbers Statute, Minn. Stat. § 325E.59, and Minnesota Access Devices Statute, Minn. Stat. § 325E.64; Missouri Merchandising Practices Act, Section 407. 1500.1(9); Montana Impediment of Identity Theft Act, Mont. Code Ann. § 30-14-170 1 et seq.; Nevada Security of Personal Information Act; Nev. Rev. Stat. §§ 603A.010, et seq.; North Carolina Identity Theft Protection Act, N.C. Gen. Stat. §§ 75-60, et seq.; North Dakota N.D.C. C. ch. 51- 13: Notice of Security Breach for Personal Information; Oregon Consumer Identity Theft Protection Act, ORS 646A.600 et seq.; Rhode Island Identity Theft Protection Act, R.I. Gen. Laws § 1 1-49. 3-1, et seq. Appendix B.; South Carolina The Family Privacy Protection Act, S.C. Code Ann. § 30-2- 10, et seq.; Texas Identify Theft Enforcement and Protection Act, Tex. Bus. & Com. Code Ann. Ch. 521 (West 2015); Utah Protection of Personal Information Act, Utah Code § 13-44- 10 1 et seq.; West Virginia Code § 46A-2A- 10 1, et al.
7. *i.e.* 9 V.S.A. § 2445 (Document Safe Destruction Act).
8. *See examples:* Iowa (https://www.iowaattorneygeneral.gov/for-crime-victims/identity-theft-passport-program/); Maryland (http://www.marylandattorneygeneral.gov/Pages/IdentityTheft/IDTpassport.aspx); New Mexico (https://www.nmag.gov/identity-theft.aspx); and Virginia (https://www.oag.state.va.us/programs-initiatives/identity-theft).
9. California Civil Code Sections 1798.80-1798.84.
10. Colorado Revised Statutes, 6-1-713, *et seq.*

11. *In re Target Corp. Customer Data Sec. Breach Litig.*, 2015 WL 7253765 (D. Minn. Nov. 17, 2015).
12. *In re The Home Depot, Inc., Customer Data Security Breach Litig.*, Case No. 14-2583, Dkt. No. 260 (N.D.Ga., Aug. 23, 2016).
13. *In re Anthem, Inc. Data Breach Litig*, 15-md-02617 (N.D. Cal.).
14. *See examples:* California (https://oag.ca.gov/news/press-releases/attorney-general-kamala-d-harris-announces-privacy-enforcement-and-protection); Connecticut (http://www.portal.ct.gov/AG/Departments/Privacy/The-Privacy-and-Data-Security-Department); and Maryland (http://www.marylandattorneygeneral.gov/press/2013/012813.pdf).
15. https://www.naag.org/naag/media/naag-news/ags-request-social-security-administration-implement-new-database-to-prevent-identity-theft.php
16. *See examples:* Missouri (https://ago.mo.gov/home/breaking-news/ag-hawley-issues-investigative-demands-to-facebook); New Jersey (https://nj.gov/oag/newsreleases18/pr20180507b.html); New York (https://ag.ny.gov/press-release/ag-barbara-underwood-statement-facebook-investigation); and North Carolina (https://www.ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Attorney-General-Josh-Stein-Asks-Facebook-For-Answ.aspx).
17. https://www.naag.org/naag/media/naag-news/state-ags-demand-answers-about-facebook-user-privacy-and-policy.php.
18. https://ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Attorney-General-Josh-Stein-Asks-Google-for-Answer.aspx.
19. *See examples*: Georgia (https://law.georgia.gov/press-releases/2017-09-15/attorney-general-chris-carr-provides-information-equifax-investigation); Mississippi (http://www.ago.state.ms.us/releases/ag-hood-joins-multistate-investigation-into-equifax-data-breach/); and New York (https://ag.ny.gov/press-release/ag-schneiderman-launches-formal-investigation-equifax-breach-issues-consumer-alert).
20. https://ago.nebraska.gov/sites/ago.nebraska.gov/files/doc/2017-09-15%20Multistate%20Letter%20to%20Equifax.pdf.
21. https://oag.dc.gov/release/ag-racine-sues-facebook-failing-protect-millions.
22. *See examples:* Arizona (https://www.azag.gov/press-release/attorney-general-mark-brnovich-files-first-multistate-hipaa-related-data-breach); Nebraska (https://protectthegoodlife.nebraska.gov/news/attorney-general-files-first-multi-state-hipaa-related-data-breach-lawsuit); and North Carolina (https://ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Attorney-General-Josh-Stein-Files-HIPAA-Related-Da.aspx).
23. http://www.mass.gov/ago/news-and-updates/press-releases/2017/2017-09-19-equifax-lawsuit.html.
24. http://www.atg.wa.gov/news/news-releases/ag-ferguson-files-multi-million-dollar-lawsuit-against-uber-failing-report.
25. https://www.nj.gov/oag/newsreleases18/pr20181210a.html.
26. *See examples:* Nebraska (https://protectthegoodlife.nebraska.gov/news/attorney-general-peterson-reaches-settlement-uber); Pennsylvania (https://www.attorneygeneral.gov/taking-action/press-releases/attorney-general-josh-shapiro-reaches-settlement-with-uber-for-data-breach-involving-13500-drivers-in-pa/); and Vermont (https://donovanforvermont.com/news/attorney-general-to-bring-600000-to-vermont-in-uber-settlement/).
27. https://healthitsecurity.com/news/aetna-reaches-settlements-with-state-ags-over-hipaa-violations.
28. https://oag.dc.gov/release/ag-racine-fines-aetna-violating-consumer-privacy.

29. https://www.nj.gov/oag/newsreleases18/pr20181010c.html.
30. https://ag.ny.gov/press-release/ag-schneiderman-announces-settlement-aetna-over-privacy-breach-new-york-members-hiv.
31. https://healthitsecurity.com/news/aetna-reaches-settlements-with-state-ags-over-hipaa-violations.
32. *See examples*: California (https://oag.ca.gov/news/press-releases/attorney-general-becerra-announces-35m-settlement-lenovo-preinstalling-software); Illinois (http://www.illinoisattorneygeneral.gov/pressroom/2017_09/20170905.html); and North Carolina (http://www.ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Attorney-General-Josh-Stein-Settles-with-Lenovo-ov.aspx).
33. *See examples*: District of Columbia (https://oag.dc.gov/release/attorney-general-racine-announces-55-million-multistate-settlement-nationwide-insurance-over); Montana (https://dojmt.gov/attorney-general-fox-announces-settlement-nationwide-mutual-insurance-company-data-breach/); and South Dakota (https://atg.sd.gov/OurOffice/Media/pressreleasesdetail.aspx?id=1840).
34. *See examples*: Delaware (https://news.delaware.gov/2017/05/23/tdb/); Florida (http://www.myfloridalegal.com/newsrel.nsf/newsreleases/267E8BE9BB21436C85258129005E37B8); and Michigan (http://www.michigan.gov/ag/0,4534,7-359–412741–,00.html).
35. https://ag.ny.gov/press-release/ag-schneiderman-announces-700000-joint-settlement-hilton-after-data-breach-exposed.
36. https://www.hipaajournal.com/samanage-usa-data-breach-settlement/.
37. *See examples*: Arkansas (https://arkansasag.gov/media-center/news-releases/17.5-million-settlement-with-ashley-madison-reached/); Federal Trade Commission (https://www.ftc.gov/news-events/press-releases/2016/12/operators-ashleymadisoncom-settle-ftc-state-charges-resulting); and Nebraska (https://ago.nebraska.gov/news/owner-ashley-madison-enters-settlement).
38. *See examples:* Connecticut (http://portal.ct.gov/AG/Press-Releases/2016-Press-Releases/AG-Jepsen-Adobe-Reach-Agreement-Resolving-ConnecticutLed-Multistate-Investigation-into-Unauthorized); Massachusetts (http://www.mass.gov/ago/news-and-updates/press-releases/2016/adobe-to-pay-1-million-update-security.html); and Ohio (http://www.ohioattorneygeneral.gov/Media/News-Releases/November-2016/Attorney-General-DeWine-Announces-Multistate-Agree).
39. *See examples*: Nevada (http://ag.nv.gov/News/PR/2013/Consumer_Protection/Attorney_General_Masto_Joins_$17_Million_Multistate_Settlement_With_Google_Regarding_Tracking_of_Consumers/); New Jersey (http://nj.gov/oag/newsreleases13/pr20131118c.html); and Washington (http://www.atg.wa.gov/news/news-releases/google-pay-washington-state-610600-settle-consumer-tracking-allegations).
40. *See examples*: Alaska (http://www.law.alaska.gov/press/releases/2013/031213-Google.html); Arizona (https://www.azag.gov/press-release/attorney-general-tom-horne-joins-7-million-multi-state-settlement-over-google-street); and Maryland (http://www.marylandattorneygeneral.gov/press/2013/031213.pdf).
41. *See example:* Massachusetts (http://www.mass.gov/ago/news-and-updates/press-releases/2009/ag-announces-multi-state-settlement-with-the.html).

NOTES

NOTES

8

Office of the Maryland Attorney General, Consumer Protection Division v. Future Income Payments, LLC, et al., OAH Case No.: OAG-CPD-04-18-13497, CPD Case No. 18-013-296084 (November 19, 2018)

Submitted by:
Philip D. Ziperman

Office of the Maryland Attorney General

OFFICE OF THE MARYLAND	*	**BEFORE JENNIFER A. NAPPIER,**
ATTORNEY GENERAL,	*	**AN ADMINISTRATIVE LAW JUDGE**
CONSUMER PROTECTION DIVISION,	*	**OF THE MARYLAND OFFICE OF**
PROPONENT	*	**ADMINISTRATIVE HEARINGS**
v.	*	**OAH CASE NO.: OAG-CPD-04-18-13497**
FUTURE INCOME	*	**CPD CASE NO. 18-013-296084**
PAYMENTS, LLC, ET AL.,[1]	*	
RESPONDENTS	*	

* * * * * * * * * * * * *

PROPOSED DECISION

STATEMENT OF THE CASE
ISSUES
SUMMARY OF THE EVIDENCE
PROPOSED FINDINGS OF FACT
DISCUSSION
PROPOSED CONCLUSIONS OF LAW

STATEMENT OF THE CASE

On April 24, 2018, the Consumer Protection Division (CPD) of the Maryland Office of the Attorney General (Proponent), filed a Petition for Hearing and a Statement of Charges (Charges or SOC) against Future Income Payments, LLC, et al. (Respondents), to enjoin Respondents from engaging in allegedly unfair and deceptive trade practices in the course of offering or providing extensions of credit to Maryland consumers, and to obtain relief for

[1] The Respondents include Scott A. Kohn and Glorilyn Cusi, as well as the following "Corporate Respondents": Future Income Payments, LLC, formerly known Pensions, Annuities and Settlements, LLC; FIP LLC; Cash Flow Outsourcing Services Inc.; Cash Flow Investment Partners, LLC, also known as Sunlife Funding, LLC; BuySellAnnuity Inc.; Pension Advance LLC, as well as all trade names, "doing business as" (DBA) names, fictitious names, and assumed names used by any of these companies.

consumers allegedly victimized by the Respondents' unfair or deceptive trade practice.[2] The Respondents are charged with violating the Maryland Consumer Protection Act (CPA), Maryland Code Annotated, Commercial Law Article sections 13-101 through 13-501 (2013 and Supp. 2017);[3] the Maryland Consumer Loan Laws (MCLL), Maryland Code Annotated, Commercial Law Article sections 12-301 through 12-317 (2013 and Supp. 2017)[4] and Maryland Code Annotated, Financial Institutions Article sections 11-201 through 11-223 (2011 and Supp. 2017);[5] the Maryland Interest and Usury Law (I&U), Maryland Code Annotated, Commercial Law Article §§ 12-101 through 12-127 (2013 and Supp. 2017);[6] and the Installments Loan-Licensing Provisions (ILLP), Maryland Code Annotated, Financial Institutions Article sections 11-301 through 11-304 (2011 and Supp. 2017).[7]

On April 25, 2018, William D. Gruhn, Chief of the CPD, issued an Order Granting Hearing and Notification of Hearing. The CPD delegated authority to the Office of Administrative Hearings (OAH) to conduct a contested case hearing and render proposed Findings of Fact and Conclusions of Law.[8] The April 25, 2018 order informed the Respondents

[2] In its Charges, the Proponent also requests an order requiring the Respondents to pay the Proponent's investigative costs and the costs of prosecuting this matter; requiring the Respondents to pay a civil penalty of $1,000.00 for each violation of the Maryland Consumer Protection Act; and holding all Respondents jointly and severally liable for the restitution, penalties, costs, and any other sanctions or required payments arising from or related to this action.
[3] Unless otherwise indicated, all references to the CPA are to the 2013 volume or 2017 supplement of the Commercial Law Article.
[4] Sections 12-301 through 12-317 of the Commercial Law Article comprise the credit provisions of the MCLL. Unless otherwise indicated, all references to the credit provisions of the MCLL are to the 2013 volume or 2017 supplement of the Commercial Law Article.
[5] Sections 11-201 through 11-223 of the Financial Institutions Article comprise the licensing provisions of the MCLL. Unless otherwise indicated, all references to the licensing provisions of the MCLL are to the 2011 volume or 2017 supplement of the Financial Institutions Article.
[6] Unless otherwise indicated, all references to the I&U are to the 2013 volume or 2017 supplement of the Commercial Law Article.
[7] Unless otherwise indicated, all references to the ILLP are to the 2011 volume or 2017 supplement of the Financial Institutions Article.
[8] The OAH was not delegated authority to propose specific relief. *See* Code of Maryland Regulations (COMAR) 02.01.02.04B.

that a hearing on the Charges was scheduled to commence before the OAH on July 24, 2018. The case was transmitted to the OAH and received on April 26, 2018.

On or about May 7 and May 14, 2018, the Proponent filed Affidavits of Service with the OAH, certifying that on April 27, 2018, each of the Respondents were served with the following documents: the April 24, 2018 Petition for Hearing, Charges, Order Granting Hearing and Notification of Hearing; copies of the CPD's Rules of Practice and Procedure for Cease and Desist Order Hearings[9] (procedural directives) and the OAH Rules of Procedure;[10] an Appointment of Designee; and separate Requests for Production of Documents (RPDs) directed to each of the corporate respondents, as well as Respondents Scott A. Kohn and Glorilyn Cusi. The Respondents were required to file a written response to the Charges within twenty days of service of the Charges. COMAR 02.01.02.07A, B(1)(a). As of the date of the hearing, none of the Respondents had filed any response to the Charges.

On July 10, 2018, having received no response to its Charges and RPDs, the Proponent filed a request for a telephone prehearing conference (Conference), along with a Motion to Compel and/or for Sanctions (Motion). COMAR 28.02.01.13E. The Proponent requested that in addition to addressing certain other issues I hear its Motion during the requested Conference.

On July 20, 2018, I held a Conference, in which Assistant Attorney General W. Thomas Lawrie appeared on behalf of the Proponent. No one appeared on behalf of the Respondents.[11] During the Conference, I heard argument on the Proponent's Motion, which I granted. COMAR 28.02.01.11B(13); COMAR 28.02.01.12B(4); COMAR 28.02.01.12B(5). In granting the

[9] COMAR 02.01.02.
[10] COMAR 28.02.01.
[11] I note the Respondents did not participate at any stage of the proceedings before the OAH. All of the correspondence sent from the OAH to the Respondents (which was sent to the same addresses at which they were successfully served with the Petition for Hearing, Charges, and Order Granting Hearing and Notification of Hearing, as well as to several other addresses) was returned by the United States Post Office as undeliverable. As of the date of this Proposed Decision, the Respondents have failed to provide the OAH with any updated contact information.

Motion, I ordered the following: that during the hearing on the merits, the Respondents would be barred from presenting any evidence consisting of documents that were requested by the Proponent and not provided by the Respondents; the Respondents would be barred from presenting testimony concerning the content of any documents that were requested by the Proponent and not provided by the Respondents; and that there would be a presumption that the documents the Respondents failed to produce would have been harmful to the Respondents' case. In addition, I ordered that the parties submit proposed findings of fact and conclusions of law with an accompanying legal memorandum within thirty days of the conclusion of the hearing on the merits. COMAR 28.02.01.11B(9).

On July 24, 2018, I conducted a hearing at the OAH in Hunt Valley, Maryland. W. Thomas Lawrie and Philip Ziperman, Assistant Attorneys General, represented the Proponent. Neither the Respondents, nor an attorney appearing on behalf of any of the Respondents, appeared for the hearing.[12] In lieu of requesting that I find the Respondents in default, the Proponent elected to proceed with the hearing in the Respondents' absence. COMAR 02.01.02.17B; COMAR 28.02.01.23A. At the conclusion of the hearing, I granted the Proponent's request to hold the evidentiary record open through August 15, 2018, for the limited purpose of allowing the Proponent to notify the OAH of whether the Respondents failed to file a timely petition for judicial review of the Commissioner of Financial Regulation's (CFR) July 11, 2018 Final Order to Cease and Desist (Final Order).[13]

[12] I find that the Respondents had actual notice of the hearing time and location, as they each were served with the April 25, 2018 Order Granting Hearing and Notification of Hearing, which contained the date, time and location of the hearing on the merits.

[13] The basis of this request was the Proponent's belief that the CFR's Final Order would become non-appealable and binding on the Respondents after August 10, 2018, since a party has thirty days to file a petition for judicial review after mailing of a final order issued by the Commissioner pursuant to Md. Rule 7-203(a)(2). I will further discuss the effect of the CFR's Final Order in the discussion, below.

On August 15, 2018,[14] the Proponent filed a letter with the OAH requesting a fourteen-day extension of the deadline for the parties' filing of post-hearing briefs and to keep the evidentiary record open through August 20, 2018. I treated the Proponent's letter as a Motion to Extend Time. On August 20, 2018, I issued a Ruling on Motion to Extend Time (Ruling), granting the Proponent's requests for reasons stated in my Ruling.[15] I ordered that the parties submit proposed findings of fact and conclusions of law with an accompanying legal memorandum by September 6, 2018 and that the evidentiary record would be held open through August 20, 2018.

On August 20, 2018, the Proponent notified the OAH that the Respondents failed to file a timely petition for judicial review of the CFR's July 11, 2018 Final Order and, therefore, the Final Order is non-appealable and binding on the Respondents.

On September 6, 2018, the Proponent emailed to the OAH a request to extend the deadline for filing the proposed findings of fact and conclusions of law with an accompanying legal memorandum to the close of business on September 7, 2018. I treated the Proponent's email as a second Motion to Extend Time. That same day, I granted the Proponent's request to extend the deadline for filing post-hearing briefs to September 7, 2018.[16] On September 7, 2018, the Proponent filed Proposed Findings of Fact and Conclusions of Law and a Memorandum of Law. The Respondents did not file any post-hearing briefs.

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[14] I received the letter on Thursday, August 16, 2018. Scott A. Kohn and Glorilyn Cusi were copied on the correspondence, individually and on behalf of the corporate Respondents.

[15] Normally, the Respondents would have had fifteen days from the date the motion was filed to file an answer to the motion. COMAR 28.02.01.12B(3)(a). However, given the tight timeframes involved in the issues presented by the Proponent's Motion to Extend Time and the lack of any meaningful way to contact the Respondents to inquire as to their position on the motion, I issued my ruling on August 20, 2018, in the absence of any response from the Respondents. COMAR 28.02.01.11B provides that "a judge has the power to regulate ... the conduct of the parties ... including the power to ... [c]onsider and rule upon motions" and to "[m]odify or waive, reasonably and for good cause, any time periods established by [the OAH's Rules of Procedure]." COMAR 28.02.01.11B(4), (8).

[16] I found that the request was reasonable as the Labor Day holiday was not taken into account when calculating the fourteen-day extension of the deadline and that the Respondents would not be prejudiced by the one day-extension of the deadline, which would apply to the deadline for any submission by either party. *See also* footnote 15, *supra*.

The contested case provisions of the Maryland Administrative Procedure Act, the CPD's procedural directives, and the OAH's Rules of Procedure govern procedure in this case. Md. Code Ann., State Gov't §§ 10-201 through 10-226 (2014 & Supp. 2017); COMAR 02.01.02; COMAR 28.02.01.

ISSUES

1. Does the MCLL apply to the Respondents' pension advances? If so, did the Respondents violate the MCLL?
2. Does the I&U apply to the Respondents' pension advances? If so, did the Respondents violate the I&U?
3. Does the ILLP apply to the Respondents' pension advances? If so, did the Respondents violate the ILLP?
4. Did the Respondents engage in unlicensed and/or unregistered business activities?
5. Did the Respondents fail to make the required disclosures to Maryland consumers?
6. Did the Respondents commit unfair and/or deceptive trade practices in violation of the CPA?
7. Are Respondents Scott A. Kohn and Glorilyn Cusi individually liable for the unfair and deceptive trade practices?

SUMMARY OF THE EVIDENCE

Exhibits

A list of the exhibits admitted into evidence is attached to this Proposed Decision as an Appendix.

Testimony

The Proponent presented live testimony from the following consumer witnesses: Darrel Clark, Joyce Johnson, Robert Outterbridge, Jesse Sutton, Jr., James Marshall Murphy, and Carol McConnell.[17]

In addition, the Proponent presented affidavit testimony from the following consumer witnesses: Joan Clay, Barbara Duckett, Deborah Denise Foster, and Patrice Pinder.[18,19]

The Proponent also presented live testimony from the following state employees: Jedd Bellman, Assistant Commissioner for Non-Depository Supervision, Office of the CFR, Maryland Department of Labor, Licensing and Regulation; and Christopher M. Waldt, Chief Investigator with the CPD.

The Respondents failed to appear and therefore presented no witnesses.

PROPOSED FINDINGS OF FACT

I find the following facts by a preponderance of the evidence[20]:

THE RESPONDENTS

1. Respondent Future Income Payments, LLC is a Delaware limited liability company that was originally formed in April 2011 as Pensions, Annuities and Settlements, LLC (PAS). (*See* CPD Ex. 1, 2; SOC ¶ 6; CFR Summary Order, CPD Ex. 82, ¶ 22.) PAS changed its

[17] On July 17, 2018, I granted the Proponent's July 3, 2018 Request to Use Telephonic Testimony during the hearing in this matter. Mr. Murphy and Ms. McConnell testified via telephone. Md. Code Ann., State Gov't § 10-211(a) (2014); COMAR 28.02.01.20B.
[18] *See* COMAR 28.02.01.21H.
[19] The Proponent also submitted into evidence the affidavits of Carol McConnell, James Marshall Murphy, and Robert Outterbridge, who each offered live testimony as well.
[20] As previously discussed, the Respondents each failed to file a response the Proponent's April 24, 2018 Charges. Therefore, pursuant to COMAR 02.01.02.07D, the allegations contained in the Charges are deemed admitted. I have cited to the Charges where applicable.
In addition, as discussed below, I have given collateral estoppel effect to the CFR's July 11, 2018 Final Order (case number CFR-FY2016-0027), and therefore have adopted the CFR's findings. I have cited to the CFR's Summary Order (which the CFR incorporated into its Final Order) where applicable.

name to Future Income Payments, LLC in May 2014. (*See* CPD Ex. 99; SOC ¶ 6; CFR Summary Order, Ex. 82, ¶ 22.)

2. Respondent Scott Alan Kohn (Kohn) is the chief executive officer (CEO), managing member, and owner of Future Income Payments, LLC. (*See* CPD Ex. 1-3, 63-83, 99; SOC ¶ 6; CFR Summary Order, CPD Ex. 82, ¶ 22.)

3. Future Income Payments, LLC has also been known as, or has conducted business as, Future Income Payments LLC; Future Income Payments; FIP LLC; FIP, LLC; FIP; Cash Flow Outsourcing Services Inc.; Cash Flow Investment Partners, LLC; BuySellAnnuity Inc.; Pension Advance LLC; Pensions, Annuities and Settlements; PAS; and Lumpsum Pension Purchase. (*See* CPD Ex. 95; SOC ¶ 6; CFR Summary Order, CPD Ex. 82, ¶ 22.)

4. Future Income Payments, LLC has conducted business, including in Maryland, from the following addresses: 18300 Von Karman Avenue, Suite 410, Irvine, California 92612; 3535 East Coast Highway, #119, Corona Del Mar, California 92625; 4500 Campus Drive, Suite 650, Newport Beach, California 92660; 2505 Anthem Village Drive, #E-578, Henderson, Nevada 89052; and 2850 W. Horizon Ridge Parkway, Henderson, Nevada 89052. (*See* CPD Ex. 1, 2, 3; SOC ¶ 6; CFR Summary Order, CPD Ex. 82, ¶ 22.)

5. Respondent FIP LLC is a Nevada limited liability company that was formed in June 2016. (*See* CPD Ex. 4, 5; SOC ¶ 7; CFR Summary Order, CPD Ex. 82, ¶ 23.)

6. Respondent Kohn owns and operates FIP LLC in conjunction with one of its managing members, Respondent Glorilyn Cusi (Cusi). (*See* CPD Ex. 4, 5, 10, 11, 95, 99; SOC ¶ 7.)

7. FIP LLC is also known as FIP, LLC; Future Income Payments, LLC; FIP; Cash Flow Outsourcing Services Inc.; Cash Flow Investment Partners, LLC; BuySellAnnuity Inc.; and

Pension Advance LLC. (*See* CPD Ex. 95; SOC ¶ 7; CFR Summary Order, CPD Ex. 82, ¶ 23.)

8. FIP LLC has conducted business, including in Maryland, from the following address: 2505 Anthem Village Drive, #E-578, Henderson, Nevada 89052. (*See* CPD Ex. 4, 5; SOC ¶ 7; CFR Summary Order, CPD Ex. 82, ¶ 23.)

9. Respondent Cash Flow Outsourcing Services Inc. (CFOS) is listed as one of the managing members of FIP LLC with the Nevada Secretary of State. (*See* CPD Ex. 4, 5; SOC ¶ 8; CFR Summary Order, CPD Ex. 82, ¶ 24.)

10. CFOS is also known as, and has conducted business as, FIP LLC; Future Income Payments, LLC; and FIP. (*See* CPD Ex. 4, 5; SOC ¶ 8; CFR Summary Order, CPD Ex. 82, ¶ 24.)

11. CFOS has conducted business, including in Maryland, from the following addresses: 2505 Anthem Village Drive, #E-578, Henderson, Nevada 89052; and 33rd Floor, Union Bank Plaza Bldg., Sapphire Cor. Onyx Road, Ortigas Center, Pasig City 1605, Philippines. (*See* CPD Ex. 4, 5; SOC ¶ 8; CFR Summary Order, CPD Ex. 82, ¶ 24.)

12. Respondent Cash Flow Investment Partners, LLC (CFIP) is a California limited liability company that was originally formed in August 2010 as Sunlife Funding, LLC. (*See* CPD Ex. 6, 7; SOC ¶ 9.) Sunlife Funding, LLC changed its name to Cash Flow Investment Partners, LLC in April 2011. (*See* CPD Ex. 6, 7; SOC ¶ 9.)

13. CFIP is also known as Cash Flow Investment Partners LLC; Cash Flow Investment Partners; Future Income Payments, LLC; FIP LLC; and FIP. (*See* CPD Ex. 6, 7; SOC ¶ 9.)

14. CFIP has conducted business, including in Maryland, from the following addresses: 18300 Von Karman Avenue, Suite 410, Irvine, California 92612; and 3535 E. Coast Highway, #119, Corona Del Mar, California 92625. (*See* CPD Ex. 6, 7; SOC ¶ 9.)

15. Respondent BuySellAnnuity Inc. (BSA) is a Delaware company that was incorporated in December 2011. (*See* CPD Ex. 8; SOC ¶ 10; CFR Summary Order, CPD Ex. 82, ¶ 25.)

16. BSA is also known as Future Income Payments, LLC; FIP LLC; and FIP. (*See* CPD Ex. 8, 95; SOC ¶ 10; CFR Summary Order, CPD Ex. 82, ¶ 25.)

17. BSA has conducted business, including in Maryland, from the following addresses: 2505 Anthem Village Drive, #E-578, Henderson, Nevada 89052; and 18300 Von Karman Avenue, Suite 410, Irvine, California 92612. (*See* CPD Ex. 8, 95; SOC ¶ 10; CFR Summary Order, CPD Ex. 82, ¶ 25.)

18. Respondent Pension Advance LLC (Pension Advance) is a Delaware limited liability company that was formed in January 2012. (*See* CPD Ex. 9; SOC ¶ 11; CFR Summary Order, CPD Ex. 82, ¶ 26.)

19. Pension Advance is also known as Future Income Payments, LLC, FIP LLC, and FIP. (*See* CPD Ex. 9, 95; SOC ¶ 11; CFR Summary Order, CPD Ex. 82, ¶ 26.)

20. Pension Advance has conducted business, including in Maryland, from the following addresses: 2505 Anthem Village Drive, #E-578, Henderson, Nevada 89052; and 18300 Von Karman Avenue, Suite 410, Irvine, California 92612. (*See* CPD Ex. 9, 95; SOC ¶ 11; CFR Summary Order, CPD Ex. 82, ¶ 26.)

21. Corporate Respondents Future Income Payments, LLC; FIP LLC; CFOS; CFIP, BSA, and Pension Advance operate as a common business enterprise, and are each individually and collectively referred to as "Future Income Payments" or "FIP" by their employees when communicating with consumers. (*See* SOC ¶ 12; CFR Summary Order, CPD Ex. 82, ¶ 27; Consumer Testimony, *passim*.)

22. The Corporate Respondents offer and extend credit to consumers in Maryland in the form of pension advances. (*See* SOC ¶ 12; CFR Summary Order, CPD Ex. 82, ¶ 27; Consumer Testimony, *passim*.)

23. None of the Corporate Respondents are properly registered with the Maryland State Department of Assessments and Taxation (SDAT), which is a necessary prerequisite for conducting business in Maryland, nor are any of them properly licensed to offer or provide extensions of credit to consumers in the State. (*See* Testimony of Christopher Waldt, Testimony of Jedd Bellman; CPD Ex. 23; SOC ¶ 12; CFR Summary Order, CPD Ex. 82, ¶ 27.)

24. The Corporate Respondents have engaged in the business activities which are the subject of this proceeding with common management, employees, business functions, office locations, phone numbers, bank accounts, and websites. (*See* SOC ¶ 12; CFR Summary Order, CPD Ex. 82, ¶ 27.)

25. Each of the Corporate Respondents is an alter ego of Respondent Kohn. (*See* SOC ¶ 12; CFR Summary Order, CPD Ex. 82, ¶ 27.)

26. Respondent Kohn is an owner, director, officer, manager, member, principal, and/or agent for each and all of the Corporate Respondents. (*See* CPD Ex. 1-10, 64-67, 72, 73-75, 77-79, 82-83, 95, 99; SOC ¶ 13; CFR Summary Order, CPD Ex. 82, ¶ 28.)

27. Respondent Kohn has conducted business in the name of, or on behalf of, each and all of the Corporate Respondents, including in Maryland, from various addresses, including from the following: 3535 East Coast Highway, #119, Corona Del Mar, California 92625; 18300 Von Karman Avenue, Suite 410, Irvine, California 92612; 4500 Campus Drive, Suite 650, Newport Beach, California 92660; 2505 Anthem Village Drive, #E-578, Henderson, Nevada

89052; and 2850 W. Horizon Ridge Parkway, Henderson, Nevada 89052. (*See* CPD Ex. 1-10, 64-67, 72, 73-75, 77-79, 82-83, 95, 99; SOC ¶ 13; CFR Summary Order, CPD Ex. 82, ¶ 28.)

28. Respondent Kohn has directed, overseen, and managed the business activities of each and all of the Corporate Respondents, including those business activities in Maryland. (*See, e.g.*, CPD Exs. 1-10, 64-67, 72, 73-75, 77-79, 82-83, 95, 99; SOC ¶ 14; CFR Summary Order, CPD Ex. 82, ¶ 29; Consumer Loan Documents, CPD Ex. 106, p. 9 (signing loan documents); Consumer Loan Documents, CPD Ex. 108, p. 7 (same).)

29. Respondent Kohn has had knowledge of and the authority to control, and/or has directly participated in, the business activities of each and all of the Corporate Respondents, including those activities in Maryland. (*Id.*)

30. Since 2016 or earlier, Respondent Cusi has directed, overseen, and managed the business activities of each and all of the Corporate Respondents in conjunction with Respondent Kohn, including those business activities in Maryland. (*See* CPD Exs. 4, 5, 10, 11; SOC ¶ 16; CFR Summary Order, CPD Ex. 82, ¶ 30.)

31. Respondent Cusi has had knowledge of and the authority to control, and/or has directly participated in, the business activities of each and all of the Corporate Respondents, including those activities in Maryland. (*See, e.g.*, CPD Exs. 4, 5, 11; SOC ¶ 16; CFR Summary Order, CPD Ex. 82, ¶ 30;Consumer Loan Documents, CPD Ex. 105, p. 7 (signing loan documents); Consumer Loan Documents, CPD Ex. 111, p. 9 (same).)

32. Respondent Cusi has conducted business in the name of, or on behalf of, each and all of the Corporate Respondents, including in Maryland, from the following addresses: 2505 Anthem Village Drive, #E-578, Henderson, Nevada 89052; and 33rd Floor, Union Bank Plaza

Bldg., Sapphire Cor. Onyx Road, Ortigas Center, Pasig City 1605, Philippines. (*See* CPD Ex. 4, p. 5; CPD Ex. 5, p.1; CPD Ex. 11; SOC ¶ 15; CFR Summary Order, CPD Ex. 82, ¶ 30.)

33. Respondents Kohn and Cusi possessed and exercised the authority to control the policies and trade practices of the Corporate Respondents. (*See* CPD Exs. 10, 11; SOC ¶ 17.) They were responsible for creating and implementing the unfair or deceptive policies and practices of the Corporate Respondents that are described in the charges and are the subject of this proceeding. (*See* SOC ¶ 17.)

34. Respondents Kohn and Cusi committed the unfair and deceptive trade practices that are described in the Charges and are the subject of this proceeding. (*See* SOC ¶ 17.) Respondents Kohn and Cusi also directed and supervised those employees of the Corporate Respondents who committed the unfair and deceptive trade practices that are described in the Charges and are the subject of this proceeding. (*See* SOC ¶ 17.)

35. Respondents Kohn and Cusi knew or should have known of the unfair and deceptive trade practices that are described herein and had the power to stop them, but rather than stop them, promoted their use. (*See* SOC ¶ 17.)

36. The Respondents' lending activities involving Maryland consumers took place primarily in Maryland, and the effect of their lending practices was felt primarily in Maryland. (*See* SOC ¶¶ 25, 26, 43; Consumer Testimony, *passim*.)

37. The Respondents have never been licensed by the CFR as a consumer lender or as an installment lender. (*See* Testimony of Jedd Bellman; CPD Ex. 89; SOC ¶¶ 12, 49a, 51a; CFR Final Order, CPD Ex. 83, p. 3; CFR Summary Order, CPD Ex. 82, ¶¶ 27, 49, 64, 69, 70.)

THE RESPONDENT'S BUSINESS DEALINGS WITH MARYLAND CONSUMERS

38. Since 2011, the Respondents have marketed, offered, and provided pension advances to retirees and other consumers nationwide, including in Maryland, via the internet, primarily through a web of interrelated websites and domain names, which they own or operate directly or through other affiliated business entities owned by Respondent Kohn, including but not limited to the following: buysellannuity.com, cashflowoutsourcing.com, cfipweb.com, futureincomepayments.com, highspeedlending.com, intlmycallcenterteam.com, investccl.com, investorschoicecommercialcapital.com, londonsquarecollections.com, londonsquarespecialtyservices.com, lsbpo.com, lumpsum-settlement.com, mycallcenterteam.com, mychoicecapital.com, nextmerchantadvance.com, and pensionpurchasing.com. (*See* CPD Ex. 25-62 (web sites and registration materials), and 95; SOC ¶ 25.)

39. In their advertising, the Respondents made various statements to the effect that they were the premier pension advance company in the country, such as claiming the following: that they are "America's largest pension cash flow originator with over $300 Million in completed transactions" (*see* CPD Ex. 26);[21] that they are "the industry leader and an innovator in buying and selling secondary market pension cash flows" (*see* CPD Ex. 25, 26); and that they have "a global footprint of over 200 employees, including executive management with experience in the mortgage and financial industries" (*see* CPD Ex. 25, 26.)

40. The Respondents did not disclose to consumers that they were either under investigation or had been found to have violated state lending laws by multiple state regulators

[21] In the Respondents' advertising, this number increased from "150 million in completed transactions" in April 2016 to "300 million" in September 2017. (*Compare* CPD Ex. 27, *with* CPD Ex. 26.)

and were actively being investigated by the Consumer Financial Protection Bureau. (*See* Findings of Fact 54-66, below.)

41. The Respondents also advertised directly by telephone and email. (*See* SOC ¶ 25.)

42. The Respondents marketed to classes of consumers who receive regular monthly pension payments, often as their sole source of income, including federal and state government retirees, military retirees, and veterans. (*See* CPD Ex. 29; CPD Ex. 30; CPD Ex. 32, p. 6; Consumer Testimony, *passim*.)

43. The Respondents advertised their products as a way for such consumers to get money quickly both for immediate needs and for long-term goals. (*See* CPD Ex. 29, 30, CPD Ex. 32, p. 6.) For example, on its web site pensionpurchasing.com, the Respondents advertised that their pension advances were a way for veterans receiving VA disability compensation or VA pensions to obtain immediate money, including "get cash to pay bills that have piled up," to "make enhancements or repairs to your property or vehicle," to "have extra money in the bank for a rainy day," and to "make investments." (*See* SOC ¶ 29.)

44. Among other things, the Respondents' web sites: encouraged pensioners to call FIP if they were "a new or existing customer that would like a cash advance on their pension;" and stated that, "[p]ension holders receiving $300 or more per month from their pension and living in the approved states are all encouraged to apply."[22] (*See* CPD Ex. 26, p. 3; SOC ¶ 30.)

45. The Respondents did not disclose in their advertising that they were making loans to consumers that were in violation of several state and federal laws governing consumer

[22] FIP's web site indicated that its pension advances were currently not available to consumers in the following states: Arkansas, California, Colorado, Connecticut, Indiana, Iowa, Maine, Massachusetts, Minnesota, Mississippi, New York, North Carolina, Pennsylvania, Vermont, Virginia, Washington, and Wisconsin. *See* https://futureincomepayments.com/faqs/ (last visited April 9, 2018). Most of these states are those that have brought enforcement actions against the Respondents for violating state lending laws, including making unlicensed and usurious loans to retirees. These actions are discussed further in paragraphs 51-64, below.

lending, nor did the Respondents disclose this in their conversations and other communications with consumers. (*See* CPD Ex. 25-62, 63-83; Consumer Testimony, *passim*.)

46. The Respondents' business model is to solicit consumers, including in Maryland, to enter into contracts in which consumers receive a lump-sum payment, or advance, in exchange for the promise to repay the Respondents for a number of months over a fixed period of time. (SOC ¶ 26; CFR Summary Order, CPD Ex. 82, ¶ 32; Consumer Testimony, *passim*.)

47. The following steps typically occurred in these transactions:

a. As a result of the Respondents' advertising, Maryland residents who wanted to obtain a loan for personal, family, or household reasons went on the internet from a computer in Maryland to a website belonging to the Respondents or to a third party that referred consumers to the Respondents, and entered their basic contact information in order to obtain a quote. (*See* Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge; Affidavit of Joan Clay, CPD Ex. 102, ¶ 2; Affidavit of Barbara Duckett, CPD Ex. No. 103, ¶ 2; Affidavit of Deborah Denise Foster, CPD Ex. 104, ¶ 3; Affidavit of Carol McConnell, CPD Ex. 109, ¶ 2; Affidavit of James Marshall Murphy, CPD Ex. 111, ¶ 2; Affidavit of Patrice Pinder, CPD Ex. No. 114, ¶ 3; SOC ¶ 31-33; CFR Summary Order, CPD Ex. 82, ¶ 35.)

b. Once contacted, the Respondents' employees communicated with Maryland consumers by phone or email, and directed them to provide various documents and information to begin an underwriting process. (*See* SOC ¶ 33; CFR Summary Order, CPD Ex. 82, ¶ 35; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge.) The

Respondents typically required consumers to submit a number of documents relating to their pension and financial situation, as well as documents evidencing their identities and marital status, to undergo credit checks and bankruptcy reviews, and to answer certain questions regarding their medical histories. (*See* Affidavit of Barbara Duckett, CPD Ex. 103, ¶ 3; Affidavit of Deborah Denise Foster, CPD Ex. 104, ¶ 3; Affidavit of Carol McConnell, CPD Ex. 109, ¶ 2; Affidavit of Robert Outterbridge, CPD Ex. No. 113, ¶ 2; Affidavit of Patrice Pinder, CPD Ex. No. 114, ¶ 3; SOC ¶ 33; CFR Summary Order, CPD Ex. 82, ¶ 36.) In addition, the Respondents required that consumers provide them with full, on-going access to their credit reports for the entire duration of their repayment periods. (*See* SOC ¶ 33.)

c. Maryland consumers believed that they were applying for a short-term loan when they contacted the Respondents and throughout the application process. (*See* SOC ¶ 32; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge.) The Respondents, indeed, confirmed to consumers that they were being provided a short-term loan to address an immediate need for cash. (Testimony of Darrel Clark.)

d. After verifying the consumers' information and deciding to extend an offer, the Respondents proposed to each Maryland consumer a cash advance in the form of a lump-sum payment. (*See* SOC ¶ 34; CFR Summary Order, CPD Ex. 82, ¶ 37; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge; Affidavit of Joan Clay, CPD

Ex. 102, ¶ 4; Affidavit of Barbara Duckett, CPD Ex. No. 103, ¶ 6; Affidavit of Deborah Denise Foster, CPD Ex. 104, ¶ 6; Affidavit of Carol McConnell, CPD Ex. 109, ¶ 6; Affidavit of James Marshall Murphy, CPD Ex. 111, ¶ 5; Affidavit of Patrice Pinder, CPD Ex. No. 114, ¶ 6.)

e. To complete the application process for the advance, the Respondents required Maryland consumers to execute various documents. (*See* SOC ¶ 35; CFR Summary Order, CPD Ex. 82, ¶ 37.) Although the specific documents varied over time, they always included a cash advance contract that was titled, at different times, "Future Income Stream Purchase and Sale Agreement," "Future Income Payment Purchase and Sale Agreement," "FIP LLC Purchase and Sale Agreement," or "FIP Purchase and Sale Agreement," as well as documents titled "Transaction Details" and "Authorization for Automatic Payment." (*See* SOC ¶ 35; CFR Summary Order, CPD Ex. 82, ¶ 38.) The Respondents required Maryland consumers to sign some or all of these documents on-line via an electronic "DocuSign" process, with the specific documents available for electronic signature varying over time. (*See* SOC ¶ 35; Testimony of Jesse Sutton; Jr., Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge; Affidavit of Barbara Duckett, CPD Ex. No. 103, ¶ 5; Affidavit of Deborah Denise Foster, CPD Ex. 104, ¶ 4; Affidavit of Carol McConnell, CPD Ex. 109, ¶ 3; Affidavit of James Marshall Murphy, CPD Ex. 111, ¶ 3; Affidavit of Patrice Pinder, CPD Ex. No. 114, ¶ 4.)

f. However, Maryland consumers were not provided the documents in advance to review, but were instead told by the Respondents that they needed to enter their

signatures on the documents right away in order to receive their cash advance. (*See* SOC ¶ 35; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge; Affidavit of Barbara Duckett, CPD Ex. No. 103, ¶ 5; Affidavit of Deborah Denise Foster, CPD Ex. 104, ¶ 4; Affidavit of Carol McConnell, CPD Ex. 109, ¶¶ 3-4; Affidavit of James Marshall Murphy, CPD Ex. 111, ¶ 3; Affidavit of Patrice Pinder, CPD Ex. No. 114, ¶ 4.)

g. The DocuSign process involves a streamlined process whereby a person is sent an email from DocuSign, and once opened, the person is able to electronically sign documents without reviewing them. (*See* SOC ¶ 36.) Maryland consumers simply followed the directions of the Respondents and electronically signed the documents right away in order to receive their cash advance as soon as possible. (*See* SOC ¶ 36; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge; Affidavit of Barbara Duckett, CPD Ex. No. 103, ¶ 5; Affidavit of Deborah Denise Foster, CPD Ex. 104, ¶ 4; Affidavit of Carol McConnell, CPD Ex. 109, ¶¶ 3-4; Affidavit of James Marshall Murphy, CPD Ex. 111, ¶ 3; Affidavit of Patrice Pinder, CPD Ex. No. 114, ¶ 4.)

h. Maryland consumers electronically signed their agreements and related documents without ever fully reviewing or understanding the contract terms. (*See* SOC ¶ 36; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge; Testimony of Carroll McConnell; Affidavit of Barbara Duckett, CPD Ex. No. 103, ¶ 5; Affidavit of

Deborah Denise Foster, CPD Ex. 104, ¶ 4; Affidavit of Carol McConnell, CPD Ex. 109, ¶¶ 3-4; Affidavit of James Marshall Murphy, CPD Ex. 111, ¶ 3; Affidavit of Patrice Pinder, CPD Ex. No. 114, ¶ 4.)

i. Further, Maryland consumers who did review parts of the agreement prior to signing it still believed that they were entering into a loan agreement with the Respondents. (*See* SOC ¶ 37; Testimony of Robert Outterbridge.) The Respondents further fostered this impression by assuring consumers they were entering into loans. (*See, e.g.*, Testimony of Darrel Clark.)

j. The Respondents also required a borrower to complete an IRS Form W-9 to report the transaction as income for the consumer, which should not have been required by the Respondents since the agreements did not actually involve the sale of assets. (*See* SOC ¶ 40; Testimony of James Marshall Murphy; Testimony of Carroll McConnell; Affidavit of Carol McConnell, CPD Ex. 109, ¶ 14.) The Respondents engaged in this practice to try to evade paying taxes on subsequent proceeds from their advances. (*See* SOC ¶ 40.) As a result of the Respondents' practices, Maryland consumers incurred an unnecessary increased tax liability. (*Id*.)

k. Once the Respondents had received and approved completed pension advance applications, the Respondents transferred the loan amounts or advances into the consumers' bank accounts in Maryland, after deducting $300.00 from the advance payment as an account set-up and servicing fee. (*See* SOC ¶ 42; CFR Summary Order, CPD Ex. 82, ¶ 44; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge.) Once

the advance was funded, the Respondents commenced collecting on the loans by debiting payments (usually via a monthly electronic funds transfer) from the consumers' bank accounts. (*See* SOC ¶ 42; CFR Summary Order, CPD Ex. 82, ¶ 43; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge.)

l. Maryland consumers expected to repay the principal amount of their loans plus interest. (*See* Testimony of Jesse Sutton, Jr., Testimony of Darrel Clark, Testimony of Robert Outterbridge; SOC ¶ 32; CFR Summary Order, CPD Ex. 82, ¶ 59.)

m. Under the terms of some of the contracts, consumers who failed to make timely payments would be charged late fees, as well as a $25 NSF[23] fee, for insufficient funds. The Respondents' agreements also permitted the Respondents to seek collection costs and attorney's fees, in the event of a partial or late payment. (*See* SOC ¶ 42; CFR Summary Order, CPD Ex. 82, ¶ 44.)

48. The economic substance of the Respondents' transactions evidence loans – not "asset purchases," as indicated by the Respondents in their consumer agreements:

a. In the context of monetary transactions, a "loan" generally involves a lender providing money to a borrower on a temporary basis, with the promise or expectation of repayment, usually with interest – which is exactly what occurs with the Respondents' transactions. (*See* SOC ¶ 46(a); CFR Summary Order, CPD Ex. 82, ¶ 60.) The overall structure of the Respondents' agreement is that of a typical installment loan, as it provides that the Respondents will transfer a lump sum advance payment to the consumer, in exchange for which the consumer is

[23] Non-sufficient funds.

obligated to repay the advance over a fixed period of time, usually 5-10 years. (*See* SOC ¶ 46(a); *see, e.g.*, CFR Summary Order, CPD Ex. 82, ¶¶ 51-59.) Further, the total repayment amounts far exceed the original advances, with the difference constituting interest. (*Id.*) Most of the Respondents' loans have an effective annual rate of interest well over 100%. (*Id.*)

b. The Respondents often advertise their products as "advances" of pension benefits. (*See* SOC ¶ 46(b).)

c. The Respondents' pension *advances* were made to consumers for personal, family, or household purposes, and in amounts of $6,000.00 or less. (*See* SOC ¶ 46(b).)

d. Prior to providing an advance, the Respondents require consumers to provide them with financial asset and marital information, as well as additional information that goes to the consumer's credit-worthiness. (*See* SOC ¶ 46(c); CFR Summary Order, CPD Ex. 82, ¶ 36.) Consumer also have an on-going obligation to allow FIP to obtain credit reports and to perform comprehensive background checks over the life of the repayment period. (*See* SOC ¶ 46(c).) When it collected credit information from consumers, FIP engaged in a risk-based underwriting process to determine the amount they were willing to advance the consumers, the interest rates, and the repayment amounts. (*See* SOC ¶ 46(c).) Such review of consumers' credit-worthiness and risk-based underwriting is typical of a loan. (*See* SOC ¶ 46(c).)

e. The remedies available to the Respondents under their contracts in event of a consumer's breach are those of a typical debtor-creditor relationship, whereby the

creditor has recourse to bring a breach of contract action against the consumer for the value of the debt. The Respondents can collect late fees and NSF fees, and in event of non-payment, the Respondents are obligated to pay all of FIP's collection and legal costs. (*See* SOC ¶ 46(d); CFR Summary Order, CPD Ex. 82, ¶ 59.) Further, the Respondents' agreements contain recourse provisions: it provides that any interruption in a consumer's monthly installment payments causes all remaining payments to be due, provides that legal action can be commenced against a consumer for nonpayment, and includes a liquidated damages clause. (*See* SOC ¶ 46(d); CFR Summary Order, CPD Ex. 82, ¶ 59.) These are all characteristic of breach of contract remedies in a typical loan agreement – not remedies available following the true sale of an asset. (*See* SOC ¶ 46(d).)

f. The Respondents' transactions are not structured to acquire consumers' rights to consumers' pension benefits (because, as previously stated, to do so would violate federal law). (*See* SOC ¶ 46(e).) Instead, the Respondents make loans, the repayment of which is calculated in an amount ostensibly tied to when consumers receive their monthly pension payment. (*Id.*) Further, in the event of the consumers' purported breach of their loan contract, the Respondents' remedy is not to receive benefits from consumers' pensions, but rather, to recover amounts allegedly owed by consumers from any assets or sources of income or turning the delinquent accounts over to a debt collector — not necessarily from the pensions. (*Id.*)

g. The Respondents' contracts also provide that the Respondents are not responsible for paying the taxes on the income streams that they supposedly

purchased, which would be the case if the Respondents had actually purchased consumers' pensions. (*See* SOC ¶ 46(h). Instead, they require consumers to sign W-9s and pay taxes on their pensions. (*See, e.g*., Consumer Loan Documents, CPD Ex. 105, pp. 13, 18, 19; McConnell Affidavit, CPD Ex. 109 ¶ 14; Consumer Loan Documents, CPD Ex. 109, pp.8, 9; *see also* Testimony of James Marshall Murphy; Testimony of Carol McConnell.)

49. All of the pension advances that the Respondents marketed, offered, made available, or otherwise provided to Maryland pensioners involved an advance of money with the expectation of repayment of the principal amount of the advance plus interest, and were made for personal, family, or household purposes. (*See* SOC ¶ 45; CFR Summary Order, CPD Ex. 82, ¶¶ 41-42, 59; Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge.) As such, they constituted "consumer loans" and "extensions of consumer credit" within the meaning of Maryland's lending, credit, and consumer protection laws, including but not limited to the MCLL, I&U, ILLP, and CPA. (*See* SOC ¶ 45; CFR Summary Order, CPD Ex. 82, ¶¶ 60-63.)

50. The advances that the Respondents made to Maryland consumers included the following 14 consumers:

a. In September 2016, Darrell Clark, sought a short-term loan and, after filling out an online form, was contacted by FIP. (*See* Testimony of Darrel Clark.) An FIP representative sent Mr. Clark an agreement to sign electronically, which he began to do, but midway through the process, he stopped because he was concerned about some of the terms. (*Id*.) On September 12, 2016, an FIP representative called Mr. Clark and reassured him that the contract reflected a

short-term loan, that he would not be locked into the loan for any period of time, and "talked [him] into signing the agreement." (*Id.*) Mr. Clark received a pension advance of $2,100.00, consisting of a $2,400.00 loan reduced by a $300.00 set-up fee. (*See* Consumer Loan Documents, CPD Ex. 101.) The Respondents transferred this money into Mr. Clark's checking account at Wells Fargo Bank in Maryland. (*See* Testimony of Darrel Clark.) In return, Mr. Clark was required to repay the Respondents $300.00 per month for 36 months, with the amount of all payments totaling $10,800.00. (*See* Consumer Loan Documents, CPD Ex. 101; Loan Data Spreadsheet, CPD Ex. 117.)[24] The annual rate of interest on this loan was 169.97%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Mr. Clark was unaware of the terms of the loan and "[i]f [he] knew they'd try to take control of [his] pension, [he] would not have signed [the loan documents]. (*See* Testimony of Darrel Clark.) Mr. Clark also felt "[t]hey kind of hid that from [him] throughout the whole process." (*Id.*) Three months after receiving his loan, Mr. Clark contacted FIP in order to pay off the balance of the loan and learned for the first time that he would be required to pay $10,800.00 regardless of when he repaid the money. (*Id.*) Mr. Clark ultimately repaid the Respondents a total of $2,900.00 or $3,000.00 (*Id.*)

b. In January 2015, Joan Clay, a retired federal employee, searched online for a personal loan to help pay her rent and personal bills. (*See* Clay Affidavit, CPD Ex. 102, ¶ 2.) After identifying FIP as a possible lender, Ms. Clay called FIP. (*Id.*) FIP offered Ms. Clay a $5,000.00 loan, but did not disclose the interest rate

[24] Annual interest was calculated by dividing the expected repayment amount by the principal loan amount and dividing the result by the total number of years of the loan.

before she signed the paperwork for her loan. (*Id.* at ¶¶ 2-3.) Ms. Clay received $4,700.00, after FIP deducted $300.00 for a set-up fee. (*Id.* at ¶ 4; *see also* Consumer Loan Documents, CPD Ex. 102.) In return, Ms. Clay was required to repay the Respondents $621.00 per month for sixty months, with the amount of all payments totaling $37,260.00. (*See* Consumer Loan Documents, CPD Ex. 102; Loan Data Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 158.46%. (*Id.*) Ms. Clay ultimately repaid the Respondents a total of $6,130.72. (Clay Affidavit, CPD Ex. 102, ¶¶ 6 and 8.)

c. In August 2013, Barbara Duckett sought a loan in the amount of $8,000.00 to help her daughter. (*See* Duckett Affidavit, CPD Ex. 103, ¶¶ 3-4.) After calling PAS, Ms. Duckett was assured she qualified for an $8,000.00 loan. (*Id.* at ¶ 4.) Following her call, PAS sent Ms. Duckett an email link instructing her to sign a series of documents electronically, without allowing her to read each document, including a contact entitled "Future Income Stream Purchase and Sale Agreement," which she signed (*Id.* at ¶ 5; *see also* Consumer Loan Documents, CPD Ex. 103.) Pursuant to this agreement, Ms. Duckett received a pension advance of $7,700.00, consisting of an $8,000.00 loan reduced by a $300.00 set-up fee. (*See* Duckett Affidavit, CPD Ex. 103, ¶ 6; Consumer Loan Documents, CPD Ex. 103.) Several months after receiving her loan, Ms. Duckett contacted PAS and requested copies of her loan paperwork. (*See* Duckett Affidavit, CPD Ex. 103, ¶ 9.) When she received her paperwork, Ms. Duckett learned she was required to repay the Respondents $347.00 per month for 60 months, with the amount of all payments totaling $20,820.00. (*Id.*; *see also* Loan Data

Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 49.23%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Ms. Duckett is seventy-nine years old, lives on a fixed income which she uses to take care of herself, has serious health issues, and is responsible for caring for her daughter and her two grandchildren. (*See* Duckett Affidavit, CPD Ex. 103, ¶ 11.) Ultimately, Ms. Duckett was only able to pay the Respondents a total of $8,759.00 between 2013 and 2017. (*Id.* at ¶ 11.)

d. In May 2017, Deborah Denise Foster was looking for a small loan of $1,000.00, to pay for repairs to her vehicle. (*See* Foster Affidavit, CPD Ex. 104, ¶¶ 3-4.) After searching online for a lender, she was contacted by FIP. (*Id.*) Although she only wanted to borrow $1,000.00, the FIP representative offered Ms. Foster a loan in the amount of $3,600.00, but only if she immediately electronically signed various documents online. (*Id.* at ¶ 4.) Following FIP's direction, Ms. Foster electronically signed a series of documents that she was unable to read. (*Id.*) At no time during the signing process, was Ms. Foster advised of the interest rate or any other terms of her loan. (*Id. at* ¶ 5.) After signing the loan documents and receiving her $3,600.00 loan, FIP sent Ms. Foster her loan documents, which she did not read carefully having already received the loan. (*Id.* at ¶ 6; *see also* Consumer Loan Documents, CPD Ex. 104.) After Ms. Foster repaid $3,600.00, the full amount of the amount she thought she had borrowed, she began to call FIP to find out when her loan would be paid in full, but her calls were not returned. (*Id.* at ¶ 8.) According to the "FIP LLC Purchase and Sale Agreement" Ms. Foster had signed, she received a pension advance of

$3,600.00, consisting of a $3,900.00 loan reduced by a $300.00 set-up fee. (*See* Consumer Loan Documents, CPD Ex. 104.) When Ms. Foster could not reach FIP, and read her loan agreement, she was shocked to learn that her contract required her to pay FIP a total $36,000.00 over 120 months. (*See* Foster Affidavit, CPD Ex. 104, ¶ 9; Consumer Loan Documents, CPD Ex. 104; and Loan Data Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 99.99%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Ms. Foster closed her bank account after making $3,600.00 in payments. (*See* Foster Affidavit, CPD Ex. 104, ¶¶ 8 and 10.

e. On February 10, 2017, the Respondents entered into an agreement with Euphemia Hinton titled "FIP LLC Purchase and Sale Agreement." (*See* Consumer Loan Documents, CPD Ex. 105.) Pursuant to this agreement, Ms. Hinton received a pension advance of $1,800.00, consisting of a $2,100.00 loan reduced by a $300.00 set-up fee. (*See* CPD Ex. 105.) In return, Ms. Hinton was required to repay the Respondents $300.00 per month for sixty months, with the amount of all payments totaling $18,000.00. (*See* Consumer Loan Documents, CPD Ex. 105; Loan Data Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 199.98 %. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Ms. Hinton ultimately repaid the Respondents a total of $2,100.00. (*See* Future Income Payment Transaction Data, CPD Ex. 116, p. 3.)

f. In January 2016, Joyce Johnson sought a one-year loan because she was getting married. (*See* Testimony of Joyce Johnson.) After filling out some information online, an FIP representative contacted her and offered to lend her the

money. (*Id*.) The FIP representative told Ms. Johnson that her monthly payments would be $300.00 and that "they don't charge no interest rate. They didn't charge late fees. That's what he was telling me." (*Id*.) The FIP representative directed Ms. Johnson to sign the agreement and only sent her a copy of the complete contract after she had signed it. (*Id*.) Ms. Johnson signed her contract and received a $2,249.00 payment consisting of a $2,549.00 loan reduced by a $300.00 set-up fee. (*Id.*) The annual rate of interest on this loan was 159.98%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) In 2017, thinking she only had two to three months remaining on her balance, Ms. Johnson contacted a FIP customer service representative in order to repay the loan in full. (*See* Testimony of Joyce Johnson.) Ms. Johnson was shocked to learn that her contract required her to pay FIP a total of more than $18,000.00 over sixty months. (*See id*.)[25] Ms. Johnson asked to speak to a supervisor who repeated the total and informed her for the first time that the contract also involved her annuity. (*See id*.) Ms. Johnson ultimately repaid the Respondents a total of $1,800.00. (*See id*.)

g. On April 16, 2016, the Respondents entered into an agreement with Alphonso Manning titled "Future Income Payments Purchase and Sale Agreement." (*See* Consumer Loan Documents, CPD Ex. 108.) Pursuant to this agreement, Mr. Manning received a pension advance of $2,321.00, consisting of a $2,621.00 loan reduced by a $300.00 set-up fee. (*Id.*) In return, Mr. Manning was required to repay the Respondents $300.00 per month for sixty months, with the amount of all payments totaling $18,000.00. (*Id.*; *see also* Loan Data Spreadsheet, CPD Ex.

[25] Although Ms. Johnson testified that she was required to pay FIP more than $20,000.00, her contract documents (CPD. Ex. 106) reflect she was required to make sixty monthly payments in the amount of $300.00 for a total of $18,000.00.

117.) The annual rate of interest on this loan was 155.00%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Mr. Manning ultimately repaid the Respondents at least $3,300.00. (*See* Future Income Payment Transaction Data, CPD Ex. 116, p. 1.)

h. In June 2017, Carol McConnell, a retired pensioner, searched for a loan online in order to pay for her medical bills. (*See* McConnell Affidavit, CPD Ex. 109, ¶¶ 1-2.) Subsequently, Ms. McConnell was contacted by a representative of FIP, who told her she could apply for her loan online and asked for information about her pension and bank statements, among other things. (*Id.* at ¶ 2.) The same representative of FIP subsequently called Ms. McConnell that same day and told her she had been approved for a loan, and that she had to sign several documents online. (*Id.*) Ms. McConnell signed the FIP documents electronically, but was unable to actually review what she was signing. (*Id.* at ¶ 3-4.) The FIP representative told Ms. McConnell her monthly payment would be $350.00, but he did not tell her any of the other terms of the loan, including the interest rate, total number of payments, and the total cost of the loan. (*Id.* at ¶ 5.) Several days later, Ms. McConnell received $2,624.00, but she did not receive any of her loan documents. (*Id.* at ¶ 6; *see also* Testimony of Carol McConnell.) Ms. McConnell called FIP repeatedly (over ten times) requesting copies of her loan documents, but they were never forwarded to her. (McConnell Affidavit, CPD Ex. 109, ¶ 8; *see also* Testimony of Carol McConnell.) Eventually, after making three payments to FIP totaling $1,050.00 but being unable to obtain a copy of her loan documents, Ms. McConnell closed her bank account from which the payments

were being electronically debited. (McConnell Affidavit, CPD Ex. 109, ¶ 10.) Following the closure of her account, FIP called Ms. McConnell to demand payments, at which point FIP also told Ms. McConnell for the first time that the total cost of her $2,264.00 loan would be $21,000.00. (*Id.* at ¶ 11; *see also* Testimony of Carol McConnell; Consumer Loan Documents, CPD Ex. 109; Loan Data Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 159.07%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Although she never received a copy of the loan documents, when she was preparing her taxes, Ms. McConnell received a Form 1099-B from FIP that "completely baffled" her because it characterized her loan as a sale of assets. (*See* Testimony of Carol McConnell.)

i. On October 12, 2017, the Respondents entered into an agreement with Grace Merritte titled "FIP Purchase and Sale Agreement." (*See* Consumer Loan Documents, CPD Ex. 110.) Pursuant to this agreement, Ms. Merritte received a pension advance of $2,923.00, consisting of a $3,223.00 loan reduced by a $300.00 set-up fee. (*See* Consumer Loan Documents, CPD Ex. 110.) In return, Ms. Merritte was required to repay the Respondents $300.00 per month for forty-eight months, with the amount of all payments totaling $14,400.00. (*See* Consumer Loan Documents; Loan Date Spreadsheet, CPD Ex. 110, 117.) The annual rate of interest on this loan was 121.98%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Ms. Merritte ultimately repaid the Respondents a total of $2,100.00. (*See* Consumer Loan Documents, CPD Ex. 110.)

j. In November 2017, James Murphy, a retired pensioner, searched online for a loan to pay some personal bills. (*See* Murphy Affidavit, CPD Ex. 111, ¶¶ 1-2; *see also* Testimony of James Marshall Murphy.) After finding an advertisement from FIP, Mr. Murphy applied for a loan by sending FIP some personal and financial information. (Murphy Affidavit, CPD Ex. 111, ¶ 2.) FIP invited Mr. Murphy to sign loan documents electronically, through a process that allowed him to sign but not read each document. (*Id.* at ¶ 3.) At no time during this process did FIP advise Mr. Murphy of the interest rate or other terms of his loan. (*Id.*) FIP sent Mr. Murphy his loan documents, but he did not read them until a few months later. (*Id.* at ¶¶ 4 and 7.) Mr. Murphy received a loan in the amount of $2,170.00. (*Id.* at ¶ 5.) In early 2018, while preparing his taxes, Mr. Murphy received a Form 1099-B from FIP, stating that he would have to pay taxes on his loan and he learned that his loan had been characterized by FIP as a sale of assets. (*Id.* at ¶ 7; *see also* Testimony of James Marshall Murphy.) He then reviewed his loan paperwork and learned for the first time that his loan required monthly payments of $300.00, over eighty-four months, for a total repayment amount of $25,200.00. (Murphy Affidavit, CPD Ex. 111, ¶ 7; *see also* Consumer Loan Documents, CPD Ex. 111.) The annual rate of interest on Mr. Murphy's loan was 165.90%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Upon learning about the very high cost of his loan, Mr. Murphy stopped making payments to FIP and ultimately paid the Respondents a total of $900.00. (*See* Murphy Affidavit, CPD Ex. 111, ¶ 2; Testimony of James Marshall Murphy.)

k. On February 18, 2016, the Respondents entered into an agreement with Maryland resident Thomas Nelson titled "Future Income Payments Purchase and Sale Agreement." (*See* Consumer Loan Documents, CPD Ex. 112.) Pursuant to this agreement, Mr. Nelson received a pension advance of $5,622.00, consisting of a $5,922.00 loan reduced by a $300.00 set-up fee. (*Id.*) In return, Mr. Nelson was required to repay the Respondents $750.00 per month for sixty months, with the amount of all payments totaling $45,000.00. (*Id.*; s*ee also* Loan Data Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 160.00%. (*See* Loan Data Spreadsheet, CPD Ex. 117.)

l. In May 2015, Robert Outterbridge, a retired postal worker, searched for a loan online because he needed some money for vehicle repairs. (Outterbridge Affidavit, ¶ 2; Testimony of Robert Outterbridge.) Mr. Outterbridge was contacted by FIP, which told him that it could provide him with a loan between $2,000.00 and $3,000.00. (Outterbridge Affidavit, at ¶ 2.) The FIP representative asked Mr. Outterbridge about his pension, and later called him back and told him he had been approved for a loan in the amount of $5,000.00. (*Id.*) FIP sent Mr. Outterbridge paperwork, which he electronically signed using his smartphone, but he was unable to actually review the documents. (*Id.* at ¶ 3.) FIP did not inform Mr. Outterbridge what he would be paying in interest, nor did it inform him of any of the other terms of the loan. (*Id.*) FIP also sent Mr. Outterbridge a copy of the paperwork, instructing him to have it notarized. (*Id.* at ¶ 4.) Mr. Outterbridge had the paperwork notarized and returned it to FIP. (*Id.*) Shortly thereafter, he received a payment of $4,700.00, and was charged a $300.00 setup fee by FIP.

(*Id.* at ¶ 4.) FIP did not return a copy of the executed loan agreement. (*Id.*) Mr. Outterbridge began to grow concerned about his loan when he learned that FIP was not licensed as a lender in Maryland. (*Id.* at ¶ 7.) He subsequently sought the assistance of the Howard County Office of Consumer Affairs and requested copies of his loan papers from FIP. (*Id.* at ¶ 8.) Thereafter, Mr. Outterbridge received his loan papers from FIP and, for the first time, realized that the total cost for repaying his $4,700.00 loan would be $29,632.32. (*Id.* at ¶ 9; *see also* Consumer Loan Documents, CPD Ex. 113.) The annual rate of interest on Mr. Outterbridge's loan was 157.19%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Mr. Outterbridge ultimately repaid the Respondents a total of $3,086.70. (*See* Future Income Payment Transaction Data, CPD Ex. 116, p. 8 (Record Number 389.)

m. In December 2014, Patrice Pinder, a retired federal worker, needed a loan to help cover expenses for a move out of the State. (Pinder Affidavit, CPD Ex. 114, ¶¶ 1-3.) While she remained a Maryland resident, Ms. Pinder conducted an online search for a lender and was contacted by FIP. After gathering personal and financial information from Ms. Pinder, including proof of her pension, FIP offered her a loan in the amount of $2,500.00. (*Id.* at ¶ 4.) To get her loan, FIP told Ms. Pinder she needed to immediately electronically sign various documents. (*Id.*) While signing her loan documents, Ms. Pinder could not read them and FIP did not disclose to her the interest rate or other terms of her loan. (*Id.* at ¶¶ 4-5.) Ms. Pinder received $2,500.00 from FIP. (*Id.* at ¶ 6.) Ms. Pinder mailed her first payment in the amount of $303.00 to FIP and intended to make future payments

by mail, but instead FIP electronically debited her next two $303.00 payments from her bank account, which resulted in her checking account becoming overdrawn. (*Id.* at ¶ 7.) At that point, while reviewing her loan agreement with FIP, Ms. Pinder learned for the first time that her $2,500.00 loan was to be paid over a ten year period for a total amount of $36,360.00. (*Id.*; *see also* Consumer Loan Documents, CPD Ex. 114; Loan Data Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 145.44%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Ms. Pinder ultimately repaid the Respondents a total of $909.00. (*See* Pinder Affidavit, CPD Ex. 114, ¶ 7.)

n. In 2016, Jesse Sutton, Jr., a disabled veteran, needed money to pay off another loan and filled out an online application for what he thought was an ordinary loan. (Testimony of Jesse Sutton, Jr.) An FIP representative contacted Mr. Sutton and walked him through the process of signing loan documents without giving him a chance to read the documents. (*Id.*) The FIP representative reassured Mr. Sutton saying, "[F]irst off you have to do this and this and don't worry about it, you will get a copy and you can always read it after we are done through signing it." (*Id.*) Mr. Sutton received a pension advance of $2,249.00, consisting of a $2,549.00 loan reduced by a $300.00 set-up fee. (*Id.*; *see also* Consumer Loan Documents, CPD Ex. 115.) When he sat down to review the loan document, he learned for the first time that instead of a loan, he had signed over his pension income to FIP and was required to make monthly payments of $300.00, over sixty months, for a total repayment amount of $18,000.00. (*See* Testimony of Jesse Sutton, Jr.; *see also* Consumer Loan Documents, CPD Ex.

115; Loan Data Spreadsheet, CPD Ex. 117.) The annual rate of interest on this loan was 159.98%. (*See* Loan Data Spreadsheet, CPD Ex. 117.) Mr. Sutton ultimately repaid the Respondents a total of $7,200.00. (*See* Testimony of Jesse Sutton, Jr.; Consumer Loan Documents, CPD Ex. 115 (Copies of twenty-four posted checks).)

51. In total, the Respondents made over 491 pension advances to Maryland consumers, including at least 486 advances to Maryland consumers from April 1, 2014 through May 2, 2017. (*See* Response to CFR Subpoenas, CPD Ex. 92, 94.) In addition, the Respondents also made advances to Maryland Consumers both before April 1, 2014 and after May 2, 2017, including an advance to Barbara Duckett in August 2013, and advances to Deborah Foster, Carol McConnell, Grace Merritte, and James Marshall Murphy after May 2, 2017.

52. The Respondents made an unknown number of additional pension advances to Maryland consumers both before April 1, 2014 and after May 2, 2017.

53. The Respondents collected over $1,000,000.00 from Maryland consumers who entered into pension advance agreements with the Respondents. (*See* Future Income Payment Transaction Data, CPD Ex. 116; Loan Data Spreadsheet, CPD Ex. 117.) Although the principal amount of these advances ranged from a low of approximately $1,400.00 to a high of over $20,000.00, over 92% of the advances involved an original principal amount of less than $6,000.00. (*See* Future Income Payment Transaction Data, CPD Ex. 116; Loan Data Spreadsheet, CPD Ex. 117.)

REGULATORY ACTIONS IN OTHER STATES

54. The Respondents have been the subject of multiple state and federal law enforcement actions, all of which contained allegations or findings that raised or addressed the same issues in the present case.

55. On March 3, 2015, the California Commissioner of Business and Oversight issued a Cease and Refrain Order against PAS, Future Income Payments, LLC, CFIP, and Respondent Kohn, rejecting their claim that they were selling pension plan and structured settlement buyouts to consumers, and finding they were acting as unlicensed consumer lenders. (*See* Cease and Refrain Order, CPD Ex. 67.) Subsequently, on September 15, 2015, PAS, Future Income Payments, LLC, CFIP, and Scott A. Kohn entered into a Stipulation and agreed not to contest the prior Cease and Refrain Order. (*See* Stipulation to Desist and Refrain Order, CPD Ex. 66.)[26]

56. On February 1, 2017, the State of California filed a Complaint for Injunctive Relief, Restitution, and Civil Penalties for Violations of the Unfair Competition Law (California Business & Professional Code sections 17200 *et seq*.) against Scott Kohn, Buysell Annuity, Inc., CFIP, Pension Advance, LLC, PAS California, LLC, Future Income Payments, LLC, London Square Specialty Services, and 100 John Does. (*See* Complaint, CPD Ex. 79.) In its Complaint, the State of California alleged that the Defendants targeted vulnerable senior citizens and military veterans by marketing predatory loans that charged usurious interest rates. (*Id.* at p. 2.)

57. The Illinois Attorney General's Office filed a Complaint for Injunctive Relief against FIP, alleging that the company targeted retirees and pensioners with products purported

[26] Although California Commissioner of Business and Oversight's the Desist and Refrain Order (CPD Ex. 67) and Stipulation to Desist and Refrain Order (CPD Ex. 66) are not executed, the orders were verified as true and accurate by a Declaration filed by the Consumer Financial Protection Bureau in litigation against FIP (*see* CFPB Declaration, CPD Ex. 76, ¶¶ 10 and 11) and are downloadable from the California Commissioner of Business and Oversight's website. (*See* Testimony of Christopher Waldt; CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT, http://www.dbo.ca.gov/ENF/List/P/pensionsannuitiesandsettlementsllc.asp (last visited November 16, 2018).

to be "pension sales," that were "nothing more than predatory loans with usurious interest rates that reach 200%." (*See* Complaint for Injunctive and Other Relief, CPD Ex. 70, pp. 1-2.) In support of the Complaint, the Illinois Attorney General alleged that FIP violated multiple provisions of Illinois' Consumer Installment Loan Law by making loans without the required licensure, charging usurious interest, and failing to use contract forms that contained required disclosures (*Id.* at ¶¶ 50-59), all of which violated the Illinois Consumer Fraud Act. (*Id.* at ¶¶ 68-70.) On June 26, 2018, an Order Granting a Motion for Entry of Default was entered in the Attorney General's action, finding that "the allegations contained in the plaintiff's Complaint for Injunctive and Other Relief are confessed against the defendant." (*See* Order Granting Motion for Entry of Default, CPD Ex. 71.) On February 16, 2018, in a parallel proceeding, the Illinois Department of Financial & Professional Regulation, Division of Financial Institutions, issued a Cease and Desist Order finding that FIP had violated the Illinois Consumer Installment Loan Law by making consumer loans without a license and by charging excessive interest, and ordering the company to cease its lending activities in the State. (*See* Cease and Desist Order, CPD Ex. 68.) Subsequently, on May 23, 2018, an Order for Default was entered in the Division of Financial Institution's proceeding. (*See* Order for Default, CPD Ex. 69.)

58. In December 2016, FIP and Respondent Kohn, entered into an Assurance of Voluntary Compliance, resolving the Iowa Attorney General's allegations that FIP's purported pension sales were in fact usurious loans that violated Iowa law. (*See* Assurance of Voluntary Compliance, CPD Ex. 72, p. 1.) FIP and Respondent Kohn agreed to stop making illegal loans to Iowans, pay restitution to consumers, and pay $35,000.00 to the Iowa Attorney General. (*Id.* at pp. 2-4.)

59. On March 28, 2018, the Massachusetts Attorney General's office issued a press release announcing it had entered into an Assurance of Voluntary Compliance with FIP, resolving its concerns that the company's purported purchase of pension income streams were actually predatory loans. (*See* Press Release, CPD Ex. 72a.)

60. On August 16, 2017, the State of Minnesota, by and through its Attorney General, filed a Complaint against FIP, alleging that the company's purported sale of consumers' future pension payments were, in fact, illegal usurious loans under Minnesota law. (*See* Complaint, CPD, Ex. 73, pp. 1-2.)

61. In October 2016, the New York State Department of Financial Services entered into a Consent Order with Future Income Payments, LLC, resolving its violations of New York Banking and Financial Services Laws, by lending without a license and charging interest that exceeded the legal rate in New York. (*See* Consent Order, CPD Ex. 74.) Although Future Income Payments, LLC, argued it was entering into valid sales of consumers' pension benefits, the Department concluded that the transaction was a loan, citing in support the following findings as indicia of a loan:

a. The agreements provided for an advance of money to pensioners and, conditioned only on the failure of their pension payor to continue making payments, pensioners' promise to repay in installments over a period set in the agreements.
b. The agreements acknowledged that the lump sum account was "significantly less" than the amount that the pensioner would pay under the agreement, and some stated differences between the account pensioners received as a lump sum and the amount they would have collected and retained if the transaction with FIP had not taken place. This difference, referred to in the agreements as the "discount," was, in fact, the interest the pensioner paid over the course of the loan. The APR, however, was not disclosed.
c. The loan agreements had stringent recourse provisions in the event a pensioner failed to make the monthly payments: any disruption, interruption, decrease, or elimination of payments was deemed a

material breach of contract and caused all remaining and unpaid payments to be immediately due and payable.

d. The agreements also provided that any breach could require a pensioner to pay FIP's and any subsequent purchaser's legal fees and costs incurred pursuing a claim against the pensioner.

e. Pensioners who failed to make timely payments were charged late fees equal to 1.5% of the delinquent payment. Payments returned to FIP for insufficient funds resulted in a $35 insufficient funds fee, in addition to any late fees.

(*Id.* at pp. 7-8.) In its Consent Order, Future Income Payments, LLC agreed, among other things, to cease its lending activity in New York, reform and forgive its existing loans, pay refunds to consumers, and pay a $500,000.00 penalty. (*Id.* at pp. 10-16.)

62. In June 2016, Future Income Payments, LLC, entered into a Settlement Agreement with the North Carolina Attorney General's Office, resolving the allegation that its purchase of income streams from consumers were, in fact, illegal consumer loans that charged usurious interest rates. (*See* Settlement Agreement, CPD Ex. 75.) Under the terms of the settlement agreement, Future Income Payments, LLC, agreed to pay penalties and costs to the North Carolina Attorney General's Office, to comply with North Carolina consumer loan laws, and to reform its prior loans with North Carolina consumers. (*Id.*)

63. On May 19, 2017, the Pennsylvania Department of Banking and Securities issued an Order requiring Future Income Payments, LLC, and Scott Kohn to cease and desist with engaging in any cash advance or lending activities, as well as collecting payments on any loans made in the amount of $35,000.00 or less from consumers. (*See* Order, CPD Ex. 77.) In support of its Order, the Department of Banking and Securities rejected Future Income and Payments, LLC's and Mr. Kohn's argument that they were purchasing pension benefits from consumers finding instead:

> In reality, Respondents' product is a loan or advancement of money on credit because it offers a lump-sum of cash in exchange for a repayment by the consumer on a monthly basis in a defined amount plus fees for a predetermined term of five or ten years, which repayment exceeds the lump-sum of cash provided and that excess in fees and other consideration is interest . . . .
>
> Respondents' product is a loan or advancement of money on credit because Respondents require consumers to provide information that reflects directly upon the consumer's ability to repay the money consistent with lending practices such as credit checks, health questions, other sources of income, and solvency evaluations.
>
> Respondents' product is a loan or advancement of money on credit because Respondents are not responsible for payment of the income taxes on the income stream allegedly purchased, but the contractual language is clear that the consumer continues to be responsible for payment of income taxes on the money that has purportedly been sold to Respondents, hence the asset was never sold.
>
> Respondents' product is a loan or advancement of money on credit because Respondents do not become assignees of the pension or other income stream and never take title in those benefits or income streams, in whole or in part, and the benefits and income stream remain fully titled in the name of the consumer pursuant to a contract between the consumer and their employer.
>
> Respondents' product is a loan or advancement of money on credit because Respondents turn over the accounts for non-payment to debt collectors who provide notice that their activity is an attempt to collect a debt.

(*Id.* at p. 5.)

64. In March 2018, the Virginia Attorney General filed a Complaint against Future Income Payments, LLC, FIP, LLC and Respondent Kohn alleging their unlawful "pension sale" scam was, in fact, disguised illegal usurious loans. (*See* Complaint, CPD Ex. 78.)

65. In May 2014, the Washington Department of Financial Institutions, Division of Consumer Services filed a Statement of Charges and Notice of Intention to enter an Order to Cease and Desist, Prohibit From Industry, Impose Fine, and Refund Fees and Interest against PAS, finding that it had engaged in unlicensed lending activity by making loans to Washington consumers. (*See* Complaint, CPD Ex. 62 and 63.) On December 2, 2016, the Department of Financial Services and PAS entered into a Consent Order resolving the matter, pursuant to which

the company agreed to refund excess interest charges to consumers, make payments to the Department totaling $50,000.00 and to cease its lending activity unless it complied with Washington law. (*See* Consent Order, CPD Ex. 65.)

66. The Consumer Financial Protection Bureau has commenced an investigation into Future Income Payments, LLC's lending activities. (*See* Order, *CFPB v. Future Income Payments, LLC*, Case No. SACV-17-00303-JLS (SSx) (C.D. Cal. May 17, 2017) CPD Ex. 81.) Although the action before the District Court concerned the enforcement of a CFPB subpoena, in entering its order to enforce the subpoena, the District Court dismissed Future Income Payments, LLC's argument that its products do not qualify as loans, citing the fact that six state regulators and the City of Los Angeles have found that Future Income Payments, LLC's products do, in fact, constitute loans. (*See id.* at p. 6.)

THE PROCEEDINGS BEFORE THE CFR

67. As a result of a consumer complaint, the CFR began an investigation into the Respondents' business activities in April 2016. (*See* CFR Summary Order, CPD Ex. 82, ¶ 2.)

68. After an investigation into the business activities of the same Respondents named in the present matter, on April 25, 2018, the CFR issued a Summary Order to Cease and Desist (Summary Order) to the Respondents, for engaging in the same lending violations that are alleged by the Proponent to have violated the CPA. (*See* CFR Summary Order, CPD Ex. 82.) During the investigation, the Respondents responded to subpoenas from the CFR, providing certain documents to the CFR.

69. The April 25, 2018 Summary Order notified the Respondents of their right to a hearing before the CFR to determine whether the Summary Order should be vacated, modified,

or entered as a final order of the Commissioner, and provided the Respondents instructions for requesting a hearing.

70. The Respondents failed to request a hearing within fifteen days of issuance of the Summary Order, and so CFR issued a Final Order to Cease and Desist to the Respondents on July 11, 2018. (*See* CFR Final Order, CPD Ex. 83.) CFR's Final Order adopted the uncontested Findings of Fact from the Summary Order. (*Id*., *See* CFR Summary Order, CPD Ex. 82.) This Final Order was mailed to the Respondents on July 16, 2018. (*See* CPD Ltr. to ALJ re Evidentiary Record, *Aug. 20, 2018*.)

71. Pursuant to Md. Rule 7-203(a)(2), the Respondents had thirty days to file a petition for judicial review of CFR's Final Order to Cease and Desist. The Respondents failed to file a timely petition for judicial review of CFR's Final Order, and thus this Final Order is no longer subject to judicial review. (*See* CPD Ltr. to ALJ re Evidentiary Record, *Aug. 20, 2018*.)

72. The Respondents' purported pension advances to Maryland consumers were not an assignment of pension benefits and were in fact loans, as the Respondents delivered a principle sum of money to the consumers, and the consumers promised to repay the principal (plus interest) over a period of time. (*See* CFR Summary Order, CPD Ex. 82, ¶59.)

73. Each advance by the Respondents to the Maryland consumers under the terms of their agreements constituted a "loan" under Maryland Code Annotated, Financial Institutions Article sections 11-201(e) and 11-302(b) and Maryland Code Annotated, Commercial Law Article sections 12-301. (*See* CFR Summary Order, CPD Ex. 82, ¶ 60.)

74. The Respondents have never been licensed by the CFR to make consumer loans, nor have they been exempt from licensing under the MCLL. As such, the Respondents' unlicensed lending activities in Maryland violated the licensing provisions of the MCLL,

including Maryland Code Annotated, Financial Institutions Article, sections 11-203.1(1) and Maryland Code Annotated, Commercial Law Article sections 12-302. (*See* CFR Final Order, CPD Ex. 83, ¶ 69.)

75. The Respondents have never been exempt from licensing under the ILLP. As such, the Respondents' unlicensed lending activities in Maryland violated the licensing provisions of the ILLP, including Maryland Code Annotated, Commercial Law Article, section 12-103(c)(4 and Maryland Code Annotated, Financial Institutions Article, sections 11-302(a0, 11-302(b), and 11-303. (*See* CFR Final Order, CPD Ex. 83, ¶ 70.)

76. The Respondents' business activities constitute usurious and unlicensed lending to Maryland consumers, in violation of Maryland law. (*See* CFR Summary Order, CPD Ex. 82, ¶¶ 61, 62, 64, 65.)

77. The Respondents engaged in acts or practices constituting violations of Maryland Code Annotated, Commercial Law Article sections 12-103(a)(3), 12-103(c)(1), 12-106(b), 12-302, 12-306(a), 12-306(d), 12-313(a) and 12-314(a). (CFR Final Order, CPD Ex. 83, pp. 3-4 an ¶ 67.)

78. The Respondents violated the usury-related provisions of the I&U law by making advance to Maryland consumers with interest rates far in excess of 24% annual cap set forth in Maryland Code Annotated, Commercial Law Article sections 12-103(a)(3) and (c). (CFR Final Order, CPD Ex. 83, ¶ 65.)

79. The Respondents engaged in acts or practices constituting violations of Maryland Code Annotated, Financial Institutions Article sections 11-203.1(a) and 11-302(b). (*Id*.)

80. The Respondents failed to provide the Maryland consumers with a written statement disclosing the applicable interest rates and other specific items regarding the loan

product prior to entering into the pension advance agreements, in violation of MCLL section 12-106(b). 72

81. Each of the Corporate Respondents is jointly and severally liable for the acts and practices which are the subject of this proceeding. (*See* CFR Summary Order, CPD Ex. 82, ¶ 27; *see also* SOC ¶ 12.)

82. Respondent Kohn is jointly and severally liable with each and all of the Corporate Respondents for the acts and practices which are the subject of this proceeding. (*See* CFR Summary Order, CPD Ex. 82, ¶ 29; *see also* SOC ¶ 14, 16.)

83. Respondent Cusi is jointly and severally liable with Respondent Kohn and with each and all of the Corporate Respondents since she began engaging in the acts and practices which are the subject of this proceeding. (*See* CFR Summary Order, CPD Ex. 82, ¶ 30; *See* SOC ¶ 16.)

DISCUSSION

The Respondents are charged with violating the MCLL, I&U, ILLP, and CPA. The Proponent bears the burden of proof, by a preponderance of the evidence, to demonstrate violations of those provisions of the law. COMAR 02.01.02.05. For the reasons set forth below, I find that the Proponent has sustained its burden of proving each and every violation of the MCLL, I&U, ILLP, and CPA alleged in its Charges.

THE RESPONDENTS ARE ESTOPPED FROM CONTESTING THE ALLEGED VIOLATIONS OF MARYLAND'S LENDING LAWS

The Proponent argues that the Respondents are estopped from contesting issues in this matter which were previously addressed by the CFR in its July 11, 2018 Final Order against the Respondents because that Final Order should be given collateral estoppel effect. Those issues include the following: whether the Respondents' purported pension advances to Maryland

consumers were, in fact, loans; whether the Respondents engaged in unlicensed and/or unregistered business activities; whether the Respondents' loans to Maryland consumers were usurious; whether the Respondents failed to make required disclosures to Maryland consumers; and whether the Respondents are jointly and severally liable for the acts and practices which are the subject of this proceeding. The Proponent cited the Court of Appeals' ruling in *Garrity v. Maryland State Board of Plumbing*, holding that that an administrative agency's decision will have a "preclusive effect for purposes of collateral estoppel upon satisfaction of the three-part test arising from *Exxon Corp. v. Fischer,* 807 F.2d 842, 845–46 (9th Cir. 1987), referred to as the *Exxon* test." *Garrity v. Maryland State Bd. of Plumbing*, 447 Md. 359, 380 (2016).

Under the *Exxon* test, "an agency decision can have preclusive effect if: (1) the agency acted in a judicial capacity; (2) the issue presented to the fact finder in the second proceeding was fully litigated before the agency; and (3) resolution of the issue was necessary to the agency's decision." *Garrity*, 447 Md. at 380. "When those elements are satisfied, agency findings made in the course of proceedings that are judicial in nature should be given the same preclusive effect as findings made by a court." *Id.* (internal citations omitted.) The Court further stated in *Garrity* that it recognized the doctrine of "non-mutual offensive collateral estoppel" in this same context, whereby the findings of a final order or judgment issued by one administrative agency is binding on the respondents in a separate administrative proceeding brought by a different state agency, provided that the respondents had an opportunity to litigate the issues in the first action. *Id*. at 369-76.

In the present matter, I find that the three-part Exxon test has been satisfied: (1) The CFR acted in its judicial capacity when making factual determinations and drawing conclusions of law when issuing its Final Order; (2) In both the CFR action against the Respondents and the present

matter, the named respondents are identical, and the alleged violations of Maryland's lending laws are essentially the same.[27] The Respondents were given the fair and full opportunity to participate in litigation of the allegations and issues addressed in the Summary Order, which ultimately became the findings in CFR's Final Order; and (3) Resolution of the aforementioned issues was necessary to the agency's decision. Thus, the doctrine of collateral estoppel precludes the Respondents from relitigating the issues addressed by the CFR in its July 10, 2018 Final Order.

THE RESPONDENTS' TRANSACTIONS ARE LOANS SUBJECT TO MARYLAND'S LENDING LAWS

The MCLL applies to the Respondents' "pension advances."

The MCLL generally applies to "any loan or advance of money or credit" made by a non-exempt lender to consumers in Maryland in amounts of $6,000.00 or less, unless the lender makes an express written election in the parties' agreement stating that the transaction is governed by Subtitle 9 or 10 of Title 12 of the Commercial Law Article. *See* Md. Code Ann., Fin. Inst. § 11-201(e); and Md. Code Ann., Com. Law §§ 12-301(e), 12-303, 12-314(a),(b), 12-913.1, 12-1013.1; *see also B&S Marketing Enterprises, LLC v. Consumer Protection Div*., 153 Md.App. 130, 153-55 (2003). Further, the MCLL contemplates various types of loan transactions, including repayment in a single lump sum or in installments, (*see, e.g*., Md. Code Ann., Com. Law § 12-306(d), (e)), as well as both secured and unsecured loans (*see, e.g*., Md. Code Ann., Com. Law §§ 12-306(a)(7)(iii), 12-311(c)). Additionally, as long as the application for the loan originates in Maryland, the MCLL applies to the loan transaction, regardless of the primary business location of the lender. *See* Md. Code Ann., Com. Law § 12-314(c). Finally, it should be noted that the MCLL is a consumer protection statute that must be "interpreted and

[27] The CFR alleged 486 violations of MCLL, I&U, and ILLP, while the Proponent had additional evidence and alleged 491 violations of the same statutory provisions (including the same 486 violation alleged by the CFR).

construed to effectuate its general remedial purpose." Md. Code Ann., Fin. Inst. § 11-221; Md. Code Ann., Com. Law § 12-315; *see also B&S Marketing*, 153 Md. App. at 153-55.

Although "credit" is not defined in the MCLL, it is defined elsewhere in the Commercial Law Article. In the Maryland Credit Services Businesses Act (MSBA), "extension of credit" is defined as "the right to defer payment of debt or to incur debt and defer its payment, offered or granted primarily for personal, family, or household purposes." Md. Code Ann., Com. Law § 14-1901(f). Similarly, in the federal Consumer Financial Protection Act of 2010 (CFPA), "credit" is defined as "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase." 12 U.S.C. § 5481(7) (2010). Although the MCLL applies to a "loan or advance of money *or credit*," I find that "a loan or advance of money" would be considered a type of credit under both the MCSBA and the CFPA, as a loan involves incurring a debt and deferring its payment. Thus, it follows that the MCLL applies broadly to all types of consumer loans, advances, and other incurred debts, provided that involves an amount of $6,000.00 or less.

Likewise, although "interest" is not defined in the MCLL, it is also defined elsewhere in the Commercial Law Article—namely, in the I&U Law—to mean, with certain exceptions, "any compensation directly or indirectly imposed by a lender for the extension of credit for the use or forbearance of money, including any loan fee, origination fee, service and carrying charge, investigator's fee, time-price differential, and any amount payable as a discount or point or otherwise payable for services." Md. Code Ann., Com. Law § 12-101(e). In the context of consumer loans, these exceptions consist of fees and actual expenses that lenders are required to pay to governmental agencies and other third parties, as well as certain permitted late charges. *See* Md. Code Ann., Com. Law § 12-105(b), (c)(3), (e). Applying this concept to the MCLL,

interest would include all of the "compensation directly or indirectly imposed by a lender for the extension of credit for the use or forbearance of money," except for those fees that the lender is specifically authorized to collect under the MCLL, which consists of certain fees paid to public officials or governmental agencies, fees and premiums paid for title searches and title insurance, bad check fees, and in the event of default, attorney's fees and court costs. Md. Code Ann., Com. Law §§ 12-307 and 12-307.1. This interpretation is consistent with Maryland case law, which has held that interest includes all of the compensation that a lender retains and does not transmit to third parties. *See B. F. Saul Co. v. West End Park North, Inc*., 250 Md. 707, 725, 727 (1968) (holding that fees and charges retained by the lender must be included in the computation of interest); *Bar Ass'n of Baltimore City v. Snyder*, 273 Md. 534, 535 (1975) (same).

A pension advance is clearly a "loan or advance of money or credit," and as evident from the testimony of the various Maryland consumers and their affidavits in this matter, is invariably obtained for personal, family, or household purposes. Having given collateral estoppel effect to the CFR's July 11, 2018 Final Order, I find that the Respondents' pension advances to Maryland consumers were not an assignment of pension benefits and were in fact loans. (*See* CFR Summary Order, CPD Ex. 82, ¶59.) Thus, persons offering or providing pension advances in amounts of $6,000.00 or less to Maryland consumers are normally subject to the MCLL, including but not limited to its licensing provisions, interest rate caps, and disclosure requirements.

All of the pension advances that the Respondents marketed, offered, made available, or otherwise provided to Maryland pensioners involved an advance of money with the expectation of repayment of the principal amount of the advance plus interest, and were made for personal, family, or household purposes. (*See* SOC ¶ 45; CFR Summary Order, CPD Ex. 82, ¶¶ 41-42, 59;

Testimony of Jesse Sutton, Jr.; Testimony of Darrel Clark; Testimony of Joyce Johnson; Testimony of Robert Outterbridge.) Further, there are no exemptions or exceptions in the MCLL applicable to the Respondents or to their pension advances to Maryland consumers, and the Respondents did not expressly elect for their transactions to be governed by Subtitle 9 or 10 of Title 12 of the Commercial Law Article. Thus, the Respondents' advances in amounts of $6,000.00 or less to Maryland consumers are "loans" which are subject to the MCLL.

Over 92% of the Respondents' loans to Maryland consumers were in amounts of $6,000.00 or less. This includes 452 of the loans listed in CPD Exhibit 116, as well as 1 of the 14 loans listed in CPD Exhibit 117. Thus, the Respondents made at least 453 loans to Maryland consumers in amounts of $6,000.00 or less, which are subject to the MCLL. This figure does not take into account the advances made to Maryland consumers that were not disclosed by Respondents to the Proponent.

The I&U and ILLP also apply to the Respondents' "pension advances."

I&U is broader in scope than the MCLL, and generally applies to *all* loans or advances of money made to Maryland consumers by non-exempt lenders, regardless of the amount of the loan, unless the lender makes an express written election in the parties' agreement stating that the transaction is governed by Subtitle 9 or 10 of Title 12 of the Commercial Law Article. *See* Md. Code Ann., Fin. Inst. § 11-201(e); and Md. Code Ann., Com. Law §§ 12-103, 12-913.1, and 12-1013.1. In turn, the ILLP applies, *inter alia*, to all persons making non-exempt loans subject to section 12-103(a)(3) or (c) of the I&U, which are considered installment loans by definition. *See* Md. Code Ann., Com. Law § 12-103(a)(3) and (c); Md. Code Ann., Fin. Inst. § 11-302(a), (b).

There are no exemptions or exceptions in the I&U or ILLP applicable to the Respondents or to their loans. Further, as previously discussed, the Respondents did not expressly elect for

their transactions to be governed by Subtitle 9 or 10 of Title 12 of the Commercial Law Article. As such, all of the Respondents' advances to Maryland consumers fall within the scope of section § 12-103(a)(3) or (c) of the I&U, and are thus installment loans under section 11-302(a) of the ILLP. Therefore, all of Respondents' advances to Maryland consumers are subject to the licensing requirements, interest rate caps, and disclosure requirements of I&U and ILLP, regardless of whether they are also regulated by the MCLL. This includes the 491 loans indicated in CPD Exhibits 116 and 117, as well as all other consumer advances that the Respondents failed to disclose to the Proponent.

THE RESPONDENTS VIOLATED MARYLAND'S LENDING LAWS

In its July 11, 2018 Final Order, the CFR determined that the same Respondents named in the present matter violated the same provisions of Maryland's lending laws alleged by the Proponent. That Final Order is now unappealable, and thus binding on Respondents. Specifically, the CFR determined that (1) the pension advances the Respondents made to Maryland consumers involved usurious rates of interest, far in excess of the 24% annual cap set forth in the I&U, in violation of sections 12-101(k), 12-103(a)(3), and 12-103(c)(1) of the Commercial Law Article;[28] (2) the pension advances the Respondents made to Maryland consumers involved usurious rates, far in excess of the 24% or 33% annual interest rates permitted (depending on both the original principal balance of the loan and the remaining, unpaid principal balance) for such loans under the MCLL, in violation of section 12-306(a)(6) of the Commercial Law Article; (3) the Respondents engaged in unlicensed lending activities, as they have never been licensed by the CFR to make consumer loans, nor have they been exempt

[28] The CFR also determined, in the alternative, that if the Respondents' agreements with Maryland consumers were not subject to section 12-103(a)(3) or (c) of the Commercial Law Article, then the Respondents' agreements with those consumers violated the 6% interest rate cap set forth in both Article II, Section 57 of the Maryland Constitution and in section 12-102 of the Commercial Law Article.

from licensing under the MCLL. The Respondents' unlicensed lending activities in Maryland violated the licensing provisions of the MCLL, including sections 11-203.1(a) of the Financial Institutions Article and section 12-302 of the Commercial Law Article; (4) the Respondents further engaged in unlicensed lending activities, as they have never been licensed by the CFR to make consumer loans, nor have they been exempt from licensing under the MCLL. The Respondents' unlicensed lending activities in Maryland violated the licensing provisions of the ILLP, including sections 11-302(a), 11-302(b), and 11-303 of the Financial Institutions Article; the Respondents' were prohibited from making any loans to Maryland consumers without the proper licensure and, therefore, the Respondents' unlicensed loans to Maryland consumers are illegal and unenforceable; and (5) Pursuant to sections 12-308 and 12-106(b) of the Commercial Law Article, the Respondents were required to provide Maryland consumers with a written statement disclosing the applicable interest rates and other specific items regarding the loan product *prior* to entering into a loan agreement. The Respondent failed to provide such a written disclosure statement to Maryland consumers prior to entering into their pension advance agreements, and thus violated section 12-106(b) of the Commercial Law Article. Accordingly, I adopt the determinations of the CFR, finding that the Respondents committed the aforementioned violations of Maryland's lending laws.

The Respondents failed to comply with other provisions of Maryland's lending laws.

Under the MCLL, section 12-313(a)(1) of the Commercial Law Article prohibits a lender from directly or indirectly contracting for, charging, or receiving "any interest, discount, fee, fine, commissioner, charge, brokerage, or other consideration in excess of that permitted by [the MCLL – Credit Provisions.]" The permissible fees that a lender may collect under the MCLL are primarily set forth in sections 12-307 and 12-307.1 of the Commercial Law Article.

However, all of the Respondents' contracts permitted the Respondents to charge set-up fees and NSF fees—neither of which are permitted under the MCLL, and which are thus in violation of section 12-313(a)(1) of the Commercial Law Article.

Both the MCLL and I&U require an applicant for a lender license to obtain and file with CFR a surety bond, which "shall run to this State for the benefit of this State and of any person who has a cause of action against the applicant..." Fin. Inst. § 11-206(c)(2). However, the Respondents never obtained the requisite surety bond required of lenders in the State (*see* CPD Ex. 96), and thus Respondents violated Fin. Inst. § 11-206(c) for every advance that they made to Maryland consumers.

THE RESPONDENTS COMMITTED UNFAIR AND/OR DECEPTIVE TRADE PRACTICES IN VIOLATION OF THE CPA

The purpose of the CPA is to "set certain minimum standards for the protection of consumers across the State ...." Md. Code Ann., Com. Law § 13-102(b)(1). In enacting the CPA, the General Assembly determined that the State:

> should take strong protective and preventive steps to investigate unlawful consumer practices, to assist the public in obtaining relief from these practices and to prevent these practices from occurring in Maryland.

Md. Code Ann., Com. Law § 13-102(b)(3). The General Assembly further instructed that the CPA shall be "construed and applied liberally to promote its purpose." Md. Code Ann., Com. Law §13-105. The CPA prohibits all trade practices that are unfair or deceptive in, among other things, the extension of consumer credit. Md. Code Ann., Com. Law § 13-303(4).

The Respondents acted as "merchants" pursuant to Md. Code Ann., Com. Law § 13-101(g)(1). The Respondents' pension advances are used primarily for personal, household or family purposes, and thus constitute "consumer credit" pursuant to Md. Code Ann., Com. Law § 13-101(d)(1) of the CPA. Pursuant to Md. Code Ann., Com. Law § 13-303(4), the Respondents

are prohibited from engaging in any unfair or deceptive trade practices in the context of offering or providing pension advances to Maryland consumers.

The CPA provides a non-exclusive list of unfair or deceptive trade practices at § 13-301. *Golt v. Phillips*, 308 Md. 1, 8 (1986). The Respondents are charged with committing unfair or deceptive trade practices prohibited by § 13-303, as defined by §§ 13-301(1), (2) and (3) of the Act. None of these subsections requires *scienter* on the part of the merchant. *See Consumer Protection Div. v. Morgan*, 387 Md. 125 (2005); *Golt,* 308 Md. at 10-11.

Further, Maryland appellate courts have already determined that the Division is within its statutory authority to find that violations of Maryland's lending laws constitute violations of the CPA. Thus, in *B&S Marketing Enterprises, LLC v. Consumer Protection Division*, 153 Md. App. 130 (2003), *cert. denied* 380 Md. 231 (2004), the Court of Special Appeals held that the CPD was permitted to look behind the form of a transaction to determine whether a transaction actually constituted a loan under Maryland law, and if so, to assess whether the transaction violated the CPA. 153 Md. App. at 152-53. The court upheld the CPD's determination that a sale-leaseback transaction actually constituted a consumer loan subject to the MCLL, and that the transaction in turn violated the CPA. *Id.,* 153 Md. App. at 152-53, 162-63.

As set forth below, the Respondents' violations of these sections are clear and were established by the evidence presented at the hearing of this matter.

The Respondent Made False or Misleading Statements that Constitute Unfair or Deceptive Trade Practices under § 13-301(1) of the CPA

A misrepresentation, as defined in section 13-301(1) of the CPA is any "false, falsely disparaging, or misleading oral or written statement, visual description, or other representation of any kind which has the capacity, tendency or effect of deceiving or misleading consumers." The Court of Appeals has stated that "[f]or consumer protection purposes, the meaning of any

statement or representation is determined not only by what is explicitly stated, but also by what is reasonably implied." *Golt*, 308 Md. at 9. The Federal Trade Commission (FTC) has long held that a representation by a merchant is judged on the total, or overall, impression it makes on the consumer's mind. *F.T.C. v. Sterling Drug, Inc.*, 317 F.2d 669, 674-75 (2nd Cir. 1963), citations omitted; *see also American Home Products Corp. v. F.T.C.*, 695 F.2d 681, 687-88 (3rd Cir. 1983); F.T.C. Policy Statement on Deception of October 14, 1983, Appendix to *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 178 (1984), *cited with approval, Luskin's, Inc. v. Consumer Protection Div.*, 353 Md. 335, 352 (1999).[29]

The burden is not on the consumer to inquire into the truth of a representation. *F.T.C. v. Sterling Drug, Inc.*, 317 F.2d at 674; *Resort Car Rental System, Inc. v. F.T.C.*, 518 F.2d 962, 964 (7th Cir. 1975), *cert. denied* 423 U.S. 827 (1975). Instead, the burden is on the party who is making the representation to convey the truth with the total impression of its advertisement. *Spiegel, Inc. v. F.T.C.*, 494 F.2d 59, 62 (7th Cir. 1974), *cert. denied*, 419 U.S. 896. (1974).

In the course of offering and provide pension advances to Maryland consumers, the Respondents made numerous misleading oral or written statements or other representations that had the capacity, tendency, or effect of deceiving or misleading Maryland consumers, which are unfair or deceptive trade practices pursuant section 13-301(1) of the CPA. The Respondents' advertising was designed to convey an overarching message that their pension advances were beneficial for retirees and disabled veterans for multiple purposes, when in fact Respondents' pension advances contained such high rates of interest that they would be completely useless for those purposes.

[29] The CPA provides that "due weight and consideration be given to the interpretation of § 5(a)(1) of the Federal Trade Commission Act by the Federal Trade Commission and the federal courts." Md. Code Ann., Com. Law § 13-105. Section 5(a)(1) of the Federal Trade Commission Act declares unlawful unfair methods of competition and unfair or deceptive acts that affect commerce. 15 U.S.C. § 45(a)(1).

Respondents misrepresented or made false statements concerning the nature of their transactions with consumers by stating that the agreement constituted the "purchase and sale" of the pensioner's future pension payments (at a tremendously discounted rate), when in fact the transactions were actually loans that violated numerous consumer protections contained in Maryland's lending laws.

By offering or providing extensions of credit to consumers in Maryland in the form of pension advances, the Respondents were representing that they could legally provide such advances, thereby representing explicitly or impliedly that, among other things, they were properly registered with SDAT, that they held all required lending licenses, and that they held all required surety bonds for the benefit of consumers. However, the Respondents could not, in fact, legally offer or make pension advances to consumers in Maryland, because they were not registered with SDAT, they were not duly licensed as a consumer lender under the MCLL, they were not duly licensed as an installment lender under ILLP, and they did not hold the requisite surety bond for the benefit of consumers. Offering services without the required licensure is a deceptive practice that violates §13-301(1) of the CPA. *Golt v. Phillips,* 308 Md. 1 (1986) (holding that a landlord's failure to disclose that a dwelling was not properly licensed for occupancy was a violation of the CPA).

Similarly, each time the Respondents offered a pension advance to consumers, they represented impliedly or expressly that the interest, fees, and other charges they collected were lawful when they were not. In *B&S Marketing*, the Court of Special Appeals upheld the CPD's finding that a payday lender's offer of usurious loans was a deceptive act that violated the CPA. 153 Md. App. at 162-63. Here, Respondents' loans carried interest rates that greatly exceeded

the caps set by Maryland's consumer loan laws. Moreover, their set up fees, NSF fees, and fees associated with collecting their loans were also not legal.

Finally, the Respondents represented that the advances they provided consumers were income for tax purposes, and required pensioners to submit an IRS Form W-9 when, in fact, the Respondents' loans were not "income" for tax purposes, and thus consumers should not have incurred additional tax liability.

Each of these misrepresentations by Respondents had the capacity, tendency or effect of misleading consumers and were thus, unfair or deceptive trade practices that violated § 13-301(1) of the CPA.

The Respondents engaged in unfair or deceptive trade practices under section 13-301(2)(i) and (ii) of the Commercial Law Article by misrepresenting their own status and the status of their products

Section 13-301(2)(i) of the Consumer Protection Act defines an unfair and deceptive trade practice to include a representation that "[c]onsumer goods, consumer realty, or consumer services have a sponsorship, approval, accessory, characteristic, ingredient, use, benefit, or quantity which they do not have." *See* Md. Code Ann., Com. Law § 13-301(2)(i). Similarly, section 13-301(2)(ii) of the Consumer Protection Act defines an unfair and deceptive trade practice to include a representation that "[a] merchant has a sponsorship, approval, status, affiliation, or connection which he does not have." *See* Md. Code Ann., Com. Law § 13-301(2)(ii).

The Respondents held themselves out as an established national company or an "industry leader" that could provide advances to military and government retirees and disabled veterans when, in fact, the Respondents have been subjected to numerous law enforcement actions, all of

which when resolved have found that the Respondents are, in fact, making illegal predatory loans with usurious interest rates.

By offering or providing extensions of credit to consumers in Maryland in the form of pension advances, the Respondents were also representing that they could legally make such advances and that their products were legal, when, in fact, the Respondents could not legally offer or make pension advances to consumers in Maryland, since they were not registered with SDAT, they were not duly licensed as a consumer lender under the MCLL, they were not duly licensed as an installment lender under ILLP, and they did not hold the requisite surety bond for the benefit of consumers. The Respondents' loans were also illegal because they charged usurious rates under Maryland law, containing rates of interest that far exceed the interest rate caps set forth in the MCLL, I&U, and the Maryland Constitution, and the Respondents charged fees prohibited under the MCLL and I&U, or charged fees in amounts that exceeded the limits for such fees under the MCLL and I&U.

The Respondents' misrepresentations concerning their own status and the status of their products were false and violated section 13-301(2) of the CPA.

The Respondents made material omissions of fact that constitute unfair or deceptive trade practices under § 13-301(3).

Section 13-301(3) of the Consumer Protection Act prohibits the omission of material facts if the omission deceives or tends to deceive. *See* Md. Code Ann., Com. Law § 13-301(3). To tell less than the whole truth is a well-known method of deception. *P. Lorrilard Co. v. F.T.C.*, 186 F.2d 52, 59 (4th Cir. 1950). "An omission is material if a significant number of unsophisticated consumers would find that information important in determining a course of action." *Green v. H & R Block*, 355 Md. 488, 524, (1999), citing, *Luskin's,* 353 Md. at 358-59, (1999); *Golt*, 308 Md. at 10; *State v. Cottman Transmissions Systems, Inc.*, 86 Md. App. 714,

723, *cert. denied*, 324 Md. 121 (1991). Information is material if it is likely to affect a consumer's choice of service; and a material misrepresentation or omission is one that is likely to cause injury to consumers. *Luskin's*, 353 Md. at 358-59.

The MCLL required the Respondents to make numerous disclosures to consumers prior to their obligating themselves to repay a loan. The Respondents succeeded in deceiving consumers into entering loan arrangements that were illegal, extremely harmful, and required consumers to make payments as much as ten times the original value of the loan, by flouting these disclosure requirements and failing to disclose the material terms of their loans, including the interest rate and the total cost of the loans.

Using the Respondents' electronic document signing process, consumers were asked to sign loan documents without the Respondents first disclosing the APR or annual interest rate on their loans or the total cost of their loans, the disclosure of which is required under both the MCLL and I&U before a consumer signs a loan document. The net effect of these omissions was that consumers did not truly understand their repayment until after they had agreed to the Respondents' loan terms. For example, after electronically signing her loan documents without having a chance to review them, Deborah Foster was later "shocked" to learn that her contract with FIP required her to pay a total $36,000.00 over 120 months for a loan of $3,600.00. (*See* Foster Affidavit, CPD Ex. 104; Consumer Loan Documents, CPD Ex. 104). Similarly, Carol McConnell did not learn she was required to pay FIP $21,000.00 for her $2,264.00 loan until after she had agreed to the Respondents' terms. (*See* McConnell Affidavit, CPD Ex. 109; McConnell Testimony; Consumer Loan Documents, CPD Ex. 109). These were circumstances described by all ten of the consumers who testified live at the hearing or by affidavit.

The Respondents also did not disclose to consumers that they were not licensed as a consumer lender under the MCLL or as an installment lender under ILLP and had otherwise failed to comply with the requirements of Maryland's consumer loan laws.

Lastly, Respondents did not disclose that their advances were not income for tax purposes, and that consumers did not need to consider the advances as income for purposes of tax liability.

Each of these omissions were material to consumers and the Respondents' failure to disclose these facts deceived or tended to deceive consumers in violation of §13-301(3) of the CPA.

The Respondents Engaged In Unfair Practices in Violation of § 13-303.

In addition to prohibiting deceptive trade practices, the CPA prohibits practices that are unfair. *See* Md. Code Ann., Com. Law § 13-303. In 1972, the Supreme Court in *Federal Trade Commision. v. Sperry and Hutchinson Co.*, 405 U.S. 233 (1972), found that the FTC's unfairness doctrine was a broader standard than deception. In 1980, the FTC summarized and focused its unfairness standard to require than an unfair practice cause substantial injury to consumers. This standard, codified in the Federal Trade Commission Act Amendments of 1994 (H.R. 2243) at 15 U.S.C. 45(n), was adopted by the Court of Special Appeals in *Legg v. Castruccio*, 100 Md. App. 748 (1994), in evaluating claims of unfairness in private actions for damages under the Consumer Protection Act. Although the Court in *Legg* specifically did not decide whether this standard would be the proper one to apply in public enforcement actions, *id.* at 771 n. 5, the Consumer Protection Division has regularly adopted the standard in the public enforcement of the CPA. *See, e.g., Consumer Protection Div. v. Tommy Edward Clack.*, CPD Case No.: 11-037-207106, OAH Case No.: OAG-CPD-04-11-44347 (July 5, 2012). The FTC's

unfairness standard, now the law in Maryland, is that a practice is unfair if (1) it causes or is likely to cause substantial injury to consumers, (2) the injury is not reasonably avoidable by consumers, and (3) the injury is not outweighed by any offsetting benefits to consumers or to competition. *Legg*, 100 Md. App. 748, 767 (1994).

In this case, the Respondents' misrepresentations and material omissions of fact caused serious financial harm to consumers in multiple ways. The consumers who Respondents targeted, who were retirees, pensioners, and veterans, all reached out to Respondents because they had an immediate need for a short term loan. The Respondents, rather than meeting that need, took advantage of it by making loans that required consumers to pay highly usurious rates of interest, as well as other illegal fees, all of which was in derogation of the MCLL designed to protect vulnerable consumers from these abuses. The Respondents also mischaracterized their products so that they could shift their tax burdens to consumers, requiring them to incur federal and state tax liability that they never should have incurred. The Respondents' illegal and predatory loans substantially harmed consumers who were already financially vulnerable.

Consumers could not reasonably avoid the harm they experienced because the Respondents' practice, in violation of Maryland's consumer laws, was to not tell consumers any of the crucial terms of their loans until after consumers had signed their loan documents, including the interest rate and cost of the loans.

Finally, no argument can be made that offering consumers illegal, usurious loans is a benefit to the marketplace. Accordingly, the Respondents' practices, in addition to being deceptive, were also unfair in violation of section 13-303 of the CPA.

Respondents Scott A. Kohn and Glorilyn Cusi are individually liable for the unfair and deceptive trade practices.

It is well-established in Maryland that officers and agents of a corporation are personally liable for torts that they personally commit, or which they "inspire," "participate in," "contributed to" or "helped to bring about." *Tedrow v. Deskin*, 265 Md. 546, 550-51 (1972); *see also Central Collection Unit v. Kossol,* 138 Md. App. 338, 348-49 (2001).[30] In *Metromedia Co. v. WCBM Maryland, Inc.*, 327 Md. 514, 519-22 (1992), the Court of Appeals reaffirmed that officers of a corporation may be held individually liable for the wrongdoing of the corporation that is undertaken based on the officers' decisions. The FTC has similarly held officers liable for unfair or deceptive trade practices committed on behalf of a corporation if the officers participated directly in the practices or knew or should have known of the practices and had the authority to control them. *F.T.C. v. Amy Travel Service, Inc.*, 875 F.2d 564, 573-74 (7th Cir.), *cert denied*, 493 U.S. 954 (1989); *F.T.C. v. Publishing Clearing House, Inc.*, 104 F.3d 1168, 1170 (9th Cir.1997). The Maryland Court of Appeals has expressly adopted the 7th Circuit standard established in *F.T.C. v. Amy* in the case of *Consumer Protection Division v. Morgan,* 387 Md. 125, 176 (2005).

Respondent Kohn is an owner, director, officer, manager, member, principal, and/or agent for each Corporate Respondent. Respondent Kohn directed, oversaw, and managed the business activities of each Corporate Respondents, created and implemented the unfair and deceptive policies and practices of the Corporate Respondents, and directed and supervised employees of the Corporate Respondents who committed the unfair and deceptive trade practices. Respondent Kohn also directly participated in these violations. For example,

[30] In *Hartford Accident and Indemnity Co. v. Scarlett Harbor Assocs. Ltd. Partnership*, 109 Md. App. 217, 265 (1996), the Court of Special Appeals held that "a Consumer Protection Act violation is in the nature of a tort action."

Respondent Kohn personally signed several deceptive loan agreements offering consumers deceptive loans. In addition, Respondent Kohn was aware that numerous state agencies and the CFPB had concluded that the transactions he directed, supervised, and managed were consumer loans or installment loans and that his attempts to characterize the loans as purchases were deceptive.

Respondent Glorilyn Cusi has also conducted business in the name of, or on behalf of, each Corporate Respondent. In conjunction with Respondent Kohn, Respondent Cusi directed, oversaw, and managed the business activities of each Corporate Respondents. Respondent Cusi created and implemented unfair and deceptive policies and practices of the Corporate Respondents, and directed and supervised employees of the Corporate Respondents who committed the unfair and deceptive trade practices. In addition, Respondent Cusi also directly participated in these violations. For example, Respondent Cusi personally signed several deceptive loan agreements offering consumers deceptive loans.

In issuing its July 11, 2018 Final Order, the CFR determined that each corporate respondent, Respondent Kohn and Respondent Cusi, are each jointly and severally liable for the acts which are the subject of the present action. (*See* CFR Summary Order, CPD Ex. 82, ¶¶ 27, 29, 30.) Thus, having given collateral estoppel effect to the CFR's July 11, 2018 Final Order, I adopt the CFR's determination that individual Respondents Kohn and Cusi are jointly and severally liable with the Corporate Respondents for any and all penalties and/or restitution that might be imposed or awarded by the Agency in this matter. *Id.*

RELIEF

In its Charges, the Proponent asks that an order be issued granting specific relief as set forth in the Charges. However, the authority delegated to the OAH did not include the

recommendation of proposed relief, as the Order Granting Petition for Hearing and Notice of Hearing specifically states: "The [CPD] is delegating its authority to the [OAH] to conduct a contested case hearing and to render proposed findings of fact and conclusions of law....The [CPD] shall make the final Findings of Fact and Conclusions of Law, shall be responsible for determining the appropriate relief, if any, and shall enter a Final Order. " Therefore, I am without authority to address the request for relief or recommend any sanctions or penalties. COMAR 02.01.02.04B.[31]

PROPOSED CONCLUSIONS OF LAW

Based upon the above Proposed Findings of Fact and Discussion, I propose the following Conclusions of Law:

1. The Respondents' pension advances to Maryland consumers for amounts of $6,000.00 or less are loans which are subject to the Maryland Consumer Loan Laws. Md. Code Ann., Com. Law §§ 12-301(e), 12-303; Md. Code Ann., Fin. Inst. § 11-201(e); CFR Summary Order, CPD Ex. 82.
2. The Respondents violated the Maryland Consumer Loan Laws. Md. Code Ann., Com. Law §§ 12-302, 12-306(a)(6), 12-313(a)(1), 12-307, 12-308, 12-307.1, 12-314(a),(b); Md. Code Ann., Fin. Inst. § 11-203.1(a), 11-204(a); 11-206(c); CFR Summary Order, CPD Ex. 82.
3. All of the Respondents' pension advances to Maryland consumers are loans which are subject to the Maryland Interest and Usury Law and Installments Loan-Licensing

[31] COMAR 02.01.02.04B provides as follows:
Scope of Authority Delegated. Unless the [CPD] notifies the parties of a different delegation, the authority delegated shall issue proposed findings of fact and proposed conclusions of law, but not recommend proposed relief.

Provisions. Md. Code Ann., Com. Law § 12-103(a)(3), 12-103(c), 12-106(b); and Md. Code Ann., Fin. Inst. § 11-302(a); CFR Summary Order, CPD Ex. 82.

4. The Respondents violated the Maryland Interest and Usury Law. Md. Code Ann., Com. Law §§ 12-101(k), 12-103(a)(3), 12-103(a)(2); 12-103(c); 12-106(b); CFR Summary Order, CPD Ex. 82.
5. The Respondents violated the Installments Loan-Licensing Provisions. Md. Code Ann., Fin. Inst. §§ 11-302(a), 11-302(b), 11-303; CFR Summary Order; CPD Ex. 82.
6. The Respondents failed to make the required disclosures to Maryland consumers. Md. Code Ann., Com. Law §§ 13-106(b), 13-308(a); CFR Summary Order; CPD Ex. 82.
7. The Respondents committed unfair and/or deceptive trade practices in violation of the Maryland Consumer Protection Act. Md. Code Ann., Com. Law §§ 13-301(1), 13-301(2)(ii) 13-301(3) 13-303(4).
8. The Respondents are jointly and severally liable for any restitution, damages, penalties, and/or costs ordered by the Division. *Consumer Protection Division v. Morgan*, 387 Md. 125, 176 (2005); CFR Summary Order; CPD Ex. 82.

November 19, 2018
Date Decision Issued

Jennifer A. Nappier
Administrative Law Judge

JAN/emh
#176690

NOTICE OF RIGHT TO FILE EXCEPTIONS

A party aggrieved by this proposed decision may file exceptions thereto and request an opportunity to present oral argument. Such exceptions and any request for argument must be made within thirty (30) days from the date of this proposed decision. COMAR 02.01.02.21. The written exceptions and request for argument, if any, should be directed to Clerk, Administrative Hearings, Consumer Protection Division, 200 St. Paul Place, 16th Floor, Baltimore, Maryland 21202.

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OFFICE OF THE MARYLAND	*	**BEFORE JENNIFER A. NAPPIER,**
ATTORNEY GENERAL,	*	**AN ADMINISTRATIVE LAW JUDGE**
CONSUMER PROTECTION DIVISION,	*	**OF THE MARYLAND OFFICE OF**
PROPONENT	*	**ADMINISTRATIVE HEARINGS**
v.	*	**OAH CASE NO.: OAG-CPD-04-18-13497**
FUTURE INCOME	*	**CPD CASE NO. 18-013-296084**
PAYMENTS, LLC, ET AL.,	*	
RESPONDENTS	*	
	*	

* * * * * * * * * * * * *

APPENDIX – FILE EXHIBIT LIST

I admitted the following exhibits into evidence on behalf of the Proponent:

CPD Exhibit No.	EXHIBIT DESCRIPTION
	VOLUME 1
1	DE State Bus. Records: Future Income Payments, LLC
2	CA State Bus. Records: Future Income Payments, LLC
3	NV State Bus. Records: Future Income Payments, LLC
4	NV State Bus. Records: FIP LLC (July 2018)
5	NV State Bus. Records: FIP LLC (Nov. 2017)
6	DE State Bus. Records: Cash Flow Investment Partners, LLC
7	CA State Bus. Records: Cash Flow Investment Partners, LLC
8	DE State Bus Records: BUYSELLANNUITY INC.

9	DE State Bus. Records: Pension Advance LLC
10	NV State Bus. Records: Scott Kohn as an officer
11	NV State Bus. Records: Glorilyn Cusi as an officer
12	NV State Bus. Records: Commercial Cash Flow LLC
13	NV State Bus. Records: Chobham LLC
14	NV State Bus. Records: Chobham LLC Series 129 (officer)
15	NV State Bus. Records: Chobham as an officer
16	Conservitas Company Services LLC (July 2018) – CPD Search Version
17	Conservitas Company Services LLC (July 2018) – CFR Investigative File
18	Conservitas Company Services LLC as Registered Agent
19	Conservitas Company Services LLC as Registered Agent (CFR version)
20	CA State Bus. Records: SK Judgement Recovery Services
21	CA State Bus. Records: London Square Collections, LLC
22	Car Champs Finance LLC Records (NV State and SEC)
23	MD SDAT Search
24	Corporate Disclosure Statement
25	FIP LLC web site (Apr. 2018)
26	FIP LLC web site (Sep. 2017)
27	Future Income Payments LLC web site (Apr. 2016)
28	Lumpsum-setttlement.com web site (Apr. 2016)
29	Pensionpurchasing.com web site (Nov. 2017)
30	Buysellannuity.com web site (Apr. 2018)
31	Respondents' Web Sites – Spreadsheet Summary
32	Buysellannuity.com – Screen shots
33	Buysellannuity.com – Domain search
34	Cashflowoutsourcing.com – Screen shots

35	Cashflowoutsourcing.com – Domain search
36	Cfipweb.com – Screen shots
37	Cfipweb.com – Domain search
38	Futureincomepayments.com – Screen shots
39	Futureincomepayments.com - Domain search
40	Highspeedlending.com – Screen shots
41	Highspeedlending.com – Domain search
42	Mycallcenterteam.com – Screen shots
43	Mycallcenterteam.com – Domain search
44	Investccl.com – Screen shots
45	Investccl.com – Domain search
46	Investorschoicecommercialcapital.com – Screen shots
47	Investorschoicecommercialcapital.com – Domain search
48	Londonsquarecolections.com – Screen shots
49	Londonsquarecolections.com – Domain search
50	Mycallcenterteam.com – Web search
51	Londonsquarespecialtyservices.com – Domain search
52	Lsbpo.com – Screen shots
53	Lsbpo.com – Domain search
54	Lumpsum-settlement.com – Screen shots
	VOLUME 2
55	Lumpsum-settlement.com – Domain search
56	Mycallcenterteam.com – Domain search
57	Mychoicecapital.com – Screen shots
58	Mychoicecapital.com – Domain search

59	Nextmerchantadvance.com – Domain search
60	Nextmerchantadvance.com – Web search
61	Pensionpurchasing.com – Screen shots
62	Pensionpurchasing.com – Domain search
63	WA Dept. Fin. Svcs. – Statement of Charges
64	WA Dept. Fin. Svcs. – Amended Statement of Charges
65	WA Dept. Fin. Svcs. – Consent Order
66	CA Dept. Bus. Oversight – Stipulation to Desist and Refrain
67	CA Dept. Bus. Oversight –Desist and Refrain
68	IL Dept. Fin. Svcs. – Charges
69	IL Dept. Fin. Svcs. – Order for Default
70	IL AG Complaint
71	IL AG Default Order
72	Iowa AG Settlement
72a	MA AG Press Release
73	MN Complaint
74	NY DFS Consent Order
75	NC AG Settlement
76	CFPB Supplemental Declaration (related to Exhibits 75, 79)
77	PA Banking Dept. Order
78	VA AG Complaint
79	LA City Complaint
80	CFPB Admin Order
81	US Dist. Ct. Order re CFPB
82	CFR Summary Order to Cease and Desist
83	CFR Final Order to Cease and Desist

84	AL Private Federal Lawsuit
85	CA Federal Class Action
86	GA Private Federal Lawsuit
87	FL Private Federal Lawsuit
	VOLUME 3
88	CFR Investigation – Futureincomepayments.com web site
89	CFR Investigation – Licensing search of CFR Records
90	CFR Subpoenas to Respondents, with proof of service
91	Womble Carlyle emails acknowledging receipt of subpoenas
92	Response to subpoenas (first and last pages)
93	Response to subpoenas: general objections 8 and 9
94	Response to subpoenas – Excerpt (p. 12)
95	Response to subpoenas – Excerpt (p. 22)
96	Response to subpoenas – Excerpt (p. 34)
97	Response to subpoenas – Consumer payment records
98	Response to subpoenas – Exhibit B (spreadsheet)
99	Response to subpoenas – Emails from counsel with follow-up answers
100	Womble letter withdrawing as counsel, with email, *April 20, 2018*[1]
101	Darrel Clark – Consumer documents
102	Joan Clay – Affidavit and related documents
103	Barbara Duckett– Affidavit and documents
104	Denise Foster– Affidavit and related documents
105	Euphemia Hinton– Consumer documents

[1] The letter itself was introduced at the hearing, but was undated. At my request, following the hearing, the Proponent supplemented the record with the related email that had transmitted the letter, thereby providing an approximate date for the letter.

106	Joyce Johnson– Consumer documents
107	Dolores King Documents– Consumer documents
108	Alphonso Manning– Consumer documents
109	Carol McConnell– Affidavit and related documents
110	Grace Merritte– Consumer documents
111	James Marshall Murphy– Affidavit and related documents
112	Thomas Nelson– Consumer documents
113	Robert Outterbridge– Affidavit and related documents
114	Patrice Pinder – Affidavit and related documents
115	Jessy Sutton Jr. – Consumer documents
116	Spreadsheet of Respondents' pension advances to Maryland consumers (data derived from Exhibit 98)
117	Spreadsheet of Respondents' pension advances to 14 Maryland consumers (witnesses/complainants)

NOTES

NOTES

9

B&S Marketing Enterprises, LLC v. Consumer Protection Division, 835 A.2d 215 (Md. Ct. Spec. App. Nov. 4, 2003)

Submitted by:
Philip D. Ziperman

Office of the Maryland Attorney General

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153 Md.App. 130

Editor's Note: Additions are indicated by Text and deletions by ~~Text~~.

Court of Special Appeals of Maryland.

B&S MARKETING ENTERPRISES, LLC.,
v.
CONSUMER PROTECTION DIVISION.

No. 1672 Sept.Term 2002.
|
Nov. 4, 2003.

Synopsis
Consumer Protection Division brought Consumer Loan Law and Consumer Protection Act proceeding against businesses and their owners engaged in alleged "sale-leaseback" transactions. The ALJ found that defendants had engaged in unfair and deceptive sales practices in violation of the Consumer Protection Act but did not violate the Consumer Loan Law. In its final decision the Division found that defendants had violated both the Consumer Loan Law and the Consumer Protection Act, and defendants filed a petition for judicial review. The Circuit Court for Baltimore City, Evelyn Omega Cannon, J., affirmed, and defendants appealed. The Court of Special Appeals, Krauser, J., held that: (1) sale-leaseback transactions made by defendants were actually usurious loans; (2) evidence was sufficient to establish that defendants misrepresented the terms of their lease transactions to customers; (3) Division did not have to show customer reliance to order restitution, only that defendants had made unlicensed usurious loans; and (5) owners of businesses making the loans had acted in bad faith, for purposes of civil penalties.

Affirmed.

West Headnotes (22)

[1] **Administrative Law and Procedure**
Scope

In reviewing a decision of an administrative agency, Court of Special Appeals' role is precisely the same as that of the circuit court.

2 Cases that cite this headnote

[2] **Administrative Law and Procedure**
Scope

In reviewing a decision of an administrative agency, Court of Special Appeals reviews only the decision of the administrative agency itself.

1 Cases that cite this headnote

[3] **Administrative Law and Procedure**
Scope

In reviewing a decision of an administrative agency, Court of Special Appeals does not evaluate the findings of fact and conclusions of law made by the circuit court.

1 Cases that cite this headnote

[4] **Administrative Law and Procedure**
Scope

In reviewing a decision of an administrative agency, whether the circuit court applied the wrong standard of review is of no consequence if Court of Special Appeals' own review satisfies it that the agency's decision was proper.

Cases that cite this headnote

[5] **Administrative Law and Procedure**
Record

To conduct a proper inquiry of an administrative agency's decision, Court of Special Appeals

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must be able to discern from the record the facts found, the law applied, and the relationship between the two.

Cases that cite this headnote

[6] **Administrative Law and Procedure**
Substantial evidence
Administrative Law and Procedure
Law questions in general

In reviewing the decision of an agency, Court of Special Appeals' role is limited to determining if there is substantial evidence in the record as a whole to support the agency's findings and conclusions, and to determine if the administrative decision is premised upon an erroneous conclusion of law.

Cases that cite this headnote

[7] **Administrative Law and Procedure**
Substantial evidence

Substantial evidence, when reviewing a decision of an administrative agency, is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.

Cases that cite this headnote

[8] **Administrative Law and Procedure**
Inferences or conclusions from evidence in general
Administrative Law and Procedure
Substantial evidence

In making determination whether substantial evidence supports an administrative agency's findings and conclusions, Court of Special Appeals must give deference not only to the agency's fact-findings, but to the drawing of inferences from the facts as well.

Cases that cite this headnote

[9] **Administrative Law and Procedure**
Particular Questions, Review of
Administrative Law and Procedure
Substantial evidence

In making determination whether substantial evidence supports an administrative agency's findings, Court of Special Appeals must accord deference to the agency's application of law to those factual findings, if reasonably supported by the administrative record, viewed as a whole.

Cases that cite this headnote

[10] **Administrative Law and Procedure**
Law questions in general

When an agency's decision is predicated solely on an error of law, no deference is appropriate and the reviewing court may substitute its judgment for that of the agency.

Cases that cite this headnote

[11] **Administrative Law and Procedure**
Rational basis for conclusions

If an agency's decision is not predicated solely on an error of law, Court of Special Appeals will not overturn it if a reasoning mind could reasonably have reached the conclusion reached by the agency.

Cases that cite this headnote

[12] **Finance, Banking, and Credit**
Leases, conditional sales, and installment transactions in general

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Usury
Construction and operation in general

"Pretended purchase" provision of Consumer Loan Law, rather than standards of Uniform Commercial Code (UCC) regarding loans, applied in determining in proceeding brought by Consumer Protection Division whether sale-leasebacks made by defendants were actually loans, and thus violated usury laws and Consumer Protection Act, as UCC specifically provided that the Consumer Loan Law prevailed when the two conflicted, and Consumer Loan Law was not too vague to apply; "loans" made by defendants were within amounts covered by Law, there was no dispute that defendants did not have lending licenses, and "pretended purchase" provision of Law was neither new or novel. West's Ann.Md.Code, Commercial Law, §§ 2A–104(2), 9–201, 12–303(a), 12–303(3)(c).

Cases that cite this headnote

[13] **Finance, Banking, and Credit**
Leases, conditional sales, and installment transactions in general

Consumer Protection Division did not err in looking beneath the form of sale-leasebacks made by defendants, pursuant to "pretended purchase" provision of the Consumer Loan Law, and determining such transaction were actually "loans," where defendants targeted customers who were in need of cash and wished to avoid a credit check, would "purchase" property of customers for $100 and allow customers to rent property back for $30 every 15 days, downplayed that customers had option of actually turning property over to defendants and stressed option that customers had to repay money received in order to "repurchase" their property, evinced little interest in property they purportedly purchased as they always purchased property for $100 regardless of its nature, when calling delinquent customers demanded payment rather than the property, and had virtually none of their customers exercise option to "return" property. West's Ann.Md.Code, Commercial Law, § 12–303(a, c).

1 Cases that cite this headnote

[14] **Bailment**
Particular forms of bailment
Usury
Leases or agreements for hiring of property

Sale-leasebacks made by defendants were loans under the Uniform Commercial Code rather than leases, for purposes of determining whether defendants were charging usurious interest rates on loans, as there was no reservation of an economically meaningful interest to defendants who were the purported lessors of property they purchased; defendants would "purchase" property of customers for $100 and allow customers to lease property back for $30 every 15 days, defendants did not appraise or inspect property they were allegedly buying, option sheets provided to customers did not reflect option of returning property to defendants, defendants never sought to repossess property when a delinquent customer's check was dishonored, on the few occasions when customers returned property defendants treated goods as having negligible value and abandoned them, and defendants in their tax returns did not claim as personal property any of the items "purchased" in their transactions. West's Ann.Md.Code, Commercial Law, § 1–201(37), 2A-103(1)(j).

Cases that cite this headnote

[15] **Bailment**
Nature and elements in general

The central figure of a true lease for purposes of the Uniform Commercial Code is the reservation of an economically meaningful interest to the lessor at the end of the lease term. West's Ann.Md.Code, Commercial Law, § 2A–103(1)(j).

1 Cases that cite this headnote

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[16] **Administrative Law and Procedure**
Admissibility
Administrative Law and Procedure
Matters which rest in discretion in general

The discretion of an administrative agency to admit evidence after the hearing is arguably broader than the discretion that is generally accorded to trial judges, and when the exercise of that discretion does not violate regulations, statutes, common law principles, due process and other constitutional requirements, it is ordinarily unreviewable by the courts.

1 Cases that cite this headnote

[17] **Administrative Law and Procedure**
Arbitrary, unreasonable or capricious action; illegality

Courts are authorized to intervene in an agency decision making process only when an agency's exercise of discretion, in an adjudicatory proceeding, is arbitrary or capricious.

Cases that cite this headnote

[18] **Finance, Banking, and Credit**
Leases, conditional sales, and installment transactions in general

Refusal of Consumer Protection Division to reopen the record in proceeding under the Consumer Loan Law against businesses and their owners regarding whether alleged "sale-leaseback" transactions were actually usurious loans, in order to allow defendants to show that after defendants began including option to return property in their options sheet they gave to customers the number of property returns did not increase significantly, was not arbitrary or capricious, as evidence that virtually all consumers continued to repay money instead of returning property was entirely consistent with Division's finding that defendants were providing consumers with short-term cash, and it was apparent that knowledge of customer cited by defendants in support of proposition that customers knew they could return property was actually acquired by customer at some point after customer engaged in transaction with defendants. West's Ann.Md.Code, Commercial Law, §§ 12–303(a, c).

1 Cases that cite this headnote

[19] **Antitrust and Trade Regulation**
Weight and sufficiency

Evidence that customers were not told they could return property allegedly purchased by defendants but rather had to pay back purchase money in full, and that even after defendants amended option sheet provided to customers listing option to return property such option sheet de-emphasized return option and defendants did not point out to customers return option, was sufficient to establish that defendants misrepresented the terms of their lease transactions through oral misrepresentations and the written options sheet, in proceeding against defendants by Consumer Protection Division regarding whether alleged "sale-leaseback" transactions by defendants were actually usurious loans under Consumer Loan Law and whether defendants engaged in unfair and deceptive sales practices under the Consumer Protection Act. West's Ann.Md.Code, Commercial Law, §§ 12–303(3)(c), 13–101 to 13–501.

Cases that cite this headnote

[20] **Antitrust and Trade Regulation**
Judicial review

Prosecutors of the Consumer Protection Division can appeal a decision of the Division if the agency is a party before the agency or the Office of Administrative Hearings. West's Ann.Md.Code, State Government, § 10–222.

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Cases that cite this headnote

[21] **Finance, Banking, and Credit**
Effect of violation of regulations or lack of license in general

In proceeding under the Consumer Loan Law against businesses and their owners regarding whether alleged "sale-leaseback" transactions were actually usurious loans, Consumer Protection Division did not have to show customer reliance to order restitution, only that defendants had made unlicensed usurious loans. West's Ann.Md.Code, Commercial Law, § 12–314(b)(2); West's Ann.Md.Code, Commercial Law, § 12–403(b)(1).

Cases that cite this headnote

[22] **Finance, Banking, and Credit**
Leases, conditional sales, and installment transactions in general

Evidence established that owners of businesses acted in bad faith, for purposes of determining whether they were subject to civil penalties under Consumer Protection Act for engaging in "sale-leaseback" transactions that actually concealed usurious and illegal loans; owners did not introduce into evidence substance of legal advice they received other than that attorney reviewed their forms, and Uniform Commercial Code (UCC) expert owners consulted with was not shown options sheet given to customers that did not inform customers that they had right to return to businesses property businesses had purchased and customers were now allegedly leasing. West's Ann.Md.Code, Commercial Law, § 13–410.

1 Cases that cite this headnote

Attorneys and Law Firms

****218 *136** Lawrence P. Fletcher–Hill (****219** Gordon, Feinblatt, Rothman, Hoffberger & Hollander, L.L.C. on the brief), Baltimore, for appellant.

William D. Gruhn, Assistant Attorney General (Lauren R. Calia, Assistant Attorney General, J. Joseph Curran, Jr., Attorney General on the brief), Baltimore, for appellee.

Argued before SALMON, EYLER, JAMES R., and KRAUSER, JJ.

Opinion

KRAUSER, Judge.

The appellants are B&S Marketing Enterprises, LLC, and S&B Marketing Enterprises, LLC and the two men, who operate and control these two entities, Louis R. Seo, Jr. and Frank A. Brown, Jr.[1] Using the trade names "Kash–2–U leasing" and "Cash–2–U leasing," B&S and S&B Enterprises provide "quick cash" to Maryland consumers through a contractual contrivance appellants call a "sale-leaseback" but which might more aptly be described, under the circumstances in which it was typically presented and enforced, as a "sale-leaseback-repurchase" agreement.

It is the last stage of this transaction—the "repurchase"—which, according to the Consumer Protection Division of the ***137** Office of the Attorney General ("Division"), transformed what might have passed as a "sale-leaseback" into an unambiguous "loan." What were dubbed "rental payments" by appellants were deemed "interest payments" by the Division. And those payments were paid, according to the Division, at the exorbitant annual interest rate of 730%.

In due course, the Division brought charges against the appellants, alleging that they had made unlicensed and usurious "loans" in violation of Maryland's Consumer Loan Law, Md.Code (2000 Repl.Vol., 2003 Supp.), §§ 12–301 to–317 of the Commercial Law Article ("CL"), and had, by misrepresenting these "loans" as "sale-leasebacks", engaged in "unfair or deceptive trade practices" in violation of the Maryland Consumer Protection Act, CL §§ 13–101 to 501. This matter was then referred to an administrative law judge for a hearing ("ALJ").

At the conclusion of that hearing, the ALJ found that the "sale-leaseback" was not a "loan," that appellants, individual and corporate, had in any event engaged in unfair and deceptive sales practices in violation of the

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Consumer Protection Act, and that Seo and Brown were personally liable for those practices. She therefore recommended that all charges pertaining to the Consumer Loan Law be dismissed but that appellants be ordered to cease and desist from violating the Consumer Protection Act and to pay restitution to "consumers for renewal and repurchase transactions, during the period of February 1994 through February 1996." Her recommendation stopped short, however, of requesting the imposition of civil penalties.

Although it adopted most of the ALJ's recommendations and all of her factual findings that were based upon her determination of witness credibility,[2] the Division reached a different conclusion as to whether the "sale-leaseback" was a loan and as to whether civil penalties should be imposed. In ***138** its Final Decision, the Division declared that appellant had "enter[ed] into loans in the form of a pretended sale-leaseback ... without complying with the Consumer Loan Law." The Division's ensuing Final Order required that appellants make certain disclosures, "cease and desist from violation of the Consumer Protection ****220** Act, take affirmative action in the form of restitution, and pay civil monetary penalties."

Challenging the conclusions reached by the Division, appellants filed a petition for judicial review in the Circuit Court for Baltimore City. That was followed by the Division's issuance of an Amended Final Order. In that order, the Division, as it did in its original order, required appellants to "cease and desist from the violation of the Consumer Protection Act," "take affirmation action in the form of restitution," and pay "civil monetary penalties" as well.

Affirming the Division's decision, the circuit court remanded "the case to the agency to issue an order that makes explicit that simply changing forms will not make the pretend leaseback valid." From that order, appellants noted this appeal, presenting the following issues for our review:[3]

> I. Did the Division apply the correct legal standard to appellant's sale-leaseback transactions?
>
> II. Did the Division err in finding that the disclosures made by appellants in connection with the sale-leaseback transactions were insufficient?
>
> III. Did the circuit court exceed its authority in remanding the matter to the Division for revision of the Amended Final Order?
>
> IV. Did the Division exceed its authority in ordering "individual awards of restitution without any showing of reliance?"
>
> V. Did the Division err in not giving deference to the ALJ's finding that Seo and Brown acted in good faith and in imposing personal liability on them?

***139** For the reasons that follow, we shall affirm the judgment of the circuit court.

The Sale–Leaseback

Using radio and television advertisements, appellants targeted employed persons between the ages of 25 and 39, "in the $20,000–or–so income bracket," needing "cash rather quickly," for their sale-leaseback program. The advertisements declared that anyone needing emergency cash could "get up to $200 today" by calling "752–C–A–S H." To qualify for the money, the potential customer was informed that he or she must have "an active checking account," "own electronics or appliances," and "have been on [his or her] job for one year." The text of one radio advertisement stated:

> MONEY PROBLEMS GETTING YOU DOWN? ? ?
>
> NO MONEY TO PAY THE ELECTRIC BILL? ? ?—**NO PROBLEM**
>
> NO MONEY TO PAY THE TELEPHONE BILL? ? ?—**NO PROBLEM**
>
> NO MONEY TO COVER THE CHECK YOU JUST WROTE? ? ?—**NO PROBLEM**
>
> THESE AND ANY OTHER EMERGENCIES CAN BE SOLVED WITH A SIMPLE PHONE CALL TO KASH–2–U LEASING. CALL 752–2274, THAT'S 752–C–A–S H AND GET UP TO $200.00 TODAY. WITH KASH–2–U LEASING EMERGENCY MONEY PROBLEMS ARE A THING OF THE PAST. GET MONEY FOR BACK TO SCHOOL ITEMS, FALL SALES AND LATE VACATIONS BY CALLING KASH–2–U LEASING AT 752–2274, ****221** THAT'S 752–C–A–S–H. IF YOU HAVE AN ACTIVE CHECKING ACCOUNT, OWN ELECTRONICS OR APPLIANCES AND HAVE BEEN ON YOUR JOB FOR ONE YEAR, KASH–2–U CAN PROBABLY QUALIFY YOU FOR THEIR SALE/LEASEBACK PROGRAM RIGHT OVER THE

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PHONE. THERE'S NO CREDIT CHECK AND NO RED TAPE AND YOU CAN HAVE THE $200.00 IN YOUR POCKET TODAY—YES, I SAID TODAY. THAT NUMBER AGAIN FOR FAST, FAST ***140** CASH TODAY. CALL KASH–2–U LEASING AT 752–2274, THAT'S 752–C–A–S–H. CALL CASH FOR CASH.

Another radio advertisement declared:

> IT'S THAT TIME AGAIN! OUT WITH THE OLD YEAR AND IN WITH THE NEW! AND ALL THE MANAGEMENT AND EMPLOYEES OF CASH–2–U LEASING WOULD LIKE TO TAKE THIS OPPORTUNITY TO SINCERELY THANK ALL OF OUR WASHINGTON CUSTOMERS FOR A GOOD AND REWARDING 1994. AND REMEMBER, MONEY EMERGENCIES NEED NOT RUIN YOUR HOLIDAY CELEBRATION. CALL CASH–2–U LEASING NORTH AT (301)949–2274, THAT'S 949–C–A–S–H OR SOUTH AT (301)702–2274, THAT'S 702–C–A–S–H AND GET UP TO $200.00 TODAY. NO CREDIT CHECK AND NO RED TAPE. JUST HAVE AN ACTIVE CHECKING ACCOUNT, BE ON YOUR JOB ONE YEAR, ANSWER YES TO A COUPLE OF QUESTIONS AND COME PICK UP $200.00 TODAY. FAST, FAST CASH! THAT'S THE CASH–2–U WAY. LET CASH–2–U GET YOU IN THE PARTY MOOD. MAKE 1994 A YEAR TO REMEMBER AND START 1995 ON A HAPPY NOTE. CALL CASH–2–U NORTH AT 949–2274, THAT'S 949–C–A–S–H OR SOUTH AT 702–2274, THAT'S 702–C–A–S–H AND LET U.S. HELP YOU HAVE A HAPPY, HAPPY NEW YEAR.

Indeed, according to the Division, "[a]dvertising run by [appellants] shortly before the hearing stated that they [were] 'not a loan company, pawn, or check cashing service' but still did not offer an explanation as to what the consumer transaction would be." (Footnote omitted). When a consumer responded to one of these ads by telephoning appellants, he was told that he could obtain up to $200 if he brought with him to one of appellants' two stores his checkbook, bank statement, photo identification, pay stub, phone bill, and serial numbers for two household items to qualify for the "sale-leaseback" program. Upon arrival, the consumer submitted these documents, filled out an application, and "sold" one or two appliances to appellants for $100 each. Appellants then leased the ***141** appliances back to the consumer for fifteen day terms at $30 per appliance. Typically, the lease ended when all rent was paid up-to-date and the appliances were repurchased.

Appellants paid the same price for each appliance, $100, regardless of the nature, condition, or actual value of the item. At no time did appellants see, appraise, inspect, or even verify the existence or ownership of an appliance, beyond requesting its serial number from the consumer. Many items purchased by appellants had a market value that was far less than the $100 purchase price. In short, the amount of the purchase price was not related to the fair market value of the specific item being purchased. The sales portion of this two-part transaction was oral until June 1995, when appellants added a "Bill of ****222** Sale" form, containing a description of the property, serial numbers, and sometimes model numbers.[4]

After the sale of the appliance to appellants, the consumer signed a "Lease Agreement for Personal Property," requiring the customer to pay appellants as rent the sum of $30 per item at 15 day intervals. Just as the purchase price was unrelated to the fair market value of the item being purchased by appellants, the amount of the rent was not related to the actual fair market rental value of the item being rented.

The lease agreement further provided for the repurchase of the rental property "at the end of the initial lease term or at the end of any renewal for a cash price equal to the fair market value of the rental property," provided that all other fees were paid. Although the lease granted the consumer the right to terminate the agreement "at any time following the expiration of the initial lease term or any renewal" by returning the property and paying all accrued charges, the green option sheet given to customers at the time they signed ***142** the lease, which was in larger print than the lease agreement, set forth only

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three termination options. None of the options stated that the lease agreement could be terminated by surrendering the rental property.

The options sheet was used by appellants from February 1994 through at least March 1996. It presented the options in the following words and format:

Options For The Sales–Leaseback Program

Options For The Sales-Leaseback Program

AT THE END OF YOUR FIRST 15 DAY CYCLE YOU HAVE 3 OPTIONS AVAILABLE TO YOU. THE OPTIONS ARE AS FOLLOWS:

OPTION # 1 — CASH OUT [5] — YOU ARE NOW OUT OF THE PROGRAM.

$ RENT

60.00

$ PURCHASE PRICE

2000.00

$ TAX

1
0
.
0
0

$
2
7
0
.
0
0

OPTION # 2 — BUYDOWN — YOU ARE BUYING YOUR ITEMS BACK 1 AT A TIME.

$ RENT

6
0
.
0
0

$ PURCHASE PRICE
1
0
0
.

0
0

$ TAX

5
.
0
0

$
1
6
5
.
0
0

YOU HAVE NOW PURCHASED 1 ITEM OUT OF THE PROGRAM AND NOW HAVE AN ADDITIONAL 15 DAYS TO PURCHASE ITEM 2 BACK.

$ RENT

3
0
.
0
0

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$ 100.00	PURCHASE PRICE
$ 5.00	TAX
$ 135.00	

OPTION # 3 — RENTAL PAYMENT — WHEN USING OPTION # 3 THE RENT DOES NOT APPLY TO THE PURCHASE PRICE. ALL THAT OPTION # 3 DOES IS GRANT YOU AN ADDITIONAL 15 DAYS TIME IN WHICH TO PURCHASE YOUR ITEMS BACK.

$ 60.00 RENT

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****223** As noted, no mention was made in the green options sheet of the right of the customer to terminate the lease by surrendering ***143** the property. Nor was that option discussed with potential customers. In fact, employees of appellants were instructed by appellants' training manual to stress that the customer was obligated to repurchase the rental property to terminate the transaction.[6]

In March 1996, however, appellants replaced the green options sheet with a "yellow multi-part options sheet," adding the missing fourth option. That option read:

> **OPTION # 4**—RETURN OF MERCHANDISE—WHEN USING OPTION # 4 YOU PAY THE $60.00 RENTAL AND RETURN THE RENTAL MERCHANDISE. ONCE YOU HAVE MADE THE RENTAL PAYMENT AND RETURNED THE RENTAL MERCHANDISE YOU HAVE NO FURTHER OBLIGATION TO US.

But "repeat" customers were never told of this revision, and they comprised 80% of appellants' monthly business.

When a customer fell behind on his or her payments, appellants began collection activities by telephoning the customer. During such calls, appellants demanded payment, but, not surrender of the property. Collection calls were followed by a demand letter in which appellants advised the customer: "Failure to contact us will leave us no choice but to use all means necessary to collect this amount." Like the collection calls, such letters never mentioned that the property could be returned.

If that produced no results, appellants deposited the security deposit check of the delinquent customer, deeming that check to be a "repurchase" of that customer's property. If a check was dishonored, appellants sent the customer a "Notice of Returned Check." That notice, among other things, advised the customer that passing a bad check was a crime and specified the criminal penalty for that crime, by setting out at length the relevant criminal statute. It concluded by informing ***144** the customer in large capitalized letters: "IF YOU FAIL TO HONOR YOUR CHECK WITHIN 10 DAYS AFTER RECEIVING THIS NOTICE, WE WILL BE FORCED TO CONSIDER APPROPRIATE LEGAL ACTION." What appellants did not attempt to do, however, was repossess the property.

The Division concluded that "[m]any customers found it difficult to come up with the $270 (purchase price for two items plus rent for two items plus tax for two items) needed to pay off their obligation to the [appellants]" and that "[s]uch customers continued paying the 'rent' until they could come up with the full 'repurchase' price." Those customers, the Division observed, "often paid rent that was many times the value of the property that they were 'renting.' " The Division cited ****224** as examples a customer who paid $1,153 in rent for one item, and others who paid $682, $600, and $503, respectively, in rent for two items. "The annual interest rate on such a loan," the Division noted, was "730%."

Despite the lease agreement's property surrender provision, the Division found that "[t]he vast majority of customers—approximately 99.5%—eventually paid back the money which they had received from [appellants]." Indeed, the Division found that appellants "designed their transaction to ensure that consumers ultimately repaid the cash advanced by the [appellants] rather than surrender the property listed in the transactional documents." When defaulting customers did surrender the property to appellants, appellants "refused to do business with them in the future" and the surrendered items "were treated as being of zero or negligible residual value and abandoned," the Division stated. In fact, so inconsequential was this property considered by appellants that they did not list the thousands of items of rental property they purchased in the course of conducting their business on the Maryland personal property return forms they filed with the Department of Assessments and Taxation.

From the inception of their business in 1994 through 1996, appellants, the Division found, had entered into sale-leaseback ***145** agreements with more than 11,000 customers. Many of those transactions were personally handled by Brown and Seo. By the date of the administrative hearing, appellants had entered into a total of 56,208 sale-leaseback transactions, but the "leased" property had been surrendered in only 84 instances.[7]

Procedural History

On August 8, 1996, the Division filed a Statement of Charges and Petition for Hearing with the Chief of the

Consumer Protection Division. That statement named as respondents, B&S Marketing Enterprises, Inc., doing business as Kash–2–U Leasing, and later S&B Marketing Enterprises, Inc., doing business as Cash–2–U Leasing, and its two officers and stockholders, Louis R. Seo, Jr., and Frank A. Brown, Jr. In that statement, Division claimed that appellants, among other things, "provide small loans to consumers in the principal amount of $200, for which they charge an interest rate of 780% per annum,"[8] and that "[i]n order to avoid Maryland's usury and consumer finance laws, which would require the maker of such loans to be licensed and to charge no more than 33% interest per annum, [appellants] have created a sham 'sale-leaseback' transaction." The statement further averred that consumers "who have cash emergencies are induced to enter into these sham transactions in order to obtain short term credit at usurious interest rates" and that appellants misrepresented and concealed "the true nature, terms and legality of these transactions."

The Division recommended that appellants be ordered "to cease and desist from violation of the Consumer Protection Act and of the Consumer Loan Law," to pay restitution "of money received from consumers in connection with a violation ***146** of the Consumer Protection Act," to "pay ****225** $1000 civil penalties per violation," and "to pay for the costs of the investigation and th [e] proceeding."

The Chief of the Consumer Protection Division granted the Division's petition for a hearing and referred the matter to the Office of Administrative Hearings for a public hearing.

Following a public hearing, the presiding ALJ, in a written decision, found that appellants' transaction was a sale-leaseback transaction, not a loan, but nonetheless concluded that appellants, in presenting the sale-leaseback program, engaged in unfair and deceptive trade practices in violation of the Consumer Protection Act. In reaching that conclusion, the ALJ noted, among other things, that, from February 4, 1994 through March 1996, appellants "used several option sheets which explained three options for repurchasing goods, but did not include an option for returning the goods." The option sheet, the ALJ explained, though "not a transactional document," misrepresented "the terms of the lease with respect to how a customer could close the transaction."

The ALJ further found that, based on the very low number of items returned by consumers, "many, if not most, consumers believed that they were obligated to purchase the leased goods." She pointed out that, from July 1994 through September 1996, appellants "had 56,208 transactions of property, yet only 44[9] items were returned by their customers."

The ALJ recommended that the Consumer Protection Division issue an order requiring that appellants: "cease and desist from violation of the Consumer Protection Act," pay "restitution of money received from consumers for renewal and repurchase transactions, during the period of February 1994 through February 1996, which violated the Consumer Protection Act," and "pay for the costs of the investigation and this proceeding." She did not, however, order appellants "to ***147** pay civil penalties for the above violations." She further recommended that the "Consumer Protection Division dismiss the charges ... alleging violations of the Consumer Loan Law."

On November 19, 1997, the parties filed exceptions to the ALJ's decision with the Division. After hearing argument on those exceptions, the Division issued a "Final Decision" on November 2, 2001.[10] In that decision, the Division found that appellants had "engaged in small loan transactions in the form of sale-leaseback and resale transactions" and were not licensed to do so under the Consumer Loan Law. It further found that the "effective annual rate of interest in a typical transaction-in which the customer paid 'rent' equaling 30% of the principal every 15 days-was approximately 730%." That rate, it stated, exceeded the limits set forth in Consumer Loan Law. It also found that appellants had not provided the consumer disclosures required by that law.

With respect to "unfair or deceptive trade practices," the Division found that appellants had "presented [their] transaction as a sale-leaseback in form, but in practice [had] engaged in loan transactions," and that they had "led consumers to believe that [appellants] could lawfully enter into a species of loan transactions ****226** with a rate of interest far in excess of that permitted by law." "Even if the transaction were construed as a sale-leaseback," the Division opined, appellants "misled consumers by omission at critical junctures as to whether the transaction could be terminated other than by repayment of the funds advanced."

With respect to the green option sheet's omission of the option to surrender the property, the Division concluded that

> [t]he omission of the option to surrender property in the versions of the options sheet used during

> most of the period at issue and [appellants] emphasis on "repurchase" options ***148** in that document and in other practices demonstrates their intent to mislead consumers as to the formal terms of the lease form. This was apparently done so that consumers would repay the money received rather than present [appellants] with property that [appellants] would otherwise abandon.

(Citation omitted).

The Division further stated that because "Seo and Brown individually participated in the unfair and deceptive practices, they are personally liable for any penalties assessed or restitution which may be ordered." It assessed a civil penalty "in the amount of $100 per transaction—or a total $591,400." That penalty was based on 5,914 transactions that occurred during the period from September 1995 to February 1996.

On November 2, 2001, the Division issued a "Final Order." That order required appellants to "cease and desist from violation of the Consumer Protection Act, take affirmative action in the form of restitution, and pay civil monetary penalties, as well as the costs of this proceeding." It further ordered appellants to "cease and desist from lending money to consumers until" they obtained a "license from the Commissioner of Financial Regulation under the Maryland Consumer Loan Law," revised their "communications with consumers to explicitly represent the transaction as a loan," and ceased "charging a higher rate of interest than allowed by the Maryland Consumer Loan Law."

Paragraph 3 of the Final Order stated:

> 3. *Relief Relating to Sale–Leaseback Program.* Alternatively, if Respondents wish to continue their operations as a sale-leaseback program involving consumer property, Respondents shall cease and desist offering a sale-leaseback program unless and until they are in compliance with the following provisions:

Those "following provisions" required in part that appellants make "clear and conspicuous" disclosures, as well as provide customers with a disclosure statement, a new options sheet, and a disclosure form of "Comparative Cost of Sale–Leaseback." ***149** The "clear and conspicuous" disclosure requirement provided that appellants "shall truthfully and affirmatively disclose to consumers all material facts about the nature of the sale-leaseback transaction and the consumer's options and obligations under the transaction."

The disclosure statement that was to be placed in appellants' advertisements was to read "substantially as follows":

> *We will pay you $ [insert range of prices offered] to buy _____ items of your personal property. You keep that property and pay us rent.*
>
> *You will owe us $ [insert rental amount and term] for the time that you keep that property.*
>
> *You have two options to get out of the sale-leaseback: (1) turn the property over to us and owe us nothing more or (2) buy back the property from us.*

****227** And finally, the disclosure statement was required to compare the cost of a sale-leaseback to a loan. It was to read:

> ***The Cost of a Sale Leaseback Compared to a Loan***
>
> *In this sale-leaseback, you will receive $ _____ to sell _____ items of property, and then pay $ _____ rent every 15 days.*
>
> *The cost to you of renting this property for a year is 730% of the money you will receive.*
>
> *By comparison, if you got the same $ _____ as a loan from a bank or finance company or credit card, the interest you would pay is limited by law to no more than 33% per year.*

After the Final Order was issued, the Division filed a motion to modify it. In that motion, the Division expressed concern that appellants could "argue that compliance with paragraph 3 constitutes full compliance with applicable law, including the Consumer Loan Law." The Division suggested that paragraph 3 be revised to read:

> 3. Relief Relating to Sale Leaseback Program. [~~Alternatively,~~ If Respondents wish to continue operations as a sale-leaseback program involving consumer property, in addition ***150** to complying with all laws that may be applicable, including but not limited to the Consumer Loan Law, Respondents shall cease and desist from offering a sale-lease back program unless and until they are in compliance with the following provisions:

(Strikeout and underlining in original). The Division further proposed deletion of "730" as the percentage in the disclosure form, which compared the cost of a sale-leaseback to a loan, because the "percentage rate would depend upon the amounts in the first paragraph of the disclosure, which are to be filled in by [appellants] based on the actual amounts charged."

On November 29, 2001, prior to a ruling on the motion, appellants filed a petition for judicial review in the Circuit Court for Baltimore City. A day later, on November 30, 2001, an "Amended Final Order" was issued, rejecting the Division's proposed change of paragraph 3 and accepting its proposed change of the disclosure form, by removing "730" as the percentage.

Following a hearing on appellants' petition, the circuit court, in a written opinion, stated that the "transactions are loans and not sales and leasebacks," that "the [Division] did not err in ordering restitution to all those who entered into the unlawful transaction with [appellants]," and that "finding Seo and Brown personally liable [was] not erroneous." The circuit court also found that the amended final order was "not as clear as it should be" and consequently remanded "the case to the agency to issue an order that makes explicit that simply changing forms will not make the pretend leasebacks valid." Later, the circuit court issued an order affirming the final decision of the Division and remanding the case for an order consistent with the court's written opinion.

Standard of Review

[1] [2] [3] [4] [5] In reviewing a decision of an administrative agency, our role "is precisely the same as that of the circuit court." *Dep't Of Health & Mental Hygiene v. Shrieves,* 100 Md.App. 283, 303–04, 641 A.2d 899 (1994). We review only the decision of the administrative agency itself. *Ahalt v. Montgomery* ***151** *County,* 113 Md.App. 14, 20, 686 A.2d 683 (1996). We "do not evaluate the findings of fact and conclusions of law made by the circuit court." *Consumer Prot. Div. v. Luskin's, Inc.,* 120 Md.App. 1, 22, 706 A.2d 102 (1998), *rev'd in part on other grounds,* ****228** 353 Md. 335, 726 A.2d 702 (1999). "Thus, whether the circuit court applied the wrong standard of review is of no consequence if our own review satisfies us that the [Board's] decision was proper." *Giant Food, Inc. v. Dep't of Labor, Licensing & Regulation,* 124 Md.App. 357, 363, 722 A.2d 398 (1999), *rev'd on other grounds,* 356 Md. 180, 738 A.2d 856 (1999). To conduct a proper inquiry of an administrative agency's decision, we " 'must be able to discern from the record the facts found, the law applied, and the relationship between the two.' " *Sweeney v. Montgomery County,* 107 Md.App. 187, 197, 667 A.2d 922 (1995) (quoting *Forman v. Motor Vehicle Admin.,* 332 Md. 201, 221, 630 A.2d 753 (1993)).

[6] [7] In reviewing the decision of an agency, our role "is limited to determining if there is substantial evidence in the record as a whole to support the agency's findings and conclusions, and to determine if the administrative decision is premised upon an erroneous conclusion of law." *United Parcel Serv., Inc. v. People's Counsel,* 336 Md. 569, 577, 650 A.2d 226 (1994). Substantial evidence is " 'such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.' " *Md. State Police v. Warwick Supply & Equip. Co.,* 330 Md. 474, 494, 624 A.2d 1238 (1993) (quoting *State Admin. Bd. of Election Laws v. Billhimer,* 314 Md. 46, 58, 548 A.2d 819 (1988)).

[8] [9] [10] [11] In making this determination, we must give " 'deference ... not only [to the agency's] fact-findings, but to the drawing of inferences from the facts as well.' " *Id.* (quoting *Billhimer,* 314 Md. at 59, 548 A.2d 819). We must also accord deference to the agency's " 'application of law to those [factual findings], if reasonably supported by the administrative record, viewed as a whole.' " *Berkshire Life Ins. Co. v. Md. Ins. Admin.,* 142 Md.App. 628, 653, 791 A.2d 942 (2002) (quoting ***152** *Ins. Comm'r v. Engleman,* 345 Md. 402, 411, 692 A.2d 474 (1997)). " 'When, however, the agency's decision is predicated solely on an error of law, no deference is appropriate and the reviewing court may substitute its judgment for that of the agency.' " *Warwick,* 330 Md. at 494, 624 A.2d 1238 (quoting *Billhimer,* 314 Md. at 59,

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548 A.2d 819). Thus, if the agency's decision " 'is not predicated solely on an error of law, we will not overturn it if a reasoning mind could reasonably have reached the conclusion reached by the agency.' " *Id.* (quoting *Billhimer,* 314 Md. at 59, 548 A.2d 819).

Discussion

I.

Appellants contend that the Division applied the wrong law and the wrong legal standard in concluding that their sale-leaseback transactions were really "loans," not leases. It should have applied, according to appellants, the more "explicit" standards of the Maryland Uniform Commercial Code, Md.Code (1975, 2002 Repl. Vol., 2003 Supp.) §§ 1–101 to 10–112 of the Commercial Law Article ("UCC"), rather than the "pretended purchase" provision of the Consumer Loan Law, which appellants insist "lack[s] any explicit criteria for a 'pretended purchase.' " Had it done so, appellants maintain, the Division would not have considered appellants' intent or purpose, but only the legal terms of the lease agreements and that would have inexorably led to the conclusion that appellants were offering sale-leasebacks and not loans to consumers.

[12] But the issue before us is not which law—the UCC or the Consumer Loan Law—offers the most "explicit standards" for determining what is or is not a loan but rather which law prevails when the two conflict. To answer that question, ****229** we need look no further than the provisions of the UCC, which categorically declare that, in such instances, the Consumer Loan Law prevails. *See* UCC §§ 2A–104(2), 9–201(c)(1) (providing that in case of a conflict between a consumer protection statute and either Title 2A, dealing with leases or Title 9, dealing with secured transactions, the consumer protection ***153** statute controls). And that law unquestionably permits the Division to look beneath the formal terms of an agreement and to consider the substance of that agreement in determining whether it constitutes a "loan."

Moreover, unlike appellants, we do not find the Consumer Loan Law is too vague to apply. Maryland's Consumer Loan Law applies to loans having "an original amount or value which does not exceed $6,000." CL § 12–303(a). Thus the "loans" made by appellants, which never exceeded $100 per appliance, were covered by this law. The law further provides that "[a] person may not engage in the business of making loans under this subtitle unless the person is licensed under or is exempt from the licensing requirements of Title 11, Subtitle 2 of the Financial Institutions Article, the Maryland Consumer Loan Law–Licensing Provisions." *Id.* § 12–302. There is no dispute that appellants did not have lending licenses. And finally, the law defines "lender" as "a person who makes a loan under this subtitle," § 12–301(c), and "loan" as "any loan or advance of money or credit made under this subtitle," § 12–301(e).

We turn now to the provision that appellants maintain is too vague for application—the "pretended purchase provision." That provision, CL § 12–303(3)(c), states:

> (c) *Pretended purchase of property or of services considered loan.*—This subtitle applies but is not limited to a lender who:
>
> (1) As security for a loan, use, or forebearance of money, goods, or things in action or for any loan, use, or sale of credit, whether or not the transaction is or purports to be made under this subtitle, makes a pretended purchase of property from any person and permits the owner or pledgor to retain possession of the property; or
>
> (2) By any device or pretense of charging for his services or otherwise, seeks to obtain any interest, charges, discount, or like consideration.

The language of CL 12–303(3)(c) is neither new nor novel. It first appeared in Maryland's former Uniform Small Loan ***154** Law.1918 Md. Laws, Chap. 88.[11] The preamble to that law is worth re-stating here. It declared that there had "long been conducted in this State an extensive business, in the making of small loans ... to persons in need of funds to meet immediate necessities," that the "conduct of such business has long been a cause of general complaint, and of much hardship and injustice to borrowers," and that there ****230** was no effective provision "for the protection of such borrowers and for the punishment of usurious lenders."

[13] Nor did the Division err in looking beneath the form of the transaction at issue, into its "true nature," in determining whether it was a "loan". *See Andrews v. Poe,* 30 Md. 485, 487 (1869). In *Andrews,* the Court of Appeals explained:

> It matters not in what part of the transaction it may lurk, or what form it may take—whether it reads six per cent[,] upon its face, with an understanding to pay *an extra four per cent.,* or whether it be a pretended sale and lease, or under whatever guise the lender—always fruitful in expedients—may attempt to evade the law[.] [C]ourts of justice, disregarding the shadow and looking to the substance, will ascertain what in truth was the contract between the parties.

Id. at 487–88. The propriety of this approach has been repeatedly reaffirmed. *See, e.g., Hoffman v. Key Fed. Sav. &* ***155** *Loan Ass'n,* 286 Md. 28, 34, 416 A.2d 1265 (1979); *Brenner v. Plitt,* 182 Md. 348, 356–57, 34 A.2d 853 (1943).

In looking beneath the form of the transaction, to determine whether the sale-leaseback was in substance a disguised loan, the Division considered "all the circumstances of the transaction." It analyzed appellants' advertising, their oral and written presentation of the transaction to consumers, their customers' understanding of the program, their "valuation and treatment of the property" they purportedly purchased, and their collection practices.

With respect to appellants' advertising, the Division found that appellants "targeted consumers who were in need of cash and who wished to avoid a credit check, presumably because they would have difficulty obtaining a loan." Although those advertisements did not use the word "loan" and, on occasion, referred to a "sale leaseback plan," they provided, the Division observed, "no details and emphasized that the customer would obtain $200 cash immediately without a credit check." Indeed, Seo testified that the advertisements targeted those who were employed, between the ages of 25 and 39, and had a "take home" income of $1,000 per month.

With respect to appellants' training materials, the Division found that "[u]p to the time of the hearing[,] the materials used to train [appellants'] employees stressed only the option for a customer to repay the money received by 'repurchasing' the items of property." The Division pointed out that, until the time of the hearing, "the training manual did not address the possibility that the customer would actually turn the property over to" appellants. In fact, one of appellants' early presentation scripts, written by Seo and Brown, emphasized to the customer: "At the end of the lease term, you have the option to repurchase these items from us." Later, after January 1996, appellants developed a training manual, stating that customers could terminate the transaction by returning the property, but emphasizing the repurchase options. That was done by listing the repurchase and rental payment options before the return property option. Subsequently, in 1997, ***156** during the ALJ hearing, appellants instituted an "office manual," which, unlike the training manual, contained, among other things, a section on handling property returned by the customers. And like the training manual, the office manual de-emphasized the return property option by listing it last.

The Division further found that, in explaining the transaction to customers, appellants' "oral representations and options sheet ... did not match the written transactional ****231** documents." The Division noted that most of appellants' customers were "not sophisticated in financial transactions," and therefore "looked to [appellants'] employees to explain the transaction." Comparing the language of the original green options sheet—used from February 1994 to March 1996—with that of the lease agreement, the Division stated: "While the lease form contained two legal-sized pages of small print legalese, [the green options sheet] ... was easier to read and in larger print." As the green options sheet only addressed repurchase options, the Division stated, appellants "led customers to believe that they were required ultimately to repay the $200 by 'repurchasing' the items ... listed in the transactional documents." And as we noted earlier, appellants did not include the option to terminate the transaction by returning the property until March 1996, in the "multi-yellow part options sheet." Moreover, repeat customers, comprising 80% of appellants business, testified that they were not told about the revisions to the options sheets.

"Most customers ...," the Division stated, "considered the 'rental merchandise' ... to be collateral that secured their payment obligation," and "understood that, if they defaulted on that obligation, they would be sued or the property would be seized as collateral." For instance, when asked what she understood her agreement with appellants to mean, customer Ruth Lampkin responded: "I gave my Magnavox TV and my Sony CD player like for collateral if I reneged on the repayment of the $270." Customer Pomra Powell gave similar ***157** testimony, stating that she saw her television as collateral for her loan.

The Division further noted that appellants "evinced little interest in th[e] property" they had purportedly purchased

and that "[a]part from obtaining a generic description of an item and a serial or model number, they obtained no information about the age, condition, or even location of the item." In fact, as the Division noted, appellants "did not list any of that property in personal property returns that they filed with the State." The Division concluded: "[Appellants'] disinterest in obtaining more information about the items 'purchased' illustrates the actual role played by the items of personal property listed in the transactional documents and demonstrates that the 'purchase' was in fact a pretense."

With respect to the "purchase" price, the Division stated: "According to [appellants'] forms, they always 'purchased' the items of property listed by consumers for $100 per item, regardless of the nature, condition, or actual value of the particular item." What is more, the Division found, appellants "never inspected the property before assigning that price" and "did not even *ask* consumers about the age, condition, or value of the items listed." The Division further stated that the fair market value of the property "ranged from $5 (*e.g.,* toasters and telephones) to as high as $500" and that appellants, "in many transactions, ... 'purchased' for $100 items that were worth far less." And appellants, the Division pointed out, "always assigned $100 as the price for 'repurchase' of an item by the consumer regardless of depreciation or how many times the item had been listed in the transactions." Thus, "as with a loan," the Division concluded, appellants "were always to be repaid the same amount they had originally advanced to the consumer."

While there was no evidence before the Division that appellants relied on a property appraisal in setting their $100 purchase price, to justify that price, appellants presented appraisals of "approximately 1,727 items shown on approximately 896" lease ****232** agreement forms. After categorizing those ***158** items, the appraiser found that the fair market value[12] of the different items ranged from a toaster at $5 to a 32" Color T.V. at $340, and concluded that $90.07 represented the average fair market value. As a result, the Division stated: "It appears that [appellants] routinely paid an average of 11 percent more than the average fair market value of the items identified in their transactional documents."

The Division also noted that "consumer testimony at the hearing confirmed that few of the items listed in the transaction documents ... could be worth $100." For example, customer Sharon Martin testified that the property appellants purportedly from purchased from her, included a ten-year-old Uniden car phone, for which she paid $190, and a five to ten-year-old radio, for which she paid less than $50. Customer Cynthia Peacock stated that she sold to appellants a small black and white television and a 19 inch color television, with a remote, which she valued at $50 each. Joanne Anthony stated that appellants purchased from her for $100 each: a two-year-old microwave, for which she paid $80, and a two-year-old telephone and answering machine. And customer Ruth Lampkin stated that appellants purchased from her a three-year-old 13 inch color TV, for which she paid $299; a twelve-year-old, 20 inch color TV, for which she paid $349; and a twelve-year-old VCR, for which she paid $200. "Given the likely depreciation of the value of some of these items," the Division concluded, "the fair market value of most individual items was less than $100 at the time of the transactions."

The Division further noted that, "[i]f items were substantially less in value than the purchase price stated in the bill of sale, [appellants] conceivably could have suffered a loss if the customer were to terminate the lease by delivering the items ***159** rather than repaying the 'purchase' price." Based on the "formal terms of [appellants'] lease form," the Division asserted, " their practice of 'purchasing' an item without any consideration of the item's value appears to be a foolish practice." It therefore concluded:

> [Appellants'] apparent willingness to assign an item a price sometimes far in excess of its appraised value makes sense only if there is an understanding that the sales transaction is to be reversed on the same terms in the future. That is, one cannot consider the 'sale' transaction in isolation for a rational person in [appellants'] position would only enter into such a transaction if a resale were contemplated at the same or a better price.

And it further observed:

> [I]f customers had truly understood that there was an option to turn in the listed property in lieu of repaying the $200 advanced, a rational consumer would have listed items of negligible value, collected $200 from [appellants], paid the $60 'rental' fee, and simply surrendered the items to [appellants] at the end of the rental period at a tidy profit. Of course, not all consumers behave as a rational economist might expect. However, the testimony at the hearing confirmed that consumers would have turned in those goods that were worth less than $200 if they had understood ****233** that they would be relieved of the obligation to pay back the money advanced by [appellants]. The fact that consumers did not take advantage of [appellants'] apparent generosity confirms the consumer testimony that [appellants] led consumers to believe that they were obligated to repay the $200 by

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'repurchasing' the property.

(Citation omitted). The Division also found that "the 'sale' and obligatory 'resale' at the same price without any transfer in possession of the property meant that the only thing that changed hands were funds advanced to, and repaid by, the customer."

With respect to the "rental" payments customers made to appellants, the Division determined that, "[l]ike the 'purchase ***160** price,' the intervening 'rent' payments were unrelated to the actual value of the property listed in the transactional documents." As noted earlier, the lease agreement required that customers pay appellants $30 per item as "rent"—which the Division characterized as "$30 per $100 principal"—at 15 day intervals.

With respect to repayment of the funds advanced to customers, the Division pointed out that,

> [i]f a customer did not have sufficient funds to pay the money advanced on the due date, he or she could continue to pay $30 "rent" with respect to every $100 advanced for successive 15–day terms. Many customers found it difficult to come up with the $270 ordinarily required at the end of the first 15–day period and often paid "rent" many times the value of the property they were "renting."

As one customer testified, "I really got stressed out ... paying $60 and never getting anywhere." Another explained: "It was hard for me to get $270. I was behind already with my bills. And ... the interest part I could pay but I just couldn't pay the $270." The Division concluded that if customers "had known of an option to surrender property rather than repay the funds advanced, they would have done so.... [C]ustomers whose goods were worth less than $100 also would have surrendered the property, if they understood it was an option." That conclusion was further bolstered by the testimony of customers Sharon Martin, Cynthia Peacock, and Joanne Anthony. Martin was asked, "If anybody had told you you could turn in your car phone and radio and not have to pay the $200 back, would you have?" She responded, "Yes, I would have turned it in." Peacock gave similar testimony:

> Q. Did the person at Cash–2–U tell you anything about your being able to bring the TVs in and their forgiving the $200?
>
> A. No, that was never mentioned.
>
> Q. If someone had offered to take the TVs off your hands for $200, what would your response have been?
>
> ***161** A. Being honest, I would have to tell them that the TVs—if I could have gotten $50 for both of them, it would have been good.

And Joanne Anthony testified:

> Q. Did anyone at Kash–2–U say, "Ms. Anthony, if you don't want that microwave, you just bring it-bring it in and we'll forgive $100"?
>
> A. No, no.
>
> Q. What was your understanding of what you were supposed to do when you left Kash 2 U?
>
> A. Come back with the money.
>
> Q. Did they tell you why they wanted these serial numbers?
>
> A. No.
>
> Q. If they said, "Ms. Anthony, we would like that microwave for $100. ****234** We'd like to pay you $100 for that," would you have sold it to them for $100?
>
> A. Yes, uh-huh.

Because "[v]irtually no customers exercised the 'option' to 'return' the property," the Division found, "customers clearly acted as though the transaction involved the loan and repayment of money."

Appellants "behaved more like a lender than a lessor" in handling delinquent customers, the Division observed. It was undisputed that, as the Division put it, if customers "failed to make intervening payments, [appellants] called the customer to demand payment" and that "if phone calls proved unsuccessful in securing payment, [appellants] followed up with dunning letters [advising] the customer that they would 'use all means necessary to collect this amount.' "

Moreover, the calls appellants made to delinquent customers demanded payment, not return of the goods.

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The "dunning" letters, which followed these calls, did not mention return of the goods. In fact, appellants made no effort to repossess the property that they had purportedly purchased. That appellants did not demand return of the property, or ***162** otherwise seek to repossess it, was "evidence," according to the Division, "of their own understanding that the true nature of the transaction did not involve the listed property, but rather the advance and repayment of money."

We therefore hold that the Division did not err in looking beneath the forms, into the substance of the transaction, to determine that appellants "engaged in small loan transactions in the form of sale-leaseback transactions." And that is precisely the approach that other jurisdictions have taken. *See,* e.g., *Fox v. Peck Iron & Metal Co.,* 25 B.R. 674, 688–92 (Bankr.S.D.Cal.1982)(looking to the substance of a sale and lease-back transaction to hold that it was really a usurious loan); *SAL Leasing Inc. v. State,* 198 Ariz. 434, 10 P.3d 1221, 1227–28 (Ct.App.2000)(holding that sale and lease-back of vehicles were disguised usurious loans violating Consumer Lenders Act); *Burr v. Capital Reserve Corp.,* 71 Cal.2d 983, 80 Cal.Rptr. 345, 458 P.2d 185, 192 (1969)(upholding trial court finding that the substance a sale-leaseback transaction was really a usurious loan); *Halco Fin. Servs., Inc. v. Foster,* 770 S.W.2d 554, 555–56 (Tenn.Ct.App.1989)(looking to the substance of a sale and lease-back transaction to hold that it was really a usurious loan).

[14] [15] What is more, the evidence is so compelling that the transaction was a loan and not a lease, that even if we apply the UCC, as appellants urge us to do, we reach the same result: appellants' sale-leaseback was nothing more than a loan. UCC § 2A–103(1)(j) defines a "lease" as "a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease." Moreover, "[i]f a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest belongs to the lessor." Official Comment UCC § 1–201(37). In other words, as one commentator has observed, "[t]he central figure of a true lease is the reservation of an economically meaningful interest to the lessor at the end of the lease term." Edwin ***163** E. Huddleston, III, *Old Wine in New Bottles: UCC Article 2A–Leases,* 39 Ala. L.Rev. 615, 625 (1988).

After concluding that, under the Consumer Loan Law, the sale-leaseback was a loan, the Division turned to the UCC. And there it found additional support for that ****235** proposition. According to the UCC, a key element of a true lease was the reversionary interest of the lessor. And that element, as the Division observed, "was absent from [appellants'] business."

In reaching that conclusion, the Division recounted the actions of appellants that demonstrated that the property was "of little or no value" to them. Appellants, it noted, did not appraise or inspect the property, but only obtained "a general description of the item and a serial or model number." The option sheets, it observed, did not reflect the option of returning the property to terminate the program until March 1996—approximately two years after appellants opened their first Maryland store in January 1994. And, as noted earlier, neither appellants' collection calls nor dunning letters demanded the return of property.

The Division also pointed out that appellants never sought to repossess the property when a delinquent customer's deposit check was dishonored. Instead, the Division observed, appellants "would credit the customer with 'free time' and close the customer's account." The Division also noted that appellants kept no record of returned property during their first two years of operation.[13] And on the few occasions where customers surrendered property, the Division continued, appellants "treated the goods as having negligible value and abandoned them"; they sought neither to re-lease the property nor to sell it.

In fact, when asked what appellants do with returned property, Brown testified that "[w]e use it in our offices." He explained that all of the microwave ovens used in the stores ***164** were "return rentals," that the returned televisions were used to monitor advertisements, and that, to sell items, they "put a price tag on them," "display[ed] them in [their] offices," and attempted to sell them at flea markets. But Seo testified that he had never seen a bill of sale "reflecting a sale of a returned good." And, as the Division observed, in their 1995 and 1996 "Personal Property Return" forms, appellants described the nature of their business as "investment activities" and did not claim as personal property any of the items "purchased" in their transactions. The "filings demonstrate," the Division opined, "an understanding that [appellants] were in the business of lending money and had no genuine interest in the property listed in the transactional documents."

As a last effort to convince this Court that their sale-leaseback transaction satisfies the definition of a lease under UCC § 2A–103(1)(j) and not of a "security interest" under UCC § 1–201(37), appellants argue that, because UCC § 1–201(37), as amended, deleted all

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reference to the parties' intent,[14] the Division erred by looking beyond the terms of an agreement, in determining that the sale-leaseback transaction created a security interest. But that argument we need not reach.

Even if we assume that the sale-leaseback created a lease under the UCC, that conflicts with the Division's determination that the transaction was a loan under the ****236** Consumer Loan Law. And, as noted earlier, in the event of such a conflict, the latter law prevails.

Appellants also contend that the record does not support the Division's conclusion that customers testified "that if they had been made aware of an option to surrender property to be relieved of their repayment obligation, they would have done ***165** so." We disagree. Indeed, appellants concede that at least one witness, Sharon Martin, said, "Yes," when asked, "If anybody had told you you could turn in your car phone and radio and not have to pay the $200 back, would you have?" Other customers gave similar testimony. When queried, "If someone had offered to take the TVs off your hands for $200, what would your response have been?" Cynthia Peacock replied, "[I]f I could have gotten $50 for both of them, it would have been good." Customer Joanne Anthony agreed. She was asked: "If they said, 'Ms. Anthony, we would like that microwave for $100. We'd like to pay you $100 for that,' would you have sold it to them for $100?" "Yes," she responded.

And finally, appellants argue that the Division abused its discretion in denying their motion to reopen the record to show that, after appellants began including the option to return property in their options sheet, the number of property returns "did not increase significantly." That abuse of discretion continued, appellants contend, in the Division's relying on the small number of returns–84 instances, from July 1994 through September 1996–to support its finding that customers did not understand that returning the property was an option. "The number of property returns," appellants claim, "is meaningless as any indication of the level of consumer awareness" without a showing of "how many customers would choose the option if they had perfect information." A "lack of consumer action does not necessarily reflect any lack of consumer understanding," appellants state. In support of that assertion, appellants rely on the testimony of Mayo Simpson, a customer who testified that he understood that he could "return the merchandise" and "be out of their program."

[16] [17] "The discretion of an administrative agency to admit evidence after the hearing is arguably broader than the discretion that is generally accorded to trial judges...." *Md. State Police v. Zeigler,* 330 Md. 540, 557, 625 A.2d 914 (1993). And when the exercise of that discretion "does not violate regulations, statutes, common law principles, due process and ***166** other constitutional requirements, it is ordinarily unreviewable by the courts." *Id.* In other words, "courts are authorized to intervene" only when "an agency's exercise of discretion, in an adjudicatory proceeding, is 'arbitrary' or 'capricious' " *Id.* at 558, 625 A.2d 914.

[18] The Division's refusal to reopen the record was neither arbitrary nor capricious. The Division's finding that the sale-leaseback transaction was really a usurious loan was not premised solely on the small number of transactions that were terminated by customers surrendering their property. As noted above, the Division considered "all the circumstances of the transaction." Moreover, as the Division observed, the evidence that "virtually all consumers continued to repay the money," instead of returning their property, "is entirely consistent with the [Division's] finding that [appellants were] providing consumers with short-term cash."

And we understand why the Division was not swayed by Mayo Simpson's testimony. The Division points out that, while Simpson testified that he understood that he could terminate the program by surrendering the property, it "became apparent that his knowledge was acquired at some ****237** point after the transaction." In fact, he testified that he signed a bill of sale on January 20, 1995, even though appellants had not begun using a bill of sale until June of that year; and that, in January of 1995, he signed a "four item option sheet" even though appellants had not added the fourth option to their options sheet until March 1996.

II.

Appellants contend that the Division's finding that it "misrepresented the terms of their lease transactions through oral misrepresentations and a written 'options sheet' is not based on substantial evidence." We disagree.

[19] The Division found:

> Through oral representations and use of the green options sheet,

> [appellants] represented to customers that they ***167** were required to 'purchase' the goods 'sold' to [appellants] using one of the three purchase options as recited on the options sheet.

That finding, as we have previously discussed at length, is supported by substantial evidence. Customer Sharon Martin was asked: "What did you think you had to do to get out of the program then?" She responded, "Pay back the money in full." She was then asked: "Did they say anything about bringing the goods back?" She said, "No, that was never mentioned." Customer Cynthia Peacock was queried, "Apart from explaining your payment options, did they give you any other options for concluding the transaction?" She replied, "No, ... just the payment plan." And customer Sheila Chambers was asked: "After reviewing the sheet with him, what was your understanding of what you had to do in this program?" She responded, "I had to follow ... either Option 1 or Option 2 or Option 3." Similar testimony was given by other customers.

Even after the options sheet was revised to include the fourth option that permitted customers to surrender the property, the Division observed that that option was de-emphasized or ignored by appellants. The Division specifically found:

> Following the adoption of the revised yellow multi-part options sheet, [appellants'] presentation of the sale-leaseback program still did not emphasize the fourth option to customers. When customers were signing the packet of documents presented to them, Respondents did not point out the addition of the fourth option. Nor did Respondents advise repeat customers that the forms had changed.

For example, Sharon Martin, a repeat customer, stated that when she entered into a second sale-leaseback transaction with appellants she was not told about any changes in the options sheet. Joanne Anthony testified that, although she received and signed the revised options sheet, she was not told that there was anything different about the program. And when customer Ruth Lampkin was asked, "Did they tell you ***168** ... if you want to fulfill your obligation just bring those items back in and you don't have to pay us the $200," she replied: "No." Since repeat customers comprised 80% of appellants' monthly business, the failure to inform them of changes in the options sheet was a serious, substantial, and misleading omission.

III.

Appellants contend that the circuit court exceeded its authority by remanding the Division's Amended Final Order to the Division for clarification as to whether appellants could proceed with their sale-leaseback program, after providing certain consumer disclosures. According to appellants, ****238** the Division's prosecutors may not appeal a decision of the Division.

[20] Contrary to appellants' claim, the Division was "entitled to judicial review of a decision ... if the agency was a party before the agency or the Office [of Administrative Hearings]." Md.Code (1984, 1999 Repl.Vol.), § 10–222(a)(2) of the State Government Article. Accordingly, the circuit court did not abuse its discretion in remanding the case to the Division.

IV.

Appellants contend that the Division "erred as a matter of law in ordering appellants to pay automatic restitution to all consumers who engaged in the transactions during a three-year period, with no showing that such customers relied on appellants' allegedly deceptive practices."

Section 13–403(b)(1) of the Consumer Protection Act requires that the Division, having found a violation of the Consumer Protection Act, "shall state its findings and issue an order requiring the violator to cease and desist from the violation and to take affirmative action, including restitution of money or property." And section 12–314(b)(2) of the Consumer Loan Law specifically provides that a person who makes a ***169** usurious loan "may not receive or retain any principal, interest, or other compensation with respect to [that] loan."

[21] Given those two provisions, the Division did not have to show customer reliance to order restitution, only that appellants had made unlicensed usurious loans.[15] Adopting what it called a "middle course," the Division only required appellants to pay as restitution to former customers the "net monetary gain" appellants received from violating the Consumer Protection Act; namely, the "rent" payments received. Although that approach was less drastic than other alternatives, it had the desirable and lawful effect of preventing appellants from being unjustly enriched by their wrongful conduct. *See Consumer Prot. Div. v. Consumer Publ'g Co.,* 304 Md. 731, 776, 501 A.2d 48 (1985).

V.

[22] Appellants contend that the Division erred in imposing civil penalties on Seo and Brown instead of deferring to the ALJ's finding that they had acted in good faith.

****239 *170** In determining that Seo and Brown should not be subject to civil penalties under CL § 13–410,[16] the ALJ found that Seo and Brown, prior to starting their sale-leaseback business in Maryland, had sought legal advice "in order to conform to existing law" and that, after they had been investigated by the Maryland Office of Consumer Credit, they had added a Bill of Sale to the transaction, and, after that, an option to return the goods to the options sheet. She also noted that they had sought advice from a UCC expert about the legality of the transaction.

The Division, on the other hand, found this purported evidence of good faith unconvincing. Although Seo and Brown did seek legal advice, they did not, the Division pointed out, "introduce into evidence the substance of the advice ... other than that the attorney reviewed the forms." As for their consultation with the UCC expert, the Division noted that "given the timing and circumstances, [that] consultation ... reveals little about whether they acted in good faith when they committed violations."

In fact, as the Division observed, the expert testified that Brown and Seo had showed the UCC expert the options sheet, containing the fourth option to return the goods, but did not show her the prior sheets, which excluded that option, because, in the expert's words, "they did not want to taint my opinion as to the documents that they were currently drafting." And, as we have previously stated, Seo and Brown devised the policies and practices of appellants and personally participated in thousands of transactions. Hence, there was substantial evidence presented that Seo and Brown were not ***171** acting in good faith when they devised and implemented their "loan" scheme, whose true nature they tried to conceal by calling it a "sale-leaseback" program.

JUDGMENT AFFIRMED. COSTS TO BE PAID BY APPELLANTS

All Citations

153 Md.App. 130, 835 A.2d 215, 52 UCC Rep.Serv.2d 687

Footnotes

1 Seo is the president of B&S and S&B and owns 75% of the stock of both companies. Brown is the vice-president of B&S and S&B and owns 25% of the stock of both companies.

2 "To the extent that the ALJ credited or did not credit the testimony of witnesses who testified in person about specific events," it would "defer," the Division declared, "to the judgment of the ALJ, who had the opportunity to hear and observe those witnesses."

3 To facilitate our review of the issues raised by appellants, we have reworded and consolidated them.

4 In May of 1995, appellants were informed by the Commissioner of Consumer Credit that their transaction was a "loan" because they did not bear the risk of loss, repairs, or maintenance of the rental property and they had not taken possession of it. As a result, appellants, as the ALJ observed, "added a written Bill of Sale to the transaction process and revised the lease agreement to the effect that the lessor bore the risk for repairs or replacement upon notice by the lessee."

5 A later version of the green options sheet changed "cash out" to "repurchase" and made minor changes in the

calculations.

6 The training manual was revised in 1997 to require employees to explain to customers that they had the option of returning the rental property to terminate the transaction.

7 From July 1994 through September 1996, S&B engaged in a total of 38,810 transactions resulting in 44 transactions in which customers surrendered goods. From October 1994 through September 1996, B&S engaged in a total of 17,398 transactions resulting in 40 transactions in which consumers surrendered goods.

8 The Division, however, found that "the annual interest rate on such a loan [was] approximately 730%."

9 This number represents items returned to S&B Marketing Enterprises, Inc., but not the 40 items returned to B&S Marketing Enterprises, Inc.

10 The decision was the work of Robert N. McDonald, Chief Counsel of Opinions & Advice, for the Office of the Attorney General, who had been delegated final decision-making authority by the the Chief of the Consumer Protection Division.

11 Section 18 stated in part:

> Sec. 18. No person, co-partnership, or corporation, except as authorized by this Act shall, directly or indirectly, charge, contract for, or receive interest or consideration greater than six (6) per centum per annum upon the loan, use or forbearance of money, goods or things in action, or upon the loan, use or sale of credit, of the amount or value of three hundred dollars ($300) or less.
> (a) The foregoing prohibition shall apply to any person who, as security for any such loan, use or forbearance of money, goods or things in action or for any such loan, use or sale of credit, makes a pretended purchase of property from any person and permits the owner or pledgor to retain the possession thereof, of who, by any device or pretense of charging for his services, or otherwise, seek to obtain a greater compensation than is authorized by this Act.

12 The appraisal report defined "fair market value" as:

> [T]he highest price estimated, in terms of money, which the property would bring if exposed for sale on the open market by a Seller who is willing but not obliged to sell, allowing a reasonable time to find a Buyer who is willing but not obliged to buy, both parties having full knowledge of all the purposes to which the property is best adapted and capable of being used.

13 The Division however found in March 1996, after Seo was deposed, that appellants "created a form entitled 'Rental Return Receipt," given to customers who terminated the transaction by surrendering the property.

14 The Official Comment to CL § 1–201 states that amended CL § 1–201(37) deleted "all reference to the parties' intent" because "[r]eference to the intent of the parties to create a lease or security interest has led to unfortunate results." It further states: "Whether a transaction creates a lease or security interest continues to be determined by the facts of each case."

15 When the Division shows any violation of the Consumer Protection Act, it can "order ... the violator to cease and desist from the violation and to take affirmative action, including [to make] restitution of money or property." CL § 13–403(b)(1). The Division can also impose fines for any violation of the Consumer Protection Act. The Attorney General can ask the court for "any order of judgment necessary to ... restore to a person any money ... acquired from him by means of any prohibited practice." § 13–406(c)(2). In this case, the dispute centered around whether the transaction was an illegal loan. That issue was decided against appellants, so that there is no dispute that every person who entered such transaction paid money as a result of the "prohibited practice." This situation differs from one in which the consumer protection violation involves only a false or misleading representation or omission. *See* CL § 13–301. In such transactions, we cannot be so certain that the money paid by each consumer was "acquired from him by means of [the] prohibited practice" without proof that the consumer entered into the transaction as a result of deceptive representations or omissions. *See* § 13–408(a)("[A]ny person may bring an action to recover for injury for loss sustained by him as the result of a practice prohibited by this title"); *see also Citaramanis v. Hallowell*, 328 Md. 142, 151–53, 613 A.2d 964 (1992)(observing that the General Assembly intended that private recovery under Consumer Protection Act be given only for actual injury or loss sustained as a result of the conduct that violates the Act).

16 CL § 13–410(d) requires the Division to consider the following factors in imposing a civil penalty:

> (1) The severity of the violation for which the penalty is assessed;

(2) The good faith of the violator;
(3) Any history of prior violations;
(4) Whether the amount of the penalty will achieve the desired deterrent purpose; and
(5) Whether the issuance of a cease and desist order, including restitution, is insufficient for the protection of consumers. Md.Code (2000 Repl.Vol.), § 13–410(d) of the Commercial Law Article.

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NOTES

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Eichenberger v. ESPN, Inc., No. 15-35449,
D.C. No. 2:14-cv-00463-TSZ
(9th Cir. Nov. 29, 2017)

Submitted by:
Andre M. Mura
Gibbs Law Group LLP

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHAD EICHENBERGER, *Plaintiff-Appellant*, v. ESPN, INC., a Delaware corporation, *Defendant-Appellee.*	No. 15-35449 D.C. No. 2:14-cv-00463-TSZ OPINION

Appeal from the United States District Court
for the Western District of Washington
Thomas S. Zilly, Senior District Judge, Presiding

Argued and Submitted October 3, 2017
Pasadena, California

Filed November 29, 2017

Before: Susan P. Graber, Mary H. Murguia,
and Morgan Christen, Circuit Judges.

Opinion by Judge Graber

SUMMARY*

Video Privacy Protection Act

The panel affirmed the district court's dismissal under Fed. R. Civ. 12(b)(6) of an action alleging that ESPN, Inc. disclosed the plaintiff's "personally identifiable information" in violation of the Video Privacy Protection Act of 1998 by giving a third party, Adobe Analytics, the plaintiff's Roku device serial number and by identifying videos he watched through the WatchESPN application.

The panel rejected ESPN's contention that the plaintiff lacked standing. The panel held that every disclosure of an individual's "personally identifiable information" and video-viewing history offends the interests that the statute protects, and that the plaintiff need not allege any further harm to have standing.

The panel held that "personally identifiable information" under the statute means only that information that would readily permit an ordinary person to identify a specific individual's video-watching behavior. Applying that definition here, the panel concluded that an ordinary person could not use the information that ESPN allegedly disclosed to identify an individual, because the allegedly-disclosed information cannot identify an individual unless it is combined with other data in Adobe's possession—data that ESPN never disclosed and apparently never even possessed.

* This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

The panel concluded that the plaintiff therefore failed to state a claim under Rule 12(b)(6).

COUNSEL

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Marc Rotenerg and Alan Butler, Washington, D.C., as and for Amicus Curiae Electronic Privacy Information Center.

OPINION

GRABER, Circuit Judge:

Plaintiff Chad Eichenberger alleges that Defendant ESPN, Inc. violated the Video Privacy Protection Act of 1988 ("VPPA"), which bars a "video tape service provider" from knowingly disclosing "personally identifiable information concerning any consumer of such provider." 18 U.S.C. § 2710(b)(1). The district court dismissed the action under Federal Rule of Civil Procedure 12(b)(6) on the ground that the operative complaint fails to state a claim that the

information disclosed was "personally identifiable information" within the meaning of the VPPA. We affirm.

FACTUAL AND PROCEDURAL HISTORY

We accept as true all factual allegations in the operative complaint, and we construe them in the light most favorable to Plaintiff as the non-moving party. *Mollett v. Netflix, Inc.*, 795 F.3d 1062, 1065 (9th Cir. 2015).

Defendant produces sports-related news and entertainment programming. Though best known for its television channel, Defendant also offers access to video content through an application called the "WatchESPN Channel," which is available on the Roku digital streaming device. Roku allows users to view videos and other content on their televisions by means of Internet streaming.

Plaintiff downloaded the WatchESPN Channel on his Roku device and used it to watch sports-related news and events. He did not consent to Defendant's sharing his information with a third party. But every time Plaintiff watched a video, Defendant knowingly disclosed to a third party, Adobe Analytics: (1) Plaintiff's Roku device serial number and (2) the identity of the video that he watched.

Adobe uses the information obtained from Defendant to identify specific consumers by connecting that information "with existing data already in Adobe's profile of th[ose] individual[s]." Adobe obtains the additional information—such as "email addresses, account information, or Facebook profile information, including photos and usernames"—from sources other than Defendant. Adobe gives the resulting data back to Defendant in an aggregated

form; Defendant in turn provides advertisers with aggregated information about its users' demographics.

In this action, Plaintiff alleges that Adobe used the foregoing process to identify him as having watched specific videos. He argues that Defendant disclosed his "personally identifiable information" by giving Adobe his Roku device serial number and identifying the videos that he watched, because Defendant knew that Adobe could and would use that information to identify him. The district court dismissed the action on the ground that the information that Defendant disclosed did not constitute "personally identifiable information" within the meaning of the VPPA. Plaintiff timely appeals.

STANDARD OF REVIEW

We review de novo the district court's decision to grant a motion to dismiss a claim under Rule 12(b)(6). *Mollett*, 795 F.3d at 1065. To survive a motion to dismiss, the claim must be plausible on its face. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). We must uphold a district court's decision to dismiss *either* if a cognizable legal theory is absent *or* if the facts alleged fail to suffice under a cognizable claim. *Mollett*, 795 F.3d at 1065.

DISCUSSION

A. *Standing*

Defendant first argues that Plaintiff lacks Article III standing because he has not alleged a concrete harm as required by *Spokeo, Inc. v. Robins* (*Spokeo I*), 136 S. Ct. 1540 (2016). We disagree.

To have Article III standing, a plaintiff must have suffered an injury in fact that is (1) concrete and particularized, (2) traceable to the defendant, and (3) redressable by judicial order. *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 560–61 (1992). For an injury to be concrete, it "must be '*de facto*'; that is, it must actually exist." *Spokeo I*, 136 S. Ct. at 1548. Nevertheless, an intangible harm may qualify as an injury in fact. *Id.* at 1549. In determining whether an intangible injury is sufficiently concrete, "both history and the judgment of Congress play important roles." *Id.*

In *Spokeo I*, the Supreme Court addressed whether a violation of procedural requirements imposed by the Fair Credit Reporting Act ("FCRA"), alone, could constitute an injury in fact sufficient to confer standing. *Id.* at 1549. There, the plaintiff (Robins) claimed that Spokeo had violated the FCRA by disseminating inaccurate information about him. *Id.* at 1546. Initially, we held that the alleged violation, by itself, sufficed to confer Article III standing. The Supreme Court vacated our decision and remanded, explaining that Article III "requires a concrete injury even in the context of a statutory violation" and that a "bare procedural violation, divorced from any concrete harm," is not enough. *Id.* at 1549. On remand, we held that even though Robins alleged procedural violations of the FCRA, he alleged a sufficient risk of harm (for example, the loss of employment opportunities) to obtain standing. *Robins v. Spokeo, Inc.* (*Spokeo II*), 867 F.3d 1108, 1118 (9th Cir. 2017).

Importantly, *Spokeo* concerned *procedural* violations of the FCRA that would not invariably injure a concrete interest. *Id.* at 1114 (describing the FCRA provisions at issue as "*procedural* requirements" (emphasis added)); *id.* at 1116

(examining the plaintiff's "*procedural* rights" (emphasis added)). Indeed, the central provision at issue in *Spokeo* was 15 U.S.C. § 1681e(b), which falls under the FCRA's "Compliance procedures" section and requires consumer reporting agencies to take "reasonable procedures to assure maximum possible accuracy" of the information they report. But a violation of that provision does not necessarily affect a plaintiff's concrete interests. *See Spokeo I*, 136 S. Ct. at 1550 (noting that "not all inaccuracies cause harm or present any material risk of harm" and giving, as an example, the dissemination of a consumer's incorrect zip code). As a consequence, the *Spokeo* plaintiff had to plead additional harm to obtain standing. *Id.*

By contrast, 18 U.S.C. § 2710(b)(1), the VPPA provision at issue here, codifies a context-specific extension of the *substantive* right to privacy: "A video tape service provider who knowingly discloses, to any person, personally identifiable information concerning any consumer of such provider shall be liable to the aggrieved person . . . ." That provision does not describe a procedure that video service providers must follow. Rather, it protects generally a consumer's substantive privacy interest in his or her video-viewing history. *Mollett*, 795 F.3d at 1065 (citing S. Rep. No. 100-599, at 1 (1988), *reprinted in* 1988 U.S.C.C.A.N. 4342). Accordingly, *every* disclosure of an individual's "personally identifiable information" and video-viewing history offends the interests that the statute protects.

Congressional judgment leaves little doubt that 18 U.S.C. § 2710(b)(1) is a substantive provision that protects concrete interests. Congress enacted the VPPA "to extend privacy protection to records that contain information about individuals." S. Rep. No. 100-599, at 2. To that end, the

VPPA permits consumers to obtain damages for a violation of § 2710(b)(1) without showing consequential harm. 18 U.S.C. § 2710(c)(2).[1] The VPPA does not protect only against harms such as embarrassment and harassment—as Defendant argues. Rather, the statute also protects privacy interests more generally by ensuring that consumers retain control over their personal information. *See* S. Rep. No. 100-599, at 6–7 (explaining that the VPPA protects against intrusion in an age when consumers "provide to businesses . . . personal information without having any control over where that information goes").

Historical practice confirms that understanding. Violations of the right to privacy have long been actionable at common law. *See Braitberg v. Charter Commc'ns, Inc.*, 836 F.3d 925, 930 (8th Cir. 2016) (stating that "there is a common law tradition of lawsuits for invasion of privacy"). Indeed, the Supreme Court has noted that "both the common law and the literal understanding of privacy encompass the individual's control of information concerning his or her person." *U.S. Dep't of Justice v. Reporters Comm. for Freedom of the Press*, 489 U.S. 749, 763 (1989). Tellingly, privacy torts do not always require additional consequences to be actionable. *See, e.g.*, Restatement (Second) of Torts § 652B cmt. b. (Am. Law Inst. 1977) (recognizing the tort of

[1] In Defendant's view, the word "aggrieved" suggests that the statute requires a showing of additional harm and that, without such a showing, a consumer does not have standing. We disagree. The Supreme Court has explained that the term "aggrieved" demonstrates an "intent to cast the standing net broadly." *Fed. Election Comm'n v. Akins*, 524 U.S. 11, 19 (1998) (addressing the term in the context of prudential standing). Regardless, congressional history clearly shows that Congress thought that every unauthorized disclosure "aggrieves" a consumer. *Mollett*, 795 F.3d at 1065.

intrusion upon seclusion, for which the "intrusion itself" makes the defendant liable). The VPPA functions in the same way.

Thus, although the FCRA outlines *procedural* obligations that *sometimes* protect individual interests, the VPPA identifies a *substantive* right to privacy that suffers *any time* a video service provider discloses otherwise private information. As a result, every 18 U.S.C. § 2710(b)(1) violation "present[s] the precise harm and infringe[s] the same privacy interests Congress sought to protect" by enacting the VPPA. *Van Patten v. Vertical Fitness Grp., LLC*, 847 F.3d 1037, 1043 (9th Cir. 2017) (so holding with respect to the Telephone Consumer Protection Act of 1991). Accordingly, *Spokeo I* and *Spokeo II* are distinguishable from this VPPA claim, and Plaintiff need not allege any further harm to have standing. *Id.*[2] We therefore join the two other circuits that, after *Spokeo I*, have found Article III standing in similar cases arising under the VPPA. *Perry v. Cable News Network, Inc.*, 854 F.3d 1336, 1341 (11th Cir. 2017); *In re Nickelodeon Consumer Privacy Litig.*, 827 F.3d 262, 274 (3d Cir. 2016), *cert. denied*, 137 S. Ct. 624 (2017).

[2] The VPPA's history shows why an allegation of additional harm is unnecessary. Congress enacted the VPPA after a newspaper published Supreme Court nominee Robert Bork's video rental history. Notably, Judge Bork's rental history was decidedly commonplace, and the article did not hurt his nomination. Case Comment, *Statutory Interpretation—The Video Privacy Protection Act—Eleventh Circuit Limits the Scope of "Subscriber" for VPPA Protections.—Ellis v. Cartoon Network, Inc., 803 F.3d 1251 (11th Cir. 2015)*, 129 Harv. L. Rev. 2011, 2018–19 (2016). Were we to accept Defendant's argument regarding standing, the VPPA would not provide legal recourse to those in the precise situation that prompted the statute's enactment in the first place.

B. "*Personally Identifiable Information*"

The district court dismissed Plaintiff's claim on the ground that the allegedly disclosed information did not constitute "personally identifiable information" within the meaning of the VPPA. The VPPA defines "personally identifiable information" to "include[] information which identifies a person as having requested or obtained specific video materials or services from a video tape service provider." 18 U.S.C. § 2710(a)(3). We agree with the district court's conclusion.

As an initial matter, "personally identifiable information" must include more information than that which, by itself, identifies an individual as having watched certain videos. Instead, "personally identifiable information" covers some information that *can be used* to identify an individual.

Two reasons support that conclusion, and both flow directly from the VPPA's text. First, § 2710(a)(3) uses the open-ended word "includes," which suggests that the proffered definition describes only one example of "personally identifiable information." Read in context, the word "includes" seems particularly deliberate here. *Compare* 18 U.S.C. § 2710(a)(3) (using the word "includes") *with* 18 U.S.C. § 2710(a)(1), (a)(2) & (a)(4) (using the word "means" to define other statutory terms). Second, Congress used the word "identifi*able*." 18 U.S.C. § 2710(a)(3) (emphasis added). And the suffix "able" means "capable of." *Webster's Third New Int'l Dictionary* 4, 1123 (unabr. ed. 1981). It follows, then, that the term "personally identifiable information" covers some information that is "capable of" identifying a person, as well as information that, standing alone, identifies a person.

The question remains, though: Under the VPPA, what information did Congress intend to cover as "capable of" identifying an individual? Two circuits have considered that question in similar cases, and each has articulated a different standard. *Yershov v. Gannett Satellite Info. Network, Inc.*, 820 F.3d 482, 486 (1st Cir. 2016); *In re Nickelodeon Consumer Privacy Litig.*, 827 F.3d 262, 284 (3d Cir. 2016).

In *Yershov*, the First Circuit held that the term "personally identifiable information" encompasses "information *reasonably and foreseeably likely* to reveal which . . . videos [a person] has obtained." 820 F.3d at 486 (emphasis added). The court concluded that an iPhone user's GPS coordinates and device identifier fell within that definition. *Id.* In a similar case, though, the Third Circuit held that a unique IP address did not qualify as "personally identifiable information," because the term includes only information that "readily permit[s] *an ordinary person* to identify a [particular individual as having watched certain videos]." *In re Nickelodeon*, 827 F.3d at 290 (emphasis added). We adopt the Third Circuit's "ordinary person" standard.

The "ordinary person" test better informs video service providers of their obligations under the VPPA. The VPPA protects consumer privacy by directing video service providers not to do certain things with consumer information. To that end, 18 U.S.C. § 2710(b)(1) focuses on what information a video service provider "knowingly discloses." In other words, the statute views disclosure from the perspective of the disclosing party. It looks to what information a video service provider discloses, not to what the recipient of that information decides to do with it. As a result, "personally identifiable information" must have the same meaning without regard to its recipient's capabilities.

Holding otherwise would make "[t]he lawfulness of [a] disclosure . . . depend on circumstances outside of [a video service provider's] control." *Mollett*, 795 F.3d at 1066. The Third Circuit's "ordinary person" test, by contrast, provides video service providers with enough guidance to comply with the VPPA's requirements.

The interpretation that we adopt fits most neatly with the regime that the VPPA's enacting Congress likely had in mind. In 1988, the Internet had not yet transformed the way that individuals and companies use consumer data—at least not to the extent that it has today. Then, the VPPA's instructions were clear. The manager of a video rental store in Los Angeles understood that if he or she disclosed the name and address of a customer—along with a list of the videos that the customer had viewed—the recipient of that information could identify the customer. By contrast, it was clear that, if the disclosure were that "a local high school teacher" had rented a particular movie, the manager would not have violated the statute. That was so even if one recipient of the information happened to be a resourceful private investigator who could, with great effort, figure out which of the hundreds of teachers had rented the video. Plaintiff's Roku device serial number is like the information in the latter scenario. It creates a sizable "pool" of possible viewers—here, Roku users—just as the information in the latter example does—there, high school teachers.

It is true that today's technology may allow Adobe to identify an individual from the large pool by using other information—as Plaintiff alleges. But the advent of the Internet did not change the disclosing-party focus of the statute. And we are not persuaded that the 1988 Congress intended for the VPPA to cover circumstances so different

from the ones that motivated its passage. Therefore, drawing on the Third Circuit's reasoning, we hold that "personally identifiable information" means only that information that would "readily permit an ordinary person to identify a specific individual's video-watching behavior." *In re Nickelodeon*, 827 F.3d at 267.

Applying that definition here, the operative complaint is deficient. Plaintiff alleges that Defendant disclosed to Adobe: (1) his Roku device serial number and (2) the names of the videos that he watched. As Plaintiff concedes, that information *cannot* identify an individual unless it is combined with other data in Adobe's possession—data that ESPN never disclosed and apparently never even possessed. Indeed, according to Plaintiff, Adobe can identify individuals only because it uses a complex "Visitor Stitching technique" to link an individual's Roku device number with other identifying information derived from "an enormous amount of information" collected "from a variety of sources." We conclude that an ordinary person could not use the information that Defendant allegedly disclosed to identify an individual. Plaintiff has therefore failed to state a claim under Rule 12(b)(6).

Our decision today, though it adopts a different test, does not necessarily conflict with *Yershov*. The First Circuit's *holding* in that case was quite narrow. The court held

> only that the transaction described in the complaint—whereby Yershov used the mobile device application that Gannett provided to him, which gave Gannett the GPS location of Yershov's mobile device at the time he viewed a video, his device identifier, and the

> titles of the videos he viewed in return for access to Gannett's video content—plausibly plead[ed] a case that the VPPA's prohibition on disclosure applies.

Yershov, 820 F.3d at 489. The First Circuit relied, in part, on the nature of GPS location data, which the court noted "would enable *most people* to identify [an individual's home and work addresses]." *Id.* at 486 (emphasis added). And the court expressly noted that, at some point, "the linkage of information to identity becomes too uncertain" to trigger liability under the VPPA. *Id.* That is precisely the situation here.

Nor does our holding make the statute powerless. Names and addresses, of course, still qualify. *See* 18 U.S.C. § 2710(b)(2)(D) (permitting video service providers to "disclose personally identifiable information . . . if [among other conditions] the disclosure is *solely of the names and addresses of consumers*" (emphasis added)). It is not difficult to imagine other examples that may also count—for example, an individual's name and telephone number or an individual's name and birthday or, as in *Yershov*, the GPS coordinates of a particular device. And modern technology may indeed alter—or may already have altered—what qualifies under the statute. A Facebook link or an email address may very well readily enable an "ordinary person" to identify an individual. We need not and do not opine on the merits of those theories. The allegations before us, though, are simply too attenuated to qualify under the standard that we adopt today.[3]

[3] In view of our holding, we need not reach any other issue. We therefore do not decide, for example, whether Plaintiff has adequately alleged his status as a "consumer" under the VPPA.

CONCLUSION

Plaintiff has Article III standing to bring his claim because 18 U.S.C. § 2710(b)(1) is a substantive provision protecting consumers' concrete interest in their privacy. We affirm the judgment of dismissal because the information described in Plaintiff's complaint does not constitute "personally identifiable information" under the VPPA.

AFFIRMED.

NOTES

NOTES

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In re: Vizio, Inc., Consumer Privacy Litigation, Order (1) Denying Motions for Leave to File *Amicus* Brief and (2) Denying Vizio Defendants' Motion to Certify in Part under 28 U.S.C. § 1292(b) the March 2, 2017 Order Granting in Part and Denying in Part Defendants' Motion to Dismiss (Docs. 155, 157, 158), Case No. 8:16-ml-02693-JLS-KES (C.D. Cal. Oct. 13, 2017)

Submitted by:
Andre M. Mura

Gibbs Law Group LLP

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In re: Vizio, Inc., Consumer Privacy Litigation	CASE NO. 8:16-ml-02693-JLS-KES **ORDER (1) DENYING MOTIONS FOR LEAVE TO FILE AMICUS BRIEF AND (2) DENYING VIZIO DEFENDANTS' MOTION TO CERTIFY IN PART UNDER 28 U.S.C. § 1292(b) THE MARCH 2, 2017 ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTION TO DISMISS (Docs. 155, 157, 158)**

Before the Court is a Motion to Certify Order for Interlocutory Appeal filed by Defendants VIZIO, Inc.; VIZIO Holdings, Inc.; VIZIO Inscape Technologies, LLC; and VIZIO Inscape Services, LLC (collectively, the "Vizio Defendants" or "Vizio"). (Mot., Doc. 155.) Plaintiffs have submitted an Opposition (Opp'n, Doc. 191), and Vizio has filed a Reply (Reply, Doc. 196). Having carefully reviewed the parties' briefing and supporting documentation, the Court DENIES Vizio's Motion.[1]

I. BACKGROUND

This multidistrict litigation concerns allegations that Vizio offered Smart TVs equipped with automatic content recognition software that collected consumers' viewing histories and then sold that information—along with "highly specific" information about consumers' digital identities—to third parties, without consumers' knowledge or consent. *In re Vizio, Inc., Consumer Privacy Litig.*, 238 F. Supp. 3d 1204, 1212–13 (C.D. Cal. 2017).

After the appointment of Co-Lead Counsel, on August 15, 2016, Plaintiffs filed their First Consolidated Complaint. (FCC, Doc. 108.) In this Complaint, Plaintiffs alleged claims for violations of: (1) the Video Privacy Protection Act, (2) Wiretap Act, (3) California's Invasion of Privacy Act, (4) California Civil Code § 1799.3, (5) California Consumer Legal Remedies Act, (6) California Unfair Competition Law, (7) California False Advertising Law, (8) Florida Deceptive and Unfair Trade Practices Act, (9) N.Y. Gen. Bus. Law §§ 349, 350, (10) N.Y. Gen Bus. Law §§ 670–675, (11) Massachusetts Unfair and Deceptive Trade Practices Statute, (12) Massachusetts Video Records Protection Statute, (13) Massachusetts Privacy Act, and (14) Washington Consumer Protection Act, as well as common law claims for (15) unjust enrichment or quasi-contract,

[1] The Motions for Leave to File Amicus Brief are DENIED because (1) Vizio is represented ably by counsel, (2) amici have not identified any interest in another pending case that may be affected by the litigation, and (3) amici reiterate views expressed by Vizio. *See AmeriCare MedServices, Inc. v. City of Anaheim*, No. 8:16-CV-1596-JLS-AFMx, 2017 WL 1836354, at *1 n.3 (C.D. Cal. Mar. 28, 2017) (Staton, J.).

(16) intrusion upon seclusion, (17) intentional misrepresentation or fraud by omission, and (18) negligent misrepresentation.[2] (*Id.* ¶¶ 111–317.) Plaintiffs dropped their state video privacy law claims in their Opposition to Defendants' Motion to Dismiss. (Opp'n at 3 n.2, Doc. 121.)

On March 2, 2017, the Court granted in part and denied in part the Vizio Defendants' Motion to Dismiss. *See generally In re Vizio, Inc., Consumer Privacy Litig.*, 238 F. Supp. 3d 1204 (C.D. Cal. 2017). Specifically, the Court granted the Motion with leave to amend as to Plaintiffs' Wiretap Act, California Invasion of Privacy Act, affirmative fraud, California False Advertising Law, state video privacy, and negligent misrepresentation claims. *Id.* at 1234. The Court denied the Motion as to Plaintiffs' Video Privacy Protection Act, fraudulent omission, state law privacy, and unjust enrichment claims. *Id.*

On Plaintiffs' VPPA cause of action, which is the only one at issue in this Motion, the Court examined each of Vizio's objections to Plaintiffs' pleading. *First*, the Court concluded that Plaintiffs had plausibly alleged that, through its Smart TVs, Vizio was a "video tape service provider," which the statute defines to encompass those "engaged in the business . . . of . . . [the] delivery" of video content. *Id.* at 1221–22; 18 U.S.C. § 2710(a)(4). "Vizio's Internet Apps and Internet Apps Plus are designed to enable consumers to seamlessly access Netflix, Hulu, YouTube, and Amazon Instant Video content in their homes." *In re Vizio, Inc., Consumer Privacy Litig.*, 238 F. Supp. 3d at 1222. Vizio allegedly markets its Smart TVs as "a passport to a world of entertainment, movies, TV shows and more[,]" and "[a] reasonable inference is that Vizio enters into agreements with . . . content providers to enable consumers to access their programming on Vizio's Smart TVs." *Id.* Thus, as opposed to mere "peripheral[] or passive[]" involvement in video content delivery, Vizio allegedly was

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[2] Plaintiffs' FCC was misnumbered, skipping from the sixteenth to its eighteenth cause of action. (*See* FCC ¶¶ 294–309.)

"substantially involved in the conveyance of video content to consumers" and its Smart TVs were "significantly tailored to serve that purpose." *Id.* at 1221.

Second, the Court found that Plaintiffs plausibly alleged that they were "subscribers" and thus fell within the Act's definition of "consumer." *Id.* at 1222–23; *see* 18 U.S.C. § 2710(a)(1). While noting some tension between the First Circuit in *Yershov v. Gannett Satellite Information Network*, 820 F.3d 482 (1st Cir. 2016), and Eleventh Circuit in *Ellis v. Cartoon Network*, 803 F.3d 1251 (11th Cir. 2015), on whether users of free mobile applications fall within the statutory definition of "subscribers," the Court concluded that this dispute was ultimately irrelevant because Plaintiffs "allege that they *do* pay for Vizio's applications." *Id.* at 1223. Specifically, Plaintiffs alleged that "Vizio charges a premium for its Smart TVs because of their ability to seamlessly deliver video content to consumers through Vizio's Internet Apps, Internet Apps Plus, and SmartCast" and "Vizio continues to service [the Smart TVs] by pushing software updates that improve security and provide additional features." *Id.* Considering these allegations, under either *Ellis* or *Yershov*, "Plaintiffs plausibly allege[d] an association with Vizio that is sufficiently substantial and ongoing to constitute a subscription." *Id.*

Third, Plaintiffs pleaded sufficient facts to plausibly suggest that—as Vizio's own document described its collection and disclosure capabilities—"provid[ing] highly specific viewing behavior data on a massive scale with great accuracy" constitutes the disclosure of "personally identifiable information," which the statute prohibits. *Id.* at 1223–26; *see* 18 U.S.C. §§ 2710(a)(3), (b). In determining how to construe the phrase "personally identifiable information," the Court was confronted with two approaches: Either focus on the text and structure of the Act, as *Yershov* did, or rely primarily on legislative history that does not squarely address what the phrase "personally identifiable information" means, the course that *In re Nickelodeon* took. *Id.* at 1223–24; *see In re Nickelodeon*, 827 F.3d 262, 281–90 (3d Cir. 2016). Because the former approach better accords with contemporary statutory interpretation, the Court followed *Yershov*. *Id.* at 1224–25. Thus, based on the plain meaning and structure of the Act, the Court held the Plaintiffs must ultimately show

that "Vizio's disclosures are 'reasonably and foreseeably likely to reveal' what video content Plaintiffs have watched." *Id.* at 1225 (quoting *Yershov*, 820 F.3d at 486). Under this standard, Plaintiffs had plausibly alleged that "highly specific" information about consumers' digital identities—in particular, linked data revealing consumers' MAC addresses, IP addresses, zip codes, product model numbers, hardware and software versions, chipset IDs, region and language settings, and information about devices connected to the same network—qualifies as "personally identifiable information." *Id.* Overall, the Court "stresse[d] the posture of this case." *Id.* Because the VPPA's statutory terms demand fact-intensive inquiries and this case involves several intricate technologies, the Court declined "to engage in judicial fact-finding or make sweeping determinations as a matter of law on this Motion to Dismiss." *Id.* at 1226.

On March 23, 2017, Plaintiffs filed a Second Consolidated Complaint that dropped all of the dismissed claims except for the Wiretap Act and California Invasion of Privacy Act claims. (SCC ¶¶ 294–309, Doc. 136.) On their Second Motion to Dismiss, the Vizio Defendants renewed their attack on Plaintiffs' Wiretap Act and California Invasion of Privacy Act claims. (Second MTD Mem. 11–14, Doc. 145-1.) Vizio separately moved to dismiss Plaintiffs' demand for injunctive relief as moot and certain additional allegations in Plaintiffs' Second Consolidated Complaint about Vizio's collection of information from additional sources. (*Id.* at 6–11, 14–16.) Finally, Vizio sought to strike Plaintiffs' class definition as overbroad because an unknown fraction of the alleged class members could be subject to mandatory arbitration agreements. (*Id.* at 16–21.) On July 25, 2017, the Court denied Defendants' Second Motion to Dismiss. (Order, Doc. 199.) Thus, after two rounds of Motions to Dismiss, Plaintiffs may proceed on their Video Privacy Protection Act, Wiretap Act, California Invasion of Privacy Act, California Consumer Legal Remedies Act, California Unfair Competition Law, Florida Deceptive and Unfair Trade Practices Act, N.Y. Gen. Bus. Law § 349, Massachusetts Unfair and Deceptive Trade Practices Statute, Massachusetts Privacy Act, Washington Consumer Protection Act,

unjust enrichment, intrusion upon seclusion, and fraudulent omission claims. (*See* SCC ¶¶ 118–284.)

II. LEGAL STANDARD

Codified in 28 U.S.C. § 1291, the final judgment rule provides that the Courts of Appeals generally have jurisdiction over only "final decisions of the district courts of the United States." 28 U.S.C. § 1291; *Cunningham v. Hamilton Cty.*, 527 U.S. 198, 203 (1999). Section 1291's finality requirement "evinces a legislative judgment that '[r]estricting appellate review to "final decisions" prevents the debilitating effect on judicial administration caused by piecemeal appeal disposition of what is, in practical consequence, but a single controversy.'" *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 471 (1978) (quoting *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 170 (1974)). Section 1292(b) provides a very narrow exception to the final judgment rule whereby "litigants can bring an immediate appeal of a non-final order upon the consent of both the district court and the court of appeals." *In re Cement Antitrust Litig.*, 673 F.2d 1020, 1025–26 (9th Cir. 1982). "This screening procedure serves the dual purpose of ensuring that such review will be confined to appropriate cases and avoiding time-consuming jurisdictional determinations in the court of appeals." *Coopers & Lybrand*, 437 U.S. at 474–75. A district court may certify an order for interlocutory appeal only where the order (1) "involves a controlling question of law," (2) "as to which there is substantial ground for difference of opinion," and (3) "an immediate appeal from the order may materially advance the ultimate termination of the litigation . . . ." 28 U.S.C. § 1292(b). Each of the three certification requirements must be satisfied for an order to be appropriate for interlocutory review. *See Couch v. Telescope Inc.*, 611 F.3d 629, 633 (9th Cir. 2010) (reversing certification under § 1292(b) where defendant failed to establish substantial ground for difference of opinion); *In re Cement Antitrust Litig.*, 673 F.2d at 1026.

Because "[s]ection 1292(b) is a departure from the normal rule that only final judgments are appealable," the statute "must be construed narrowly" and a district court should invoke its certification authority "sparingly and only in exceptional circumstances."

James v. Price Stern Sloan, Inc., 283 F.3d 1064, 1068 n.6 (9th Cir. 2002); *United States v. Woodbury*, 263 F.2d 784, 788 n.4 (9th Cir. 1959). Accordingly, a party displeased with a pretrial ruling cannot employ section 1292(b) merely to secure "early review of difficult rulings in hard cases." *In re Adelphia Commc'ns Corp.*, No. 02-41729 (REG), 2008 WL 361082, at *1 (S.D.N.Y. Feb. 7, 2008) (quoting *In re Levine*, No. 94-44257, 2004 WL 764709, at *2 (S.D.N.Y. Apr. 9, 2004)). "The party seeking review bears the burden of showing that 'exceptional circumstances justify a departure from the basic policy of postponing appellate review until after the entry of a final judgment.'" *Ass'n of Irritated Residents v. Fred Schakel Dairy*, 634 F. Supp. 2d 1081, 1087 (E.D. Cal. 2008) (quoting *Coopers & Lybrand*, 437 U.S. at 475).

III. DISCUSSION

In its Motion to Certify, Vizio seeks to certify whether "Plaintiffs [have] adequately alleged" that Defendants, through their Smart TV products, are "video tape service providers," that Plaintiffs are "consumers," and that Defendants disclosed "personally identifiable information." (Mem. at 2.) Plaintiffs object to Vizio's Motion, arguing that Vizio unreasonably delayed bringing this Motion without explanation, that an interlocutory appeal on the questions posed would not materially advance this multidistrict litigation, that substantial grounds for disagreement do not exist, and that the questions posed do not involve controlling questions of law. (Opp'n at 2–18.) The Court focuses on whether granting an immediate, interlocutory appeal would materially advance this litigation and whether substantial grounds for disagreement exist, as these matters are dispositive and straightforward.

A. At This Stage, an Interlocutory Appeal Does Not Hold the Potential to Materially Advance This Litigation.

On this Motion, the Court's inquiry begins with whether an appeal would materially advance this litigation. Courts have repeatedly found that certification is unwarranted where "there is a good prospect that the certified question may be mooted by further proceedings." Charles Alan Wright et al., 16 Fed. Prac. & Proc. Juris. § 3930 (3d ed.

2017); *see, e.g.*, *In re City of Memphis*, 293 F.3d 345, 351 (6th Cir. 2002); *Oneida Indian Nation of New York State v. Oneida Cty.*, 622 F.2d 624, 628–29 (2d Cir. 1980); *United States v. Rent-A-Homes Sys. of Illinois, Inc.*, 602 F.2d 795, 797 (7th Cir. 1979); *Lillehagen v. Alorica, Inc.*, No. SACV 13-0092-DOC, 2014 WL 2009031, at *7 (C.D. Cal. May 15, 2014); *Dukes v. Wal-Mart Stores, Inc.*, No. C 01-02252 CRB, 2012 WL 6115536, at *5 (N.D. Cal. Dec. 10, 2012). Indeed, other district courts have recognized that allowing interlocutory appeals of decisions resolving motions to dismiss in multidistrict proceedings often "would serve only to impede institutional efficiency by 'prolong[ing] judicial proceedings, add[ing] delay and expense to litigants, burden[ing] appellate courts, and present[ing] issues for decisions on uncertain and incomplete records, tending to weaken the precedential value of judicial opinions.'" *In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 986 F. Supp. 2d 524, 534 (S.D.N.Y. 2014) (quoting *In re World Trade Ctr. Disaster Site Litig.*, 469 F.Supp.2d 134, 144 (S.D.N.Y.2007)); *see also In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 986 F. Supp. 2d at 533 ("Interlocutory review . . . is especially rare in the early stages of litigation.").

Such is the case here. In the March 2 Order, this Court did not hold that Vizio's collection and disclosure practices *violate* the Video Privacy Protection Act or even that a *reasonable jury* could find as much; all the Court did was open the door to discovery on these highly fact-dependent issues involving intricate technologies. *See In re Vizio, Inc., Consumer Privacy Litig.*, 238 F. Supp. 3d at 1225–26. Because there is a "good prospect" that the proposed questions would be entirely academic by the time the Ninth Circuit could possibly resolve them, Vizio has not shown that an interlocutory appeal would materially advance this litigation.

Further cautioning against an interlocutory appeal, the questions Vizio seeks to certify would be presented to the Ninth Circuit in a particularly awkward posture. Not only would the Ninth Circuit lack any factual record, but Plaintiffs' First Consolidated Complaint lacks the additional allegations about Vizio's collection and disclosure practices found in the FTC Complaint. *See In re Vizio, Inc., Consumer Privacy Litig.*, 238 F. Supp.

3d at 1225 n.6 (noting that the Court could not consider the allegations in the FTC's complaint because they were not incorporated into Plaintiffs' First Consolidated Complaint). And, if Plaintiffs claims have merit, they will undoubtedly have additional allegations to plead at a later juncture. So, even if Vizio were to prevail on an interlocutory appeal, the parties would be left to litigate yet another round of motions to dismiss in two years. *See In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 986 F. Supp. 2d at 531 ("The Second Circuit regularly denies interlocutory appeals at such preliminary stages where, as here, the appeal could at most lead only to a remand for repleading."). Which is to say, instead of materially advancing the multidistrict litigation, an interlocutory appeal on Vizio's Motion to Dismiss could derail it.

For this reason, perhaps, Vizio represents that it will seek a sweeping ruling from the Ninth Circuit entirely exempting Smart TV manufacturers, like itself, from the purview of the Video Privacy Protection Act. (Reply at 7.) The Court has at least some doubts whether this would be Vizio's sole strategy because it devotes substantial attention in its Motion to minor quibbles over whether Plaintiffs should have been more explicit in their pleading, rather than any substantial legal questions. (*See* Mem. at 11 n.3, 13 at nn. 4, 5, 6.) At any rate, whatever standard the Ninth Circuit may adopt, Vizio is unlikely to obtain a ruling completely exempting those who offer integrated hardware and software platforms designed for accessing streaming video content from the VPPA. Vizio's attempt to distinguish itself from, say, Hulu finds no support in the text of the Act, and Vizio's proffered distinction between software and hardware providers proves elusive.

Finally, even if Vizio obtains a far-reaching ruling on an interlocutory appeal, such a decision would resolve only one of Plaintiffs' thirteen claims. (*See* SCC at ¶¶ 118–284.) Where "a substantial amount of litigation remains in [a] case regardless of the correctness of the Court's ruling, . . . arguments that interlocutory appeal would advance the resolution of this litigation are unpersuasive." *Lillehagen*, 2014 WL 2009031, at *7; *Friedman v. 24 Hour Fitness USA, Inc.*, No. CV 06-6282 AHM CTX, 2009 WL 545783, at *2 (C.D. Cal. Mar. 3, 2009); *United States ex rel. Bagley v. TRW, Inc.*, No. CV-954153-

AHM-AJWx, 2001 WL 369790, at *2 (C.D. Cal. Mar. 26, 2001). When applying this standard to determine whether to certify an order resolving a motion to dismiss, "it is 'quite unlikely' that an immediate appeal will materially advance the termination of the litigation" if "discovery as to the challenged claims 'appears likely to overlap to a considerable extent'" with others brought in the same litigation. *In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 986 F. Supp. 2d at 533 (quoting *Isra Fruit Ltd. v. Agrexco Agr. Exp. Co.*, 804 F.2d 24, 25 (2d Cir. 1986)). True, before the appointment of Co-Lead Counsel, Plaintiffs highlighted the importance of the VPPA claims to this multidistrict litigation in a Joint Statement filed with the Court. (*See* Joint Statement at 9, Doc. 48.) But nothing suggests that the questions Vizio seeks to certify would affect that nature of discovery or even the length of a trial, because Plaintiffs' Wiretap Act and state privacy claims remain viable at this stage as well. Plaintiffs need not succeed on their VPPA claims for their Wiretap Act, consumer protection, and state privacy claims to have merit. Vizio also focuses on the statutory damages available under the VPPA (Reply at 5–6), but—assuming this is a relevant consideration—the Wiretap Act offers similar penalties. *See* 18 U.S.C. § 2520(c).

Thus, considering the potential for further proceedings to moot the questions presented, the peculiar manner in which these questions would be presented to the Ninth Circuit, and the unlikelihood at this point that an appeal would affect the scope of discovery or length of trial, Vizio has failed to demonstrate that an interlocutory appeal would materially advance this litigation.[3]

B. <u>Vizio has Failed to Show a Substantial Ground for Disagreement on Two of the Questions Posed</u>

Vizio's failure to identify a substantial ground for disagreement on two of the

[3] The Court further notes that Ninth Circuit may provide guidance on the meaning of "personally identifiable information," in *Chad Eichenberger v. ESPN, Inc.*, Case No. 15-35449, which was argued on October 3, 2017. Certifying an issue already pending before the Ninth Circuit would be a peculiar use of judicial and private resources.

questions also precludes certification of those issues. A substantial ground for a difference of opinion may exist if "the circuits are in dispute on the question and the court of appeals of the circuit has not spoken on the point, if complicated questions arise under foreign law, or if novel and difficult questions of first impression are presented." *Couch*, 611 F.3d at 633 (quoting 3 Federal Procedure, Lawyers Edition § 3:212 (2010) (footnotes omitted)). But "just because a court is the first to rule on a particular question or just because counsel contends that one precedent rather than another is controlling does not mean there is such a substantial difference of opinion as will support an interlocutory appeal." *Id.*; *see also In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 986 F. Supp. 2d at 539 ("A substantial ground for difference of opinion exists when '(1) there is conflicting authority on the issue, or (2) the issue is particularly difficult and of first impression for the [governing circuit].'").

For the reasons discussed in the March 2 Order, the Court finds *In re Nickelodeon*'s appraisal of the legislative history unconvincing when compared with the more conventional approach to statutory interpretation found in the First Circuit's decision in *Yershov v. Gannett Satellite Info. Network, Inc.* To put it simply, "[a] statute says what it says, and the place to begin is with the words themselves." *Yershov v. Gannett Satellite Info. Network, Inc.*, 104 F. Supp. 3d 135, 140 (D. Mass. 2015), *rev'd on other grounds*, 820 F.3d 482 (1st Cir. 2016); *see also*, *e.g.*, *Henson v. Santander Consumer USA Inc.*, 137 S. Ct. 1718, 1725 (2017) ("[W]e . . . presume . . . 'that [the] legislature says . . . what it means and means . . . what it says.'" (quoting *Dodd v. United States*, 545 U.S. 353, 357 (2005)). Further, the panel in *In re Nickelodeon* appears to have been animated by the concern that a literal interpretation of "personally identifiable information" would mean that certain websites would be "presumptively illegal" due to their disclosure of consumers' IP addresses. *In re Nickelodeon Consumer Privacy Litig.*, 827 F.3d at 290. But the decision does not acknowledge that the VPPA creates an explicit exception allowing the disclosure of such information to "any person if the disclosure is incident to the ordinary course of business of the video tape service provider." 18 U.S.C. §

2710(b)(2)(E). Nonetheless, the strongest evidence of a substantial ground for disagreement is tension or outright disagreement among the circuits with the governing circuit providing few clues on how it would rule. As such, a substantial ground for disagreement exists over the import of "personally identifiable information" under the VPPA.[4]

As for the other two questions Vizio poses, however, the company offers little other than its vehement disagreement with the Court's disposition. On whether Plaintiffs have plausibly pleaded that they qualify as "subscribers," any tension between the First Circuit's decision in *Yershov* and the Eleventh Circuit's decisions in *Perry v. Cable News Network, Inc.*, 854 F.3d 1336 (11th Cir. 2017), and *Ellis v. Cartoon Network, Inc.*, 803 F.3d 1251 (11th Cir. 2015), has no bearing on this case. While Vizio correctly notes that *Perry* mentioned that the plaintiff did not create a login account for the free mobile application, both *Perry* and *Ellis* focused on how consumers paid nothing for the product and the ease at which the application could be quickly "delete[d] . . . without consequences whenever [the user] likes." *Ellis*, 803 F.3d at 1257 (describing these two factors as "[i]mportant[]"); *Perry*, 854 F.3d at 1342 (reiterating these factors in describing *Ellis*'s holding). In contrast to these decisions about free mobile applications, this litigation concerns products allegedly sold at a premium because of their ability to access video content, that have a relatively long lifecycle, and for which the manufacturer provides continuing updates and support after consumers purchase the product. *Ellis* and *Perry* did not suggest that—even if a consumer pays for the product and the defendant provides ongoing support and updates—a consumer is not a subscriber unless she creates a login account. This Court did

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[4] Vizio again protests that it should not be held liable for the "idiosyncratic" capabilities of third parties to whom it discloses consumers' information. (Mem. at 7–8 n.2.) By its very definition, an "idiosyncratic" usage is not "reasonable and foreseeable," so Vizio's conclusion does not follow logically from its premise. Rather, the relevant inquiry is whether a video tape service provider can escape liability for disclosures that would reasonably and foreseeably result in identifying a specific person as watching a particular program merely because an "ordinary person" would not be able, on her own, to identify the consumer.

not mechanically march through the factors articulated in *Ellis* because—considering this was a motion to dismiss—Plaintiffs had clearly alleged the requisite "commitment, relationship, or association (financial or otherwise) between a person and an entity." *Ellis*, 803 F.3d at 1256; *see Perry*, 854 F.3d at 1343.

For the reasons touched upon already, Vizio fares no better in its attempts to argue that a substantial ground exists over whether integrated hardware and software platforms designed to access streaming video content are categorically excluded from the VPPA. Besides reiterating the contentions made in its Motion to Dismiss, Vizio's argument reduces to observing that prior VPPA litigation did not involve this product. (Mem. at 10.) To conjure up disagreement, Vizio asserts that the Court's holding contravenes the district court's holding in *In re Nickelodeon* that Google was not a video tape service provider. (*Id.* at 10.) That court, however, simply concluded that Google's ownership of YouTube was insufficient to make it a videotape service provider when the plaintiffs' allegations did not involve the collection of data via YouTube. *See In re Nickelodeon Consumer Privacy Litig.*, No. CIV.A. 12-07829, 2014 WL 3012873, at *8 (D.N.J. July 2, 2014) ("YouTube videos are irrelevant to this lawsuit, which focuses exclusively on three Viacom websites and the Defendants' data collection activities in regards to those sites."). This Court in no way took a contrary position: Plaintiffs allege that Vizio is collecting consumers' data through the *very product* that Vizio markets as a "passport to a world of entertainment, movies, TV shows and more" and that consumers use to seamlessly access streaming video content. *In re Vizio, Inc., Consumer Privacy Litig.*, 238 F. Supp. 3d at 1222. Vizio's failure to identify a single case—from either a circuit or district court—holding that offering an analogous product does not qualify as "the business . . . of . . . deliver[ing]" video content strongly suggests that a substantial ground for disagreement does not at present exist. *See Couch*, 611 F.3d a 633 (finding that a defendant's failure to "provide[] a single case that conflicts with the district court's construction or application" of the relevant statute to be a "[s]ignificant[]" indication that a substantial ground for disagreement did not exist); *Fenters v. Yosemite Chevron*, 761 F. Supp. 2d 957, 1005 (E.D.

Cal. 2010) (observing that a "substantial ground for difference of opinion" requires more than "a showing that there is a dearth of case law, or that the issue is a question of first impression").

In sum, the Court appreciates that this Motion is motived at least in part by an attempt to resolve questions reaching beyond the facts at issue in this multidistrict litigation for the benefit of the Smart TV industry. (Mem. at 14–16.) But section 1292(b) does not permit district courts to certify orders merely because they pose interesting questions. As the Ninth Circuit has stressed, "[a] district court confronting a motion to certify pursuant to § 1292(b) should remain focused on the statutory requirements, not policy considerations which may or may not be furthered by certification."[5] *Couch*, 611 F.3d at 635. Because Vizio has not shown that this case falls within the very narrow category of "exceptional circumstances" where an interlocutory appeal is warranted, the Court DENIES its Motion to Certify.

IV. CONCLUSION

For the foregoing reasons, the Court DENIES the Vizio Defendants' Motion to Certify.

DATED: October 13, 2017

HON. JOSEPHINE L. STATON
UNITED STATES DISTRICT JUDGE

[5] Besides, Vizio grossly overstates the policy implications of this Court's construction of the VPPA; the Court simply did not suggest that anything with a screen is a video tape service provider. (*Contra* Mem at 11, Reply at 7–8.)

NOTES

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In re: Vizio, Inc., Consumer Privacy Litigation, Order Granting in Part and Denying in Part Defendants' Motion to Dismiss (Doc.116), Case No. 8:16-ml-02693-JLS-KES (C.D. Cal. Mar. 2, 2017)

Submitted by:
Andre M. Mura
Gibbs Law Group LLP

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In Re: Vizio, Inc., Consumer Privacy Litigation	CASE NO. 8:16-ml-02693-JLS-KES **ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTION TO DISMISS (Doc. 116)**

I. INTRODUCTION

Before the Court is a Motion to Dismiss filed by Defendants VIZIO Inc., VIZIO Holdings, Inc., VIZIO Inscape Technologies, LLC, and VIZIO Inscape Services, LLC (collectively, "Vizio"). (Mot., Doc. 116.) Plaintiffs Dieisha Hodges, Rory Zufolo, William DeLaurentis, John Walsh, Chris Rizzitello, and Linda Thomson filed an Opposition, and Defendants replied. (Opp'n, Doc. 121; Reply, Doc. 123.) For the following reasons, the Court GRANTS IN PART and DENIES IN PART Defendants' Motion to Dismiss.

II. BACKGROUND

Vizio is the second-largest manufacturer of "Smart TVs," cutting-edge televisions equipped with integrated software that enables consumers to access the Internet and on-demand services such as Netflix, Hulu, and Pandora. (Compl. ¶¶ 33, 35, 45, Doc. 108.) Known as the "Vizio Internet Apps," "Internet Apps Plus," and "SmartCast," Vizio's content delivery software comes either preinstalled on its Smart TVs or is installed through software updates. (*Id.* ¶ 45.) Vizio markets its Smart TVs as a "passport to a world of entertainment, movies, TV shows and more" and charges a premium for them because they are designed to seamlessly deliver on-demand video content to consumers. (*Id.* ¶¶ 34, 81.)

Plaintiffs allege that, unbeknownst to them, Vizio's Smart TVs use automatic content recognition software to collect and report consumers' content viewing histories. (*Id.* ¶¶ 39, 50, 127.) This software, called "Smart Interactivity," collects up to 100 billion content "viewing data points" along with detailed information about a consumer's digital identity, such as consumers' IP addresses, zip codes, MAC addresses, product model numbers, hardware and software versions, chipset IDs, region and language settings, as well as similar information about other devices connected to the same network. (*Id.* ¶¶ 39, 42, 54, 62.) The Smart Interactivity software transmits this information to Vizio's Inscape data services platform, which identifies the content a consumer has been watching by comparing the "viewing data points" to a database of existing content. (*Id.* ¶¶ 50, 62.) Vizio then sells all of this information to advertisers and media content providers so that

they can deliver highly targeted advertisements to Vizio Smart TVs and any smartphones, tablets, or computers connected to the same network. (*Id.* ¶¶ 2, 5, 35, 41-42.)

Plaintiffs contend that the constellation of information Vizio shares about consumers' digital identities "provides a 'game plan' to associate individuals with their viewing habits." (*Id.* ¶ 72.) One digital identifier that Vizio discloses, a MAC address, is a unique 12-digit identifier assigned to every mobile device, computer, Smart TV, or other electronic device. (*Id.* ¶ 69.) Because a MAC address is tied to a device's embedded chipsets, the identifier remains unchanged throughout the life of the electronic device. (*Id.*) MAC addresses, Plaintiffs allege, are frequently linked to an individual's name and can be used to acquire highly specific geolocation data. (*Id.* ¶¶ 70-71.) And, even if a MAC address alone is insufficient to identify a person, the information can readily identify a person when combined with the other information that Vizio discloses, such as IP addresses, zip codes, product model numbers, hardware and software versions, chipset IDs, and region and language settings. (*Id.* ¶¶ 72-79.) To support their argument, Plaintiffs provide two case studies where researchers were able to identify a significant percentage of individuals by analyzing several details about them. (*Id.* ¶¶ 74-78.) Plaintiffs also point to a Vizio prospectus, which highlights how the Inscape data services platform is able to "provide[] highly specific viewing behavior data on a massive scale with great accuracy." (*Id.* ¶ 62.)

Vizio's data collection and dissemination practices, Plaintiffs contend, are not adequately disclosed in its marketing or privacy policies. (*Id.* ¶¶ 22, 81-94, 105.) The packaging for its Smart TVs highlights Vizio's Internet Apps and Internet Apps Plus without mentioning that, if consumers use these features, Vizio's Smart Interactivity software will collect and disseminate information about their viewing history and digital identity. (*Id.* ¶¶ 81-85.) Nowhere during the setup process for a Vizio Smart TV does Vizio reference its Smart Interactivity software. (*Id.* ¶ 85.) Vizio's Privacy Policy, which consumers can view in very small font under the "Reset & Admin" submenu, assuages

consumers that it collects only "non-personal" and "anonymous" information and does not reveal that Vizio sells the information it collects to third parties. (*Id.* ¶¶ 86, 89-91.)

Contrary to the industry's standard practice, Vizio's Smart TVs come with Smart Interactivity automatically enabled. (*Id.* ¶¶ 6, 61.) To turn off Smart Interactivity, consumers must navigate through the Smart TV's menu to an obscure settings option that does not describe what Smart Interactivity does. (*Id.* ¶¶ 7, 85.) If a Smart TV is reset to its factory default settings—either intentionally or inadvertently—the Smart Interactivity software reactivates without consumers receiving any notice. (*Id.* ¶ 66.) A 2015 report by the security software company Avast found that the "off" capability for Smart Interactivity was not functional "for months, if not years." (*Id.* ¶¶ 7, 65.) So, even if consumers believed they had disabled Smart Interactivity (and the feature appeared to be "off"), their Smart TVs were still transmitting their digital information without their knowledge. (*Id.*)

Vizio allegedly has a strong incentive to ensure that consumers do not disable its Smart Interactivity software. (*Id.* ¶ 44.) Vizio's business model relies on the profits from its sales of consumer data to compensate for its relatively slim margins on Smart TVs. (*Id.* ¶¶ 43-44.) Vizio distinguishes its Inscape data services platform from competitors such as A.C. Nielson and Rentrak based on its ability to provide highly detailed information about 8 million American consumers in "real time." (*Id.* ¶¶ 40, 42.) As Vizio noted in an SEC filing, if consumers objected to or opted out of its Smart Interactivity software, Vizio's growth strategy would be jeopardized. (*Id.* ¶¶ 43-44.)

Plaintiffs assert they purchased Vizio Smart TVs unaware of Vizio's data collection and dissemination practices. (*Id.* ¶¶ 16-21.) They provide details about their Vizio Smart TVs, such as the model numbers and cities where they purchased them, and describe how they used their Vizio Smart TVs to watch on-demand video content. (*Id.*) After learning about Vizio's Smart Interactivity software, Plaintiffs disconnected their Smart TVs from the Internet or ceased watching certain on-demand video content on them. (*Id.*) Plaintiffs allege that, had they known about Vizio's data collection and disclosure practices, they

would not have purchased their Vizio Smart TVs or would have paid less for them. (*Id.* ¶ 22.)

Based on these allegations, Plaintiffs bring various privacy and misrepresentation-based claims under both federal and state law. Plaintiffs allege federal claims under the Video Privacy Protection Act (VPPA) and the Wiretap Act. (*Id.* ¶¶ 111-32.) Under state law, Plaintiffs bring common law fraud and negligent misrepresentation claims as well as consumer protection claims under California's Consumers Legal Remedies Act, California's Unfair Competition Law ("UCL"), California's False Advertising Law, Florida's Deceptive and Unfair Trade Practices Act, New York's General Business Law sections 349 and 350, Massachusetts's Chapter 93A, and Washington's Consumer Protection Act. (*Id.* ¶¶ 150-241, 250-53, 263-87, 301-17.) As for their state law privacy claims, Plaintiffs allege intrusion upon seclusion claims as well as causes of action under the California Constitution,[1] California's Invasion of Privacy Act, the Massachusetts Privacy Act, and state video privacy statutes. (*Id.* ¶¶ 133-49, 242-49, 254-62, 294-300.) Finally, Plaintiffs allege common law claims for unjust enrichment. (*Id.* ¶¶ 288-93.)

III. LEGAL STANDARD

A defendant may move to dismiss an action for lack of subject matter jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(1). Fed. R. Civ. P. 12(b)(1). "Dismissal for lack of subject matter jurisdiction is appropriate if the complaint, considered in its entirety, on its face fails to allege facts sufficient to establish subject matter jurisdiction." *In re Dynamic Random Access Memory (DRAM) Antitrust Litig.*, 546 F.3d 981, 984-85 (9th Cir. 2008). When considering a Rule 12(b)(1) motion, the Court "is not restricted to the face of the pleadings, but may review any evidence, such as affidavits and testimony,

[1] The parties briefed Plaintiffs' sixteenth cause of action, titled "Privacy Violation Based on Intrusion" (*see* Compl. ¶¶ 294-300), as a cause of action under both the California Constitution and state common law (*see* Mem. 34-37 & n.18; Opp'n at 31-35; Reply at 22-24), so the Court will treat it as such for purposes of this Motion. For clarity, Plaintiffs should specify in any amended complaint that they are alleging claims under both the California Constitution and common law.

to resolve factual disputes concerning the existence of jurisdiction." *McCarthy v. United States*, 850 F.2d 558, 560 (9th Cir. 1988). "The party asserting . . . subject matter jurisdiction bears the burden of proving its existence." *Chandler v. State Farm Mut. Auto. Ins. Co*., 598 F.3d 1115, 1122 (9th Cir. 2010).

In deciding a motion to dismiss under Rule 12(b)(6), courts must accept as true all "well-pleaded factual allegations" in a complaint. *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009). A court must draw all reasonable inferences in the light most favorable to the non-moving party. *See Daniels-Hall v. Nat'l Educ. Ass'n*, 629 F.3d 992, 998 (9th Cir. 2010). Yet, "courts 'are not bound to accept as true a legal conclusion couched as a factual allegation.'" *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (quoting *Papasan v. Allain*, 478 U.S. 265, 286 (1986)). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 570). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (citing *Twombly*, 550 U.S. at 556).

"[W]here a complaint includes allegations of fraud, Federal Rule of Civil Procedure 9(b) requires more specificity including an account of the 'time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentations.'" *Swartz v. KPMG LLP*, 476 F.3d 756, 764 (9th Cir. 2007) (quoting *Edwards v. Marin Park, Inc.*, 356 F.3d 1058, 1066 (9th Cir. 2004)). "A pleading is sufficient under [R]ule 9(b) if it identifies the circumstances constituting fraud so that a defendant can prepare an adequate answer from the allegations." *Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 540 (9th Cir. 1989).

IV. DISCUSSION

In their Motion, Defendants contend that Plaintiffs have not suffered a concrete injury sufficient to confer Article III standing. (Mem. at 6-13.) Defendants also move to dismiss all of Plaintiffs' claims for failure to state a claim. (Mem. at 13-38.) The Court will

first examine whether Plaintiffs have Article III and statutory standing before turning to whether they have adequately pleaded their claims.

A. Article III Standing

For Plaintiffs to have Article III standing, they must (1) have suffered an "injury in fact" that is "concrete and particularized" and "actual or imminent, not conjectural or hypothetical," (2) the harm must be "fairly trace[able]" to the defendants' conduct, and (3) the Court must be able to redress the claimed injury. *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 560-61 (1992). At each stage of a suit, the elements of Article III standing must "be supported in the same way as any other matter on which the plaintiff bears the burden of proof, *i.e.*, with the manner and degree of evidence required at the successive stages of the litigation." *Id.* at 561. Hence, "[a]t the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice." *Id.*; *Maya v. Centex Corp.*, 658 F.3d 1060, 1068 (9th Cir. 2011). Here, Defendants contest only whether Plaintiffs' averred injuries are sufficiently concrete to confer Article III standing. (Mem. 6-13.)

"For an injury to be 'concrete,' it must be 'real,' and not 'abstract.'" *Rodriguez v. El Toro Med. Inv'rs Ltd. P'ship*, No. SACV 16-59 (JLS) (KES), 2016 WL 6804394, at *3 (C.D. Cal. Nov. 16, 2016) (quoting *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1548 (2016)). But an injury need not be tangible—some injuries, though unquantifiable, are sufficiently concrete to establish Article III standing. *Spokeo*, 136 S. Ct. at 1549; *Rodriguez*, 2016 WL 6804394, at *3. In determining whether an intangible injury satisfies Article III's case-or-controversy requirement, "both history and the judgment of Congress play important roles." *Spokeo*, 136 S. Ct. at 1549. Although its discretion is not absolute, Congress may properly "elevat[e] to the status of legally cognizable injuries concrete, de facto injuries that were previously inadequate in law." *Id.* (quoting *Lujan*, 504 U.S. at 578).

i. The Video Privacy Protection Act and Wiretap Act Claims

1. The Common Law History of the Right to Privacy

Plaintiffs' federal claims under the Wiretap Act bear a "close relationship" to the tort of invasion of privacy. *See Spokeo*, 136 S. Ct. at 1549. The invasion of person's privacy was first identified as an independent "legal *injuria*" in Samuel D. Warren and future-Justice Louis Brandeis's seminal article *The Right to Privacy*. *See* Samuel D. Warren & Louis D. Brandeis, *The Right to Privacy*, 4 Harv. L. Rev. 193 (1890); William L. Prosser, *Privacy*, 48 Cal. L. Rev. 383, 384-85 (1960). Warren and Brandeis argued that certain lines of cases, although ostensibly sounding in intellectual property, contract, or fiduciary obligations are fundamentally irreconcilable with principles of those areas of the law and instead suggest a broader right "of the individual to be let alone." *See* Warren & Brandeis, *supra*, at 197-213. A natural development of the common law, Warren and Brandeis asserted, would be the recognition of a separate tort for invasion of privacy. *Id.* at 213-14. After some initial judicial trepidation, *see, e.g.*, *Roberson v. Rochester Folding Box Co.*, 64 N.E. 442 (N.Y. 1902), the tort quickly gained currency, such that the American Law Institute incorporated it in the First Restatement. *See* Restatement (First) of Torts § 867 (1939). As articulated in the First Restatement, an invasion of privacy is an "unreasonabl[e] and serious[] interfere[nce] with another's interest in not having his affairs known to others or his likeness exhibited to the public . . . ." *Id.*

Seventy years after the publication of Warren and Brandeis's original article, William Prosser added clarity to the field by identifying four distinct torts that fell under the general term "invasion of privacy": intrusion upon seclusion, public disclosure of private facts, false light, and appropriation of a person's name or likeness. *See* Prosser, *supra*, at 389-407. Of particular relevance here, Prosser found that intrusion upon seclusion covered a broad range of "offensive or objectionable" meddling, such as eavesdropping, harassing someone through incessant telephone calls, and prying into a person's private records. *See id.* at 389-91.

The Second Restatement adopted Prosser's interpretation of intrusion upon seclusion, defining the tort as the intentional intrusion "upon the solitude or seclusion of another or his private affairs or concerns . . . if the intrusion would be highly offensive to a reasonable person." Restatement (Second) of Torts § 652B (1977). Like Prosser, the Second Restatement identified as examples of actionable conduct eavesdropping ("with or without mechanical aids"), examining a person's private correspondence or records without consent, and making repeated telephone calls. *See id.* at cmts. b, c. While the modern contours of the tort of intrusion upon seclusion—and invasion of privacy more broadly—may not encompass the kind of detailed collection of a consumer's content viewing history alleged here, the close similarity between the conduct proscribed under the Wiretap Act and the tort of intrusion upon seclusion confirms the concreteness of Plaintiffs' injury.

Plaintiffs' VPPA claims are even more deeply rooted in the common law. Warren and Brandeis traced the development of the tort of invasion of privacy in part to cases involving the disclosure of information in breach of a confidential relationship. *See* Warren & Brandeis, *supra*, at 207-11; Prosser, *supra*, at 389-407 (observing that there must be "some breach of contract, trust or confidential relation" for a disclosure of information to a limited group of people to be tortious). Here, like in many other circumstances, the duty of confidentiality is imposed by statute. *See In re Nickelodeon Consumer Privacy Litig.*, 827 F.3d 262, 274 (3d Cir. 2016); *see also, e.g.*, 5 U.S.C. § 552a(g)(1) (Privacy Act); 12 U.S.C. § 3417(a) (Right to Financial Privacy Act); 18 U.S.C. § 2724(a) (Driver's Privacy Protection Act of 1994).

2. Congress's Judgement

Besides the close relationship between Plaintiffs' federal causes of action and well-established torts, Congress has determined that the interception of a person's electronic communications and the unauthorized disclosure of a person's video viewing history are sufficiently harmful to warrant private causes of action. "[B]ecause Congress is well positioned to identify intangible harms that meet minimum Article III requirements," its

conclusion is "instructive and important." *Spokeo, Inc.*, 136 S. Ct. at 1549. Defendants counter that the information they disclose is not personally identifiable, so Congress's creation of a private right of action for violations of the VPPA does not support Plaintiffs' claim of standing. (Reply at 3 n.1.) But this argument improperly conflates the merits of Plaintiffs' claims with their standing to bring suit. Taken to its logical conclusion, Defendants' argument absurdly implies that a court could never enter judgment against a plaintiff on a VPPA claim if it found that the disclosed information was not within the statutory definition of personally identifiable information; instead, it would have to remand or dismiss the action for lack of jurisdiction.[2] *Cf. Thornhill Pub. Co. v. Gen. Tel. & Elecs. Corp.*, 594 F.2d 730, 734 (9th Cir. 1979) ("[W]hen a statute provides the basis for both the subject matter jurisdiction of the federal court and the plaintiffs' substantive claim for relief, a motion to dismiss for lack of subject matter jurisdiction rather than for failure to state a claim is proper only when the allegations of the complaint are frivolous").

In sum, both history and Congress's judgment demonstrate that Plaintiffs' claimed injuries are sufficiently concrete for Plaintiffs to have standing to bring suit under the Video Privacy Protection Act and Wiretap Act.

ii. State Law Privacy Claims

For similar reasons, Plaintiffs have Article III standing to pursue their state law claims for invasion of privacy and intrusion upon seclusion. *See Opperman v. Path, Inc.*, 87 F. Supp. 3d 1018, 1057 (N.D. Cal. 2014) ("It is beyond meaningful dispute that a plaintiff alleging invasion of privacy as Plaintiffs do here presents a dispute the Court is permitted to adjudicate."); 13A Charles Alan Wright & Arthur R. Miller et al., Federal

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[2] The only case Defendants cite in which a district court dismissed a VPPA claim for lack of standing involved a complaint so inadequately pleaded that there was no support for the plaintiffs' claimed injury. *See Mendoza v. Microsoft Inc.*, No. C14-316-MJP, 2014 WL 4540213, at *3 (W.D. Wash. Sept. 11, 2014) ("Plaintiffs do not allege a single fact to support their allegation that Microsoft allegedly retained and disclosed personally identifiable information."). By contrast, Plaintiffs' 61-page complaint is well pleaded.

Practice & Procedure § 3531.4 (3d ed. 2017). As noted earlier, the tort of invasion of privacy has been firmly established in the American common law for approximately a century. Regardless of whether the alleged conduct ultimately states a claim, "the events that the complaint describes are concrete, particularized, and actual as to the plaintiffs." *In re Google Inc. Cookie Placement Consumer Privacy Litig.*, 806 F.3d 125, 134-35 (3d Cir. 2015).

iii. Consumer Protection Claims

As for their state consumer protection claims, Plaintiffs' allege that they "would not have purchased, or would have paid less for, their Vizio Smart TVs had Defendants not concealed their collection and disclosure of Plaintiffs' personal information. (Compl. ¶¶ 14, 22, 180, 188, 192, 200, 212, 214, 219, 225, 235, 237, 273, 278, 286.) Such "palpable economic injuries have long been recognized as sufficient to lay the basis for standing." *Sierra Club v. Morton*, 405 U.S. 727, 733 (1972). Indeed, in *Hinojos v. Kohl's Corp.*, the Ninth Circuit found "no difficulty" in concluding that the plaintiffs had Article III standing based on their assertion that they "paid more for [a product] than they otherwise would have paid, or bought it when they otherwise would not have done so." 718 F.3d 1098, 1104 n.3 (9th Cir. 2013) (quoting *Mazza v. Am. Honda Motor Co.*, 666 F.3d 581, 595 (9th Cir. 2012)). Defendants unpersuasively attempt to distinguish *Hinojos* by arguing that Plaintiffs do not allege that Vizio misrepresented its "product's quality or ability to perform an intrinsic function." (Mem. at 11 n.5.) In other words, Defendants argue that the only factors material to a consumer's purchasing decision are whether the Smart TV performs its "television-related functions" and is not "defective" (*see id.*), terms that Defendants do not define. The Court cannot conclude that materiality should be so narrowly defined for the purpose of determining subject matter jurisdiction. Accordingly, Plaintiffs have Article III standing to bring their consumer protection claims.

iv. Scope of Named Plaintiffs' Article III Standing

Defendants finally contend that Plaintiffs lack Article III standing to bring claims on behalf of consumers who purchased Smart TVs with SmartCast because Plaintiffs did

not purchase Smart TVs with this software. (Mem. at 12-13; Reply at 4.) Plaintiffs respond that the products and operative facts at issue are sufficiently similar to give them standing to bring claims on behalf of purchasers of Vizio TVs with SmartCast as well. (Opp'n at 10.)

Courts have taken three broad positions on how related the product purchased by the named plaintiff and putative class members must be. Some courts find that the named plaintiff can represent only those who purchased the exact same product. *See, e.g.*, *Kisting v. Gregg Appliances, Inc.*, No. 16-CV-141, 2016 WL 5875007, at *5 (E.D. Wis. Oct. 7, 2016). These courts often rely heavily on language from the Supreme Court's decision in *Lewis v. Casey*, 518 U.S. 343 (1996). *See, e.g.*, *Kisting*, 2016 WL 5875007, at *4-5; *Ferrari v. Best Buy Co.*, No. CIV. 14-2956 MJD/FLN, 2015 WL 2242128, at *7 (D. Minn. May 12, 2015). Other courts hold that the relatedness of the putative class representative's and proposed class members' claims implicates only Rule 23's adequacy and typicality requirements—not Article III standing—and accordingly reserve judgment until a class certification motion. *See, e.g.*, *Weisblum v. Prophase Labs, Inc.*, 88 F. Supp. 3d 283, 291 (S.D.N.Y. 2015); *Cardenas v. NBTY, Inc.*, 870 F. Supp. 2d 984, 992 (E.D. Cal. 2012). Still others allow a named plaintiff to assert claims on behalf of absent class members if the products that the putative class members bought are "substantially similar" to the product the named plaintiff purchased. *Coleman-Anacleto v. Samsung Elecs. Am., Inc.*, No. 16-CV-02941-LHK, 2016 WL 4729302, at *10 (N.D. Cal. Sept. 12, 2016).

The first approach, which holds that a putative class member has standing to represent only those who purchased the exact same model, is irreconcilable with the Supreme Court's decision in *Gratz v. Bollinger*, 539 U.S. 244 (2003). In *Gratz*, Justice Stevens argued in dissent that the University of Michigan's treatment of race in transfer admissions differed from its treatment of race in freshmen admissions, so the class representative—who intended to submit a transfer application—lacked standing to seek an injunction on behalf of the freshmen applicants. 539 U.S. at 286-87 (Stevens, J., dissenting). The *Gratz* majority acknowledged that "there is tension in our prior cases"

over whether this is properly considered a question of standing or the propriety of class certification under Rule 23(a). *Id.* at 263 & n.15. Either way, the class representative could represent the freshman applicants because the freshman admissions process "[did] not implicate a *significantly different* set of concerns." *Id.* at 265 (emphasis added).

The second approach, which characterizes the question as one solely of adequacy and typicality under Rule 23(a), is also difficult to square with Supreme Court precedent. In *Blum v. Yaretsky*, the Supreme Court held that nursing home patients, though having standing to represent a class of patients threatened with discharges or transfers to lower levels of care, did not have standing to represent those threatened with transfers to higher levels of care. 457 U.S. 991, 1001 (1982). The Supreme Court held that "the conditions under which such transfers occur are sufficiently different from" those faced by the named plaintiffs "that any judicial assessment of their procedural adequacy would be wholly gratuitous and advisory." *Id.* Similarly, in *Lewis*, the Supreme Court held that an illiterate prisoner lacked standing to challenge other prisoners' lack of access to courts where the other class members' claims were unrelated to the inability to read legal materials. 518 U.S. at 358. Specifically, the Supreme Court held that the class representative could not represent non-English speakers, prisoners in lockdown, or the inmate population at large. *Id. Blum* and *Lewis* thus treated the relatedness of a named plaintiff's claims to those of the class as implicating standing as well as the propriety of class certification. *See Blum*, 457 U.S. at 1001; *Lewis*, 518 U.S. at 358; *Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 158-59 n.13 (1982) (evaluating the question under Rule 23(a)'s adequacy, typicality, and commonality requirements). *Lewis* further suggests—albeit in dicta—that, although a motion to dismiss typically addresses only a named plaintiff's individual claims, a named plaintiff's standing to seek relief on behalf of putative class members can be raised on a motion to dismiss. *See Lewis*, 518 U.S. at 357.

The Court, therefore, finds that the third approach most closely accords with *Blum*, *Lewis*, and *Gratz*. Using the "substantially similar" standard, the overarching question is whether the plaintiff's averred injury is substantially similar to the claims of those she

seeks to represent.[3] At the motion to dismiss stage, however, the Court's review of the scope of a named plaintiff's Article III standing is necessarily limited. Like any other question of standing resolved at the pleading stage, "general factual allegations" that raise a reasonable inference that the products are substantially similar "may suffice." *Lujan*, 504 U.S. at 561. The Supreme Court observed as much in *Lewis*, stating, "[t]he general allegations of the complaint in the present case may well have sufficed to claim injury by named plaintiffs, and hence standing to demand remediation" on behalf of the various putative class members. 518 U.S. at 357. And, by the class certification stage, this standing question becomes effectively subsumed into Rule 23(a)'s "rigorous" typicality and adequacy requirements. *See Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350-51 (2011); *Falcon*, 457 U.S. at 158-59 n.13.

Here, Plaintiffs allege that their Smart TVs and those with SmartCast collect and disclose the same information through Vizio's Smart Interactivity software. (Compl. ¶¶ 55, 58.) While Plaintiffs' Complaint includes a few paragraphs alleging additional information collected by Vizio's SmartCast software (*id.* ¶¶ 48, 55, 57), none of Plaintiffs' alleged injuries hinge on the collection of this additional information. Plaintiffs, therefore, have adequately alleged that Vizio's SmartCast-enabled Smart TVs and their Smart TVs are "sufficiently similar" for Plaintiffs to have Article III standing to represent a class encompassing purchasers of both types of televisions.

In sum, because Plaintiffs have adequately pleaded Article III standing, the Court DENIES Defendants' Motion to Dismiss for lack of subject matter jurisdiction.

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[3] While the similarity of the products at issue is one important factor to consider, the similarity of the operative facts that give rise to the putative class representative and putative class's claims is equally important. *See In re L'Oreal Wrinkle Cream Mktg. & Sales Practices Litig.*, No. CIV. 2:12-03571 WJM, 2013 WL 6450701, at *4 (D.N.J. Dec. 9, 2013).

B. Statutory Standing

Unlike Article III standing, statutory standing is not a question of subject matter jurisdiction but rather an element of a plaintiff's cause of action. As such, statutory standing is properly scrutinized under Rule 12(b)(6). *See Maya*, 658 F.3d at 1067. In this case, Plaintiffs plausibly allege that they would not have purchased or would have paid less for their Vizio Smart TVs had Vizio properly disclosed its consumer data collection and disclosure practices. (Compl. ¶¶ 22, 161, 164-69, 180, 182-88, 192-93, 200-01, 212-15, 219, 225, 233-38, 272-74, 278, 286.) This price premium theory is cognizable under California's UCL, CLRA, and FAL; Florida's FDUTPA; and Massachusetts's Chapter 93A. *See Kwikset Corp. v. Super. Ct.*, 246 P.3d 877, 881 (Cal. 2011) ("[P]laintiffs who can truthfully allege they were deceived by a product's label into spending money to purchase the product, and would not have purchased it otherwise, have 'lost money or property' within the meaning of [the UCL.]"); *Smith v. Wm. Wrigley Jr. Co.*, 663 F. Supp. 2d 1336, 1339 (S.D. Fla. 2009) ("Florida courts have allowed diminished value to serve as 'actual damages' recoverable in a FDUTPA claim."); *Ferreira v. Sterling Jewelers, Inc.*, 130 F. Supp. 3d 471, 479 (D. Mass. 2015) ("Overpayment can constitute an economic loss that is cognizable under [Massachusetts's] chapter 93A where the consumer continues to own the misrepresented product 'whose value was artificially inflated by a deceptive act or practice at the time of purchase.'" (citation omitted)).

While the viability of a price premium theory may be less settled under New York's General Business Law sections 349 and 350, *see In re: Lenovo Adware Litigation*, No. 15-MD-02624-RMW, 2016 WL 6277245, at *10-11 (N.D. Cal. Oct. 27, 2016), the case law on balance recognizes that a plaintiff has statutory standing if she paid a premium due to the defendant's deceptive practice. In *Koenig v. Boulder Brands, Inc.*, the district court found plaintiffs' allegations that they paid a premium for a product based on its "fat free" label sufficient to establish statutory standing under General Business Law sections 349 and 350. 995 F. Supp. 2d 274, 288 (S.D.N.Y. 2014). Citing *Koenig* with approval, the Second Circuit subsequently held in *Orlander v. Staples, Inc.* that plaintiffs have statutory

standing under New York's General Business Law sections 349 and 350 if they "paid more than they would have for the good but for the deceptive practices of the defendant-sellers." 802 F.3d 289, 302 (2d Cir. 2015); *see also Small v. Lorillard Tobacco Co.*, 720 N.E.2d 892, 898 & n.5 (N.Y. 1999). New York Plaintiff Chris Rizzitello indicates that, after purchasing his Vizio Smart TV at a Walmart in Catskill, New York, he used the Smart TV's features to stream videos from YouTube and other content providers. (Compl. ¶ 20.) After learning about Vizio's data collection and disclosure practices, he stopped streaming content, disconnected his Smart TV from the Internet, and, after learning how to turn off the Smart Interactivity feature, did so. (*Id.* ¶ 20.) Thus, like the other named Plaintiffs, Rizzitello plausibly alleges that, had he been informed about Vizio's data collection and disclosure practices, he would have paid less for the Smart TV or not purchased the product at all. (*Id.* ¶¶ 14, 20, 22, 235.)

Accordingly, Defendants' Motion to Dismiss Plaintiffs' state consumer protection claims for lack of statutory standing is DENIED.

C. Video Privacy Protection Act (VPPA) Claims

Enacted in 1988, the Video Privacy Protection Act provides that "[a] *video tape service provider* who knowingly discloses, to any person, *personally identifiable information* concerning any *consumer* of such provider shall be liable to the aggrieved person . . . ." 18 U.S.C. § 2710(b)(1) (emphasis added); *see* Video Privacy Protection Act of 1988, S. 2361, 100th Cong., 102 Stat. 3195 (1988). Defendants seek to dismiss Plaintiffs' VPPA claims, arguing that they are not "video tape service provider[s]," that Plaintiffs are not "consumer[s]" as defined by the statute, and that Defendants do not disclose "personally identifiable information." (Mem. at 12-21.)

"[W]hen [a] statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.*, 530 U.S. 1, 6 (2000)). "The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in

which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). A statute is not ambiguous merely because it is awkward or even ungrammatical. *Lamie*, 540 U.S. at 534. By striving to interpret a statute based on its text, a court "avoid[s] the pitfalls that plague too quick a turn to the more controversial realm of legislative history." *Id.* at 536.

i. "Video Tape Service Provider"

The VPPA provides that a "'video tape service provider' means any person, engaged in the business, in or affecting interstate or foreign commerce, of rental, sale, or delivery of prerecorded video cassette tapes or similar audio visual materials . . ." 18 U.S.C. § 2710(a)(4). Defendants contend that they are not "engaged in the business . . . of . . . delivery of . . . similar audio visual materials." (Mem. at 13-16.)

The plain text of the statute provides otherwise. As an initial matter, Congress's use of a disjunctive list (*i.e.*, "engaged in the business . . . of . . . rental, sale, *or* delivery") unmistakably indicates that Congress intended to cover more than just the local video rental store. Indeed, lest the word "delivery" be superfluous, a person need not be in the business of either renting or selling video content for the statute to apply. Further, Congress's use of the phrase "similar audiovisual materials" indicates that the definition is medium-neutral; the defendant must be in the business of delivering video content, but that content need not be in a particular format. *See, e.g.*, *In re Hulu Privacy Litig.*, No. C 11-03764 LB, 2012 WL 3282960, at *5 (N.D. Cal. Aug. 10, 2012).

Finally, to be a "video tape service provider," a defendant must be "*engaged in the business . . . of . . .* delivery of" video content. 18 U.S.C. § 2710(a)(4) (emphasis added). When used in this context, "business" connotes "a particular field of endeavor," *i.e.*, a focus of the defendant's work. *See* Webster's Third New International Dictionary 302 (1981) (def. 1d); *see also* The American Heritage Dictionary: Second College Edition 220 (1991) (defs. 1a, 1b); 2 Oxford English Dictionary 695 (1989) (def. 14b); Webster's New World Dictionary: Third College Edition 189 (1988) (def. 1). Under this definition, a defendant can be "engaged in the business" of delivering video content even if other actors

also take part in the delivery of the same video content. But, for the defendant to be engaged in the business of delivering video content, the defendant's product must not only be substantially involved in the conveyance of video content to consumers but also significantly tailored to serve that purpose.

Take, for instance, a letter carrier who physically places a package that happens to contain a videotape into a consumer's mailbox. No person is more obviously "delivering" a video tape to a consumer than this employee. Yet, the letter carrier could not be characterized as "engaged in *the business*" of delivering video content because her job responsibilities are in no way tailored to delivering packages that contain videotapes as opposed to any other package. In the same way, the developers of many other products or services that might be peripherally or passively involved in video content delivery do not fall within the statutory definition of a video tape service provider.

In keeping with this statutory definition, Plaintiffs plausibly allege that Vizio's Internet Apps and Internet Apps Plus are designed to enable consumers to seamlessly access Netflix, Hulu, YouTube, and Amazon Instant Video content in their homes. (Compl. ¶¶ 33-34, 45-46, 81.) A reasonable inference is that Vizio enters into agreements with these content providers to enable consumers to access their programming on Vizio's Smart TVs. (*See id.* ¶ 45; Opp'n at 12-13.) Vizio then advertises its Smart TVs as "a passport to a world of entertainment, movies, TV shows and more," and charges consumers a premium for its Vizio Smart TVs specifically because these Smart TVs are designed to stream video content through Vizio's Internet Apps and Internet Apps Plus software. (Compl. ¶¶ 34, 81.) Essentially, Vizio has designed its Smart TVs to perform all the same functions of—and its Smart TVs are in direct competition with—Roku's devices (*see id.* at ¶ 18; Opp'n at 11); that Vizio has integrated what others sell as a separate device into its televisions makes no meaningful difference.

Vizio's alternative construction of the statute starts with the implicit premise that there can be only one video tape service provider in any transaction, and, because the content provider (like Hulu or Netflix) does fit within the statutory definition of a video

tape service provider, Vizio cannot. (*See* Mem. 14-16.) But such a limitation is found nowhere in the text of the statute, and Vizio's construction fails to give the phrase "engaged in the business . . . of" any real meaning.

Defendants also resort to parade of horribles, arguing that if Vizio is considered a video tape service provider, "[c]ountless products and services," such as "shipping services, Blu-Ray players, smartphones, app stores, cable boxes, wireless routers, personal computers, video game consoles, and even cars" would also fall within the statutory definition of video tape service providers. (Mem. at 16; Reply at 5-7.) But the statute's text once again alleviates Vizio's concerns. Most of these products or services are far too peripherally or passively involved in the delivery of video content to reasonably constitute "the business" of delivering video content. By contrast, Plaintiffs allege that Vizio has developed a product intimately involved in the delivery of video content to consumers, has created a supporting ecosystem to seamlessly deliver video content to consumers (including entering into agreements with content providers such as Netflix and Hulu), and has marketed its product to consumers as a "passport" to this video content. Other textual limitations further cabin the scope of the Act: The VPPA applies only if the consumer is a "renter, purchaser, or subscriber of goods or services" from the video tape service provider. 18 U.S.C. §§ 2710(a)(1), (b). And a video tape service provider is liable only if it releases personally identifiable information without the consent of the consumer. *Id.* §§ 2710(a)(3), (b). Accordingly, Vizio's policy-laden argument cannot overcome the statute's plain meaning.

ii. "Consumer"

The VPPA defines a "consumer" as "any renter, purchaser, or subscriber of goods or services from a video tape service provider." 18 U.S.C. § 2710(a)(1). Thus, unlike its definition of "video tape service provider," the statute's definition of "consumer" is somewhat narrower than the word's ordinary meaning. Because Plaintiffs do not contend they are renters or purchasers, they must be "subscribers" for the VPPA to apply.

In *Ellis v. Cartoon Network, Inc.*, the Eleventh Circuit held that "a person who downloads and uses a free mobile application on his smartphone to view freely available content, without more, is not a 'subscriber' . . . under the VPPA." 803 F.3d 1251, 1252 (11th Cir. 2015). After analyzing various definitions of "subscriber," the Eleventh Circuit concluded that that a "'subscription' involves some type of commitment, relationship, or association (financial or otherwise) between a person and an entity." *Id.* at 1256. While a "payment is not a necessary element of subscription," it is "one factor a court should consider when determining whether an individual is a 'subscriber' under the VPPA." *Id.* Besides payment, other factors to consider are "registration, commitment, delivery, [expressed association,] and/or access to restricted content." *Id.* (citation omitted).

By contrast, in *Yershov v. Gannett Satellite Information Network, Inc.*, the First Circuit concluded that a consumer need not make a monetary payment in return for a mobile application to be considered a "subscriber." 820 F.3d 482, 488-89 (1st Cir. 2016). Instead, the plaintiff's provision of personal information in return for the defendant's video content was sufficient consideration for the plaintiff to be a "subscriber." *Id.* at 489. And, by downloading the defendant's application, the plaintiff "established a relationship with [the defendant] that [was] materially different from what would have been the case had [the defendant's publication] simply remained one of millions of sites on the web that [the plaintiff] might have accessed through a web browser." *Id.*

Here, Plaintiffs are more plausibly "subscribers" than the plaintiffs in either *Ellis* or *Yershov* because they allege that they *do* pay for Vizio's applications. Plaintiffs contend that Vizio charges a premium for its Smart TVs because of their ability to seamlessly deliver video content to consumers through Vizio's Internet Apps, Internet Apps Plus, and SmartCast. (Compl. ¶¶ 22, 33.) After consumers purchase their Smart TVs, Vizio continues to service them by pushing software updates that improve security and provide additional features. (*See id.* ¶¶ 45, 59, 66, 92.) Thus, under either *Ellis* or *Yershov*'s holdings, Plaintiffs plausibly allege an association with Vizio that is sufficiently substantial and ongoing to constitute a subscription.

iii. "Personally Identifiable Information"

Defendants' finally contend that they do not disclose "personally identifiable information" because "Plaintiffs have alleged . . . only that Defendants have disclosed device identifying information." (Mem. at 17-21; Reply 7-9.) For their part, Plaintiffs assert that the array of data Vizio purportedly discloses about them—including MAC addresses, IP addresses, zip codes, chipset IDs, product model numbers, hardware and software versions, region and language settings, viewing history, purchase history, and "the presence of other devices connected to [the same] network"—falls within the statutory definition of "personally identifiable information." (Opp'n 15-18; Compl. ¶¶ 63, 72.)

By its own terms, the VPPA prohibits the disclosure of "personally identifi*able* information." 18 U.S.C. § 2710(a)(3) (emphasis added). The suffix "able" means "capable of," so "personally identifiable information" plainly extends beyond a consumer's name. Webster's Third New International Dictionary 4, 1123 (1981). Indeed, had Congress intended to limit the statute to protecting the disclosure of an individual's name (when linked to particular video rentals), it could have easily done so and avoided the Act's broader—and admittedly clunky—phrasing. *See Yershov*, 820 F.3d at 486. Turning to the VPPA's defined terms, three of the four statutory definitions use the word "means" to restrict the defined term to the statutory definition. *See* 18 U.S.C. §§ 2710(a)(1), (a)(2), (a)(4). "As a rule, [a] definition which declares what a term 'means' . . . excludes any meaning that is not stated." *Burgess v. United States*, 553 U.S. 124, 130 (2008) (citation omitted). But Congress chose the word "includes" instead for the definition of "personally identifiable information." *See* 18 U.S.C. § 2710(a)(3). This word "normally implies that the proffered definition falls short of capturing the whole meaning."[4] *Yershov*, 820 F.3d at

[4] Although the Court does not believe that resorting to the legislative history is necessary, the Senate Report on the VPPA confirms that this different wording (*i.e.*, "includes" instead of "means") was intentional. S. Rep. No. 100-599, at 12 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 4342-1, 4342-9 ("[P]aragraph (a)(3) uses the word "includes" to establish a minimum, but not exclusive, definition of personally identifiable information.").

486; *see, e.g.*, *United States v. Angelilli*, 660 F.2d 23, 31 (2d Cir. 1981) ("The use of the word 'includes,' rather than a more restrictive term such as 'means,' 'indicates that the list is not exhaustive but merely illustrative.'" (citation omitted)). Hence, while "information which identifies a person as having [selected] a video" surely is covered, "personally identifiable information" is not restricted to such information. *See* 18 U.S.C. § 2710(a)(3); *Yershov*, 820 F.3d at 486.

The statutory structure confirms that Congress intended "personally identifiable information" to encompass more than a person's name and physical address. In the original Act, Congress included both an opt-out and opt-in disclosure process. If a consumer opted in to a disclosure, a video tape service provider could reveal any type of personally identifiable information. Video Privacy Protection Act of 1988, S. 2361, 100th Cong. § 2, 102 Stat. 3195 (1988). But if the consumer had to opt out of the disclosure, the video tape service provider could disclose only the consumer's name and address. *See id.* Thus, Congress contemplated that the Act would protect more than just a person's name or physical address. *Yershov v. Gannett Satellite Info. Network, Inc.*, 104 F. Supp. 3d 135, 140 (D. Mass. 2015), *rev'd in part on other grounds*, 820 F.3d 482 (1st Cir. 2016).

Based on many of these textual clues, the First Circuit in *Yershov* concluded that "personally identifiable information" extends beyond a person's name to embrace "information reasonably and foreseeably likely to reveal which . . . videos [the plaintiff] has obtained." 820 F.3d at 486. While at some point "the linkage of information to identity becomes too uncertain, or too dependent on too much yet-to-be-done, or unforeseeable detective work," the court found the plaintiff's allegations that the defendant disclosed his phone's GPS coordinates from the moment when he watched videos to be personally identifiable information. *Id.*

By contrast, the Third Circuit in *In re Nickelodeon* held that IP addresses do not constitute personally identifiable information under the VPPA. *See* 827 F.3d at 290. While recognizing that the "text itself is . . . amenable" to a broader interpretation, the Third Circuit relied heavily on statements by Senator Patrick Leahy and Representative Robert

Kastenmeier at a joint hearing to conclude that personally identifiable information covers only "the kind of information that would readily permit an ordinary person to identify a specific individual's video-watching behavior." *Id.* at 285-86, 290.

The Court finds *Yershov* to be a more persuasive interpretation of the VPPA than *In re Nickelodeon*. First, *Yershov* focused foremost on the text of the statute, while *In re Nickelodeon* turned quickly to "the more controversial realm of legislative history." *See Lamie*, 540 U.S. at 536. Perhaps, if the statutory language were particularly indecipherable and the legislative history decisively resolved the issue, this approach might be understandable. But *In re Nickelodeon* recognized that "portions" of the legislative history suggested a *broader* interpretation of personally identifiable information and the statutory text was "amenable" to such an interpretation. 827 F.3d at 286-86.[5] Second, *In re Nickelodeon* relied heavily on Congress's decision *not* to amend the statute substantially in 2002. As the Supreme Court has instructed, this kind of "[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation." *Bruesewitz v. Wyeth LLC*, 562 U.S. 223, 242 (2011). Indeed, *Yershov* examined the same Congressional inaction and reached the exact *opposite* conclusion about its proper meaning. *See* 820 F.3d at 488. Third, under the Third Circuit's "ordinary person" test it would be highly questionable whether even social security numbers would constitute personally identifiable information because, as the Third Circuit itself recognized, this information "might not be easily matched to . . . persons without consulting another entity, such as a credit reporting agency or government bureau." *In re Nickelodeon Consumer Privacy Litig.*, 827 F.3d at 283.

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[5] The Third Circuit's legislative history analysis focused on two statements made at a joint hearing that do not obviously concern the proper scope of the term "personally identifiable information" and relate to a prior version of the bill that also covered libraries. *In re Nickelodeon Consumer Privacy Litig.*, 827 F.3d at 285-86. The Supreme Court has repeatedly criticized attempts to divine Congressional intent from "highly generalized, conflicting statements in the legislative history." *Rust v. Sullivan*, 500 U.S. 173, 185 (1991).

Yet, the Court need not disagree with *In re Nickelodeon* because Plaintiffs allege that Vizio's Inscape platform discloses even more about their digital identities—in particular, consumers' MAC addresses and information about other devices connected to the same network. Plaintiffs allege that MAC addresses are frequently linked to an individual's name and can be used to acquire highly specific geolocation data. (Compl. ¶¶ 69-71.) MAC addresses allegedly can also identify a person when combined with Vizio's disclosure of consumers' IP addresses, zip codes, product model numbers, hardware and software versions, chipset IDs, and region and language settings. (*Id.* ¶¶ 72-79.) Besides collecting and disclosing extensive information regarding consumers' Smart TVs, Vizio supposedly collects and discloses information about all other devices connected to the same network. (*Id.* ¶¶ 63, 72.) Plaintiffs have thus plausibly alleged that Vizio's provision of—to quote its own prospectus—"highly specific viewing behavior data on a massive scale with great accuracy" amounts to the disclosure of personally identifiable information.[6] (*Id.* ¶ 62.)

The Court stresses the posture of this case: Ultimately, Plaintiffs will have to demonstrate that Vizio's disclosures are "reasonably and foreseeably likely to reveal" what video content Plaintiffs have watched. *Yershov*, 820 F.3d at 486. But this is a factual inquiry ill-suited for resolution on a motion to dismiss. *Yershov*, 104 F. Supp. 3d at 145 (observing that a "factual record would need to be developed before concluding that an Android ID is not PII"). The Court simply cannot accept Vizio's offer to engage in judicial fact-finding or make sweeping determinations as a matter of law on this Motion to Dismiss. Because Plaintiffs have plausibly alleged that the array of information Vizio

[6] While this Motion was pending, the FTC, in conjunction with a consent decree, filed a complaint against Vizio regarding its collection and disclosure practices. (*See* Notice of Pendency, Doc. 128.) Because the FTC's allegations have not been incorporated into Plaintiffs' Complaint, the Court does not consider them in determining the plausibility of Plaintiffs' claims.

discloses about them is personally identifiable information, the Court must DENY Vizio's Motion to Dismiss Plaintiffs' VPPA claims.[7]

D. Wiretap Act Claims

The Wiretap Act affords a private right of action to "any person whose wire, oral, or electronic communication is intercepted, disclosed, or intentionally used in violation of this chapter . . . ." 18 U.S.C. § 2520(a). Defendants argue that Plaintiffs' Wiretap Act claims should be dismissed because Defendants do not "intercept" any electronic communications and the messages they collect do not constitute the "contents" of an electronic communication. (Mem. at 23-27.) For the reasons elaborated below, the Court concludes that Plaintiffs have inadequately pleaded interception.

The Wiretap Act proscribes the "intentional[] intercept[ion] . . . [of] any wire, oral, or electronic communication." 18 U.S.C. § 2511(1)(a). In *Konop v. Hawaiian Airlines, Inc.*, the Ninth Circuit held that, for an electronic communication "to be 'intercepted' in violation of the Wiretap Act, it must be acquired during transmission, not while it is in electronic storage." 302 F.3d 868, 878 (9th Cir. 2002). In so holding, *Konop* strove to distinguish between information acquired *contemporaneously* to its transmission and information that resides in electronic storage. *Id.*; *see Theofel v. Farey-Jones*, 359 F.3d 1066, 1077 (9th Cir. 2004) ("We . . . held in *Konop v. Hawaiian Airlines, Inc.* . . . that the Act applies only to "acquisition contemporaneous with transmission." (citation omitted)). Access to information maintained in electronic storage is governed by the Stored Communications Act, while the Wiretap Act regulates access to information acquired contemporaneously to its transmission. *See Konop*, 302 F.3d at 878.

While some language in *Konop* suggests that information cannot be "intercepted" within the meaning of the Wiretap Act if it is acquired *simultaneously* with its arrival, *see id.* at 879-880, the issue was not squarely presented in the case. The plaintiff in *Konop*

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[7] Plaintiffs have chosen to abandon their state law video privacy claims (Opp'n at 3 n.2), so the Court DISMISSES Plaintiffs' fourth, tenth, and twelfth causes of action.

alleged that his former employer used another employee's password to access disparaging posts that the plaintiff kept on his online bulletin board. *Id.* at 873. Thus, the information the employer acquired had been in electronic storage for a considerable period before his employer accessed it. Like *Konop*, most of the decisions in this Circuit addressing the simultaneous transmission requirement involve the collection of emails or other communications that were unquestionably in electronic storage for a substantial period before the defendants collected them. *See, e.g.*, *Theofel v. Farey-Jones*, 359 F.3d 1066, 1077 (9th Cir. 2004) (stored emails); *NovelPoster v. Javitch Canfield Grp.*, 140 F. Supp. 3d 938, 953 (N.D. Cal. 2014) (stored emails); *see also Steve Jackson Games, Inc. v. U.S. Secret Serv.*, 36 F.3d 457, 460 (5th Cir. 1994) (stored unread emails).

In *United States v. Szymuszkiewicz*, the Seventh Circuit concluded that information acquired "within a second of each message's arrival and assembly" satisfies the contemporaneous interception requirement. 622 F.3d 701, 706 (7th Cir. 2010). In *Szymuszkiewicz*, the defendant inserted a command into his supervisor's copy of Microsoft Outlook that directed a copy of all incoming messages to him. *Id.* at 703. The defendant argued that "he did not 'intercept' anything, for (at least in football) 'interception' means catching a thing in flight, and any message would have reached its destination ([his supervisor's] inbox) before a copy was made for him." *Id.* Judge Easterbook observed that it did not matter whether his supervisor's computer or an intermediary diverted the information:

> Several circuits have said that, to violate § 2511, an interception must be "contemporaneous" with the communication. . . . [The defendant] sees this as support for his "in flight" reading, but it is not. "Contemporaneous" differs from "in the middle" or any football metaphor. Either the server in Kansas City or [his supervisor's] computer made copies of the messages for [the defendant] within a second of each message's arrival and assembly; if both [the defendant and his supervisor] were sitting at their computers at the same

> time, they would have received each message with no more than an eyeblink in between. That's contemporaneous by any standard. Even if [the supervisor's] computer (rather than the server) was doing the duplication and forwarding, it was effectively acting as just another router, sending packets along to their destination . . . .

Id. at 705-06 (citations omitted). In reaching this conclusion, the Seventh Circuit cited *Konop*, *see id.* at 706, indicating that the court found its decision consistent with the Ninth Circuit's simultaneous transmission requirement.[8]

Szymuszkiewicz emphasized that its holding was necessary to keep modern telephonic communications within the purview of the Wiretap Act. *Id.* Interception of telephone calls made through modern "packet switching" technology "must be done by programming a computer to copy the contents [of packets] it sends along . . . ." *Id.* So, if interception "within a second of each message's arrival and assembly" did not qualify as "simultaneous," the Wiretap Act would no longer govern phone calls—the very communications Congress had in mind when it enacted the Wiretap Act. *Id.* at 704, 706; *see In re Carrier IQ, Inc.*, 78 F. Supp. 3d 1051, 1076-81 (N.D. Cal. 2015) (concluding that *Konop*'s simultaneous transmission requirement does not place packet switching technology outside the ambit of the Wiretap Act). A contrary holding would also mean that different substantive rules would apply to those engaged in the same real-time electronic conversation based on whose electronic device was bugged and who was sending or receiving the particular message in question. If, say, Person A's device was bugged, all of

[8] *DirecTV, LLC v. Wright*, No. 15-CV-474-FPG, 2016 WL 3181170 (W.D.N.Y. June 3, 2016) is not to the contrary. In *DirecTV*, the district court stressed that the defendant "*legitimately received*" the plaintiff's satellite signals and then illegally rebroadcasted them. *Id.* at *6. As the district court observed, "numerous courts have focused on this distinction in finding that [the Wiretap Act] requires the unauthorized receipt, not simply the unauthorized redistribution." *Id.* at *6.

the messages she *sends* to Person B would be subject to the Wiretap Act, while all the message she *receives*—even if immediately collected—would be subject to the Stored Communications Act. Nothing in the text or structure of the Wiretap Act or Stored Communications Act suggests such a hopelessly convoluted legal framework.

But, even if the Court were to accept *Szymuszkiewicz*'s reasoning, Plaintiffs have not articulated with sufficient clarity when Vizio supposedly intercepted their communications. Besides their conclusory allegation that Vizio intercepted their electronic communications "during transmission" (Compl. ¶ 128.), Plaintiffs rely on a rather inscrutable graphic with no textual explanation (*id.* ¶ 52) and vague allegations about how Vizio's data collection occurs "in real time" (*id.* ¶¶ 39, 41-42, 49, 62). While Plaintiffs need not prove their theory of interception on a motion to dismiss, Plaintiffs must provide fair notice to Defendants of when they believe Vizio intercepts their communications. A written explanation of Plaintiffs' theory of interception is particularly important in this case because the graphic Plaintiffs include in their Complaint suggests that Vizio transmits their data to its Inscape platform significantly after the data arrive at their Smart TVs. (*See id.* ¶ 52.) The Court, therefore, DISMISSES with LEAVE TO AMEND Plaintiffs' Wiretap Act claims. As Plaintiffs have inadequately pleaded interception, the Court need not address Defendants' alternative argument that Vizio does not collect the "contents" of any electronic communications.[9]

[9] Courts have generally construed the California Invasion of Privacy Act ("CIPA") as coextensive with the Wiretap Act, *Sunbelt Rentals, Inc. v. Victor*, 43 F. Supp. 3d 1026, 1033 (N.D. Cal. 2014); *NovelPoster v. Javitch Canfield Grp.*, 140 F. Supp. 3d 938, 954 (N.D. Cal. 2014), and Plaintiffs have offered no reason why the Court's analysis would be any different under the CIPA (*see* Opp'n at 21). The Court, therefore, DISMISSES with LEAVE TO AMEND Plaintiffs' CIPA claims.

E. Fraud Claims

Defendants move to dismiss Plaintiffs' fraud-based claims[10] for failure to satisfy Rule 9(b). (Mem. at 28-33.) Plaintiffs contend that Defendants overstate Plaintiffs' burden in alleging claims based on fraudulent omissions and that both their fraudulent omission and affirmative misrepresentation theories are well pleaded. (Opp'n at 21-27.)

i. Fraudulent Omission-Based Claims

Under Rule 9(b), a party must plead allegations of fraud, whether through affirmative misrepresentations or omissions, "with particularity." Fed. R. Civ. P. 9(b). To satisfy this Rule, a plaintiff must generally allege the "'who, what, when, where, and how' of the misconduct charged." *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1124 (9th Cir. 2009). "However, in the context of a fraudulent omission claim, a plaintiff cannot plead a specific time or place of a failure to act." *Peel v. BrooksAmerica Mortg. Corp.*, 788 F. Supp. 2d 1149, 1160 (C.D. Cal. 2011). In such circumstances, "a plaintiff may plead fraud by alternative means." *Id.* The purpose of Rule 9(b)'s heightened pleadings standard is "to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." *Swartz v. KPMG LLP*, 476 F.3d 756, 764 (9th Cir. 2007) (citation omitted).

Relying on *Marolda v. Symantec Corp.*, Defendants assert that to satisfy Rule 9(b), a fraudulent omission claim "must describe the content of the omission and where the omitted information should or could have been revealed, as well as provide representative samples of advertisements, offers, or other representations that plaintiff relied on to make her purchase and that failed to include the allegedly omitted information." 672 F. Supp. 2d 992, 1002 (N.D. Cal. 2009). "As other courts have recognized, however, 'the *Marolda*

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[10] By "fraud-based claims," the Court refers to Plaintiffs' fifth, sixth, eighth, ninth, eleventh, fourteenth, and eighteenth causes of action to the extent that these claims sound in fraud. *See Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1124 (9th Cir. 2009). The Court addresses Plaintiffs' FAL claims separately.

requirements are not necessarily appropriate for all cases alleging a fraudulent omission.'" *Philips v. Ford Motor Co.*, No. 14-CV-02989-LHK, 2015 WL 4111448, at *12 (N.D. Cal. July 7, 2015). Rather, courts have applied Rule 9(b)'s "who, what, when, where, and how" test mindful of the "the inherent limitations of an omission claim." *MacDonald v. Ford Motor Co.*, 37 F. Supp. 3d 1087, 1096 (N.D. Cal. 2014); *Velasco v. Chrysler Grp. LLC*, No. CV 13-08080 DDP VBKX, 2014 WL 4187796, at *5 (C.D. Cal. Aug. 22, 2014); *Philips*, 2015 WL 4111448, at *12.

Here, Plaintiffs allege that Vizio ("who") failed to disclose to consumers that its Smart Interactivity software collects and discloses consumers' viewing histories as well as personally identifiable information related to their Vizio Smart TVs and other devices connected to the same Wi-Fi network ("what"). (Compl. ¶¶ 35-42, 45-73.) This material information, Plaintiffs allege, was not disclosed prior to their purchase of their Smart TVs or while they used their Smart TV's capabilities ("when") on the product packaging, in Vizio's Privacy Policy, or on Vizio's website ("where"). (*Id.* ¶¶ 81-94.) Besides providing the exact model numbers for their televisions and where they purchased them, Plaintiffs provide a representative sample of a Vizio Smart TV's product packaging that omits any mention of Vizio's Smart Interactivity software. (*Id.* ¶¶ 16-21, 81-84.) Plaintiffs further contend that, when using a Vizio Smart TV, the only reference to Smart Interactivity is "deeply imbedded in an obscure settings menu" and "does not explain what Smart Interactivity is." (*Id.* ¶¶ 7, 85.) Viewed together, Plaintiffs' allegations are as well pleaded, if not more detailed, than those found sufficient in *Velasco*, *Philips*, and *MacDonald*. *See* 2015 WL 4111448, at *12; 2014 WL 4187796, at *5; 37 F. Supp. 3d 1087, 1096. Contrary to Defendants' assertion, Plaintiffs do not need to specify the precise date they purchased their Smart TVs to state a fraudulent omission claim, because Vizio's fraudulent omissions allegedly continued from the launch of its Smart Interactivity software through Plaintiffs' purchases of their Smart TVs. Thus, Defendants' Motion to Dismiss Plaintiffs' claims based on fraudulent omissions is DENIED.

ii. Affirmative Fraud-Based Claims

In contrast to Plaintiffs' omission-based fraud claims, Plaintiffs' affirmative fraud-based claims are devoid of the "who, what, where, when, and how" allegations required by Rule 9(b). For instance, Plaintiffs contend that certain language in Vizio's Privacy Policy and on Vizio's website is misleading, but none of the Plaintiffs allege that they even viewed these purported misrepresentations. (*See* Compl. ¶¶ 22, 88.) *See, e.g.*, *Durell v. Sharp Healthcare*, 108 Cal. Rptr. 3d 682, 694 (Ct. App. 2010) ("[T]he SAC does not allege [plaintiff] ever visited Sharp's Web site or even that he ever read the Agreement for Services"). Plaintiffs also reference certain statements on the Smart TV packaging that they contend are misleading "in light of the information not provided." (Opp'n at 25.) Besides Plaintiffs' failure to provide the "who, what, where, when, and how" allegations necessary to support this theory, the statements Plaintiffs reference on Vizio's product packaging about a Vizio Smart TV's functions have little to do consumers' data security or privacy. (*See* Compl. ¶¶ 81-84.) Therefore, to the extent that Plaintiffs' fraud claims are based on supposed affirmative misrepresentations, Defendants' Motion to Dismiss is GRANTED with LEAVE TO AMEND. In any amended complaint, Plaintiffs must plead the necessary "who, what, where, when, and how" allegations necessary to state a claim for affirmative fraud.

F. Negligent Misrepresentation Claims

Under California law, "[a] negligent misrepresentation claim 'requires a positive assertion,' not merely an omission." *Lopez v. Nissan N. Am., Inc.*, 135 Cal. Rptr. 3d 116, 136 (Ct. App. 2011) (quoting *Vega v. Jones, Day, Reavis & Pogue*, 17 Cal. Rptr. 3d 26, 32 (Ct. App. 2004). "An 'implied' assertion or representation is not enough." *Wilson v. Century 21 Great W. Realty*, 18 Cal. Rptr. 2d 779, 783 (Ct. App. 1993). Similarly, under Washington law, "[a]n omission alone cannot constitute negligent misrepresentation, since the plaintiff must justifiably rely on a misrepresentation." *Ross v. Kirner*, 172 P.3d 701, 704 (Wash. 2007); *see Trimble v. Washington State Univ.*, 993 P.2d 259, 264 (Wash.

2000) (holding that failing to discuss the downsides of an offer of employment did not create the false impression necessary to state a claim for negligent misrepresentation).

Plaintiffs' negligent misrepresentation claims under California and Washington law are inadequately pleaded for much the same reason why Plaintiffs' affirmative fraud claims fail: Plaintiffs allege that Vizio's Smart TV packaging is misleading because Vizio advertises how its Smart TVs are ideal for watching programming from cable, satellite, and streaming content providers as well from devices connected to the Smart TV without disclosing that utilizing these features could result in Vizio collecting and disclosing consumers' personally identifiable information. (*Id.* ¶¶ 81-84.) None of the statements on the product packing, however, relate to Vizio's privacy policies or the security of consumers' personal information more broadly. Thus, because any alleged statements on Vizio's product packaging are too remotely related to Vizio's treatment of consumers' data to amount to the "positive assertion" necessary to state a claim for negligent misrepresentation, the Court DISMISSES these claims under California and Washington law with LEAVE TO AMEND. *See Lopez*, 135 Cal. Rptr. 3d at 136 (holding, in a case involving odometers that supposedly overregistered the number of miles driven, that "innocuous statements . . . about the basic function of odometers" did not amount to the "positive assertion" necessary to state a claim for negligent misrepresentation); *Ross v. Kirner*, 172 P.3d at 704.

G. <u>False Advertising Law Claims</u>

The False Advertising Law (FAL) prohibits making or disseminating "any statement" in the course of "dispos[ing]" of any property, product, or service that "is untrue or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue or misleading . . . ." Cal. Bus. & Prof. Code § 17500. Under the FAL, courts apply the "reasonable consumer" test, which requires a plaintiff to show that "members of the public are likely to be deceived." *Williams v. Gerber Products Co.*, 552 F.3d 934, 938 (9th Cir. 2008) (quotation marks omitted). The FAL proscribes "not only advertising which is false but also advertising which[,] although true, is either

actually misleading or which has a capacity, likelihood or tendency to deceive or confuse the public." *Williams*, 552 F.3d at 938 (quoting *Kasky v. Nike, Inc.*, 45 P.3d 243, 250 (Cal. 2002)).

At first glance, districts courts seem to be divided over whether a plaintiff can predicate a FAL claim on a defendant's failure to disclose certain information. *Compare Handy v. LogMeIn, Inc.*, No. 1:14-CV-01355-JLT, 2015 WL 1729681, at *5 (E.D. Cal. Apr. 15, 2015) ("[A] a plaintiff may state a claim under the FAL for fraudulent omissions by a defendant."); *In re Sony Gaming Networks & Customer Data Sec. Breach Litig*., 996 F. Supp. 2d 942, 991 (S.D. Cal. 2014) (finding that "fraud-based omission claims" under the FAL were adequately pleaded) *with Norcia v. Samsung Telecommunications Am.*, LLC, No. 14-CV-00582-JD, 2015 WL 4967247, at *8 (N.D. Cal. Aug. 20, 2015) ("There can be no FAL claim where there is no 'statement' at all."); *Stanwood v. Mary Kay, Inc.*, 941 F. Supp. 2d 1212, 1222 (C.D. Cal. 2012). In practice, though, the disagreement seems largely superficial: Courts reject FAL claims premised solely on a defendant's omissions, but a plaintiff may base a FAL claim on an affirmative statement that is misleading in light of the information omitted. *Hodsdon v. Mars, Inc.*, 162 F. Supp. 3d 1016, 1023 (N.D. Cal. 2016); *see In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 991 (S.D. Cal. 2014); *In re Toyota Motor Corp.*, 790 F. Supp. 2d 1152, 1157-59, 1173 (C.D. Cal. 2011). This approach comports with the text of the False Advertising Law, which prohibits false or misleading "statement[s]," not omissions. *See* Cal. Bus. & Prof. Code § 17500.

Plaintiffs allege that their FAL claims are premised on "partial representations . . . as well as omissions." (Opp'n at 28 (citing Compl. ¶¶ 8, 10, 72-79, 84, 90-91.)) But none of the Plaintiffs allege that they were aware that Vizio had represented that it collects only anonymous data, which would be necessary for Plaintiffs to satisfy the FAL's standing requirement. *See In re Tobacco II Cases*, 207 P.3d 20 (Cal. 2009) (holding that a plaintiff must demonstrate "actual reliance" to show that he lost "money or property as a result of" the allegedly unlawful conduct); *Kwikset Corp.,* 246 P.3d at 888 (applying the same

standard to the FAL). And, as the Court has already noted, the statements Plaintiffs did see on Vizio's product packaging about the Smart TV's functionality are too tangentially related to consumers' personal privacy or security to be misleading in light of Vizio's failure to disclosure its data collection and disclosure practices. To be clear, as *In re Tobacco II Cases* instructs, Plaintiffs do not have to allege they "relied on particular advertisements or statements," especially if they allege a lengthy pattern of misrepresentations by Vizio, 207 P.3d at 40, but Plaintiffs must allege at least that they were generally familiar with Vizio's statements about its data privacy or security practices. Thus, because Plaintiffs have not plausibly alleged that they relied on any affirmative misstatements by Vizio, the Court DISMISSES with LEAVE TO AMEND Plaintiffs' FAL claims.

H. Invasion of Privacy and Intrusion Upon Seclusion Claims

The elements of intrusion upon seclusion and invasion of privacy are similar in each of the states included in Plaintiffs' Complaint. California, Florida, and Washington have all endorsed the definition of the tort found in the Second Restatement, which requires (1) an intentional intrusion, physical or otherwise, "upon the solitude or seclusion of another," (2) in a manner "highly offensive to a reasonable person." *Deteresa v. Am. Broad. Companies, Inc.*, 121 F.3d 460, 465 (9th Cir. 1997) (quoting *Miller v. Nat'l Broad. Co.*, 232 Cal. Rptr. 668, 678 (Ct. App. 1986)); *Taus v. Loftus*, 151 P.3d 1185, 1212 (Cal. 2007); *Purrelli v. State Farm Fire & Cas. Co.*, 698 So. 2d 618, 620 (Fla. Dist. Ct. App. 1997); *Mark v. Seattle Time*s, 635 P.2d 1081, 1094 (Wash. 1981); *see also* Restatement (Second) of Torts § 652B (1977).

The California Constitution and Massachusetts Privacy Act create similar causes of action for invasion of privacy. A cause of action under the California Constitution for invasion of privacy requires: (1) "the identification of a specific, legally protected privacy interest," (2) a reasonable expectation of privacy under the circumstances presented, and (3) a "sufficiently serious" intrusion upon the privacy interest by the defendant. *Hill v. Nat'l Collegiate Athletic Assn.*, 865 P.2d 633, 654-55 (Cal. 1994). California has

recognized two broad categories of legally protected privacy interests: "(1) interests in precluding the dissemination or misuse of sensitive and confidential information ('informational privacy'); and (2) interests in making intimate personal decisions or conducting personal activities without observation, intrusion, or interference ('autonomy privacy')." *Id.* at 654.[11] If a plaintiff satisfies these threshold requirements, the privacy interest must be balanced against a defendant's countervailing interests. *Id.* at 655-57. Like its California counterpart, the Massachusetts Privacy Act creates "a right against unreasonable, substantial or serious interference with [a person's] privacy." Mass. Gen. Laws ch. 214, § 1B. The invasion of privacy "must be both unreasonable and substantial or serious" to violate the Act. *Polay v. McMahon*, 10 N.E.3d 1122, 1126 (Mass. 2014). The Massachusetts Supreme Judicial Court has clarified that a plaintiff need not allege a public disclosure of the private information; an unreasonable intrusion upon a person's "solitude" or "seclusion" may suffice. *Id.*

As an initial matter, the Court rejects Vizio's argument that Plaintiffs have no cognizable interest in keeping detailed data about what video content they watch private. (Mem. at 36-37.) Defendants provide no reason why this information would be any less sensitive than the URL information that the Third Circuit found legally protected in *In re Google Inc. Cookie Placement*. *See* 806 F.3d at 151. To the contrary, the various federal and state statutes that specifically protect video viewing histories make Plaintiffs' assertion of a protected privacy interest here stronger than the claimed privacy interest in *In re Google Inc. Cookie Placement. See, e.g.*, 18 U.S.C. § 2710; Cal. Civ. Code § 1799.3; Mass. Gen. Laws ch. 93, § 106; N.Y. Gen. Bus. Law § 673. Nor does *In re Yahoo Mail Litigation*, 7 F. Supp. 3d 1016 (N.D. Cal. 2014), hold otherwise. *In re Yahoo Mail Litigation* found that there is no "legally protected privacy interest [or] reasonable

[11] Because of the substantial overlap between the constitutional and common law causes of action under California law, California courts have examined claims brought under both sources together. *See Hernandez v. Hillsides, Inc.*, 211 P.3d 1063, 1073-74 (Cal. 2009).

expectation of privacy in email *generally* . . . ." *Id.* at 1040. There, the court determined that allegations that an email service provider scanned, stored, and distributed to third parties the content of emails between users and non-users of its service were insufficient because the plaintiffs failed to allege the specific content of the emails at issue. *Id.* Whether or not this Court agrees with this holding in *In re Yahoo Mail Litigation*, it does not apply here. Unlike in *In re Yahoo Mail Litigation*, Plaintiffs identify a discrete type of sensitive information (video viewing history) that is legally protected, rather than arguing they have a legally protected interest in a method of communication. *See id.* at 1040-41.

Courts have been hesitant to extend the tort of invasion of privacy to the routine collection of personally identifiable information as part of electronic communications. *See, e.g.*, *Low v. LinkedIn Corp.*, 900 F. Supp. 2d 1010, 1025 (N.D. Cal. 2012); *Yunker v. Pandora Media, Inc.*, No. 11-CV-03113 JSW, 2013 WL 1282980, at *15 (N.D. Cal. Mar. 26, 2013). By contrast, collection of intimate or sensitive personally identifiable information may amount to a highly offensive intrusion. *See Goodman v. HTC Am., Inc.*, No. C11-1793MJP, 2012 WL 2412070, at *14-15 (W.D. Wash. June 26, 2012). Further, more routine data collection practices may be highly offensive if a defendant disregards consumers' privacy choices while simultaneously "h[olding] itself out as respecting' them." *In re Nickelodeon Consumer Privacy Litig.*, 827 F.3d at 292 (quoting *In re Google Inc. Cookie Placement Consumer Privacy Litig.*, 806 F.3d 125, 151 (3d Cir. 2015)). As the Third Circuit observed, "[w]hether or not data-based targeting is the internet's pole star, users are entitled to deny consent, and they are entitled to rely on the public promises of the companies they deal with." *In re Google Inc. Cookie Placement Consumer Privacy Litig.*, 806 F.3d at 151.

Plaintiffs have plausibly alleged a pattern of "highly offensive" conduct. Plaintiffs point to a report by the security software company Avast, which concluded that Smart Interactivity's "off" function was not operational "for months, if not years." (Compl. ¶¶ 7, 65.) So, even if consumers believed they had opted out of Vizio's data collection practices, Vizio was still collecting their data for a considerable period. (*See id.*) In addition, Vizio's

Smart Interactivity software switches back on without warning if the Smart TV ever reverts to the factory settings—as can occur through Vizio's software updates. (*Id*. ¶ 66.) Consumers would likely not realize for a significant period that Vizio's collection and disclosure software has been re-enabled because the opt-out feature is allegedly buried in an obscure settings menu. (*Id.* ¶¶ 7, 85.) Further, Vizio's disclosure practices are far less routine than, say, the use of cookies at issue in *In re Google Inc. Cookie Placement Consumer Privacy Litigation*: Plaintiffs allege not only that Vizio collects an exceptionally vast array of information about their digital identities and viewing histories, but also that the standard industry practice is not to collect viewing history data unless a consumer affirmatively opts in. (*Id.* ¶¶ 6, 61.) Considering the quantum and nature of the information collected, the purported failure to respect consumers' privacy choices, and the divergence from the standard industry practice, Plaintiffs plausibly allege Vizio's collection practices amount to a highly offensive intrusion. Defendants' Motion to Dismiss Plaintiffs' intrusion upon seclusion, Massachusetts's Privacy Act, and California Constitution claims is accordingly DENIED.

I. Unjust Enrichment Claims

Defendants contend that the Court should dismiss Plaintiffs' unjust enrichment claims because they have adequate remedies at law. The Court finds no basis for doing so. The Ninth Circuit has instructed district courts to construe claims for unjust enrichment under California law as quasi-contract claims. *Astiana v. Hain Celestial Grp., Inc.*, 783 F.3d 753, 762 (9th Cir. 2015); *see Brazil v. Dole Packaged Foods, LLC*, No. 14-17480, 2016 WL 5539863, at *3 (9th Cir. Sept. 30, 2016) (reversing a district court's dismissal of a claim for unjust enrichment). Similarly, under Florida law, an unjust enrichment claim fails "only upon a showing that an express contract exists [between the parties.]" *State Farm Mut. Auto. Ins. Co. v. Physicians Injury Care Ctr., Inc.*, 427 F. App'x 714, 722 (11th Cir. 2011), *rev'd in part sub nom. State Farm Mut. Auto. Ins. Co. v. Williams*, 824 F.3d 1311 (11th Cir. 2014) (quoting *Williams v. Bear Stearns & Co.*, 725 So. 2d 397, 400 (Fla. Dist. Ct. App. 1998)); *accord Diamond "S" Dev. Corp. v. Mercantile Bank*, 989 So. 2d

696, 697 (Fla. Dist. Ct. App. 2008). As for Plaintiffs' unjust enrichment claims under New York, Washington, and Massachusetts law, "[w]hether plaintiffs [have] an adequate remedy at law remains to be seen."[12] *Fenerjian v. Nongshim Co., Ltd*, 72 F. Supp. 3d 1058, 1086 (N.D. Cal. 2014). Because Plaintiffs can plead in the alternative under Rule 8(d)(3), it would be "premature to dismiss the unjust enrichment claims on that basis at this point." *Id.* Defendants' Motion to Dismiss Plaintiffs' unjust enrichment claims, therefore, is DENIED.

V. CONCLUSION

For the foregoing reasons, Defendants' Motion is GRANTED IN PART and DENIED IN PART. Plaintiffs' Wiretap Act claims, California Invasion of Privacy Act claims, False Advertising Law claims, negligent misrepresentation claims under California and Washington law, and state law video privacy claims are DISMISSED with LEAVE TO AMEND. To the extent that Plaintiffs' fifth, sixth, eighth, ninth, eleventh, fourteenth, and eighteenth causes of action are premised on allegations of affirmative fraudulent

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[12] Defendants contend that "in Massachusetts, New York, Florida, and Washington . . . an unjust enrichment claim *cannot* be pleaded when an adequate remedy at law exists." (Reply at 25.) The Court finds no basis in the cases Defendants cite for a rule holding that a court must determine on a motion to dismiss whether an adequate remedy at law exists; rather, the decisions Defendants reference merely support the uncontroversial proposition that in some circumstances the remedy at law is so obvious from the allegations in a complaint that the question may be resolved on a motion to dismiss. For instance, one of the decisions Defendants reference, *Go2Net, Inc. v. Freeyellow.com, Inc.*, 109 P.3d 875 (Wash. Ct. App. 2005), merely held in an unpublished part of the opinion that the trial court properly dismissed an unjust enrichment claim after determining that the plaintiff's claim "sounded in contract and thereby provided him an adequate remedy at law." *Id.* at 881. Similarly, another case Defendants cite, *Fed. Treasury Enter. Sojuzplodoimport v. Spirits Int'l N.V.*, 400 F. App'x 611 (2d Cir. 2010), addressed an attempt "to evade the statute of limitations applicable to a tortious interference with contract claim" by artfully pleading it as an unjust enrichment claim. *Id.* at 614. To the extent that *Licul v. Volkswagen Group of America* holds that a plaintiff must allege distinct predicate facts merely to plead a claim for unjust enrichment, *see* 2013 WL 6328734, at *7 (S.D. Fla. Dec. 5, 2013), that decision finds little support in the common law and "improperly require[s] a complete absence of an adequate remedy at law to state a claim for unjust enrichment." *Harris v. Nordyne, LLC*, No. 14-CIV-21884, 2014 WL 12516076, at *7 n.5 (S.D. Fla. Nov. 14, 2014).

conduct, they are DISMISSED with LEAVE TO AMEND. Defendants' Motion is otherwise DENIED. Plaintiffs are given leave to file a Second Consolidated Complaint within 21 days of this Order. Failure to file a Second Consolidated Complaint by that date shall be deemed consent to the dismissal of Plaintiffs' claims against Defendants with prejudice.

DATED: March 2, 2017

JOSEPHINE L. STATON
UNITED STATES DISTRICT JUDGE

NOTES

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Remijas, et al. v. The Neiman Marcus Group, LLC, 341 F.Supp.3d 823 (N.D. Ill. Sept. 17, 2018)

Submitted by:
Jay Edelson

Edelson PC

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341 F.Supp.3d 823
United States District Court, N.D. Illinois, Eastern Division.

Hilary REMIJAS, Melissa Frank, Debbie Farnoush, and Joanne Kao, Individually and on Behalf of All Others Similarly Situated, Plaintiffs,
v.
The NEIMAN MARCUS GROUP, LLC, a Delaware Limited Liability Company, Defendant.

Case No. 14-cv-1735
|
Signed 09/17/2018

Synopsis
Background: In data breach litigation pursued on class basis against retailer, named plaintiffs moved for approval of proposed class settlement.

[Holding:] The District Court, Sharon Johnson Coleman, J., held that settlement class as currently composed, consisting of customers who had made purchases at retailer's stores both during the time when malware was operating to compromise customer data and those who made purchases outside the malware period, had fundamental conflict that undermined adequacy of representation.

Motion denied; settlement class decertified.

West Headnotes (8)

[1] **Compromise and Settlement**
Nature and Requisites

Federal courts naturally favor the settlement of class action litigation, as promoting interests of litigants by saving them the expense and uncertainty of trial and as also promoting interests of judicial system by preserving public resources.

Cases that cite this headnote

[2] **Compromise and Settlement**
Class actions

Court approval is necessary for the settlement of class action.

Cases that cite this headnote

[3] **Compromise and Settlement**
Fairness, adequacy, and reasonableness

In deciding whether to approve class action settlement, court's inquiry is limited to consideration of whether the proposed settlement is lawful, fair, reasonable, and adequate.

Cases that cite this headnote

[4] **Federal Civil Procedure**
Hearing and determination; decertification; effect

Motions to decertify a class are reviewed using the same standards as motions to certify a class.

Cases that cite this headnote

[5] **Federal Civil Procedure**
Hearing and determination; decertification; effect

Motions to decertify a class are not subject to the heightened standards of review applied to motions for reconsideration, not even if the class was previously certified by a different judge.

Cases that cite this headnote

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Cases that cite this headnote

[6] **Compromise and Settlement**
Factors, Standards and Considerations; Discretion Generally

District court judge reviewing class action settlement is to act as a fiduciary of the class and to exercise a high duty of care in ensuring the propriety of class certification and the proposed class action settlement.

Cases that cite this headnote

[7] **Federal Civil Procedure**
Representation of class; typicality; standing in general

Single class cannot be fairly or adequately represented by its named representatives and class counsel if members of the class have antagonistic or conflicting claims. Fed. R. Civ. P. 23(a)(4).

Cases that cite this headnote

[8] **Compromise and Settlement**
Class, existence and determination; parties
Federal Civil Procedure
Consumers, purchasers, borrowers, and debtors

In data breach litigation pursued on class basis against retailer, settlement class as it was currently composed, consisting of customers who had made purchases at retailer's stores both during the time when malware was operating to compromise customer data and those who made purchases outside the malware period, had fundamental conflict that undermined adequacy of representation of class, that prevented court from approving proposed class settlement, and that necessitated decertification of settlement class.

Cases that cite this headnote

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER

SHARON JOHNSON COLEMAN, United States District Court Judge

In 2013, Neiman Marcus suffered a major data breach that exposed consumers' credit card numbers and gave rise to this litigation. In June of 2017, Judge Der-Yeghiayan provisionally certified the settlement class and preliminarily approved the settlement in this class action. The parties now move this Court to approve the settlement and award attorney's fees, costs, and service awards. Multiple objectors have appeared to challenge the proposed settlement on numerous grounds. For the reasons set forth herein, this Court denies the motion for final approval [158] and the motion for attorney's fees [159] without prejudice and decertifies the proposed settlement class.

Background

In December 2013, Neiman Marcus began to receive reports of fraudulent charges on its customers' credit cards. Neiman Marcus investigated these reports and ultimately discovered malware[1] in its computer systems.

On January 10, 2014, Neiman Marcus disclosed the data breach to the public and individually notified the customers who had incurred fraudulent charges. At the time, Neiman Marcus disclosed that the malware had compromised customer's credit card numbers but not their birth dates or social security numbers. Neiman Marcus subsequently revealed that the malware had been active at various locations between July 16, 2013, and October 30, 2013, potentially exposing 350,000 customers' credit card information, and that 9,200 of those cards had since been used fraudulently. Neiman Marcus attempted to contact all of the customers who had shopped at a Neiman Marcus store within the past year (for whom it had contact information) to offer them one year of credit-monitoring and identity-theft protection. Neiman Marcus subsequently learned, during the pendency of this litigation, that the malware at issue was not installed at all Neiman Marcus locations, and that it was only operational on various dates and times between July 16, 2013, and October 30, 2013, at each location where it was installed.

News of Neiman Marcus' data breach yielded multiple class-action complaints, which were consolidated in this action brought by plaintiffs Hilary Remijas, Melissa Frank, Debbie Farnoush, and Joanne Kao. Remijas alleges that she made purchases using a credit card at the Neiman ***825** Marcus store in Oak Brook, Illinois in August and December 2013. Frank alleged that she and her husband used a joint debit card to make purchases at Neiman Marcus' Long Island store in December 2013, and that fraudulent charges subsequently appeared on their account on January 9, 2014. Farnoush alleges that she visited an unidentified Neiman Marcus store in 2013, and subsequently had fraudulent charges placed on her card. Finally, Kao alleges that she made purchases at a Neiman Marcus in San Francisco between February and December 2013, and that her bank subsequently replaced her debit card because it had been compromised.

This case was filed in March of 2014, and was initially assigned to Judge James Zagel. The defendant filed a motion to dismiss, which Judge Zagel granted in September 2014. In pertinent part, Judge Zagel held that the plaintiffs could not establish standing because they could only establish that their data might have been stolen and might subsequently result in fraudulent charges, injuries which he contended were not sufficiently concrete. That decision was subsequently appealed to the Seventh Circuit, which, in July 2015, reversed Judge Zagel's ruling with respect to standing and remanded the case for further proceedings. On remand, Neiman Marcus filed a renewed motion to dismiss, which was denied. Neiman Marcus then filed twelve consecutive motions to extend the responsive pleading deadline, pushing that deadline from February 12, 2016, to February 10, 2017. During that time, this case was transferred to Judge Der-Yeghiayan, who, on February 9, 2017, dismissed it based on the parties' failure to proceed with the litigation. The plaintiff promptly moved to reinstated the action and filed a motion for class certification and preliminary approval, which was granted. Following the requisite notice period, the plaintiffs filed their motions for final approval of the class action settlement [158] and for attorney's fees, costs, and service awards [159]. Parvinder Chohan, Gretchen Carey, and Donald L. Plunkett, Jr., all potential class members, subsequently filed detailed objections to the class settlement. Those objections were fully briefed and Judge Der-Yeghiayan heard arguments regarding them. Judge Der-Yeghiayan subsequently retired, and the case was transferred to this Court with those motions pending.

Discussion

[1] [2] [3]As the Seventh Circuit has recognized, federal courts "naturally favor" the settlement of class action litigation. *Isby v. Bayh*, 75 F.3d 1191, 1196 (7th Cir. 1996). Settlements promote the interests of litigants by saving them the expense and uncertainty of trial and promote the interests of the judicial system by preserving public resources. *Hispanics United of DuPage Cnty. v. Vill. of Addison, Ill.*, 988 F.Supp. 1130, 1149 (N.D. Ill. 1997). Thus, although class action settlements must be approved by the court, the inquiry is limited to consideration of whether the proposed settlement is lawful, fair, reasonable, and adequate. *E.E.O.C. v. Hiram Walker & Sons, Inc.*, 768 F.2d 884, 888–89 (7th Cir. 1985), ***cert. denied,*** 478 U.S. 1004, 106 S.Ct. 3293, 92 L.Ed.2d 709 (1986).

[4] [5] [6]Motions to decertify a class, however, are reviewed using the same standards as motions to certify a class. Motions to decertify a class are not subject to the heightened standards of review applied to motions for reconsideration, even if the class was previously certified by a different judge. *See Ellis v. Elgin Riverboat Resort*, 217 F.R.D. 415, 420 (N.D. Ill. 2003) (Ashman, Mag. J.); *see also Phillips v. Sheriff of Cook County*, 828 F.3d 541, 549 (7th Cir. 2016) (applying the class certification analysis to an order decertifying a class). Indeed, the Seventh Circuit has instructed district court judges reviewing ***826** class action settlements to act as "a fiduciary of the class" and to exercise a high duty of care in ensuring the propriety of class certification and the proposed class action settlement. *Reynolds v. Beneficial Nat. Bank*, 288 F.3d 277, 279–80 (7th Cir. 2002). In order

for a class to be certified, (1) the class must be so numerous that joinder of all members is impracticable; (2) there must be questions of law or fact common to the class; (3) the claims of defenses of the class representatives must be typical of the class; and (4) the class representatives must adequately protect the interests of the class. Fed. R Civ. P. 23(a). Here, the parties propose that the class be certified under Fed. R. Civ. P. 23(b)(3), which additionally requires that common questions of law or fact predominate over any questions affecting only individual members and that the class action mechanism be superior to the available alternatives for fairly and efficiently adjudicating the controversy.

There is no doubt that there is a question of law or fact common to the class: whether Neiman Marcus put reasonable information technology security measures in place before the incident and otherwise complied with its legal duties. This question is common with respect to all Neiman Marcus customers who made purchases within the proposed class period. Numerosity also cannot be reasonably disputed, given that the proposed class contains over two million individuals.

[7]The objectors, however, contend that the settlement class contains impermissible intra-class conflicts, an argument which challenges the adequacy of the named plaintiffs' representation of the "different, separate, and distinct interest[s] of the class members." *Retired Chicago Police Ass'n v. City of Chicago*, 7 F.3d 584, 598 (7th Cir. 1993) (quoting *Secretary of Labor v. Fitzsimmons*, 805 F.2d 682, 697 (7th Cir. 1986) (en banc)). A single class cannot be fairly or adequately represented by the named plaintiffs and class counsel if members of the class have antagonistic or conflicting claims. *Id.*

[8]For the purpose of analysis, it makes sense to divide the proposed class into three groups based on factual differences in their claims: (1) those who made purchases during the time range within which the malware was operating ("the malware period") but whose purchases were not affected by the malware; (2) those who made purchases during the malware period and while the malware was active at the location of their purchase; and (3) those who made purchases outside the malware period.

The Court turns its attention first to those class-members who made purchases within the malware period. Of those who made their purchases during the malware period, some made their purchases at times and locations when the malware was active, and the remainder did not. Under the terms of the proposed settlement those who made their purchases while the malware was active stood to receive financial compensation, while others who made their purchases during the malware period but at a time or place that the malware was not active did not. The objectors contend that because of this disparity the interests of those malware-period purchasers whose credit card information was accessed are at odds with those malware-period purchasers whose credit card numbers were not compromised and who therefore stand to make a de minimis recovery.

The parties, seemingly in anticipation of this potential argument, attempted to deliberately blind the class representatives. They structured their settlement such that individual class members could not learn whether their card number had been compromised until after they had opted into the settlement. The parties therefore assert ***827** that the named plaintiffs were able to adequately represent the interests of all class members who made purchases during the malware period because the named representatives had a personal stake in both groups within the scope of the malware period until after the settlement had already been agreed upon.

The Court finds this mechanism to be highly suspect. Although it may simplify matters of class action settlement, delaying the notification of individual victims no doubt caused potential class members continued uncertainty and caused them to continue to make unnecessary efforts to mitigate the perceived release of their credit card information. The refusal to inform class members of how they were situated until after they opted into the settlement also creates an appearance of manipulation or dishonesty, undermining the integrity of the class action mechanism.

The settling parties' position on this issue is strongly supported by *Uhl v. Thoroughbred Technology and Telecommunications, Inc.*, 309 F.3d 978 (7th Cir. 2002). In *Uhl*, the defendant announced its intention to install fiber optic conduits along a railroad right-of-way. The named plaintiff brought a class action on behalf of those who owned real estate on either side of the right-of-way. At the time of the class action settlement, the defendant had not yet surveyed or determined which side of the tracks the conduit would be installed on (and could not do so without trespassing on the land-owners land, absent the settlement at issue). The settlement thus divided the class into two categories: those on the side of the tracks that the conduit would be installed on, and those on the side of the tracks that the conduit would not be installed on. Because the location of the installation of the conduit was not yet known, the Seventh Circuit concluded that the class representative, who lived on one side of the tracks, could adequately represent both categories of class-members.

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See Id. at 986 ("[T]he named representative had an equal incentive to represent both sides as long as he did not know where his property would end up."). The named representatives here were similarly cloaked in a veil of ignorance with respect to whether or not the malware was active at the time that they made their purchase within the malware period. Thus, at the time that the settlement was negotiated the class representatives and class counsel had equal incentive to represent the interests of all class members who made a purchase within the malware period. Accordingly, the Court sees no adequacy problem as between the recovering and non-recovering class members who made their purchases within the malware period.

The same is not true, however, with respect to customers who made their purchases outside the malware period (the non-malware period subclass). At the time settlement in this case was reached, the parties already knew that the malware was only active between July 16, 2013, and October 30, 2013. Indeed, it appears that this date range was disclosed well before the settlement negotiations even began.[2] ***828** Nevertheless, the settlement class encompasses those who made purchases between July 16, 2013, and January 10, 2014. The settlement class in this case thus includes individuals who the parties (and class representatives) knew from the outset could not have made their purchases at a time when the malware was active.

More important, at the time of the settlement the class representatives knew whether or not they had made their purchases within the malware period. Accordingly, the reasoning of *Uhl* cannot be applied to that subclass because the class representatives had no incentive to represent that group or its interests.[3] The interests of the non-malware period subclass, moreover, plainly conflict with those of the remaining class-members. Unlike those within the malware period, the non-malware period subclass has no chance of monetary recovery under the current settlement terms because there appears to be no chance that their credit card numbers were actually compromised by the malware now at issue. Those who purchased during the malware period, by contrast, had heightened incentive to agree to the lackluster non-monetary relief offered to those whose credit card numbers weren't compromised because, if their credit card number was compromised, they stood to receive actual damages to offset that more pressing harm. The non-Malware-Period subclass, by contrast, has no chance of monetary recovery under the proposed settlement agreement, and thus has strong incentive to pursue additional legal that the plaintiffs have declined to pursue in favor of settling. Accordingly, the settlement class as it is currently composed has a fundamental conflict that undermines the adequacy of the representation of the class. *See Rosario v. Livaditis*, 963 F.2d 1013, 1018 (7th Cir. 1992) ("A class is not fairly and adequately represented if class members have antagonistic or conflicting claims."); *see also In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation,* 827 F.3d 223, 233 (2nd Cir. 2016) (recognizing that intense and protracted mediation with respected and capable mediators does not compensate for the absence of independent representation because there could be no assurance that anyone advanced the strongest arguments in favor of the disfavored claims).

The Court's concerns about the representation of the interests of all members of the proposed settlement class is only amplified by the illusory nature of the relief being afforded to those whose credit card information was not compromised, including those who made their purchases outside the malware period. The settling parties' assert that these individuals are receiving valuable non-monetary relief. Once the data breach that gave rise to this case was publicized, Neiman Marcus agreed to provide everyone who shopped in its stores between July 2013 and January 2014 with a year of free credit monitoring and identity theft insurance. Neiman Marcus also took actions to enhance its cybersecurity business practices. The settling parties attempt to argue that these are non-monetary benefits flowing from the settlement. These non-monetary benefits, however, were issued prior to the class action settlement and thus cannot be fairly attributed to that settlement. Neiman Marcus' changed business practices, moreover, cannot be characterized as relief ***829** given their non-binding nature. In the settlement agreement, the business practice changes that Neiman Marcus implemented are listed "for informational purposes only" with an explicit disclaimer stating that their identification did not create "any rights or obligations" and that Neiman Marcus was free to alter (or abandon) the practices at any time. *See in re Subway Footlong Sandwich Marketing and Sales Practices Litig.*, 869 F.3d 551, 557 (7th Cir. 2017) (recognizing that injunctive relief that did not correct the complained-of business practices was "worthless" to the class). Although the Court does not hold that these actions conferred no value on the non-malware period subclass, the Court questions whether they constitute the relief that an adequately represented non-malware period subclass would seek to recover. *See Grok Lines, Inc. v. Paschall Truck Lines, Inc.*, No. 14 C 8033, 2015 WL 5544504, at *2 (N.D. Ill. Sept. 18, 2015) (Chang, J.) (recognizing the Court's duty to vigilantly guard against settlements that enrich class counsel with scant reward to the class itself) (quoting *Thorogood v. Sears, Roebuck & Co.*, 627 F.3d

289, 293 (7th Cir. 2010) and *Reynolds*, 288 F.3d at 279–280).

Considering the inevitable conflict between the interests of those who made purchases during the malware period and those who made purchases outside the malware period, the Court has no alternative but to decertify the class in this case.[4] The Court declines to instruct the parties on how best to resolve the current flaws in the representation of the proposed class, but does caution that if the named plaintiffs have learned whether their credit card information was compromised, they will no longer be able to act from within the veil of ignorance described by *Uhl* should it be necessary to substantively modify the conditions of the settlement agreement.

In light of its determination that the class here must be decertified, this Court need not evaluate the merits of the objectors' arguments challenging the fairness of the proposed settlement at this time. The Court does, however, address one area of procedural concern. In their motion for preliminary approval of the settlement, the settling parties represented that the proposed notice program would include "direct Notice to all proposed Settlement Class Members." That representation was false, as was reflected by both the contemporaneously filed Settlement Agreement and the materials filed in support of the parties' motion for final approval of the settlement. The plaintiffs represent that this misstatement resulted from a typographical error, and the Court has no reason to doubt that. Whatever the cause of the error, it concerned a key substantive provision of the parties' motion and this Court therefore cannot presume that it was harmless in effect. Instead of providing direct notice to all class members, direct notice was only provided to less than 773,292 potential class members out of a proposed class of over two million. Further, indirect notice was provided through a single print advertisement and a four-week internet banner advertisement campaign which purportedly was seen by 71.48% of class members an average of 2.95 times each.[5] The result of these efforts, ***830** however, was paltry; three months before the claim deadline only 16,447 claim forms had been submitted. That figure represents three-quarters of a percent of the settling class in this case. Because of the erroneous representation at issue and the poor response rate demonstrated, the Court encourages the parties to consider whether further attempts at notice are warranted in this case.

Conclusion

For the foregoing reasons, the Court decertifies the settlement class. The pending motions for final approval of the class action settlement [158] and for attorney fees, costs, and class representative service awards [159] are therefore denied without prejudice.

IT IS SO ORDERED.

All Citations

341 F.Supp.3d 823

Footnotes

1 The term "malware" generally describes computer programs written with the intent of being disruptive or damaging to a computer or computer user, and encompasses computer viruses, worms, and spyware.

2 Interestingly, the plaintiffs' original complaint in this action defined the class as being comprised of individuals who made a purchase from Neiman Marcus between July 16, 2013, and October 30, 2013. Although the amended complaint expanded that definition to include "all persons whose personal and/or financial information was disclosed in the data incursion affecting Neiman Marcus in 2013," it did not expressly expand that definition to encompass those who made their purchases outside of the malware period. Although the plaintiffs at one point argued that the data breach continued through January 10, 2014, they abandoned that argument at settlement. It is therefore unclear to this court why the parties subsequently sought to expand the class beyond the malware period.

3 The Court notes that it appears from the allegations of the complaint that Frank made a purchase at Neiman Marcus outside the malware period and was subsequently the victim of unauthorized fraudulent charges. Frank thus may be a member of the non-malware period subclass. The Court, however, has no evidence before it establishing that this is the case or that Frank engaged in any effort to represent the interests of that sub-class against the interests of the broader class.

4 The Court acknowledges the lengthy history of this case, which has been heard by three district court judges as well as the Seventh Circuit. The Court concedes that it is loathe to issue a ruling that prolongs this case and further delays class members' recoveries. Nevertheless, the age and history of this case are not considerations which this Court may

consider when assessing the validity of class certification or the fairness of the proposed settlement.

5 The Chief Innovation Officer of the firm responsible for providing notice to the class provided these numbers in a signed declaration, but offered no underlying data or methodology justifying this calculation. The Court also takes note of the objectors' assertion that the funds available for providing notice to the class were not fully utilized.

End of Document

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NOTES

14

State Legislative and Enforcement Activity in the Debt Collection Industry: Selected Examples

Submitted by:
Christopher J. Willis
Ballard Spahr LLP

STATE OF INDIANA
IN THE MARION COUNTY CIRCUIT/SUPERIOR COURT

MISC. CAUSE NO. _____

IN THE MATTER OF: ENCORE CAPITAL GROUP, INC., MIDLAND FUNDING, LLC, and MIDLAND CREDIT MANAGEMENT, INC., Respondents.	**ASSURANCE OF VOLUNTARY COMPLIANCE/ASSURANCE OF DISCONTINUANCE**

This Assurance of Voluntary Compliance/Assurance of Discontinuance[1] ("Assurance") is entered into between Encore Capital Group, Inc., and the States of Alaska, Alabama, Arizona, Arkansas, Colorado, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Hawaii[2], Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia, Washington, Wisconsin, and Wyoming (collectively referred to as the "Participating States," or individually, as a "State"), acting through and by their respective Attorneys General, and, provides as follows:

DEFINITIONS

As used in this Assurance, the following terms shall be defined as follows:

[1] The State of Delaware and Midland agree that this Assurance shall be treated as a cease and desist agreement pursuant to 29 *Del. C.* §§ 2525(a) and 2526.

[2] Hawaii is represented on this matter by its Office of Consumer Protection, an agency which is not part of the state Attorney General's Office, but which is statutorily authorized to undertake consumer protection functions, including legal representation of the State of Hawaii. For simplicity purposes, the entire group will be referred to as the "Attorneys General" or individually as "Attorney General" and the designations, as they pertain to Hawaii, refer to the Executive Director of the State of Hawaii's Office of Consumer Protection.

"Charge-off" means the act of the Creditor that treats an account receivable or other Debt as a loss or expense because payment is unlikely.

"Charge-off Balance" means the amount allegedly due on a Debt at the time of Charge-off.

"Collect" or "Collection" means any attempts by Midland, whether directly or indirectly through a third party on Midland's behalf, to obtain payments from Consumers for Debts owned by Midland involving a representation, expressly or by implication, that a Consumer owes a Debt or as to the amount of a Debt owed, but does not include any post-judgment activities or Midland's activities in connection with or participation in bankruptcy or probate proceedings or processes involving a Consumer or a Consumer's estate, including any act to create, perfect, or enforce any lien that survives a bankruptcy.

"Collections Litigation" means efforts by any internal legal department or a third-party Law Firm on Midland's behalf to Collect a Debt owned by Midland, including sending correspondence on Law Firm letterhead and filing Collection lawsuits. Collections Litigation does not include any post-judgment Collection or Midland's activities in connection with or participation in bankruptcy or probate proceedings or processes involving a Consumer or a Consumer's estate, including any act to create, perfect, or enforce any lien that survives a bankruptcy.

"Consumer" means any natural person obligated or allegedly obligated to pay any Debt, as that term is defined in the Fair Debt Collection Practices Act, 15 U.S.C. §1692(a)(3).

"Consumer Account" means an account for a Debt that Midland has acquired.

"Consumer Reporting Agency" means "consumer reporting agency" as defined in the Fair Credit Reporting Act at 15 U.S.C. § 1681(a)(f).

"Consumer Transaction" means a transaction involving an individual or individuals seeking or acquiring real or personal property, services, future services, money, or credit for personal, family, or household purposes.

"Creditor" means any person who offers or extends credit creating a Debt or to whom a Debt is owed, but such term does not include any person to the extent that person receives an assignment or transfer of a Debt in default solely for the purpose of facilitating Collection of such Debt for another.

"Debt" means any obligation or alleged obligation of a Consumer to pay money arising out of a Consumer Transaction.

"Effective Date" means December 14, 2018.

"Law Firm" shall refer to all in-house counsel, third party law firms, and any other legal representatives retained by Midland, directly or indirectly through a third party, for the purpose of conducting Collections Litigation on Midland's behalf.

"Legacy Account" shall mean any Consumer Account Midland contracted to acquire before the Effective Date, but in no event shall it mean any Consumer Account Midland first acquired more than thirteen months after the Effective Date.

"Midland" shall refer to Encore Capital Group, Inc., as well as its current, as of the Effective Date, direct or indirect, affiliates, subsidiaries, parents, divisions, or branches, and all of their successors and assigns, that are engaged in the purchase or Collection of U.S. consumer receivables.

"Original Account Level-Documentation" means:

a. any documentation that a Creditor or that Creditor's agent provided to a Consumer about a Debt; or

b. a complete transactional history of a Debt created by the Creditor or that Creditor's agent; or

c. where applicable, a copy of the judgment.

"Prior Owners" shall mean all previous owners or assignees of an alleged Debt subsequently sold, assigned, or otherwise transferred to Midland by the Seller, beginning with the Creditor at the time of Charge-off.

"Seller" shall mean the immediate Prior Owner of the Debt sold, assigned, or otherwise transferred to Midland.

"Time-barred" when used to describe a Debt means any Debt that is beyond the applicable statute of limitations for a Collection lawsuit.

I. REQUIREMENTS TO COMPLY WITH ALL APPLICABLE LAWS

1. Midland shall comply with applicable provisions of the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. § 1692, *et seq.*, and the Fair Credit Reporting Act ("FCRA"), 15 U.S.C. § 1681, *et seq.*, as amended, with respect to its Collection activities.

2. Midland shall comply with applicable State consumer protection laws, rules and regulations pertaining to its Collection activities, including, to the extent applicable, laws, rules and regulations pertaining to the activities or licensing of debt collectors, debt buyers, and collection agencies, and laws governing credit reporting.

3. Midland shall maintain the confidentiality of all financial information maintained on Consumers in compliance with applicable federal, state, and local laws.

4. Specifically, without limiting the scope of the foregoing, Midland shall not:

a. State that Consumers owe Debts when corresponding with any person other than the Consumers for the purposes of acquiring

location information, in violation of the FDCPA, 15 U.S.C. § 1692b(2);

b. Communicate with Consumers in connection with the Collection of Debts at times or places that Midland knows or should know to be inconvenient to the Consumer, in violation of FDCPA, 15 U.S.C. § 1692c(a)(1);

c. Communicate with Consumers in connection with the Collection of Debts, without the prior consent of the Consumers, if Midland knows that the Consumers are represented by attorneys with respect to such Debts and has knowledge of, or can readily ascertain, such attorneys' names and addresses, unless the attorneys fail to respond within a reasonable period of time to a communication from Midland or Midland's representatives or unless the attorneys consent to direct communication with the Consumers, in violation of the FDCPA, 15 U.S.C. § 1692c(a)(2);

d. Communicate with Consumers in connection with the Collection of Debts at the Consumers' place(s) of employment when Midland knows that the Consumers' employer(s) prohibit the Consumers from receiving such communications, in violation of the FDCPA, 15 U.S.C. § 1692c(a)(3);

e. Communicate further with Consumers if a Consumer notifies Midland in writing that the Consumer refuses to pay a Debt or that the Consumer wishes Midland to cease further communication with

the Consumer (except: (i) to advise the Consumer that Midland's further efforts are being terminated; (ii) to notify the Consumer that Midland may invoke specified remedies which are ordinarily invoked by Midland; or (iii) where applicable, to notify the Consumer that Midland intends to invoke a specified remedy), in violation of the FDCPA, 15 U.S.C. § 1692c(c). Midland shall not violate this Subparagraph if it communicates with a Consumer in order to comply with a court order, a binding agreement entered into by Midland and any federal, state, or local governmental body, or as otherwise required to comply with the law;

f. Engage in conduct the natural consequence of which is to harass, oppress, or abuse persons in connection with the Collection of a Debt, in violation of the FDCPA, 15 U.S.C. § 1692d;

g. Use obscene or profane language in connection with the Collection of Debts the natural consequence of which is to abuse the hearer or reader, in violation of the FDCPA, 15 U.S.C. § 1692d(2);

h. Cause a telephone to ring or engage any person in telephone conversation repeatedly or continuously with intent to annoy, abuse, or harass any person at the called number, in violation of the FDCPA, 15 U.S.C. § 1692d(5);

i. Except to acquire location information as provided in 15 U.S.C. § 1692b of the FDCPA, attempt to Collect Debts by telephone

without providing meaningful disclosure of the caller's identity, in violation of the FDCPA, 15 U.S.C. § 1692d(6);

j. Use false, deceptive, or misleading representations to Collect or attempt to Collect Debts, in violation of the FDCPA, 15 U.S.C. § 1692e;

k. Use false representations about the character, amount, or legal status of Debts or services rendered or compensation that may be lawfully received by Midland, in violation of the FDCPA, 15 U.S.C. § 1692e(2);

l. Threaten to take legal actions against a Consumer when there is no legal authority or intention to do so, in violation of the FDCPA, 15 U.S.C. § 1692e(5);

m. Use any false representation or deceptive means to Collect or attempt to Collect any Debt, in violation of the FDCPA, 15 U.S.C. § 1692e(10);

n. Use unfair or unconscionable means to Collect or attempt to Collect Debts, in violation of the FDCPA, 15 U.S.C. § 1692f; or

o. Collect or attempt to Collect amounts that were not expressly authorized by the agreements creating the Debts or permitted by law, in violation of the FDCPA, 15 U.S.C. § 1692f(1);

II. ADDITIONAL REQUIREMENTS RELATED TO DEBT COLLECTION

Prerequisites to Collection

5. When Collecting a Debt, Midland shall not make any representation that a Consumer owes a Debt or as to the amount of a Debt, unless, at the time of making the representation, Midland has a reasonable basis for making such representation.

6. *^Midland shall not Collect or attempt to Collect any Debt allegedly owed to Midland unless it has in its possession the following information:

a. The name and address of the Consumer as they appeared in the Seller's records at or immediately prior to the sale of the Debt;

b. The name of the Creditor at the time of Charge-off, including, where available and applicable, the name under which the Creditor did business with the Consumer or the affinity name associated with the Consumer Account;

c. The last four digits of the account number used by the Creditor or other information as will reasonably enable the Consumer to identify the original account;

d. The name of the current person or entity to whom the Debt is owed and the date on which Midland first acquired the Consumer Account;

e. The date of Charge-off (or other date, such as the date of default, as may be required by regulations the Consumer Financial Protection Bureau may adopt regarding the Collection of Debt);

f. If Midland reports, or intends to report, the Debt to any Credit Reporting Agency, the date of first delinquency; and

g. The amount of the Debt at Charge-off (or other date, such as the date of default, as may be required by regulations the Consumer Financial Protection Bureau may adopt regarding the Collection of Debt).

7. *^Midland shall not Collect or attempt to Collect a Debt unless it has reasonable access to documentation supporting the Consumer Accounts.

8. ^ In the following circumstances, Midland shall not make a representation that a Consumer owes a Debt or as to the amount of the Debt until Midland has reviewed Original Account-Level Documentation reflecting the Consumer's name and the claimed amount, excluding any post Charge-off or post-judgment payments or credits (unless the claimed amount is higher than the Charge-off Balance or judgment balance, in which case Midland must review (i) Original Account-Level Documentation reflecting the Charge-off Balance or judgment balance and (ii) an explanation of how the claimed amount was calculated and why such increase is authorized by the agreement relating to the Debt or permitted by law):

a. The Consumer has disputed the validity or accuracy of the Debt orally or in writing;

b. The Debt was purchased, after the Effective Date, through a purchase agreement without meaningful and effective representations and warranties as to the accuracy or validity of the Debt;

c. The Debt was purchased, after the Effective Date, through a purchase agreement without meaningful and effective

commitments to provide Original Account-Level Documentation during the time period in which Midland is Collecting the Debt; or

d. The Debt was purchased in a portfolio, after the Effective Date, which Midland knows contains unsupportable or materially inaccurate information about the Debt, based on either of the following factors:

   i. At any time during the preceding twelve months, a Consumer disputed, orally or in writing, the accuracy or validity of a Debt in the portfolio and Midland sought but was unable to obtain Original Account-Level Documentation reflecting the amount of the Debt or the identity of the person responsible for the Debt, unless Midland can establish, based on a documented and thorough review of Original Account-Level Documentation concerning other Consumer Accounts in the portfolio, that the inability to obtain Original Account-Level Documentation to support the Consumer Account in the portfolio was an anomaly; or

   ii. Original Account-Level Documentation produced to Midland, by a Seller or a Consumer, reflected information about the amount of the Debt or the identity of the person responsible for the Debt that was inconsistent and irreconcilable with information previously provided to

Midland by the Seller, unless Midland can establish, based on a documented and thorough review of Original Account-Level Documentation concerning other Consumer Accounts in the portfolio, that the production of inaccurate or inconsistent information concerning the Consumer Account in the portfolio was an anomaly.

9. ^Where Midland is required to review Original Account-Level Documentation in accordance with Subsection (a) of Paragraph 8, Midland shall refrain from engaging in new attempts to Collect the Debt until Midland completes the review. Provided, however, for purposes of this Paragraph, Collecting or attempting to Collect do not include furnishing information to the Credit Reporting Agencies. Where Midland completes such a review, Midland, either directly or by use of a third party such as a Law Firm, shall provide a copy of such documentation to the Consumer without cost unless Midland has sent to the Consumer the documentation within the last six months.

10. At any time during Midland's ownership of a Debt, if Midland determines that the Debt is not owed by a Consumer, Midland shall:

a. Cease any and all Collection efforts directed to the Consumer in connection with the Debt;

b. Request the deletion of any negative information (or the entire trade line) associated with the Debt that Midland furnished to a Consumer Reporting Agency relating to that Consumer; and

c. If Midland returns the Debt to the Seller, Midland shall inform the Seller that it has determined that the Debt is not owed by the Consumer.

11. For Consumer Accounts on which Midland has not commenced Collection activity as of the Effective Date, Midland shall not commence Collection activity against a Consumer unless Midland has attempted, either directly or by use of a third party, to determine whether:

a. The Debt is subject to the Consumer's active bankruptcy case or has been discharged in bankruptcy;

b. The Consumer is deceased; and

c. The Consumer is a service member on active duty.

Midland shall perform subsequent screening as needed, either directly or by use of a third party, to determine the Consumer Account status as set forth in this Paragraph.

12. Determination by Midland that a Consumer Account meets any of the statuses set forth in Paragraph 11 shall not prohibit Midland from Collecting on such account so long as Collections are in accordance with the law and the following terms:

a. If a Debt is subject to bankruptcy, then Midland shall cease Collecting or attempting to Collect on the Debt from the Consumer that has filed for bankruptcy unless:

   i. The applicable court approves Collection or attempted Collection;

   ii. The bankruptcy is dismissed; or

   iii. The bankruptcy is completed and the Debt is not discharged.

b. If the Debt has been discharged in bankruptcy, then Midland shall cease attempting to Collect on the Debt from the Consumer who was subject to the bankruptcy.

c. Subparagraphs (a) and (b) shall not be deemed to preclude Midland from filing a proof of claim or otherwise participating in the bankruptcy proceeding as a creditor and seeking such relief as the law may allow.

d. If the Consumer(s) responsible for the Debt are deceased, Midland shall cease Collecting or attempting to Collect on the Debt unless Midland complies with the FDCPA or any regulations the Consumer Financial Protection Bureau may adopt regarding the collection of decedents' debts; and

e. If the individual is an active duty service member, Midland shall comply with the Servicemembers Civil Relief Act and state law equivalents.

13. ^Midland shall not re-sell Debt to anyone other than (a) the entity that initially sold the Debt to Midland or to the Creditor, (b) a subsidiary or affiliate of Midland that is subject to the terms of this Assurance (either by operation of law or by agreement), (c) any entity that is subject to the terms of this Assurance as part of an acquisition or merger with Midland, or purchase of all or substantially all of Midland's assets, or (d) Midland's (or its affiliates') creditors or any agent of such creditors in settlement or satisfaction of any claims under, or in connection with the default or remedial provisions of, any relevant loan or lending agreement. The foregoing provisions of this paragraph shall expire on September 9, 2020. As of that date, Midland shall comply with any regulations the Consumer Financial Protection Bureau may adopt regarding the re-sale of Debt.

14. Once Midland begins Collection activity on a Consumer Account, and continuing for so long as Midland pursues Collection activity on that Consumer Account, it will update regularly the Consumer Account information with information obtained by Midland in the

course of its efforts to Collect on that Consumer Account that Midland deems material and relevant to Collections.

Notice and Validation

15. For Consumer Accounts on which Midland has not commenced Collection activity as of the Effective Date, before sending the correspondence required by 15 U.S.C. Section 1692g(a), Midland shall use reasonable efforts, such as using the United States Postal Service's National Change of Address database, to verify the Consumer's current postal or email address. If any validation notice is returned as undeliverable, Midland will disable that address, use reasonable efforts to verify the Consumer's current address, and, if found, send another validation letter to the new address.

16. *^Midland shall, no later than five days after any initial communication with a Consumer (verbal or written) made in connection with the Collection of a Debt, mail a written notice to the Consumer in accordance with 15 U.S.C. Section 1692g(a) (unless the initial communication included the below information or the debt has been paid). That notice shall include the following information:

a. The name of the Creditor at the time of Charge-off (or other date, such as the date of default, as may be required by regulations the Consumer Financial Protection Bureau may adopt regarding the Collection of Debt), including, where available and applicable, the name under which the Creditor did business with the Consumer or the affinity name associated with the Consumer Account;

b. The last four digits of the account number used by the Creditor or such other information as will reasonably enable the Consumer to identify the original account;

c. The name of the current person or entity to whom the Debt is owed and the date on which Midland first acquired the Consumer Account;

d. The amount of the Debt at Charge-off (or other date, such as the date of default, as may be required by regulations the Consumer Financial Protection Bureau may adopt regarding the Collection of Debt) and, if the claimed amount of the Debt is more than the Charge-off Balance (or post-default balance), a breakdown of any post-Charge-off (or post-default) fees and interest; and

e. A clear and conspicuous statement that Midland has purchased the Debt and is attempting to Collect it from the Consumer.

Furnishing Collection Information to Consumer Reporting Agencies

17. Midland shall not furnish information to the Consumer Reporting Agencies that Midland knows or has reasonable cause to believe is inaccurate. "Reasonable cause to believe that the information is inaccurate" has the same meaning as the term is defined in section 15 U.S.C. § 1681s-2(a)(1)(D) of the FCRA.

Requirements Related to Personnel

18. Midland shall not knowingly employ or permit its agents, employees, representatives, Law Firms or affiliates to employ any deceptive means to Collect a Debt or obtain information concerning a Consumer.

19. Midland shall conduct background checks on all newly hired employees who are located in the United States and whose duties involve personal contact with Consumers or preparation of affidavits. Such background checks shall be carried out before the employee undertakes such duties.

20. Midland shall dedicate an appropriate number of trained representatives to resolve disputes and address questions from Consumers in a timely manner.

21. Midland shall maintain a mandatory training program for newly-hired collection representatives that covers state and federal laws, including the FDCPA, Consumer Financial Protection Act, as well as state law variations, FDCPA terminology, the legal requirements of communicating with Consumers, Midland's internal policies for compliance, the Servicemembers Civil Relief Act, the Gramm-Leach-Bliley Act, and the FCRA. As part of the training program, Midland will require collection representatives to pass a comprehensive examination that includes information on the FDCPA before they are assigned to permanent duties, and to also complete an annual re-examination on the FDCPA.

22. Midland shall monitor a sample of Collection calls of its account managers (*i.e.*, call center employees) for legal compliance and training purposes and will record a sample of Collection calls to the extent permissible or feasible under applicable laws. Based on this monitoring, Midland's quality assurance team will assess the job performance of Midland's account managers and the potential need for corrective or disciplinary action.

23. ^Midland shall confirm in writing any arrangement to settle a Consumer's Debt agreed to after the Effective Date between a Consumer and Midland, or between a Consumer's representative and Midland, over the telephone, and Midland will, not later than 10 business days,

mail, fax, or electronically deliver the confirmation to the Consumer or that Consumer's representative.

III. REQUIREMENTS RELATED TO COLLECTIONS LITIGATION

24. Midland, whether acting directly or indirectly through its Law Firms, shall comply with applicable state and local pleading requirements governing a good faith basis for the filing of Collection lawsuits.

25. Midland, whether acting directly or indirectly through its Law Firms, shall not make material factual assertions in documents filed with a court in Collections Litigation based on information Midland knows or has reasonable cause to believe is inaccurate. Midland shall not be deemed in violation of this Paragraph if the material factual assertions it makes in documents filed with a court comply with the relevant pleading standards applicable in that court.

26. ^Midland, whether acting directly or indirectly through its Law Firms, shall not initiate a Collection lawsuit against Consumers unless it has in its possession:

a. Original Account-Level Documentation reflecting, at minimum:

i. The name of the Consumer;

ii. The last four digits of the account number associated with the Debt at the time of Charge-off (or other date, such as the date of default, as may be required by regulations the Consumer Financial Protection Bureau may adopt regarding the Collection of Debt) or other such information as will reasonably enable the Consumer to identify the original account; and

iii. The claimed amount, excluding any post-Charge-off payments or credits, unless the claimed amount is higher than the Charge-off Balance in which case Midland must possess:

1. Original Account-Level Documentation reflecting the Charge-Off Balance; and
2. an explanation of how the claimed amount was calculated and why such an increase is authorized by the agreement creating the Debt or permitted by law.

b. The name of the Creditor at the time of Charge-off (or other date, such as the date of default, as may be required by regulations the Consumer Financial Protection Bureau may adopt regarding the Collection of Debt), including, where available and applicable, the name under which the Creditor did business with the Consumer or the affinity name associated with the Consumer Account;

c. The date of Charge-off (or other date, such as the date of default, as may be required by regulations the Consumer Financial Protection Bureau may adopt regarding the Collection of Debt);

d. The address of the Consumer as it appeared in the Seller's records at or immediately prior to the sale of the Debt;

e. The name of the current person or entity to whom the Debt is owed and the date on which Midland first acquired the Consumer Account;

f. The terms and conditions applicable to the Debt if Midland is suing under a breach of contract theory. Compliance with regulations the Consumer Financial Protection Bureau may adopt relating to the possession of terms and conditions shall be sufficient to comply with this subparagraph); and

g. At least one of the following:

i. A document signed by the Consumer evidencing the Debt or the opening of the account; or

ii. A bill or other record that reflects purchases, payments, or other actual use of a credit card or account by the Consumer.

h. A chronological listing of the names of all Prior Owners of the Debt and the date of each transfer of ownership, beginning with the name of the Creditor at the time of Charge-off; and

i. A certified, verified, or otherwise properly authenticated copy of each bill of sale, or other document, evidencing or otherwise attesting to the transfer of ownership of the Debt beginning at the time of Charge-off to each successive owner, including Midland.

27. ^Midland shall not engage in Collections Litigation without providing the Consumer, either directly or indirectly through a Law Firm, with certain information about the Debt, unless previously provided, including but not limited to:

a. The name of the Creditor at the time of Charge-off, including, where available and applicable, the name under which the Creditor did business

with the Consumer or the affinity name associated with the Consumer Account;

b. Midland's or the Law Firm's name and address;

c. The last four digits of the account number associated with the Debt at the time of Charge-off or other such information as will reasonably enable the Consumer to identify the original account;

d. The Charge-off Balance;

e. The method used to calculate any amount claimed in excess of the Charge-off Balance; and

f. A statement that Midland, or Midland's agent, will, within 30 days of a written request, provide the Consumer with copies of the documentation referenced in Paragraph 27, at no cost. Provided that, Midland has to provide such documentation upon request only once per year and Midland is not required to provide such documentation in response to a request made more than one year after Midland has ceased collecting the Debt.

28. Midland shall not restrict its Law Firms' ability to order from Midland Original Account-Level Documentation that they may request about a Debt that has been placed in Collections Litigation. This Paragraph shall not create an independent obligation on Midland to order Original Account-Level Documentation from Sellers or Prior Owners of a Debt.

29. Midland shall instruct its Law Firms to which Midland places Consumer Accounts that (a) the Law Firms are responsible for calculating the limitations period for each Consumer Account according to applicable law and based on a review of relevant data and/or records (however, Midland may require its Law Firms to use a shorter limitations period), (b) a

Collection lawsuit shall not be filed on a Consumer Account for which the statute of limitations has expired, and (c) the prosecution of any Collection lawsuit must cease and the Law Firm must take reasonable steps to seek to dismiss the lawsuit in accordance with applicable rules if it is determined that the lawsuit was filed after the applicable statute of limitations had expired. Subparagraph (c) shall not apply where the lawsuit is the subject of litigation between the Consumer and Midland.

30. Midland shall instruct its Law Firms to bring suit in the name of the proper party, consistent with all local, state and federal laws, court rules, and other authorities and take appropriate steps to ensure that such instructions are carried out.

31. Midland, whether acting directly or indirectly through its Law Firms, shall not pursue or threaten litigation or otherwise Collect on Consumer Accounts where it knows or has reason to know that it is not the rightful and named owner. This Paragraph shall not apply to Collections that Midland may hereafter make for third parties.

32. Midland shall instruct its Law Firms to engage process servers who are reputable, licensed (where applicable), in good standing with applicable regulatory agencies and trade associations, and who both conform to all legal requirements concerning the service of process and employ systematic checks to validate effective service (*e.g.*, the appropriate use of technology, digital pictures, compliance audits, etc.). Midland shall also instruct its Law Firms to comply with all relevant state and local laws and procedures related to service of process upon Consumers.

IV. REQUIREMENTS RELATED TO AFFIDAVITS

33. Midland's affiants shall not sign an affidavit in connection with Collections Litigation unless the facts stated in the affidavit are based upon:

a. The affiant's review of pertinent business/account records (in either hard copy or electronic format) in Midland's possession, and

b. Any personal knowledge gained by those records actually reviewed by and relied upon by the affiant.

34. Midland shall not produce an affidavit in connection with Collections Litigation that it knows or should know contains false representations regarding the validity, source, authenticity, trustworthiness, or reliability of the records relied on to Collect the Debt, including but not limited to:

a. Falsely asserting that the Creditor affirmed the accuracy or reliability of the account records it sold or transferred to Midland;

b. Falsely asserting that account data was obtained from a source other than the actual source of the data; and

c. Falsely asserting that the affiant has personal knowledge of the manner and mode by which the Creditor prepared, recorded, or maintained the account records.

35. When an affidavit used in connection with Collections Litigation contains attached documents, the affiant shall review the attached documents before executing the affidavit to confirm that the correct documents have been attached and are true and correct copies of documents contained in Midland's records, and Midland shall, either directly or indirectly through its Law Firms, retain a copy of the attached documents for the duration of the litigation.

36. Midland shall not pay incentives to employees or third-party providers based solely on volume of affidavits prepared, verified, executed, or notarized (except for notaries not employed by Midland, who may be paid customary fees for notarial services).

37. Affidavits shall be signed by hand signature of the affiant, except in jurisdictions and situations where electronic signatures are permitted by law.

38. Midland's procedures for the generation and use of affidavits in Collections Litigation shall require, at a minimum, the following tasks of those employees who review and sign affidavits:

a. Such employees must carefully review and fully understand any proposed affidavit prior to executing the proposed affidavit;

b. Such employees must confirm that all of the data points in the proposed affidavit accurately reflect data in Midland's account records prior to executing the proposed affidavit;

c. Such employees will carefully review attachments to the proposed affidavit to confirm that true and correct copies of documents contained within Midland's records are attached and are accurately described in the proposed affidavit; and

d. Affidavits passing such review and confirmation will then be executed in the presence of a notary where required by applicable state or local law. In no event will any affidavit be executed by an affiant if it has not been through the review and confirmation procedures set forth above.

39. Midland's procedures for the generation and use of affidavits shall be in writing, and each employee who has job duties involving the preparation and signing of affidavits to be used in Collections Litigation will be trained annually on those procedures, as set forth in Paragraph 40.

40. Midland shall ensure that its affiants, both as new hires and throughout their tenure, undergo, at minimum, annual training regarding the following topics:

a. the purpose of an affidavit in the legal process;

b. the general legal terms commonly used in affidavits or lawsuits;

c. specialized terms used in the collection industry;

d. federal and state laws specific to the collection industry;

e. requirements regarding personal review and knowledge of records; and

f. the penalties associated with making false statements or signing affidavits without requisite personal knowledge of account records.

41. Midland, whether directly or through Law Firms, shall not knowingly file, or knowingly cause to be filed, affidavits that do not comply with applicable state law. Midland will instruct its Law Firms that affidavits filed in Collection lawsuits shall fully comply with all applicable state laws, and take appropriate steps to ensure that such instructions are carried out and document steps taken to ensure compliance with the provisions of this Assurance.

V. REQUIREMENTS RELATED TO TIME-BARRED DEBT

42. Midland shall not knowingly pursue or threaten to pursue, directly or indirectly, Collections Litigation on any Time-barred Consumer Accounts.

43. ^Midland, whether directly or through Law Firms or other third parties, shall disclose clearly and conspicuously the following disclosures regarding the statute of limitations in oral or written communications to applicable Consumers, depending on the following specific status of the Consumer Account:

a. For those Consumer Accounts where the Debt is Time-barred and generally cannot be included in a consumer report under the provisions of the FCRA,

15 U.S.C. § 1681c(a), Midland, whether directly or through Law Firms or other third parties, shall include the following statement, either verbatim or in substance, in any oral or written Collection attempt: "The law limits how long you can be sued on a debt and how long a debt can appear on your credit report. Due to the age of this debt, we will not sue you for it or report payment or non-payment of it to a credit bureau;" and

b. For those Consumer Accounts where the Debt is Time-barred but collectible, and may be included in a consumer report under the provisions of the FCRA, 15 U.S.C. § 1681c(a), Midland, whether directly or through Law Firms or other third parties, will include the following statement, either verbatim or in substance, in any oral or written Collection attempt: "The law limits how long you can be sued on a debt. Because of the age of your debt, we will not sue you for it."

Provided, however, that with regard to oral communications, Midland is not required to make either disclosure to any individual person more than once per 30-day period. Midland will be deemed to have complied with the disclosure requirements of this Paragraph if it makes a disclosure to Consumers that is substantially similar to the disclosure required by this Paragraph.

44. ^Midland shall not, directly or indirectly through a Law Firm or other third parties, make any representation or statement, or take any other action that interferes with, detracts from, contradicts, or otherwise undermines the disclosures required in Paragraph 43 above. Nothing contained in paragraphs 43 or 44 shall be construed to require Midland to make any disclosure that would otherwise be prohibited by, or create liability under, federal, state or local

law; and nothing contained in paragraphs 43 or 44 shall be construed to prohibit Midland from making any disclosure that would otherwise be required by, or to avoid liability under, federal, state or local law.

VI. MISCELLANEOUS COMPLIANCE PROCEDURES

45. Midland shall employ legal counsel, compliance officer(s), and/or other senior manager(s) responsible for compliance oversight, who will identify reasonably foreseeable internal and external violations of applicable laws by its employees and agents.

46. All new Law Firms engaged by Midland after the Effective Date shall be subject to a due diligence process, which will include a site visit by a member of Midland's vendor management team (or equivalent). All Law Firms active as of the Effective Date will be also subject to regular performance reviews for so long as they are engaged in Collections Litigation.

47. Midland shall create, to the extent not already in existence, policies and procedures reasonably expected to ensure compliance with this Assurance.

48. Should Midland learn that any Midland employee, Law Firm, third-party collection agency, or other agent acting on its behalf, is acting in violation of the law or the requirements of this Assurance, Midland shall take such action as may be reasonable to prevent further violation, up to and including the termination of any individual or agent that is in violation of the law or this Assurance.

49. In lieu of any steps required by this Assurance as a prerequisite to any Collection efforts, Midland may, at its option, choose not to pursue Collection efforts on any given Consumer Account.

50. No later than 30 days after the Effective Date of this Assurance, Midland shall deliver a copy of this Assurance to all of its current officers, directors, third-party collection agencies, and Law Firms (current as of the Effective Date).

VII. DISPUTE RESOLUTION

51. Before seeking any relief from any court for any alleged violation of this Assurance, and if in the discretion of the State, the lack of immediate enforcement action will not threaten the health, safety, or welfare of the citizens of their State, the State will give Midland written notice of the alleged violation. Midland shall then be provided the opportunity to respond to the State regarding the alleged violation within a period of ten (10) business days after the written notice is received. Within that ten (10) business day period, Midland may request a meeting to discuss the alleged violation. If Midland makes such a request, the State shall meet with Midland, either by phone or in person, at the earliest possible date, but in no event more than ten (10) business days from the date of Midland's request. The State and Midland agree to attempt to resolve any alleged violation of this Assurance through good-faith negotiation using the procedure described herein prior to the State initiating any action for enforcement.

52. In the event that any statute or regulation pertaining to the subject matter of this Assurance is modified, enacted, promulgated or interpreted by any State with respect to its own laws, or by the federal government or any federal agency, such that Midland contends the statute or regulation is in conflict with any provision of this Assurance and therefore that Midland cannot comply with both the statute or regulation and the provision of this Assurance, Midland shall provide advance written notice of at least thirty (30) days to the State of the inconsistent provision of the statute or regulation with which Midland intends to comply and of the counterpart provision of this Assurance that Midland contends is in conflict with the statute or regulation. If the State

disagrees, that State shall, within thirty (30) days of receipt of Midland's notice, notify Midland that the State does not agree there is a conflict between the requirements of the Assurance and the state or federal law. Any court orders modifying the Assurance in one or more states do not in any way affect the validity or enforceability of the Assurance entered in other states, and cannot be used to support modification of the Assurance in other states. Nothing in this Paragraph shall be deemed to relieve Midland from following any subsequently enacted law that is more restrictive than the provisions of this Assurance, or from following this Assurance if it is more restrictive than applicable laws, to the extent Midland can adhere to both this Assurance and the provisions of state or federal law.

53. To seek a modification of this Assurance for any reason, Midland will send a request to the State. The State will make a good-faith evaluation of the then-existing circumstances and Midland's request, and after collecting any information the State deems necessary, make a prompt decision as to whether to agree to the modification of this Assurance. In the event that the State timely denies the modification request, Midland reserves all rights to pursue any legal or equitable remedies that may be available to it.

VIII. ENFORCEMENT

54. By execution of this Assurance, the Attorney General of each State releases and forever discharges Midland as well as Midland's past and present directors, employees, officers, shareholders, agents and attorneys ("Released Parties") from the following: all common law and other civil law claims that arise under any statute, regulation, or other law that the Attorney General of such State has authority to enforce, and that relate to consumer protection, unfair and deceptive business practices, the purchase and/or collection of debts (including but not limited to laws related to registration, licensing, or certification to engage in debt purchasing and/or debt collection),

and/or the enforcement of judgments (all of which shall be deemed to include, without limitation, the Dodd-Frank Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act) insofar as such claims relate to Midland's Collection activities, up to and including the Effective Date of this Assurance (collectively, the "Released Claims").

55. Nothing in this Assurance shall impair any private right of action as provided by federal or state law or any action by any other local, state, federal, governmental agency; nor shall this Assurance create any right of action in any person or entity, except that the Attorney General in each of the Participating States shall have the right to seek enforcement of this Assurance.

IX. PAYMENT PROVISIONS

Payment Other Than Consumer Relief

56. Within thirty (30) days after the Effective Date of this Assurance, Midland shall pay $6,000,000 to the States. At the sole discretion of the Attorneys General, the payment shall be used for reimbursement of attorneys' fees and/or investigative costs, used for future public protection purposes, placed in or applied to the consumer protection enforcement fund, consumer education, litigation, or local consumer aid fund or revolving fund, or similar fund by whatever name, or used for other consumer protection purposes permitted by state or local statutes, rules, or regulations.

Consumer Relief

57. Upon full execution of this Assurance,

a. Midland shall internally set aside $25,000 per State to be available for restitution for Consumer redress. Notwithstanding Midland's express denial of any violation of local, state or federal law, rule or regulation, for a

period of two years from the Effective Date, a State may submit a claim for restitution to Midland demonstrating a *prima facie* showing that, as a result of Collection efforts undertaken by Midland:

i. Midland submitted an affidavit in support of a Collection lawsuit against a Consumer where the amounts allegedly owed by the Consumer reflected in the affidavit did not accurately reflect Midland's account records related to that Consumer's Debt at the time of execution of the affidavit;

ii. A Consumer of the State made a payment to Midland on a Debt that was not actually owed by the Consumer, and which was not refunded; or

iii. A Consumer of the State made a payment to Midland in excess of that which was owed by the Consumer, and which was not refunded.

Upon any such occurrence, within thirty (30) days of the receipt of the State's claim for restitution, Midland will refund to the Consumer an amount equal to the Consumer's overpayment, unless Midland provides information within that thirty (30) day period that raises a question of fact regarding the validity of that claim. If such evidence is provided by Midland, the State submitting the claim will have thirty (30) days to evaluate the claim in good faith. The State's decision, however, will be final and binding on Midland. After two years from the date of the full execution of this Assurance, or at the

time that the $25,000 fund set aside by Midland for the State has been exhausted, whichever comes first, Midland's obligations under this provision shall terminate.

b. Midland shall provide a credit to the outstanding balance of the judgment up to $1,850 to each Consumer where: (i) the judgment was taken in a court in a Participating State; (ii) the Consumer disputed the Debt with Midland; (iii) Midland filed a Collection lawsuit against the Consumer after the Consumer disputed the Debt with Midland and a Law Firm requested an affidavit from Midland to support the lawsuit between January 1, 2003 and September 14, 2009; and (iv) the Consumer never made a payment to Midland in connection with the Debt. If the amount of the credit would extinguish the outstanding balance of the judgment, Midland shall apply only such amount as will reduce the balance to zero and no refund shall be due. The credits provided by Midland under this subparagraph: (a) shall not renew or extend the period within which the underlying judgments remain valid and subject to enforcement by legal process; and (b) represent settlements, by Midland and the Participating States, of contested liabilities that were disputed in good faith by the Attorneys General of the Participating States on behalf of the Consumers who receive the credits.

c. Consumer relief under this Paragraph does not cover accounts or Debts owned by any subsidiaries of Encore Capital Group before the subsidiaries were acquired by Encore Capital Group.

d. In addition, within 90 days of the Effective Date, Midland shall send notice to all Consumers whose accounts receive a credit under Paragraph 57(b) of the Agreement informing them of the credit. That notice shall be sent to such Consumers' last known mail address or last known email address, as appearing in the records of Midland. Within 120 days of the Effective Date, Midland shall provide the Attorney General of each Participating State a spreadsheet showing the identity of the Consumers in that State who received the credit and the amount of the credit provided.

X. GENERAL PROVISIONS

58. Midland shall not seek, nor is it entitled to obtain, specific releases from Consumers in conjunction with the restitution ordered herein or related to this Assurance.

59. Any notices required or permitted by this Assurance shall be in writing and sent by United States mail, certified mail return receipt requested, or other nationally-recognized courier service that provides for tracking services and identification of the person signing for the document. Any notice to any Attorney General shall be addressed to such contact and address as the Attorney General shall designate.

Any notices or other documents required by this Assurance to be sent to Midland shall be sent to both of the following addresses:

Midland Credit Management, Inc.
Attention:
Andrew Asch, General Counsel
3111 Camino del Rio North, Suite 1300
San Diego, CA 92108

Siran S. Faulders, Esq.
and/or Ashley L. Taylor, Jr., Esq.
Troutman Sanders LLP
1001 Haxall Point, Suite 1500

Richmond, VA 23219

Either Party may change or add the name and address or addresses of the person(s) designated to receive notice on its behalf by notice given (effective upon the giving of such notice), as provided in this Paragraph.

60. Midland shall designate one or more management-level employees to be the primary contact for the Signatory Attorneys General regarding complaints and inquiries from Consumers regarding their Debt. Midland shall provide the Attorney General or Consumer a written response to such inquiries, or seek from the Attorney General additional time to respond, within forty-five (45) days after Midland receives the inquiry from the Attorney General.

61. Midland's assurance to undertake the obligations described herein shall not be construed as evidence that such steps are necessary to comply with any statute, regulation or other rule of law of any State or the United States of America, nor shall such Assurance be construed as evidence that such measures did not exist at Midland prior to the execution of this Assurance, nor shall this Assurance otherwise prejudice the position of Midland with respect to whether it has complied with any statute, regulation or other rule of law of the State.

62. Each of the Parties is represented by counsel who participated in the drafting of this Assurance shall be deemed to have been mutually drafted by the Parties and shall not be construed against either Party as the author thereof.

63. Nothing in this Assurance shall be construed to authorize or require any action by Midland in violation of applicable federal, state or other laws.

64. The titles or headings to each section or provision of this Assurance are for convenience purposes only and are not intended by the parties to lend meaning to the actual provisions of this Assurance.

65. If any clause, provision, or section of this Assurance shall, for any reason, be held illegal, invalid, or unenforceable, such illegality, invalidity, or unenforceability shall not affect any other clause, provision, or section of this Assurance, and this Assurance shall be construed and enforced as if such illegal, invalid, or unenforceable clause, section, or other provision had not been contained herein.

66. Nothing contained herein, and no act required to be performed hereunder, including, but not limited to, the provision of information and/or material, is intended to require the disclosure by Midland of any communication by and between any officer, director, employee, agent or consultant of Midland and any person retained to provide Midland with legal advice, or otherwise, to constitute, cause or effect any waiver (whether by subject matter, in whole, or in part) of: (a) attorney-client privilege, work product protection, common law defense privilege and/or any other applicable privilege; or (b) confidential, proprietary or trade secret exception under each States' public records laws.

67. Nothing contained in this Assurance shall be construed to diminish the post-investigation obligations undertaken by the States in the course of their investigation of Midland (including but not necessarily limited to the post-investigation obligations set forth in the Confidentiality Agreement executed by Midland and the members of the Executive Committee in October 2012). Said obligations shall survive the execution of this Assurance and shall continue to be in effect. Nothing contained herein shall be construed to diminish any confidentiality obligations arising under state law with respect to materials or information obtained during the course of said investigation. Any documents provided to the States under the terms of this Assurance shall be treated in accordance with the Confidentiality Agreement that was executed by Midland and the members of the Executive Committee in October 2012.

68. This Assurance supersedes and nullifies the terms of any prior Tolling Order executed between Midland and any of the States during this investigation.

69. Notwithstanding any provision of this Assurance, Midland is not required to refuse to accept any payments voluntarily submitted by Consumers; suspend Collections for Consumers who have acknowledged the Debt and agreed to make payments, or refuse to communicate with a Consumer who affirmatively contacts Midland (or Midland's agents) or requests contact from Midland (or Midland's agents) to discuss the Consumer Account.

70. This Assurance shall be effective upon the Effective Date, except that the obligations of Paragraphs 10(c), 16, 27(b), and 47 shall not take effect until 60 days after the Effective Date. Notwithstanding the foregoing, the obligations imposed by this Assurance by Paragraphs 6, 7, and 16 shall not apply to any Legacy Accounts.[3]

71. Paragraphs 6, 7, 8, 9, 13, 16, 23, 26, 27, 43, and 44 shall terminate September 9, 2020.[4]

72. Except for Midland's obligations to credit judgments, as set forth in Paragraph 57(b), nothing contained herein shall be deemed to apply to any act or omission by Midland (i) with respect to any natural person who is not a resident of a Participating State at the time of such act or omission; or (ii) with respect to Collections Litigation in any court outside of the Participating States.

73. Midland shall ensure that any entities acquired by Midland subsequent to the Effective Date are brought into compliance with the applicable terms of this Assurance within one year after the closing of the acquisition transaction.

[3] *Indicates that paragraph will not apply to Legacy Accounts
[4] ^Indicates that paragraph will sunset

74. Midland shall not participate directly or indirectly in any activity or form a separate entity or corporation for the purpose of engaging in acts or practices in whole or in part that are prohibited by this Assurance or for any other purpose that would otherwise circumvent any part of this Assurance.

75. Midland shall not represent directly or indirectly or in any way whatsoever imply that the State has sanctioned, condoned, or approved any part or aspect of Midland's business practices, current efforts to reform its practices, or any further practices that Midland may adopt or consider adopting.

76. This Assurance does not constitute an admission by Midland of any fact or any violation of any local, state or federal law, rule or regulation, and Midland expressly denies any such violation. Midland enters into this Assurance for settlement purposes only. This Assurance is made without trial or adjudication of any issues of fact or law other than those finding that Midland was engaged in trade or commerce. This Assurance does not constitute evidence or admission of any issues of fact or law.

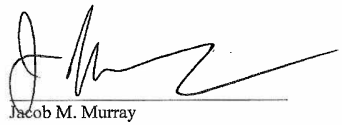
77. The provisions of this Assurance, stating that Midland shall perform a certain action or engage in certain practices or conduct itself in a certain manner (*e.g.*, comply with various statutes), shall not be construed to imply that Midland did not perform that action or engage in that practice or conduct itself in that manner before the execution of this Assurance. Likewise, the provisions of this Assurance, stating that Midland shall not perform a certain action or engage in certain practices or conduct itself in a certain manner, shall not be construed to imply that Midland performed that action, or engaged in that practice, or conducted itself in that manner before the execution of this Assurance.

IN WITNESS WHEREOF, Midland and the undersigned Attorneys General have executed this Assurance on the dates set forth below.

IN THE MATTER OF:

Encore Capital Group, Inc., Midland Funding, LLC, and Midland Credit Management, Inc.

STATE OF INDIANA

By: 

Jacob M. Murray
Deputy Attorney General
Office of the Indiana Attorney General
302 West Washington St., 5th Floor
Indianapolis, IN 46204

Date: 11/27/2018

IN THE MATTER OF:

Encore Capital Group, Inc., Midland Funding, LLC, and Midland Credit Management, Inc.

ENCORE CAPITAL GROUP, INC., et al.

By: Troutman Sanders, LLP

By: _____
Siran S. Faulders, Esq.

Date: December 4, 2018

FILED
18 SEP 21 AM 9:00

KING COUNTY
SUPERIOR COURT CLERK
E-FILED
CASE NUMBER: 18-2-23698-3 SEA

STATE OF WASHINGTON
KING COUNTY SUPERIOR COURT

STATE OF WASHINGTON, Plaintiff, v. EGP INVESTMENTS, LLC, a Washington limited liability company; JPRD INVESTMENTS, LLC, a Washington limited liability company; THE COLLECTION GROUP LLC, a Washington limited liability company; FAIR RESOLUTIONS, INC., a Washington corporation; and BRIAN FAIR, an individual, Defendants.	NO. COMPLAINT FOR INJUNCTIVE AND OTHER RELIEF UNDER THE CONSUMER PROTECTION ACT, RCW 19.86, AND THE COLLECTION AGENCY ACT, RCW 19.16

COMES NOW PLAINTIFF, State of Washington, by and through its attorneys Robert W. Ferguson, Attorney General, and Assistant Attorneys General Matthew Geyman and Amy C. Teng, and brings this action against Defendants EGP Investments, LLC ("EGP"), JPRD Investments, LLC ("JPRD"), The Collection Group LLC ("TCG"), Fair Resolutions, Inc. ("Fair Resolutions") and Brian Fair (collectively, "Defendants"), alleging as follows on information and belief:

I. INTRODUCTION

1.1 Defendants EGP, JPRD and TCG are debt buying companies owned and managed by Defendant Brian Fair. Each of these companies bought large portfolios of charged-

ATTORNEY GENERAL OF WASHINGTON
Consumer Protection Division
800 Fifth Avenue, Suite 2000
Seattle, WA 98104-3188
(206) 464-7745

off debt accounts for pennies on the dollar, then sued Washington consumers to collect the full face amount of the accounts, plus pre-judgment interest, attorneys' fees, court filing fees, and other collection costs.

1.2 However, EGP, JPRD and TCG missed a key requirement for any company that solicits, purchases and sues to collect on consumer debt accounts in the State of Washington: obtaining a license to operate as a collection agency.

1.3 Under the Washington Collection Agency Act, RCW 19.16 ("Collection Agency Act"), operating as a collection agency in Washington without being licensed is prohibited. RCW 19.16.110. Aiding or abetting the operation of an unlicensed collection agency is also prohibited. RCW 19.16.250(1). Operating as a collection agency without a license, or aiding or abetting such an operation, is also a *per se* unfair act or practice in the conduct of trade or commerce under the Washington Consumer Protection Act, RCW 19.86 ("CPA"). RCW 19.16.440.

1.4 EGP, JPRD and TCG were not licensed collection agencies prior to August 2013. Prior to licensure, EGP, JPRD and TCG obtained thousands of debt collection judgments against Washington consumers unlawfully.

1.5 Since obtaining these unlawful judgments, EGP, JPRD and TCG, aided by Defendants Brian Fair and Fair Resolutions, have collected and continue to collect on the unlawful judgments by garnishing consumers' wages, seizing funds from consumers' bank accounts, and foreclosing or threatening to foreclose on consumers' homes.

1.6 By identifying and bidding on debt portfolios, negotiating and entering into contracts to purchase charged-off debt accounts, then suing Washington consumers to collect on the accounts without being licensed as required by Washington law, EGP, JPRD and TCG, along with Brian Fair and Fair Resolutions, violated both the CPA and the Collection Agency Act.

1.7 Defendants' continuing efforts to collect on these unlawful judgments are unfair, deceptive and unlawful under the CPA and the Collection Agency Act and contrary to the public interest.

ATTORNEY GENERAL OF WASHINGTON
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1.8 The State, therefore, brings this action and asks the Court to enjoin Defendants from engaging in the unlawful conduct complained of herein; assess civil penalties under RCW 19.86.140 of up to $2,000 per violation for each violation of RCW 19.86.020; order Defendants to provide restitution to consumers of the money acquired through their unlawful conduct pursuant to RCW 19.86.080; reimburse the State for the costs of this action, including reasonable attorneys' fees, pursuant to RCW 19.86.080; and order such other and further relief as the Court deems just and proper.

II. PARTIES

2.1 The Plaintiff is the State of Washington.

2.2 Authority of the Attorney General to commence this action is conferred by RCW 19.86.080, RCW 19.86.140, RCW 19.16.440 and RCW 19.16.460. The Attorney General may seek restitution, injunctive relief, civil fines and penalties, and its costs and reasonable attorneys' fees in this action under RCW 19.86.080, RCW 19.86.140 and RCW 19.16.460.

2.3 Defendant EGP Investments, LLC is a Washington limited liability company with its principal place of business located at 1697 N. Western Avenue, Wenatchee, Washington 98801. EGP was formed on December 15, 2009. Defendant Brian Fair is a managing member of EGP and has been at all times material hereto. At all times material hereto, EGP regularly conducted business through its agents, employees, and/or representatives throughout the State of Washington, including King County.

2.4 Defendant JPRD Investments, LLC is a Washington limited liability company with its principal place of business located at 1697 N. Western Avenue, Wenatchee, Washington 98801. JPRD was formed on June 27, 2007. Defendant Brian Fair is a managing member of JPRD and has been at all times material hereto. At all times material hereto, JPRD regularly conducted business through its agents, employees, and/or representatives throughout the State of Washington, including King County.

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2.5 Defendant The Collection Group LLC is a Washington limited liability company with its principal place of business located at 1697 N. Western Avenue, Wenatchee, Washington 98801. TCG was formed on May 10, 2004. Defendant Brian Fair is a managing member of TCG and has been at all times material hereto. At all times material hereto, TCG regularly conducted business through its agents, employees, and/or representatives throughout the State of Washington, including King County.

2.6 Defendant Fair Resolutions, Inc. is a Washington corporation with its principal place of business located at 1697 N. Western Avenue, Wenatchee, Washington 98801. It was formed on June 27, 2007 and was licensed as a Washington collection agency on August 14, 2007. Defendant Brian Fair owns Fair Resolutions, in whole or in part, and is President of the company and has been at all times material hereto. At all times material hereto, Fair Resolutions regularly conducted business through its agents, employees, and/or representatives throughout the State of Washington, including King County.

2.7 Defendant Brian Fair is a resident of Wenatchee, Chelan County, Washington. At all times material hereto, he was an owner, manager, agent, employee, and/or representative of Defendants EGP, JPRD, TCG, and Fair Resolutions.

2.8 At all times material hereto, Defendants, and each of them, have been engaged in trade or commerce within the meaning of the CPA, RCW 19.86.020.

2.9 Defendants, and each of them, knowingly assisted, directed, controlled, participated in, carried out, and/or approved of the acts, practices, and activities that are the subject of this Complaint. Because Defendants operated as a common enterprise, each of them is jointly and severally liable for the unfair or deceptive acts and practices described herein.

III. JURISDICTION AND VENUE

3.1 This Court has subject matter jurisdiction over this Complaint under the provisions of the CPA, RCW 19.86, and the Collection Agency Act, RCW 19.16.

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3.2 This Court has personal jurisdiction over Defendants because each of them has engaged in the conduct set forth in this Complaint in King County and elsewhere in the State of Washington.

3.3 Venue is proper in King County because many of the events giving rise to this action occurred in King County, and because one or more of the Defendants has done and continues to do business in King County. RCW 4.12.020(3); RCW 4.12.025(1).

IV. FACTS

A. EGP, JPRD and TCG Took Affirmative Steps as Debt Buyers to Acquire Thousands of Charged-Off Debt Accounts and Then Collect on the Accounts

4.1 The high rate of consumer indebtedness has created a market for companies such as EGP, JPRD and TCG, which purchase charged-off debt accounts (*i.e.*, accounts written off by the creditor) for pennies on the dollar and then attempt to collect on the charged-off accounts. This practice is known as debt buying.

4.2 On average, debt buyers pay four cents on the dollar for charged-off debt accounts. Federal Trade Commission, *The Structure and Practices of the Debt Buying Industry* ("FTC Report") 22-23 (2013), *available at* https://www.ftc.gov/reports/structure-practices-debt-buying-industry. Thus, for example, if a debt buyer paid the average of four cents on the dollar for an account, it would have paid $80 for the right to sue on an alleged $2,000 debt.

4.3 The debt buyer's business model is simple: "If debt buyers can acquire debts cheaply enough, and develop efficient, low-cost methods of pursuing debtors, they can realize substantial profits by collecting even a small percentage of the debts they purchase." Human Rights Watch, *Rubber Stamp Justice: U.S. Courts, Debt Buying Corporations, and the Poor* 11 (2016), *available at* https://www.hrw.org/sites/default/files/report_pdf/us0116_web.pdf.

4.4 In this case, the affirmative steps that EGP, JPRD and TCG took as debt buyers included identifying sellers of debt accounts, bidding on debt portfolios, and/or negotiating and

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entering into contracts to buy debt accounts, and then suing Washington consumers to collect on the debt accounts they purchased.

4.5 In 2009, Brian Fair stated in a sworn declaration filed in King County Superior Court that JPRD was "in the business of buying consumer debt" and that "[a]s of May 14, 2009, [JPRD] owned approximately $20,000,000 in consumer debt." *See* Exhibit A, ¶ 2.[1]

4.6 Similarly, EGP and TCG—like JPRD—were in the business of buying consumer debt accounts, and they also purchased and owned millions of dollars in consumer debt accounts.

4.7 In 2010, EGP and Fair Resolutions entered into a services agreement under which Fair Resolutions agreed to provide and did provide, the following services to EGP, among others: locating sellers of debt; researching portfolios of debt for purchase consideration; negotiating with sellers of debt; and executing purchase and sale agreements with sellers of debt.

4.8 Fair Resolutions took these and other affirmative steps to assist EGP in locating sellers of debt accounts, researching debt portfolios for consideration, negotiating with sellers of debt, and/or entering into purchase and sale agreements with sellers of debt.

4.9 JPRD entered into one or more similar agreements with Fair Resolutions and/or another contracting party, under which Fair Resolution and/or another contracting party agreed to undertake, and did undertake, affirmative steps to assist JPRD in locating sellers of debt, researching portfolios of debt for consideration, negotiating with sellers of debt, and/or entering into purchase and sale agreements with sellers of debt.

4.10 Likewise, TCG also entered into one or more similar agreements with Fair Resolutions and/or another contracting party, under which Fair Resolution and/or another contracting party agreed to undertake, and did undertake, affirmative steps to assist TCG in

[1] The State has redacted consumers' names and other personal information from Exhibits A, C, D, E, F and G to this Complaint to protect consumers' privacy.

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locating sellers of debt, researching portfolios of debt for consideration, negotiating with sellers of debt, and/or entering into purchase and sale agreements with sellers of debt.

4.11 The steps that Brian Fair took to acquire debt accounts for collection for TCG are also described in court pleadings that he and TCG filed in a lawsuit with a former business partner. *See LK Operating, LLC v. The Collection Group, LLC*, 181 Wn.2d 48, 331 P.3d 1147 (2014).

4.12 In one of their court filings in that case, Brian Fair and TCG described the affirmative steps they took to negotiate contracts with debt sellers, purchase debt accounts, and then collect on the accounts they purchased. *See* Brief of Respondents/Cross-Appellants, filed in *LK Operating, LLC v. The Collection Group, LLC*, No. 297411-III, Washington Court of Appeals, Division 3 (Sept. 26, 2011), relevant excerpts attached as Exhibit B.

4.13 In the filing, Brian Fair and TCG stated that "Fair formed TCG to engage in the business of debt collection, by purchasing debt on the open market and then taking steps, including legal proceedings if necessary, to collect that debt," and that "Fair, as manager of TCG, set up the company and investigated possible sources of debt." *See* Exhibit B, p. 4.

4.14 Brian Fair and TCG went on to describe the steps they took to purchase debt accounts from a debt seller, Unifund, stating: "Fair, as manager of TCG . . . negotiate[d] with Unifund," TCG "went forward with the purchase of two accounts from Unifund," and "Fair then began work to collect the debt that TCG had purchased." *See* Exhibit B, pp. 6-7.

4.15 In many cases, after purchasing the debt accounts, TCG would then send one or more collection letters to consumers stating that TCG had purchased the accounts allegedly owed by the consumers and seeking to collect payment on the accounts. Attached as Exhibit C is a representative sample of these collection letters.

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4.16 In these initial communications with consumers regarding the alleged debts, TCG did not include an itemization of the interest added to the accounts by TCG, nor did it provide a separate itemization of the interest added to the accounts before they were purchased by TCG.

4.17 In these collection letters, TCG also told consumers, "THIS LETTER IS AN ATTEMPT TO COLLECT A DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE." TCG made this statement to consumers even though it was not a licensed collection agency at the time.

B. EGP, JPRD and TCG Acted as Collection Agencies Without Being Licensed

4.18 EGP, JPRD and TCG, directly and through their agents, including Brian Fair and Fair Resolutions, took these and other affirmative steps to identify sellers, bid on debt portfolios, negotiate and enter into contracts to purchase the subject debt accounts, and collect on the accounts—thus constituting and acting as collection agencies—without being licensed Washington collection agencies as required by law.

4.19 Under the Collection Agency Act, a collection agency includes any person or entity that directly or indirectly engages in soliciting claims for collection, or collecting or attempting to collect claims owed or due or asserted to be owed or due another person. RCW 19.16.100(4)(a).

4.20 The Washington Supreme Court has noted that the business of debt collection affects the public interest, and under the Collection Agency Act, collection agencies are subject to strict regulation to ensure they deal fairly and honestly with alleged debtors. *Panag v. Farmers Ins. Co. of Washington*, 166 Wn.2d 27, 54, 204 P.3d 885 (2009).

4.21 Among other prohibited collection practices, the Collection Agency Act prohibits any licensed collection agency or its employees from making false representations as to the legal status of a debt, threatening alleged debtors with impairment of their credit rating, attempting to

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collect amounts not actually owed, or implying legal liability for costs not actually recoverable. RCW 19.16.250.

4.22 In order to protect alleged debtors from these and other prohibited collection practices and achieve the purposes of the Collection Agency Act, it is essential that all persons or entities acting, assuming to act, or advertising as a collection agency in Washington must be licensed. RCW 19.16.110.

4.23 Under Washington law, a debt buyer is a collection agency under the Collection Agency Act and must be licensed as a collection agency if it enters into contracts with sellers of debt accounts or takes other affirmative steps to acquire accounts for collection, either directly or through an agent. *Gray v. Suttell & Associates*, 181 Wn.2d 329, 340-42, 334 P.3d 14 (2014).

4.24 Because EGP, JPRD and TCG identified sellers of debt accounts, bid on debt portfolios, negotiated and entered into contracts to buy debt accounts, then sued Washington consumers to collect on the debt accounts purchased, each of them was a collection agency under the Collection Agency Act. Each of them was required to be licensed when it solicited and acquired the debt accounts and sued to collect on the accounts.

4.25 EGP was not licensed as a Washington collection agency until August 21, 2013, *after* it solicited and acquired the debt accounts at issue and *after* it sued Washington consumers to collect on the accounts.

4.26 EGP's filings in Washington superior courts show that between December 15, 2009 and August 20, 2013, the day before EGP was licensed, EGP had sued to collect on over 1,200 debt accounts of Washington consumers.

4.27 In addition to the 1,200 collection actions reflected in EGP's Washington superior court filings, EGP filed numerous additional lawsuits in state district courts before it was licensed that are not reflected in the superior court filings. The number of the additional collection

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lawsuits EGP filed in state district courts before being licensed is believed to be considerable but is presently unknown.

4.28 Similarly, JPRD was not licensed as a Washington collection agency until September 17, 2013, *after* it solicited and acquired the debt accounts at issue and *after* it sued Washington consumers to collect on the accounts.

4.29 JPRD's filings in Washington superior courts show that between June 27, 2007 and September 16, 2013, the day before JPRD was licensed, JPRD had sued to collect on over 1,600 debt accounts of Washington consumers.

4.30 In addition to the 1,600 collection actions reflected in JPRD's Washington superior court filings, JPRD filed numerous additional lawsuits in state district courts before it was licensed that are not reflected in the superior court filings. The number of the additional collection lawsuits JPRD filed in state district courts before being licensed is believed to be considerable but is presently unknown.

4.31 Again similarly, TCG was not licensed as a Washington collection agency until September 23, 2013, *after* it solicited and acquired the debt accounts at issue and *after* it sued Washington consumers to collect on the accounts.

4.32 TCG's filings in Washington superior courts show that between May 10, 2004 and September 22, 2013, the day before TCG was licensed, TCG had sued to collect on over 700 debt accounts of Washington consumers.

4.33 In addition to the 700 collection actions reflected in TCG's Washington superior court filings, TCG filed numerous additional lawsuits in state district courts before it was licensed that are not reflected in the superior court filings. The number of the additional collection lawsuits TCG filed in state district courts before being licensed is believed to be considerable but is presently unknown.

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4.34 In these collection lawsuits that EGP, JPRD and TCG filed as unlicensed collection agencies, they sought to collect not only the face amount of the debts accounts, but also interest, attorneys' fees, court filing fees, and other collection costs.

C. Brian Fair and Fair Resolution Provided Substantial Assistance to EGP, JPRD and TCG in Their Actions as Unlicensed Collection Agencies and in Obtaining and Collecting on these Unlawful Judgments

4.35 Brian Fair's knowledge that EGP, JPRD and TCG were not licensed collection agencies is evidenced by the fact that he was a managing member of each company and was personally involved in obtaining their collection licenses on August 21, 2013, September 17, 2013, and September 23, 2013, respectively, *after* EGP, JPRD and TCG solicited and acquired the debt accounts at issue and *after* they sued Washington consumers to collect on the debt accounts as described above.

4.36 Fair Resolution's knowledge that EGP, JPRD and TCG were not licensed collection agencies is established by the fact that Fair Resolutions was and is owned and operated by Brian Fair as its President.

4.37 Brian Fair and Fair Resolutions provided substantial assistance to EGP in the actions it took as an unlicensed collection agency prior to August 21, 2013. Brian Fair and Fair Resolutions did so with knowledge that EGP was unlicensed prior to that date.

4.38 The substantial assistance that Brian Fair and Fair Resolutions provided to EGP in its solicitation, acquisition and collection of consumer debt accounts as an unlicensed collection agency prior to August 21, 2013 included, but was not limited to, sending collection letters to Washington consumers through Fair Resolutions. Many of the letters were signed by Brian Fair and intended to collect on the accounts purchased by EGP.

4.39 Brian Fair and Fair Resolutions also provided substantial assistance to JPRD in the actions it took as an unlicensed collection agency prior to September 17, 2013. Brian Fair

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and Fair Resolutions did so with knowledge that JPRD was unlicensed prior to that date.

4.40 The substantial assistance that Brian Fair and Fair Resolutions provided to JPRD in its solicitation, acquisition and collection of consumer debt accounts as an unlicensed collection agency prior to September 17, 2013 included, but was not limited to, sending collection letters to Washington consumers through Fair Resolutions. Many of the letters were signed by Brian Fair and intended to collect on the accounts purchased by JPRD.

4.41 Similarly, Brian Fair or Fair Resolutions, or both, provided substantial assistance to TCG in the actions it took as an unlicensed collection agency prior to September 23, 2013. Again, this assistance was provided with knowledge that TCG was unlicensed prior to that date.

4.42 The substantial assistance that Brian Fair or Fair Resolutions, or both of them, provided to TCG in its solicitation, acquisition and collection of consumer debt accounts as an unlicensed collection agency prior to September 23, 2013 included, but was not limited to, sending collection letters to Washington consumers. Many of the letters were signed by Brian Fair and intended to collect on the accounts purchased by TCG.

4.43 The substantial assistance that Brian Fair and his company, Fair Resolutions, provided to EGP, JPRD and TCG in the solicitation, acquisition and collection of these consumer debt accounts is also evidenced by Fair Resolutions' statement on its website that "Fair Resolutions *handles all of the affairs* of our specific clients including . . . The Collection Group, LLC . . . [;] JPRD Investments, LLC . . . [;] [and] EGP Investments, LLC." Fair Resolutions website, "Clients," http://fairresolutionsinc.com/clients.php (emphasis added).

4.44 In handling the affairs of EGP, JPRD and TCG, Fair Resolutions, under the direction of Brian Fair, assisted EGP, JPRD and TCG with their efforts to solicit, acquire and collect on consumer debts as unlicensed collection agencies.

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4.45 In many cases, Fair Resolutions, under the direction of Brian Fair, would send one or more collection letters to a consumer, stating that JPRD had purchased a debt account allegedly owed by consumer and seeking payment on behalf of JPRD, even though JPRD was operating as an unlicensed debt collection agency.

4.46 These letters would serve as the first written communication the consumer received that JPRD had purchased the alleged debt. Attached as Exhibit D is a representative sample of these letters.

4.47 At the time of these written communications, JPRD was operating as an unlicensed debt collection agency. Fair Resolutions did not notify consumers of this fact.

4.48 In these initial communications with consumers, Fair Resolutions and JPRD failed to include any itemization of the interest added to the debt accounts after they were acquired by JPRD or received by Fair Resolutions for collection. Fair Resolutions and JPRD similarly failed to provide a separate itemization of interest added to the accounts before they were purchased by JPRD.

D. Since Obtaining the Unlawful Collection Judgments, EGP, JPRD and TCG Have Continued to Enforce the Judgments

4.49 Through their actions, EGP, JPRD and TCG obtained thousands of collection judgments against Washington consumers on debt accounts they solicited, purchased, and sued on as unlicensed collection agencies.

4.50 Since obtaining these unlawful collection judgments, EGP, JPRD and TCG have sought to enforce the judgments by garnishing consumers' wages, seizing funds from consumers' bank accounts, and foreclosing or threatening to foreclose on consumers' homes.

4.51 EGP, JPRD and TCG have filed writs of garnishment to garnish up to 25 percent of the paychecks of consumers named in the unlawfully obtained collection judgments.

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4.52 EGP, JPRD and TCG have filed writs of attachment to seize funds from bank accounts of consumers named in the unlawfully obtained collection judgments.

4.53 EGP, JPRD and TCG have recorded thousands of judgment liens in the counties where these judgments were unlawfully obtained, allowing EGP, JPRD and TCG to foreclose, or threaten to foreclose, on the homes of consumers named in the unlawfully obtained collection judgments.

4.54 In King County alone, the county auditor's records show that EGP, JPRD and TCG currently have more than 230, 160, and 100 recorded judgment liens, respectively, based on collection judgments they unlawfully obtained.

4.55 EGP, JPRD and TCG have used and continue to use these judgment liens to force consumers to pay the unlawful collection judgments by threatening to foreclose and filing foreclosure actions to foreclose on consumers' homes.

4.56 In early 2018, for example, Brian Fair, EGP and Fair Resolutions wrote to a consumer in Lynnwood and told her EGP was prepared to file a writ of execution with the county sheriff and would foreclose on her home unless she contacted them immediately to pay off a collection judgment EGP had unlawfully obtained as an unlicensed collection agency. In the letter, Brian Fair described Fair Resolutions as the "Managing Company" of EGP, and he said they were "prepared to file a Writ of Execution with the Snohomish County Sheriff to begin the foreclosure process" and to contact them "if you wish to make arrangements to avoid this process." *See* Exhibit E.

4.57 In response, the consumer sent them a handwritten letter explaining that she was living on a monthly SSI check and that her only functioning vehicle was a 2004 Honda Civic that needed new tires and a clutch replacement. *See* Exhibit F.

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4.58 Despite her precarious financial situation, Brian Fair responded that "Interest continues to accrue at 12%" and he advised her to "begin the process of applying for a 'reverse' mortgage" to pay off the unlawful collection judgment. *See* Exhibit G.

4.59 At no time did Brian Fair, EGP or Fair Resolutions tell the Lynnwood consumer that EGP was not licensed as a collection agency when it solicited and acquired her debt account, sued to collect on the account, and obtained the unlawful collection judgment it sought to enforce by targeting her home.

V. VIOLATION OF COLLECTION AGENCY ACT UNLICENSED COLLECTION AGENCY—RCW 19.16.110

(Defendants EGP, JPRD, TCG, Brian Fair, and Fair Resolutions)

5.1 Plaintiff re-alleges Paragraphs 1.1 through 4.59 and incorporates them as if set forth fully herein.

5.2 Under the Collection Agency Act, it is prohibited for any person or entity to act as a collection agency in Washington without having a collection agency license. RCW 19.16.110.

5.3 The Collection Agency Act defines a "collection agency" as "[a]ny person or entity that directly or indirectly engages in soliciting claims for collection, or collecting or attempting to collect claims owed or due or asserted to be owed or due another person." RCW 19.16.100(4)(a).

5.4 Under this definition, a debt buyer is a collection agency and must be licensed if it enters into contracts with sellers of claims or takes other affirmative steps to obtain claims for collection, either directly or through an agent. *Gray v. Suttell*, 181 Wn.2d at 340-42.

5.5 Thus, when a debt buyer enters into contracts with sellers to purchase debt accounts or takes other affirmative steps to purchase such accounts, it is a collection agency and is prohibited from filing lawsuits in Washington to collect on the debt accounts without being licensed. *Id.* at 344.

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5.6 EGP, JPRD and TCG were required to be licensed as Washington collection agencies when they located sellers of debt accounts, bid on debt portfolios, negotiated and entered into contracts to buy the debt accounts, and then sued Washington consumers and obtained collection judgments on the debt accounts purchased, as outlined above.

5.7 Yet EGP, JPRD and TCG were not licensed as Washington collection agencies until August 21, 2013, September 17, 2013, and September 23, 2013, respectively, *after* they solicited and contracted to purchase the debt accounts for collection and *after* they filed the collection lawsuits to obtain judgments against Washington consumers.

5.8 By purchasing these thousands of debt accounts as described above and then suing consumers to collect on the purchased accounts without being licensed collection agencies as required by law, EGP, JPRD and TCG violated the Collection Agency Act. RCW 19.86.110.

5.9 Fair Resolutions, which Brian Fair owns, and directs as its President, knowingly assisted, directed, controlled, participated in, carried out, and/or with knowledge approved of the actions of EGP, JPRD and TCG as unlicensed collection agencies in violation of RCW 19.86.110. As such, Fair Resolutions is liable for its role in these violations of the Collection Agency Act by EGP, JPRD and TCG.

5.10 As an owner and managing member of EGP, JPRD and TCG, Brian Fair knowingly assisted, directed, controlled, participated in, carried out, and/or with knowledge approved of their actions as unlicensed collection agencies. As such, Brian Fair is also personally liable for these violations of the Collection Agency Act by EGP, JPRD and TCG.

VI. VIOLATION OF COLLECTION AGENCY ACT PROHIBITED COLLECTION PRACTICES—RCW 19.16.250(1) & (8)(c)(ii)-(iii)

(Defendants Fair Resolutions and Brian Fair)

6.1 Plaintiff re-alleges Paragraphs 1.1 through 5.10 and incorporates them as if set forth fully herein.

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6.2 Under the Collection Agency Act, it is prohibited for any licensee or employee of a licensee, directly or indirectly, to aid or abet any unlicensed person to engage in business as a collection agency in Washington or to receive compensation from an unlicensed collection agency. RCW 19.16.250(1).

6.3 Fair Resolutions was and is a licensee for purposes of RCW 19.16.250, which states that "No licensee or employee shall" take any of the prohibited practices listed therein, including RCW 19.16.250(1)'s prohibition against aiding or abetting an unlicensed person to engage in business as a collection agency.

6.4 Fair Resolutions, under the direction of Brian Fair, aided or abetted EGP, JPRD and TCG in operating as unlicensed collection agencies in violation of the Collection Agency Act. RCW 19.16.250(1).

6.5 As an owner and President of Fair Resolutions, Brian Fair is also personally liable for Fair Resolution's actions in aiding or abetting EGP, JPRD and TCG in their conduct as unlicensed collection agencies in violation of the Collection Agency Act. RCW 19.16.250(1).

6.6 The Collection Agency Act also requires that a licensed Washington collection agency must include in its first written communication with the alleged debtor an itemization of the claim asserted, including an itemization of any interest added to the original obligation by the original creditor, customer or assignor before it was received for collection, and also including a separate itemization of any interest added by the collection agency, customer or assignor after the obligation was received for collection. RCW 19.16.250(8)(c)(ii) & (iii).

6.7 By collecting or attempting to collect on these accounts without first providing to consumers, in the first written notices they received regarding the alleged debts, any itemization of interest added to the accounts before the accounts were purchased by JPRD, or any separate itemization of interest added by JPRD or Fair Resolutions after the accounts were received for

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collection, Fair Resolutions violated RCW 19.16.250(8)(c)(ii) & (iii).

6.8 As an owner and President of Fair Resolutions, Brian Fair is also personally liable for these violations of RCW 19.16.250(8)(c)(ii) & (iii) by Fair Resolution.

VII. VIOLATION OF CONSUMER PROTECTION ACT *PER SE* VIOLATIONS OF RCW 19.86.020—BASED ON RCW 19.16.110

(Defendants EGP, JPRD, TCG, Brian Fair and Fair Resolutions)

7.1 Plaintiff re-alleges Paragraphs 1.1 through 6.8 and incorporates them as if set forth fully herein.

7.2 Pursuant to the CPA, "[u]nfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are . . . unlawful." RCW 19.86.020.

7.3 Violations of RCW 19.16.110 of the Collection Agency Act are *per se* unfair or deceptive practices in trade or commerce under the CPA. RCW 19.16.440.

7.4 Violations of the Collection Agency Act also satisfy the "public interest impact" element required to establish a CPA claim. *Panag*, 166 Wn.2d at 54.

7.5 Under the Collection Agency Act, it is prohibited for any person or entity to act as a collection agency in Washington without a collection agency license. RCW 19.16.110.

7.6 EGP, JPRD and TCG violated the Collection Agency Act, RCW 19.16.110, by engaging in business as collection agencies in Washington without first obtaining licenses.

7.7 These violations of RCW 19.16.110 are *per se* unfair or deceptive practices in trade or commerce that violate the CPA. RCW 19.16.440.

7.8 By acting as collection agencies in Washington without a collection agency license, EGP, JPRD and TCG each committed unfair or deceptive acts or practices in trade or commerce in violation of the CPA. RCW 19.86.020; RCW 19.16.440.

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7.9 Because Brian Fair and Fair Resolutions knowingly assisted, directed, controlled, participated in, carried out, and/or approved of the acts, practices, and activities of EGP, JPRD and TCG in acting as collection agencies without a license, Brian Fair and Fair Resolutions also committed unfair or deceptive acts or practices in trade or commerce in violation of the CPA and they are also liable for these violations of the CPA. RCW 19.86.020; RCW 19.16.440.

7.10 Each *per se* violation of RCW 19.86.020 by Defendants, based on their violations of RCW 19.16.110, constitutes a separate violation of the CPA under RCW 19.86.140.

VIII. VIOLATION OF CONSUMER PROTECTION ACT *PER SE* VIOLATIONS OF RCW 19.86.020—BASED ON RCW 19.16.250(1) & (8)(c)(ii)-(iii)

(Defendants Fair Resolutions and Brian Fair)

8.1 Plaintiff re-alleges Paragraphs 1.1 through 7.10 and incorporates them as if set forth fully herein.

8.2 Violations of RCW 19.16.250(1) of the Collection Agency Act are *per se* unfair or deceptive practices in trade or commerce under the CPA. RCW 19.16.440.

8.3 Violations of RCW 19.16.250(1) of the Collection Agency Act satisfy the "public interest impact" element of a CPA claim. *Panag*, 166 Wn.2d at 54.

8.4 Under RCW 19.16.250(1), it is prohibited for any person or entity, directly or indirectly, to aid or abet any unlicensed person to engage in business as a collection agency in Washington or to receive compensation from an unlicensed collection agency. RCW 19.16.250(1).

8.5 Fair Resolutions and Brian Fair violated RCW 19.16.250(1) by aiding or abetting EGP, JPRD and TCG in acting as collection agencies in Washington without first obtaining collection agency licenses, as set forth above.

8.6 Fair Resolutions' and Brian Fair's violations of RCW 19.16.250(1) are *per se* unfair or deceptive practices in trade or commerce that affect the public interest and violate the

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CPA. RCW 19.86.020; RCW 19.16.440.

8.7 In addition, Fair Resolutions violated the Collection Agency Act, RCW 19.16.250(8)(c)(ii)-(iii), by collecting or attempting to collect on these accounts without first providing to consumers, in the first written notices they received regarding the alleged debts, any itemization of interest added to the accounts before the accounts were purchased by JPRD, or any separate itemization of interest added by JPRD or Fair Resolutions after the accounts were received for collection.

8.8 These violations of RCW 19.16.250(8)(c)(ii)-(iii) by Fair Resolutions are *per se* unfair or deceptive practices in trade or commerce that violate the CPA. RCW 19.16.440.

8.9 By collecting or attempting to collect on these accounts without first providing to consumers, in the first written notices they received regarding the alleged debts, any itemization of interest added to the accounts before the accounts were purchased by JPRD, or any separate itemization of interest added by JPRD or Fair Resolutions after the accounts were received for collection, Fair Resolutions committed unfair or deceptive acts or practices in trade or commerce in violation of the CPA. RCW 19.86.020; RCW 19.16.440.

8.10 Because Brian Fair knowingly assisted, directed, controlled, participated in, carried out, and/or approved of these acts, practices, and activities of Fair Resolutions in violation of RCW 19.16.250(8)(c)(ii)-(iii), he is also personally liable for these violations of the CPA. RCW 19.86.020; RCW 19.16.440.

8.11 As a result of the above unlawful actions and practices in violation of RCW 19.16.250(1) and RCW 19.16.250(8)(c)(ii)-(iii), Fair Resolutions and Brian Fair were and are prohibited from recovering any interest, service charges, attorneys' fees, collection costs, delinquency charges, or any other fees or charges on any of these claims. RCW 19.16.450.

ATTORNEY GENERAL OF WASHINGTON
Consumer Protection Division
800 Fifth Avenue, Suite 2000
Seattle, WA 98104-3188
(206) 464-7745

8.12 Each *per se* violation of RCW 19.86.020 by Fair Resolutions and Brian Fair, based on their violations of RCW 19.16.250(1) and RCW 19.16.250(8)(c)(ii)-(iii), constitutes a separate violation of the CPA under RCW 19.86.140.

IX. PRAYER FOR RELIEF

Wherefore, the State prays for the following relief:

9.1 That the Court adjudge and decree that Defendants have engaged in the conduct complained herein;

9.2 That the Court adjudge and decree that the conduct complained of violates the Collection Agency Act, RCW 19.16.110, RCW 19.16.250(1), and RCW 19.16.250(8)(c)(ii)-(iii);

9.3 That the Court adjudge and decree that the conduct complained of constitutes unfair or deceptive acts or practices in trade or commerce that affects the public interest, in violation of the CPA, RCW 19.86.020;

9.4 That the Court issue a permanent injunction, pursuant to the Collection Agency Act, RCW 19.16.460, the CPA, RCW 19.86.080, and other authority, enjoining and restraining Defendants and their representatives, successors, assigns, offices, agents, servants, employees, and all other persons acting or claiming to act for, on behalf of, or in concert or participation with Defendants, from continuing or engaging in the unlawful conduct complained of herein;

9.5 That the Court assess civil penalties against Defendants pursuant to the CPA, RCW 19.86.140, of up to $2,000 per violation for each violation of RCW 19.86.020;

9.6 That the Court make such orders pursuant to the CPA, RCW 19.86.080, as it deems appropriate to require Defendants to provide restitution to Washington consumers for the money or property Defendants acquired as a result of their violations of RCW 19.86.020;

ATTORNEY GENERAL OF WASHINGTON
Consumer Protection Division
800 Fifth Avenue, Suite 2000
Seattle, WA 98104-3188
(206) 464-7745

9.7 That the Court order Defendants Fair Resolutions and Brian Fair pursuant to the Collection Agency Act, RCW 19.16.450, to disgorge, and forever discharge the right to recover, any interest, service charges, attorneys' fees, collection costs, delinquency charges or other fees applied to affected debt accounts of Washington consumers as a result of their violations of RCW 19.16.250(1) and RCW 19.16.250(8)(c)(ii)-(iii);

9.8 That the Court order Defendants to file satisfactions of judgment, release judgment liens, and correct or update the credit reports of Washington consumers as necessary to remedy the harms caused by the conduct complained of herein;

9.9 That the Plaintiff, State of Washington, recover from Defendants the costs of this action, including reasonable attorneys' fees, pursuant to RCW 19.86.080; and

9.10 That the Court order such other and further relief as it deems just and proper to remedy the effects of the conduct complained of herein.

DATED this 21st day of September, 2018.

Presented by:

ROBERT W. FERGUSON
Attorney General

MATTHEW GEYMAN, WSBA #17544
AMY C. TENG, WSBA #50003
Assistant Attorneys General
Attorneys for Plaintiff State of Washington
800 Fifth Avenue, Suite 2000
Seattle, WA 98104
(206) 464-7745
matthewg@atg.wa.gov
amyt2@atg.wa.gov

EXHIBIT A

FILED

09 JUN 17 PM 1:27

KING COUNTY
SUPERIOR COURT CLERK
KENT, WA

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF KING

JPRD INVESTMENTS, LLC, a Washington Limited Liability Company,

Plaintiff,

vs.

[redacted], wife and husband,

Defendants.

The Honorable Hollis R. Hill

NO. 09-2-11802-7 KNT

DECLARATION OF BRIAN FAIR IN SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

I, BRIAN FAIR, state and declare as follows:

1. I am the member manager of JPRD Investments, LLC, Plaintiff herein, over the age of eighteen, and competent to be a witness herein. I make this declaration in support of Plaintiff's Motion for Summary Judgment after reviewing Plaintiff's records and files concerning this lawsuit.

2. Plaintiff is in the business of buying consumer debt receivables. As of May 14, 2009, Plaintiff owned approximately $20,000,000.00 in consumer debt receivables. The majority of these receivables consist of revolving charge accounts or credit cards issued by large national banks. As the member manager of Plaintiff, I have extensive firsthand knowledge of

ORIGINAL

EISENHOWER
EISENHOWER & CARLSON, PLLC
1200 Wells Fargo Plaza
1201 Pacific Avenue
Tacoma, WA 98402
Tel 253.572.4800
Fax 253.272.5732

such revolving charge accounts and the policies and practices implemented by the national banks that issue these accounts and their assignees, and I consider myself to be an expert in this regard.

3. Bank of America ("**B of A**") is a national bank organized under the federal National Bank Act ("**NBA**"). Defendant [redacted], previously opened a revolving charge account through B of A under Account Number [redacted] on February 17, 2000 ("**Account**"). Public records reflect the fact that [redacted] was married to her current husband, [redacted] when she opened the Account. Defendants borrowed money and/or obtained goods and services from the Account.

4. B of A assigned the Account to CACH, LLC ("**CACH**"). CACH later sold the Account to Plaintiff. Plaintiff has received a complete assignment of the Account, and is now the owner and holder thereof and successor in interest to B of A and CACH insofar as the Account is concerned. A true and correct copy of the B of A Affidavit of Claim and Certification of Debt and the Affidavit of Kristin E. Dougherty of CACH, which reflect Plaintiff's ownership of the Account, is attached as **Exhibit A**. A true and correct copy of the Assignment and Bill of Sale reflecting Plaintiff's purchase of the Account from CACH is attached as **Exhibit B**.

5. By borrowing money and/or purchasing goods and services using the Account, Defendants became bound to the duties and obligations as set forth in the written terms and conditions issued in connection with the Account ("**Agreement**"). A true and correct copy of the Agreement, which Plaintiff received in connection with its purchase of the Account, is attached as **Exhibit C**.

6. I believe Defendants were provided with a copy of the Agreement. Plaintiff regularly receives copies of agreements issued in connection with the revolving charge accounts Plaintiff purchases. Plaintiff relies on the accuracy and validity of the information contained in said agreements in conducting its business and affairs, and I believe the attached Agreement to

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1200 Wells Fargo Plaza
1201 Pacific Avenue
Tacoma, WA 98402
Tel: 253.572.4500
Fax: 253.272.5732

be a true and correct copy of the Agreement that was provided to Defendants concerning the Account.

7. The Account is in default. All monies owing thereunder are now due and owing to Plaintiff.

8. Attached as **Exhibit D** is a true and correct copy of [redacted] TransUnion Credit report. Plaintiff is legally entitled to obtain this credit report. Plaintiff regularly obtains credit reports like this in conducting Plaintiff's business and affairs. Plaintiff relies on the accuracy and validity of information contained in such reports in conducting its business and affairs, and Plaintiff pays a respectable sum of money to obtain such credit reports. I believe the contents of this credit report are true, correct, and accurate.

9. Said credit report reflects the existence on the Account on page 1 under the subname "BK OF AMER." This credit report lists the last four digits of the Account's account number and reflects that the Account was opened in February 2000. This credit report does not list the Account as being disputed by [redacted] nor does it state that said Defendant has been the victim of fraud or identity theft.

10. The first address listed for [redacted] on her TransUnion credit report under the "former address" heading on Page 1 of the credit report is the same address where [redacted] was served with Plaintiff's Summons and Complaint.

11. Attached as **Exhibit E** is a true and correct copy of two letters [redacted] sent to Plaintiff, which are dated December 11, 2008 and March 6, 2009. In her December 11, 2008 letter to Plaintiff, [redacted] states she disputes the subject debt and argues the statute of limitations on Plaintiff's claims has run. In her March 6, 2009 letter to Plaintiff, [redacted] admits the Account is hers. [redacted] also claims in her March 6, 2009 letter "that the last activity on this account occurred January 2003." Plaintiff is treating this correspondence as [redacted] Answer to Plaintiff's Complaint.

12. Attached as **Exhibit F** is a true and correct copy of the federal case entitled Munoz v. Pipestone Financial, LLC, 513 F. Supp. 2d 1076 (D. Minn. 2007). This case discusses, among other things, credit cards, the NBA, interest rates on credit cards in the context of the NBA, and an assignee's right to collect interest on credit cards issued by national banks.

13. Plaintiff's Account documents reflect that the interest rate on the Account is 23.990% per annum. Given that Plaintiff is the successor in interest to B of A and CACH regarding the Account, Plaintiff is entitled to recover from Defendants pre-judgment and post-judgment interest on the Account at the parties' contract rate of 23.990% per annum pursuant to the NBA and RCW 4.56.110(1).

14. By way of the Account documents and the use of a calculator, Plaintiff has determined Defendants owe Plaintiff $40,857.77 in principal and interest on the Account as of May 14, 2009. This sum is comprised of a principal balance of $20,054.66 as of January 18, 2005 and interest that has accrued on said balance at the rate of 23.990% per annum or $13.18 per day from January 18, 2005 to date. As of this date, no less than $20,803.11 in interest has accrued on the Account since January 18, 2005. Plaintiff can properly recover this interest pursuant to the NBA and applicable state law. The aforementioned sum does not include Plaintiff's costs and attorney's fees, which are recoverable from Defendants under the Agreement.

I declare under the penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED at Wenatchee, Washington, this 15th day of May, 2009.

BRIAN FAIR

EISENHOWER & CARLSON, PLLC
1200 Wells Fargo Plaza
1201 Pacific Avenue
Tacoma, WA 98402
Tel: 253.572.4500
Fax: 253.272.5732

EXHIBIT B

FILED

SEP 26 2011

COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By_____

No. 297411-III

COURT OF APPEALS, DIVISION III
OF THE STATE OF WASHINGTON

LK OPERATING, LLC,
a Washington Limited Liability Company,

Appellant,
v.
THE COLLECTION GROUP, LLC,
a Washington Limited Liability Company,
and BRIAN FAIR and SHIRLEY FAIR, husband and wife,
and the marital community composed thereof

Respondents/Cross-Appellants.

APPEAL FROM THE SUPERIOR COURT
FOR CHELAN COUNTY
THE HONORABLE THEODORE SMALL

BRIEF OF RESPONDENTS/CROSS-APPELLANTS

SMITH GOODFRIEND, P.S.

By: Catherine W. Smith
WSBA No. 9542

1109 First Avenue, Suite 500
Seattle, WA 98101
(206) 624-0974

HACKETT, BEECHER & HART

By: Ronald J. Trompeter
WSBA No. 3593

1201 Third Avenue, Suite 1650
Seattle, WA 98101-3036
(206) 382-1830

A. Appellant LKO Was Controlled By Two Attorneys Who Never Told Their Client Fair Of The Ethical Constraints On Their Business Dealings With Respondents TCG Or Fair.

On May 10, 2004, Fair formed The Judgment Group LLC, a Washington limited liability company, by filing a Certificate of Formation with the Washington Secretary of State. (CP 214) The name of the company was changed to The Collection Group LLC ("TCG") by article of amendment filed with the Secretary of State on June 7, 2004. (CP 1614, 1621)

Fair formed TCG to engage in the business of debt collection, by purchasing debt on the open market and then taking steps, including legal proceedings if necessary, to collect that debt. (CP 195-96) The Certificate of Formation expressly states that the company was to be manager-managed. (CP 214) It is undisputed that the manager of the company is and has always been Fair. (*See* CP 847, 924-25, 1412)

During the summer and fall of 2004, Fair, as manager of TCG, set up the company and investigated possible sources of debt. (CP 195) Fair, who is a CPA, knew that a necessary part of any debt collection business would be filing legal actions to obtain judgments in cases where debtors could not or would not pay the

balances owed. (CP 908) For that reason, he believed that it would be useful to include in the business an attorney. In the fall of 2004, Fair spoke with at least two attorneys about the possibility of joining in the venture. (CP 942) One of those attorneys was Powers. (CP 195-96) In his CPA practice, Fair had become acquainted with lawyers Powers and his partner Therrien, who practiced together as Powers & Therrien in Yakima, Washington. (CP 194-95) Earlier in 2004, Powers and Therrien had assisted Fair in tax planning by providing legal services to form, renew, and close a Nevada corporation, BF Trading, of which Fair was sole shareholder. (CP 195, 1591) These services continued until after the commencement of this lawsuit. (CP 1520-21)

Following discussions with attorneys Powers and Therrien in the fall of 2004, on October 27, 2004, Fair, as manager of TCG, sent to Powers and Therrien an email that discussed the possibility of TCG, Powers and Therrien working together to purchase a particular portfolio of debt, two accounts from the company Unifund:

> Les, Keith
>
> ...
>
> Attached is a sample purchase agreement from Unifund, the company selling the debt, and the attachment for when they sell FUSA debt (aka First

> USA). I have not had a chance to review it, but I will do so tonight.
>
> *Regarding an agreement between myself and you two*, this is how I would like to see it:
>
> ....
>
> B. You will contribute legal services you can provide (review the purchase agreement contract, *legal doc for this JV (if needed)*, demand letter, ask smart questions, kick the tires, etc.)

(CP 216) (emphasis added). Fair did not have any particular structure in mind, but thought a joint venture ("JV") between TCG and Powers & Therrien P.S. might be a possibility, and therefore asked the attorneys to draft an agreement. (CP 196, 1007) Fair attached to the e-mail a sample purchase agreement from Unifund, a seller of indebtedness. (CP 216, 1416) The sample agreement did not identify the buyer. (CP 1417-30)

On December 16, 2004, Powers sent Fair an e-mail forwarding a redlined redraft of the Unifund agreement. (CP 218) Powers made extensive changes to the Unifund agreement, but did not directly respond to Fair's request that he draft a joint venture agreement. (CP 196-97, 219-27)

Fair, as manager of TCG, continued to negotiate with Unifund. (*See* CP 1442) On January 26, 2005, Fair received from

Unifund an updated purchase and sale agreement naming TCG as the prospective purchaser of debt from Unifund. (CP 1906; *see also* CP 1911) The same day, Fair sent that updated agreement to Powers. (CP 1118) In the body of the email, Fair asked Powers whether he was still interested in the deal with Unifund. (CP 1118) Powers did not respond. (CP 197, 1114)

On February 1, 2005, TCG went forward with the purchase of two accounts from Unifund using its own resources. (CP 197) Fair then began work to collect the debt that TCG had purchased. (CP 197) On February 8, 2005, Fair sent e-mails to Powers forwarding a quitclaim deed for review and legal advice (CP 729-30, 731), and told Powers: "Also, the name of the company is The Collection Group, LLC." (CP 732)

The following day, on February 9, 2005, Diane Sires, a legal assistant employed by Powers & Therrien, sent an e-mail to Fair forwarding legal pleadings for TCG to use:

> Attached is the DRAFT Summons and Lis Pendens . . . . Les is working on the Complaint. We checked the statute and once we file with the court it must be served and/or published in the newspaper within 90 days. Thought you would like to know.

Dated this 22nd day of September, 2011.

HACKETT, BEECHER & HART

By: _____
Ronald J. Trompeter
WSBA No. 3593
1201 Third Ave., Suite 1650
Seattle, WA 98101-3036
(206) 382-1830

SMITH GOODFRIEND, P.S.

By: _____
Catherine W. Smith
WSBA No. 9542
1109 First Ave., Suite 500
Seattle, WA 98101-2988
(206) 624-0974

EXHIBIT C

The Collection Group, LLC
610 N. Mission St., Suite B3
Wenatchee, WA 98801
Tel (509) 662-1790 Fax (509) 662-4150
Toll Free (866) 530-5888

05/03/2007

[redacted]
Seattle WA [redacted]

Original Issuer: HOUSEHOLD BANK
Card Number: [redacted]
Balance: $4,293.99

The Collection Group, LLC, has purchased your account with the above named bank.

The records of HOUSEHOLD BANK indicate that your balance is now seriously past due and that you owe the balance indicated above. If you wish to make payment now, please remit to the above address.

If payment has already been made, or if you desire to arrange alternate payment arrangements, please contact us immediately by phone, fax, or regular mail, as listed above.

UNLESS YOU NOTIFY THIS OFFICE WITHIN 30 DAYS AFTER RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL ASSUME THE DEBT IS VALID. IF YOU NOTIFY THIS OFFICE IN WRITING WITHIN 30 DAYS FROM RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL OBTAIN VERIFICATION OF THE DEBT OR OBTAIN A COPY OF A JUDGMENT AND MAIL YOU A COPY OF SUCH JUDGMENT OR VERIFICATION. IF YOU REQUEST THIS OFFICE IN WRITING WITHIN 30 DAYS AFTER RECEIVING THIS NOTICE THIS OFFICE WILL PROVIDE YOU WITH THE NAME AND ADDRESS OF THE ORIGINAL CREDITOR, IF DIFFERENT FROM THE CURRENT CREDITOR.

THIS LETTER IS AN ATTEMPT TO COLLECT A DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE.

Sincerely,

Christy Gay, Operations Manager
The Collection Group, LLC

The Collection Group, LLC
610 N. Mission St., Suite B3
Wenatchee, WA 98801
Tel (509) 662-1790 Fax (509) 662-4150
Toll Free (866) 530-5868

11/01/2006

[redacted]
Seattle WA [redacted]

Credit Card Bank: Metris Companies
Card Number: [redacted]
Balance: $1,411.82

The Collection Group, LLC, has purchased your account balance with the above named bank.

The records of Metris Companies indicate that your balance is now seriously past due and that you owe the balance indicated above. If you wish to make payment now, please remit to the above address.

If payment has already been made, or if you desire to arrange alternate payment arrangements, please contact us immediately by phone, fax, or regular mail, as listed above.

UNLESS YOU NOTIFY THIS OFFICE WTHIN 30 DAYS AFTER RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL ASSUME THE DEBT IS VALID. IF YOU NOTIFY THIS OFFICE IN WRITING WITHIN 30 DAYS FROM RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL OBTAIN VERIFICATION OF THE DEBT OR OBTAIN A COPY OF A JUDGEMENT AND MAIL YOU A COPY OF SUCH JUDGMENT OR VERIFICATION. IF YOU REQUEST THIS OFFICE IN WRITING WITHIN 30 DAYS AFTER RECEIVING THIS NOTICE THIS OFFICE WILL PROVIDE YOU WITH THE NAME AND ADDRESS OF THE ORIGINAL CREDITOR, IF DIFFERENT FROM THE CURRENT CREDITOR.

THIS LETTER IS AN ATTEMPT TO COLLECT A DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE.

Sincerely,

Christy Gay, Operations Manager
The Collection Group, LLC

EXHIBIT D

Fair Resolutions, Inc.
610 N. Mission St., Suite 200
Wenatchee, WA 98801
Tel (509) 662-1790 • Fax (509) 662-4150
Toll Free (866) 530-5888

September 23, 2008

[redacted]
KIRKLAND, WA

Original Issuer:	BANK OF AMERICA, N.A.
Account Number:	[redacted]
Charge off Date:	3/15/2005
Charge off Balance:	$2,205.16
Accrued Interest through today:	$2,338.51
Total Balance Due:	$4,543.67

JPRD Investments, LLC has purchased your above listed account balance originated with the above named bank, JPRD Investments, LLC, has assigned your account to Fair Resolutions, Inc., to collect the balance owed by you.

The records of BANK OF AMERICA, N.A. indicate that your balance is now seriously past due and that you owe the balance indicated above. If you wish to make payment now, please remit to the above address.

If payment has already been made, or if you desire to arrange alternate payment arrangements, please contact us immediately by phone, fax, or regular mail, as listed above.

UNLESS YOU NOTIFY THIS OFFICE WITHIN 30 DAYS AFTER RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL ASSUME THE DEBT IS VALID. IF YOU NOTIFY THIS OFFICE IN WRITING WITHIN 30 DAYS FROM RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL OBTAIN VERIFICATION OF THE DEBT OR OBTAIN A COPY OF A JUDGMENT AND MAIL YOU A COPY OF SUCH JUDGMENT OR VERIFICATION. IF YOU REQUEST THIS OFFICE IN WRITING WITHIN 30 DAYS AFTER RECEIVING THIS NOTICE THIS OFFICE WILL PROVIDE YOU WITH THE NAME AND ADDRESS OF THE ORIGINAL CREDITOR, IF DIFFERENT FROM THE CURRENT CREDITOR.

THIS LETTER IS AN ATTEMPT TO COLLECT A DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE.

Sincerely,

Tiffany Billingsley, Operations Manager
Fair Resolutions, Inc.

TB/hsp

Fair Resolutions, Inc.
610 N. Mission St., Suite 200
Wenatchee, WA 98801
Tel (509) 662-1790 • Fax (509) 662-4150
Toll Free (866) 530-5888

April 21, 2008

[redacted]
PUYALLUP, WA [redacted]

Original Issuer:	Bank of America, N.A.
Account Number:	[redacted]
Date Sagres Company acquired account:	3/1/2007
Balance as of date acquired by Sagres:	$10,185.64
Additional Accrued Interest through today:	$ 1,790.91
Total Balance Due:	$11,976.55

JPRD Investments, LLC has purchased your above listed account balance from Sagres Company which originated with the above named bank. JPRD Investments, LLC, has assigned your account to Fair Resolutions, Inc., to collect the balance owed by you.

The records of Bank of America, N.A. and Sagres Company indicate that your balance is now considerably past due and that you owe the balance indicated above. If you wish to make payment now, please remit to the above address.

If payment has already been made, or if you desire to arrange alternate payment arrangements, please contact us immediately by phone, fax, or regular mail, as listed above.

UNLESS YOU NOTIFY THIS OFFICE WITHIN 30 DAYS AFTER RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL ASSUME THE DEBT IS VALID. IF YOU NOTIFY THIS OFFICE IN WRITING WITHIN 30 DAYS FROM RECEIVING THIS NOTICE THAT YOU DISPUTE THE VALIDITY OF THIS DEBT OR ANY PORTION THEREOF, THIS OFFICE WILL OBTAIN VERIFICATION OF THE DEBT OR OBTAIN A COPY OF A JUDGMENT AND MAIL YOU A COPY OF SUCH JUDGMENT OR VERIFICATION. IF YOU REQUEST THIS OFFICE IN WRITING WITHIN 30 DAYS AFTER RECEIVING THIS NOTICE THIS OFFICE WILL PROVIDE YOU WITH THE NAME AND ADDRESS OF THE ORIGINAL CREDITOR, IF DIFFERENT FROM THE CURRENT CREDITOR.

THIS LETTER IS AN ATTEMPT TO COLLECT A DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE.

Sincerely,

Christy Gay, Operations Manager
Fair Resolutions, Inc.

EXHIBIT E

Fair Resolutions, Inc.
PO BOX 2858
Wenatchee, WA 98807
Tel (509) 662-1790 • Fax (509) 662-4150
Toll Free (866) 530-5888

January 11, 2018

Ms. [redacted]
Lynnwood, WA [redacted]

Total Judgment/Current Amount Due:

Balance of Judgment entered 4/19/11:	$33,458.11
Interest accrued through 1/11/18:	$27,048.82
Prior Costs:	
Attorney:	$0.00
Court Cost:	$0.00
Less: Prior payments/credits:	<$0.00>
Total Balance due:	$60,506.93

Re: EGP INVESTMENTS, LLC vs [redacted]
Snohomish County Superior Court Cause No: 11-2-06325-7

Dear Ms. [redacted]

On July 12, 2011, our client, EGP Investments, LLC recorded a judgment against your property in Snohomish County. A copy of the recorded judgment in enclosed. With accrued interest, the balance as of today is $60,506.93.

The estimated fair market value of the property per Zillow is now $578,363.

We are prepared to file a Writ of Execution with the Snohomish County Sheriff to begin the foreclosure process. Please contact us by January 19, 2018, if you wish to make arrangements to avoid this process. Alternatives other than payment in full are possible.

THIS LETTER IS AN ATTEMPT TO COLLECT A DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE. THIS IS A COMMUNICATION FROM A DEBT COLLECTOR.

Sincerely,

Brian Fair, President
Fair Resolutions, Inc.
Managing Company of EGP INVESTMENTS, LLC

BF/crf

EXHIBIT F

May 10, 2018

Fair Resolutions, Inc.
P.O. Box 2868
Wenatchee, WA 98807
Fax 509-662-4150

Re: EGP Investments, LLC vs [redacted]
Snohomish County Superior Court Case No. 11-2-06325-7

To whom it may concern:

This letter is in response to your attach request for source of income and assets information per our phone conversation today, May 10, 2018.

I do solemnly declare that my only source of income is my monthly SSI payments. My only assets are my home valued at $358,800 and my primary vehicle, a Honda Civic 2004 I purchased for $1,035 that needs new tires & a clutch replacement work done, and my previous vehicle a 1993 Mercury Topaz salvaged vehicle that I retained at a cost of $119. (I estimate the value of the Mercury Topaz at $250. The Honda Civic's value is close to $2000 in its current state.) I swear under penalty of perjury this is a true statement.

Sincerely,

[redacted]

EXHIBIT G

Fair Resolutions, Inc.
PO BOX 2868
Wenatchee, WA 98807
Tel (509) 662-1790 • Fax (509) 662-4150
Toll Free (866) 530-5888

May 14, 2018

[redacted]
Lynnwood, WA [redacted]

Total Judgment/Current Amount Due:

Balance of Judgment entered 4/19/11:	$33,458.11
Interest accrued through 5/14/18:	$28,401.81
Prior Costs:	
Attorney:	$0.00
Court Cost:	$0.00
Less: Prior payments/credits:	<$0.00>
Total Balance due:	$61,859.92

Re: EGP INVESTMENTS, LLC vs [redacted]
Snohomish County Superior Court Cause No: 11-2-06325-7

Dear [redacted]

Thank you for communicating with us last week regarding your current financial position. The hearing dated for May 15, 2018 has been stricken. As of today, you owe our client EGP Investments, LLC, $61,859.92. Interest continues to accrue at 12%.

Based on the information you provided it appears that the only asset you possess that could potentially be sold to pay this debt is your home. The Washington State "Homestead Exemption" protects up to $125,000 of a consumer's equity in their home from a creditor's foreclosure. Your home has significantly more than $125,000 of equity, which means potentially we could initiate a foreclosure process.

We don't want to do that. At this time, we advise you to research and begin the process of applying for a "reverse" mortgage that could possibly pay our debt and a monthly payment to you as well.

You may want to start your research with the Federal Trade Commission. The following is a link to an article you may want to review:

https://www.consumer.ftc.gov/articles/0192-reverse-mortgages

Please call us once you receive this letter so that we know you are addressing the issue.

THIS LETTER IS AN ATTEMPT TO COLLECT A DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE. THIS IS A COMMUNICATION FROM A DEBT COLLECTOR.

Sincerely,

Brian Fair, President
Fair Resolutions, Inc.
Managing Company of EGP INVESTMENTS, LLC

BF/crf

Assembly Bill No. 1526

CHAPTER 247

An act to amend Section 1788.14 of the Civil Code, and to amend Section 337 of the Code of Civil Procedure, relating to debt collection.

[Approved by Governor September 5, 2018. Filed with Secretary of State September 5, 2018.]

LEGISLATIVE COUNSEL'S DIGEST

AB 1526, Kalra. Debt collection.

The Rosenthal Fair Debt Collection Practices Act regulates the practice of debt collection and the conduct of debt collectors, as defined. The act prohibits specified conduct by a debt collector in connection with the collection or attempted collection of a consumer debt. The act provides for enforcement by means of civil penalties and damages, as specified.

This bill would prohibit a debt collector from sending a written communication to a debtor attempting to collect a time-barred debt without providing specified written notices stating that the debtor may not be sued for the debt, but that the debt, depending on its age, may be reported as unpaid to credit reporting agencies, as specified.

Existing law prescribes periods for commencement of various actions. Among others, an action must be commenced within 4 years if the action is to recover (1) upon a book account whether consisting of one or more entries; (2) upon an account stated based upon an account in writing, but the acknowledgment of the account stated need not be in writing; or (3) a balance due upon a mutual, open and current account, the items of which are in writing. Existing law provides, however, that where an account stated is based upon an account of one item, the time shall begin to run from the date of the item, and where an account stated is based upon an account of more than one item, the time shall begin to run from the date of the last item.

This bill would specify that when the 4-year period in which an action must be commenced has run, no person may bring suit or initiate an arbitration or other legal proceeding to collect the debt. This bill would provide that the period may be extended only in specified circumstances.

The people of the State of California do enact as follows:

SECTION 1. Section 1788.14 of the Civil Code is amended to read:

1788.14. No debt collector shall collect or attempt to collect a consumer debt by means of the following practices:

(a) Obtaining an affirmation from a debtor of a consumer debt which has been discharged in bankruptcy, without clearly and conspicuously disclosing to the debtor, in writing, at the time such affirmation is sought, the fact that the debtor is not legally obligated to make such affirmation;

(b) Collecting or attempting to collect from the debtor the whole or any part of the debt collector's fee or charge for services rendered, or other expense incurred by the debt collector in the collection of the consumer debt, except as permitted by law; or

(c) Initiating communications, other than statements of account, with the debtor with regard to the consumer debt, when the debt collector has been previously notified in writing by the debtor's attorney that the debtor is represented by such attorney with respect to the consumer debt and such notice includes the attorney's name and address and a request by such attorney that all communications regarding the consumer debt be addressed to such attorney, unless the attorney fails to answer correspondence, return telephone calls, or discuss the obligation in question. This subdivision shall not apply where prior approval has been obtained from the debtor's attorney, or where the communication is a response in the ordinary course of business to a debtor's inquiry.

(d) Sending a written communication to a debtor in an attempt to collect a time-barred debt without providing the debtor with one of the following written notices:

(1) If the debt is not past the date for obsolescence set forth in Section 605(a) of the federal Fair Credit Reporting Act (15 U.S.C. Sec. 1681c), the following notice shall be included in the first written communication provided to the debtor after the debt has become time-barred:

"The law limits how long you can be sued on a debt. Because of the age of your debt, we will not sue you for it. If you do not pay the debt, [insert name of debt collector] may [continue to] report it to the credit reporting agencies as unpaid for as long as the law permits this reporting."

(2) If the debt is past the date for obsolescence set forth in Section 605(a) of the federal Fair Credit Reporting Act (15 U.S.C. Sec. 1681c), the following notice shall be included in the first written communication provided to the debtor after the date for obsolescence:

"The law limits how long you can be sued on a debt. Because of the age of your debt, we will not sue you for it, and we will not report it to any credit reporting agency."

(e) For purposes of this section, "first written communication" means the first communication sent to the debtor in writing or by facsimile, email, or other similar means.

SEC. 2. Section 337 of the Code of Civil Procedure is amended to read:

337. Within four years:

(a) An action upon any contract, obligation or liability founded upon an instrument in writing, except as provided in Section 336a; provided, that the time within which any action for a money judgment for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as

security, following the exercise of the power of sale in such deed of trust or mortgage, may be brought shall not extend beyond three months after the time of sale under such deed of trust or mortgage.

(b) An action to recover (1) upon a book account whether consisting of one or more entries; (2) upon an account stated based upon an account in writing, but the acknowledgment of the account stated need not be in writing; (3) a balance due upon a mutual, open and current account, the items of which are in writing; provided, however, that if an account stated is based upon an account of one item, the time shall begin to run from the date of the item, and if an account stated is based upon an account of more than one item, the time shall begin to run from the date of the last item.

(c) An action based upon the rescission of a contract in writing. The time begins to run from the date upon which the facts that entitle the aggrieved party to rescind occurred. Where the ground for rescission is fraud or mistake, the time shall not begin to run until the discovery by the aggrieved party of the facts constituting the fraud or mistake. Where the ground for rescission is misrepresentation under Section 359 of the Insurance Code, the time shall not begin to run until the representation becomes false.

(d) When the period in which an action must be commenced under this section has run, a person shall not bring suit or initiate an arbitration or other legal proceeding to collect the debt. The period in which an action may be commenced under this section shall only be extended pursuant to Section 360.

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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

FEDERAL TRADE COMMISSION, and PEOPLE OF THE STATE OF NEW YORK, by BARBARA D. UNDERWOOD, Attorney General of the State of New York, Plaintiffs, v. HYLAN ASSET MANAGEMENT, LLC, a New York limited liability company; WORLDWIDE PROCESSING GROUP, LLC, a New York limited liability company, also d/b/a WORLDWIDE PROCESSING, also d/b/a FORWARD MOVEMENT RECOVERY, and also d/b/a FMR; FRANK A. UNGARO, JR., individually and as a corporate officer of Worldwide Processing Group, LLC; and, ANDREW SHAEVEL, individually and as a corporate officer of Hylan Asset Management, LLC, Defendants.	**Case No. _____** **COMPLAINT FOR PERMANENT INJUNCTION AND OTHER EQUITABLE RELIEF**

Plaintiffs, the Federal Trade Commission ("FTC") and the People of the State of New York, by Barbara D. Underwood, Attorney General of the State of New York ("State of New York") (collectively, "Plaintiffs"), for their Complaint allege:

1. The FTC brings this action under Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), and Section 814 of the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. § 1692*l*, to obtain temporary, preliminary, and permanent injunctive relief, rescission or reformation of contracts, restitution, the refund of monies paid, disgorgement of ill-gotten monies, and other equitable relief for Defendants' acts or practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), and the FDCPA, 15 U.S.C. §§ 1692-1692p, in connection with Defendants' deceptive and abusive debt collection practices, including the marketing and selling of portfolios that are fake or the result of fraudulently originated loans, and attempting to harass consumers into paying debts that they do not owe.

2. The State of New York, by and through the Office of the Attorney General ("OAG"), brings this action under New York Executive Law § 63(12) and New York General Business Law Article 22-A, § 349, and Article 29-H, § 602, to obtain damages, restitution, injunctive and equitable relief and penalties of up to $5,000 for each violation of General Business Law Article 22-A.

JURISDICTION AND VENUE

3. This Court has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331, 1337(a), and 1345, and 15 U.S.C. §§ 45(a), 53(b), and 1692*l*. Subject matter jurisdiction is conferred upon this Court with respect to the supplemental state law claims of the State of New York by 28 U.S.C. § 1367.

4. Venue is proper in this district under 28 U.S.C. § 1391(b)(1), (b)(2), (c)(1), (c)(2), and (d), and 15 U.S.C. § 53(b).

PLAINTIFFS

5. The FTC is an independent agency of the United States Government created by statute. 15 U.S.C. §§ 41-58. The FTC enforces Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce. The FTC also enforces the FDCPA, 15 U.S.C. §§ 1692-1692p, which prohibits abusive, deceptive, and unfair debt collection practices and imposes duties upon debt collectors.

6. The FTC is authorized to initiate federal district court proceedings, by its own attorneys, to enjoin violations of the FTC Act and the FDCPA and to secure such equitable relief as may be appropriate in each case, including rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies. 15 U.S.C. §§ 53(b), 56(a)(2)(A), and 1692*l*(a).

7. The State of New York, by its Attorney General, is authorized to take action to enjoin (i) repeated and persistent fraudulent and illegal business conduct under New York Executive Law § 63(12); (ii) deceptive business practices under New York General Business Law § 349; and (iii) illegal debt collection practices under General Business Law § 602; and to obtain legal or equitable relief, including rescission or reformation of contracts, restitution, the appointment of a receiver, disgorgement of ill-gotten monies, or other relief as may be appropriate.

DEFENDANTS

8. Defendant **Hylan Asset Management, LLC** ("Hylan") is a New York corporation, formerly known as Solex Asset Group, LLC, with its registered address and

principal place of business at 5477 Main Street, Amherst, New York, 14221. Hylan transacts or has transacted business in this district and throughout the United States.

9. Defendant **Andrew Shaevel** is or has been an owner, officer, director, member, and/or manager of Defendant Hylan. At times material to this Complaint, acting alone or in concert with others, Shaevel has formulated, directed, controlled, had the authority to control, or participated in Hylan's acts and practices, including the acts and practices set forth in this Complaint. Among other things, Shaevel has controlled Hylan's finances and business operations, purchased debt through it and affiliated entities, and signed corporate papers. Shaevel resides in this district and, in connection with the matters alleged herein, transacts or has transacted business in this district and throughout the United States.

10. Defendant **Worldwide Processing Group, LLC**, also d/b/a Worldwide Processing, also d/b/a Forward Movement Recovery or FMR ("Worldwide Processing"), is a New York limited liability company that has held its principal place of business out as 5817 South Park Ave., Hamburg, NY 14075. Worldwide Processing, transacts or has transacted business in this district and throughout the United States.

11. Defendant **Frank A. Ungaro, Jr.** is or has been the owner and an officer of Worldwide Processing. At times material to this complaint, acting alone or in concert with others, he has formulated, directed, controlled, had the authority to control, or participated in the acts and practices of Worldwide Processing, including the acts and practices set forth in this Complaint. Among other things, Ungaro has controlled Worldwide Processing's finances and business operations, purchased debt through it, and signed corporate papers. Ungaro resides in this district and, in connection with the matters alleged herein, transacts or has transacted business in this district and throughout the United States.

12. Defendants Worldwide Processing and Frank A. Ungaro, Jr. (collectively, the "Worldwide Defendants") are third-party debt collectors that, in many instances, have purchased or received portfolios of allegedly past-due consumer debt and collected payments from consumers nationwide. The Worldwide Defendants are "debt collectors" as defined in Section 803(6) of the FDCPA, 15 U.S.C. § 1692a(6). The Worldwide Defendants have attempted to collect purported debts by contacting consumers using instrumentalities of interstate commerce, including telephone calls, electronic mail, and United States mail.

COMMERCE

13. At all times material to this Complaint, Defendants have maintained a substantial course of trade in or affecting commerce, as "commerce" is defined in Section 4 of the FTC Act, 15 U.S.C. § 44.

DEFENDANTS' MARKETING AND DISTRIBUTION OF COUNTERFEIT AND UNAUTHORIZED DEBTS

14. This is a case against Defendants who have profited from collecting on "phantom debt." Hylan, and its owner Shaevel, have purchased and distributed for collection two types of purported debts that consumers did not owe: counterfeit debts fabricated from misappropriated information about consumers' identities and finances; and debts purportedly owed on bogus "autofunded" payday loans that fraudulent enterprises foisted on consumers without their permission. Hylan and Shaevel have distributed and profited from these phantom debts despite receiving ample notice that the consumers did not actually owe them.

15. The Worldwide Defendants have collected on phantom debts, including many obtained from Hylan. The Worldwide Defendants have also received ample notice that consumers did not actually owe them. To coerce consumers into paying the fake or unauthorized debts, the Worldwide Defendants have made unlawful threats to harass consumers'

friends and family members and failed to provide consumers with statutorily required notices of how to dispute the debts.

Creation of the Phantom Debts

16. Consumer debts that have been charged-off by the original creditors are often sold to third parties for collection or sale to other collectors. Typically, the creditor or seller bundles debts into what they call "debt portfolios." The portfolios are typically spreadsheets with details about the consumers and their alleged debts.

17. Since no later than 2014, a person named Joel Tucker has sold debt portfolios that he either fabricated or that consisted of purported debts that consumers did not legitimately owe. Tucker has marketed counterfeit debts as owed to a number of different entities. Tucker has also distributed "debts" from loans that were foisted on consumers without their permission, which he packaged together with other purported debts under the name "Bahamas Marketing Group" or "BMG". Plaintiff Federal Trade Commission sued Tucker for selling phantom debt in 2016. *See FTC v. Tucker et al.*, No. 2:16-cv-02816 (D. Kan. filed Dec. 16, 2016). On September 20, 2017, the court in that case found that Tucker had, "marketed, distributed and sold counterfeit debt portfolios that purported to represent loans made by a variety of purported originators," in contravention of Section 5 of the FTC Act. *FTC v. Tucker*, No. 2:16-cv-02816 (D. Kan. Sept. 20, 2017), ECF No. 69 at *3.

18. Prior to 2016, Tucker had access to sensitive consumer information for millions of consumers. This information included consumers' bank account numbers, social security numbers, and other sensitive personal information. Tucker used this information to create or cause to be created fake debt portfolios by matching consumers' personal information to fabricated payday loan debts. Tucker, either directly or through entities under his control, then

sold these portfolios of counterfeit debt in spreadsheet format. The portfolios list consumer names and contact information along with social security numbers and financial account information. For each consumer identified, the portfolios provide detailed, but fabricated, information about purported payday loans, such as alleged original loan amounts, loan dates, repayment histories, and unpaid balances.

19. In addition, Tucker, through entities he controlled, obtained and sold unauthorized payday loan debts. Tucker first sold purported payday loan leads to lenders associated with him. In many instances, these lenders then issued "loans" to consumers identified in the leads without their permission, a practice referred to as "autofunding." The lenders then attempted to withdraw money from consumers' bank accounts as "finance charges" without consumers' consent. When consumers denied the attempted debits, the lenders transferred the unauthorized loans to Tucker as "debts." In 2014, the FTC and Consumer Financial Protection Bureau ("CFPB") filed suits against these purported lenders. *FTC v. CWB Services, et al*., 4:14-cv-00783 (W.D. Mo.) and *CFPB v. Moseley, et al.*, 4:14-cv-00789 (W.D. Mo.). Tucker, either directly or through entities under his control, sold these debts to debt brokers, including Defendant Hylan.

Hylan Repeatedly Purchases and Distributes the Phantom Debts for Collection

20. Hylan has operated as a debt broker since at least March 2011. Among other things, Hylan has purchased and sold debt portfolios. Hylan has also placed debt for collection with third parties, including the Worldwide Defendants.

21. Starting no later than 2014, Hylan began purchasing phantom debt portfolios from entities controlled by Tucker, through an intermediary, Hirsh Mohindra. In 2016, the FTC sued

Mohindra for selling counterfeit debt portfolios. *FTC v. Stark Law, LLC, et al.*, No. 1:16-cv-3463 (N.D. Ill. filed Mar. 21, 2016).

22. On October 27, 2017, Mohindra agreed to entry of a stipulated judgment that, among other things, banned him from the debt collection industry and imposed a $47,220,491 judgment. *FTC v. Stark Law, LLC,* No. 1:16-cv-3463 (N.D. Ill. Oct. 27, 2017), at *7, *9.

23. Hylan does not collect on phantom portfolios directly. Instead, it "places" them with debt-collection agencies, including the Worldwide Defendants. It also sells phantom debt to other brokers or collectors.

24. Hylan purchases, sells, and places these portfolios despite having notice that consumers do not owe the purported debts. For example, by the fall of 2014, a Hylan employee was raising issues internally about the accuracy and veracity of the information contained in the portfolios. And by November 2014, Hylan and its owner, Defendant Andrew Shaevel began receiving from collection agencies reports of a high number of consumer complaints stating that consumers did not owe the alleged debts. From their discussions with Mohindra, the federal government enforcement actions against Mohindra, CWB Services, and Moseley, and information from debt buyers, Hylan and Shaevel had notice that they were disseminating phantom debts.

25. In a November 2014 email to Mohindra regarding a debt portfolio that originated from Tucker, Shaevel stated, "There is a MAJOR problem with data on this file. Either there was a data transformation error or there is major FRAUD with this file. [A Hylan employee] discovered that there are debtors with the same name and address that have different SSNs, same bank accounts but different names and/or SSN's. THIS IS NOT KOSHER!" Mohindra assured Shaevel that, "Joel [Tucker] would not and is not frauding over these amounts," and one

of Mohindra's employees blamed consumers who input incorrect Social Security numbers during the application process. The employee added that Tucker was willing to replace the $4.79 million of disputed loans. Shaevel remained unconvinced, stating, "We understand the business and the data. These problems are not consistent with the data we have received in the last $500m of payday loans. This is a problem that needs to be fixed." After Mohindra told Shaevel that he would provide him with "replacement files" and assured him that it was "a non issu[e]," Shaevel replied "Ok thanks!" Hylan continued to purchase from Mohindra, and sell to third parties, debts originating from Joel Tucker.

26. Likewise, in a November 2014 email, a collection agency informed Shaevel that a "[c]onsiderable number of people are saying that they never received the loan and we were able to get a few bank statements showing that there was no deposit matching the loan amount anywhere near the loan date."

27. In January 2016, Hylan emailed Mohindra an attachment listing 74 alleged debtors who had signed sworn affidavits denying that they owed the debts. Shaevel was copied on the email. Nevertheless, Hylan continued to sell and place portfolios for collection with third parties.

28. Hylan and Shaevel also received notice that they had purchased and were selling autofunded "debts." In February 2015, Shaevel received an email with a news article describing the FTC and CFPB's actions against the companies engaged in autofunding. The article described how the purported lenders in Tucker portfolios "used information from online loan shopping sites to deposit loans in unwitting consumers' accounts and then repeatedly dinged them for finance charges." The article further reported, "When people disputed the debits with their banks, the lenders fabricated documents that purported to show consumers had agreed to

the loans." Finally, the article noted that many consumers that tried to stop the unauthorized charges "were hounded by debt collectors." Shaevel forwarded the email to Mohindra with the added text "FYI. This might be an issue."

29. Within the debt collection industry, BMG debts were notoriously problematic. On April 7, 2015, a collection agency forwarded to a Hylan employee an email that it had received from another debt seller who was attempting to sell BMG debts. The email stated in part, "At the end of last nights convo I said if you wanted squeaky clean BMG with legit chain [of title] I said go to Hylan. After speaking with a few companies this morning who have bought this BMG i market and Hylans BMG i hear that it does come with the same issues because the issues lie in the underwriting process from BMG directly and not the companies selling it. … With BMG you always have to expect issues but if you have experience with BMG these will be normal issues that your agencies are already familiar with." Shortly after receiving it, the Hylan employee forwarded the email to Shaevel with the comment, "Wow," specifically flagging the issue for him. The email's reference to "issues [] in the underwriting process" was yet another warning that Tucker-related debts were tainted at the source.

30. On June 17, 2015, counsel for the Receiver in the *FTC v. CWB Services* matter mailed Hylan a copy of the preliminary injunction in that case. In an accompanying cover letter, counsel for the Receiver identified by name 18 "Receivership Defendants" that had originated autofunded loans and noted that a third-party debt collection agency "has informed the Receiver's counsel one or more consumer loan portfolios of alleged debt owed to [one of the receivership defendants] were purchased from Hylan Asset Management, LLC. The FTC contests the validity of the underlying loans insofar as they originated without consumer consent. Accordingly, the Receiver has directed the collection of any loan balances and the sale of any

loan portfolios immediately cease. . . . Furthermore, Hylan Asset Management, LLC is directed to immediately cease the sale of any loans allegedly originated by any of the Receivership Defendants." He also demanded that Hylan provide him, "with an accounting of any loan or loan portfolio containing loans originated by any of the Receivership Defendants. . . ."

31. Despite these reports and voluminous complaints from consumers asserting that they did not actually owe the debts, Hylan and Shaevel did not stop purchasing, selling, and placing Tucker portfolios for collection. Nor did they recall Tucker portfolios that they had already placed, or tell purchasers of these portfolios that they contained phantom debt.

32. In numerous instances, using information in debt portfolios marketed, distributed, sold, and placed by Hylan and Shaevel, debt collectors have contacted these consumers, demanded payment, and successfully induced consumers to pay the purported debts. In many instances, the debts in these portfolios were counterfeit or from "autofunded" loans.

33. Consumers cannot reasonably avoid collection on these phantom portfolios. Consumers are not aware that their personal information has been misappropriated and used to create a counterfeit debt or an unauthorized loan. From the portfolios, debt collectors, including the Worldwide Defendants, obtain consumers' private personal information and sensitive financial information, such as Social Security numbers, bank account numbers, and names of references. Debt collectors recite such information to consumers to convince them that the purported loan is legitimate or that the collectors will be able to coerce the consumers to pay, even if they do not legitimately owe the loan. Using this detailed information, collectors intimidated consumers into paying the purported debts.

The Worldwide Defendants' Illegal Collection Practices

34. In many instances, Hylan placed debts that were counterfeit or from unauthorized loans for collection with the Worldwide Defendants.

35. The Worldwide Defendants have operated as a debt collection enterprise since at least 2011. The Worldwide Defendants call consumers and demand payment for purported debts arising from payday loans purportedly taken out several years ago. But many of these debts simply do not exist, or are not owed by the consumers whom these Defendants contact.

36. As part of their attempt to deceive and intimidate consumers into paying these debts, the Worldwide Defendants have often refused to provide consumers with critical information about the debts. And they fail to send statutorily required validation notices that would also provide consumers with information about how to dispute the debts – something critically important here, where the consumers do not actually owe the debts. In addition, these Defendants have threatened to harass consumers' friends and family members.

Attempts to Collect Fake or Unauthorized Debts

37. In numerous instances, since at least 2014, the Worldwide Defendants have attempted to collect money on debts that were either fake or from loans that were not authorized by the consumers.

38. In many of these instances, the Worldwide Defendants have claimed that consumers owed a debt arising from a payday loan. They often assert that the underlying loan was several hundred dollars, and that the debt includes this amount plus hundreds of dollars from interest or fees. In some cases, the Worldwide Defendants state that the loan was from 2010, 2011, 2012, or 2013. And in other cases, they fail to provide a date for when the purported loan was taken out.

39. But many of the consumers that the Worldwide Defendants contact have never taken out a payday loan, do not owe any outstanding debts, or were the victims of an the autofunded loan scam.

40. In numerous instances, consumers have asked for additional information or have explained to the Worldwide Defendants that they do not owe the purported debts. The Worldwide Defendants often respond to these inquiries by reciting consumers' personal information—including addresses, social security numbers, employment history, and banking information—in an attempt to make the debt appear legitimate or represent that they can collect on the debt regardless of its validity.

41. The Worldwide Defendants continued to collect on the debts even after consumers told them that they had never heard of the lenders, did not owe debts, and in some cases provided bank statements and other records to prove it. Worldwide Processing also was the top generator of Better Business Bureau consumer complaints in its geographical region, many of which contained statements by consumers that they did not owe the alleged debts. The Better Business Bureau generally forwarded these complaints to Worldwide Processing, as did the New York Attorney General, who received similar complaints. Even after acknowledging receipt of numerous consumer complaints, Defendants continued to collect on the fake and autofunded debts and failed to make any meaningful attempt to verify the authenticity of the debts.

Unlawful Threats to Contact Third Parties

42. In numerous instances, to pressure consumers into paying the purported debts, the Worldwide Defendants have threatened to contact consumers' family members or other third parties—even after the Worldwide Defendants have already spoken with the consumer or

otherwise verified the consumer's location information. In many of these instances, the Worldwide Defendants have sent pre-recorded messages from "Sarah" that state the call "is regarding our location and tracing efforts" for the purported debtor. The messages claim that "if we cannot verify this information through you, the law allows us to contact all references on file." In fact, the FDCPA limits the parties that a debt collector may contact, particularly when the collector has already obtained location information about the consumer, and the law does not give a debt collector carte blanche to contact "all references on file."

Unlawful Contacts with Third Parties

43. In numerous instances, the Worldwide Defendants have communicated with third parties where they already possessed contact information for the consumer, including the consumer's place of abode, telephone number, or place of employment.

Failure to Provide Statutorily Required Disclosures and Notices

44. In numerous instances, in initial calls to consumers, the Worldwide Defendants' collectors have not disclosed that the call is coming from a debt collector who is attempting to collect a debt from the consumer and that any information obtained from the consumer will be used for that purpose.

45. In numerous instances, in subsequent communications with consumers, the Worldwide Defendants' collectors have failed to disclose that they are debt collectors.

46. In numerous instances, the Worldwide Defendants also have failed to provide consumers with a statutorily required notice, either orally in their initial communication with the consumer or in writing within five days of the initial oral communication, setting forth the following: (1) the amount of the alleged debt; (2) the name of the creditor to whom the purported debt is owed; (3) a statement that unless the consumer disputes the debt within 30

days, the debt will be assumed valid; (4) a statement that if the consumer disputes all or part of the debt in writing within 30 days, the debt collector will obtain verification of the debt and mail it to the consumer; and (5) a statement that, upon the consumer's written request within the 30-day period, the debt collector will provide the name and address of the original creditor, if different from the current creditor.

47. In numerous instances, the Worldwide Defendants have refused to provide consumers with this notice. Indeed, the Worldwide Defendants did not provide this notice even when consumers requested it. As a result, consumers have been unable to exercise their rights under the FDCPA.

VIOLATIONS OF THE FTC ACT

48. Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), prohibits "unfair or deceptive acts or practices in or affecting commerce."

49. Misrepresentations or deceptive omissions of material fact constitute deceptive acts or practices prohibited by Section 5(a) of the FTC Act.

50. Acts or practices are unfair under Section 5 of the FTC Act if they cause or are likely to cause substantial injury to consumers that consumers cannot reasonably avoid themselves and that is not outweighed by countervailing benefits to consumers or competition. 15 U.S.C. § 45(n).

Count I by Plaintiff FTC
Means and Instrumentalities to Mislead
(Against Hylan Asset Management, LLC and Andrew Shaevel)

51. In numerous instances, in connection with their marketing, distribution, sale, and placement of purported payday loan debt portfolios, Defendants have represented, directly or indirectly, expressly or by implication, that consumers listed in those portfolios owe unpaid

payday loan debts, and that those who obtain the portfolios through Defendants have the right to collect debts listed in the portfolios.

52. In truth and in fact, consumers listed in those portfolios that Defendants have marketed, distributed, placed, and sold did not owe the purported debts, and collectors that obtained those portfolios did not have the right to collect those purported debts.

53. By making the representations in Paragraph 51, Defendants placed in the hands of debt collectors the means and instrumentalities by and through which they may mislead consumers regarding their debt obligations.

54. Therefore, Defendants' representations, as set forth in Paragraph 51 of this Complaint are false or misleading, and constitute deceptive acts and practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

Count II by Plaintiff FTC
Distribution of Counterfeit or Unauthorized Debts for Collection
(Against Hylan Asset Management, LLC and Andrew Shaevel)

55. In numerous instances, Defendants have distributed, placed for collection, and sold debts that were counterfeit or from unauthorized loans.

56. Defendants' actions cause or are likely to cause substantial injury to consumers that consumers cannot reasonably avoid themselves and that is not outweighed by countervailing benefits to consumers or competition.

57. Therefore, Defendants' actions as described in paragraph 55 above constitute unfair acts or practices in violation of Section 5 of the FTC Act, 15 U.S.C. §§ 45(a) and (n).

Count III by Plaintiff FTC
False or Unsubstantiated Representations That Consumers Owe Debts
(Against Worldwide Processing Group, LLC and Frank A. Ungaro, Jr.)

58. In numerous instances, in connection with the collection of purported consumer debt, Defendants have represented, directly or indirectly, expressly or by implication, that:

a. a consumer is delinquent on a debt that Defendants have the authority to collect; or

b. the consumer has a legal obligation to pay Defendants.

59. In truth and in fact, in numerous instances in which Defendants have made the representations set forth in Paragraph 58 of this Complaint, these representations have been false, or Defendants have not had a reasonable basis for the representations at the time Defendants made them.

60. Therefore, Defendants' representations as set forth in Paragraph 58 of this Complaint are false or misleading and constitute deceptive acts or practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

Count IV by Plaintiff FTC
False or Misleading Representations Regarding Contacts with Consumers' Friends and Families
(Against Worldwide Processing Group, LLC and Frank A. Ungaro, Jr.)

61. In numerous instances, in connection with the collection of purported consumer debts, Defendants have represented to consumers, directly or indirectly, expressly or by implication, that the law allows them to contact third parties without limitation.

62. In truth and in fact, the FDCPA strictly limits the circumstances under which a debt collector may contact a third party, 15 U.S.C. §§ 1692b, 1692c(b).

63. Therefore, Defendants' representations as set forth in Paragraph 61 of this Complaint are false or misleading and constitute deceptive acts or practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

VIOLATIONS OF THE FDCPA

64. In 1977, Congress passed the FDCPA, 15 U.S.C. §§ 1692-1692p, which became effective on March 20, 1978, and has been in force since that date. Under Section 814 of the FDCPA, 15 U.S.C. § 1692*l*, a violation of the FDCPA is deemed an unfair or deceptive act or practice in violation of the FTC Act. Further, the FTC is authorized to use all of its functions and powers under the FTC Act to enforce compliance with the FDCPA.

65. Throughout this Complaint, the term "consumer," as defined in Section 803(3) of the FDCPA, 15 U.S.C. § 1692a(3), means "any natural person obligated or allegedly obligated to pay any debt."

66. Throughout this Complaint, the term "debt," as defined in Section 803(5) of the FDCPA, 15 U.S.C. § 1692a(5), means "any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment."

67. Throughout this Complaint, the term "location information," as defined in Section 803(7) of the FDCPA, 15 U.S.C. § 1692a(7), means "a consumer's place of abode and his telephone number at such place, or his place of employment."

Count V by Plaintiff FTC
Unlawful Communications with Third Parties
(Against Worldwide Processing Group, LLC and Frank A. Ungaro, Jr.)

68. As described in Paragraph 43, in numerous instances, in connection with the collection of debts, Defendants have communicated with persons other than the consumer, the consumer's attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, the attorney of the debt collector, the consumer's spouse, parent (if the consumer is a minor), guardian, executor, or administrator for purposes other than acquiring location information about the consumer, without having obtained directly the prior consent of the consumer or the express permission of a court of competent jurisdiction, and when not reasonably necessary to effectuate a post judgment judicial remedy, in violation of Section 805(b) of the FDCPA, 15 U.S.C. § 1692c(b).

Count VI by Plaintiff FTC
False, Deceptive, or Misleading Representations to Consumers
(Against Worldwide Processing Group, LLC and Frank A. Ungaro, Jr.)

69. In numerous instances, in connection with the collection of debts, Defendants have, directly or indirectly, expressly or by implication, used false, deceptive, or misleading representations or means, in violation of Section 807 of the FDCPA, 15 U.S.C. § 1692e, including, but not limited to:

a. falsely representing the character, amount, or legal status of any debt, in violation of Section 807(2)(a) of the FDCPA, 15 U.S.C. § 1692e(2)(a);

b. threatening to take an action that Defendants cannot legally take, such as contacting third parties for reasons other than confirming or correcting location information, in violation of Section 807(5) of the FDCPA, 15 U.S.C. § 1692e(5);

c. using false representations or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer, in violation of Section 807(10) of the FDCPA, 15U.S.C. § 1692e(10); and

d. failing to disclose in the initial communication with a consumer that Defendants are debt collectors attempting to collect a debt and that any information obtained will be used for that purpose, or failing to disclose in subsequent communications that the communication is from a debt collector, in violation of Section 807(11) of the FDCPA, 15 U.S.C. § 1692e(11).

Count VII by Plaintiff FTC
Failure to Provide Statutorily Required Notice
(Against Worldwide Processing Group, LLC and Frank A. Ungaro, Jr.)

70. In numerous instances, in connection with the collection of debts, Defendants have failed to provide consumers, either in the initial communication or a written notice sent within five days after the initial communication, with the information required by Section 809(a) of the FDCPA, 15 U.S.C. § 1692g(a), including information about the debt and consumers' rights to dispute the debt.

VIOLATIONS OF NEW YORK STATE LAW

Count VIII by Plaintiff State of New York
Repeated Fraudulent or Illegal Acts
(Against All Defendants)

71. New York Executive Law § 63(12) empowers the Attorney General to seek restitution and injunctive relief when any person or business entity has engaged in repeated fraudulent or illegal acts or otherwise demonstrates persistent fraud or illegality in the carrying on, conducting, or transaction of business.

72. Defendants have engaged in repeated fraudulent or illegal acts or otherwise demonstrated persistent fraud or illegality in the carrying on, conducting, or transaction of their debt collection business for purposes of Executive Law § 63(12).

Count IX by Plaintiff State of New York
Deceptive Acts or Practices
(Against All Defendants)

73. New York General Business Law § 349 provides that "[d]eceptive acts or practices in the conduct of any business […] in this state are hereby declared unlawful."

74. In numerous instances, Defendants have violated New York General Business Law § 349 by engaging in deceptive acts or practices in connection with conducting their debt collection business.

Count X by Plaintiff State of New York
Violation of New York State Debt Collection Law
(Against All Defendants)

75. New York General Business Law § 601 sets forth a list of prohibited debt collection practices, including:

a. disclosing or threatening to disclose information affecting the debtor's reputation for credit worthiness with knowledge or reason to know that the information is false (N.Y. Gen. Bus. Law § 601(3));

b. disclosing or threatening to disclose information concerning the existence of a debt known to be disputed by the debtor without disclosing that fact (N.Y. Gen. Bus. Law § 601(5));

c. claiming, or attempting or threatening to enforce a right with knowledge or reason to know that the right does not exist (N.Y. Gen. Bus. Law § 601(8)).

76. In numerous instances, Defendants have violated New York General Business Law § 601 by engaging in prohibited debt collection practices under that statute.

CONSUMER INJURY

77. Consumers have suffered and will continue to suffer substantial injury as a result of Defendants' violations of the FTC Act, the FDCPA, New York Executive Law § 63(12), and New York General Business Law Articles 22-A and 29-H. In addition, Defendants have been unjustly enriched as a result of their unlawful acts or practices. Absent injunctive relief by this Court, Defendants are likely to continue to injure consumers, reap unjust enrichment, and harm the public interest.

THIS COURT'S POWER TO GRANT RELIEF

78. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and Section 814(a) of the FDCPA, 15 U.S.C. § 1692*l*(a), empower this Court to grant injunctive and such other relief as the Court may deem appropriate to halt and redress violations of any provision of law enforced by the FTC. The Court, in the exercise of its equitable jurisdiction, may award ancillary relief, including rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies, to prevent and remedy any violation of any provision of law enforced by the FTC.

79. New York Executive Law § 63(12) empowers the Attorney General to seek injunctive relief, restitution, damages, disgorgement, and other relief when any person or business entity has engaged in repeated fraudulent or illegal acts, or has otherwise demonstrated persistent fraud or illegality in the carrying on, conducting, or transaction of business. New York General Business Law § 349 prohibits deceptive business practices and empowers the Attorney General to seek injunctive relief, restitution, and civil penalties when violations occur.

General Business Law Article 29-H, § 602 empowers the Attorney General to bring an action to restrain any violation of Article 29-H, New York's Debt Collection Procedures.

PRAYER FOR RELIEF

Wherefore, Plaintiffs FTC and the State of New York, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), Section 814(a) of the FDCPA, 15 U.S.C. § 1692*l*(a), New York Executive Law § 63(12), and New York General Business Law §§ 349, 350-d, and 602(2), and the Court's own equitable powers, request that the Court:

A. Award Plaintiffs such preliminary injunctive and ancillary relief as may be necessary to avert the likelihood of consumer injury during the pendency of this action and to preserve the possibility of effective final relief, including, but not limited to, temporary and preliminary injunctions with ancillary equitable relief.

B. Enter a permanent injunction to prevent future violations of the FTC Act, the FDCPA, New York General Business Law Articles 22-A and 29-H, and New York Executive Law § 63(12) by Defendants;

C. Award such relief as the Court finds necessary to redress injury to consumers resulting from Defendants' violations of the FTC Act, the FDCPA, New York General Business Law Articles 22-A and 29-H, and New York Executive Law § 63(12), including, but not limited to, rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies;

D. Pursuant to New York General Business Law § 350-d, impose a civil penalty of $5,000 for each violation of New York General Business Law Article 22-A; and

E. Award Plaintiffs the costs of bringing this action, as well as such other and additional relief as the Court may determine to be just and proper.

Dated: June 26, 2018

Respectfully submitted,

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Attorneys for Plaintiff Federal Trade Commission

GEORGIAGOV

Carr Fights for Consumers in $8.5 Million Settlement with Debt Collector

April 4, 2018

ATLANTA, GA – Attorney General Chris Carr today announced an $8.5 million settlement with National Check Resolution, Inc., resolving charges that the debt collection company committed multiple violations of the federal Fair Debt Collection Practices Act and the Georgia Fair Business Practices Act.

“Our office will hold debt collectors that try to coerce and intimidate consumers by employing abusive, deceptive and illegal tactics accountable,” said Attorney General Chris Carr.

The Attorney General alleges that National Check Resolution, owner Samuel Tulumello and manager Rhonda Tulumello repeatedly harassed and deceived consumers by:

- Representing that consumers had committed a crime and threatening them with arrest or imprisonment if they did not pay the debt;
- Falsely representing themselves as attorneys, legal couriers or government entities;
- Failing to disclose that they were debt collectors attempting to collect a debt;
- Contacting third parties and divulging information about the debtor’s account; and
- Collecting or attempting to collect debts from Georgia consumers that resulted from payday loans, which are illegal and enforceable under Georgia law.

Under the settlement, National Check Resolution must cease collections on 11,980 accounts it owns and turn those accounts over to the Attorney General so that they cannot be sold or collected on in the future. This represents a total of $8,500,338.72 in purported consumer debt. In addition, the company must pay a $20,000 civil penalty and fully comply with the Fair Debt Collection Practices Act and the Georgia Fair Business Practices Act in the future. If, during a three-year monitoring period, the company violates any provisions of the settlement, an additional $240,000 civil penalty will immediately become due.

Source URL: https://law.georgia.gov/press-releases/2018-04-04/carr-fights-consumers-85-million-settlement-debt-collector-0

COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, ss.

SUPERIOR COURT
CIVIL ACTION NO. 15-3852 BLS

COMMONWEALTH OF MASSACHUSETTS,

Plaintiff,

v.

LUSTIG, GLASER & WILSON, P.C.,
RONALD E. LUSTIG, individually, and
KENNETH C. WILSON, individually,

Defendants.

JOINT MOTION FOR ENTRY OF FINAL JUDGMENT BY CONSENT

The Commonwealth of Massachusetts and Lustig, Glaser & Wilson, P.C. ("LGW"), Ronald E. Lustig ("Lustig"), and Kenneth C. Wilson ("Wilson") (collectively, the "Responding Parties," and collectively with Plaintiff, the "Parties"), respectfully move this Court to enter this Final Judgment by Consent (attached as Exhibit A), pursuant to Rule 58 of the Massachusetts Rules of Civil Procedure. In support of this motion, the parties assert that there is no just cause for delay and that, without any admission or finding of wrongdoing or liability, the Responding Parties consent to the entry of the Final Judgment by Consent (attached as Exhibit B).

COMMONWEALTH OF MASSACHUSETTS
ATTORNEY GENERAL MAURA HEALEY

Peter Downing, BBO #675969
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Chief, Consumer Protection Division
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Boston, MA 02108
(617) 727-2200

Dated: 5/31/2017
7/19/2017

LUSTIG, GLASER & WILSON, P.C.,
RONALD E. LUSTIG, individually, and
KENNETH C. WILSON, individually

Marc C. Laredo, BBO#543973
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COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, ss.

SUPERIOR COURT
CIVIL ACTION NO. 15-3852 BLS

COMMONWEALTH OF MASSACHUSETTS,

Plaintiff,

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LUSTIG, GLASER & WILSON, P.C.,
RONALD E. LUSTIG, individually, and
KENNETH C. WILSON, individually,

Defendants.

FINAL JUDGMENT BY CONSENT

Plaintiff, the Commonwealth of Massachusetts ("Commonwealth" or "Plaintiff"), by and through its Attorney General, Maura Healey, and Defendants Lustig, Glaser & Wilson, P.C. ("LGW"), Ronald E. Lustig ("Lustig"), individually, and Kenneth C. Wilson ("Wilson"), individually, (collectively, the "Responding Parties," and collectively with Plaintiff, the "Parties"), submit for entry this Final Judgment by Consent ("Final Judgment") without trial or adjudication.

WHEREAS, the Commonwealth alleges in its Complaint that the Responding Parties engaged in unfair or deceptive conduct related to the collection of consumer debts in violation of the Massachusetts Consumer Protection Act, G.L. c. 93A § 2;

WHEREAS, the Responding Parties deny the Commonwealth's allegations in the Complaint and any allegations of liability or wrongdoing;

JUDGMENT ENTERED ON DOCKET 1/24/20 17
PURSUANT TO THE PROVISIONS OF MASS. R. CIV. P. 58(a)
AND NOTICE SENT TO PARTIES PURSUANT TO THE PRO-
VISIONS OF MASS. R. CIV. P. 77(d) AS FOLLOWS

WHEREAS, the Final Judgment shall not be construed as an admission, waiver of defenses, or finding of liability or wrongdoing by the Responding Parties and shall not ever be offered by the Commonwealth as such in any proceeding;

WHEREAS, the Parties wish to resolve this action through the entry of this Final Judgment;

NOW THEREFORE, based upon the Parties' joint motion and with the consent of the Responding Parties;

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED:

I. JURISDICTION

1. This Court has jurisdiction over the subject matter of this action pursuant to G.L. c. 93A, § 4 and over the Defendants pursuant to G. L. c. 223A, § 3.

II. VENUE

2. Venue is appropriate in Suffolk County pursuant to G.L. c. 223, § 5 and G.L. c. 93A, § 4.

III. PARTIES

3. Plaintiff is the Commonwealth of Massachusetts, represented by the Office of the Attorney General and acting on behalf of the Commonwealth of Massachusetts.

4. The Responding Parties are LGW, Lustig, individually, and Wilson, individually. Wilson is the President and a Director of LGW. Lustig is the Treasurer, Secretary, Registered Agent, and a Director of LGW.

IV. DEFINITIONS

5. "Charge-off" means the treatment of a receivable balance by a creditor as a loss or expense because payment is unlikely.

6. "Charge-off Balance" means the amount alleged due on an account receivable at the time of charge-off.

7. "Clear and conspicuous disclosure" means in a type size no smaller than the type size in the body of a notice or letter containing the disclosure.

8. "Collection Suit" means any civil action commenced in any court or tribunal against a consumer to attempt to collect a debt, but does not include post-judgment collection efforts or domestication of a judgment.

9. "Collection" or "collect" refers to any attempt or other means used to obtain payment from a consumer including, without limitation, sending letters or placing telephone calls, initiating or litigating collection suits, or attempting to collect on a judgment, including the filing of supplementary actions in the District Court and/or the Boston Municipal Court.

10. "Consumer" means a natural person, or his or her guardian, administrator or executor, present or residing in Massachusetts who is allegedly obligated to pay a debt incurred for personal, family or household purposes.

11. "Communication" or "communicating" means "communication" as defined in 940 C.M.R. 7.03: "conveying information directly or indirectly to any person through any medium excluding non-identifying communications."

12. "Creditor" means "creditor" as defined in 940 C.M.R. 7.03: "any person and his or her agents, servants, employees, or attorneys engaged in collecting a debt owed or alleged to be owed to him or her by a debtor and shall also include a buyer of delinquent debt who hires a third party or an attorney to collect such debt."

13. "Debt" means "debt" as defined in 940 C.M.R. 7.03: "money or its equivalent which is, or is alleged to be, more than 30 days past due and owing, unless a different period is

agreed to by the debtor, under a single account as a result of a purchase, lease, or loan of goods, services, or real or personal property, for personal, family or household purposes or as a result of a loan of money which is obtained for personal, family or household purposes whether or not the obligation has been reduced to judgment."

14. "Debt Buyer" means any entity or person that purchases a portfolio of delinquent and/or charged off debts.

15. "Debtor" has the same meaning as "Consumer."

16. "Effective Date" means the date of entry of this Final Judgment by the Court.

17. "Exempt Income" means all income exempt under Massachusetts law or federal law from any court-ordered payment, garnishment, seizure, or attachment by trustee process.

18. "LGW Financial Form" means the financial form attached as Exhibit 1.

19. "LGW Consent Form" means the consent form attached as Exhibit 2.

20. "LGW" means Lustig, Glaser & Wilson, P.C.

21. "Original Account-Level Documentation" means all of the following:

a. All documentation that a creditor or that creditor's agent (such as a servicer) provided to a consumer about a debt;

b. Any record of payment by the consumer, including, without limitation, copies of checks or automatic bank account withdrawal receipts;

c. A complete transactional history of a debt, created by a creditor or that creditor's agent (such as a servicer); or

d. A copy of a final judgment, execution, or a court docket entry evidencing the entry of a final judgment concerning the debt awarded to a creditor or debt buyer.

V. FINANCIAL TERMS

22. In consideration for the release of claims by the Commonwealth in Section IX ("Release"), Responding Parties have made a payment of one million dollars ($1,000,000) to the Commonwealth of Massachusetts, which payment the Parties agree and acknowledge has been fully paid and accepted. No portion of this payment shall be characterized as or considered to be a penalty, fine or forfeiture. At her sole discretion, the Attorney General may distribute this payment, in any amount, allocation or apportionment and for any purpose permitted by law, including but not limited to: (a) payments to or for consumers; and/or (b) use by the Attorney General in the facilitation of this Final Judgment; and/or (c) payments to the General Fund of the Commonwealth of Massachusetts; and/or (d) payments to the Local Consumer Aid Fund established pursuant to M.G.L. c. 12, § 11G; and/or (e) for programs or initiatives designed to address the negative effects of unfair or deceptive practices related to debt collection.

VI. INJUNCTIVE TERMS

A. Administrative Requirements.

23. For a period of three (3) years following the Effective Date, the Responding Parties shall notify the Attorney General in writing of any development that they reasonably believe may materially affect compliance with this Final Judgment.

24. Within twenty-one (21) days of the Effective Date, the Responding Parties shall appoint a representative ("Representative") responsible for implementing and supervising LGW's compliance with this Final Judgment for three (3) years following the Effective Date. If the Representative (or his successor) is unable to serve as the Representative during that three (3) year period, then the Responding Parties shall appoint a successor Representative. The Responding Parties shall designate one telephone number and one email address for the Attorney

General to communicate with the Representative. The Attorney General is authorized to communicate directly with the Representative unless and until the Responding Parties direct the Attorney General to communicate through legal counsel and identify the name and contact information for said counsel. During this three (3) year period, the Representative or his designee shall respond to all inquiries from the Attorney General about consumer complaints the Attorney General receives about the Responding Parties.

25. Within ninety (90) days following the Effective Date, the Representative shall implement procedures to ensure LGW's compliance with this Final Judgment, and provide copies of those procedures to the Attorney General. In the event that the proposed procedures are determined by the Attorney General to be insufficient and the Parties are unable to agree upon appropriate modification, the Attorney General may, pursuant to the procedures set forth in this Agreement, ask the Court to reject and/or revise the terms of any procedure she alleges is inconsistent with the Final Judgment and, in any such instance, the Court shall be the arbiter of whether or not the procedure is consistent with the Final Judgment.

B. Prohibiting Debt Collection without Adequate Documentation and Review.

26. LGW is restrained and enjoined from collecting any debt from a consumer placed with LGW for collection on or after the Effective Date unless, prior to initiating any collection, LGW has obtained and reviewed original account-level documentation of the debt, and reasonably concluded based on LGW's review of original account-level documentation of the debt that the consumer is obligated to pay the debt. Notwithstanding the foregoing, LGW is not required pursuant to Paragraph 26 to (i) refuse to accept any payment submitted by Consumers; or (ii) refuse to communicate with a Consumer who initiates contact with LGW or requests contact from LGW to discuss the Consumer's account.

27. LGW is restrained and enjoined from threatening or initiating a collection suit for any debt that a creditor or debt buyer places with LGW for collection after the Effective Date where LGW does not have in its possession a final judgment or execution against the consumer (or a copy of a court docket entry evidencing the entry of a final judgment) or the following:

a. original account-level documentation reflecting, at a minimum, the consumer's name, the last four digits of the account number associated with the debt at the time of charge-off (if such creditor assigned account number exists), the claimed amount, excluding any post charge-off payments, and/or credits (unless the claimed amount is higher than the charge-off balance, in which case LGW must possess (i) original account-level documentation reflecting the charge-off balance, and (ii) an explanation of how the claimed amount was calculated and why such increase is authorized by the agreement creating the debt or permitted by law), and if LGW is suing under a breach of contract theory, the contractual terms and conditions applicable to the debt; and

b. either one of the following:

i. a document signed (either physically or electronically as a signature is defined in 15 U.S.C. § 7006(5)) by the consumer evidencing the opening of the account forming the basis for the debt; or

ii. original account-level documentation reflecting a purchase, payment, or other actual use of the account by the consumer; and

c. if LGW is initiating a collection suit on behalf of a debt buyer, a chronological listing of the names of all prior owners of the debt and the date of each

transfer of ownership of the debt, beginning with the name of the creditor at the time of charge-off; and

d. if LGW is initiating a collection suit on behalf of a debt buyer, a certified or otherwise properly authenticated copy of each bill of sale or other document evidencing the transfer of ownership of the debt from the time of charge-off to each successive owner, including the debt buyer on whose behalf LGW initiates a collection suit. Each of the documents evidencing the transfer of ownership of the debt must:

i. include a specific reference to the particular debt being collected upon; or

ii. incorporate by reference another document that includes a specific reference to the particular debt being collected upon provided that the other document is also in the possession of LGW.

28. LGW is restrained and enjoined from initiating a collection suit against any consumer unless:

a. an attorney whose name appears on the complaint in the collection suit has logged into the consumer's account on LGW's computerized account management system or any other software that would create an electronic record that the attorney of record has accessed a consumer's file; and

b. an attorney has reviewed either a final judgment (or a copy of a court docket entry evidencing the entry of a final judgment) or execution against the consumer or original account-level documentation reflecting, at a minimum, the consumer's name, the last four digits of the account number associated with the debt

at the time of charge-off (if such a creditor-assigned account number exists), the claimed amount, excluding any post charge-off payments and/or credits, and if LGW is suing under a breach of contract theory, the contractual terms and conditions applicable to the debt; and

c. an attorney has reviewed a certified or otherwise properly authenticated copy, which authentication may be made by affidavit, of each bill of sale or other account level documentation and has a reasonable basis to conclude that it evidences the transfer of ownership of the debt to each successive owner, including the debt buyer on whose behalf LGW initiates a collection suit or, if the suit is one to enforce a judgment that is not in the name of the current creditor, a certified or otherwise properly authenticated copy of each bill of sale or other document and has a reasonable basis to conclude that it evidences the transfer of ownership of the judgment; and

d. an attorney has reviewed either one of the following:

i. A document signed (either physically or electronically as a signature is defined in 15 U.S.C. § 7006(5)) by the consumer evidencing the opening of the account forming the basis for the debt; or

ii. original account-level documentation reflecting a purchase, payment, or other actual use by the consumer or a judgment against the consumer or a copy of a court docket entry evidencing the entry of a final judgment; and

e. an attorney has a reasonable basis to conclude that the statute of limitations has not expired on the consumer's debt; and

f. an attorney has a reasonable basis to conclude, based upon methods or means proven to be historically reliable and accurate, that the consumer's debt was not discharged in bankruptcy or subject to a pending bankruptcy proceeding; and

g. an attorney has a reasonable basis to conclude that LGW has, based upon methods or means proven to be historically reliable and accurate, the consumer's correct identity and current address and, in the case of an action to enforce an interest in real property securing the consumer's obligation, the location of such real property, to determine the appropriate venue for a collection suit; and

h. an attorney whose name appears on the complaint in the collection suit has certified in writing or in LGW's computerized account management system or any other software that would create an electronic record that the initiation of the collection suit complies with the terms and conditions of Paragraph 28(a)-(h).

C. Prohibiting Certain Collection from Consumers with Exempt Income.

29. Definition. For the purpose of this section (Section VI.C), LGW shall be deemed to have "reason to believe a consumer has only exempt income and exempt assets" when LGW obtains (1) a fully completed and executed LGW Financial Form from a consumer showing the consumer presently has only exempt income and exempt assets, or (2) any document reasonably establishing that the consumer presently has only exempt income and exempt assets.

30. Written Disclosure.

a. LGW is restrained and enjoined from sending a consumer any written communication unless, in its first written communication with a consumer, it has provided the following clear and conspicuous disclosure:

PROTECTED INCOME DISCLOSURE

You may not have to pay us while your only income is any of the following:

- Wages up to $550 per week
- Social Security benefits
- Pensions
- veterans' benefits
- child support
- unemployment benefits or
- workers' compensation benefits.

Please write or call us if you receive any income from the above sources or any other government benefits, and we will send you a form for you to complete regarding your income. Although you may not be legally required to pay us from any of the above sources, you may voluntarily pay us using money from any of them. Even if you do not have to pay us at this time, we may still seek a judgment in court against you, if a judgment has not already entered, but you cannot be ordered to pay the judgment from the sources of income listed above. We also reserve the

right to make future inquiry about any changes in your financial circumstances.

b. The amount in wages cited in the disclosure above shall be adjusted as necessary to ensure compliance with both federal and/or state wage exemption allowances.

c. In addition to providing the Protected Income Disclosure in its first written communication with a consumer, LGW shall provide such Disclosure in all written communications explicitly demanding or soliciting a payment as well as any written communication with a consumer in which a settlement is proposed or confirmed, a periodic payment arrangement or court order for payment is proposed or confirmed, and on all acknowledgments of payments received by LGW from or on behalf of consumers. Letters in the forms specified in Exhibit 3 shall not be subject to the requirements of Paragraph 30(a)-(c).

d. Written communications sent by LGW to a consumer's attorney shall be exempt from the disclosure requirements in Paragraph 30(a)-(c).

31. Oral Disclosure.

a. LGW is restrained and enjoined from making any oral demand, proposal, or request for payment unless such communication includes the following oral disclosure:

You may not have to pay us at this time if you make less than $550 a week or receive only social security benefits, disability benefits, pension income, child support, or certain other government benefits. Even if you

do not have to pay us at this time due to the amount of wages you receive or your receipt of certain government benefits you may make voluntary payments to us using funds from these sources. Do you make less than $550 per week or receive any of these types of benefits or any other government benefits?

b. Oral communications by LGW to a consumer's attorney shall be exempt from the disclosure requirements in Paragraph 31(a).

32. Consumer response procedure. If a consumer communicates to LGW that the consumer has exempt income, makes less than $550 a week, or is currently unemployed, LGW shall take the following steps, unless the consumer has communicated to LGW a request that LGW cease and desist from further communication with the consumer:

a. mail the consumer the LGW Financial Form with a pre-addressed envelope to return the form to LGW;

b. cease collection, other than those collection communications necessary to, or activities and/or court appearances regarding, an ongoing collection action, for either of the following time periods, whichever is shorter:

i. 30 days after mailing the LGW Financial Form required by Paragraph 32(a) to the consumer; or

ii. the date on which the consumer returns the LGW Financial Form and, upon review of such information, LGW does not have reason to believe a consumer has only exempt income and exempt assets.

c. Notwithstanding Paragraphs 32(a)-(b), LGW may accept any payments from or made on behalf of the consumer.

33. Cease Collections.

a. LGW is restrained and enjoined from engaging in collection of a debt from a consumer if at any point LGW has reason to believe that the consumer:

i. has only exempt income and exempt assets; and

ii. is either:

1) handicapped, as defined by G.L. c. 224 § 16; or

2) 70 years of age or older.

b. If at any point LGW has reason to believe that the consumer has only exempt income and exempt assets but such consumer is not handicapped, as defined by G.L. c. 224 § 16, or 70 years of age or older, LGW is restrained and enjoined from engaging in collection of a debt from such consumer except for the following:

i. LGW may commence and litigate to judgment a collection suit; and

ii. In the event judgment enters, LGW may communicate with the consumer seeking an updated LGW Financial Form no more frequently than once every ninety (90) days. If, based on the consumer's response or information obtained from a historically reliable source, LGW determines that the consumer has non-exempt income and/or non-exempt assets, LGW may resume collection of the debt; and

iii. In the event the consumer does not respond to LGW's request for an updated LGW Financial Form made pursuant to Paragraph 33(b)(ii) , within thirty (30) days of the date of the attempted communication, LGW may resume collection of the debt.

c. Nothing in Paragraph 33(a)-(b)(iii) shall prohibit LGW from accepting any payments from or made on behalf of consumers or providing the consumer with a written acknowledgement of its receipt of such payment or notification of the consumer's next payment due date, amount, and remaining account balance pursuant to a voluntary payment arrangement made by the consumer.

34. Consumer Consent. If LGW is unable, based on 15 U.S.C. § 6802, to inform a creditor or debt buyer that LGW has reason to believe a consumer has only exempt income and exempt assets, LGW shall provide the consumer with the LGW Consent Form in order to seek express consent from the consumer to disclose such information consistent with 15 U.S.C. § 6802.

35. Payment Hearings/Examinations. LGW shall request to cancel any pending payment hearing in a small claims matter or examination in a supplementary process matter when LGW has reason to believe a consumer has only exempt income and exempt assets and the consumer's financial situation is unlikely to improve in the foreseeable future. In the event LGW in good faith determines that the consumer's financial difficulties are temporary in nature LGW may seek a continuance of the pending payment hearing in a small claims matter or examination in a supplementary process matter to a date at least ninety (90) days following the anticipated improvement in the consumer's financial situation. LGW may appear at such hearing on behalf of its client(s) where such cancellation or continuance is not granted by the court(s) upon LGW's request made in advance of the pending hearing.

36. LGW is restrained and enjoined from claiming, implying or otherwise leading a consumer to believe that any source of exempt income shall be subject to a payment order, garnishment, seizure, attachment, or other compulsory judicial or non-judicial process.

D. Prohibiting Unfair and Deceptive Collection through the Judicial Process.

37. No ability to pay determination.

a. If a court has determined that a consumer has no present ability to pay the debt:

i. LGW is restrained and enjoined from collection of the debt unless a court in a subsequent examination of a judgment debtor in a supplementary process matter enters an order requiring the consumer to pay the debt or the consumer fails to appear for and participate in a subsequent examination or LGW receives a new LGW Financial Form or other information reasonably establishing that the consumer presently has non-exempt income or non-exempt assets.

ii. LGW is restrained and enjoined from collection of the debt and shall either not request or shall affirmatively seek to cancel any scheduled payment hearing in a small claims action if it has reason to believe the consumer is unlikely to have a future ability to pay the debt.

b. Nothing in Paragraph 37(a) shall prohibit LGW from attending an examination of a debtor in a supplementary process matter or payment hearing in a small claims matter or communicating with a consumer in accordance with the procedures in Section VI.C, Paragraph 32 to request updated financial information about the consumer.

38. Capias Warrants. LGW is restrained and enjoined from seeking or serving, or advising that they shall seek or serve, a capias or other warrant for the arrest of a consumer while LGW has reason to believe a consumer has only exempt income and exempt assets. LGW shall

not be charged with such knowledge in the event the consumer fails to provide LGW with an updated LGW Financial Form provided pursuant to the procedures outlined in Section VI.C, Paragraph 32(a)-(c) or fails to appear and participate in a supplementary process examination or a small claims post-judgment examination hearing and therefore lacks knowledge regarding the consumer's current financial situation.

39. Suit Dismissal. LGW is restrained and enjoined from collection of a debt if any of the following occurs after the Effective Date:

a. A collection suit is dismissed with prejudice (except that it shall be permissible to pursue a motion for reconsideration, a motion made under Mass. R. Civ. P. 60 or an appeal from any such dismissal);

b. A collection suit is dismissed without prejudice where LGW lacked original account-level documentation to prove the allegations of the collection suit on the scheduled day of trial; or

c. A court dismisses a supplementary process matter pursuant to G.L. c. 224 § 16 on the record or so specifies in the order of dismissal.

E. Prohibiting the Use of False and Misleading Affidavits to Collect Debts.

40. LGW is restrained and enjoined from submitting any affidavit in connection with any collection suit unless:

a. Where the affidavit is signed by a creditor and makes a representation as to the ownership, validity, or amount of the debt, LGW is in possession of and has reviewed original account level documentation of the debt and other relevant information and documentation relating to the account which corroborates such representations; or

b. Where the affidavit is signed by LGW and makes a representation that a consumer owes a debt, the person signing the affidavit has personally reviewed original account-level documentation of the debt and determined that such documentation corroborates the representation in the affidavit.

F. Substantiation of Disputed Debt.

41. If, at any time after the time period set forth at 940 CMR 7.08 for disputing the validity of a debt, the consumer informs LGW that he/she disputes the debt, either orally or in writing, LGW shall cease collection until such time as LGW has:

a. obtained and reviewed original account-level documentation and other information necessary to substantiate the debt; and

b. responded to the consumer's dispute by providing the consumer free of charge with copies of the documentation reviewed by LGW to substantiate the debt.

42. LGW shall not be required to respond to a dispute to which LGW has previously responded.

43. Oral or written notification of disputes relating to the validity of a debt received during the course of litigation shall not be subject to the requirements set forth in Paragraph 41(a)-(b) but shall instead be considered as requests for discovery of all documents described in Paragraph 41(a) and shall be governed by the applicable provision(s) of the Massachusetts Rules of Civil Procedure.

G. Prohibition Against Filing Collection Suits on Time-Barred Debt.

44. LGW is restrained and enjoined from filing a collection suit on the basis of a debt which would be time-barred but for an alleged post-origination payment, unless LGW has

obtained and reviewed documentation reasonably demonstrating the existence and date of that payment contained in the business records of the party that received the payment.

H. Relation to G.L. c. 93A, § 3.

45. The Attorney General considers acts taken by the Responding Parties to comply with the terms of Section VI.B through G of this Consent Judgment to be "exempted transactions" pursuant to G.L. c. 93A, § 3.

VII. RECORD KEEPING

46. For a period of three (3) years following the Effective Date, LGW shall retain the following records:

a. Complaints (defined for purposes of Paragraph 46 as any communication from a consumer or a third party on behalf of a consumer, questioning any actions taken by LGW) received by LGW after the Effective Date, including the name, address, and telephone number of each complainant, the substance of the complaint, and any communications between LGW and the complainant;

b. Materials that were reviewed by LGW after the Effective Date when taking any action in response to complaints from consumers; and

c. Materials that were reviewed by LGW when submitting written reports to the Attorney General pursuant to the section of this Final Judgment titled "Compliance Reporting."

47. For a period of three (3) years following the Effective Date, upon written request by the Attorney General, the Responding Parties shall produce all records, excluding attorney-client communication protected by Massachusetts Rule of Professional Conduct 1.6, reasonably necessary for the Attorney General to assess the Responding Parties' compliance with this Final Judgment.

VIII. COMPLIANCE REPORTING

48. The requirements of this Section (Section VIII) to provide compliance reporting to the Attorney General do not apply to attorney-client communication protected by Massachusetts Rule of Professional Conduct 1.6.

49. For a period of three (3) years following the Effective Date, the Responding Parties shall notify the Attorney General of any changes in the corporate structure of LGW or any business entity substantially similar to LGW that any Responding Party directly or indirectly controls, or has an ownership interest in, that may affect compliance with this Final Judgment, including but not limited to: incorporation or other reorganization; a dissolution, assignment, sale, merger, or other action that would result in the emergence of a successor corporation; the creation or dissolution of a subsidiary, parent, or affiliate that engages in any acts or practices subject to this Final Judgment; or a change in the business name or address, at least thirty (30) days prior to such change. Upon request of the Attorney General or her representatives, the Responding Parties shall produce within a reasonable time all documents or provide all information reasonably related to compliance and/or efforts to comply with the provisions of this Final Judgment.

50. Unless otherwise directed in writing by the Attorney General, the Responding Parties shall send by overnight courier all written reports required by this Final Judgment to:

Peter Downing and Benjamin Golden
Office of the Attorney General
Consumer Protection Division
One Ashburton Place, 18th Floor
Boston, Massachusetts 02108

Provided that, in lieu of overnight courier, the Responding Parties may send such reports by first-class mail, but only if the Responding Parties contemporaneously send an electronic version of such reports to:

peter.downing@state.ma.us and

benjamin.golden@state.ma.us

or as subsequently directed by the Attorney General.

IX. RELEASE

51. For the purpose of this section "Release," the term "Responding Parties" means Lustig, Glaser & Wilson, P.C., Ronald E. Lustig, individually and in his capacity as a shareholder, director, officer, resident agent and employee of Lustig, Glaser & Wilson, P.C. , and Kenneth C. Wilson, individually and in his capacity as a shareholder, director, officer and employee of Lustig, Glaser & Wilson, P.C. and their past, present and future shareholders, directors, officers, employees, agents, attorneys, representatives, personal representatives, executors, administrators, parents, affiliates, spouses, children and all of their heirs, representatives, personal representatives, executors, administrators, agents, and assigns, but does not include any client, creditor, or debt buyer for whom LGW collected debts.

52. This Final Judgment resolves, releases, and discharges any and all actual and potential civil liability of the Responding Parties to the Commonwealth for all claims specifically alleged or based on facts alleged in the Complaint SUCV2015-03852, filed in Suffolk Superior Court on December 22, 2015, and all potential civil claims the Commonwealth has related to the Responding Parties' debt collection practices before the entry of the Final Judgment. The term claims shall mean liabilities, causes of action, liens, demands, rights, damages, multiple damages, punitive damages, penalties, judgments, debts, obligations, assessments, rents compensations, costs, attorneys' fees, interest, deficiencies, and damages of any nature whatsoever.

X. OTHER PROVISIONS

53. Continuing Jurisdiction and Notice with an Opportunity to Cure. The Suffolk Superior Court shall retain jurisdiction for the purpose of enforcing the terms of this Final Judgment or for granting such further relief as the Court deems just and proper. Any Party may seek to enforce the provisions of this Final Judgment. Prior to initiating any such enforcement proceeding, the Party seeking enforcement must provide written notice to the other Parties of its or his intent to initiate such a proceeding and provide the other Parties twenty-one (21) days in which to cure any alleged breach of the Final Judgment. In any such proceeding to enforce a provision of this Final Judgment, the prevailing Party shall be entitled to its or his reasonable attorneys' fees and costs related to such proceeding.

54. Sale, Transfer, or Assignment of LGW. During the three (3) year period from the Effective Date, if the Responding Parties seek to sell, transfer or assign a controlling interest in LGW or merge said controlling interest with any other entity, and the successor, assignee or merged entity intends to engage in collection of debt, the Responding Parties shall as a condition of sale obtain the written assumption of the successor or assignee to any obligations remaining under this Final Judgment.

55. Obligations on Other Entities in Certain Circumstances. In the event that either Lustig or Wilson becomes a shareholder, manager, officer, or director of any entity, other than LGW, which is engaged in the collection of debt during the time period specific in Paragraph 56, the obligations, restraints, and injunctions binding on LGW under this Final Judgment shall also bind such entity.

56. Termination of the Responding Parties' Obligations under this Final Judgment. The obligations, restraints, and injunctions of the Responding Parties under this Final

Judgment shall cease three (3) years from the Effective Date except that they shall cease earlier as follows:

a. the obligations of Wilson under this Final Judgment shall cease upon the earliest of any of the following events: (a) his death; (b) his ceasing to engage in the active private practice of law for more than thirty (30) days (whether voluntarily or involuntarily) unless he resumes the active private practice of law thereafter; or (c) his ceasing to be a shareholder of LGW (or any successor firm);

b. the obligations of Lustig under this Final Judgment shall cease upon the earliest of any of the following events: (a) his death; (b) his ceasing to engage in the active private practice of law for more than thirty (30) days (whether voluntarily or involuntarily) unless he resumes the active practice of law thereafter; or (c) his ceasing to be a shareholder of LGW (or any successor firm).

c. The obligations of LGW under this Final Judgment shall cease upon the earliest of any of the following events: (a) the dissolution of LGW; (b) the bankruptcy of LGW; (c) the transfer of the stock or the assets of LGW to a person other than Wilson and/or Lustig; or (d) the transfer of the stock or the assets of LGW to an entity in which neither Wilson nor Lustig have an ownership interest.

57. Governing Law. The provisions of this Final Judgment shall be construed in accordance with the laws of the Commonwealth of Massachusetts.

58. Conduct Neither Condoned nor Admitted. Nothing in this Final Judgment constitutes an approval by the Commonwealth of any of the Responding Parties' acts and practices, nor does it constitute any admission or finding by the Attorney General or the Court of any liability or wrongdoing by the Responding Parties. This order is not and shall not be deemed

to be a sanction or punishment of any of the Responding Parties by the Court, as this order merely represents a settlement of contested and disputed claims.

59. Effect of Court's Failure to Approve Final Judgment. If the Court does not approve this Final Judgment, the Final Judgment shall be of no force and effect against any of the Parties.

60. Severability. The provisions of this Final Judgment shall be severable and, should any provision be declared by a court of competent jurisdiction to be unenforceable, the other provisions of this Final Judgment shall remain in full force and effect.

61. Waiver of Right to Rehearing or Appeal. The Parties have, by signature of counsel hereto, waived their right to add, alter, amend, appeal, petition for certiorari, or move to reargue or rehear or be heard in connection with any judicial proceeding concerning the entry of this Final Judgment and any challenges in law or equity to the entry of this Final Judgment.

62. Complete Resolution. This Final Judgment completely resolves this civil action. No promises, representations, or warranties relating to the resolution of this civil action other than those set forth in this Final Judgment have been made by any of the Parties. This Final Judgment supersedes all prior communications, discussions, or understandings, if any, of the Parties relating to the resolution of this civil action, whether oral or in writing. Notwithstanding the foregoing, any and all prior agreements regarding the confidentiality of information between the Commonwealth of Massachusetts and the Responding Parties, including but not limited to the Confidentiality Agreement Governing Certain Material and Information to be Produced Pursuant to Civil Investigative Demand 2014-CPD-09 dated April 10, 2014, the Stipulated Protective Order entered on March 25, 2016, and the Confidentiality Agreement dated June 23,

2016, including all obligations to return documents to the producing party shall remain in full force and effect.

63. Modification. No waiver, modification, or amendment of the terms of this Final Judgment shall be valid or binding unless made in writing, agreed to by all Parties, and approved by this Court, and then only to the extent specifically set forth in such written waiver, modification, or amendment.

64. Ongoing Obligation to Comply with the Law. Nothing in this Final Judgment shall be construed as relieving the Responding Parties of their duty to comply with all applicable federal and state laws, regulations, and rules nor does this Final Judgment constitute a finding that the Responding Parties have failed to do so. Consent to this Final Judgment does not constitute an approval by the Commonwealth of any of the Responding parties' acts or practices, and the Responding Parties shall not make any representations to the contrary. If complying with any provision of the Final Judgment would cause the Responding Parties to act in a manner prohibited by or in contradiction of federal, state or local law, then the Responding Parties shall be relieved from any obligation to comply with that provision of this Final Judgment.

65. Non-Waiver. The failure of the Commonwealth to insist upon the strict performance of any of the provisions of this Final Judgment shall not be deemed a waiver of any of the provisions of this Final Judgment, and, notwithstanding such failure, the Commonwealth shall have the right thereafter to insist upon the specific performance of any of the provisions of this Final Judgment. This shall be without prejudice in the future to the imposition of any applicable penalties and any other remedies under applicable state or federal law, regulation, or rule.

66. Time is of the Essence. Time shall be of the essence with respect to each provision of this Final Judgment that requires action to be taken by the Responding Parties within a stated time period or upon a specified date.

APPROVED AND ORDERED:

Date: July 20, 2017

Edward P. Leibensperger
Associate Justice of the Superior Court

By the Court:
Edward P. Leibensperger
Associate Justice
Superior Court

Exhibit 1



LUSTIG, GLASER & WILSON, P.C.

Financial Information Form

Instructions: We are sending you this form because you may not have to pay us at this time depending on the sources and amounts of your income and assets. Please fill out this form, sign it, and return it to us. You **MUST** complete each section, sign the form, and then return it to us for review. A return envelope has been included for your convenience. You are not required to provide documentation to substantiate your income sources or assets owned, but it is appreciated. We may follow-up with you to ask for additional information or clarification about the information you provide below.

Name:_____ LGW File No: _____

Section 1 – Income from Wages & Salary

If you are Unemployed, please check here _____. If you checked this box, you may skip to Section 2.

If you are Employed, please check this box _____. If you checked this box, please provide us with your Average Weekly Income (wages and salary) at all jobs at which you are now employed: $_____.

Section 2 – Assets

Please respond to each of the following questions:

1. Do you own your **home**? _____(Y/N) $_____Estimated Value
2. Do you own **other real estate**? _____(Y/N) $_____Estimated Value
3. Do you receive **rental income?** _____(Y/N) $_____Monthly Average Amount
4. Do you own an **automobile**? _____(Y/N) $_____Estimated Value
5. **Checking** Account(s) Balance $_____Account Balance(s)
6. **Savings** Account(s) Balance $_____Account Balances(s)
7. **Cash** on Hand $_____Cash on Hand
8. **Other Assets** $_____Estimated Value

Section 3 – Other Sources of Income

Do you receive benefits from any of the following sources? If so, please select **all** that apply.

___	Social Security Benefits	Amount Received Each Month	$_____
___	Pension(s)	Amount Received Each Month	$_____
___	Veterans Benefits	Amount Received Each Month	$_____
___	Child Support	Amount Received Each Month	$_____
___	Unemployment *	Amount Received Each Week	$_____

____	Workers' Compensation*	Amount Received Each Week	$_____
____	Other (please explain)	Amount Received Each Month	$_____

*If you are currently receiving Unemployment Benefits or Workers' Compensation Benefits, please inform us when you believe you will return to work.

_____(Date)

Certification of Accuracy

I,_____do hereby certify **under the pains and penalties of perjury** that the information provided above is true, correct, and complete.

Todays' Date: _____ _____

(Signature)

Exhibit 2

CONSENT NOTICE – PLEASE READ!

A creditor, [name], has placed a debt with Lustig, Glaser & Wilson, P.C. (hereafter referred to as "LGW") for collection. However, you previously provided LGW with information showing that you make less than $550 a week or have income solely from certain government benefits. If your financial situation has not changed, we wish to inform [creditor] that based on your financial situation you may not have the ability to pay this debt at this time.

We will only share the information as permitted by law (the Gramm-Leach Bliley Act, 15 U.S.C. § 6802) and in accordance with LGW's data privacy and security policies if you provide us with your consent to do so. Before we share the information, **you have the right to tell us that you DO NOT want your information shared.**

Please provide us with your consent by CHECKING ONE OF THE BOXES BELOW and RETURNING THIS FORM TO OUR OFFICE or by calling us at 800-743-8602 with your instructions. Until such time as we hear back from you in this regard we will NOT share your information.

Yes, you have my permission to share my financial information with [Client Name]_____

No, you may not share my financial information with [Client Name]_____

Exhibit 3

Exhibit 3

Letter Code	Letter Description
ANSWRDFT	Answer from Debtor Requested
ARROWPRNT	Arrow GLB Privacy Rights Notice
A4JFOLLW	Agreement for Judgment Follow-Up
CRL	Contact Request Letter
DEBTVLCC	Debt Validation Response
DIRCHECK	Direct Check Authorization Form
DIRCKDEP	Notice of Intent to Deposit
DOCCOVER	Document Request Response
FINHST	Financial History Response
FRAUDQCL	Fraud Questionnaire Cover Letter
FRAUDQF1	Fraud Questionnaire First Follow-up
FRAUDQF2	Fraud Questionnaire Second Follow-Up
FRAUD QF3	Fraud Questionnaire Third Follow-Up
GARNRTN	Garnishment Overpayment Returned
HRDSPFND	Hardship Finding Closing Letter
IDAFF1	ID Theft Affidavit First Follow-Up
IDAFF2	ID Theft Affidavit Second Follow-Up
IDAFF3	ID Theft Affidavit Third Follow-Up
IDTHEFTA	ID Theft Affidavit Cover Letter
NOC	No Calls to Place of Employment Notification
PAYRTNPD	Payment Returned on Paid Account
PAYRTNRN	Payment Returned on Recalled Account
PAYRTRNB	Payment Returned - Bankruptcy Filed
PDL	Post-Dated Check Notice of Intent to Deposit
RECPIF	Payment Receipt - Account PIF
RECSIF	Payment Receipt - Account SIF
RSGGLBNT	Resurgent GLB Privacy Rights Notice
STIPDISD	Stipulation of Dismissal Cover Letter
SUBSTLTR	Substantiation Letter
TRKODRCL	Tracking Order Service Letter

EXHIBIT B

CONSENT OF LUSTIG, GLASER & WILSON, P.C.,
TO FINAL JUDGMENT

Lustig, Glaser & Wilson, P.C. ("LGW") admits to the continuing jurisdiction of the Suffolk Superior Court as to the personal and subject matter jurisdiction of this action and consents to the entry of this Final Judgment between the Commonwealth of Massachusetts, represented by the Office of the Attorney General and acting on behalf of the citizens of the Commonwealth of Massachusetts and the Responding Parties, to which this Consent is attached. In so consenting, LGW states that the undersigned, a duly authorized representative of LGW, has read and understands each numbered paragraph in the Final Judgment, and that s/he is authorized to enter into this Final Judgment.

CONSENTED TO, WAIVING ALL RIGHTS OF APPEAL:

Lustig, Glaser & Wilson, P.C.

_____, President

Dated: 6/2/2017

CONSENT OF RONALD E. LUSTIG
TO FINAL JUDGMENT

Ronald E. Lustig ("Lustig") admits to the continuing jurisdiction of the Suffolk Superior Court as to the personal and subject matter jurisdiction of this action and consents to the entry of this Final Judgment between the Commonwealth of Massachusetts, represented by the Office of the Attorney General and acting on behalf of the citizens of the Commonwealth of Massachusetts and the Responding Parties, to which this Consent is attached. In so consenting, Lustig states that he has read and understands each numbered paragraph in the Final Judgment.

CONSENTED TO, WAIVING ALL RIGHTS OF APPEAL:

Ronald E. Lustig



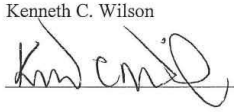
Dated: 06-02-2017

CONSENT OF KENNETH C. WILSON
TO FINAL JUDGMENT

Kenneth C. Wilson ("Wilson") admits to the continuing jurisdiction of the Suffolk Superior Court as to the personal and subject matter jurisdiction of this action and consents to the entry of this Final Judgment between the Commonwealth of Massachusetts, represented by the Office of the Attorney General and acting on behalf of the citizens of the Commonwealth of Massachusetts and the Responding Parties, to which this Consent is attached. In so consenting, Wilson states that he has read and understands each numbered paragraph in the Final Judgment.

CONSENTED TO, WAIVING ALL RIGHTS OF APPEAL:

Kenneth C. Wilson



Dated: 6/2/2017

40082

State of Minnesota
Dept. of Commerce
JUL 24 2017
Rec'd $ 100,000.00

SETTLEMENT AGREEMENT

RECEIVED
JUL 13 2017
MAILROOM

WHEREAS, Respondent Allied Interstate, LLC ("Respondent Allied") is a limited liability company domiciled in Minnesota; and

WHEREAS, Respondent The Receivables Management Services Corporation and its wholly owned subsidiary Receivable Management Services – Recovery Division LLC (collectively "Respondent RMS") are corporations domiciled in Pennsylvania; and

WHEREAS, Respondent Allied and Respondent RMS are collectively referred to as the "Respondents"; and

WHEREAS, the states of Connecticut, Idaho, Massachusetts, Minnesota and North Dakota (individually, a "Participating State," and collectively, the "Participating States") have agreed, through each state's respective state regulatory agency (individually "State Regulator", collectively "State Regulators"), to negotiate and enter into this Settlement Agreement (hereinafter referred to as the "Agreement"); and

WHEREAS, Respondents are licensed as collection agencies under the respective laws of each Participating State; and

WHEREAS, on July 6, 2015, the Participating States commenced a multi-state examination of the Respondents in order to determine the Respondents' compliance with applicable federal and state laws and regulations, financial condition, and control and supervision of the licensed collection operations. The examination was conducted concurrently with a targeted review of Respondent Allied's federal student loan collection activity by the Consumer Financial Protection Bureaus ("CFPB"). On May 20, 2013, State Regulators signed the CFPB-State Supervisory Coordination Framework ("Framework"), which established the structure for conducting coordinated examination of non-depository institutions. This examination was conducted using the Framework; and

WHEREAS, the initial examination review period covered collection activity during the period from February 11, 2013 to February 27, 2015; however, additional operations and activity outside of that period were also considered; and

WHEREAS, Respondents submitted information and documentation to facilitate the examination and evaluation of compliance with applicable standards.

VIOLATIONS

WHEREAS, the Participating States allege several violations detailed below:

1. During the months of October, November and December 2015 the Respondent Allied violated the Fair Debt Collection Practices Act (FDCPA), applicable state consumer protection requirements, and its own internal compliance policies limiting contact with third parties or with consumers at their places

of employment in an effort to meet revenue goals. In October 2015, management over a collection portfolio, in consultation with other management within the Compliance Department, initiated a "REHAB PUSH" calling campaign. Agents were directed to make telephone calls to telephone numbers that had previously been marked as Do Not Call ("DNC"). Agents were instructed to document the accounts "REHAB PUSH" as an identifier to avoid potential disciplinary action for violating consumer protection requirements and company policy. After a review of several consumer packets assigned to the Respondent Allied for collection, it was found that Respondent Allied's collectors placed numerous calls to consumer telephone numbers that had previously been marked as DNC in violation of the Respondent's own Cease and Desist Policy. In doing so, Respondent Allied is in violation of several provisions of the Fair Debt Collection Practices Act of 1977, Public Law 95-109. These violations include:

a. Respondent Allied placed calls to third parties that had previously advised Respondent Allied that the person they were trying to reach did not live there or was unknown, in violation of section 804 (3) [15 USC 1692b].
b. Respondent Allied communicated with third parties on more than one occasion without sufficient cause to believe the third parties had previously provided erroneous or incomplete information while obtaining location information which is in violation of section 804 (3) [15 USC 1692b]. Respondent Allied added an identifier to several telephone numbers to reflect a "double cease" to ensure during the calling campaign the numbers reaffirmed as DNC numbers would not be called again.
c. Respondent Allied, without prior or express permission, contacted multiple consumers at their place of employment after having already obtained knowledge that the consumer's employer prohibits the consumer from receiving such communication which is in violation section 805 (a) (3) [15 USD 1692c].
d. Respondent Allied made multiple harassing telephone calls to the consumer which is a violation of section 806 [15 USC 1692d] by engaging in behavior in which the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt.

The above activities also represent a violation of the Consumer Financial Protection Act of 2010 –12 USC § 5536(a)(1)(B), which prohibits covered persons from engaging "in any unfair, deceptive, or abusive act or practice." Respondent Allied is a covered person under 12 USC § 5481 (6) and (26).

Respondent Allied engaged in unfair practices by directing its agents to violate federal and state consumer protection requirements and its own Cease and Desist policy by calling third parties who had previously provided information that the number being called was incorrect and that they did not know the person the company was trying to reach, and by placing numerous calls to consumers' places of employment. In addition, Respondent Allied created an unfair competitive advantage by directing its collectors to violate place of employment ceases.

The above listed actions and behaviors are also violations of the following state specific rules and regulations:

- Section 36a-812 of the Connecticut General Statutes
- Section 36a-809-9(d) of the Regulations of Connecticut State Agencies
- Idaho Code § 26-2229A(1,2)
- Massachusetts Regulations 209 CMR 18.13 (3), 209 CMR 18.14, & 209 CMR 18.15
- Minn. Stat. §45.027 subd. 7 (4) (2016)
- Minn. Stat. §332.37 (12) (2016)
- North Dakota Administrative Code Chapter 13-04-02-04 (6)
- North Dakota Administrative Code Chapter 13-04-02-06 (4)

2. Respondent Allied engaged in unfair and deceptive acts or practices by failing to credit debtor accounts upon receipt of payment by check on the day the check was received. Instead, Respondent Allied delayed credit until the check cleared, typically a period of four to five days. On interest bearing accounts this resulted in unearned interest accruing on consumer accounts. This practice harms debtors making payments to Respondent Allied by check, and the debtors have no way of knowing that this practice is occurring and avoiding injury. Furthermore, the Respondent Allied is misrepresenting the actual date that a payment is received from a consumer debtor to its clients. Based on the foregoing, Respondent Allied violated the following provision of the Fair Debt Collection Practices Act of 1977, Public Law 95-109 while attempting to collect on an account, bill or other indebtedness:

   a. Respondent Allied collected amounts (including interest, fees, charges, or expenses incidental to the principal obligation) that were not expressly authorized by the agreement creating the debt or permitted by law which is in violation of section 808 [15 USC 1692f(1)].
   b. Respondent Allied engaged in behavior that is considered an unfair method of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce and thereby Respondent Allied violated 15 USC § 45 (a)(1) of the Federal Trade Commission Act.

c. Respondent Allied engaged in behavior that is considered unfair, deceptive, or abusive in violation of the Consumer Financial Protection Act of 2010 – 12 USC § 5536(a)(1)(B).

Respondent Allied's behavior also violated the following state specific regulations:

- Section 36a-808 of the Connecticut General Statutes
- Section 36a-809-12(1) of the Regulations of Connecticut State Agencies
- Idaho Code §26-2229A (1,4)
- Massachusetts General Laws chapter 93A, section 2(a) & 209 CMR 18.17(1)
- Minn. Stat. §332.37 (12) (2016)
- North Dakota Administrative Code §13-04-02-09

3. Respondents failed to provide immediate and unfettered access to all collection records in violation of the state statutes and regulations cited below:
   - Connecticut General Statutes Section 36a-17(d)
   - Idaho Code § 26-2234(1)
   - Massachusetts General Laws chapter 93, section 24D (a) & Massachusetts Regulation 209 CMR 48.04
   - Minn.Stat. §§ 45.027 subd. 1(5) and 332.40 (2016)
   - North Dakota Century Code § 13-05-06(2)

4. Respondents failed to submit complete responses to requested information in a timely manner in violation of the state statutes and regulations cited below:
   - Connecticut General Statutes Section 36a-17(d)
   - Idaho Code § 26-2234(1)
   - Massachusetts Regulation 209 CMR 48.04(2)
   - Minn. Stat. § 45.027 subd. 1a (2016)
   - North Dakota Century Code § 13-05-07.1

WHEREAS, Respondents neither admit nor deny any of the allegations, and hereby irrevocably consent to the execution of this Agreement pursuant to the authority vested in each State Regulator and agree that they understand all of the terms and conditions contained herein. Respondents acknowledge that they have full knowledge of their rights to notice and a hearing pursuant to the laws of the respective Participating States. By voluntarily entering into this Agreement, Respondents waive any rights to notice and a hearing, and review of such hearing, and also waive all rights to any other judicial appeal concerning the terms, conditions, and related obligations set forth in this Agreement. Respondents further acknowledge that they have had the opportunity to consult with independent legal counsel or have knowingly elected not to do so; and

WHEREAS, Respondents represent that the person signing below is authorized to execute this Agreement and to legally bind Respondents; and

WHEREAS, in that the Parties have had the opportunity to draft, review and edit the language of this Agreement, the Parties agree that no presumption for or against any party arising out of drafting all or any part of this Agreement will be applied to any action related to, connected to, or involving this Agreement. Accordingly, the Parties agree to waive the benefit of any state statute, providing that in cases of uncertainty, language of a contract should be interpreted most strongly against the party who causes the uncertainty to exist.

NOW, THEREFORE, this Agreement having been negotiated by the Parties in order to resolve the issues identified herein and in the Report of Examination, without incurring the costs, inconvenience and delays associated with protracted administrative and judicial proceedings, it is by the State Regulators listed below hereby **ORDERED**:

I. JURISDICTION

1. That pursuant to the licensing and supervision laws of the Participating States, the Participating States have jurisdiction over Respondents herein and may enforce the terms of this Agreement thereon unless otherwise stated in this Agreement.

II. SETTLEMENT PAYMENT

2. *Settlement Payment – Participating States.* Respondents shall pay five hundred thousand dollars ($500,000) to be divided equally among the State Regulators. Payment is due upon signing of this agreement for the states of Minnesota, Connecticut, Idaho, and Massachusetts. Payment to North Dakota is due between July 1 and July 31, 2017.
3. In the event that Respondents fail to submit any settlement payment set forth in this Agreement, in the amounts specified herein and in accordance with the applicable deadlines, or if any transfer of any monetary amount required under this Agreement is voided by a Court Order, including a Bankruptcy Court Order, Respondents agree not to object to a Participating State submitting a claim, nor attempt to defend or defeat such authorized claim, for any unpaid amounts against any surety bond that Respondents may maintain in such Participating State as a condition of maintaining a license under the jurisdiction of that State Regulator.

III. SPECIFIC PROVISIONS

Compliance Management System

4. Respondents must immediately implement measures to comply with obligations under this Agreement and will hereafter continue to comply with all regulatory requirements imposed by each State Regulator.

5. *Oversight.* The Board and Senior Management must make a commitment to operate in compliance, and resolve to adhere to consumer protection requirements governing debt collection, regardless of operational or revenue concerns. The Board and Senior Management must continue to work to further implement an effective compliance management system into Respondent RMS' operations and work to ensure consistent compliance across all debt collector subsidiaries.

6. *Monitoring.* Respondents must review the Red Card Disciplinary Program and take steps to ensure it cannot be circumvented under any circumstances.

7. *Training.* Not later than 180 days from the date of this Agreement, Respondents shall complete re-training for all management, individual collectors, and related support staff in all areas regarding the company's internal Whistleblower Policy. Respondents must ensure that all employees are empowered to report or identify potential wrongdoing or circumvention of company policies and procedures. Respondents shall submit to the Participating States a report accompanied by an Affidavit signed by a member of senior management (such as the Chief Compliance Officer), showing the dates of the training presentations, the content of the respective presentations, the name and title of the presenter(s), and names of the attendees.

8. *Audit.* Respondents must develop, implement and maintain an effective compliance audit program designed to verify adherence to state and federal consumer protection requirements and identify compliance deficiencies. The compliance audit function should be independent of operational units and the compliance management function, with sufficient frequency, scope and depth to cover all compliance-related activities. The audit plan should address the deficiencies identified by the Report of Examination and verify the successful implementation of corrective action implemented to address the findings in the report.

Collection Operations

9. The Respondents must not engage in any unfair, deceptive, or abusive act or practice in violation of the Consumer Financial Protection Act of 2010 –12 USC § 5536(a) (1)(B), 15 USC § 45 (a)(1) of the Federal Trade Commission Act, and applicable state consumer protection requirements.

10. Respondents must not harass third parties or consumers at their places of employment in an effort to meet revenue goals by contacting them in willful violation of the restrictions on such contact established by the FDCPA or the following state consumer protection requirements:
    - Section 36a-812 of the Connecticut General Statutes
    - Section 36a-809-9(d) of the Regulations of Connecticut State Agencies
    - Idaho Code § 26-2229A (1,2)
    - Massachusetts Regulation 209 CMR 18.13 (3), 209 CMR 18.14 & 209 CMR 18.15
    - Minn. Stat. §45.027 subd. 7 (4) & §332.37 (12) (2016)
    - North Dakota Chapter 13-04-02-04 (6) & Chapter 13-04-02-06 (4)

    i. Respondents must not place calls to third parties that have previously advised Respondents that the person they were trying to reach did not live there or was unknown as required by section 804 (3) [15 USC 1692b].

    ii. Respondents must not communicate with third parties on more than one occasion without sufficient cause to believe the third parties had previously provided erroneous or incomplete information in accordance with section 804 (3) [15 USC 1692b].

    iii. Respondents must not contact consumers at their place of employment after obtaining knowledge that the consumer's employer prohibits the consumer from receiving such communication or without prior or express permission as required by section 805 (a) (3) [15 USD 1692c].

    iv. Respondents must not make harassing phone calls or engage in any other behavior the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt as prohibited by section 806 [15 USC 1692d] and applicable state consumer protection requirements.

11. Respondents must improve oversight and monitoring of payment processing activity to ensure payments are properly credited to debtor accounts in a timely manner. Respondents must credit debtor accounts upon receipt of payment by check on the day the check is received, ensuring that no unearned

interest accrues on consumer accounts and that wage garnishments are released promptly upon satisfaction of a debt.

i. Respondents must accurately represent the actual date that a payment is received from a consumer debtor to its clients.

ii. Respondents must not collect amounts (including interest, fees, charges, or expenses incidental to the principal obligation) that were not expressly authorized by the agreement creating the debt or permitted by law as required by FDCPA section 808 [15 USC 1692f(1)].

iii. Respondents must review all interest bearing consumer accounts, open and closed, system wide, under its management since February 11, 2013. Respondents must identify each account where a payment was made by check during the period under review. The Respondents must conduct an independent audit of each account identified to establish an accurate amortization of each account as if payments had been credited on the date of receipt of the check. Each consumer's account, open or closed, must be recompensed by credit or direct payment to the extent the delay in posting payments by check resulted in greater expense to the debtor in interest or fees. The Respondents will submit a report of the review and reimbursements made to the Participating States within 30 days of the effective date of this Agreement.

12. Respondents must maintain complete and accurate trust account records, with regular reconciliations of each trust account to ensure the proper management of these accounts as required by the state statutes and regulations cited below:
    - Section 36a-811 of the Connecticut General Statutes
    - Idaho Code § 26-2234
    - Massachusetts Regulation 209 CMR 18.12(4)

13. Respondents must clear adjustments on trust account reconciliations in a timely manner going forward and clear the large number of currently outstanding items, some dating back to 2013 as required by the following state statutes:
    - Section 36a-811 of the Connecticut General Statutes
    - Idaho Code § 26-2234(6)

14. Respondents must monitor outstanding checks issued on trust accounts to ensure they are cleared in a timely manner. Respondents must review outstanding debtor refund checks dating back to 2010 to ensure they are escheated as required by applicable state laws governing abandoned property:
    - Section 36a-805(a)(9) of the Connecticut General Statutes
    - Idaho Code §26-2234 (5,6)
    - Massachusetts General Laws chapter 200A

15. Respondents must provide immediate and unfettered access to all collection records upon a request by the Participating States as required by the state statutes and regulations cited below:
    - Connecticut General Statutes Section 36a-17(d)
    - Idaho Code § 26-2234(1)
    - Massachusetts General Laws chapter 93, section 24D (a) & Massachusetts Regulation 209 CMR 48.04
    - Minn.Stat. §§ 45.027 subd. 1(5) and 332.40 (2016)
    - North Dakota Century Code § 13-05-06(2)

16. Respondents must submit complete responses to requested information in a timely manner in connection with future examinations as required by the state statutes and regulations cited below:
    - Connecticut General Statutes Section 36a-17(d)
    - Idaho Code § 26-2234(1)
    - Massachusetts Regulation 209 CMR 48.04(2)
    - Minn. Stat. § 45.027 subd. 1a (2016)
    - North Dakota Century Code § 13-05-07.1

17. Respondents must revise their record retention policies and procedures to ensure all records, including call recordings, generated or possessed by the Respondents in the course of business are preserved and retained in a manner as prescribed by applicable federal and state laws.

18. Respondents' collection letters sent to Connecticut debtors must contain an identifiable number or title as required by Section 36a-809-9(a) of the Regulations of Connecticut State Agencies.

19. *Reporting.* The Respondents must submit written progress reports to the Participating States by the thirtieth (30th) day after the end of each calendar quarter following the effective date of this Settlement Agreement, which describe the form, content, and manner of any actions taken to address

each Section of this Settlement Agreement and the results thereof; and a description of any operational changes implemented during such quarter which are intended to improve Respondents' compliance condition in the Participating States, and the results thereof.

This reporting requirement will remain in effect and must not be amended or rescinded without the prior written modification, termination, or suspension of the applicable provision of this Settlement Agreement from the Participating States.

IV. ENFORCEMENT

20. *No Restriction on Existing Examination and Investigative Authority.* This Agreement shall in no way preclude any State Regulator from exercising its examination or investigative authority authorized under the laws of the corresponding Participating State in the instance a determination is made wherein Respondents are found not to be adhering to the requirements of the Agreement, other than inadvertent and isolated errors that are promptly corrected by Respondents, or involving any unrelated matter not subject to the terms of this agreement.

21. Notwithstanding any other relief to the contrary, if Respondents fail to comply with the terms and conditions of this Agreement, the State Regulators may pursue any action allowed by law concerning the conduct and compliance violations stated in the Report of Examination, such action including, but not limited to, suspension or revocation of a license issued by the State Regulators to Respondents, imposition of a civil money penalty against Respondents, or any other remedy allowed by law. The Parties agree that failure of Respondents to comply with any term or condition of this Agreement with respect to a particular State shall be treated as a violation of any Order of the State and may be enforced as such. Moreover, Respondents acknowledge and agree that this Agreement is only binding on the State Regulators and not any other local, state or federal agency, department or office.

22. *Sharing of Information and Cooperation.* The State Regulators may collectively or individually request and receive any information or documents in the possession of the Joint State Examiners. This Agreement shall not limit Respondents' obligations, as licensees of the State Regulators, to cooperate with any examination or investigation, including but not limited to, any obligation to timely provide requested information or documents to any State Regulator.

V. GENERAL PROVISIONS

23. *Effectiveness.* This Agreement shall become effective upon execution by all of the named State Regulators (the "Effective Date").

24. *Public Record.* This Agreement shall become public upon the Effective Date and is a reportable event for purposes of the regulatory disclosure questions on NMLS.

25. *Binding Nature.* The terms of this Agreement shall be legally binding upon Respondents' officers, owners, directors, employees, heirs, successors and assigns. The provisions of this Agreement shall remain effective and enforceable except to the extent that, and until such time as, any provisions of this Agreement shall have been modified, terminated, suspended, or set aside in writing by mutual agreement of the State Regulators collectively and Respondents.

26. *Standing and Choice of Law.* Each State Regulator has standing to enforce this Agreement in the judicial or administrative process otherwise authorized under the laws and regulations of the correspondent Participating State. Upon entry, this Agreement shall be deemed a final order of each respective State Regulator unless adoption of a subsequent agreement is necessary under the laws of the corresponding Participating State. In the event of any disagreement between any State Regulator and Respondents regarding the enforceability or interpretation of this Agreement and compliance therewith, the courts or administrative agency authorized under the laws of the Participating State shall have exclusive jurisdiction over the dispute, and the laws of the Participating State shall govern the interpretation, construction, and enforceability of this Agreement.

27. *Adoption of Subsequent Orders to Incorporate Terms.* A State Regulator, if deemed necessary under the laws and regulations of the corresponding Participating State, may issue a separate administrative order to adopt and incorporate the terms and conditions of this Agreement. A State Regulator may *sua sponte* issue each subsequent order without the review and approval of Respondents provided the subsequent order does not amend, alter, or otherwise change the terms of the Agreement. In the event a subsequent order amends, alters, or otherwise changes the terms of the Agreement, the terms of the Agreement as set forth herein will control.

28. *Privilege.* This Agreement shall not constitute a waiver of any applicable attorney-client or work product privilege, confidentiality, or any other protection applicable to any negotiations relative to this Agreement.

29. *Titles.* The titles used to identify the paragraphs of this Agreement are for the convenience of reference only and do not control the interpretation of this Agreement.

30. *Final Agreement.* This Agreement is the final written expression and the complete and exclusive statement of all the agreements, conditions, promises, representations, and covenants between the Parties with respect to the subject matter hereof, and supersedes all prior or contemporaneous agreements, negotiations, representations, understandings, and discussions between and among the Parties, their respective representatives, and any other person or entity, with respect to the subject matter covered hereby, excepting therefrom any proceeding or action if such proceeding or action is based upon facts not presently known to the State Regulator or which were knowingly concealed from the State Regulator by Respondents. The Parties further acknowledge and agree that nothing contained in this Agreement shall operate to limit the State Regulators' ability to assist any other local, state or federal agency, department or office with any prosecution, administrative, civil or criminal action brought by any such Agency, Department or Office against Respondents or any other person based upon any of the activities alleged in these matters or otherwise.

31. *Waiver.* The waiver of any provision of this Agreement shall not operate to waive any other provision set forth herein, and any waiver, amendment and/or change to the terms of this Agreement must be in writing signed by the Parties.

32. *No Private Right of Action Created.* This Agreement does not create any private rights or remedies against Respondents (or any of their affiliates or subsidiaries), create any liability for Respondents (or any of their affiliates or subsidiaries) for any person or entity not a party to this Agreement.

33. *Counterparts.* This Agreement may be executed in separate counterparts, by facsimile or by PDF. A copy of the signed Agreement will be given the same effect as the originally signed Agreement.

34. Nothing in this Agreement shall relieve Respondents of their obligation to comply with applicable State and Federal law.

It is so **ORDERED.**

IN WITNESS WHEREOF, in consideration of the foregoing, including the recital paragraphs, and with the Parties intending to be legally bound, the Parties do hereby execute this Agreement this 7th day of JULY, 2017.

Allied Interstate LLC

The Receivables Management Services Corporation

Receivable Management Services – Recovery Division LLC

By: _____

(insert name and title)

DANIELL MONTEJANO, PRESIDENT

Allied Interstate LLC, The Receivables Management Services Corporation, Receivable Management Services - Recovery Division LLC Settlement Agreement Regulatory Signatures:

Jorge L. Perez, Commissioner
Connecticut Department of Banking

Mary E. Hughes, Acting Director of Finance
Idaho Department of Finance

Terence A. McGinnis, Commissioner of Banks
Massachusetts Division of Banks

Mike Rothman, Commissioner
Minnesota Department of Commerce

Robert J. Entringer, Commissioner
North Dakota Department of Financial Institutions

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National Consumer Law Center, Excerpts Summarizing Fair Credit Reporting Act Provisions in the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 from "Congress Amends Eight Consumer Statutes" (May 29, 2018)

Submitted by:
Chi Chi Wu
National Consumer Law Center

CONGRESS AMENDS EIGHT CONSUMER STATUTES

Jon Sheldon

May 29, 2018

The President on May 24 signed **Public Law 115-174** that amends the Dodd-Frank Act to provide many depositories relief from federal supervision and regulation. The Act also makes a number of changes to legislation providing consumer rights. While many of the changes relate to the Truth in Lending Act or the Fair Credit Reporting Act, at least eight consumer statutes are implicated, affecting consumer rights involving:

- Tenants in foreclosed property;
- Former military personnel facing foreclosures;
- Private student loan borrowers and their co-signers;
- Manufactured home credit;
- Mortgage loan originations;
- Refinancing of VA mortgage loans;
- Security freezes, fraud alerts and credit monitoring;
- Credit reporting of veterans' medical debt;
- PACE loans;
- HMDA disclosures.

While titled the "Economic Growth, Regulatory Relief, and Consumer Protection Act," the Act is generally called "the Crapo bill" after its lead sponsor, Republican Senator Mike Crapo of Idaho. With a few exceptions discussed below, the changes either carve out exceptions from compliance with consumer statutes or codify consumer protections that at least certain industry players are already following on their own.

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CREDIT REPORTING SECURITY FREEZES AND FRAUD ALERTS

Section 301 of Public Law No. 115-174 amends the Fair Credit Reporting Act, effective September 21, 2018, to establish a new federal right for consumers to implement a security freeze of their credit file. (A security freeze prevents users from accessing a credit file, with a number of exceptions.) The legislation also preempts state security freeze laws and extends

initial fraud alerts from 90 days to one year. (A fraud alert notifies the users that the consumer has been or may become a victim of fraud or identity thief.)

The legislation adds new 15 U.S.C. § 1681c-1(i), which establishes standards for the creation, temporary lifting or "thaw," and permanent removal of security freezes from the nationwide consumer reporting agencies as defined in section 1681a(p). The freezes are free of charge. They are essentially limited to parties seeking the consumer's information for credit purposes.

The freeze does not apply to parties who want the report for employment, insurance, or tenant-screening purposes. It also does not apply to existing creditors or their agents or assignees conducting an account review, collecting on a financial obligation owed them, or seeking to extend a "firm offer of credit" (i.e., prescreening).

New section 1681c-1(i) also governs notices and disclosures concerning security freezes. Finally, the legislation adds new section 1681c-1(j), which sets standards where a representative of a minor or incapacitated individual seeks to freeze the individual's consumer report.

The legislation's preemption extends to any state requirement or prohibition with respect to subject matter regulated by the above provisions relating to security freezes. For example, some state statutes are stronger than the new federal standards by allowing consumers to freeze access to credit reports for employment or insurance purposes. For more on security freezes and state laws that are now preempted, see NCLC's ***Fair Credit Reporting* § 9.4.4** and **Appendix H**.

CREDIT REPORTING OF VETERANS' MEDICAL DEBT

Section 302 of Public Law No. 115-174 amends the Fair Credit Reporting Act, effective May 24, 2019, to provide credit reporting protections for veterans regarding certain medical debts. These include debts owed to a non-VA medical provider for medical care authorized by the VA and where the provider sought payment from the VA, as well as medical debt for bills wrongfully charged by the VA.

In general, a nationwide consumer reporting agency shall not report this type of veterans' medical debt until the debt is over one year old. The legislation also sets out a process whereby the veteran can dispute medical debt in the veteran's credit report and requires the VA to establish a database to enable the CRAs to verify veteran's medical debt. For more on restrictions involving the credit reporting of medical debt, see NCLC's ***Fair Credit Reporting* § 5.4**.

FREE CREDIT MONITORING TO CONSUMERS ON ACTIVE DUTY OR THE NATIONAL GUARD

Section 302 of Public Law No. 115-174 amends the Fair Credit Reporting Act, effective May 24, 2019, to provide free "credit monitoring" to any military personnel on active duty or in the national guard. The credit monitoring as defined by section 302 is much more limited than the commercial products currently available, in that it only requires electronic notifications of additions or modifications to a consumer's file, i.e., "alerts." There is no private remedy for violation of this requirement. For a discussion of other credit monitoring products, see NCLC's ***Fair Credit Reporting* § 3.3.3.1**.

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National Consumer Law Center, Consumer Groups' Comments in Response to the CFPB's Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process (May 19, 2017)

Submitted by:
Chi Chi Wu

National Consumer Law Center

May 19, 2017

Via regulations.gov
Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Re: Comments in Response to Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process, Docket No. CFPB-2017-0005

The undersigned consumer groups are pleased to submit the following comments in response to the CFPB's Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process. Alternative data has the potential to benefit millions of consumers, whether they are "credit invisible" or they have impaired records with the traditional Big Three nationwide consumer reporting agencies (CRAs) - Equifax, Experian, and TransUnion. However, alternative data is not without its risks.

Much of the analysis of whether alternative data will benefit or hurt consumers depends on several key factors –

- What kind of alternative data is being used?
- How is the alternative data being used?
- What is the accuracy and predictiveness of the data?
- What level of disparate impact does the data have on protected groups, especially communities of color?

If alternative data is used for credit decisionmaking, its use is regulated by the Equal Credit Opportunity Act (ECOA). Unless it is firsthand experience information, most likely it is also regulated by the Fair Credit Reporting Act (FCRA). Compliance with both these laws will be critical for the purposes of accuracy, predictiveness, transparency, and minimizing disparate impact.

A. FIRST CONSIDERATIONS

We appreciate the CFPB's focus on the issue of "credit invisibility." The Bureau has conducted very valuable and enlightening research estimating that 26 million Americans do not have a credit history, and that 18 million

Americans do not have a credit score because their histories are too scant ("thin") or old to generate a score.[1] The research also found that credit invisibility has a disparate impact, in that African American and Hispanic (as well as low-income) consumers are more likely to have no credit history or to be unscorable.

The natural reaction to such data is the desire to address this invisibility, to make the invisible seen. To that end, the CFPB, industry, policymakers, and consumer and civil rights advocates have considered the use of alternative data to address credit invisibility. Before doing so, however, we should carefully weigh the risks of alternative data. We urge a cautious and thoughtful approach in developing solutions to credit invisibility, including the use of alternative data. As with so many aspects of credit and financial services, the old adage of "the devil is in the details" rings true.

First, we should challenge the premise that invisibility is always a negative. Certainly, credit invisibility poses real and significant problems for consumers who are actively seeking credit. But in some areas, the lack of a credit history could be better than a negative history. Employment and insurance are two uses of credit report information where no history may be better than solely negative information, and where invisibility may be a benefit. For insurance, a number of state laws are designed to ensure that a consumer with no credit score is not treated worse than someone with an average credit score.[2] Invisibility might also help consumers avoid lead generators and predatory lenders who target high-cost credit to consumers with low credit scores.

Another important consideration before tackling credit invisibility is to consider the ultimate goal. Access to credit by itself should not be the goal, if there is no consideration of the type of credit involved, whether that credit is fairly priced or predatory, and whether the consumer can afford to repay the credit. The goal should be increase access to affordably priced credit with fair terms that the consumer has the ability to repay.

Not all credit is good credit, as we should be reminded by how the freewheeling granting of credit in the early- and mid-2000s precipitated the foreclosure crisis and the Great Recession. And in the current era, some of the lenders using alternative data have offered credit at triple

1. *See* Consumer Financial Protection Bureau, Data Point: Credit Invisibles, May 2015, *available at* http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.
2. The Supreme Court observed the existence of these laws in Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 73, 127 S. Ct. 2201, 2217, 167 L. Ed. 2d 1045 (2007)("[a] number of States permit the use of such "neutral" credit scores to ensure that consumers with thin or unidentifiable credit histories are not treated disadvantageously").

digit APRs, making them little better than high tech payday lenders.[3] Using alternative data may result in giving subprime scores to formerly invisible consumers,[4] boxing them into high-priced credit and making them targets for predatory lenders.

B. CONVENTIONAL ALTERNATIVE DATA

One of the most critical points in discussing alternative data is that the type of data matters. Not all data is created equal. Some data shows promise, other data is a mixed bag, and some data is harmful enough that it should not be used. We discuss specific types of data below.

Before doing so, however, we have one taxonomic point. The CFPB has stated it considers any data outside of the nationwide CRA files to be alternative data.[5] However, we would divide it into two types: conventional and Big Data. Conventional alternative data includes information about payment obligations that are periodic and recurring, similar to the loan payment obligations in a credit report, or reflect other mainstream financial information, such as bank account transactions. Big Data includes information such as web searches, social media, and other types of data that seem far removed from the information usually in a credit report.

1. Gas and Electric Utility Payment Information

One of the most often promoted types of alternative data is "full file" utility credit reporting, *i.e.* monthly reporting of customer payments, including late payments, by gas and electric utilities to the nationwide CRAs. Currently, the vast majority of electric and natural gas utility

3. *See* Persis Yu, NCLC, Big Data: A Big Disappointment for Scoring Consumer Credit Risk, March 2014, at 7, *available at* www.nclc.org/images/pdf/pr-reports/report-big-data.pdf (Big Data loan products with APRs of 134% to 448%). We are especially concerned about non-bank fintech lenders using alternative data to make triple-digit APR loans given the Office of Comptroller of Currency's proposal to allow such lenders to obtain national bank charters, which they could use to evade state usury caps.
4. For example, a study by a proponent of utility credit reporting states: "For all those that become scoreable, about one-third [i.e., 33%] scored in the F category, 22% scored in the D category, and 45% scored in the C or higher category." Michael Turner, et al., PERC, A New Pathway to Financial Inclusion: Alternative Data, Credit Building, and Responsible Lending in the Wake of the Great Recession, June 2012, at 13. Thus, over half (55%) of consumers without scores end up with a probably subprime score (Ds and Fs) and about 35% end up with a C. Only a few percent of the formerly unscorable consumers ended up with an "A" or "B" score.
5. 82 Fed. Reg. at 11,184.

companies only report to the nationwide CRAs when a seriously delinquent account has been referred to a collection agency or written off as uncollectible.[6]

However, we are concerned that full file utility credit reporting could end up harming consumers who already have thick files and visible credit scores.[7] Furthermore, credit invisible consumers will more likely end up with low scores instead of no scores. This is because many low-income customers would receive negative marks for 30- or 60-day late payments during months when utility costs are high, even though they eventually catch up when costs are lower (*e.g.*, in summer months for cold weather winter states). These negative marks can be damaging, as a single 30-day late payment damages a credit score by as much as 60 to 110 points.[8]

One study claims that negative information will be minimal because its data shows that less than 3% of consumers earning $50,000 or less have a single 60-day late utility payment during a one-year period.[9] Yet data from utility companies and regulators shows that the percentage of utility consumers, especially low-income and energy assistance customers, who are delinquent in paying is much higher:

- Data from Pacific Gas and Electric shows that 6.6% of general residential customers and 17.1% of low-income/energy assistance customers were in arrears by 61 or more days in just one month–March 2017.[10]

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6. CFPB, Does my history of paying utility bills, like telephone, cable, electricity, or water, go in my credit report?, May 27, 2016, *available at* https://www.consumerfinance.gov/askcfpb/1817/does-my-history-paying-utility-bills-telephone-cable-electricity-or-water-go-my-credit-report.html.
7. While we have significant concerns about full-file utility reporting in which consumers do not have a choice as to whether or not to participate, we do not oppose permitting consumers to voluntarily opt-in to utility credit reporting if consent is knowingly and meaningfully given.
8. Equifax, Can One Late Payment Affect My Credit Score? Feb. 7, 2014, at https://blog.equifax.com/credit/can-one-late-payment-affect-my-credit-score/ ("[a]ccording to FICO data, a 30-day delinquency could cause as much as a 90- to 110-point drop on a FICO Score of 780 for a consumer who has never missed a payment on any credit account. In comparison, a consumer with a 680 FICO Score … would experience a 60- to 80-point drop").
9. Michael Turner, et al., PERC, The Credit Impacts on Low-Income Americans from Reporting Moderately Late Utility Payments, August 2012, at 12.
10. Pacific Gas and Electric Company, Quarterly Disconnect Data Report, California Public Utilities Commission, R. 10-02-005, April 25, 2017.

- In Massachusetts, well over one-third (36.4%) of low-income/ energy assistance customers of Eversource Electric were more than 60 days late in paying their bills in May 2016.[11]
- Among investor-owned electric and natural gas companies in Iowa, nearly 18% of all customers and over 38% of energy assistance customers in March 2017 were late in paying a bill.[12] The number of days late for these delinquencies was not reported.
- For Indianapolis Power and Light Company, the monthly average 60-day delinquency rate among energy assistance customers was 33% between 2012 and 2014.[13]
- Among investor-owned electric and natural gas companies in Pennsylvania, the delinquency rate for low-income customers was 18% (electric) and 26% (gas), respectively, in 2015.[14] The number of days late past 30 days for these delinquencies was not reported.
- In March 2017 in Washington D.C., the delinquency rate among all customers of Potomac Electric Power Company was 25% and for low-income customers was a whopping 75%.[15] The number of days late for these delinquencies was not reported.

In addition to introducing a great deal of negative information into the nationwide CRA files, we are concerned that full file utility credit reporting conflicts with established state utility consumer protections. State laws often include consumer protections intended to protect vulnerable populations from the loss of electric and natural gas utility service during high cost months, and in times of illness or financial

11. Eversource (f.k.a. NSTAR Electric), Monthly Credit and Collections Report to Massachusetts Department of Public Utilities, March 2017.
12. Iowa Utilities Board, Residential Customer Statistics: Breakdown by Company for March 2017, April 17, 2017, *available at* https://iub.iowa.gov/sites/default/files/files/records_center/residential_data/MY2017/Moratorium_03-Mar17.pdf.
13. Indianapolis Power and Light Company Response to Citizens Action Coalition Data Request 1.6, Cause No. 44576, Indiana Utility Regulatory Commission, March 2015.
14. Pennsylvania Public Utility Commission- Bureau of Consumer Services, Report on 2015 Universal Service Programs and Collections Performance, *available at* http://www.puc.pa.gov/General/publications_reports/pdf/EDC_NGDC_UniServ_Rpt2015.pdf.
15. Potomac Electric Power Company, Compliance Filing pursuant to Public Service Commission of the District of Columbia Orders No. 14293 and 15134, April 19, 2017, *available at* http://edocket.dcpsc.org/edocket/docketsheets_pdf_FS.asp?caseno=ARDIR2017-01&docketno=8&flag=D&show_result=Y.

hardship.[16] These consumers may sometimes defer full payment of utility bills until later in the year, knowing they are protected from shutoff. Adopting full file utility credit reporting would undermine these health and safety protections.

2. Telecommunications data

Over the past several years, there have been efforts to create scores using data from wireless phone and cable television providers. For example, FICO XD uses data from the National Consumers Telecom and Utility Exchange (NCTUE) as well as LexisNexis to generate an alternative score that can be used for otherwise credit invisible consumers.

Unlike regulated electric and gas service, telecommunications industries have fewer consumer protections that could be undermined by monthly reporting. Thus, they do not raise the same concerns as those sources of data. However, the level of accuracy of the data has not been assessed, nor the impact on consumers who lodge disputes over issues such as cramming, early termination fees, and questionable surcharges.

Transparency is also an issue; consumers may also not be aware that their cell phone and cable payment histories are being supplied to nationwide or specialty CRAs. This is critical for low-income consumers because when they juggle bills, they often do so in consideration of multiple factors including credit reporting.

3. Rental payments

Traditionally, rental data is only reported when a tenant is so delinquent that the account is sent to a debt collector. Efforts to add positive data appear to be promising, especially those efforts that do not report late payments prior to the debt being sent to collections. However, tenants who invoke their rights under state or local laws to withhold rent due to poor conditions should not be penalized.

A variation on using rental payments is to use address stability (*i.e.* number of times a consumer has moved) as a proxy for on-time payments. This is an overly crude measure of rental payment history, because consumers often move due to many reasons other than nonpayment of rent. As the CFPB notes, military servicemembers are one

16. National Consumer Law Center, Access to Utility Service, Appx. A, (5th ed. 2011), *updated at* www.nclc.org/library.

population that moves often. 82 Fed. Reg. at 11187. Another population that moves frequently are students. This lack of precision makes address stability a poor measure, and one goal of improving tools to assess creditworthiness should be greater precision, not less. Also, address stability to assess creditworthiness probably results in disparate impact, since renters move more often than owners and communities of color have lower rates of homeownership.[17]

4. Subprime Credit

Payday loans and other forms of subprime credit are often not reported on traditional credit reports. Adding these types of credit could damage the credit records of these borrowers. High-cost credit is often designed to lead to a cycle of debt, and even merely using a subprime form of credit can negatively affect a credit score.[18] Creating a database of consumers who have used high-cost credit could make them even more vulnerable. Adopting the use of subprime credit data would likely harm consumers who use such credit.

Furthermore, the necessity of using subprime credit as a form of alternative data is questionable, as most payday borrowers are not credit

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17. The homeownership rate for non-Hispanic whites was about 72% at the end of 2016, compared to 42% for African Americans, 46% for Hispanics and 57% for Asians. U.S. Census Bureau, Quarterly Residential Vacancies and Homeownership, First Quarter 2017 - CB17-55, Table 7: Homeownership Rates by Race and Ethnicity of Householder: 2013 to 2017, April 27, 2017, *available at* https://www.census.gov/housing/hvs/files/currenthvspress.pdf.
18. Experian states:

> Do finance companies have a negative impact on a credit score?
>
> The presence of a loan finance account can negatively affect your score because these *accounts often carry high interest rates which may hamper your ability to repay and which many lenders view negatively.* However, when paid on time, these accounts can also have a positive effect on your score (if the loan helps you to make your payments in a more timely fashion, for example). (emphasis added)

Experian, Credit Score Basics FAQs, *available at* www.experian.com/blogs/ask-experian/credit-education/faqs/credit-score-faqs/ (viewed May 15, 2017).

If a finance company loan is viewed negatively because of high interest rates, the use of even more expensive credit sources (such as payday loans) to develop consumer reports would logically create a database of "bad risks." *See, e.g.,* Ruth Lythe, A Payday Loan Can Stop You Getting a Mortgage: Worrying News for Three Million Who Have Needed Fast Cash, The Daily Mail, July 13, 2012, *available at* http://www.dailymail.co.uk/money/mortgageshome/article-2173443/Payday-loans-Worrying-news-million-needed-fast-cash.html#ixzz20beuLWIm (in United Kingdom, reporting that lenders refusing to grant mortgages to payday loan borrowers).

invisible. The authors of one research study analyzing payday loan applications noted that the results of their matching payday borrowers to nationwide CRA files "imply that nearly all of the payday loan applicants had a credit record at the time they applied for their first payday loan."[19]

5. Bank account transaction data

Bank account transaction data appears to be a promising form of alternative data. First, it incorporates an analysis of ability to repay, since it includes information about both income being deposited into the account as well as expenses being paid out of the account.

Second, bank account data allows for less emphasis on historical events that could have been due to no fault of the consumers. One of our critiques of traditional credit reporting and scoring is that it is overly blunt, failing to distinguish between "can't pay" and "won't pay."

Data suggests that many of the consumers with impaired credit were the victims of unfortunate events such as illness or job loss.[20] Bank account data can avoid the need to rely on long historical timeframes such as seven years, given that lenders review 12 months of statements at most when they manually review bank account activity.[21] This means that negative marks from a period of economic hardship from several years ago need not impair a consumer's ability to obtain

19. Neil Bhutta, Paige Marta Skiba, & Jeremy Tobacman, Payday Loan Choices and Consequences (2014) at 12, *available at* http://www.calcfa.com/docs/PaydayLoanChoicesandConsequences.pdf. The authors matched 250,000 payday loan application files to credit report files in the Federal Reserve Bank of New York's Consumer Credit Panel (CCP), composed of Equifax data. Since the primary CCP dataset is a five-percent random sample, the authors had expected to match roughly 12,400 applicants to the CCP. Indeed, they were able to match 12,151 individuals, suggesting that most payday borrowers had a file with Equifax. *Id.* at 11.
20. About 70 to 80% of consumers with impaired credit or a low score, such as a 600, will actually not default. These may be victims of extraordinary life circumstances who do not default again once they have recovered economically. *See* Chi Chi Wu, NCLC, Solving the Credit Conundrum: Helping Consumers' Credit Records Impaired by the Foreclosure Crisis and Great Recession, Dec. 2013, at 9-11, *available at* www.nclc.org/images/pdf/credit_reports/report-credit-conundrum-2013.pdf (summarizing research).
21. For example, Fannie Mae requires lenders to review 12 months of bank account statements to establish payment activity. Fannie Mae Selling Guide, B3-5.4-03: Documentation and Assessment of a Nontraditional Credit History, August 30, 2016, *available at* https://www.fanniemae.com/content/guide/selling/b3/5.4/03.html. Anecdotally, we have heard that some lenders only require 3 to 6 months of bank account statements.

credit for an extended period of time. Also, bank account data can show when there has been a healthy sustained recovery from an extraordinary life event such as a job loss or illness.

However, bank account transaction information raises significant privacy issues, and should only be used when the consumer has knowingly and actively consented to its use. Transaction data includes sensitive information beyond just financial patterns, such as debit card purchases showing where the consumer shops or even which political causes she supports. There will need to be methods to protect the privacy of this information while being able to use account information for credit decisionmaking. One method might be for a third party to analyze the data and then provide its own type of score or recommendation, with protections in place that prevent the third party from revealing individual account level transactions.

Another issue is providing access to third parties, whether they be aggregators or lenders, in order to obtain and analyze the bank account data. As the CFPB knows from the comments submitted in response to its Request for Information regarding consumer access to their own financial information,[22] some banks have put up roadblocks to a consumer's ability to share his or her bank account data with third party entities. If a bank can block the consumer from sharing data, then the only lender who can utilize bank account transaction data for credit decisionmaking would be the consumer's own bank. This would limit the consumer's choice and ability to shop around. That is why this issue goes hand in hand with the Bureau's examination of account aggregator issues and whether to require data sharing under Section 1033 of the Dodd-Frank Act.[23]

Last, but certainly not least, any meaningful effort to expand access to credit using bank account transaction data must be accompanied by significant reform of overdraft practices. As the CFPB well knows, abusive and unfair practices by financial institutions in the triggering of overdrafts and imposition of related fees has cost consumers billions

22. Request for Information: Consumer Access to Financial Records, Docket No. CFPB-2016-0048, November 17, 2016.
23. We commend those banks that have made the decision to allow data sharing, such as JPMorgan Chase. Press Release, Intuit, Chase, Intuit to Give Customers Greater Control of Their Information (Jan. 25, 2017), *available at* https://www.intuit.com/company/press-room/press-releases/2017/Chase-Intuit-to-Give-Customers-Greater-Control-of-Their-Information/.

of dollars.[24] These practices then result in shutting out millions of consumers from mainstream bank accounts,[25] and will similarly shut them out from credit access based on account transaction data. Bank account transaction data will be contaminated from the impact of unfair overdraft practices unless there is significant reform on this issue.

6. Trended data

The CFPB mentions data showing trends in traditional loan payments, *i.e.*, "trended data," as a type of alternative data. 82 Fed. Reg. at 11185. While it does not quite meet the definition of alternative data, since this data does originate from the files of the nationwide CRAs, the use of trended data is certainly a novel development. One of the drivers of its use is Fannie Mae, which now uses trended data in its Desktop Underwriting program.[26]

A significant issue around trended data will be the accuracy of payment information. In order for trended data to work accurately, information furnishers, most particular credit card issuers, must provide complete and correct information to the nationwide CRAs about the amount of each monthly payment – not just whether a payment was made that met or exceeded the minimum required. We have seen that several credit card issuers do not provide such information.

7. Automating income data

The CFPB mentions automating verification of employment and income data as a sort of alternative data or modeling. 82 Fed. Reg. at 11186-87. An example of a CRA that provides automated employment or income verification is The Work Number, a subsidiary of Equifax. The Work Number collects information from employers regarding employment and salary information that can be used to verify income.

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24. Consumer Financial Prot. Bureau, CFPB Study of Overdraft Programs: A white paper of initial data findings 15 (June 2013), *available at* www.consumerfinance.gov (estimating that banks earned roughly $12.6 billion in consumer NSF and overdraft fees in 2011).
25. *See* Chi Chi Wu, Katie Plat, NCLC, Cities for Financial Empowerment Fund, Account Screening Consumer Reporting Agencies: A Banking Access Perspective (October 2015), *available at* http://www.nclc.org/images/pdf/pr-reports/Account-Screening-CRA-Agencies-BankingAccess101915.pdf.
26. Fannie Mae, Trended Credit Data and Desktop Underwriter (DU), 2016, *available at* https://www.fanniemae.com/content/fact_sheet/desktop-underwriter-trended-data.pdf.

We are not opposed to the use of automated income data per se. It does have the potential to make income verification faster and less burdensome. But there are issues around accuracy, in that we have seen several instances where consumers were erroneously reported to be employed and have income when they did not. Furthermore, a limited number of employers furnish information to The Work Number. Employers of other organizations should not be disadvantaged because their employer does not participate in The Work Number. We do not want to create another sort of "invisibility" problem.

C. BIG DATA

"Big Data" encompasses many types of information, and not all of them are created equal. There are many unanswered questions about the predictiveness and accuracy of these data sources. For example, in one study in which NCLC employees ordered their own reports from four data brokers, these reports were found to be riddled with inaccuracies, ranging from the mundane (a wrong e-mail address or incorrect phone number) to the seriously flawed (wrong occupation or salary estimate).[27] Of the 15 records sought, some brokers had as many as 13 reports with errors in them.[28]

Furthermore, compliance with statutory requirements seems questionable. Any data used for credit decisionmaking, whether conventional or Big Data, implicates the ECOA. In addition, we suspect that many "Big Data" purveyors do not realize the broad scope of the FCRA, as discussed in Section F.1 below, and do not consider themselves to be CRAs when they actually are covered as such.

1. Educational or occupational attainment

The CFPB asks about the potential of using data about a consumer's educational or occupational attainment. We are highly concerned about the use of this data. First, there are obvious racial disparities in educational and occupational attainment. For example, 93% of non-Hispanic whites graduate high school, but only 67% of Hispanics and

27. *See* Persis Yu, NCLC, Big Data: A Big Disappointment for Scoring Consumer Credit Risk, at 18, March 2014, *available at* www.nclc.org/images/pdf/pr-reports/report-big-data.pdf. (reviewing the accuracy of reports by eBureau, ID Analytics, Spokeo, and Intelius).
28. *Id*.

87% of African Americans do.[29] Over 36% of non-Hispanic whites and nearly 54% of Asians have a bachelor's degree, but less than 16% of Hispanics and 23% of African Americans do.[30] As for occupation, 40% of non-Hispanic whites and 51% of Asians are employed in management, professional, and related positions, but only 30% of African Americans and 22% of Hispanics are similarly employed.[31]

The use of education and occupational attainment also reinforces other types of inequality. As one researcher summarized the literature "In most studies, parental education has been identified as the single strongest correlate of children's success in school, the number of years they attend school, and their success later in life."[32] In other words, a consumer's educational attainment is most strongly linked with the educational level of his or her parents. Thus, judging the consumer's creditworthiness based on educational attainment is essentially basing credit decisions on the socio-economic class that the consumer was born into, perpetuating economic inequality.

Some products have also looked at the specific school that the consumer attended.[33] This is concerning given research on widespread undermatching – where students do not apply to or enroll in the best colleges likely to admit them – and its converse, overmatching enrollment.[34] Undermatching is often a result of a lack of financial resources or general information about the admissions process, which disproportionately affects low-income students. In contrast, researchers found that "[s]tudents from the wealthiest families, from neighborhoods where many adults have college degrees, and from high schools where many students go on to college are less likely to be undermatched but also more likely to be overmatched."[35]

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29. Camille L. Ryan and Kurt Bauman, U.S. Census: Current Population Reports, Educational Attainment in the United States: 2015, March 2016, at https://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf.
30. *Id.*
31. Bureau of Labor Statistics, BLS Reports, Report 1062: Labor Force Characteristics by Race and Ethnicity, 2015, September 2016, *available at* https://www.bls.gov/opub/reports/race-and-ethnicity/2015/home.htm.
32. Anna J. Egalite, How Family Background Influences Student Achievement, EducationNext, Vol. 16, No.2, Spring 2016, *available at* http://educationnext.org/how-family-background-influences-student-achievement/.
33. https://www.credible.com/refinance-student-loans.
34. Scott Jaschik, Admissions Mismatch, InsideHigherEd.com (August 13, 2013) *available at* https://www.insidehighered.com/news/2013/08/13/study-finds-widespread-mismatching-students-and-colleges-primarily-due-student.
35. *Id.*

The CFPB has raised concerns in the RFI that certain alternative data could harden barriers to economic and social mobility. 82 Fed. Reg. at 11,187. Educational or occupational attainment would probably be top on the list of mobility-impeding data, and would ossify the gaping racial and economic inequality in our country.

2. Friends and family data, including social media

The CFPB has asked about the use of data related to consumers' friends and associates, including data about connections on social media. Creditworthiness by association raises serious concerns about racial disparities.

Although it is not yet widely used in the United States, consideration of social media and other social networks is more common outside of the United States. One such company, Lenddo, which operates in twenty different countries, may deem a consumer to be less creditworthy if he or she is friends on Facebook with someone who was late paying back a loan to Lenddo.[36] Given the segregation that still exists in American society, most people's friends and family are likely to be of the same race, class, and cultural background. Combined with the fact that for the past two decades, study after study has found that African American and Latino communities have lower credit scores as a group than whites (and Asians, when the data is available), using this type of data would raise great concerns.[37]

Creditors have used other methods to base a consumer's creditworthiness on the characteristics of others. For example, at one point it was reported that American Express lowered a customer's credit limit from $10,800 to $3,800, not based on his payment history with the company, but because "[o]ther customers who have used their card at establishments where you recently shopped have a poor repayment history with American Express."[38] With this type of analysis, low-income consumers with pristine credit histories could find their big data credit scores lowered simply because they save costs by shopping at

36. Katie Lobosco, Facebook friends could change your credit score, CNN.com (August 27, 2013) *available at* http://money.cnn.com/2013/08/26/technology/social/facebook-credit-score/index.html.
37. National Consumer Law Center, Past Imperfect: How Credit Scores and Other Analytics "Bake In" Past Discrimination and Perpetuate It, May 2016, *available at* http://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.
38. Lori Andrews, Facebook Is Using You, *New York Times*, Feb. 4, 2012, www.nytimes.com/2012/02/05/opinion/sunday/facebook-is-using-you.html?pagewanted=all.

low-end outlets whose customers include people who have trouble paying their bills.

Location or geographic neighborhood is another way that creditors have based creditworthiness by association. A recent report by TransUnion highlights this ominous trend:

> …aggregated credit data is…helpful to [debt] collectors because it can identify local credit conditions clustered around common demographics. This is especially true for consumers with little or no credit history. For example, if the consumer is living in a ZIP code where the mortgage delinquency rates are climbing or always high, the chance for collection may be significantly less than for those in ZIP codes where the delinquency rate is relatively low and stable.[39]

There is already evidence that some companies target different zip codes differently. In 2016, Bloomberg compared Amazon same-day delivery areas with U.S. Census Bureau data and found that in six major metropolitan areas, predominantly black ZIP codes are largely excluded.[40] While there is no evidence that Amazon makes decisions on where to deliver based on race, and Amazon's spokesperson said that the ethnic composition of neighborhoods is not part of the data Amazon examines when drawing up its maps, the impact is clear.

Census data, zip code, and location can function as a proxy for race and income and its use by creditors would reflect, and likely exacerbate, racial and socio-economic disparities.

3. Behavioral data, including web browsing

The CFPB has asked about the use of behavioral data about consumers, such as how consumers interact with a web interface or answer specific questions, or data about how they shop, browse, use devices, or move about their daily lives. The use of behavioral data has consistently shown racial bias, despite relying on seemingly racially neutral algorithms. In 2013, Latanya Sweeney, a professor of government at Harvard University, led a research project that concluded that Google searches of names more likely associated with black people often yielded advertisements for a criminal records search in that person's

39. Jeffrey S. Morrison & Andy Feltovich, Leveraging Aggregated Credit Data and in Portfolio Forecasting and Collection Scoring, *The RMA Journal*, Oct. 2010, at 47, *available at* www.forecastingsolutions.com/publications/RMA_OCT2010.pdf.
40. David Ingold and Spencer Soper, Amazon Doesn't Consider the Race of Its Customers. Should It?, Bloomberg, April 21, 2016 *available at* https://www.bloomberg.com/graphics/2016-amazon-same-day/.

name.[41] On one website, searches of black-sounding names were 25 percent more likely to yield ads with offers to view the person's arrest or criminal record.[42] One industry analyst explained that this result could have occurred because black Google users clicking on those ads more than white users.[43] He then asked, "[i]f most of the searches for black names are done by black people…is that racially biased?" The answer is yes. If people of a certain race disproportionately engage display a certain behavior and that behavior is then imputed to *all* members of that race, then that would be racist.

Although, industry analysts dismissed Sweeney's research as "isolated," when working for the FTC, Sweeney found similar effects when reviewing the advertisers on *omegapsiphi2011.com*, a website for Omega Psi Phi, a high profile historically black fraternity.[44] Looking at the total number of ads shown on that website, she found large number of ads prompting viewers to click for "your" arrest records. She also looked at the type of credit cards companies that advertised on this site and found that the credit card ads that appeared on *omegapsiphi2011.com* were offers for cards that were highly criticized on the internet or were generic. None of the highly desirable credit card companies advertised on this site. On an individual ad level, this may not indicate a problem. Taken across the millions of websites on the internet, this differential treatment may lead some segments of our population towards inferior or more expensive products. While these are not examples of companies using this information for credit determinations, they show how difficult it is to generate racially neutral algorithms.

Some other companies, such as German-based Kreditech, also gather information from the manner in which a customer fills out an online application. For example, Kreditech uses information such as the time spent reading information about the loan on Kreditech's website or whether the application is typed in all-caps (or with no caps), in its credit decisionmaking. Though the discriminatory impact of these

41. Hiawatha Bray, Racial bias alleged in Google's ad results, Boston Globe (February 6, 2013) https://www.bostonglobe.com/business/2013/02/06/harvard-professor-spots-web-search-bias/PtOgSh1ivTZMfyEGj00X4I/story.html.
42. *Id.*
43. *Id.*
44. Latanya Sweeney, Federal Trade Commission, Online ads roll the dice (Sep 25, 2014) *available at* https://www.ftc.gov/news-events/blogs/techftc/2014/09/online-ads-roll-dice?utm_campaign=Submission&utm_medium=Community&utm_source=GrowthHackers.com.

criteria is unclear, it is worth exploring whether these types of behaviors produce disparities based on race or other protected classes. While this information might be relevant to fraud prevention for some reason, its predictiveness as to creditworthiness is open to question. Consumers should be judged based upon information that is truly predictive of their creditworthiness.

Behavioral data also raises accuracy concerns. As discussed in greater detail in Section F.1, consumers have the right to access their reports to check for accuracy and to dispute items. Given the type and volume of data that would be collected, the process of proactively checking their credit file would be nearly impossible for the typical consumer to do.

Finally, there is information that is clearly discriminatory in its targeting of a specific group. In fact, some companies intentionally target potential customers whose interests and demographic information they have identified through social networking data, web browsing history, and purchase information. Target, for example, can reliably predict which shoppers are pregnant based on the history of products purchased at the store, combined with other demographic information purchased from third-party data brokers.[45] The CFPB should be very skeptical about the use of this type of data for credit decisionmaking or other financial product or service related purpose.

D. HOW ALTERNATIVE DATA IS USED IS CRITICAL

The manner in which alternative data is used is a crucial factor. Using alternative data to create special scores for otherwise unscorable consumers is preferable to the wholesale addition of the same data to traditional nationwide CRA credit reports, where it might harm consumers who already have a credit score. Thus, an effort such as FICO XD, which currently uses alternate data only when a consumer has a thin file or no file, is preferable to a situation where the information in NCTUE is added to the main credit reporting files of the nationwide CRAs.

In the same vein, the use of alternative data as a "second chance" screen, as opposed to an initial screen, is preferable. With a second chance screen, there is a potential that alternative data could help a credit invisible consumer but would not present risks to a thick file consumer. The riskiest

45. Kashmir Hill, *How Target Figured Out A Teen Girl Was Pregnant Before Her Father Did*,. Forbes, Feb. 16, 2012, *available at* www.forbes.com/sites/kashmirhill/2012/02/16/how-target-figured-out-a-teen-girl-was-pregnant-before-her-father-did.

part of a "second chance" score is the possibility that a lender might use it as either an initial screen despite its intended use, or as a sequential second score that could result in a denial for a thick file consumer.

E. ALTERNATIVE MODELS

As for alternative models, one of the key issues is transparency – whether consumers understand not only *what* information is being used to assess them, but *how* that information is being used. Having "black boxes" that evaluate creditworthiness should be a thing of the past, as a matter of both fairness and ensuring that consumers are fully educated about financial issues. Consumers should always be able know, access, and understand both what is the information being used in credit decisions and how it is used. They should be able to review the information for inaccuracies so they can dispute errors.

A key element of transparency will be whether consumers receive the information they are entitled to under the ECOA and FCRA, as discussed in Section F below. Users of alternative modeling techniques will need to not only provide ECOA and FCRA adverse action notices, but make sure the notices contain sufficient information to satisfy the ECOA standard that the notice disclose the specific reasons for the action taken,[46] as defined by Regulation B and its corresponding Official Staff Interpretations.[47]

Another issue with alternative models, as well as existing ones, are assumptions that they are automatically fair, unbiased, or judgment-free. Algorithms and models, despite their perception as impartial, reflect the goals and perspectives of those who develop them. They are not truly free of value judgments or preconceptions. And machine learning models can end up "learning" the prejudices of the society they were created in, as shown by the examples in Section C.3 of how Internet search algorithms "learned" racial biases from search behavior.

46. 15 U.S.C. § 1691(d)(3).
47. Reg. B, 12 C.F.R. § 1002.9(b)(2); Official Interpretations of Reg. B, 12 C.F.R. pt. 1002, supp. I, § 1002.9(b)(2). *See generally* National Consumer Law Center, Credit Discrimination § 10.5.4.2 (6th ed. 2013), *updated at* www.nclc.org/library.

F. REGULATORY CONSIDERATIONS

When data is used in the decision whether or not to grant credit, its use is regulated by the Equal Credit Opportunity Act – period. If that data is not firsthand experience data, it is also covered by the Fair Credit Reporting Act. These statutes provide the regulatory framework that governs the use of all data for credit decisionmaking, including alternative data.

The key requirements for any data used for credit decisions are that it be accurate, predictive, and transparent. The regulatory schemes for the FCRA and ECOA speak to each of these requirements.

1. Fair Credit Reporting Act (FCRA)

As the CFPB knows, the FCRA has a very broad scope of coverage. Information is a consumer report if it is:

- Used or expected to be used or collected in whole or in part to serve as a factor in establishing eligibility for consumer credit;
- Pertains to seven characteristics, which cover an extremely far-reaching range of information – credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, and mode of living;
- Issued by third party that regularly assembles or evaluates such data for money or on a nonprofit cooperative basis.

Thus, almost all third party data collected for credit decisionmaking purposes is likely a "consumer report."

One of the key issues with alternative data is the level of accuracy of the data. Accuracy is not just a good idea; it's required by the FCRA. Section 607(b) of the FCRA, 15 U.S.C. § 16181e(b), requires consumer reporting agencies (CRAs) to follow "reasonable procedures to ensure maximum possible accuracy." As discussed in Section C, our 2014 Big Data report revealed serious levels of inaccuracy in certain Big Data sources, and these purveyors may be in violation of Section 607(b).

The FCRA also has specific notice requirements, which are intended to ensure transparency when information from a CRA is used. Mostly importantly, Section 615(a) and (h) of the Act, 15 U.S.C. § 1681m(a) and (h), require users of consumer reports to provide adverse action and risk-based pricing notices when information from a CRA has been used to deny them credit or charge them a higher price. This ensures that consumers are aware of the sources and types of information that are used against them in credit (and other) decisions, so

that they are not left in the dark as to the reasons for credit decisions, which may have critical consequences for their lives.

Furthermore, even if third party information is somehow not considered a consumer report, the FCRA includes a little-known provision that requires transparency in its usage. Section 615(b), 15 U.S.C. § 1681m(b), requires that lenders provide a specific notice if information that fits the seven characteristics listed in the definition of "consumer report" is obtained from a person other than a CRA and used to deny credit or charge more for it. This notice must inform consumers of their right to make a written request for the reasons for the adverse action, and then must disclose the nature of such information. Section 615(b) should apply to alternative data used for credit decisionmaking even if it somehow escapes the definition of a consumer report.

2. Equal Credit Opportunity Act (ECOA)

If alternative data is used for credit, there will be implications under the ECOA. Like the FCRA, the ECOA is a statute with a broad scope. It prohibits discrimination "with respect to any aspect of a credit transaction" on the basis of, *inter alia*, race, color, religion, national origin, sex or marital status, or age. 15 U.S.C. § 1691(a). "Credit" is broadly defined, as is the concept of "creditor," which is not limited to banks or traditional lenders. 15 U.S.C. § 1691a(d) and (e). Finally, the ECOA is not limited to consumer credit but applies to certain types of business credit as well.

Most importantly for our purposes, Regulation B, which implements the ECOA, expressly notes that "legislative history of the Act indicates that the Congress intended an 'effects test' concept … be applicable to a creditor's determination of creditworthiness." 12 C.F.R. § 1002.6(a). The effects test is another name for the disparate impact test, and the Official Staff Interpretations explain that the test:

> may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact.

Official Interpretations of Reg. B, 12 C.F.R. pt. 1002, supp. I, § 1002.6(a)-2.[48]

48. *See generally* National Consumer Law Center, Credit Discrimination § 4.3 (6th ed. 2013), updated at www.nclc.org/library.

As discussed in both Section C above and in Section G below, much of the data used for credit decisionmaking will have a disparate impact on protected classes. Thus, lenders must be extremely cautious in using any alternative data given the effects test. This test has a three-step analysis, which teasing out the Official Staff Interpretation quoted above, consists of:

1. Does the practice have a disproportionately negative impact on a protected class even if appears neutral on its face?
2. If so, does the practice meet a legitimate business need?
3. Can the same need be reasonably achieved using a less discriminatory alternative?

Like the FCRA, the ECOA also has specific notice requirements. It requires creditors to notify consumers of the action on an application. 15 U.S.C. § 1691(d)(1). If the creditor takes an adverse action, it must provide either a statement of reasons for the action or written notification of the right to such a statement. 15 U.S.C. § 1691(d)(2). This notice must be specific, and must meet the requirements of Regulation B and its corresponding Official Staff Interpretations.[49]

G. ALTERNATIVE DATA, STRUCTURAL RACISM, AND REACHING FOR EQUITY

> "If we can agree that racialized wealth disparities are, in fact, unjust, then simply leaving these disparities alone to perpetuate themselves indefinitely is not an option. This is true regardless of whether there are currently racist policies creating wealth disparities, or whether the disparities, because of how wealth functions in a capitalist economy, are perpetuating themselves."
>
> – john a. powell, "Understanding Structural Racialization"[50]

It is very likely that most alternative data sources will have a disparate impact. This is because our society itself is deeply imbued with racial disparities. As Congressman John Lewis has noted "The scars and stains of

49. Reg. B, 12 C.F.R. § 1002.9(b)(2); Official Interpretations of Reg. B, 12 C.F.R. pt. 1002, supp. I, § 1002.9(b)(2). *See generally* National Consumer Law Center, Credit Discrimination § 10.5.4.2 (6th ed. 2013), *updated at* www.nclc.org/library.
50. Clearinghouse Review - Journal of Poverty Law and Policy, at 149, September–October 2013.

racism are still deeply embedded in the American society."[51] This extends to credit scoring itself, which has stunning racially disparate impacts.[52]

As discussed more in one of our Policy Briefs,[53] the explanation for these disparities lies in the aftereffects of historical inequalities and the racial wealth gap. African American families own less than seven cents for every dollar in wealth owned by white families, while Latino households own less than eight cents for every dollar of white wealth. With fewer assets to draw on, people of color – and the friends and family to whom they might turn – are far less able to cushion the blows of financial catastrophes, such as job losses, income reductions, sickness, or unplanned expenses.

Despite the fact that credit scoring has a disparate impact, it is also predictive. That is why it is legal under the ECOA – there is a legitimate business need for credit scoring given its predictiveness.

Thus, any alternative data will need to pass this same test of legitimate business need, because any alternative data will almost certainly exhibit racial disparities. Credit scores are not unique is showing economic disparities by race. Inequality is ingrained in many, if not, most of the social and political institutions and practices in our society. This is due to the phenomenon of "structural racism," the idea that:

> public policies, institutional practices, cultural representations, and other norms work in various, often reinforcing ways to perpetuate racial group inequity. … Structural racism is not something that a few people or institutions choose to practice. Instead it has been a feature of the social, economic and political systems in which we all exist.[54]

In other words, systems replicate themselves, and racism is a system that keeps perpetuating itself long after individual animus-driven bias has eroded over the decades. Structural racism impacts the very foundations

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51. Athena Jones, Selma 50 years later: John Lewis's memories of the march, CNN, March 6, 2015, *available at* http://www.cnn.com/2015/03/06/politics/selma-50-years-john-lewis-bridge-anniversary/.
52. For the past two decades, numerous studies has found that African American and Latino communities have lower credit scores as a group than whites (and Asians, when the data is available). National Consumer Law Center, Past Imperfect: How Credit Scores and Other Analytics "Bake In" Past Discrimination and Perpetuate It, May 2016, *available at* http://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.
53. National Consumer Law Center, Past Imperfect: How Credit Scores and Other Analytics "Bake In" Past Discrimination and Perpetuate It, May 2016, *available at* http://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.
54. The Aspen Institute, Glossary for Understanding the Dismantling Structural Racism/ Promoting Racial Equity Analysis, June 2004, *available at* https://assets.aspeninstitute.org/content/uploads/files/content/docs/rcc/RCC-Structural-Racism-Glossary.pdf.

and institutions of our society – education, income, employment, housing, and criminal justice. This is why all the indicators discussed above – education, employment, income, and assets – exhibit such racial disparities.

Thus, because any economically based data is likely to show racial disparities, the Regulation B test for disparate impact will require a "legitimate business need" to use it for credit decisionmaking purposes. At a minimum, this means the data must be accurate and predictive. But we believe it should be more than just predictive – it should be more predictive than traditional data or should provide more access to credit (not less) to credit invisible or credit impaired consumers, and such credit should be affordably priced.

Also, even if predictive, there is certain data that is troubling because it entrenches and perpetuates inequality in such an obvious and stark way. One obvious example is educational attainment level, which as discussed in Section C.1 is highly correlated with parents' income and education. Another type of data would be the consumer's geographic neighborhood, given the obvious racial and economic segregation in housing in this country. Using these factors would only worsen the already herculean barriers that disadvantaged children face in making economic progress. And beyond race, we know that income and wealth inequality are already increasingly stark; using factors like educational level or neighborhood would just make it worse.

What data would be free of disparate racial impact and would not increase economic inequality? That is the brass ring. What kind of data would be future-looking data and not reproduce the inequality of the past? Bank account data could be promising. It is possible that alternative data and Big Data – used very carefully and judiciously – could have a role in this.

We urge significant research by data scientists, whether from the CFPB or industry or academia, to develop new tools or to adjust the current tools to account for discrimination. We also urge research as to whether the data models, whether traditional or alternative, could be programmed to reduce racial and economic disparities while maintaining – and hopefully, improving – predictiveness. Models could be refined and modified so as to reduce racial disparities, to create the third prong of the disparate impact test - "a less discriminatory alternative."

Such modifications to create a less discriminatory alternative might need to take race actively into account.[55] But that is not a radical concept. As the late Supreme Court Justice Harry Blackmun once noted, "In order to get beyond racism, we must first take account of race. There is no other way."[56] To address invisibility and disparity, we must look *at* race, not away from it.

never
trust anyone
who says
they do not see color.
this means
to them,
you are invisible.

— from salt. by Nayyirah Waheed

* * *

Thank you for the opportunity to submit these comments and for your work to explore both the benefits and the risks of alternative data and modeling. If you have questions about these comments, please contact Chi Chi Wu at cwu@nclc.org or 617-542-8010.

Respectfully submitted,

National Consumers Law Center
(on behalf of its low income clients)
California Reinvestment Coalition
Consumer Action
Consumers Union
National Association of Consumer Advocates
U.S. PIRG
Woodstock Institute
World Privacy Forum

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55. For example, one modification proposed by researchers would require including minority status as a "control variable" during the development of a credit scoring model. Michael LaCour-Little and Elaine Fortowsky, *Credit Scoring and the Fair Lending Issue of Disparate Impact* in Credit Scoring for Risk Managers: The Handbook for Lenders (Elizabeth Mays ed. South-Western Educational Pub. 2003); Elaine Fortowsky and Michael LaCour-Little, *Credit Scoring and Disparate Impact* (Dec. 2001), *available at* https://www.phil.frb.org/-/media/consumer-credit-and-payments/payment-cards-center/events/conferences/2002/lacourpaper.pdf.
56. University of California Regents v. Bakke, 438 U.S. 265, 98 S. Ct. 2733 (1978).

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National Consumer Law Center, Free Security Freezes Required from Nationwide Consumer Reporting Agencies

Submitted by:
Chi Chi Wu

National Consumer Law Center

1. INTRODUCTION

As a result of the Equifax data breach, Congress included a number of consumer reporting provisions when it passed the "Economic Growth, Regulatory Relief, and Consumer Protection Act" in May 2018.[1] The most significant provision is that Congress added subsection 1681c-1(i) to the FCRA,[2] which requires that the nationwide consumer reporting agencies[3] provide for free security freezes.

2. PLACEMENT OF A SECURITY FREEZE; CONFIRMATION

Upon a consumer's direct request,[4] and after the nationwide CRA receives "proper identification,"[5] a nationwide CRA must freeze access to the consumer's report at no charge.[6] A security freeze means, for purposes of the FCRA, "a restriction that prohibits a consumer reporting agency from disclosing the contents of a consumer report . . . to any person requesting [it]."[7]

The nationwide CRA is subject to strict time limits; the FCRA requires the agency to place the freeze within one business day if the consumer has requested it by toll-free telephone or electronic means, and within three business days if the consumer has sought the freeze by mail.[8] Once the nationwide CRA has placed the freeze, it has five business days to send confirmation of the freeze's placement to the consumer and inform the consumer of the process by which to remove the freeze.[9] The nationwide CRA must also send the information about the consumer's right to opt out of prescreening[10] as set forth in section 1681m(d)(1)(D).[11]

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1. Pub. L. No. 115-174, 132 Stat. 1296 (May 24, 2018).
2. Pub. L. No. 115-174,§ 301(a), codified at 15 U.S.C. § 1681c-1(i).
3. Subsection 1681c-(i) defines "consumer reporting agency" to means "a consumer reporting agency described in [15 U.S.C. § 1681a(p)]," which is also known as a "nationwide" CRA.
4. 15 U.S.C. § 1681c-1(i).
5. As defined in 15 U.S.C. § 1681h(a) and implementing regulations. *See* National Consumer Law Center, Fair Credit Reporting § 3.4.3 (9th ed. 2017), *updated at* www.nclc.org/library.
6. 15 U.S.C. § 1681c-1(i)(2)(A).
7. 15 U.S.C. § 1681c-1(i)(1)(C).
8. 15 U.S.C. § 1681c-1(i)(2)(A)(i), (ii).
9. 15 U.S.C. § 1681c-1(i)(2)(B)(i),(ii)(I).
10. *See* § 7.3.3, supra (discussing prescreening).
11. 15 U.S.C. § 1681c-1(i)(2)(B)(ii)(II). National Consumer Law Center, Fair Credit Reporting § 8.8.2.2 (9th ed. 2017), updated at *www.nclc.org/library* (prescreening opt out notice).

The new security freeze provision also allows for a freeze to be requested on behalf of a "protected consumer," which is a consumer either under the age of 16 years or under the protection of a guardian or conservator.[12] Upon sufficient proof of authority[13] and identification[14] from a protected consumer's representative, a nationwide CRA must place a freeze on the protected consumer's file in much the same way as described above for other consumers.[15] If at the time of the request the agency does not have a file pertaining to the protected consumer, it must create a record for the consumer.[16]

The nationwide CRAs must establish webpages that allow consumers to request a security freeze, initial fraud alert, or extended fraud alert, or to opt-out of prescreening.[17] Furthermore, the FTC is to establish a single webpage that links to each of these webpages at www.identitytheft.gov.[18]

3. REMOVAL AND THAWS

Once placed, a nationwide consumer reporting agency may remove a security freeze only under three circumstances: (1) upon the direct request of the consumer;[19] (2) in the case of protected consumers, upon the direct request of the consumer's representative;[20] or (3) if the security freeze was placed "due to a material misrepresentation of fact" by the consumer[21] or a protected consumer's representative.[22] If the nationwide CRA removes a freeze by reason of a material misrepresentation of fact, it must notify the consumer or a protected consumer's representative in writing before removing it.[23] A nationwide CRA must remove a freeze within one hour

12. 15 U.S.C. § 1681c-1(j)(1).
13. 15 U.S.C. § 1681c-1(j)(1)(F). Such proof includes a court order, a valid power of attorney, a birth certificate, and certain other documents. *Id.*
14. 15 U.S.C. § 1681c-1(j)(1)(G). Such proof can include a social security number or a copy of a social security card, birth certificate, or driver's license. *Id.*
15. 15 U.S.C. § 1681c-1(j)(2).
16. 15 U.S.C. § 1681c-1(j)(2)(C).
17. 15 U.S.C. § 1681c-1(i)(6)(A).
18. 15 U.S.C. § 1681c-1(i)(6)(B).
19. 15 U.S.C. § 1681c-1(i)(3)(A).
20. 15 U.S.C. §1681c-1(j)(4). Protected consumers can themselves request removal after they reach 16 years of age. *Id.* at § 1681c-1(j)(4)(A)(ii).
21. 15 U.S.C. § 1681c-1(i)(3)(A)(ii).
22. 15 U.S.C. § 1681c-1(j)(4)(A)(iii).
23. 15 U.S.C. § 1681c-1(i)(3)(B), 15 U.S.C. § 1681c-1(j)(4)(B).

if the agency receives the request through toll-free telephone or electronic means; if by mail, the CRA has three business days.[24]

Consumers (or protected consumers' representatives) can also request a temporary removal of a security freeze, sometimes known as a "thaw," for a period of time specified by the consumer or the representative.[25] The procedures are the same as those for a permanent removal.[26]

4. EFFECT OF A FREEZE; EXEMPTIONS

If a creditor or other third party seeks a consumer report that is frozen and the consumer does not allow access to the report, the creditor may treat the application is incomplete.[27] A nationwide CRA may advise a third party that it has placed a security freeze with respect to a consumer.[28]

The security freeze provision provides for a number of exceptions to the general right to freeze a file, summarized as follows:

- Entities to which a consumer owes a financial obligation for the purposes of account review or collecting on the account;[29]
- Any federal, state, local, private collection, or law enforcement agency, or trial court acting pursuant to a court order, warrant, or subpoena;[30]
- A child support agency acting pursuant to the Social Security Act;[31]
- A federal agency or a state acting to investigate fraud or collect delinquent taxes or unpaid court orders or otherwise fulfilling statutory responsibilities, so long as those responsibilities are consistent with the FCRA's permissible purpose provision;[32]
- A person using credit information for the purposes described in 15 U.S.C. § 1681b(c) (furnishing reports in connection with credit

24. 15 U.S.C. § 1681c-1(i)(3(C) (ordinary consumers), 15 U.S.C. § 1681c-1(j)(4)(C) (requests from a protected consumer 16 or older or a protected consumer's representative).
25. 15 U.S.C. § 1681c-1(i)(3)(E), 15 U.S.C. § 1681c-1(j)(4)(D).
26. 15 U.S.C. § 1681c-1(i)(3)(E), 15 U.S.C. § 1681c-1(j)(4)(D).
27. 15 U.S.C. § 1681c-1(i)(3)(D).
28. 15 U.S.C. § 1681c-1(i)(2)(C).
29. 15 U.S.C. § 1681c-1(i)(4)(A).
30. 15 U.S.C. § 1681c-1(i)(4)(B).
31. 15 U.S.C. § 1681c-1(i)(4)(C).
32. 15 U.S.C. § 1681c-1(i)(4)(D).

or insurance transactions not initiated by a consumer, i.e., prescreening);[33]

- Any entity administering a credit monitoring or similar service to which the consumer has subscribed;[34]
- Any person or entity who is providing the consumer with their file at the consumer's request;[35]
- Any person using the consumer's information in connection with underwriting insurance;[36]
- Any person using the information for employment, tenant, or background screening purposes;[37] and
- Any person using the consumer's information for verifying the consumer's identity for reasons other than the granting of credit, or for investigating fraud.[38]

These exemptions appear to apply only to security freezes that a consumer directly requests, and not to those freezes that a protected consumer's representative requests. Among them, perhaps the most significant are those that mean that a consumer cannot freeze his or her file from potential or current employers, landlords, or insurers, or from those that are seeking the information in connection with prescreening (though consumers do have the right to opt out of such inquiries).[39]

5. NOTICE OF RIGHT TO A FREEZE

Any time a consumer has the right to receive a Summary of Consumer Rights under § 1681g(c), that summary must include a designated notice that describes the consumer's right to obtain a security freeze.[40] The

33. 15 U.S.C. § 1681c-1(i)(4)(E).
34. 15 U.S.C. § 1681c-1(i)(4)(F).
35. 15 U.S.C. § 1681c-1(i)(4)(G).
36. 15 U.S.C. § 1681c-1(i)(4)(H).
37. 15 U.S.C. § 1681c-1(i)(4)(I).
38. 15 U.S.C. § 1681c-1(i)(4)(J).
39. *See* National Consumer Law Center, Fair Credit Reporting § 7.3.3 (9th ed. 2017), *updated at* www.nclc.org/library(discussing prescreening).
40. 15 U.S.C. § 1681c-1(i)(5). *See* National Consumer Law Center, Fair Credit Reporting § 8.2 (9th ed. 2017), *updated at* www.nclc.org/library(discussing the Summary of Consumer Rights).

Consumer Financial Protection Bureau has created a model summary of such a notice.[41]

6. REMEDIES; PREEMPTION

It appears that consumers may bring causes of action for negligent or willful violations of the federal security freeze provision, as nothing in the new provision bars such actions.[42] State laws "with respect to any subject matter regulated by" the new security freeze provisions of section 1681c-1(i) and (j) are preempted.[43] Thus, for example, any state laws that apply security freezes to employment or insurance use of a consumer report are preempted.[44]

41. 83 Fed. Reg. 47027 (Sept. 18, 2018) (interim final rule) (modifying 12 C.F.R. pt. 1022 App. I).
42. 15 U.S.C. §§ 1681n, 1681o.
43. 15 U.S.C. § 1681t(b)(1)(J).
44. *See* National Consumer Law Center, Fair Credit Reporting § 9.4.4 (9th ed. 2017), *updated at* www.nclc.org/library(discussing state security freeze laws); *id.* at Appx. H, *infra* (summary of state security freeze laws).

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Public Records Settlements

Submitted by:
E. Michelle Drake
Berger & Montague, P.C.

EXPERIAN PUBLIC RECORDS SETTLEMENT

http://www.experianpublicrecordsettlement.com/

Settlement Agreement

Long Form Notice

Preliminary Approval Order

Class action settlement of claims that Experian violated the Fair Credit Reporting Act by (1) failing to disclose its third-party vendor from which it obtains its public record information, and (2) reporting inaccurate and out-of-date tax lien and civil judgment information. Settlement provides for injunctive relief in which Experian has agreed to stop reporting the public record information at issue completely for at least 18 months, and when that period ends, Experian will be implementing practice changes to ensure sufficient information is gathered about public records to avoid inaccurate reporting in the future, and Experian will disclose its public records vendor on all consumer file disclosures containing a public record. Settlement also provides individual consumers with the opportunity to file a claim for monetary payment (which is uncapped) if meet certain criteria, and the opportunity to claim a benefit code for two years of free credit monitoring product.

TRANS UNION PUBLIC RECORDS SETTLEMENT

https://www.tupublicrecordsettlement.com/

ADR Program

Settlement Agreement

Long Form Notice

Preliminary Approval Order

Class action settlement of claims that Trans Union violated the Fair Credit Reporting Act by (1) failing to disclose its third-party vendor from which it obtains its public record information, and (2) reporting inaccurate and out-of-date tax lien and civil judgment information. Settlement provides for injunctive relief in which Trans Union has agreed to stop reporting the public record information at issue completely for at least 18 months, and when that period ends, Trans Union will be implementing practice changes to ensure sufficient information is gathered about public records to avoid inaccurate reporting in the future, and Trans Union will disclose its public

records vendor on all consumer file disclosures containing a public record. Settlement also provides for an ADR Program, where individual consumers may file claims to receive a $1,500 payment (or $2,000 if can show that they had disputed an inaccurate Trans Union report), if they meet certain criteria and provide required documentation.

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CFPB v. The Source for Public Data, L.P., 903 F.3d 456 (5th Cir. Sept. 6, 2018)

Submitted by:
E. Michelle Drake

Berger & Montague, P.C.

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903 F.3d 456
United States Court of Appeals, Fifth Circuit.

CONSUMER FINANCIAL PROTECTION BUREAU, Plaintiff – Appellee,
v.
The SOURCE FOR PUBLIC DATA, L.P., Defendant – Appellant.

No. 17-10732
|
September 6, 2018

Synopsis

Background: Consumer Financial Protection Bureau (CFPB) filed petition, seeking to enforce civil investigative demand (CID) issued to provider of public records through internet-based search engine in investigation of whether provider or its users violated the Fair Credit Reporting Act (FCRA). The United States District Court for the Northern District of Texas, David L. Horan, United States Magistrate Judge, 2017 WL 2443135, granted the petition. Provider appealed.

The Court of Appeals, Jennifer Walker Elrod, Circuit Judge, held that CFPB failed to comply with the requirements under Consumer Financial Protection Act (CFPA) before issuing a CID.

Reversed and Rendered.

Procedural Posture(s): On Appeal; Other.

***457** Appeal from the United States District Court for the Northern District of Texas

Attorneys and Law Firms

Kevin E. Friedl, Consumer Financial Protection Bureau General Counsel's Office, Washington, DC, for Plaintiff – Appellee.

Ronald Irvin Raether, Jr., Troutman Sanders, Irvine, CA, Keith Jerrod Barnett, Esq., Troutman Sanders, L.L.P., Atlanta, GA, John Edward Collins, Burleson, Pate & Gibson, L.L.P., Dallas, TX, for Defendant – Appellant.

Allen Hand Denson, Trial Attorney, Rebecca Kuehn, Hudson Cook, L.L.P., Washington, DC, for Amicus Curiae NATIONAL ASSOCIATION OF PROFESSIONAL BACKGROUND SCREENERS.

Before JOLLY, ELROD, and WILLETT, Circuit Judges.

Opinion

JENNIFER WALKER ELROD, Circuit Judge:

The Consumer Financial Protection Bureau issued a civil investigative demand (CID) to the Source for Public Data, Inc., a company that provides public records to the public through an Internet-based search engine. Public Data objected to the CID for, among other things, failing to comply with the statute authorizing the CFPB to issue these demands. The CFPB eventually filed a petition to enforce the CID, and the district court granted the petition. Because the CFPB did not comply with the governing statute when it issued the CID, we now REVERSE and RENDER.

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I.

Congress created the CFPB to "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws." 12 U.S.C. § 5491(a). One of the CFPB's "primary functions" is to "supervis[e] covered persons for compliance with Federal consumer financial law, and tak[e] appropriate enforcement action to address violations of Federal consumer financial law[.]" *Id.* § 5511(c)(4). The CFPB may issue CIDs to "any person" whom the CFPB "has reason to believe" may have documents, tangible things, or information "relevant to a violation." *Id.* § 5562(c)(1). Each CID must "state the nature of the conduct constituting the alleged violation which is under investigation and the provision of law applicable to such violation." *Id.* § 5562(c)(2). This is known as the "notification of purpose." 12 C.F.R. § 1080.5. If a recipient does not comply with the CID, the CFPB may file a petition in federal court to enforce it. 12 U.S.C. § 5562(e)(1).

***458** The CFPB issued a CID to Public Data. The CID's "Notification of Purpose" read:

> The purpose of this investigation is to determine whether consumer reporting agencies, persons using consumer reports, or other persons have engaged or are engaging in unlawful acts and practices in connection with the provision or use of public records information in violation of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681, et. seq., Regulation V, 12 C.F.R. Part 1022, or any other federal consumer financial law. The purpose of this investigation is also to determine whether Bureau action to obtain legal or equitable relief would be in the public interest.

The CID required Public Data to produce documents, provide answers to interrogatories, and produce a written report.

During a meet-and-confer with the CFPB, Public Data asserted that the Notification of Purpose was inadequate. It also insisted that the CFPB did not have jurisdiction over Public Data. Public Data then filed a petition with the CFPB to set aside the CID. The CFPB's Director denied the petition in a written order. Public Data confirmed with the CFPB that it did not intend to comply, so the CFPB filed a petition in federal court seeking an order to enforce the CID.

The district court granted CFPB's petition. It rejected Public Data's argument that the CID failed to provide fair notice of the violation under investigation as required by 12 U.S.C. § 5562(c)(2). The district court also rejected Public Data's argument that the CID should be quashed because the CFPB lacked jurisdiction. Accordingly, the district court ordered Public Data to respond to the CID, but this court granted a stay pending the resolution of this appeal. [1]

II.

We review a subpoena enforcement order for abuse of discretion. *United States v. Zadeh*, 820 F.3d 746, 751 (5th Cir. 2016). "We review the district court's conclusions of law underlying its decision to enforce the subpoena *de novo*, and its factual findings for clear error." *Id.*

III.

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An administrative agency's authority to issue subpoenas is a creature of statute. *Consumer Fin. Prot. Bureau v. Accrediting Council for Indep. Colleges & Schs. (ACICS)*, 854 F.3d 683, 690 (D.C. Cir. 2017). Section 5562(c)(2) requires that a civil investigative demand identify both: (1) "the nature of the conduct constituting the alleged violation which is under investigation;" and (2) "the provision of law applicable to such violation." This statutory requirement "ensures that the recipient ... is provided with fair notice as to the nature of the Bureau's investigation." *ACICS*, 854 F.3d at 690.

The CFPB did not comply with 12 U.S.C. § 5562(c)(2) when it issued this CID to Public Data. First, it did not state the "conduct constituting the alleged violation which is under investigation." According to its Notification of Purpose, the CFPB is investigating "unlawful acts and practices in connection with the provision or use of public records information." Simply put, this Notification of Purpose does not identify what conduct, it believes, constitutes an alleged violation. Providing and using public records are not violations of federal law, and the CFPB fails to explain how these activities violate federal consumer law.

Moreover, this CID does not identify "the provision of law applicable to such ***459** violation." As discussed, the CID never identifies an alleged violation, so it is unsurprising that it fails to identify a relevant provision of law. Rather, the Notification of Purpose refers to the Fair Credit Reporting Act, an expansive law governing all activities relating to the reporting of consumers' credit information. Such a reference to a broad provision of law that the CFPB has authority to enforce does nothing to clarify what conduct is under investigation. Then, the Notification of Purpose states that the CFPB is investigating the violation of "any other federal consumer financial law." Such an uninformative catch-all phrase defeats any specificity provided by the reference to the FCRA.[2] *See* *ACICS*, 854 F.3d at 691–92 ("The inclusion of the uninformative catch-all phrase 'any other Federal consumer financial protection law' does nothing to cure the CID's defects.").

The D.C. Circuit recently rejected a CID like this one. *See* *ACICS*, 854 F.3d at 689–92. The D.C. Circuit observed that the CFPB failed to explain what "the broad and non-specific term 'unlawful acts and practices' mean[t] in this investigation." *Id.* at 690. Such an observation applies in equal force to our case. As to the applicable law, the Notification of Purpose referenced 12 U.S.C. §§ 5531 and 5536, as well as "any other Federal consumer financial protection law," and the D.C. Circuit held that "framing the applicable law in such a broad manner does not satisfy Congress's clear directive" spelled out in 18 U.S.C. § 5562(c)(2). *Id.* at 691–92. Accordingly, it determined that the CFPB failed to comply with the statutory requirements of 18 U.S.C. § 5562(c)(2).

There are consequences to the "absurdity of giving a notification that notifies of no purpose whatsoever." *Consumer Fin. Prot. Bureau v. Heartland Campus Sols., ECSI,* No. 18-1516, —— Fed.Appx. ——, ——, 2018 WL 3831444, at *6 (3d Cir. Aug. 13, 2018) (Rendell, J., dissenting). Applying our "reasonable relevance" standard, courts will enforce an administrative subpoena if: "(1) the subpoena is within the statutory authority of the agency; (2) the information sought is reasonably relevant to the inquiry; and (3) the demand is not unreasonably broad or burdensome." *Zadeh*, 820 F.3d at 755 (quoting *United States v. Transocean Deepwater Drilling, Inc.*, 767 F.3d 485, 488 (5th Cir. 2014)). Because the CID issued to Public Data fails to identify the conduct under investigation or the provision of law at issue, we cannot review it under our "reasonable relevance" standard. And if a court cannot exercise meaningful judicial review, a CID recipient has no opportunity to challenge an agency's investigatory authority. For instance, we cannot evaluate whether the CFPB requests information that is reasonably relevant to the CFPB's inquiry because we do not know what the inquiry actually is. Likewise, we cannot assess whether the CFPB's demand is "unreasonably broad or burdensome." Presumably, it would be reasonable for the CFPB to demand more information from a target of an investigation than a third party, but this Notification of Purpose does not indicate whether Public Data or one of its clients is the target of the investigation. As the D.C. Circuit observed, "[b]ecause the validity of a CID is measured by the purposes stated in

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the notification of purpose, the adequacy of the notification of purpose is an important ***460** statutory requirement." *ACICS*, 854 F.3d at 690 (internal citation omitted).

Simply put, the CFPB does not have "unfettered authority to cast about for potential wrongdoing." *In re Sealed Case (Admin. Subpoena)*, 42 F.3d 1412, 1418 (D.C. Cir. 1994). As such, it must comply with statutory requirements, and here it did not.

IV.

For the reasons above, we hold that the CFPB failed to advise Public Data of "the nature of the conduct constituting alleged violation which is under investigation and the provision of law applicable to such violation." 12 U.SC. § 5562(c)(2). Accordingly, we REVERSE and RENDER. [3]

All Citations

903 F.3d 456

Footnotes

1 According to the parties, this case does not implicate the issues raised in *PHH Corporation v. Consumer Financial Protection Bureau*, 881 F.3d 75 (D.C. Cir. 2018) (en banc).

2 This catch-all would presumably include the Interstate Land Sales Full Disclosure Act, Equal Credit Opportunity Act, the Fair Credit Billing Act, the Truth in Lending Act, the Truth in Savings Act, the Consumer Leasing Act of 1976, the Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act of 1975, just to name a few. *See* 12 U.S.C. § 5481(12); (14).

3 Because we reverse the district court's order based on the CFPB's failure to comply with 12 U.S.C. § 5562(c)(2), we need not address Public Data's other argument that the district court erred when it declined to address whether the CFPB has jurisdiction over Public Data.

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NOTES

NOTES

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CFPB v. The Source for Public Data, LP, 2017 WL 2443135 (N.D. Tex. June 6, 2017)

Submitted by:
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KeyCite Red Flag - Severe Negative Treatment
Reversed by Consumer Financial Protection Bureau v. Source for Public Data, L.P., 5th Cir.(Tex.), September 6, 2018

2017 WL 2443135
Only the Westlaw citation is currently available.
United States District Court, N.D. Texas, Dallas Division.

CONSUMER FINANCIAL PROTECTION BUREAU, Petitioner,
v.
The SOURCE FOR PUBLIC DATA, LP, Respondent.

No. 3:17-mc-16-G-BN
|
Signed 06/06/2017

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER

DAVID L. HORAN, UNITED STATES MAGISTRATE JUDGE

***1** The Consumer Financial Protection Bureau has filed a Petition to Enforce Civil Investigative Demand. *See* Dkt. No. 1. Senior United States District Judge A. Joe Fish referred this petition to the undersigned United States magistrate judge for determination under 28 U.S.C. § 636(b). *See* Dkt. No. 5.

As the petition explains,

> [o]n January 5, 2017, the Consumer Financial Protection Bureau (Bureau) issued a civil investigative demand (CID) to The Source for Public Data, L.P. (Public Data). The CID was issued as part of a nonpublic investigation to determine whether consumer reporting agencies, persons using consumer reports, or other persons have engaged or are engaging in unlawful acts and practices in connection with the provision or use of public records information in violation of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681 et seq., Regulation V, 12 C.F.R. Part 1022, or any other federal consumer financial law. The CID required Public Data to produce documents and provide answers to interrogatories and a written report by February 16, 2017.
>
> On January 25, 2017, pursuant to the Bureau's rules, Public Data filed a petition to set aside or modify its CID. The Bureau denied the petition on February 14, 2017, and the Bureau served the order on Public Data on February 16, 2017. That order directed Public Data to comply with the CID within 10 calendar days. The order also invited Public Data to engage in further discussions with Bureau staff about modifying the CID.
>
> Public Data has not complied with the CID. Accordingly, the Bureau petitions this Court for an order requiring Public Data to comply with its CID.

Dkt. 1 at 1-2. More specifically, the Bureau's petition asks the Court to enter "[a]n order directing Public Data to show cause why it should not be required to comply with the CID" and, "[a]fter Public Data's response to the order to show cause, an order directing Public Data to comply with the CID within ten days of the order or at a later date as may be established by the Court or the Bureau." *Id.* at 3; *see also* Dkt. No. 2 at 5-6.

"In support of this petition, the Bureau has filed a memorandum of law with exhibits [Dkt. No. 2], including the Declaration of Erin Mary Kelly," who is "an Enforcement Attorney in the Consumer Financial Protection Bureau's (Bureau) Office of Enforcement" and "the lead attorney on an investigation to determine whether consumer reporting agencies, persons using consumer reports, or other persons have engaged or are engaging in unlawful acts and practices in connection with the provision or use of public records information in violation of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681 et seq., Regulation V, 12 C.F.R. Part 1022, or any other 'Federal consumer financial law' as defined by 12 U.S.C. § 5481(14)." Dkt. No. 2-1 at 1.

The Court issued an Order to Show Cause, and Public Data filed a response, *see* Dkt. No. 15, and a notice of supplemental authority in support of its opposition to the petition, *see* Dkt. No. 17, and the Bureau has filed a reply, *see* Dkt. No. 16.

***2** The Court held a show cause hearing on April 26, 2017, at which the Bureau's counsel and Public Data's counsel appeared. *See* Dkt. Nos. 20, 24.

After the hearing, the Bureau filed a Notice of Supplemental Authority. *See* Dkt. No. 21. Public Data filed a response, *see* Dkt. No. 22, and the Bureau filed a reply, *see* Dkt. No. 23. The Bureau subsequently filed a Second Notice of Supplemental Authority. *See* Dkt. No. 25.

For the reasons and to the extent explained below, the Court GRANTS the Bureau's Petition to Enforce Civil Investigative Demand [Dkt. No. 1].

Background

The Bureau's petition explains that

> [o]n January 5, 2017, the Bureau issued a CID to Public Data, a company that purchases or obtains public records from governmental entities and provides its users with access to these records via an internet website for a fee. The Bureau issued the CID as part of its investigation into possible violations of the Fair Credit Reporting Act (FCRA), 15 U.S.C. §§ 1681 *et seq.*, Regulation V, 12 C.F.R. Part 1022, or any other federal consumer-financial laws. The CID requires Public Data to respond to fifteen document requests, fourteen interrogatories, and one written-report request.
>
> On January 25, 2017, Public Data petitioned the Bureau to set aside the CID (Petition). The Bureau denied the Petition on February 14, 2017, issuing an order that directed Public Data to produce "all responsive documents, items, and information within its possession, custody, or control that are covered by the CID" within 10 days. The order also invited Public Data to engage in further discussions with Bureau staff about modifying the CID. The Bureau served the order on Public Data on February 16, 2017.
>
> Public Data has not responded to any of the CID requests. On March 6, 2017, Bureau counsel conferred with counsel for Public Data, Keith Barnett of Troutman Sanders, LLP. Counsel stated that Public Data did not intend to comply with the Bureau's CID. As of March 6, 2017, Public Data has not complied with the CID.
>
> ....

> The law is well-settled that administrative agencies should be given wide latitude in exercising their power to investigate by subpoena, including investigating by CID. It is also well-settled that the requirements for judicial enforcement are minimal. As a general rule, courts will enforce an administrative subpoena if (1) the subpoena is within the statutory authority of the agency, (2) the information sought is reasonably relevant, and (3) the demand is not unreasonably broad or burdensome. These three criteria are readily met here.

Dkt. No. 2 at 2, 3 (footnotes omitted).

The Bureau asserts that

> [t]he Consumer Financial Protection Act of 2010 (CFPA) gives the Bureau authority to issue CIDs and to enforce them in federal district court. CIDs are a type of investigative, administrative subpoena. The Bureau may initiate a proceeding to enforce a CID by filing a petition to the federal district court where the CID recipient "resides, is found, or transacts business" for an order to enforce the CID. Because the Bureau has authority to issue the CID, and the Court has authority to enforce it, the Bureau respectfully requests that this Court order Public Data to show cause as to why it should not be required to comply with the CID and, thereafter, enter an order requiring compliance.
>
> ***3** ....
>
> [T]he CID falls squarely within the Bureau's authority. The CFPA broadly authorizes the Bureau to investigate violations of federal consumer-financial laws, including the Fair Credit Reporting Act and Regulation V, and to issue a CID to "any person" the Bureau "has reason to believe ... may be in possession, custody, or control of ... any information, relevant to a violation." Here, the Bureau followed all applicable procedural requirements for the issuance of a CID. The CID was issued by a Deputy Assistant Director of the Office of Enforcement and included a Notification of Purpose advising Public Data of the nature of the conduct being investigated. The CID was served by a Bureau investigator on Public Data's registered agent via certified US Mail, return receipt requested. The CID seeks information to determine whether consumer reporting agencies, persons using consumer reports, or other persons have engaged or are engaging in unlawful acts and practices in connection with the provision or use of public records information in violation of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681 *et seq.*, Regulation V, 12 C.F.R. Part 1022, or any other federal consumer financial law. Such an investigation is plainly an acceptable use of the Bureau's authority under the CFPA. Moreover, it is well-settled that "agencies should remain free to determine, in the first instance, the scope of their own jurisdiction when issuing investigative subpoenas." An agency such as the Bureau "has a power of inquisition ... [and] can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not."
>
> Second, the information the Bureau seeks is relevant and material to its investigation. Courts traditionally give wide latitude in determining relevance in the context of an administrative subpoena, which must be enforced if the information sought could be pertinent to a legitimate agency inquiry. An agency request is relevant as long as it is "not plainly incompetent or irrelevant to any lawful purpose" of the agency. Here, the Bureau seeks materials as part of its investigation into whether the FCRA, Regulation V, and other federal consumer-financial laws have been violated in connection with the provision or use of public records information. Each request in the CID relates to Public Data's role in use or provision of public records. The information the Bureau seeks is relevant and material to the Bureau's inquiry into whether the laws the Bureau enforces have been violated in connection with the provision or use of public records information. Among other information, the Bureau has requested information about Public Data's: operations and structure; the products and services it offers; form contracts with its users; policies and procedures; data collection relating to the use or provision of public records information; databases and systems used in the provision of public records information; and information regarding consumer disputes about public records information.
>
> ***4** Finally, the CID is not overly broad or unduly burdensome. The Bureau met with Public Data on January 17, 2017 for a meet-and-confer to discuss any possible modifications to the CID. Public Data did not make any specific requests

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> to modify the requests, nor did it claim that the CID was overly burdensome. The Bureau fashioned the requests specifically to determine whether consumer reporting agencies, persons using consumer reports, or other persons may have violated the FCRA or other federal consumer-financial laws. The Bureau focused the requests on materials that should be readily producible and Public Data does not contend otherwise. Further, when the Bureau Director denied Public Data's Petition to Modify the CID, the order invited Public Data to engage with the Enforcement team to suggest modifications. To date, Public Data has not asked for any changes to reduce the breadth or burden of responding to the CID.

Dkt. No. 2 at 1, 3-5 (footnotes omitted).

In opposition to the petition, Public Data provides its own procedural history:

> On January 5, 2017, the CFPB mailed its improperly issued CID to Public Data. The CID was received by Public Data on January 9, 2017. The CID provided the following inadequate and nonspecific Notification of Purpose under 12 C.F.R. § 1080.5:
>
> > The purpose of this investigation is to determine whether consumer reporting agencies, persons using consumer reports, or other persons have engaged or are engaging in unlawful acts and practices in connection with the provision or use of public records information in violation of the Fair Credit Reporting Act, 15 U.S.C. § 1681, et seq., Regulation V, 12 C.F.R. Part 1022, or any other federal consumer financial law. The purpose of this investigation is also to determine whether Bureau action to obtain legal or equitable relief would be in the public interest.
>
> On January 17, 2017, Public Data's attorney met and conferred with the CFPB via teleconference about the defective CID in accordance with 12 C.F.R. § 1080.6(c). At this conference, Public Data's counsel advised the CFPB that it lacked jurisdiction over Public Data, that the Notification of Purpose stated in the CID was inadequate, and that the CID was grossly overbroad, especially since Public Data was not a CRA. Public Data also inquired into the factual basis for the CFPB's investigation as it had not received any client or employee complaints, and was unaware of any other grounds for such an invasive and sweepingly broad investigation. The CFPB refused to provide any substantive response and further would not consider any modifications to or narrowing of the CID. Accordingly, Public Data informed that it would be filing a petition to modify or set aside the CID, which it subsequently submitted on January 25, 2017.
>
> On February 16, 2017, the CFPB's Director denied Public Data's Petition, seemingly as a matter of course, and issued a short, approximately three-page boilerplate decision and order directing Public Data to simply comply with the CID. On March 6, 2017, the CFPB conferred with Public Data's counsel who advised that Public Data would not comply with the CFPB's improperly issued CID.
>
> On March 6, 2017, the CFPB filed the instant Petition to enforce the CID against Public Data.

Dkt. No. 15 at 7-8.

Public Data asserts that the Bureau

> improperly issued an unwarranted and extremely invasive Civil Investigative Demand ("CID") to Respondent, The Source for Public Data, L.P. ("Respondent" or "Public Data"), seeking information on all of Public Data's employees, contractors, clients, databases, confidential and proprietary technologies, policies, procedures, products, and services, as well as its parent and related companies and subsidiaries.
>
> However, to date, the CFPB has provided no reason or justification for issuing the sweepingly overbroad and thus burdensome CID. Public Data has requested that the CFPB provide any legal or factual basis for imposing such an

enormous burden on Public Data's business, but the CFPB has refused to do so. The CFPB has not informed Public Data of any complaints filed against it (which the CFPB would generally disclose), and Public Data is not aware of any complaints or other grounds that would support the instant investigation, let alone the involvement of the CFPB which does not even have jurisdiction over Public Data. *See, e.g.*, *U.S. v. Morton Salt Co.*, 338 U.S. 632, 652 (1950) (CIDs should not be enforced if they demand information that is (a) not "within the authority of the agency," (b) "too indefinite," or (c) not "reasonably relevant to the inquiry.").

***5** The only explanation provided to date is the vague and incomplete Notice of Purpose included by the CFPB in its CID stating that the investigation relates to the CFPB's jurisdiction under the Fair Credit Reporting Act ("FCRA") or "any other federal consumer financial law." The CFPB, however, fails to recognize Public Data is not subject to the FCRA, and therefore the CFPB does not have jurisdiction over Public Data. Indeed, the U.S. District Court for the Southern District of Texas has already ruled that Public Data is not a consumer reporting agency ("CRA") and therefore Public Data is not subject to the FCRA. *Wilson v. The Source for Public Data, L.P.*, 4:12-cv-00185 (S.D. TX. 2013), Memorandum and Order (Dkt. No. 36). Specifically, the District Court in *Wilson* granted Public Data's Motion for Summary Judgment, after substantial discovery had been conducted in the case, finding that Public Data simply generates search results and does not have or prepare any consumer "files" subject to the FCRA. *Id.* at p. 8. Indeed, Public Data does not create, use, or maintain consumer reports or files, nor does it provide or participate in the provision of any financial product or service. Instead, Public Data is essentially a "Google-like" search engine for public records, no different from the access that courts provide to records through Pacer and the like. If Public Data is governed by the FCRA, then so too is Pacer and any other web-based access point offered by government agencies —a result clearly not intended by Congress. As such, there is no basis on which the CFPB may exercise jurisdiction over Public Data under either the FCRA or any other "federal consumer financial law."

Public Data has repeatedly advised the CFPB of these facts and of the U.S. District Court precedent. The CFPB still maintains, without any legal authority or further explanation, that it may nevertheless exercise unlimited jurisdiction over Public Data. The CFPB has completely failed to address this threshold issue in its Petition, and has not presented any evidence, argument, or other authority as to why the CFPB can ignore the *Wilson* court's holding that Public Data is not subject to the FCRA. Public Data's public records search functions have not materially changed since the court's holding in *Wilson*, thus the finding still holds true. The CFPB's Petition should be denied for this reason alone.

Notwithstanding the above jurisdictional defects, even if the CFPB could somehow exercise jurisdiction, the CID is fundamentally defective. The CID fails to adequately state the nature of the conduct underlying the investigation into Public Data as required by statute and is therefore too indefinite. *Morton Salt*, supra, 338 U.S. at 652 (CIDs should be quashed if "too indefinite.") The CID's requests are also grossly overbroad and demonstrate a misunderstanding of the nature of Public Data's business. Because Public Data is not a CRA, the requests which assume Public Data is a CRA are fundamentally flawed and are not reasonably relevant to any authorized inquiry.

Ultimately, this is an action involving the clear over-stepping of a federal agency outside the boundaries of its established authority. The CFPB's Petition and supporting memorandum concede this fact as not a single sentence therein substantively addresses the above-referenced issues, all of which were raised in the parties' prior meet and confer conference as well as in Public Data's prior Petition to Set Aside or Modify the CID. Instead, the CFPB's petition is comprised of only boilerplate and conclusory contentions that insist, without any legal or factual support or analysis, that Public Data must simply defer to the CFPB's authority and comply with the CID. This is not the law, especially in light of the U.S. District Court's holding in *Wilson* that Public Data is not subject to the FCRA. *Wilson*, supra, 4:12-cv-00185 (S.D. TX. 2013). For these reasons, the CID was improperly issued and the Petition to enforce the CID must be denied.

Id. at 1-3 (emphasis removed).

The Bureau replies that

> [t]he question before the Court is whether to enforce the Bureau's civil investigative demand (CID). Respondent argues that the CID is unenforceable, primarily by raising premature substantive defenses about the Bureau's authority to enforce consumer protection laws against it—an issue that is irrelevant to the Court's inquiry. The Bureau may issue a CID to any person to gather facts to inform itself about whether unlawful conduct has occurred and whether the Bureau should take action to address it. Because the CID meets the applicable standard, and the Bureau's jurisdiction is not "plainly lacking," the Court should enforce the CID.

***6** Dkt. No. 16 at 1.

In a notice of supplemental authority, Public Data submitted a copy of a decision of the United States Court of Appeals for the District of Columbia in *Consumer Financial Protection Bureau v. Accrediting Council for Independent Colleges and Schools (ACICS)*, 854 F.3d 683 (D.C. Cir. 2017), and argued that, where "the Court of Appeals affirmed the District Court's denial of the CFPB's Petition to enforce a civil investigative demand ('CID') issued against ACICS" and "noted that the CID's 'Notification of Purpose' did not comply with the governing statute, 12 U.S.C. § 5562(c)(2), and that it 'fail[ed] to state adequately the unlawful conduct under investigation or the applicable law,' " and where "[t]he CFPB's defective Notification of Purpose in the *ACICS* CID is essentially identical to its Notification of Purpose in the CID in this action directed to Public Data," "the D.C. Circuit Court of Appeals' Opinion in the *ACICS* case supports its Opposition to the CFPB's Petition to enforce the CID in this action, and the CFPB's Petition should be denied in its entirety." Dkt. No. 17 at 1-2.

Legal Standards

The United States Court of Appeals for the D.C. Circuit very recently summarized the statutory background of a petition by the Bureau to enforce a civil investigative demand:

> Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") in the wake of the financial crisis of 2008 and 2009. *State Nat'l Bank of Big Spring v. Lew*, 795 F.3d 48, 51 (D.C. Cir. 2015) (citing Pub. L. No. 111-203, 124 Stat. 1376 (2010)). Title X of the Dodd-Frank Act—the Consumer Financial Protection Act ("CFPA")—established the Consumer Financial Protection Bureau to "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws," 12 U.S.C. § 5491(a), and "to implement and ... enforce Federal consumer financial law," *id.* § 5511(a); *see also id.* §§ 5492(a), 5511(b)-(c). The "Federal consumer financial law" that the CFPB enforces includes the CFPA and eighteen pre-existing consumer protection statutes. *Id.* § 5481(12), (14); *Morgan Drexen, Inc. v. CFPB*, 785 F.3d 684, 686–87 (D.C. Cir. 2015). Relevant to our analysis, the CFPA prohibits "unfair, deceptive, or abusive act[s] or practice[s] under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service." 12 U.S.C. § 5531(a); *see also id.* § 5536(a)(1)(B). "Consumer financial product[s] or service[s]" include consumer loans and debt collection activities. *See id.* § 5481(5), (15).
>
> The CFPA vests the Bureau with broad "rulemaking, supervisory, investigatory, adjudicatory, and enforcement authority...." *Morgan Drexen*, 785 F.3d at 687 (citing 12 U.S.C. §§ 5512(b), 5514-5516, 5562-5564). One of the CFPB's "primary functions" is to "supervis[e] covered persons for compliance with Federal consumer financial law, and tak[e] appropriate enforcement action to address violations of Federal consumer financial law[.]" 12 U.S.C. § 5511(c)(4). Pursuant to its investigative authority, the Bureau may issue CIDs requiring the production of documents

and oral testimony from "any person" that it believes may be in possession of "any documentary material or tangible things, or may have any information, relevant to a violation" of the laws that the Bureau enforces. *Id.* § 5562(c)(1); *see also* 12 C.F.R. § 1080.6. CIDs allow the Bureau to investigate and collect information "before the institution of any proceedings." 12 U.S.C. § 5562(c)(1). Each CID must "state the nature of the conduct constituting the alleged violation which is under investigation and the provision of law applicable to such violation." *Id.* § 5562(c)(2); see also 12 C.F.R. § 1080.5. Because "CIDs are not self-enforcing," *John Doe Co. v. CFPB*, 849 F.3d 1129, 1131 (D.C. Cir. 2017), the CFPB must file a petition in federal court to enforce a CID if a recipient refuses to comply, 12 U.S.C. § 5562(e)(1).

***7** *Consumer Fin. Prot. Bureau v. Accrediting Council for Indep. Colleges & Sch.*, 854 F.3d 683, 687-88 (D.C. Cir. 2017) ("*ACICS*"). More fully, 12 U.S.C. § 5562(c)(1) provides that, "[w]henever the Bureau has reason to believe that any person may be in possession, custody, or control of any documentary material or tangible things, or may have any information, relevant to a violation, the Bureau may, before the institution of any proceedings under the Federal consumer financial law, issue in writing, and cause to be served upon such person, a civil investigative demand requiring such person to—(A) produce such documentary material for inspection and copying or reproduction in the form or medium requested by the Bureau; (B) submit such tangible things; (C) file written reports or answers to questions; (D) give oral testimony concerning documentary material, tangible things, or other information; or (E) furnish any combination of such material, answers, or testimony." The courts—and the parties here—"have treated CIDs as a form of administrative subpoena." *ACICS*, 854 F.3d at 688.

"Under the 'reasonable relevance' standard, courts will enforce an administrative subpoena issued in aid of an investigation if: '(1) the subpoena is within the statutory authority of the agency; (2) the information sought is reasonably relevant to the inquiry; and (3) the demand is not unreasonably broad or burdensome.' " *United States v. Zadeh*, 820 F.3d 746, 755 (5th Cir. 2016) (quoting *United States v. Transocean Deepwater Drilling, Inc.*, 767 F.3d 485, 488 (5th Cir. 2014) (footnote omitted)). In previously affirming a district court's decision to enforce an administrative subpoena, the United States Court of Appeals has "noted that [t]he court's inquiry is limited to two questions: (1) whether the investigation is for a proper purpose and (2) whether the documents the agency seeks are relevant to the investigation, essentially a tracking of the reasonable relevance standard." *Id.* at 756 (internal quotation marks and footnote omitted).

The Fifth Circuit "has consistently recognized the summary nature of administrative subpoena enforcement proceedings, and has made clear that when reviewing an administrative subpoena, the court plays a strictly limited role. The government need only make a prima facie showing under the reasonable relevance standard, at which point the party opposing enforcement bears the heavy burden of demonstrating that the government has not met this standard." *Zadeh*, 820 F.3d at 757 (internal quotation marks and footnotes omitted). "The burden on the government ... can be fulfilled by a simple affidavit of an agent involved in the investigation." *Id.* at 757-58 (internal quotation marks and footnote omitted). Thus, " '[i]t is settled that the requirements for judicial enforcement of an administrative subpoena are minimal.' " *United States v. Chevron U.S.A., Inc.*, 186 F.3d 644, 647 (5th Cir. 1999) (quoting *Burlington Northern Railroad Co. v. Office of Inspector General, Railroad Retirement Board*, 983 F.2d 631, 637 (5th Cir. 1993)). "Courts will not enforce an administrative subpoena, however, if the above requirements are not met or if the subpoena was issued for an improper purpose, such as harassment." *Burlington Northern*, 983 F.2d at 638.

The Fifth Circuit has explained that "an administrative agency's power to issue subpoenas as it performs its investigatory function is a broad-ranging one which courts are reluctant to trammel. The agency 'has a power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not. When investigative and accusatory duties

are delegated by statute to an administrative body, it, too, may inform itself as to whether there is probable violation of the law.' " *Sandsend Fin. Consultants, Ltd. v. Fed. Home Loan Bank Bd.*, 878 F.2d 875, 878 (5th Cir. 1989) (quoting *United States v. Morton Salt Co.*, 338 U.S. 632, 642 (1950)).

***8** Where the party opposing enforcement contends that the agency had no authority to issue the administrative subpoenas because it lacks jurisdiction, the Fifth Circuit has noted that "[a]n administrative agency's authority is necessarily derived from the statute it administers and may not be exercised in a manner that is inconsistent with the administrative structure that Congress has enacted." *Transocean*, 767 F.3d at 489. But the inquiry focuses on whether the agency has jurisdiction to investigate the subject of the investigation, not the subject of the subpoena. *See id.* at 489-97; *cf.* *Sandsend*, 878 F.2d at 880, 881 ("[12 U.S.C. §] 481 limits only the class of people national bank examiners may examine; it does not, for example, limit the class of people from whom national bank examiners may request documents with a subpoena duces tecum. .... The FHLBB's subpoena power extends to the records of persons who, like Sandsend, are not directly associated with the target of the FHLBB's inquiry.").

Analysis

Public Data opposes enforcement of the CID on four grounds. First, Public Data argues that the Bureau exceeded its statutory authority in issuing the CID. Second, Public Data argues that the Bureau lacks jurisdiction to issue the CID and, specifically, that the Bureau does not have jurisdiction under either the Fair Credit Reporting Act ("FCRA") or any other federal consumer financial law. Third, Public Data argues that the CID must be quashed because it fails to identify the nature of the conduct under investigation as required by statute. Fourth, Public Data argues that the CID should be quashed because it is grossly overbroad. At oral argument, the dispute was narrowed to the issue of whether the Bureau has statutory authority to issue the CID.

An administrative agency's authority to issue subpoenas "is created solely by statute." *ACICS,* 854 F.3d at 690 (quoting *Peters v. United States*, 853 F.2d 692, 696 (9th Cir. 1988)). "Although the [Bureau] may define the boundary of its investigation 'quite generally,' it must comply with the terms of 12 U.S.C. § 5562(c)(2)." *Id.* (quoting *FTC v. Invention Submission Corp.*, 965 F.2d 1086, 1090 (D.C. Cir. 1992)).

Section 5562(c)(1) authorizes the Bureau to issue CIDs to "any person" who "may be in possession, custody, or control of any documentary material or tangible things, or may have any information, relevant to a violation" of federal consumer financial law. 12 U.S.C. § 5562(c)(1). "Federal consumer financial law" includes the Fair Credit Reporting Act. *See* 12 U.S.C. §§ 5481(12), (14).

Section 5562(c)(2) mandates that each CID "state the nature of the conduct constituting the alleged violation which is under investigation and the provision of law applicable to such violation." 12 U.S.C. § 5562(c)(2); *see also* 12 C.F.R. 1080.5. "Section 5562(c)(2) ensures that the recipient of a CID is provided with fair notice as to the nature of the Bureau's investigation. Because the validity of a CID is measured by the purposes stated in the notification of purpose, the adequacy of the notification of purpose is an important statutory requirement." *ACICS,* 854 F.3d at 690 (citation omitted).

The Bureau contends that Public Data waived its lack-of-specificity and notice arguments by not raising them during the mandatory meet and confer process or in its petition to set aside or modify the CID. As a general matter, courts have held

that "[a] party waives arguments that are not raised during the administrative process." *N. Plains Res. Council, Inc. v. Surface Transp. Bd.*, 668 F.3d 1067, 1081 (9th Cir. 2013); *see also* 12 C.F.R. § 1080.6(c)(3) (when reviewing petitions to set aside or modify a CID, the Bureau "will consider only issues raised during the meet and confer process."). While the parties disagree on what issues Public Data raised during the meet and confer process, Public Data challenged the specificity of the Notification of Purpose in the CID in its motion to set aside or modify, and the Bureau addressed that issue in its decision denying the order. *See* Dkt. No. 2-2 at 2. Public Data sufficiently alerted the Bureau to its position and contentions, and the specificity and lack-of-notice arguments were not waived.

***9** Public Data relies heavily on the D.C. Circuit's recent *ACICS* case to support its argument that it is not subject to the FCRA. In that case, the Bureau issued a CID that was identical to the one at issue here except that it was directed to "any entity or person ... engaged ... or engaging in unlawful acts and practices in connection with accrediting for-profit colleges" in violation of the Consumer Financial Protection Act. *ACICS,* 854 F.3d at 690. The Court concluded that, "as written, the Notification of Purpose fails to state adequately the unlawful conduct under investigation or the applicable law." *Id.*

> To begin with, the CID describes "the nature of the conduct constituting the alleged violation which is under investigation," 12 U.S.C. § 5562(c)(2), as simply "unlawful acts and practices in connection with accrediting for-profit colleges." Granted a notification of purpose may use broad terms to articulate an investigation's purpose, but § 5562(c)(2) mandates that the Bureau provide the recipient of the CID with sufficient notice as to the nature of the conduct and the alleged violation under investigation. ... [T]he CID in this case does not inform ACICS of the investigation's purpose. The Notification of Purpose defines the relevant conduct as "unlawful acts and practices in connection with accrediting for-profit colleges." It never explains what the broad and non-specific term "unlawful acts and practices" means in this investigation. Tellingly, in attempting to explain the scope of its investigation, the Bureau merely repeats the broad language used in the Notification of Purpose. As we observed above, our review of the validity of a CID is governed by the *Morton Salt* analysis. While that review is narrow, it is not without content. As we noted in a subpoena enforcement proceeding involving a different federal agency, "broad language used to describe th[e] purpose makes it impossible to apply the other prongs of the *Morton Salt* test." ... We cannot determine, for example, whether the information sought in the CID is reasonably relevant to the [Bureau's] investigation without knowing what "unlawful acts and practices" are under investigation. That is to say, where, as in this case, the Notification of Purpose gives no description whatsoever of the conduct the CFPB is interested in investigating, we need not and probably cannot accurately determine whether the inquiry is within the authority of the agency and whether the information sought is reasonably relevant.

Id. at 690-91 (citations omitted). The *ACICS* Court also noted the Bureau's recognition that it lacked statutory authority over the accreditation process of for-profit colleges. *See id.* at 691. The Court of Appeals found the Bureau's interest in a "possible connection" and "intersection" between the lending practices of ACICS-accredited institutions and the accreditation process too tenuous, and the D.C. Circuit held that, even if correct, the interest did not appear on the face of the Notification of Purpose. *Id.* The Court of Appeals explained that, "[w]hile the Bureau may be correct in noting that it need not speculate as to 'the precise character of [the] possible violations' its investigation might uncover, it is required by statute to adequately inform ACICS of the link between the relevant conduct and the alleged violation" and that "the Notification of Purpose 'says nothing' about this potential link." *Id.* (footnote and citation omitted). And, the *ACICS* Court determined,

> [t]he CID's description of "the provision of law applicable to such violation," 12 U.S.C. § 5562(c)(2), is similarly inadequate. The Notification of Purpose identifies 12 U.S.C. §§ 5531 and 5536, as well as "any other Federal consumer financial protection law," as the applicable laws. Sections 5531 and 5536 set forth the CFPA's general prohibition of unfair, deceptive, or abusive acts and practices in connection with transactions involving consumer

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financial products and services. *See* *id.* §§ 5531(a), 5536(a)(1)(B). These provisions "stand[ ] broadly alone" in the Bureau's Notification of Purpose, especially considering the Bureau's failure to adequately state "the specific conduct under investigation," and thus tell ACICS nothing about the statutory basis for the Bureau's investigation. The CFPA provides detailed definitions of "Federal consumer financial law," 12 U.S.C. § 5481(12), (14), and "[c]onsumer financial product or service," *id.* § 5481(5), (15), yet the CID contains no mention of these definitions or how they relate to its investigation. The inclusion of the uninformative catch-all phrase "any other Federal consumer financial protection law" does nothing to cure the CID's defects. Congress limited the Bureau's CID authority with § 5562(c)(2)'s notice requirements, and framing the applicable law in such a broad manner does not satisfy Congress's clear directive.

***10** *Id.* at 691-92 (citation omitted).

The D.C. Circuit concluded that the Notification of Purpose to ACICS did not meet Section 5562's statutory requirements and that, "were we to hold that the unspecific language of this CID is sufficient to comply with the statute, we would effectively write out of the statute all of the notice requirements that Congress put in." *Id.* at 692.

Public Data asserts that, just as in *ACICS*, based on the Notification of Purpose in the CID issued here—which Public Data asserts does not give fair notice of what the Bureau is investigating—the Court and Public Data are not in a position to meaningfully analyze and argue the *Morton Salt* factors.

The Bureau responds that the CID here does not present the same issue as in *ACICS*, where the Notification of Purpose in the CID to Public Data identifies specific persons and specific conduct under specific statutes and laws. The Bureau argues that the Notification of Purpose in *ACICS*, in contrast, did not provide notice of the nature of the investigation and conduct at issue.

The CID to Public Data presents a closer case than the one in *ACICS.* The CID's Notification of Purpose states:

> The purpose of this investigation is to determine whether consumer reporting agencies, persons using consumer reports, or other persons have engaged or are engaging in unlawful acts and practices in connection with the provision or use of public records information in violation of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681m et seq., Regulation V, 12 C.F.R. Part 1022, or any other federal consumer financial law. The purpose of this investigation is also to determine whether Bureau action to obtain legal or equitable relief would be in the public interest.

Dkt. No. 2-2 at 2.

Whereas, in *ACICS*, the D.C. Circuit noted the Bureau's "recognition that it lacks statutory authority over the accreditation process of for-profit colleges," 854 F.3d at 691, here the Bureau has broad statutory authority to investigate consumer reporting agencies, *see* 12 U.S.C. §§ 5481(12), (14). The FCRA defines a "consumer reporting agency" as

> any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and

> which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports.

15 U.S.C. § 1681(c)(f). And it defines a "consumer report" as

> any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumers eligibility for (A) credit or insurance to be used primarily for personal, family, or household purposes; (B) employment purposes; or (C) any other purpose authorized under section 1681b of this title.

***11** 15 U.S.C. § 1681(c)(d)(1). The term "other persons" is not defined. *See* 15 U.S.C. § 1681(c).

Public Data's counsel may believe that the statutory definition of a "consumer reporting agency" is a mess and a lawyer's dream, but the Bureau's reference to it in context, along with the persons and specific laws at issue and other details identified in the Notification of Purpose, provides fair notice of an investigation with generally defined boundaries and a purpose articulated in broad terms and complies with the requirements that the Bureau adequately inform Public Data of the link between the relevant conduct and the alleged violation. The Notification of Purpose in the CID to Public Data therefore meets Section 5562(c)(2)'s statutory requirements.

Public Data further asserts that it is not subject to the FCRA because it is not a consumer reporting agency. And Public Data has relied heavily on *Wilson v. The Source for Public Data, L.P.*, Civil Action No. H-12-0185, 2013 WL 12106128 (S.D. Tex. April 30, 2013), for support. The plaintiff in that case sued Public Data for a violation of Section 1681e(b) of the FCRA based on a search of her name through Public Data's website that revealed information concerning more than one person with the plaintiff's name. Section 1681e(b) "requires a consumer reporting agency preparing a consumer report to 'follow reasonable procedures to assure maximum possible accuracy of the information *concerning the individual about whom the report relates.*' " *Wilson*, 2013 WL 12106128, at *2 (quoting 15 U.S.C. § 1681e(b) (emphasis in original)). The district court in *Wilson* granted Public Data's motion for summary judgment because Plaintiff failed to present evidence that raised a genuine issue of material fact regarding whether the result of a search of Public Data's website contained "information concerning" Plaintiff, as opposed to other persons with the same name, for the purposes of her FCRA claim. *See id.* at *4. While instructive, *Wilson* arises in a different procedural context and is not controlling.

Public Data also asserts that the Bureau lacks authority to issue the CID because Public Data merely operates an internet website that allows users to conduct searches for public records using search criteria selected by the customer and the search results simply contain public record information for all public records that match the customer's search terms. Public Data further asserts that it does not alter, assemble, or merge any records or make any determination as to whether a public record is accurate or relates to a specific person. *See* Dkt. No. 15-2.

Although couched as a challenge to the Bureau's jurisdiction, this argument invites a fact-intensive inquiry into whether Public Data is a consumer reporting agency. Because Public Data's challenge concerns the "coverage" of the applicable consumer financial statutes and the company's compliance with the law, it cannot raise this issue to prevent enforcement of the Bureau's administrative subpoena. *See* *Consumer Fin. Prot. Bureau v. Future Income Payments, LLC*, Case No. SACV 17-00303-JLS (Ssx), 2017 WL 2190069, at *3 (C.D. Cal. May 17, 2017). Public Data is raising a premature

defense to an enforcement action, rather than a challenge to the Bureau's investigative authority. *See Consumer Fin. Prot. Bureau v. Harbour Portfolio Advisor, LLC*, No. 16-14183, 2017 WL 631914, at *3 (S.D. Mich. Feb. 16, 2017). It would be premature for the Court to decide whether Public Data is a consumer reporting agency at this stage. *See* *EEOC v. Karuk Tribe Hous. Auth.*, 260 F.3d 1071, 1076 (9th Cir. 2001) (stating that the Supreme Court has "consistently reaffirmed" that courts should not refuse to enforce an administrative subpoena when confronted by a fact-based claim regarding coverage or compliance with the law); *FTC v. Texaco*, 555 F.2d 862, 872 (D.C. Cir. 1977) (stating that courts considering petitions to enforce administrative subpoenas should not consider the ultimate question of whether the subpoenaed entity's activities are in fact covered by the statute); *Future Income Payments,* 2017 WL 2190069, at *2 ("[A] party cannot avoid complying with an administrative subpoena based on what would normally would be a defense to an action by the agency." (internal quotation and citation omitted)).

***12** Instead, the question when an agency's investigative action is challenged is whether there is "some plausible ground for jurisdiction or, to phrase it another way, [whether] jurisdiction is plainly lacking." *Karuk Tribe Hous. Auth.*, 260 F.3d at 1077 (internal quotation marks and citations omitted); *see also* *EEOC v. Sidley Austin Brown & Wood*, 315 F.3d 696, 700 (7th Cir. 2002) ("Only if ... the information that the subpoenaed firm resists furnishing is not even arguably relevant ... can the court resolve the issue then and there without insisting on further compliance with the subpoena." (internal citations omitted)); *FTC v. Ken Roberts Co.*, 276 F.3d 583, 587 (D.C. Cir. 2001) ("[E]nforcement of an agency's investigatory subpoena will be denied only when there is a 'patent lack of jurisdiction' in an agency to regulate or to investigate.").

Here, the Bureau's jurisdiction for issuing the CID is not plainly lacking because there are plausible grounds to believe that Public Data may have information related to a violation of the FCRA. Public Data may have information that is relevant to a violation of federal consumer financial law, and the Bureau " 'can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.' " *Harbour Portfolio Advisors*, 2017 WL 631914, at *3 (quoting *Morton Salt Co.*, 338 U.S. at 642-43).

In light of the foregoing, the Court concludes that the Bureau's authority to issue the CID—as opposed to any authority to undertake an enforcement action against, for example, Public Data, which the Bureau is seeking information to assess and which is not the issue before the Court on this petition—is not "plainly lacking." *Karuk Tribe Hous. Auth.*, 260 F.3d at 1076. Without deciding the question of whether Public DataI is a consumer reporting agency, the Court finds that there are plausible grounds to believe that Public Data may have information related to violations of the FCRA.

Conclusion

For the reasons and to the extent explained above, the Court GRANTS the Bureau's Petition to Enforce Civil Investigative Demand [Dkt. No. 1].

SO ORDERED.

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Not Reported in Fed. Supp., 2017 WL 2443135

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NOTES

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Henderson, et al. v. Corelogic National Background Data, LLC, 161 F.Supp.3d 389 (E.D. Va. Feb. 18, 2016)

Submitted by:
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KeyCite Yellow Flag - Negative Treatment
Disagreed With by Jones v. Sterling Infosystems, Inc., S.D.N.Y., March 30, 2016

161 F.Supp.3d 389
United States District Court, E.D. Virginia,
Richmond Division.

Tyrone HENDERSON, et al., On behalf of themselves and others similarly situated, Plaintiffs,
v.
CORELOGIC NATIONAL BACKGROUND DATA, LLC f/k/a National Background Data, LLC, Defendant.

Civil Action No. 3:12cv97
|
Signed February 18, 2016

Synopsis

Background: Job applicants brought putative class action against owner and operator of internet database providing criminal history information to credit reporting agencies, under the Fair Credit Reporting Act (FCRA) alleging that they were denied employment based on inaccurate and incomplete criminal history information provided by owner and operator. Owner and operator moved for summary judgment.

The District Court, Robert E. Payne, Senior District Judge, held that fact issues barred summary judgment.

Motion denied.

Attorneys and Law Firms

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MEMORANDUM OPINION

Robert E. Payne, Senior United States District Judge

This matter is before the Court on DEFENDANT'S RENEWED MOTION FOR PARTIAL SUMMARY JUDGMENT ON COUNT I OF THE SECOND AMENDED COMPLAINT (Docket No. 201). For the reasons set forth herein, the motion will be denied.

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FACTUAL BACKGROUND

CoreLogic National Background Data, LLC ("NBD") is a company that provides its customers access to a database ("The Multistate Database" or "the Database") of criminal record information. (Defendant's Memorandum in Support of its Renewed Motion for Partial Summary Judgment on Count I of the Second Amended Complaint ("Def. Mem.," ECF No. 195), Statement of Undisputed Facts ("SOF") ¶ 18). NBD's customers, which in this instance are credit reporting agencies ("CRAs"), pay to search the Multistate Database by way of the Internet. The Multistate Database then returns results (such as arrest records) that match the search criteria entered by NBD's customer. *Id.*

***391** The Multistate Database is owned and managed by CoreLogic SafeRent, LLC ("SafeRent"), a sister company to NBD. *Id.* SafeRent obtains most of the criminal record data in the Database electronically from governmental sources, although approximately ten percent of the data is purchased from a third party vendor. *Id.* ¶ 19. SafeRent buys criminal records in bulk, formats the records it purchases so that they can be properly incorporated into the Multistate Database, and updates the records at varying intervals. *Id.* ¶¶ 20–24. Because SafeRent purchases criminal record data in bulk, the public records in the Multistate Database typically contain only limited identifying information. For example, public records purchased in bulk rarely, if ever, contain Social Security Numbers ("SSNs"), and typically do not contain other identifying data such as middle names or addresses. Therefore, the portions of the public records that are in the Multistate Database are typically insufficient to identify the particular consumer to whom the records pertain. *Id.* ¶¶ 5–6.

SafeRent oversees all formatting, updating, and maintenance of the Multistate Database; NBD merely acts as an intermediary between SafeRent and the customer CRAs, and transmits this data to its customers without change. The contracts between NBD and its customers obligate the customers to independently verify the records returned in response to their search queries before providing consumer reports to their clients. *Id.* ¶¶ 8–15.

The Named Class Plaintiffs Tyrone Henderson ("Henderson") and James O. Hines, Jr. ("Hines") present factually similar cases. Specifically, Henderson and Hines were denied employment based on allegedly inaccurate and incomplete criminal history information supplied by NBD. Henderson applied for a job at Interstate Brands Corporation ("Interstate") in August or September of 2009. (Second Amended Complaint ("SAC") (ECF No. 191) ¶ 19). Interstate made Henderson a conditional offer of employment, and subsequently requested a background check on Henderson from Verifications, Inc. ("Verifications), a third party CRA. *Id.* ¶ 21. As part of the background check process, Verifications conducted a search of the Multistate Database by inputting Henderson's last name, the first three letters of his first name, and his date of birth. Def. Mem. SOF ¶ 29. The results of this search correctly included Henderson's criminal history, but the search results also contained several records, including felony convictions, belonging to at least one other individual who had the same first and last name and date of birth as Henderson. SAC ¶¶ 24–26. In the background check that it provided to Interstate, Verifications included multiple criminal records that were incorrectly attributed to Henderson by NBD. *Id.* ¶ 27. As a result of the incorrect information, Interstate withdrew its conditional offer of employment. *Id.*

Hines applied for a position as a physical therapist with CareSouth Homecare Professionals ("CareSouth") in May 2011. *Id.* ¶ 39. As part of its consideration of Hines for that position, CareSouth purchased a consumer report from ADP Screening and Selection Services ("ADP"), a CRA similar to Verifications. *Id.* ¶¶ 41–42. As part of the compilation of this report, ADP conducted a search of the Multistate Database by inputting Hines' first and last names and his date of birth. Def. Mem. SOF ¶ 41. These search results contained criminal records correctly attributed to Hines, but also contained records belonging to at least one other individual with the same first name, last name, and date of birth, including an Indiana record indicating that Hines was a registered sex offender. SAC ¶¶ 42–45. ADP included this incorrect information ***392** in the consumer report it provided to CareSouth. As a result of the incorrect information, Hines was not hired for the position at that time. Id. ¶ 5.

SUMMARY JUDGMENT STANDARD

Summary judgment is proper when there is no genuine issue as to any material fact in the case such that the moving party is entitled to judgment as a matter of law. *See* Fed.R.Civ.P. 56(c). Once the moving party properly files and supports its motion for summary judgment, the opposing party must show that a genuine issue of fact exists. *See* *Matsushita Elec. Indus. Co v. Zenith Radio Corp.,* 475 U.S. 574, 586–87, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).

A fact is material if the existence or non-existence thereof could lead a jury to different resolutions of the case. *See* *Anderson v. Liberty Lobby, Inc.* 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). A genuine issue of material fact only exists when the opposing party has presented sufficient evidence upon which a reasonable jury could return a verdict in its favor. *Id.* This means that "summary judgment is only appropriate when, after discovery, the non-moving party has failed to make a 'showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.' " *BM v. Chesterfield County School Dist.,* 2010 WL 1445661, at *1 (E.D.Va.2010) (quoting *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986)). In considering motions for summary judgment, the court must consider the evidence in the light most favorable to the non-moving party. *Smith v. Virginia Commonwealth Univ.,* 84 F.3d 672, 675 (4th Cir.1985).

PROCEDURAL POSTURE

As relevant to this motion, Plaintiffs claim in Count I of the SAC that NBD, a qualifying consumer reporting agency as defined in the preamble to 15 U.S.C. § 1681k, failed to satisfy the requirements thereof because: (1) NBD never sent notices to consumers when it provided criminal background information to its customers; and (2) NBD failed to satisfy the alternative provision [1] of § 1681k (a)(2) due to "the manner in which it obtains and furnishes" criminal records. SAC SI 66.

NBD seeks summary judgment on Count I, brought under 15 U.S.C. § 1681k(a). That section provides:

> A consumer reporting agency which furnishes a consumer report for employment purposes and which for that purpose compiles and reports items of information on consumers which are matters of public record and are likely to have an adverse effect upon a consumer's ability to obtain employment shall—
>
> **(1)** at the time such public record information is reported to the user of such consumer report, notify the consumer of the fact that public record information is being reported by the consumer reporting agency, together with the name and address of the person to whom such information is being reported; or
>
> **(2)** maintain strict procedures designed to insure that whenever public record information which is likely to ***393** have an adverse effect on a consumer's ability to obtain employment is reported it is complete and up to date. For purposes of this paragraph, items of public record relating to arrests, indictments, convictions, suits, tax liens, and outstanding judgments shall be considered up to date if the current public record status of the item at the time of the report is reported.

15 U.S.C. § 1681k(a).

NBD's arguments in support of summary judgment fall into two categories. First, NBD argues that § 1681k does not apply to its business model at all, because it offers only "wholesale data" and does not provide "consumer reports" for "employment purposes" that are "likely adverse" to "a" consumer's "ability to obtain employment." (Def. Mem. at 11–18). Second, NBD contends that, even if § 1681k does apply, § 1681k (a)(2) is satisfied because there is no dispute of material fact that NBD maintained "strict procedures" to insure that its reports were "complete and up to date," and those reports were, in fact, complete and up to date. *Id.* at 20–26. Each of these arguments will be addressed in turn.

DISCUSSION

A. Does Section 1681k(a) Apply to NBD?

NBD's first ground for summary judgment is that § 1681k(a) does not apply to it because its "wholesale results are not 'consumer reports' " furnished for "employment purposes" that are " 'likely' to have an adverse effect on a consumer's ability to obtain employment." (Def. Mem. at 11–18). This argument may be separated into several components. First, NBD contends that the criminal history records it provides are not "consumer reports" within the scope of the FCRA because the data "do[es] not relate to 'a' specific consumer." *Id.* at 11. Second, NBD asserts that § 1681k(a) is inapplicable because "NBD did not deliver data for 'employment purposes.' " *Id.* at 17–20. Finally, NBD argues that the "data returned by NBD's system was not 'likely' adverse to Plaintiffs." *Id.* at 14–17.

Each facet of NBD's argument lacks merit. Each is addressed in turn.

1. The Search Results that NBD Provides To Its Customers Constitute "Consumer Reports."

NBD first asserts that the reports that it sells to its customers are not "consumer reports" within the meaning of the FCRA because NBD "provides data in its 'raw' form," which is "*not descriptive about any one person,*" but rather is simply a "movement of data" in response to the search queries provided by its customers. (Def. Mem. at 11–12) (emphasis added). NBD adds that it is the "contractual and legal requirement" of the CRAs to whom NBD sells information to match the "raw data" that NBD provides to a specific individual. *Id.* at 13. The linchpin of NBD's argument is that "criminal record data cannot bear on 'a consumer' unless and until it is later linked to a specific individual by the recipient CRA." *Id.* at 14. Therefore, NBD concludes, the search results that it provides are not "consumer reports."

The FCRA defines a "consumer report" as "any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used in whole or in part for the purposes of serving as a factor in establishing the consumer's eligibility for: ... employment purposes [.]" 15 U.S.C. § 1681a(d). This statutory definition is ***394** considered to have "three fundamental elements." *Yang v. Govt. Emp. Ins. Co.,* 146 F.3d 1320, 1323 (11th Cir.1998). The first element is the "communication" element, which requires that a consumer reporting agency[2] communicate information. *Id.* The second element is the "information" element, which requires that the information communicated bear on "a consumer's credit worthiness, character, general reputation, personal characteristics, or mode of living." *Id.* The third element is the "purpose clause." *Id.* The "purpose clause" requires that the information communicated must be "used or expected to be used or collected in whole or in part" for one of the enumerated purposes, which in this case is for "employment purposes." NBD does not dispute that the first element of this definition is satisfied. The third element is addressed in more detail later in this opinion.

As to the second element, NBD does not dispute that "public record information relating to records of arrest ... or the institution or disposition of ... criminal proceedings, bears on one or more of [the enumerated] characteristics." FED. TRADE COMM'N, FORTY YEARS OF EXPERIENCE WITH THE FAIR CREDIT REPORTING ACT: An FTC

Staff Report with Summary of Interpretations 20–21 (2011). Therefore, the only question to be resolved as to the second element is whether the search results provided by NBD bear on "a" particular consumer, even though those results include criminal records of multiple consumers.

The answer is that the search results do pertain to a particular consumer. Indeed, simply because the search results provided by NBD include information about several, indeed many, consumers, it does not necessarily follow that the search results do not "bear[ ] on" the reputation and character of "a" specific consumer. Those results relate to a number of particular consumers, including, most importantly, the one about whom the search query is initiated.

The undisputed facts reveal that, when a customer of NBD submits a search query, typically consisting of a first name or partial first name, the last name, and the date of birth, NBD's customer is seeking to obtain information about "a" specific consumer. And, when NBD provides a response to the query, the criminal history included in the response "bear[s] on" the character and reputation of the individual as to whom the customer inquired. That the response also includes criminal records belonging to individuals other than the subject consumer does not mean that the posited request and the returned information do not bear on the particular individual about whom the query was made in the first instance; it merely reveals that the search query and results were overly broad.

Henderson's predicament concretely illustrates this reality. When Interstate requested a background check from Verifications, and when Verifications requested a background check from NBD, both Verifications and Interstate were concerned with the employment eligibility of a specific individual: Tyrone Bennett Henderson, Sr. That the search results returned by NBD included criminal records belonging to several individuals does not change the fact that those search results "b[ore] on" Henderson's character and reputation, and were used "as a factor in establishing [Henderson's] eligibility for" employment, as evidenced by Interstate's ultimate withdrawal of Henderson's offer of employment based on those search results. Therefore, NBD's argument that its reports are not "consumer reports" because ***395** they do not pertain to individual consumers must fail. [3]

More importantly, NBD's argument that its search results are not consumer reports is squarely at odds with its own documents, wherein it acknowledges that it resells *consumer reports. See, e.g.,* Plaintiffs' Memorandum in Opposition to Defendant's Motion for Summary Judgment ("Pl. Mem. in Opp.," EOF No. 205) Ex. A, NBD *Basic FCRA/FACTA Training* June 2007, at CLH000625 ("NBD is essentially a Reseller of consumer information and reports") (emphasis added); Ex. F, NBD–ADP Reseller Services Agreement, at CL–H288 ("The Data Services will consist of consumer report information with respect to individuals ('Consumers')[...] Each access of the [NBD] Data Services by Reseller [ADP] shall be considered a procurement of a consumer report for resale by Reseller."); Ex. H, NBD Standard Reseller Agreement, at CL–H2775–78 ("Solution Provider [e.g., ADP or Verifications] may request and NBD may provide to Solution Provider Consumer Reports ('Report' or 'Reports') for employment and/or tenant screening purposes only, as defined under the Fair Credit Reporting Act"). [4] On this record, the undisputed documentary evidence from NBD establishes that, in practice, NBD has freely recognized that the background checks that it provides are indeed "consumer reports" pertaining to individual consumers within the meaning of the FCRA. [5] That further undercuts the argument that NBD makes here. [6] On this ***396** record, NBD is not entitled to partial summary judgment on the ground that it does not provide "consumer reports."

2. NBD's Consumer Reports Are Provided "For Employment Purposes."

NBD next argues that the data packages that it sells are not for "employment purposes." (Def. Mem. at 17). The definition of "employment purposes," NBD contends, requires that a consumer report be "used" by its recipient. *Id.* Moreover, NBD says, "use" in this context entails only the actual hiring decision. *Id.* at 18–19. Because Verifications and ADP did not themselves "evaluate" potential job applicants, says NBD, but merely "verified" criminal record data before providing it to potential employers, NBD's reports were not "used" for "evaluating" a potential employee. *Id.*

Therefore, NBD concludes, § 1681k does not apply because NBD did not provide any consumer reports "to the user[s] of such consumer report[s]" for "employment purposes." *Id.*

In response, Plaintiffs point out that, again, this position is directly contradicted by NBD's documents: NBD's contracts with both SafeRent and its customers specify that the data NBD obtains from SafeRent and provides to its clients shall be used for one of a limited number of "permissible purposes" as defined by the FCRA, including "employment purposes." *Id.* at 16. Plaintiffs further argue that it is immaterial whether ADP or Verifications "used" NBD's reports to make a hiring decision because "the 'permissible purpose' and 'use' of the report travels and extends [sic] from reseller through to the originating consumer reporting agency." *Id.* at 17. Moreover, Plaintiffs add, because NBD sells consumer reports, it must have a permissible purpose for doing so under § 1681b. Thus, say the Plaintiffs, if NBD did not furnish its reports for "employment purposes," it would effectively be "confess[ing] an intentional violation of this alternate section —impermissibly furnishing *every single report it has ever sold.*" (Pl. Mem. in Opp. at 15) (footnote omitted).

The FCRA provides that the term "employment purposes, when used in connection with a consumer report means a report used for the purpose of evaluating a consumer for employment, promotion, reassignment or retention as an employee." 15 U.S.C. § 1681a(h). As set forth in Part A.1 above, the FCRA's definition of the term "consumer report" includes any communication of qualifying information by a CRA "which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for" certain enumerated purposes, including "employment purposes."

When these two definitions are considered together, the statutory text reveals that NBD's reading of the definition of "employment purposes" is incorrect, for several reasons. First, to read the word "use" into the phrase "employment purposes" "would violate settled statutory construction principles by ignoring subsection [1681a(d)]'s structure and grammar and in so doing" render surrounding clauses "virtually superfluous." *Bloate v. United States,* 559 U.S. 196, 208, 130 S.Ct. 1345, 176 L.Ed.2d 54 (2010). Specifically, NBD's proposed reading would render the final clause of the definition of "consumer report" ("which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for ...") both substantively and grammatically redundant. Thus, when placed in context, it ***397** becomes clear that the "purpose" of a consumer report actually refers to the purpose for which the report is "used or expected to be used or collected" (emphasis added), which, in this case, is "the purpose of evaluating a consumer for employment, promotion, reassignment or retention as an employee." Therefore, § 1681k(a) applies whenever a consumer reporting agency "furnishes a consumer report for [the purpose of evaluating a consumer for employment, promotion, reassignment or retention as an employee] [7] and which for that purpose compiles and reports" qualifying "items of information on consumers[.]"

Second, the text of both § 1681a(d) and § 1681a(h) is in the passive voice: "the actor who is using, expecting to use or collecting the report is neither limited nor specified." *Ernst v. Dish Network, LLC*, 49 F.Supp.3d 377, 383 (S.D.N.Y.2014). Similarly, § 1681k(a) applies to every "consumer reporting agency which furnishes a consumer report for employment purposes and which for that purpose compiles and reports items of information on consumers ..." This clause neither mandates nor implies a particular recipient of the consumer report. This means that if anyone uses the information for employment purposes, and the CRA providing the information reasonably anticipated that use, the "employment purposes" component of § 1681k(a) is satisfied. *Id.* As one court put it, rejecting an argument similar to NBD's:

> Even though [Defendant] itself did not intend to contract with those parties [e.g., potential employers] directly, but instead contracted with other entities such as [an intermediary] to provide

> that access, such an arrangement does not save [Defendant]. *All that is required is that [Defendant] expected the information to be used or collected, in whole or in part, for employment or insurance purposes.*

Lewis v. Ohio Prof'l Elec. Network LLC, 190 F.Supp.2d 1049, 1059 (S.D.Ohio 2002) (emphasis added).

Third, the FCRA neither states explicitly nor implies that only consumer reports provided directly to an end-user (here, a potential employer) fall within the definition of reports provided for "employment purposes." In fact, the statute specifically refers to "end-users" in several other sections. *See* §§ 1681e(e)(1)(A); 1681e(e)(1)(B); 1681e(e)(2)(A)(i); 1681e(3); 1681g(a)(3)(A). Thus, if Congress had wished to somehow limit the definition of "employment purposes" to reports provided only directly to "end-users," it clearly could have done so. *See, e.g., Soliman v. Gonzales,* 419 F.3d 276, 283 (4th Cir.2008) ***398** (noting that "where Congress includes particular language in one section of a statute but omits it in another provision of the same Act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion" (internal citation omitted)). Read as a whole, the statutory text then does not support NBD's unfounded assertion that "the definition of 'employment purpose further provides that the information must be 'used' *by the recipient entity.*" (Def. Mem. at 18) (emphasis added).

Here, the record permits a finding that the information in NBD's reports was collected, expected to be used and was actually used to evaluate Plaintiffs for suitability as potential employees. First, there is evidence that NBD expected the reports at issue in this case to be used for employment purposes because, when the customer requested a report on a particular consumer, the customer certified that it was requesting the data for employment purposes. *See* Pl. Mem. in Opp. Ex. FF, Declaration of Thomas Burtner, [8] at ¶¶ 7, 20–21. NBD's request archives actually reflect, with respect to the queries pertaining to Henderson and Hines, a "user supplied code" that indicated the use was for an employment purpose. (Pl. Mem. in Opp. Exs. J–K). Similarly, NBD's Reseller Agreements with ADP and Verifications provide that those companies "may request and NBD may provide to Solution Provider[s] Consumer Reports ('Report' or 'Reports') for *employment and/or tenant screening purposes* only, as defined under the Fair Credit Reporting Act." (Pl. Mem. in Opp. Ex. H, at CL–H2775–2778)(emphasis added).

Moreover, NBD's data licensing agreement with SafeRent demonstrates that it also collected data from SafeRent with the expectation that the data would be used for employment purposes. That contract provides that NBD will request data from SafeRent "solely for one or more of the Permissible Purposes, as defined herein, including consumer inquiries in *connection with ... employment purposes (e.g., hiring, promotion, transfer or security-related issues*)[.]" (Pl. Mem. in Opp. Ex. G, SafeRent/NBD Data Licensing Agreement, at CL–H546) (emphasis added).

It is also clear that NBD's reports were ultimately "used" for employment purposes. In particular, with respect to Hines and Henderson, both ADP and Verifications used the results obtained from NBD as a starting point for their own reports, and both companies included several of the results provided by NBD in their reports to Interstate and Caresouth. Plaintiffs' potential employers then used the ADP and Verification reports to determine Plaintiffs' suitability for employment. Thus, the data provided by NBD was used, expected to be used, and collected for employment purposes.

Finally, NBD's position on this point, if accepted, would lead to absurd results. It would be illogical and unrealistic to conclude that the purpose for which a report was furnished depends entirely on whether the report goes through a "middleman," such as ADP or Verifications. Under NBD's proposed reading, any credit reporting agency could relieve itself of all responsibility under the FCRA merely by ensuring that its reports moved through an intermediary. Theoretically, that intermediary could then enlist another intermediary to relieve itself of FCRA liability, and so forth and so on, *ad infinitum.* ***399** That, of course, would defeat a principal purpose of the FCRA. And, courts should not interpret a law so as to defeat its purpose.

Moreover, when considered in context, the authority that NBD cites for this proposition does not actually provide any support for the reading of the statute that NBD urges here. First, NBD relies heavily on the FTC's interpretation of "use" as adopted in *Nat'l Auto. Dealers Ass'n v. F.T.C.,* 864 F.Supp.2d 65 (D.D.C.2012). (Def. Mem. at 16–20). In the context of that record, the court deferred to the FTC's decision that a creditor who relied on a third party's interpretation of a consumer report was a "user" of that consumer report, even though the initial creditor never actually physically possessed the report.

NBD's reliance on *Nat'l Auto. Dealers* is misplaced, for several reasons. First, the evidence in this record permits a finding that NBD both expected that its reports would be used for employment purposes, and that it collected the data from SafeRent for that purpose. Second, the record permits a finding that the reports provided by NBD were ultimately "used" for employment purposes. Third, based on NBD's own assertions, ADP and Verifications clearly do more than "physically possess" NBD's reports. NBD's own brief states that "Verifications conducted a search of the public records ... through a field researcher, before any such information was included in the background investigation report provided to [Henderson's potential employer]." (Def. Mem. at 15). NBD cannot, on the one hand, argue that it is the sole responsibility of its customers to "filter" and "independently review" NBD's reports to ensure the accuracy thereof, and, at the same time, that the use of the report by those same entities amounts to no more than "physical possession."

Finally, NBD relies on the Tenth Circuit's affirmance of the district court's decision in *Owner–Operator Indep. Drivers Ass'n v. USIS Commercial Servs.,* 537 F.3d 1184, 1192 (10th Cir.2008). In the part of the decision cited by NBD, the Tenth Circuit briefly notes that "the district court determined that, because USIS did not intend to evaluate the consumer, it did not procure the [TRF] reports for 'employment purposes.' " *Id.* However, as Plaintiffs point out, the sentence that NBD cites is merely a "general statement summarizing the issues considered in the court below." (Pl. Mem. in Opp. at 19 n.1). Neither NBD's briefing nor the Tenth Circuit's opinion provides any context for this statement, and it does not appear that the district court issued a written decision on the issue. Furthermore, it appears that that case ultimately turned on the exclusion in 15 U.S.C. § 1681a(d)(2)(A)(i), which exempts from FCRA coverage "reports limited to transactions or experiences between the consumer and the entity making the report." *Id.* at 1192. Thus, *Owner–Operator* is of no real significance here.

In any event, as explained above, the record contains evidence that would permit a jury to find that the consumer reports prepared by NBD were produced for "employment purposes" under the FCRA. Thus, summary judgment cannot be granted on the premise that the reports were not prepared for that purpose.

3. NBD's Reports Are "Likely" Adverse To A Consumer's Ability To Obtain Employment.

It is NBD's next contention that the data returned by its system was not categorically "likely" adverse to Plaintiffs because:

> its customers, [ADP and Verifications] filtered the data that they obtained from NBD; and (2) neither ADP nor Verifications ***400** made any employment related decision, such that NBD's return of data had no prospect of being 'likely' adverse to anything at the time of its reporting.

Def. Mem. at 15. Not so, say the Plaintiffs, because the "phrase '*likely* to adversely effect' is a categorical description. It means a *type* of public record." Pl. Mem. in Opp. at 12 (emphasis in original). Therefore, Plaintiffs contend, whether a

record is "likely to adversely affect" a consumer's employment prospects depends on the record itself, rather than whether and to what extent an employer actually relied on the record in denying a consumer's application for employment.

NBD's argument must fail, for several reasons. To begin, the interpretation urged by the Plaintiffs is supported by the plain text of the statute, which provides, in pertinent part:

> A consumer reporting agency which furnishes a consumer report for employment purposes and which for that purpose compiles and reports items of information on consumers which are matters of public record and are likely to have an adverse effect upon a consumer's ability to obtain employment ...

15 U.S.C. § 1681k(a). The statute requires that the "items of information" that are compiled and reported be "matters of public record that are likely to have an adverse effect upon a consumer's ability to obtain employment ..." Read as a whole, it is rather clear that the clauses "which are matter of public record" and "which ... are likely to have an adverse effect upon a consumer's ability to obtain employment" modify the *type* of "information on consumers" that a CRA "compiles and reports." Thus, one looks at the type of information to see if it is "likely" to have the kind of effect that calls § 1681k (a) into play. One does not look at how a particular record affects an individual plaintiff.

The plain text of § 1681k(a)'s opening paragraph is underscored by the text of § 1681k(a)(2), which enumerates several types of public records that fall within the scope of § 1681k(a). Specifically, § 1681k(a)(2) points to such records as "arrests, indictments, convictions, suits, tax liens and outstanding judgments." This list provides guidance respecting the category of items in public records that are "likely to have an adverse effect upon a consumer's ability to obtain employment." *See also* FTC Informal Staff Letter (May 5, 1999), explaining that "a criminal history that indicates that the consumer has been convicted would be adverse to the consumer's ability to obtain employment, and would be covered by § 613 [§ 1681k(a)]."

Furthermore, criminal record data, such as that sold by NBD, is the paradigmatic example of information that is "likely adverse" to a consumer's employment prospects. Cases applying this section uniformly acknowledge that reality. *See, e.g., Brown v. Lowe's Companies, Inc.,* 52 F.Supp.3d 749, 758 (W.D.N.C.2014) ("[Defendant] does not contest that ... Plaintiffs' criminal history was reported for employment purposes, the criminal history was a matter of public record, and it was likely to have an adverse effect on each Plaintiff"); *Farmer v. Phillips Agency, Inc.,* 285 F.R.D. 688, 695 (N.D.Ga.2012) (noting the "undisputed" fact that Defendant's reports, based on reports *obtained from NBD,* "were likely to have an adverse effect on the consumer's ability to obtain employment"); *Christensen v. Acxiom Info. Sec. Servs., Inc.,* 2009 WL 2424453, at *2 (W.D.Ark. Aug. 6, 2009) ("there is no dispute that the consumer report in question [containing erroneous criminal convictions] was likely to have an ***401** adverse effect upon [plaintiff's] ability to obtain employment").

Finally, NBD's own documents confirm that the records that it compiles and reports are likely to adversely affect consumers' employment prospects. For example, NBD points out that its business model is beneficial because it allows employers to *avoid hiring* potentially dangerous applicants. (Def. Mem. at 30, n.11; Defendant's Reply in Support of its Renewed Motion for Partial Summary Judgment ("Def. Reply", ECF No. 222) at 20). NBD does not argue that it provides any information to its customers other than criminal record data. Thus, NBD's description of the utility of its product actually concedes that the results it provides are "likely to have an adverse effect upon a consumer's ability to obtain employment": its information precludes the hiring of dangerous people, *i.e.,* those with criminal records. In NBD's own view, its raison d'etre is to provide information that is likely to have an adverse effect on an employment application.

Whether an employer ultimately relies on or even receives any given criminal record provided by NBD does not alter that acknowledged state of affairs. Again, NBD's contention is directly contradicted by the text of the statute: Section 1681k(a) simply does not require that a particular public record *actually* adversely affect a particular consumer's employment prospects. Rather, this section governs items of information that are "likely" to have an adverse effect. There is no indication that Congress intended "likely," as used in this section, to have anything other than its ordinary meaning: "of such a nature or so circumstanced as to make something more probable." Webster's Third New International Dictionary 1310 (2002). The decisions above, as well as NBD's own documents, reflect a unanimous understanding that criminal history data, whether correctly attributed or not, makes it "more probable" that a consumer will be denied employment.

Moreover, the reasoning set forth in part A.2 above applies with equal force here. Accepting NBD's position would mean that a CRA could escape its responsibilities under § 1681k(a) entirely simply by requiring its reports to pass through an intermediary CRA. And, if the application of § 1681k(a) were to depend on an employer's evaluation of a particular record, a CRA could never know, *ex ante,* whether it is subject to this section. Thus, NBD's position flies in the face of the axiom that the boundaries of permissible conduct set out in a valid statute "do not require reference to later actions by a third party." *City of Chicago v. Morales,* 527 U.S. 41, 58–59, 119 S.Ct. 1849, 144 L.Ed.2d 67 (1999). Therefore, "the better interpretation is that the status of a[n item of information] is static," *Ernst,* 49 F.Supp.3d at 384, and depends on the type and content of the public records at issue, rather than whether or to what extent the information actually affects a particular consumer's job prospects.

For the foregoing reasons, NBD is not entitled to summary judgment on the theory that the reports it provides are not "likely to have an adverse effect on a consumer's ability to obtain employment" within the meaning of § 1681k.

B. NBD Is Not Entitled To Summary Judgment On § 1681k(a)(2)

Section 1681k(a) provides that a consumer reporting agency that satisfies the threshold definitional requirements set forth above may comply with that section by providing notice to consumers under § 1681k(a)(1), which NBD concedes it has not done, *or* it may "maintain strict procedures designed to insure that whenever public record information which is likely to ***402** have an adverse effect on a consumer's ability to obtain employment is reported it is complete and up to date." The few courts that have had occasion to interpret this section have agreed that "[t]he logical starting point for an analysis of Section 1681k is whether the information provided was complete and up to date. If this is so, then an inquiry into the specific procedures is unnecessary." *Obabueki v. Int'l Bus. Mach. Corp.,* 145 F.Supp.2d 371, 396 (S.D.N.Y.2001). That is, in order to show a violation of this subsection, a plaintiff must show that: "(1) a CRA furnished a consumer report for employment purposes compiled from public records containing adverse information; (2) the CRA failed to maintain strict procedures designed to insure that the information in that report was complete and up to date; and (3) the consumer report was either incomplete or not up to date." *Farmer,* 285 F.R.D. at 700. Therefore, "absent a showing that the information obtained by [a defendant CRA] was inaccurate or incomplete ... [a] plaintiff's claim under § 1681k must fail[.]" *Haro v. Shilo Inn,* 2009 WL 2252105, at *3 (D.Ore. July 27, 2009); *see also Farmer,* 285 F.R.D. at 698 (noting that "courts have uniformly read [largely parallel provision] § 1681e(b) as requiring a CRA to both maintain reasonable procedures and disclose an accurate report.") (internal citations omitted). Thus, this analysis proceeds from the premise that the question whether NBD maintained strict procedures is only reached if its reports are not complete and up to date.

1. NBD Has Failed To Show That, As A Matter Of Law, Its Reports Are "Complete And Up To Date."

NBD contends that there is no genuine dispute of material fact as to whether its reports are "complete and up to date" because "there is no dispute that the results that NBD returned to ADP and Verifications reflected the existing public record status of the listed convictions and charges at the time of reporting." (Def. Mem. at 23).

The analysis begins with the statute. Section 1681k(a)(2) provides that "items of public record relating to arrests, indictments, convictions, suits, tax liens, and outstanding judgments shall be considered up to date if the current public record status of the item at the time of the report is reported." 15 U.S.C. § 1681k(a)(2). However, "the act does not define 'complete.' " *Poore v. Sterling Testing Sys. Inc.,* 410 F.Supp.2d 557, 572 (E.D.Ky.2006).

In attempting to determine the "plain meaning" of the word "complete," the court in *Poore* noted that "Webster's Dictionary defines 'complete' as 'having all necessary parts.' Webster's Collegiate Dictionary 235 (10th ed.1998)." *Id.* Unfortunately, that definition is not particularly helpful because there is a dearth of authority concerning which specific items of information comprise the "necessary parts" of a public record in this context. Courts have sidestepped this particular question either by conflating the concepts of "accuracy" and "completeness," or by merging the inquiries of "completeness" and "strict procedures." The parties have not cited, nor has the Court found, a decision determining whether a consumer report can be "complete" when it includes adverse public record items that pertain to consumers other than the subject consumer. Even the FTC's analysis is only marginally more informative:

> This section requires that each "item of [public record] information" reported be complete and up to date. For example, if the CRA reports an indictment, it must also report any dismissal or acquittal available on the public record as of the date of the report. Similarly, if the CRA reports a conviction, it must report a reversal that has occurred on appeal. ***403** In some cases, often at an employer's request, a report may deliberately omit data such as arrest or probation data. Although the report is not a "complete" reflection of every single piece of public record information, because the requirement to report complete and up-todate information is item-specific, the CRA complies if its report includes the current, complete, and up-to-date public record status of each individual item reported.

FED. TRADE COMM'N, FORTY YEARS OF EXPERIENCE WITH THE FAIR CREDIT REPORTING ACT: AN FTC STAFF REPORT WITH SUMMARY OF INTERPRETATIONS 81 (2011).

An assessment of the FRCA's statutory purpose provides some help in analyzing the "complete and up to date" issue. As explained by the United States Court of Appeals of the Ninth Circuit in *Guimond v. Trans Union Credit Info. Co.,* "[t]he legislative history of the FCRA reveals that it was crafted to protect the consumers from the transmission of inadequate information about them, and to establish credit reporting practices that utilized accurate, relevant, and current information in a confidential and responsible manner." 45 F.3d 1329, 1333 (9th Cir.1995). In light of the purposes of the FCRA, it *seems* that the "necessary parts" of a public record must be sufficient to connect a particular public record to a particular consumer. In other words, to be "complete" under the FCRA, a record must contain sufficient information to link the record with the subject of the query, here, Henderson or Hines.

As NBD's own arguments confirm (*see* Part A.1 above), its search results miss that mark rather significantly because those results include conviction records that belong to any number of individuals having the same first and last names and date of birth as the specific consumer as to whom the search is really directed. That NBD faithfully transmits the parts of the records that are available for purchase in bulk is insufficient to demonstrate, as a matter of law, "completeness."

Thus, because NBD disseminates only the portions of criminal records that the public entities from whom SafeRent purchases its data choose to provide in bulk, NBD, by its own admission, appears not to be compiling or reporting "complete" items of information. Moreover, the record in this case shows that NBD is capable of obtaining, from its customers and from its governmental sources, sufficient information to determine the specific consumer to whom a particular public record pertains. *See, e. g.,* Def. Mem. Ex. A, at SI 18 ("In response to [Hines' complaint] NBD contacted the clerk of court and confirmed by reference to Plaintiff Hines's Social Security Number ... that the charge was attributed to him."); Pl. Mem. in Opp. Ex. Q, Internal Henderson Report Showing Manual Corrections; Ex. DD, at CL–H000483 (detailing process for removing incorrectly attributed criminal cases by attaching the consumer's SSN to the record). That fact, if proved, would permit a finding in the Plaintiffs' favor on the "completeness" issue.

The Plaintiffs take the view that the necessary linkage can be made by obtaining social security numbers in the court records directly from governmental sources. NBD takes the view that that is not possible when only bulk data is purchased. That may be true. However, true or not, that inability does not exempt NBD from the "completeness" requirement of § 1681k(a)(2), when it has chosen not to provide the notices mandated by § 1681k(a)(1). It simply is not complete under the FCRA to say that "someone named Bill Jones has a conviction record, but whether this is the Bill Jones you are ***404** inquiring about, I do not know." Yet, that is precisely what NBD acknowledges to be the result that it provides.

Whether social security numbers are necessary for completeness is not, as Plaintiffs would have it, a matter of law. Rather, that is a matter of fact. The record is neither clear nor settled respecting the availability of such information or whether social security numbers are essential to provide completeness. In that circumstance, and in light of the uncertainty inherent in this record, summary judgment is inappropriate. That is especially inappropriate where, as here, NBD acknowledges that its provisions in its contracts with resellers disclaim any warranty of completeness or accuracy.

2. NBD Has Failed To Show That, As A Matter Of Law, It Followed "Strict Procedures" To Insure That Its Reports Were Complete And Up To Date.

NBD contends that it is entitled to summary judgment on Count I because "Plaintiffs developed no actual evidence in discovery that could be used to challenge the nature of NBD's procedures and to negate its compliance with § 1681k(a)(2)." (Def. Mem. at 24). NBD relies entirely on SafeRent's "quality control" procedures to satisfy its summary judgment burden on this element. (Def. Mem. at 24–27). NBD reports that SafeRent "receives approximately 300 separate updates of [the data in the Multistate Database] each month," and "more than 85% of the records in the Multistate Database are updated at least monthly[.]" *Id.* Ex. B, at ¶¶ 14–15. NBD also adds that SafeRent conducts periodic reviews to ensure that its data is formatted correctly and matches the text of the records received from its sources (primarily "electronic governmental sources," although SafeRent also uses a third party commercial vendor to obtain records of registered sex offenders). *Id.* at ¶¶ 16–22.

In response, Plaintiffs contend that it is exactly this faithful verbatim transcription that makes SafeRent's (and, consequently, NBD's) procedures inadequate. (Pl. Mem. in Opp. at 24–26). Plaintiffs argue that NBD must conduct a manual review of the public record data information that it reports in order to satisfy § 1681k(a)(2). *Id.* at 24.

The FCRA does not define "strict procedures." *Poore,* 410 F.Supp.2d at 571. However, federal courts have noted that "strict procedures" are "necessarily a more stringent standard" than the "reasonable procedures" standard of § 1681e(b). [9] *Id.* at 572. In construing § 1681e(b), the Fourth Circuit has held that it is the plaintiff's burden to show that the defendant did not follow reasonable procedures, but that this burden is relatively minimal, and that "the issue of whether the agency failed to follow 'reasonable procedures' will be a 'jury question in the overwhelming majority of

cases.' " *Dalton,* 257 F.3d at 415–416 (quoting *Guimond,* 45 F.3d at 1333); *see also* *Sarver v. Experian Info. Sol.,* 390 F.3d 969, 971 (7th Cir.2004) (finding that the reasonableness of a CRA's procedures is "normally a question for trial unless the reasonableness or unreasonableness of the procedures is beyond question."). In *Dalton,* the Fourth Circuit held that a jury could find it unreasonable that the defendant "had no procedures governing the sources that a subvendor could rely on in collecting information for a criminal background report." *Id.* at 417. The Court of Appeals also found that, because there was a genuine dispute of material ***405** fact as to whether the agency maintained reasonable procedures, there was "necessarily" a factual dispute over whether it followed strict procedures, but "[left] for another day the determination of what constitutes 'strict' as opposed to 'reasonable procedures.' " *Id.* at 417 (internal citations omitted).

Several district courts have held the inaccurate attribution of criminal records constitutes sufficient evidence to permit the question of "reasonable procedures" to go to a jury, even where, as here, the defendant attempted to avoid liability by pointing to a disclaimer or other contractual delegation of responsibility. *See, e.g., Smith v. E–Backgroundchecks.com, Inc.*, 81 F.Supp.3d at 1358–1359 (holding that reasonableness of procedures was a jury question, despite disclaimer of accuracy and completeness provided by defendant, because defendant inaccurately attributed criminal records to plaintiff); *Adams v. Nat'l Eng'g Serv. Corp.,* 620 F.Supp.2d 319, 333 (D.Conn.2009) (denying summary judgment because a reasonable jury could conclude that Verifications' inaccurate attribution of a criminal record to Plaintiff—the result of a report obtained *from NBD* —despite having the means to verify that record, was neither reasonable nor strict); *Fahey v. Experian Info. Sol.,* 571 F.Supp.2d 1082, 1091 (E.D.Mo.2008) (a reasonable jury could conclude that Experian's reporting procedures were unreasonable because it failed to require sufficient identifying information to correctly match criminal records to specific consumers); *Poore,* 410 F.Supp.2d at 571 (denying summary judgment because "the Court ha[d] no evidence that [reseller CRA] employed any procedures to ensure the accuracy of its consumer reports at all other than relying on [a sub-vendor]. The Court cannot rule as a matter of law that such reliance was reasonable.").

The only decision cited by NBD or found by the Court in which summary judgment was granted in favor of a consumer reporting agency on the issue of strict procedures is *Moore v. First Advantage Screening Corp.,* 2013 WL 1662959, at *6 (N.D.Ohio Apr. 17, 2013). In *Moore,* the district court held that, as a matter of law, defendant First Advantage maintained strict procedures because:

> The undisputed evidence show[ed] that First Advantage took three separate steps before it reported that Plaintiff was convicted[.] First, First Advantage searched its database for potential records. Second, First Advantage engaged a third part [sic] contractor to confirm the existence of those records. Third, when there was a discrepancy between the information provided by the third party contractor and the results of the database search, First Advantage personnel spoke directly with the court.

The court in *Moore* distinguished *Dalton* on the ground that, in *Dalton,* the defendant agency accepted the "legal opinion that the clerk independently offered," rather than asking the clerk of court "to simply read information captured in the court record," as First Advantage did in *Moore.* *Id.* at *7. The facts of *Moore* are entirely different than those in this record, because here it does not appear that NBD took any steps to confirm the correctness of the convictions attributed to Plaintiffs. [10]

In this case, Plaintiffs have presented sufficient evidence to allow a jury to find that NBD failed to maintain "strict procedures" to insure the completeness of its reports. As noted above, NBD relies entirely on the frequency of SafeRent's updates—which, ***406** NBD admits, sometimes do not occur for months for a given public record—to satisfy this requirement. It appears that SafeRent inputs court records verbatim into the Multistate Database, and NBD then transmits the records that match a particular search query verbatim to its customers. *See* Def. Mem. at 7, ¶ 26 ("During each step of the process, SafeRent does not alter the data, and it is placed into the Multistate Database using the exact text in which it was supplied"); Def. Mem. Ex. B ("NBD supplies criminal record public information from ... the Multistate Database ... owned and managed by CoreLogic SafeRent, LLC[.]"); Ex. A ("NBD contractually engages and permits third-party background screening companies to access the public-record information that is stored by CoreLogic SafeRent, LLC ("SafeRent").).

NBD only investigates the accuracy or completeness of court records when a consumer initiates an inquiry. (Def. Mem. Ex. A, at ¶ 18 ("In response to [Hines' complaint] NBD contacted the clerk of court and confirmed by reference to Plaintiff Hines's Social Security Number ... that the charge was attributed to him.")). In fact, NBD's brief and exhibits are completely devoid of any evidence from which the Court could infer that NBD has any sort of quality control procedures of its own in place. Moreover, it is undisputed that NBD provided results to Verifications and ADP in response to their queries concerning Henderson and Hines that contained criminal record data that did not relate to Plaintiffs. As discussed above, incorrect attribution of criminal records, particularly where "a review of the report would have uncovered the discrepanc[ies]," has been found sufficient to allow the question of *reasonable* procedures to go to the jury, and the standard for "strict procedures" is unquestionably higher. *See, e.g., Smith v. LexisNexis Screening Sol., Inc.,* 138 F.Supp.3d 872, 2015 WL 5719675 (E.D.Mich. Sept. 30, 2015).

Because the Plaintiffs have presented sufficient evidence to allow the question of whether NBD maintained "strict procedures" in accordance with § 1681k(a)(2) to be decided by the jury, summary judgment on that issue is inappropriate.

CONCLUSION

For the reasons set forth above, DEFENDANT'S RENEWED MOTION FOR PARTIAL SUMMARY JUDGMENT ON COUNT I OF THE SECOND AMENDED COMPLAINT (Docket No. 194) will be denied.

It is so ORDERED.

All Citations

161 F.Supp.3d 389

Footnotes

1 The Fourth Circuit has held that, "when a consumer reporting agency furnishes a report, the agency is not obligated to notify the consumer and maintain strict procedures." *Brown v. Lowe's Companies, Inc.*, 52 F.Supp.3d 749, 758 (W.D.N.C.2014) (citing *Dalton v. Capital Associated Indus., Inc.*, 257 F.3d 409, 417 (4th Cir.2001)). Most interpreting courts have reached the same conclusion. Thus, NBD need only satisfy one of the two subsections of § 1681k(a).

2 NBD does not argue that it is not a consumer reporting agency. Rather, its position is that its business product is not a "consumer report.'

3 Other district courts have also held, without much discussion, that analogous search results, that are provided in response to similar queries and that contain criminal records belonging to multiple consumers, are "consumer reports" within the

meaning of the FCRA. *See, e.g., Smith v. LexisNexis Screening Sol., Inc.,* 76 F.Supp.3d 651 (E.D.Mich.2014) ("*Smith I*") (background check containing criminal records pertaining to multiple consumers other than plaintiff, provided in response to query consisting of first name, last name, and date of birth, was a consumer report governed by the FCRA); *see also Smith v. E–Backgroundchecks.com, Inc.,* 81 F.Supp.3d 1342 (N.D.Ga.2015); *Lopez v. Nat'l Credit Reporting, Inc.,* 2013 WL 1999624 (N.D.Cal. May 13, 2013).

4 Furthermore, NBD has stipulated that discovery of its customers would allow Plaintiffs "to identify (including, without limitation, by name, address, date of birth, social security number and other identifiers) *the individual of interest* that was the subject of a particular search query submitted to CoreLogic National Background Data LLC by its customers." (ECF No. 56, at ¶ 3) (emphasis added). This further undermines NBD's assertions in its briefs that NBD has no way of discerning the individual consumer whom a particular search query concerns, and further supports the inescapable conclusion that not only do NBD's reports do pertain to "a" consumer as contemplated by the FCRA, but also, NBD is fully aware of that fact.

5 Interestingly, in a case that is currently pending in the Northern District of Illinois, SafeRent has not disputed that the "wholesale" criminal records it provides are consumer reports. *Oses v. CoreLogic SafeRent, LLC,* Case No. 1:13–cv–06096, Docket No. 75 (N.D.Ill. Aug. 21, 2015). Of course, SafeRent's acknowledgment in other litigation that it provides consumer reports is by no means dispositive in this case, but it does further undermine NBD's argument, given that it appears that NBD directly relays its customers' queries to SafeRent and then relays the criminal records it receives from SafeRent to its customers without any material change.

6 *Fiscella v. Intelius, Inc.,* 2010 WL 2405650 (E.D.Va. June 10, 2010), which NBD contends supports its position, is inapposite. In that case, the plaintiff requested all of Intelius' Virginia records containing the name "Edward Fiscella," and sought to have the records of other individuals named "Edward Fiscella" removed from the defendant's database. The court dismissed the case without deciding whether those search results constituted a "consumer report," because the plaintiff failed to allege that those search results constituted a "file" on the plaintiff, and failed to allege that "any information produced or held by Intelius in connection with *him* is inaccurate," as required to state a claim under § 1681i(a) for failure to reinvestigate disputed information. 2010 WL 2405650, at *4. Thus, neither the facts nor the legal contentions presented in *Fiscella* provide guidance here.

7 Moreover, NBD's argument conflates the purpose for which a report is furnished and the purpose for which it is used. Of course, typically these purposes are identical, but their occasional divergence reveals the fallacy of the assumption, on which NBD implicitly relies in its interpretation of the definition of "employment purposes,' that the purpose for which NBD *furnished* reports necessarily depends on how and by whom those reports were used. Decisional law interpreting § 1681(b), which imposes liability on CRAs who furnish reports for "impermissible purposes,' demonstrates this distinction: to show that a report was "furnished' for a permissible purpose, e.g., employment purposes, a CRA need only show that it had "reason to believe' that the report would be used for that purpose, and obtained appropriate certifications from its customers that the report would be used only for that purpose. See 15 U.S.C. § 1681b; 15 U.S.C § 1681e; *Harris v. Database Mqmt. & Marketing Inc.*, 609 F.Supp.2d 509, 514–515 (D.Md.2009) ; *Korotki v. Atty. Servs. Corp.*, 931 F.Supp. 1269 (D.Md.1996). That is, a permissible purpose will be attributed to a CRA so long as that CRA had "reason to believe' that it was providing reports only for that purpose. This further undermines NBD's argument that the definition of "employment purposes' necessarily turns on the "use' of the reports.

8 Defendants opposed this declaration on the grounds that it is actually a declaration of an expert witness, rather than a fact witness, as Plaintiffs claim, and Plaintiffs failed to provide notice thereof in a timely manner. For reasons set forth in a separate opinion (ECF No. 240), the affidavit will be considered.

9 Section 1681e(b) provides that "[w]henever a consumer reporting agency prepares a consumer report it shall follow reasonable procedures to assure maximum possible accuracy of the information concerning the individual about whom the report relates."

10 *Moore* also did not address whether the report was "complete," apparently deciding that it was unnecessary to reach that question in light of the finding that First Advantage maintained strict procedures to ensure accuracy and completeness.

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Data Aggregation Webinar Outline, The Use of Data Aggregation in the Consumer Financial Services Industry (August 2, 2018)

Alan S. Kaplinsky
Christopher J. Willis
Ballard Spahr LLP

I. BACKGROUND

What does data aggregation involve?

- Collection or assembly of info from multiple disparate sources
- Cleaning / standardizing data

Entities in the data aggregation eco-system

- Data holders – banks, non-bank FIs; providers of asset accounts including deposit accounts and prepaid accounts; creditors issuing mortgages, credit cards, auto loans, student loans, personal loans, etc.
- Aggregators – companies with technology ("pipes") to collect or access information from data holders
- Third-party permissioned companies – companies accessing consumers' financial data held by data holders, often through an aggregator, with the authorization of a consumer
- Consumer / end-user – consumer authorizing access to data by third-party permissioned company

Screen scraping vs. APIs – How aggregators and third-party permissioned companies get information

- Access consumer account info, typically using a consumer's username and password
- Screen scraping – logging in as user, deploying technology to gather info from site using scraping algorithms; requires standardization of data; increased likelihood of error due to improper characterization of info
    - Access is arguably overbroad – permits access to all info available to consumer rather than just info needed to provide service
- APIs – Application program interface that allows two systems to systematically share data using standardized protocols; no need for standardization of data, reducing likelihood of errors; often based on bilateral agreement between bank and aggregator or third-party permissioned company
    - Can be based on bilateral terms or standard API specs; FS-ISAC released a spec, Quovo, Morningstar and Yodlee announced common spec

- Can be used as a basis to require companies to meet certain data security standards before accessing data
- APIs to share data may or may not be connected to authentication mechanisms

Authentication & data security

- Access using consumers' usernames and passwords presents data security risk to banks and FIs
  - Some have defined giving usernames and passwords a violation of terms and conditions; others have pointed to this as a basis for concluding that fraudulent transactions stemming from aggregator / third party site are not "unauthorized transactions" under Reg E
- OAuth – authentication protocol that directs consumer to holders of data to authenticate; upon sufficient authentication, third party permission company is given a token to access information in the future
  - Gives holders of data opportunity to present terms – consumer clearly authorizes disclosure, qualifying for GLBA exception
  - Tokens held by aggregators or third-party permissioned companies rather than username and password
    - Gives bank/FI/account holder ability to turn on/off access to account without tying to username and password; hence creation of access dashboards

II. USE CASES

- Consolidated account view
- Account and income validation
  - Eliminate trial deposits
  - Eliminate submitting account statements, paystubs, tax returns to verify income
- Personal financial management tools – advice / suggestions / nudging
  - Budgeting tools
    - Cash flow management – income and expense forecasts

        - Saving recommendations / nudges / automation
        - Overdraft avoidance – nudge (hey, transfer money) / automation (hey, here's a loan that's cheaper than an overdraft fee)
    - Optimize use of product features – e.g., use X credit card when making y purchase
        - Asset allocation and debt repayment strategies
    - Optimize product selection
        - Get a credit card with a better rate
        - Apply for x personal loan to consolidate credit card debt
        - Refinance mortgage from current rate to lower rate
        - Issues:
            - Accuracy in determining current interest rate; identifying potential rates
            - Inability to determine if consumer is a revolver or transactor – inaccurate savings claims
            - Incomplete information
            - Providing advice – UDAAPs
- Broadened availability of credit
    - Enhanced underwriting by creditors, especially for thin- or no-file consumers where checking account information may prove to be helpful
    - Fair lending concerns with data
    - FCRA issues – are data aggregators providing consumer reports?
        - Info provided by consumer rather than aggregator?
        - Aggregators only acting as conduits, providing mechanical reproduction of info; not analyzing or interpreting data
        - NYDFS reg requiring CRAs to register as a CRA and prohibiting creditors from paying for consumer reports from unregistered CRAs

        - VT data broker laws
- AI – other insights identified by machines
    - Trending – monitoring of transaction activity trends is valuable to hedge funds

III. PRINCIPLES FOR SAFE DATA AGGREGATION ACTIVITIES

- CFSI Principles
- SODA framework
- CFPB principles on data aggregation
    - Access
    - Data Scope and Usability
    - Control and Informed Consent
    - Authorizing Payments
    - Security
    - Access Transparency
    - Accuracy
    - Ability to Dispute and Resolve Unauthorized Access
    - Efficient and Effective Accountability Mechanisms
- Similarities and differences between sets of principles

IV. CURRENT MARKET AND REGULATORY TRENDS

What has happened since the CFPB's principles were issued?

1. Has there been a noticeable change in the volume (increase or decrease) of business initiatives involving aggregated data? Where are we seeing the most interest?
2. Is the trend towards bilateral agreements continuing?
    - Standardized API specs
        - FS-ISAC API spec released
        - Yodlee, Morningstar By All Accounts, & Quovo issued standard API protocol

        - *How do standardized API specs relate to bilateral API agreements?*
    - The Clearing House calls for broader API use
    - One large card issuer restricted API access, citing data security concerns with aggregator practices
    - Opponents of bilateral APIs continue voicing concerns that bilateral agreements are untenable, create a patchwork of obligations based on data holder demands and controls
    - Calls for broader adoption of OAuth, decoupling APIs from authentication
3. Global perspective - given privacy and information governance reforms in the UK and Europe, will they impose pressure on the US to take similar steps?
    - GDPR and UK's Open Banking initiative – recognize right to portability of data
        - Open Banking had plenty of hype but uptake has been limited
    - CCPA & state by state approach
    - Challenges with consistency – across FIs, states, countries
    - Likelihood of federal legislation or regulation affecting aggregation activities

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Artificial Intelligence Webinar Outline, Artificial Intelligence in the Consumer Financial Services Industry (July 11, 2018)

Alan S. Kaplinsky
Christopher J. Willis
Ballard Spahr LLP

I. WHAT IS ARTIFICIAL INTELLIGENCE?

Computer software continuously evaluating the best equation to solve a problem

A subset of machine learning

Computer has ability to "learn" without additional programming

- Recognize patterns, trends, and outliers and synthesize this information
- Draw conclusions and make forecasts – potential to make relatively accurate predictions based on past observations
    - Autonomous decision making and improvements to algorithms

Involves the collection of vast data sets, the development of continuously improving algorithms, and computing power

II. AI MODELS: WHAT ARE THE DIFFERENCES?

Logistic Regression Model

- Limited number of variables
- Variables selected by modelers to achieve best fit and avoid collinearity
- Variables have specific weights and directions
- Each variable operates somewhat independently

AI Model

- Large number of variables
- Variables chosen through multiple iterations of machine learning
- Variable weights and directions can vary in context with other variables
- Model looks at combinations of variables together

III. USES OF BIG DATA AND MACHINE LEARNING

- Predictive policing
- Handwriting recognition
- Speech recognition
- Real estate pricing
- Spam filters

– Self-driving cars
– You might also like… (marketing)
– Interpreting "wearables" data
– Hiring decision process
– And, of course, fraud and credit risk models

IV. DATA SETS

Internal Data

– Customer performance information, e.g., credit card transactions and payment history

External Data

– Consumer report information
– Demographic information, e.g., household size and education
– Electronic footprint information, e.g., device type
– Financial account transaction information based on consumer-permissioned access, e.g., income and balances over time

The intersection of "big data" and financial services

V. TYPES OF DATA THAT COULD POSE CHALLENGES

– Social media connections/relationships
– Academic records/educational background
– Job type/status
– Online shopping purchase patterns/behaviors
– Website subscriptions
– GPS/location data
– IP address

VI. USE OF AI BY FINANCIAL INSTITUTIONS

Marketing

– Modeling to improve ad targeting

Underwriting

- Using unconventional factors, such as transaction activity at certain merchants
- Potential to score no-file or thin-file consumers and enhance access to credit
- Challenge explaining denials in an adverse action notice

Servicing and collections

- Voice command tools – to pay balances, make payments, etc.
- Collections optimization

Fraud screening

Personal financial management tools

- Nudging
- Product selection and use optimization

VII. REGULATORY CHALLENGES

- Data accuracy
- Correlation vs. causation
- Fair lending
- Adverse action and risk-based pricing notices
- Identifying "consumer report" information
- New data security rules and permissions
    - EU's General Data Protection Reguation
    - California's Consumer Privacy Act of 2018

VIII. MANAGING REGULATORY CHALLENGES

- Structured and supervised learning
    - Document objectives, findings, and execution rationales
    - High/medium/low risk classifications for variables
    - Approval for any new variables
    - Have qualified data scientists evaluate program inputs, models, and outputs

- Human review of all adverse action reasons
- Automated fair lending testing (using machine learning?)
- Complaint monitoring
- Performance monitoring as economic conditions change

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Ballard Spahr LLP, Selected Blog Posts and Alerts Related to the Panel, *The Rapidly Evolving Landscape for FinTech*

Submitted by:
Alan S. Kaplinsky

Ballard Spahr LLP

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August 3, 2018

OCC to Accept Applications from Fintech Companies Seeking National Bank Charters

by Ballard Spahr's Consumer Financial Services Group

The Office of the Comptroller of the Currency's (OCC) announcement this week that it will begin accepting applications for special purpose national bank (SPNB) charters from financial technology (Fintech) companies represents a major development that provides Fintech companies with the opportunity to take advantage of the benefits of federal preemption available to full-service national banks. Most significantly, the OCC's decision means that obtaining an SPNB charter is now an option for Fintech companies that would be disqualified from obtaining a full-service national bank charter due to their own non-financial activities or those of an affiliate.

On August 28, 2018, from 12 p.m. to 1 p.m. ET, Ballard Spahr will conduct a webinar, "The OCC's Special Purpose National Bank Charter: What Fintech Companies Need to Know." A link to register is available here.

As set forth in a new Policy Statement, it is now the OCC's policy to consider applications for SPNB charters from Fintech companies "that are engaged in the business of banking but do not take deposits." The statement confirms the OCC's authority under the National Bank Act (NBA) to grant the charters and generally describes the chartering standards the OCC will apply and its supervisory expectations for Fintech companies that receive an SPNB charter. The application and decision process is described more fully in a supplement to the OCC's existing Licensing Manual, "Considering Charter Applications from Financial Technology Companies." The supplement describes an SPNB as a bank "that would engage in one or more of the core banking activities of paying checks or lending money, but would not be insured by the Federal Deposit Insurance Corporation (FDIC)."

The supplement discusses:

- the application process, including prefiling communications with the OCC's Office of Innovation and Licensing Department;
- key factors considered by the OCC in reviewing an application, including the qualifications and experience of organizers, managers, and directors, as well as the applicants' business plan, and the SPNB's capital and liquidity, commitment to financial inclusion, and contingency planning;
- the OCC's chartering decision, including conditions of approval; and
- OCC supervision of approved SPNBs.

Below are some items of particular note in the supplement:

- An SPNB's organizers will be expected to propose a minimum level of capital the bank will meet or exceed at all times. If preliminary approval of an SPNB charter is granted, the approval will include a condition specifying the minimum level of capital that the bank must meet or exceed at all times. Organizers will also be expected to describe how the SPNB can be funded and maintain sufficient liquidity under stressed conditions.
- Because it is uninsured, an SPNB, as a condition of charter approval, must have a contingency plan that includes options to sell itself, wind down, or merge with a nonbank affiliate, if necessary.

- Assessments imposed on an SPNB as a condition of charter approval will be modified from those charged to full-service national banks based on factors tailored to the SPNB's business model.
- In considering applications, the OCC will coordinate with other regulators to facilitate consideration of any applications or approvals required by those regulators.
- A pending enforcement action involving a significant supervisory matter may be grounds for denial of an application. If an application is approved for a company that has an obligation to remediate or pay penalties for violations cited by another regulator, the OCC will ensure that the obligation is carried forward and enforced through conditions imposed on a charter approval.

A SPNB charter would allow Fintech companies that engage in lending activities or payment services to enjoy the benefits of federal preemption afforded to full-service national banks under the NBA. (In the supplement, the OCC states that "facilitating payments electronically may be considered the modern equivalent of paying checks.") An SPNB charter would allow such Fintech companies to avoid burdensome state licensing requirements for lending activities and money transmission. They would also be entitled to the NBA's preemption of state consumer financial laws that "prevent[] or substantially interfere[] with the national bank's exercise of its powers."

For Fintech companies engaged in lending activities, an SPNB's entitlement to federal preemption would eliminate the need for a bank partner and the potential for "true lender," *Madden,* and other legal challenges arising from such relationships. In particular, an SPNB would be entitled to the NBA's preemption of state usury laws so that it could export the maximum interest rate allowed in the state where the bank is located and make loans in other states without regard to their usury laws.

Under the Bank Holding Company Act (BHCA), a "bank" is defined as an institution that is an "insured bank" as defined in the Federal Deposit Insurance Act (FDIA) or that both receives "demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others" and makes "commercial loans." The parent company of an SPNB that does not take deposits, but only makes loans, will not be deemed a bank holding company under the BHCA or be subject to Federal Reserve oversight. As a result, the activities in which the parent company could engage would not be restricted by the BHCA. It is uncertain, however, whether the Federal Reserve would assert jurisdiction over, and thereby seek to restrict the activities of, the parent company of an SPNB that offers payments services that are akin to the payment of checks but does not have deposit insurance or take deposits.

SPNBs also would not be subject to the FDIA's provisions applicable to "insured depository institutions" because they would not be required to have deposit insurance. However, in the Policy Statement, the OCC made clear that it would not approve charter applications from Fintech companies that include "financial products and services that have predatory, unfair, or deceptive features or that pose undue risk to consumer protection."

While not discussed in the supplement, it appears that a Fintech company holding an SPNB charter would be required to be a member of the Federal Reserve System and be subject to oversight as a member bank. As a Federal Reserve member, an SPNB would have access to the Federal Reserve discount window and other Federal Reserve services. To become a Federal Reserve member, an SPNB would have to subscribe to the capital stock of the Federal Reserve, a requirement that should not be particularly burdensome. However, since Federal Reserve membership would make the affiliate transaction restrictions of Sections 23A and 23B of the Federal Reserve Act applicable to the SPNB, a Fintech company interested in obtaining an SPNB charter should consider the potential impact of these restrictions.

The OCC's decision to begin accepting SPNB charter applications from nondepository Fintech companies is consistent with the views of the Treasury Department set forth in its report, "Nonbank Financials, Fintech, and Innovation," which was issued the same day as the OCC's announcement. In the report, the Treasury Department endorsed the OCC's proposal to grant the charters and recommended that it finalize the proposal.

The OCC's decision to begin accepting applications, however, is likely to be challenged by state regulators who have opposed the proposal. Lawsuits challenging the OCC's authority to grant SPNB charters to nondepository Fintech companies filed by the Conference of State Bank Supervisors (CSBS) and the New York Department of Financial Services (DFS) were dismissed for lack of standing and ripeness by federal district courts in D.C. and New York respectively. Indeed, the DFS Superintendent released a statement on the day of the OCC's announcement in

which she stated that the OCC's decision to begin accepting the charter applications was "wrongly supported by the Treasury Department" and "is clearly not authorized under the [NBA]." In addition, according to media reports, the OCC's decision has also been criticized by the CSBS President.

It is unclear whether, based on the decisions dismissing the two lawsuits, the OCC's announcement that it will begin accepting applications would be sufficient to allow state regulators to file new lawsuits that would survive a motion to dismiss for lack of standing and ripeness or whether the OCC would first have to approve an application. In its opinion dismissing the DFS complaint, the court noted that the DFS had sent it a letter asking it to require the OCC to promptly notify the DFS "if and when" the OCC decided to accept SPNB charter applications and allow the DFS to reinstate the case and litigate its challenge before an application is approved. The court indicated that it did not have the subject matter jurisdiction necessary to grant the relief requested but indicated that it would be "sensible" for the OCC to provide such notice.

Ballard Spahr's Consumer Financial Services Group is nationally recognized for its guidance in structuring and documenting new consumer financial services products and programs, its experience with the full range of federal and state consumer credit laws, and its skill in litigation defense and avoidance.

The firm's Marketplace Lending Task Force is nationally recognized for counseling marketplace lending businesses in both the consumer and small business spaces. We offer soup-to-nuts guidance, working with startup alternative lenders, long-established market leaders, banks, institutional investors, and others. We document and advise on the structure and strategy of bank, platform, and investor relationships, assist in concluding account servicing arrangements, provide extensive consumer regulatory advice, documentation, and diligence assistance, and help with state licensing. We have been advising clients on the steps involved in obtaining an SPNB charter.

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Ballard Spahr LLP
Consumer Finance Monitor
CFPB, Federal Agencies, State Agencies, and Attorneys General

NYDFS calls for application of NY usury limits to all online lending and more regulation in online lending report

By **Alan S. Kaplinsky** & **James Kim** on July 12, 2018

The New York Department of Financial Services (NYDFS) has issued an **Online Lending Report** that calls for the application of New York usury limits to all online lending and increased regulation of online lenders making loans to New York consumers and small businesses.

On August 22, 2018, from 12:00 p.m. to 1:00 p.m. ET, Ballard Spahr attorneys will hold a webinar to discuss the report. Click **here** to register.

A bill signed by New York Governor Cuomo required the NYDFS to study online lending in New York and issue a public report of its findings and recommendations by July 1, 2018. The report indicates that to gather data, the NYDFS asked 48 businesses believed to be engaged in online lending activities in New York to complete a "New York Marketplace Lending Survey." The NYDFS received responses from 35 of those 48 businesses. According to the report, the respondents varied in size "from small to some of the largest online lenders in the industry," and of the 35 respondents, 28 were not currently licensed by the NYDFS and 7 were licensed by the NYDFS.

The report includes a background discussion of the NYDFS's supervisory authority and New York usury limits, payday lending, "lessons from the financial crisis," "New York's leadership in consumer protection," and consumer litigation financing. It also sets forth the survey results, which cover consumer and business loans and consist of statistical and other information about (1) customer and loan numbers, (2) duration of loans, (3) loan sizes, (4) APRs, (5) fees, costs, expenses, and other charges, (6) loan delinquencies (past due 30 days or more), (7) business models, (8) marketing and advertising, (9) credit assessment/underwriting, and (10) complaints and investigations.

The NYDFS had listed topics to be addressed in the report on its website and solicited public comments on such topics. In the report, the NYDFS also summarizes the 12 comments it received in response to that solicitation. The NYDFS describes the commenters as "technology and lending associations, chambers of commerce, business associations, and banking, mortgage and credit union associations."

The report concludes with a discussion of the benefits and risks associated with the lending activities and practices of online lenders based on the survey results followed by the NYDFS's conclusions and recommendations. Most of these recommendations will require legislation.

Key items in the report consist of the following:

- Application of consumer protection laws to small business loans. The NYDFS recommends that New York consumer protection laws and regulations "should apply equally to all consumer lending and small business lending activities." According to the NYDFS, such protections include laws and regulations relating to transparency in pricing, fair lending, fair debt collection practices, and data protection. The NYDFS further states that its "equal application" recommendation "includes robust consumer disclosures; the use of technology easily permits transparency, including disclosures of the full cost of a loan to a borrower and providing the consumer with full understanding of the long-term

consequences of accepting short-term relief for a financial need." The NYDFS acknowledges that under existing federal law, small business loans are generally exempt from coverage. To our knowledge, no state has ever subjected small business loans to the same regulations as consumer loans. The report is devoid of any empirical data supporting this extreme recommendation. The report does not even mention, let alone address, the risk that subjecting small business loans to the same state statutes that apply to consumer loans may lead to a reduction in the availability of small business loans and an increase in pricing for such loans. The NYDFS does not even define what would be considered a "small business loan."

- Application of New York usury laws to all online lending. The NYDFS recommends the application of New York usury law "to all lending in New York." According to the NYDFS, "a loan is a loan from a borrower's perspective, and the borrower deserves to get the benefit of New York's protections, whether the borrower borrows from a bank or credit union or from an online lender." While the report acknowledges that out-of-state banks are exporting their interest rates into New York, the report cavalierly suggests that, contrary to well-established U.S. Supreme Court precedent, New York can nevertheless apply its usury limits to such loans. The recommendation follows earlier discussions in the report in which (1) the NYDFS observes that "a number of online lenders" have partnered "with federally chartered banks, or FDIC-insured banks located in jurisdictions that do not have interest rate protections on par with New York's" to expand their consumer lending "through their online platforms without regard to the type of loan offered, the size of the loans or the interest rates charged," (2) the NYDFS expresses its support for the use of **the "true lender theory"** to challenge claims by such online lenders that loans they have made in partnership with banks are not subject to New York usury law, and (3) the NYDFS describes the Second Circuit's holding in ***Madden v. Midland Funding*** that a nonbank that purchases loans from a national bank could not charge the same rate of interest on the loan that Section 85 of the National

> Bank Act allows the national bank to charge, but makes no mention of the fact that **the OCC believes *Madden* was wrongly decided**.

Thus, in recommending that "all lending in New York" be subject to New York usury laws, the NYDFS appears to be taking the position that no online lender partnering with a bank can permissibly rely on the bank's federal law power to export interest rates to charge the interest the bank is permitted to charge on loans the bank has assigned to the online lender when such interest exceeds New York usury limits. The NYDFS also notes its opposition to H.R. 4439, the "Modernizing Credit Opportunities Act," which is intended to address the uncertainty created by "true lender" challenges. (A group of 21 state attorneys general **recently sent a letter** to the Senate majority and minority leaders as well as to the chairman and ranking member of the Senate Banking Committee urging them to reject H.R. 4439 and H.R. 3299, the "Protecting Consumers' Access to Credit Act of 2017," a bill often referred to as the "Madden fix" bill.)

The NYDFS also appears to be willing to ignore the comments it discusses in the report highlighting the importance of the access to credit that online lending provides to consumers and small businesses. The NYDFS's recommendation is likely to further reduce credit availability for New York consumers and small businesses. Indeed, a recent study showed that credit availability contracted sharply in Connecticut, Vermont, and New York after *Madden* was decided. *See* Colleen Honigsberg, Robert J. Jackson, Jr., and Richard Squire, "The Effects of Usury Laws on Higher-Risk Borrowers," Columbia Business School Research Paper No. 16-38 (May 13, 2016).

- Expansion of licensing and supervision. New York law currently requires a nonbank lender to obtain a "Licensed Lender" license if it makes consumer purpose loans of $25,000 or less or business purpose loans of $50,000 or less and the interest rate is greater than 16% (New York's civil usury limit). The NYDFS comments in the report that "given the low level of national interest rates in recent years, certain online lenders have been able to offer profitable

rates under New York's usury limit such that they would not be required to be licensed and overseen by the Department." The NYDFS expresses its continued support for legislation that would "reduce the interest rate above which a non-depository lender is required to be licensed to 7 percent per annum from 16 percent per annum."

- Scrutiny of consumer litigation financing. The NYDFS "notes the growth of consumer litigation financing" and expresses concern "about the amounts that consumers are required to provide to financing companies, which can be a significant portion of the total recoveries from their lawsuits that would be usurious if lending rules were to apply." It also expresses concern "about the information many companies provide to consumers about the transactions and the manner in which they provide that information." The NYDFS calls for further study of these issues and expresses its belief that "legislation could provide important safeguards for consumer that do not currently exist." The NYDFS does not provide a scintilla of empirical data for its apparent conclusion that legislation containing consumer safeguards is necessary. It should be noted that the discussion of litigation financing consists of just one paragraph of a 31-page report.

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OCC moves to dismiss state regulators' second lawsuit opposing fintech charter

By **Alan S. Kaplinsky** on January 9, 2019

The OCC has filed a **motion to dismiss** the lawsuit filed in D.C. federal district court in October 2018 by the Conference of State Bank Supervisors (CSBS) to stop the OCC from issuing special purpose national bank (SPNB) charters to fintech companies.

The CSBS had previously filed a lawsuit challenging the OCC's authority to grant SPNB charters to fintech companies at a time when the OCC had not yet decided whether it would move forward on its charter proposal. That lawsuit **was dismissed** for failing to establish an injury in fact necessary for Article III standing and for lacking ripeness for judicial review. The **new lawsuit** was filed in response to the OCC's **July 2018 announcement** that it would begin accepting applications for SPNB charters from fintech companies.

In its brief, the OCC makes the following principal arguments in favor of dismissal:

- CSBS cannot have standing to sue until the OCC approves an application for an SPNB charter because only then could a CSBS member suffer an injury in fact.
- Because the OCC "remains several stages away from actually granting an SPNB Charter" and "has not finalized its decision to issue an SPNB Charter to a particular applicant," the matter remains both constitutionally and prudentially unripe for judicial review.

- Because the OCC's July 2018 announcement was not a final agency action within the meaning of the Administrative Procedure Act, it is not subject to judicial review under the APA's arbitrary and capricious standard.
- The OCC's July 2018 announcement does not represent a preemption determination to which notice and comment procedures apply "because the question of whether granting a proposed national bank will result in the preemption of any particular state consumer financial law is not relevant to the chartering process." (According to the OCC, in deciding whether to grant a charter, its focus is on "the proposed institution's prospects and whether it will operate in a safe and sound manner.")
- The OCC's rule (12 C.F.R. Section 5.20(e)(1)) interpreting the term "business of banking" in the National Bank Act by reference to three core banking functions—receiving deposits, paying checks, or lending money—represents a reasonable interpretation of such term and supports treating any one of such functions as the required core activity for purposes of the OCC's chartering authority. Nothing in the NBA identifies deposit-taking as an indispensable function for a national bank to be engaged in the "business of banking."

In September 2018, the New York Department of Financial Services (DFS) filed a second in a New York federal district court to block the OCC's issuance of SPNB charters. Like the first CSBS lawsuit, the first DFS lawsuit challenging the OCC's authority to grant SPNB charters **was dismissed** for failing to establish an injury in fact necessary for Article III standing and for lacking ripeness for judicial review.

]Last month, the OCC **submitted a letter to the court** indicating that it intends to file a motion to dismiss the DFS lawsuit. The grounds for the motion set forth in the OCC's letter substantially mirror its arguments for dismissal above in the CSBS lawsuit. The DFS also submitted a letter to the court in which, in addition to outlining the arguments it would make in opposing an OCC motion to dismiss, it indicated that it intends to file a motion for a preliminary injunction to prevent the OCC from issuing any SPNB charters while the lawsuit is pending.

The next step in the case is likely to be the entry of an order by the court setting a motion schedule. However, based on a docket entry indicating that a standing order was entered on December 27 requiring the U.S. Attorney's Office to notify the court immediately upon the restoration of DOJ funding, it appears any further developments will not occur until the partial government shutdown ends.

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State regulators file second lawsuit opposing OCC fintech charter

By **Alan S. Kaplinsky** on October 29, 2018

The Conference of State Bank Supervisors (CSBS) **has filed a second lawsuit** in D.C. federal district court to stop the Office of the Comptroller of the Currency (OCC) from issuing special purpose national bank (SPNB) charters to fintech companies. A similar lawsuit was filed last month in a New York federal district court by the New York Department of Financial Services.

The CSBS and **the DFS** had previously filed lawsuits challenging the OCC's authority to grant SPNB charters to fintech companies at a time when the OCC had not yet decided whether it would move forward on its charter proposal. Both lawsuits were dismissed for failing to establish an injury in fact necessary for Article III standing and for lacking ripeness for judicial review. The new lawsuits were filed in response to **the OCC's July 2018 announcement** that it would begin accepting applications for SPNB charters from fintech companies. In its complaint, the CSBS alleges that "things have changed substantially since the Court's decision [dismissing the prior CSBS lawsuit]. The issuance of a [SPNB] charter is now clearly imminent." It further alleges that "upon information and belief, multiple pre-qualified candidates have already decided to apply (and may have already applied)."

The CSBS challenges the OCC's SPNB charter plans in the new lawsuit on the following grounds (which generally track those asserted in the first CSBS lawsuit):

- 12 C.F.R. Section 5.20(e)(1), on which the OCC has relied for its authority to charter a bank that performs a single core banking function—receiving deposits, paying checks, or lending money—is inconsistent with the National Bank Act because the NBA does not allow the OCC to charter entities that do not receive deposits unless they are carrying on a special purpose expressly authorized by Congress.
- Because the OCC has indicated that state law would be preempted as to fintech companies that obtain a SPNB charter, the OCC's plans to issue the charters represent a preemption determination to which notice and comment procedures apply.
- The OCC's plans to issue SPNB charters to fintech companies represent a "rule" that was made without compliance with the Administrative Procedure Act and is an arbitrary and capricious action that does not constitute "reasoned decision making" as required by the APA.
- The OCC's plans to issue SPNB charters to fintech companies, by enabling nonbank charter holders to disregard state law, violate the Tenth Amendment of the U.S. Constitution under which states retain the powers not delegated to the federal government, including the police powers necessary to regulate nonbank providers of financial services and protect consumers and the public interest from unsound and abusive financial practices.

For the reasons **discussed in our blog post** about the second lawsuit filed by the DFS, we expect the OCC's power to issue an SPNB charter will ultimately be withheld.

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FTC enforcement to focus on fintech lenders

By **Scott M. Pearson** on September 11, 2018

Politico has reported that in remarks made at a fintech policy event last week, Andrew Smith, the FTC's Director of Consumer Protection, indicated that fintech companies will be a focus of the FTC's enforcement activities.

According to Politico, Mr. Smith said that FTC was particularly interested in online lending, with an emphasis on small-business lending. Mr. Smith is also reported to have identified lead generation in the context of online lending as a key area of interest for the FTC.

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Paul Watkins named Director of CFPB Office of Innovation

By **Alan S. Kaplinsky** on July 19, 2018

Paul Watkins, who formerly was in charge of fintech initiatives in the Arizona Attorney General's office, has been named by Acting Director Mulvaney to serve as Director of the Bureau's Office of Innovation.

The Bureau's **press release** indicates that the recently-created Office of Innovation will "focus on creating policies to facilitate innovation, engaging with entrepreneurs and regulators, and reviewing outdated or unnecessary regulations" and identifies the encouragement of "consumer-friendly innovation" as "a key priority for the Bureau." The new Office will take over the work that was being done under Project Catalyst, the initiative launched by the CFPB in 2012 for facilitating innovation in consumer financial products and services.

Earlier this year, **the State of Arizona created the first "regulatory sandbox"** in the United States which allows new financial technologies and products to be tested in a controlled environment with reduced regulatory risk. Last month, Ballard Spahr attorneys held a webinar, "**The Regulatory Sandbox – What it Means for Fintech Companies**," in which the topics included a discussion of the concept of a regulatory sandbox, the benefits and risks associated with using one, and what a possible sandbox created by the CFPB might look like. Mr. Watkins was one of the webinar speakers and discussed the Arizona initiative.

We applaud the Bureau for the selection of Mr. Watkins to serve in this important position.

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Arizona enacts "regulatory sandbox" for fintech companies; Ballard Spahr to hold June 13 webinar

By **Scott M. Pearson** on April 9, 2018

Arizona's Governor recently signed into law **legislation** that directs the state's Attorney General to establish a "regulatory sandbox program" for the purpose of "enabl[ing] a person to obtain limited access to the market in this state to test innovative financial products or services without obtaining a license or other authorization that would otherwise apply." Businesses that are already licensed "under state laws that regulate a financial product or service" can also participate in the program.

On Tuesday, April 10, 2018, I will moderate a **panel** at the **LendIt Fintech conference** during which the Arizona program will be discussed with Arizona Representative Jeff Weninger, who wrote the sandbox legislation, joined by former OCC Comptroller Thomas Curry and Cross River Bank CEO Gilles Gade.

Also, on June 13, 2018, Ballard Spahr will hold a webinar, "Playing in the Regulatory Sandbox: What It Means for Fintech Companies," featuring Paul Watkins of the Arizona Attorney General's office, together with Funding Circle General Counsel Conor French and Brian Knight of the Mercatus Center at George Washington University. **Click here** to register.

Key definitions in the Arizona law include:

- An “innovative financial product or service” means “a financial product or service that includes an innovation.”
- “Financial product or service” means a “product or service that requires licensure under [specified Arizona laws] or a product or service that includes a business model, delivery mechanism or element that may otherwise require a license or other authorization to act as a financial institution or enterprise or other entity that is regulated by [specified Arizona laws].”
- “Innovation” means “the use or incorporation of new or emerging technology or the reimagination of uses for existing technology to address a problem, provide a benefit or otherwise offer a product, service, business model, or delivery mechanism that is not known by the attorney general to have a comparable widespread offering in this state.”

Applicants for the program must provide specified information that includes the benefits and risks to consumers using the innovative financial product or service and must satisfy certain conditions, including that the applicant “has established a location, whether physical or virtual, that is adequately accessible to the attorney general, from which testing will be developed and performed and where all required records, documents and data will be maintained.”

If an applicant is approved for the program, the “sandbox participant” will have 24 months to test its innovative financial product or service. Requirements and limitations that apply to approved participants include the following:

- Participants generally may not enter into transactions with more than 10,000 consumers and participants testing consumer loans (as defined under specified Arizona law) may issue individual loans for an amount up to $15,000 but not more than $50,000 in aggregate loans per consumer.
- Participants testing products or services as a money transmitter (as defined under specified Arizona law) may enter into a transaction with a consumer in an

amount up to $500 but may not enter into more than $2,500 in aggregate transactions per consumer

- If a participant demonstrates adequate capitalization, risk management processes, and management oversight, the Attorney General can allow the participant to enter into transactions with up to 17,500 consumers and, if the participant is also testing products or services as a money transmitter, the Attorney General can allow the participant to enter into a transaction with a consumer in an amount up to $15,000 and up to $50,000 in aggregate transactions per consumer
- Participants must comply with specified provisions of Arizona law, including consumer fraud provisions, and any additional state law requirements applicable to a financial product or service as determined by the Attorney General
- Before providing an innovative financial product or service to a consumer, a participant must provide specified disclosures to the consumer and any additional disclosures required by the Attorney General

Participants are not exempt from compliance with federal law, including the enumerated federal consumer financial services laws as defined in the Consumer Financial Protection Act and the CFPA's UDAAP prohibition. However, the Arizona law provides that a participant "is deemed to possess an appropriate license under the laws of this state for purposes of any provision of federal law requiring state licensure or authorization." Also, while the program only covers transactions with consumers who are Arizona residents, the law authorizes the Arizona Attorney General to "enter into agreements with state, federal or foreign regulators that allow sandbox participants to operate in other jurisdictions and allow entities authorized to operate in other jurisdictions to be recognized as sandbox participants in this state."

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Update on Colorado bank-model lawsuits

By **Scott M. Pearson** on June 29, 2018

In two closely-watched enforcement actions pending in Colorado state court, the Administrator of the Uniform Consumer Credit Code for the State of Colorado is employing the "true lender" theory and the Second Circuit's decision in ***Madden v. Midland Funding, LLC*** to challenge two bank-model lending programs. Specifically, the Administrator asserts that the origination of the loans by state-chartered banks should be disregarded under the "predominant economic interest" test employed by some district courts in true lender cases, and that the banks' power to export interest rates under federal law does not follow loans they assign to their program partners. For these reasons, the Administrator contends that the loans are subject to Colorado usury laws despite the fact that state interest rate limits on state bank loans are preempted by Section 27 of the Federal Deposit Insurance Act (FDIA).

Although these cases were filed in January 2017, little has happened on the merits to date. The cases were removed to federal court by the program sponsors and remanded a year later. The banks involved in the programs filed separate **declaratory relief actions** in federal court, but those cases were dismissed without prejudice on abstention grounds. The banks then filed motions to intervene in the state court actions, and the program sponsors moved to dismiss the state court cases. The motions to dismiss argue that the usury claims are preempted by the FDIA, that *Madden* was wrongly decided and should not be followed, and that the

banks are the “true lenders” as a matter of federal law, and also under state law if it applies.

On June 22, 2018, the state court heard oral argument on the motions to dismiss and to intervene in both cases. The Court allowed argument for nearly two hours, and provided no clear indication on how it would rule before taking the motions under submission. We will continue to follow the cases closely and report on additional developments.

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August 8, 2018

Treasury Recommends Sweeping Regulatory Changes for Consumer Financial Services

by the Consumer Financial Services Group

A report issued last week by the U.S. Treasury Department recommends sweeping regulatory changes intended to promote innovation in the consumer financial services market, reduce regulatory burdens on consumer financial services providers, and update regulations applicable to various types of consumer lending and related consumer financial products and services.

The report, titled "*Nonbank Financials, Fintech, and Innovation*," is the fourth in a series of reports issued in response to President Donald J. Trump's Executive Order 13772, which established a set of core principles for regulating the U.S. financial system.

On September 20, 2018, from 12 p.m. to 1 p.m. ET, Ballard Spahr will conduct a webinar, "More Than Just Fintech: What Are the Important Takeaways for All Consumer Financial Services Providers from Treasury's Sweeping Report?" A link to register is available here.

Each set of recommendations made by the Treasury is preceded by an explanation of the current statutory and regulatory framework applying to the subject of the recommendations, and a detailed discussion of the issues sought to be addressed by the recommendations. Such issues particularly concern those arising from impediments or uncertainties that the current legal framework creates for marketplace developments driven by changes in technology.

The four categories into which the Treasury's recommendations are organized are set forth below. Given the report's length and the wide range of issues covered, we have limited the scope of this alert to several of the Treasury's key recommendations in each category and will publish supplemental discussions of additional recommendations, such as those concerning data aggregation and mortgage lending and servicing.

1. *Embracing the efficient and responsible use of consumer financial data and competitive technologies.* The recommendations in this category address how regulatory approaches can be adapted to the digitization of communications and changes in the aggregation, sharing, and use of consumer financial data.

The Treasury recommends:

- The Federal Communications Commission (FCC) should continue its efforts to create a database of reassigned telephone numbers that would provide a safe harbor from Telephone Consumer Protection Act (TCPA) liability for callers who use such a database. (In April 2018, the FCC published a notice in the *Federal Register* seeking comment on a variety of issues relating to the creation of a "reassigned numbers" database, including the FCC's ability to create such a safe harbor.) The FCC should also provide clear guidance on reasonable methods for consumers to revoke consent to receive autodialed calls under the TCPA and Congress should consider statutory changes to mitigate unwanted calls to consumers and provide a revocation standard similar to the standard under the Fair Debt Collection Practices Act (FDCPA), which requires a consumer seeking to stop debt collector communications to provide written notice. In its March 2018 ACA International decision, the U.S. Court of Appeals for the District of Columbia Circuit upheld the FCC's ruling that a called party can revoke consent to receive autodialed calls at a wireless number "at any time and through any reasonable means that clearly expresses a desire not to receive further messages." In May 2018, the FCC published a notice in the *Federal Register* seeking comment

on various issues arising from *ACA International*, including the "clearly defined and easy" methods a called party might use to revoke prior express consent.)
- Congress should enact a federal data security law to protect consumer financial data and provide consumers with timely notice of a breach, with such a law to create national standards that preempt state laws and contain standards that take into account an entity's size and activities.

2. *Streamlining the regulatory framework to eliminate unnecessary fragmentation and foster new business models that are enabled by innovations in financial technology.*

The Treasury recommends:

- State legislators and regulators should accelerate their efforts to reduce unnecessary inconsistences across state laws and regulations to achieve more harmonization, with such efforts to potentially include adoption of a system that allows "passporting" and reciprocity of state licensing. (The report discusses some of the limitations of the Nationwide Multistate Licensing System, which it describes as "one of the primary efforts of state regulators to achieve…enhanced cooperation [in the supervision of nonbank financial services companies.]." If the states cannot "achieve meaningful harmonization across their licensing and supervisory regimes within three years, Congress should act to encourage greater uniformity in rules governing lending and money transmission to be adopted, supervised, and enforced by state regulators." (The report points to the minimum mortgage licensing requirements of the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) as a "similar model" used by Congress.)
- The Office of the Comptroller of the Currency (OCC) should finalize its proposal to grant special purpose national bank (SPNB) charters to nondepository financial technology companies. (Last week, the OCC announced that it will begin accepting applications for SPNB charters. See our legal alert for a detailed discussion of the OCC's decision to accept applications and to register for our August 28 webinar, "The OCC's Special Purpose National Bank Charter: What Fintech Companies Need to Know.")
- Federal banking regulators should, in coordination, review their third-party vendor and service provider guidance through a notice and comment process and further harmonize their guidance to place more emphasis on (i) making third-party oversight more efficient by removing inconsistencies in how banks should apply the guidance and allowing banks to more comfortably apply risk-based or tailored approaches when conducting due diligence on third parties, and (ii) enabling innovation in a safe and prudent manner.

3. Updating activity-specific regulations that apply to various products and services offered by nonbanks to accommodate technological advances.

The Treasury recommends:

- **Marketplace Lending**. Federal and state lawmakers should make legislative changes to address the following constraints that unnecessarily limit the operation of partnerships between banks and marketplace lenders:
  - **"Valid When Made."** In response to the U.S. Court of Appeals for the Second Circuit's decision in *Madden v. Midland Funding*, Congress should codify the "valid when made" doctrine, which provides that a loan contract that is valid when made cannot be invalidated by a subsequent transfer to a third party. In that decision, the Second Circuit held that a nonbank that purchases loans from a national bank could not charge the same rate of interest on the loan that Section 85 of the National Bank Act (NBA) allows the national bank to charge. The federal banking regulators should use their available authorities to address challenges posed by *Madden*. (For several years, we have advocated for the OCC's adoption of a rule providing that loans funded by a bank in its own name as creditor are fully subject to Section 85 and other provisions of the NBA for their entire term. Given the political uncertainty of Congressional action, we believe that the OCC's adoption of a rule represents the most practical approach. In February 2018, the House passed H.R. 3299, the "Protecting Consumers' Access to Credit Act of 2017," also known as the "Madden fix" bill, to address the uncertainty created by *Madden* by amending Section 85, as well as relevant provisions of the Home Owners' Loan Act (HOLA), the Federal Credit Union Act, and the Federal Deposit Insurance Act (FDIA.))
  - **"True Lender."** Congress should codify that the existence of a service or economic relationship between a bank and a third party (including a Fintech company) does not affect the bank's role as the true lender of the loans it makes. Federal banking regulators should reaffirm (through additional clarification of applicable compliance and risk-

management requirements, for example) that the bank continues to be the true lender in such partnership arrangements. (We have similarly urged the OCC to adopt a rule providing that the regulatory treatment of a loan under federal law should turn on the loan's origination by a national bank, and not on whether the bank retains the predominant economic interest in the loan. Like the challenges posed by *Madden*, we believe that given the political uncertainty of Congressional action, the OCC's adoption of a rule addressing "true lender" concerns represents the most practical approach. In November 2017, H.R. 4439, the "Modernizing Credit Opportunities Act," was referred to the House Financial Services Committee to address "true lender" challenges. The bill would amend Section 85 of the NBA, as well as relevant provisions of the Bank Service Company Act, the HOLA, and the FDIA.)

    - **Credit Services/State Licensing**. States should revise credit services laws to exclude businesses that solicit, market, or originate loans on behalf of a federal depository institution pursuant to a partnership agreement. This recommendation is intended to address the threat that state licensing statutes can create for bank partnership arrangements with nonbanks. (The Treasury report references the decision of the Maryland Court of Appeals in *CashCall, Inc. et al. v. Maryland Commissioner of Financial Regulation*, which held that CashCall could not assist Maryland consumers in obtaining loans from out-of-state, state-chartered banks at interest rates in excess of the maximum rate permitted by Maryland law without being licensed as a "credit services business" under the Maryland Credit Services Business Act.)

- **Student lenders and servicers**. The Department of Education should create guidance on minimum servicing standards for federal student loans that address how servicers handle decisions with significant financial implications (e.g. applying payments to multiple loans, prioritizing repayment plans, and using deferment options), minimum contact requirements, standard monthly statements, and timeframes for completing certain activities (e.g. processing forms or correcting specific account issues). Although student loan servicing had been included as a "long-term actions" item in the Consumer Financial Protection Bureau's (CFPB) rulemaking agenda for several years under the leadership of former Director Richard Cordray, it was designated "inactive" in the Spring 2018 rulemaking agenda published under Acting Director Mick Mulvaney's leadership.
- **Short-term, small-dollar installment lending**. The CFPB should rescind its final payday/auto title/high-rate installment loan rule (Payday Rule) in light of comprehensive state product restrictions and licensing requirements for nonbank, short-term, small-dollar installment lenders. The Treasury believes that such state restrictions and requirements make additional federal regulation unnecessary. (In January 2018, the CFPB announced that it intends to engage in a rulemaking process to reconsider the Payday Rule pursuant to the Administrative Procedure Act. Although the Payday Rule became "effective" on January 16, 2018, the compliance date for the rule's substantive requirements and limits (Sections 1041.2 through 1041.10), compliance program/documentation requirements (Section 1041.12), and prohibition against evasion (Section 1041.13) is August 19, 2019. On June 12, 2018, the Texas federal court hearing the lawsuit filed by two trade groups challenging the Payday Rule granted the stay of the lawsuit requested in a joint motion filed by the trade groups and the CFPB, but denied the stay of the Payday Rule's August 19, 2019, compliance date that was also requested in the joint motion. A motion for reconsideration filed by the trade groups seeking reconsideration of the court's June 12 order was denied.) To encourage responsible short-term, small-dollar installment lending by banks, the FDIC should reconsider its guidance on direct deposit advance services and issue new guidance similar to that issued by the OCC. (In May 2018, the OCC issued a bulletin setting forth core lending principles and policies and practices for short-term, small-dollar installment lending by national banks, federal savings banks, and federal branches and agencies of foreign banks and encouraging banks to engage in such lending.)
- **Debt collection**. The CFPB should establish minimum federal standards for third-party debt collectors that address the information that is transferred with a debt for the purposes of debt collection or in the sale of the debt. The CFPB should determine whether the FDCPA's existing validation letter standards should be expanded "to help consumers assess whether the debt is owed and determine an appropriate response to collection attempts." The Treasury does not support the FDCPA's expansion to first-party collections absent further Congressional consideration. (In its Spring 2018 rulemaking agenda, the CFPB stated that it was "preparing a proposed rule focused on FDCPA collectors that may address such issues as communication practices and consumer disclosures." The CFPB estimated the issuance of a Notice of Proposed Rulemaking in March 2019.)

- **Credit models**. Federal and state financial regulators should enable the testing of creditworthiness models by banks and nonbanks that employ new approaches, such as the use of machine learning-based algorithms and the consideration of alternative data, such as utility and rent payments and technology use patterns (e.g. social media, browsing history). Regulators, through interagency coordination whenever possible, should tailor regulations and guidance to enable the increased use of such alternative data and new modeling approaches by reducing uncertainties. In particular, they should provide regulatory clarity for the use of alternative data and new modeling approaches that are generally recognized to have predictive value for use in credit decisions consistent with applicable law. The Treasury is supportive of industry efforts to obtain alternative data, such as monthly payments to telecom, utility, or rental companies through regular reporting of such data to consumer credit reporting agencies (CRAs). (H.R. 435, the "Credit Access and Inclusion Act of 2017," passed the House in June 2018 with bipartisan support and is currently under consideration by the Senate. The bill would amend the Fair Credit Reporting Act to allow landlords (including the Department of Housing and Urban Development), utility companies, and telecommunications providers to provide consumer credit information to CRAs.)

4. *Advocating an approach to regulation that facilitates responsible experimentation.*

The Treasury recommends:

- Federal and state financial regulators should establish a unified solution to the fragmented nature of the U.S. financial regulatory system to permit meaningful experimentation for innovative products, services, and processes. This solution would be in the form of a "regulatory sandbox" to promote the adoption and growth of innovation and technological transformation in financial services by providing targeted relief across multiple regulatory frameworks. Instead of promoting the establishment of a formal sandbox overseen by a single regulator, the Treasury plans to work with federal and state financial regulators to design a sandbox solution. However, the Treasury recommends that Congress consider legislation to provide for a single process that includes preemption of state laws if necessary should financial regulators be unable to address the Treasury's objectives. (Earlier this year, the State of Arizona created the first regulatory sandbox in the United States. Paul Watkins, who was formerly in charge of Fintech initiatives in the Arizona Attorney General's office, was recently named the Director of the CFPB's Office of Innovation and is expected to consider the creation of a regulatory sandbox at the federal level.)

Ballard Spahr's Consumer Financial Services Group is nationally recognized for its guidance in structuring and documenting new consumer financial services products and programs, its experience with the full range of federal and state consumer credit laws, and its skill in litigation defense and avoidance.

The firm's Marketplace Lending Task Force is nationally recognized for counseling marketplace lending businesses in both the consumer and small business spaces. We offer soup-to-nuts guidance, working with startup alternative lenders, long-established market leaders, banks, institutional investors, and others. We document and advise on the structure and strategy of bank, platform, and investor relationships, assist in concluding account servicing arrangements, provide extensive consumer regulatory advice, documentation, and diligence assistance, and help with state licensing. We are already advising clients on the steps involved in obtaining an SPNB charter.

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August 17, 2018

Mortgage Banking Update

by the Mortgage Banking Group



Treasury Recommends Sweeping Industry Changes for Mortgage Lenders and Servicers

As covered earlier this week in a legal alert, the U.S. Department of Treasury issued a report recommending sweeping regulatory changes for consumer financial services. Within the report, the Treasury also recommended a wide range of changes for the mortgage industry.

In connection with a discussion of the post-crisis increase in market share for nonbank mortgage lenders, the report notes that many nonbank lenders have been early adopters of financial technology innovations. According to the report, early studies indicate that such innovations have accelerated and simplified the loan application and approval process for front-end mortgage originations. The report also notes that the departure of depository institutions from the mortgage market has been driven in part by various factors that have unnecessarily raised the cost of doing business, including False Claims Act (FCA) enforcement and the increased costs of default mortgage servicing.

To further the aim of promoting broad market participation and the adoption of beneficial technological developments, the Treasury makes the following general findings:

- Financial technology and digital mortgage capabilities have the potential to improve the customer experience, shorten origination timelines, and deliver a more reliable, lower cost mortgage product.
- Current limitations on the acceptance of electronic promissory notes by market participants limit the wider use and adoption of this technology, along with the associated benefits to consumers and the marketplace.
- The mortgage production process is unnecessarily time-intensive, with certain components prone to delays. These delays could be relieved through policy changes that enable the adoption of time- and cost-saving technology.
- State-level policy and regulatory differences across key components of the mortgage lifecycle create compliance uncertainty for lenders and servicers, increase costs, and inhibit the wider adoption of enhancing innovations.
- The use of the FCA to impose civil liability for violations of mortgage origination and servicing requirements has likely contributed to the exit of traditional commercial lenders from federal mortgage programs. This has resulted in increased costs and has limited borrower access to mortgage credit for federally insured or guaranteed loans.
- Differences in loss mitigation programs for federally supported mortgages, including the GSEs, Federal Housing Administration (FHA), U.S. Department of Veterans Affairs (VA), and U.S. Department of Agriculture (USDA), have the potential to negatively impact borrowers during periods of financial hardship and slow loss mitigation responses during a period of sustained financial stress.
- Federally supported mortgage programs exposed to nonbank counterparty credit risk could benefit from increased transparency into these counterparties' financial condition through greater standardization and reporting.

Issues and Recommendations

In light of the above findings, the report makes a series recommendations for the mortgage industry.

Electronic Mortgage Notes

The report recommends a transition from paper-based promissory notes, with "wet signatures" and physical storage, to fully electronic notes (eNotes). Among the advantages of eNotes, the report describes greater uniformity with related digital capabilities, more efficient quality control, faster origination timelines, and ease of transferability in secondary market transactions. Treasury describes certain impediments to a wider adoption of eNotes, including delays in developing capabilities in the primary market, and lack of acceptance by certain key secondary market participants.

Treasury recommends:

- Ginnie Mae should pursue acceptance of eNotes and the measures outlined in its Ginnie Mae 2020 roadmap to more broadly develop its digital capabilities.
- Congress should appropriate for FHA the funding requested for technological upgrades in the President's Fiscal Year 2019 Budget. Part of this funding would be used by FHA to improve digitization of loan files.
- FHA, VA, and USDA should explore the development of shared technology platforms, including for certain origination and servicing activities.
- The Federal Home Loan Banks should explore ways to address their concerns regarding eNotes, with the goal of accepting eNotes on collateral pledged to secure advances.

Appraisals

The report notes that appraisal requirements, enacted in the wake of the housing bubble and subsequent collapse in home prices, have greatly affected the appraisal industry. Appraisals have consequently become the source of delays and extended closing timelines for mortgage originations. At the same time, technological advances have been made that can lower costs and expedite closing timelines, including improvements to automated valuation models and hybrid/desktop appraisals.

Treasury recommends:

- Congress should revisit the Title XI FIRREA appraisal requirements to update them for market developments. Such an updated appraisal statute should account for the development of automated and hybrid appraisals and permit their use depending on the characteristics of the transaction and market conditions.
- Support is voiced for the GSE's efforts to implement standardized appraisal reporting, the GSE's and FHA's adoption of proprietary electronic portals to submit appraisal forms, and the GSE's limited adoption of appraisal waivers. However, the report cautions that further use of digital, automated property valuations must be carefully monitored and integrated with rigorous market standards when used in lieu of traditional appraisals.
- FHA and other government loan programs should develop enhanced automated appraisal capabilities to improve origination quality and mitigate the credit risk of overvaluation. Further, the programs should consider allowing targeted appraisal waivers in situations where a high degree of property standardization and information about credit risk exists to support automated valuation, and where the overall risk of a mortgage transaction make such a waiver appropriate.
- Government loan programs should explore opportunities to leverage industry-leading technology capabilities, to reduce costs to taxpayers and accelerate the adoption of new technology in the government-insured market.
- Support is voiced for the Appraisal Qualifications Board's recently updated appraisal certification guidelines, which ease the education requirements to obtain an appraiser credential. The report notes that providing off-ramps for the education requirement—in favor of on-the-job training or other education credits—can attract qualified appraisers and relieve appraiser supply shortages.

Electronic Closing and Recording

The report notes that notarization methods have expanded and now can be performed either in person using a digital document and notary seal, or remotely using webcam interaction along with a knowledge-based identification to confirm the borrower's identity. Treasury states that additional legal clarity is needed, beyond existing state eNotarization laws and the revised model notarial act framework promulgated by the Uniform Law Commission, to ensure acceptance of both in-person and remote electronic notarizations. Despite progress in certain states, and model legislation published by the American Land Title Association and Mortgage Bankers Association (MBA), the report cites issues stemming from a lack of broad nationwide acceptance.

The report also discusses the acceptance of digital security instruments on the county level. While 33 states and U.S. territories have enacted the Uniform Real Property Electronic Recording Act (URPERA), implementation of these measures may still be held up in particular counties for those states.

Treasury recommends:

- States that have not yet authorized electronic and remote online notarization should pursue legislation to expressly permit the use of this technology, and the interstate recognition of remotely notarized documents. Such legislation should align for further standardization.
- Congress should consider legislation providing a minimum national standard for electronic and remote online notarizations. Such legislation would facilitate, but not require, this aspect of a fully digital mortgage process.
- Recording jurisdictions that do not yet recognize and accept electronic records should implement the necessary technology upgrades to process and record such documents, and to digitize existing property records.

False Claims Act

The report details the recent trend of civil actions brought under the FCA by the U.S. Department of Justice (DOJ), for claims that lenders submitted loans for government insurance that did not meet federal eligibility standards. Liability under the FCA, having resulted in approximately $7 billion in FCA settlements and judgments to date, is cited as a factor in the departure of depositories from the government-insured market. The report claims that this market shift has negatively impacted borrower access to credit.

Regarding FCA enforcement practices, the report details concerns with the manner in which the DOJ and HUD-FHA calculate damages, and determine that a false claim is knowing and material. Treasury affirms that material errors in origination and servicing of government loans should continue to be subject to enforcement, and that bad actors who knowingly defraud the government should face significant penalties. However, when FCA enforcement practices cause reluctance in the broader industry to originate or service government loans, such practices counterproductively increase the cost of credit and limit borrower access to federal loan programs.

Treasury recommends:

- An appropriate balance should be struck between program requirements that an agency deems material, and thus subject to potential FCA enforcement, and program requirements that are not material, which are appropriately addressed outside of the FCA.
- HUD should establish more transparent standards in determining which program requirements and violations it considers to be material in order to assist the DOJ in determining which knowing defects to pursue. This clarification should include information on the remedies and liability lenders and servicers face, such as indemnification or premium adjustments.
- Lenders that make errors deemed immaterial to loan approval should receive safe harbor from a denial of claim and forfeiture of premiums. A similar safe harbor should be granted for material violations that are cured based on remedies prescribed by FHA, absent patterns indicating a systemic issue.
- In determining the appropriate remedies for program requirement violations, HUD should consider the systemic nature of the problem, involvement or knowledge of the lender's senior management, the overall quality of the originations of a specific lender, and whether or to what extent the loan defect may have impacted the incidence or severity of the default.
- DOJ should ensure that materiality, for purposes of the FCA, is linked to the standards in place at the agency administering the program to which the claim has been filed, and that DOJ and HUD work to clarify the process by which mutual agreement is reached on the resolution of claims. DOJ, in consultation with HUD and FHA, should consider seeking dismissal in the event a *qui tam* action is pursued against a lender for a nonmaterial error or omission.
- If the above recommended administrative actions are unsuccessful at increasing lender and servicer participation in federal mortgage programs, Congress should consider appropriate remedial legislation.

Aligned Federal Mortgage Loss Mitigation Standards

The report notes that while the CFPB has implemented regulations that mandate certain procedures for evaluating delinquent borrowers for loss mitigation, there are no federal

regulations dictating a national loss mitigation standard. Accordingly, market participants have raised concerns with the variance in loss mitigation options across different federal mortgage programs. The report commends recent efforts to establish loss mitigation standards that include components of crisis-era programs, including the GSE's Flex Modification, the MBA's One Modification proposal, and FHA-HAMP. However, loss-mitigation offerings continue to vary across the GSE's, FHA, VA, USDA, bank portfolio servicers, and private-label securities servicers. This varied landscape leads to particular challenges and inefficiencies for mortgage servicers, and substantially differing treatment among borrowers experiencing a financial hardship.

Treasury states that a greater degree of standardization and transparency across the federal housing footprint would benefit the market, and accelerate the ability of the industry to respond during a future economic downturn. Further, the report states the position of mortgage servicers that FHA servicing rules are complex, and in some cases, conflicting and outdated when compared to GSE requirements, private-label guidelines, and other regulatory requirements.

Treasury recommends:

- Federally supported mortgage programs should explore standardizing the most effective features of a loss mitigation program across the federal footprint. The standardization should align a loss mitigation approach that facilitates effective and efficient loan modifications when in the financial interest of the borrower and investor, promotes transparency, reduces costs, and mitigates the impact of defaults on housing valuations during downturns. The standards should also establish parameters such as a standardized application package, affordability standards (e.g., suggested housing-expense-to-income ratios and minimum payment reductions), modification waterfall standards that specify suggested acceptable loss mitigation steps, and referral of delinquent borrowers to financial counseling. However, these standards should not prescribe a specific modification product.
- FHA should continue to review FHA servicing requirements, in order to increase certainty, reduce needlessly costly and burdensome regulatory requirements, but fulfill FHA's obligation to the Mutual Mortgage Insurance Fund.
- FHA should consider changes to the manner in which penalties are assessed across FHA's multi-part foreclosure timeline. Such changes should allow servicers to miss intermediate deadlines, while adhering to the broader resolution timeline, and to better align with the CFPB's loss mitigation requirements.
- FHA should explore changes to its property conveyance framework to reduce costs and increase efficiencies.
- FHA should continue use of—and consider expanding—programs that reduce the need for foreclosed properties to be conveyed to HUD, such as Note Sales and FHA's Claim Without Conveyance of Title.

State Foreclosure Practices

The report notes that foreclosure practices are one of the most divergent state-level requirements for the mortgage industry, and that the variation has been highly problematic for housing markets since the collapse. According to the report, the national average timeline to complete a foreclosure increased from approximately six months in 2007 to about 33 months by the end of 2017, with generally longer periods for judicial states. Further, while the nationwide number of loans in the foreclosure process have returned to pre-crisis levels, the foreclosure rate in judicial states remain elevated as compared to both nonjudicial states and the pre-crisis level. Timelines in some judicial states, such as Florida and New Jersey, exceed three years on average—and in certain judicial review cases, a borrower has been able to remain in a property for more than five years without making a payment before a foreclosure is completed.

Treasury asserts that borrowers in states with protracted foreclosure timelines likely bear a portion of the cost of these delays, due to a risk premium embedded in interest rates for loans in that state. The report further states that prolonged foreclosure timelines create a negative externality on home prices, which may impact nearby property values and dampen appreciation. The report notes that, since their pre-crisis peak, housing prices in nonjudicial states have appreciated twice as much as those in judicial states. According to Treasury, evidence suggests that the judicial review process leads to higher rates of persistent delinquency than nonjudicial foreclosures, without measurably improving foreclosure outcomes.

The report notes in particular that for federal housing programs, which impose a degree of national pricing, a portion of the added cost from long foreclosure timelines is borne by borrowers in states with shorter timelines. In 2013, in response to differences in loss severities

due to varying foreclosure procedures, the FHFA directed the GSEs to impose a quarter-point guaranty surcharge in Connecticut, Florida, New Jersey, and New York (all judicial review states), as the foreclosure costs in those states were more than two standard deviations above the national average. The decision, however, was subsequently reversed in 2014 under a new FHFA director.

Treasury recommends:

- States should pursue the establishment of a model foreclosure law, or make any modifications they deem appropriate to an existing model law, and amend their foreclosure statutes accordingly.
- Federally supported housing programs, including FHA, USDA, VA, and the GSEs, should explore imposing guaranty fee and insurance fee surcharges to account for added costs in states where foreclosure timelines significantly exceed the national average.

Nondepository Counterparty Transparency

The report notes that, with the departure of credit investors following the housing collapse, Ginnie Mae experienced a surge in volume. In addition, Ginnie Mae's issuer base changed significantly, with nondepository issuers filling the market vacated by depositories exiting government loan programs. The GSEs have also seen their seller-servicer counterparty population shift toward nondepositories. Many in the industry have consequently observed that the increase in nondepository activity, with a less standardized approach to safety and soundness regulation, creates heightened counterparty risk.

The report notes that nondepositories are subject to federal financial oversight, and must comply with the net worth, capital, and liquidity requirements imposed by Ginnie Mae and the GSEs. However, unlike their bank counterparts, nonbanks are not subject to uniform safety and soundness standards, and do not have access to the same sources of liquidity in the event of sustained financial stress. Of particular concern is the durability of funding structures for nonbank servicers. Required advances to investors in the event of nonpayment by borrowers may expose servicers to extended periods of liquidity strain. Because counterparty risk represents Ginnie Mae's primary financial exposure, the report finds that its leadership is reasonably concerned about these issues.

While Ginnie Mae and the GSEs have various counterparty risk-management tools, the data quality and present reporting fields may not be sufficient to gain the insight needed to assess counterparty financial health. Further, despite the dramatic increase in Ginnie Mae's portfolio, it lacks the flexibility to adjust its MBS fees and hire additional staff for risk management.

Treasury recommends:

- Ginnie Mae should collaborate with FHFA, the GSEs, and the Conference of State Bank Supervisors to expand and align standardized, detailed reporting requirements on nonbank financial health. Such reporting should include terms and covenants associated with funding structures, to give confidence that taxpayers are protected during severe market stress.
- Support is given to Ginnie Mae's consideration of enhancing its counterparty risk mitigation approach, including the imposition of stress-testing requirements.
- Ginnie Mae should have sufficient flexibility to charge guaranty fees appropriate to cover additional risk arising from market or program level changes.
- Ginnie Mae should undergo a comprehensive assessment of its staffing and contracting policies, including the costs and benefits of alternative pay and/or contracting structures. Ginnie Mae should be enabled to more readily attract personnel, with the necessary expertise, by paying salaries comparable to other financial agencies with premium pay authority. In addition, being able to adopt contracting procedures, similar to other agencies that are outside of federal acquisition laws, would enable Ginnie Mae to effectively respond to changing market conditions and needs.
- Nondepositories should provide greater transparency about their financial health, to address concerns about their sustainability. Greater standardization of requirements and reporting could benefit nondepositories by reducing disparate state-level and principal counterparty requirements.

The full report, titled "A Financial System That Creates Economic Opportunities - Nonbank Financials, Fintech, and Innovation," can be found here.

- Reid F. Herlihy

HUD Looking to Bring Lenders Back to FHA Lending Space

In a July 2018 interview with *HousingWire*, FHA Commissioner Brian Montgomery stated that the FHA wants to bring big banks back to the FHA lending space by increasing transparency and decreasing False Claims Act (FCA) enforcement, which ballooned in the Obama era. Mr. Montgomery remarked on how unfortunate it is that big banks have thousands of locations and even more loan officers—the vast majority of which do not offer FHA loan products.

He attributed the sharp drop in the availability of FHA Loan products in recent years, in part, to the billions of dollars in FCA settlements extracted from big banks in relation to their FHA loans. To counter this, he indicated that FHA lending could be brought back under the FHA's jurisdiction and highlighted key moves by the administration, HUD, and the Department of Justice to dial back the use of the FCA. HUD Secretary Ben Carson has also been working with the DOJ to dial back the number of FCA complaints against FHA lenders.

By limiting FCA cases, Commissioner Montgomery wants to increase certainty and decrease the risk for lenders. Consumers who use such products generally present more risk to begin with. FHA loan products are designed to encourage lending to those consumers. Slapping lenders with huge penalties and fines for doing what the program was designed to do is no way to help consumers.

He made clear that FHA, HUD, and DOJ will not "look the other way" when confronted with fraud, but indicated that penalizing lenders for minor issues is no way to have a robust, transparent, and consumer-friendly system.

- Constantinos G. Panagopoulos and Theodore R. Flo

CFPB Issues HMDA File Verification Tool

The Consumer Financial Protection Bureau (CFPB) recently released a File Format Verification Tool for 2018 Home Mortgage Disclosure Act (HMDA) data. As we reported in October 2015, the CFPB adopted significant changes to HMDA rules that significantly expanded the amount of information that must be collected and reported. Calendar year 2018 is the first year in which the expanded data must be collected.

The tool can be used by HMDA filers to test whether their HMDA data file meets the following formatting requirements: (1) whether the file is in the pipe-delimited format, (2) whether the file has the proper number of data fields, and (3) whether the file has data fields that are formatted as integers, when applicable. The tool cannot be used to file HMDA data. The CFPB advises that there are no login requirements to use the tool, and it will not log identifying information about users or the files that they test. Also, no federal agency will receive or be able to view the files that are tested using the tool.

- Richard J. Andreano, Jr.

Federal Reserve Board Launches "Consumer Compliance Supervision Bulletin"

On July 26, 2018, the Federal Reserve Board (FRB) announced the launch of the "Consumer Compliance Supervision Bulletin" and simultaneously published its first issue. Aimed at "senior executives in banking organizations," the Bulletin is published by the FRB's Division of Consumer and Community Affairs with the intent to provide high-level summaries of various consumer protection issues and to enhance the transparency of the Federal Reserve's consumer compliance supervisory program. While the Bulletin is primarily focused on state-chartered banks that are members of the Federal Reserve System, it contains advice which will be applicable to all banks and even non-banks. For example, it will highlight violations identified through supervision and examiner observations and provide practical steps for managing consumer compliance risks in coordination with similar FRB programs such as the Consumer Compliance Outlook and the Outlook Live webinar series. In comparison to the CFPB's publication of Supervisory Highlights—which, notably, has not been published since mid-2017—the initial issue of the Bulletin appears focused on providing high-level risk management guidance to institutions as opposed to a simple laundry list of violations identified through examinations.

With this in mind, the July 2018 Bulletin focuses on a wide range of consumer protection issues, including:

- Redlining. The Bulletin reminds institutions that redlining risk may arise from failure to market products or locate branches in the minority prevalent locations or as a result of institutional changes such as mergers, acquisitions and new lending patterns and describes the key risk factors Federal Reserve examiners may consider, including whether a bank's (i)

Community Reinvestment Act (CRA) assessment area appears to inappropriately exclude majority minority census tracts; (ii) record of HMDA and/or CRA small business lending shows statistical disparities in majority minority census tracts; (iii) branch, product and marketing strategies have an impact on minority census tracts; and (iv) consumer complaints. It also provides guidance as to redlining risk management techniques such as (i) the regular review of assessment areas and credit market areas; (ii) evaluation of fair lending risk arising from the opening, acquiring or closing of branches and offices; (iii) evaluation through marketing and outreach programs; and (iv) complaint monitoring.

- Mortgage Target Pricing. The Federal Reserve details risk management insights related to "target prices" for mortgage loan originators, particularly where a higher target price is set for originators that serve minority areas, including: (i) reviewing financial incentives for compliance with Regulation Z; (ii) implementing policies and procedures to control for fair lending risks; (iii) managing risks for loan originators with higher target prices that serve minority neighborhoods; (iv) monitoring pricing by race and ethnicity across mortgage loan originators; and (v) mapping loans by target price.
- Small Dollar Loan Pricing. It details fair lending issues associated with small dollar loan pricing such as (i) a lack of rate sheets or other pricing guidelines; (ii) broad pricing discretion at the loan officer level; (iii) lack of clear documentation for pricing decisions; and (iv) lack of monitoring for pricing disparities, and it suggests managing these risks through detailed rate sheets and documentation and the monitoring of pricing exceptions.
- Disability Discrimination. The Federal Reserve notes that some bank practices related to disability benefits, such as requiring applicants receiving disability income to provide proof of disability through a doctor's letter, may raise fair lending concerns, and suggests addressing these risks by reviewing policies and procedures and training employees to ensure compliance.
- Maternity Leave Discrimination. Similarly, it indicates that some bank practices related to applicants on maternity leave, such as treating such applicants as unemployed, may raise fair lending risks and also suggests managing this risk through policy and procedure reviews and training.
- UDAP Issues Related to Student Loans. While noting previous enforcement with respect to deceptive practices surrounding student loan deposit accounts, the Bulletin stresses the increased UDAP risk associated with third-party student loan servicers and suggests that such risks can be managed through (i) evaluating the financial condition and experience of the third party before onboarding; (ii) monitoring third party complaints; and (iii) ensuring oversight of the third party through monitoring and assessment.
- UDAP Issues with Overdraft Fees. The Federal Reserve reiterates assessing overdraft fees on transactions with sufficient funds at the time of the transaction but not at posting is a UDAP and details risk management techniques for overdraft fee practices that include: (i) vendor management; (ii) analysis of the overdraft processing methodology and accurate disclosure of same to consumers; (iii) prohibiting overdraft fees where there are sufficient funds at the time of the transaction; and (iv) review of overdraft fee guidance and implementation of best practices.
- UDAP Issues Related to Loan Officer Misrepresentations. The Bulletin describes potential UDAP violations that may occur when loan officers make misrepresentations, particularly with respect to eligibility for loan programs or qualifications for a loan. It notes that these misrepresentations are typically identified through consumer complaints and highlights related risk management strategies such as (i) consumer complaint monitoring; (ii) refraining from definitive statements when qualifications are uncertain; (iii) clear and accurate disclosure of qualification requirements; (iv) review and modification of internal policies; (v) adoption of automated underwriting criteria; and (v) appropriate employee training.
- Other Topics of Note. The Bulletin concludes with a brief discussion of the Uniform Interagency Consumer Compliance Rating System and changes to the Military Lending Act's implementing regulation.

- Jason M. Cover

DID YOU KNOW?

Illinois Revises Advertisement "Tag Line" Requirement

Effective immediately, Illinois Residential Mortgage licensees will no longer required to include the phrase "Illinois Residential Mortgage Licensee" in advertisements, and instead will be required to include their NMLS Unique Identifier and include language referring consumers to the Nationwide Multistate Licensing System and Registry's Consumer Access website.

- John D. Socknat

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Ballard Spahr LLP
Consumer Finance Monitor
CFPB, Federal Agencies, State Agencies, and Attorneys General

Treasury's fintech report recommends changes directed at payments

By **Fred H. Miller** on August 13, 2018

A portion of the Treasury's report entitled "**A Financial System That Creates Economic Opportunities, Nonbank Financials, Fintech, and Innovation**," focuses on payments. (**See our legal alert** for a discussion of other portions of the Treasury's report.)

Current payment methods. The report notes four primary core payment systems: credit cards, debit cards, automated clearing house (ACH) transfers, and wire transfers. Among the issues facing such systems is that their regulation is fragmented, with the first two systems subject to significant federal regulation, the ACH system heavily dependent on agreement, and wire transfers primarily subject to uniform state law. The report, given its focus, ignores the check system, also regulated by uniform state law, and virtual currency payment methods that have yet to reach significant volume as a payment method.

Nonbank Funds Transfers. The report focuses on nonbank methods of funds transfers between individuals. It discusses money transmitters that, while subject to federal Bank Secrecy Act regulation, are primarily state-licensed and regulated by diverse state statutes and, for multi-state businesses, are subject to burdensome state licensing. The report also discusses the Regulation E remittance provisions, P2P and non-P2P transfers, and so-called digital wallets. The report's discussion

concludes with a review of (1) the effort to encourage faster payments including the Faster Payments Task Force, the Real-Time Payments System of The Clearing House, same day ACH efforts by NACHA and ACH operators, and the challenges these efforts face, and (2) the work of the Secure Payments Task Force.

Recommendations. The Treasury makes the following recommendations:

- States should work to harmonize money transmitter requirements for licensing and supervisory examinations–a task that may require some federal incentives since the Uniform Money Services Act, requested by Congress that the Uniform Law Commission research and write, has only been enacted by 12 states to date;
- The CFPB should provide more flexibility regarding the issue of remittance disclosures in Regulation E; and
- The Federal Reserve should accelerate its efforts to facilitate a faster retail payments system.

Our observations. While the Treasury's report is a good start, it could have gone much further. Noting the complexity in the U.S. payments system, the Treasury might have recommended that efforts be directed at reconciling the credit and debit card systems for similar issues. For example, the Treasury could encourage the Uniform Law Commission to update Uniform Commercial Code (UCC) payment articles for electronic instruments. Such a project is already under consideration by the UCC sponsors, the Uniform Law Commission, and the American Law Institute for notes which, when completed, would replace paper instruments as the only payment vehicles covered by the UCC. Another recommendation could provide support for the **Uniform Regulation of Virtual Currency Businesses Act**, which supplies what the Treasury's report characterizes as the need for "adequate prudential regulation and supervision" for that emerging payment method.

On September 20, 2018, from 12 p.m. to 1 p.m. ET, Ballard Spahr will conduct a webinar, "More Than Just Fintech: What Are the Important Takeaways for All

Consumer Financial Services Providers from Treasury's Sweeping Report?" A link to register **is available here**.

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Consumer Finance Monitor
CFPB, Federal Agencies, State Agencies, and Attorneys General

Treasury report promotes data aggregators in the consumer financial services ecosystem

By **Adam D. Maarec** on August 21, 2018

The U.S. Department of the Treasury's **recent report** evaluating economic opportunities presented by nonbank financial institution and fintech company innovations includes a detailed account of current data aggregation activities in the financial services marketplace and provides policy recommendations that shed light on the federal government's current views on data aggregation. (See our **legal alert** and blog posts (**here** and **here**) for a discussion of other portions of the Treasury's report.) In seeking to harness the potential benefits that can come from data aggregation, the Treasury report firmly supports the inclusion of these market participants.

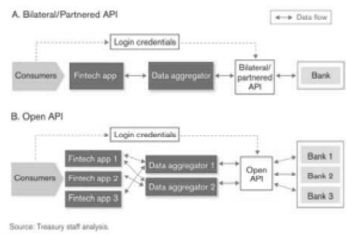
Following are key takeaways from the Treasury's report with respect to data aggregation practices and regulatory issues.

- **BCFP and private sector should develop consumer disclosure best practices**. The Treasury suggests that the Bureau of Consumer Financial Protection (BCFP) should develop, either with the private sector *or pursuant to its rulemaking authority*, consumer-facing disclosures that are "plain language, readily accessible, readable through the preferred device used by consumers to access services... so that consumers can give informed and affirmative consent

regarding to whom they are granting access, what data is being accessed and shared, and for what purpose," and to opt-out of such sharing.

- **APIs provide advantages and should be supported**. The report raises a number of issues with screen scraping while promoting the benefits of application programming interfaces (APIs) "that allow for the inclusion of robust security features, greater transparency and access controls for consumers, improved data accuracy, and more predictable and manageable information technology costs." Following is a graphic from the report identifying the similarities and differences between bilateral/partnered API and open API arrangements. It highlights how APIs can remove the need for fintech apps (users of aggregated data) and data aggregators to access consumers' bank account login credentials and, therefore, supports Treasury's suggestion that the private sector and financial regulators should work to implement API solutions that "address data sharing, [data normalization,] security, and liability [and should support] efforts to mitigate implementation costs for community banks and smaller financial services companies with more limited resources to invest in technology."

Figure 4: Application Programming Interfaces (API)



- **Clarifying applicability of third-party oversight guidance to data aggregators**. The report states that there is some ambiguity regarding when third-party oversight guidance issued by federal banking regulators applies to data aggregator relationships, noting that data aggregators entering into "an API agreement with a bank [] may become subject to third-party guidance because

of the contractual relationship, which can increase compliance costs." The Treasury suggests that federal banking regulators take action to resolve this ambiguity.

- **Third-party data aggregators should be treated as "consumers."** Section 1033 of the Dodd-Frank Act provides "consumers" a right to access certain account information electronically upon request. Treasury recommends that this section be interpreted so that "third parties properly authorized by consumers, including data aggregators and consumer fintech application providers, fall within the definition of 'consumer'... for the purpose of obtaining access to financial account and transaction data."
- **Data security addressed by GLBA Safeguards Rule**. The report assumes that "data aggregators and consumer fintech application providers are subject to the Gramm-Leach-Bliley Act (GLBA)" and that "the Safeguards Rule appropriately addresses" data security concerns with data aggregation activities. To the extent additional regulatory or legislative measures are considered to address data aggregation data security issues, the Treasury suggests that such activities occur at the federal level rather than the state level to ensure uniformity.
- **Other financial regulators should support data aggregation**. The report suggests that regulators in addition to the BCFP should take steps to enhance data aggregation activities, including the Securities and Exchange Commission, the Financial Industry Regulatory Authority, Department of Labor, and state insurance regulators.

On September 20, 2018, from 12 p.m. to 1 p.m. ET, Ballard Spahr will conduct a webinar, "More Than Just Fintech: What Are the Important Takeaways for All Consumer Financial Services Providers from Treasury's Sweeping Report?" A link to register **is available here**.

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Rick Roque and Debbie Hoffman, *Greater Profits in Capital Markets, Blockchain and the Democratization of Mortgage Debt*, Housingwire Magazine (December 2018/January 2019)

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GREATER PROFITS IN CAPITAL MARKETS

BLOCKCHAIN AND THE DEMOCRATIZATION OF MORTGAGE DEBT

By Rick Roque and Debbie Hoffman



Over the course of the past decade, there have been several disruptors in the mortgage industry – advances that include eNotarization, desktop underwriter, Day 1 Certainty and, of course, the digital loan application process. All these improvements have a common factor in that they streamline the mortgage process and ultimately improve the customer experience.

The next step to advancement lies with utilization of blockchain technology. This nascent technology will take all these measures and truly transform the industry from paper to digital, resulting in transparency, better data security and higher revenues from operational efficiencies.

The advent of enterprise blockchain technology has been making its way through a multitude of industries due to the protocol's attributes. These characteristics can enhance almost any business which has the following factors: a supply chain, continued use of similar data, need for transparency and an exchange of money – or really value – leading to liquidity. The mortgage industry is no different. Particularly, however, blockchain technology has tremendous potential in transforming capital markets – both globally and nationwide. There are a multitude of methods by which blockchain innovation can be applied to the capital markets industry for benefits across this financial services sector.

EXPLAINING BLOCKCHAIN

Blockchain, a subset of distributed ledger technology or DLT, is essentially a methodology of storing and tracking information on a series of blocks which together form a chain of blocks and resemble a ledger. This ledger is not stored on one server, but on a decentralized database which includes a multitude of computers, or "nodes." One of the benefits of such a decentralized database is that it sets a higher standard for a cyberattack due to the fact that more than 51% of the computers would have to be simultaneously hacked for such an attack to occur. Furthermore, the decentralized storage of information allows for peer-to-peer business; this means information can be obtained more directly and there may not be a need for a middleman or facilitator of payment or data.



Blockchain protocols also allow for the simultaneous transfer of value (equivalent to money) via electronic currency – sometimes referred to as tokens or cryptocurrency. This could lead to easing of liquidity so long as there is enough supply and demand. Another important benefit of the technology is that data that is entered into a blockchain-based platform can be accessed simultaneously by all users who are given rights to enter the ledger. Data points on a blockchain are therefore retrieved by the user directly from the protocol, as opposed to having to transmit this data among parties. Due to the way the blockchain is architected (in what is called "consensus protocols," one of which, for example is "Proof of Work"), there is no risk that data could get altered during transfer.

A blockchain has an "append only" feature. This means that information entered onto a blockchain is time and data stamped and cannot be erased. Changes to such information occur in the form of amendments added to the blockchain. If data is entered onto a blockchain and checked for accuracy once, it need not be checked again and the data then contains a single source of truth. Furthermore, blockchain ledgers can be architected in a manner which allows for complete transparency as to who accessed it and when. This results in a comprehensive audit trail without the need to recreate.

The characteristics of blockchain make it an extremely useful emerging technology which continues to improve each day. As such, a number of new blockchain-based protocols have emerged in the first half of 2018 focusing on capital markets. It is likely that the industry will continue to see these initial protocols develop and new blockchain based platforms emerge which will allow for a complete transformation and improvement in the capital markets process.

CAPITAL MARKETS TODAY

Capital markets is a broader term associated with a financial ecosystem made up of financial institutions whose focus is to raise or sell capital by dealing with shares, bonds and other longer-term investment vehicles. Capital

markets are primarily composed of two different and distinct market sectors: the equity market and the debt market. In the context of the mortgage industry, financial assets (debt) held by mortgage institutions acquired and then traded into asset backed securities. The equity market generally includes stocks, while the debt market includes bonds. Moreover, several different financial institutions operate in capital markets, including stock exchanges, commercial banks, various types of corporations, insurance companies and mortgage banks. A highly liquid capital market is a market that both rapidly and consistently trades in either debt or equity.

Mortgage capital markets is a complex, relationship-driven process that is vital to replacing capital and increasing revenue margins by mortgage companies. Within this realm, when a mortgage loan funds, it gets pooled with other mortgages of the same risk pool – the risk is broken down by credit score, ZIP code, loan-to-value ratio and debt-to-income ratio. Such risk factors are mitigated via the rates assigned to the mortgages and the product types. Larger mortgage lenders will create a pool of their own loans of various risk buckets, and then are sold as a mortgage-backed security to investors. The largest mortgage investors are Fannie Mae and Freddie Mac. They set guidelines to direct mortgage originators on how loans should be underwritten. This is to control the risk and valuation of loan pools.

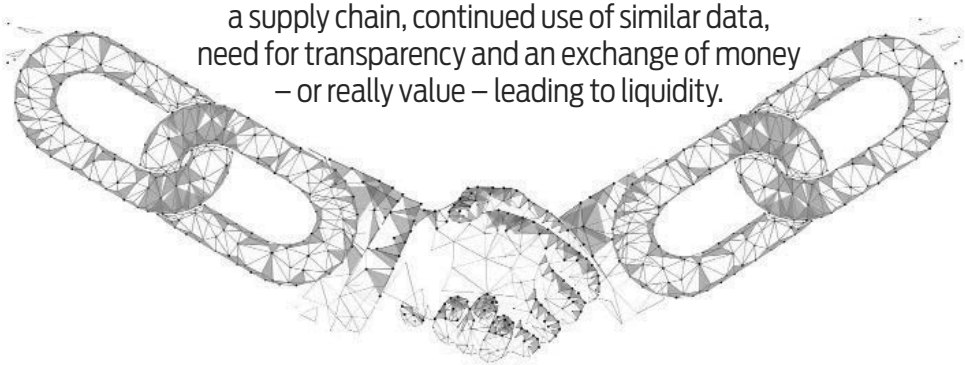
How loan level risk is quantified is intimately connected to how familiar loan aggregators are with the information associated to all aspects of the real estate and the borrowers. The more investors know about the details of the mortgage and borrowers, the better for the investor to assess risk and assign a suggested price or bid on the mortgage pool. Traditionally, investors have been limited by the access and visibility of mortgage debt across the United States. More information provided to investors yields a higher confidence assessment in their investment. The greater the confidence, the more investors will pay for mortgage pools. The access and visibility to loan and borrower level details have largely been limited by technology aggregation and distribution factors; blockchain is uniquely organized across industry verticals to safely organize, secure and make accessible to potential investors.

THE ADVENT OF ENTERPRISE BLOCKCHAIN TECHNOLOGY

has been making its way through a multitude of industries due to the protocol's attributes.

These characteristics can enhance almost any business which has the following factors:

a supply chain, continued use of similar data, need for transparency and an exchange of money – or really value – leading to liquidity.



INTEGRATING BLOCKCHAIN

Blockchain technology, if integrated into use by capital market firms, can provide efficiencies and other benefits due to the central, permanent and accessible nature of the technology and related smart contracts. Specifically, the technology could help with processes in the trading of loans or bundles, reporting, compliance and credit risk management.

Trading Blockchain technology can be used by firms in the secondary market to source loans and perform due diligence. Using the technology alleviates the need to transfer data and allows for a central depository where buyers and due diligence providers are given permissioned access to the loan level data. Most importantly, using blockchain allows for the same access to transparent data to be accessed by all parties involved during the settlement process.

Blockchain's central ledger essentially eliminates reconcilement issues in capital market transactions because it creates a single source of truth. Furthermore, the use of blockchain technology allows for an overall reduction in violations concerning trading limits. In capital markets, trading limits are typically set for both notional amounts and settlement dates and if these are not complied with, severe financial penalties could be imposed upon the financial financial institution.

An example of a blockchain company utilizing the technology in the capital markets space is Elphi.io, which, according to founder Eilon Shalev, uses the R3 Corda protocol that creates a secure, decentralized database where information is transparent and agreed upon by all parties involved in the transaction. Shalev notes that "by introducing a secured, trusted and transparent mechanism for reconciling debt transactions, we are able to save creditors and debtors billions of dollars."

Reporting and Compliance Another use of blockchain is in the market-to-market valuation reporting process, particularly with respect to more swiftly generating trade data, including real-time reports. The inherent features of blockchain can also be used to improve multi-jurisdictional regulatory reporting and provide for a more streamlined and efficient approach with the multitude of reporting requirements faced by firms. As an immutable ledger with time and date stamps of all transactions between parties, the ledger serves as a recording mechanism for all transactions and is suitable for compliance audits. Utilizing blockchain as a main depository of data and information for financial institutions would also be advantageous to risk departments who could be given transparency into the process via permissioned access (real-time or not) to the ledger.

The more investors know about the details of the mortgage and borrowers, the better for the investor to assess risk and assign a suggested price or bid on the mortgage pool.

Smart Contracts and Credit Risk Management Blockchain could also be implemented in the capital markets space by using the technology to create smart contracts that could be used in various scenarios. Smart contracts essentially codify into the technology an "if/then" scenario or workflow that triggers upon a specific condition. Thus, if there were trading agreements among parties, upon execution of a trade, the technology could be implemented to provide for a streamlined trade settlement process. Smart contracts could also be utilized in escrow scenarios where conditions must be met prior to release of funds.

Finally, blockchain protocols can be utilized to improve credit risk management for financial institutions. The size of the credit line granted to the client of a firm usually depends upon several different factors, including the volatility of the traded asset and the notional size of the transactions. If market conditions change, additional collateral could be required to secure the traded or transferred asset and manage the altered credit risk that resulted from this market change. Smart contracts could be used to write debit funds to satisfy the changed market conditions and the shared blockchain ledger could provide an accessible, central database for the financial institutions.

While there are leaders in the technology of blockchain such as Ethereum, Hyperledger, Corda and Digital Asset, there are not any financial institutions that have emerged as the blockchain leader as it pertains to use in capital markets. Nevertheless, the technology is being implemented in a wide variety of uses across the financial services sector. These range from trading and payment platforms to building databases for properties, loans and borrowers. The use of blockchain technology is exploding across a variety of other sectors and it is only a matter of time before it infiltrates as a common underlying technology protocol within capital markets.

Due to the fact that blockchain has already been successfully implemented a variety of other industries providing for benefits to the the overall efficiency and transparency of these sectors, its implementation in the capital market industry will also prove significantly beneficial. The use and implementation of this emerging technology could provide the capital market with the tools to successfully compete against other growing industries already taking hold of the multifaceted new technology protocol. ■

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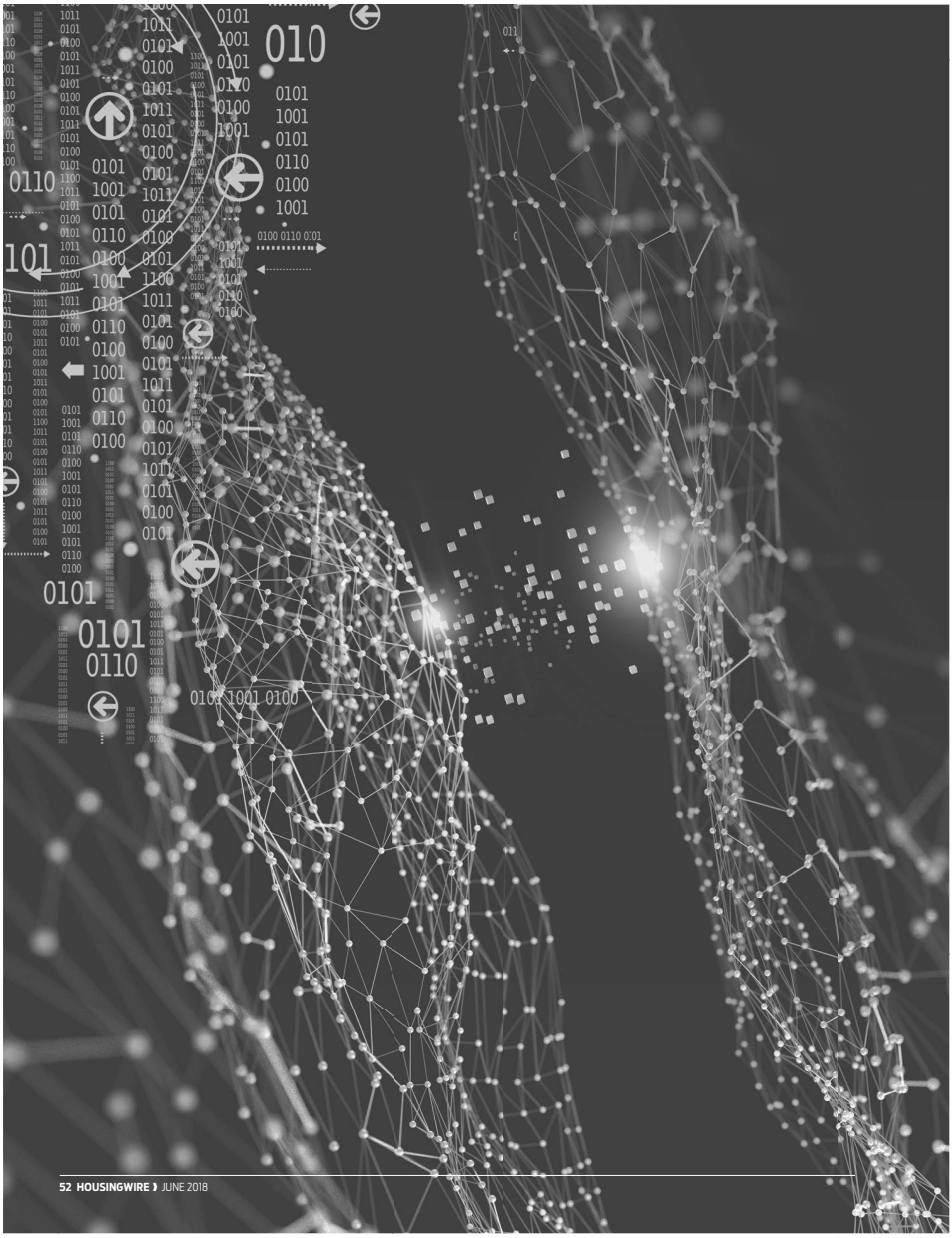
Alexandria Decatur and Debbie Hoffman, *How Title Companies Can Exploit Blockchain, Digital Ledger Technology Promises More Efficiency and Security, But Hurdles Remain*, Housingwire Magazine (June 2018)

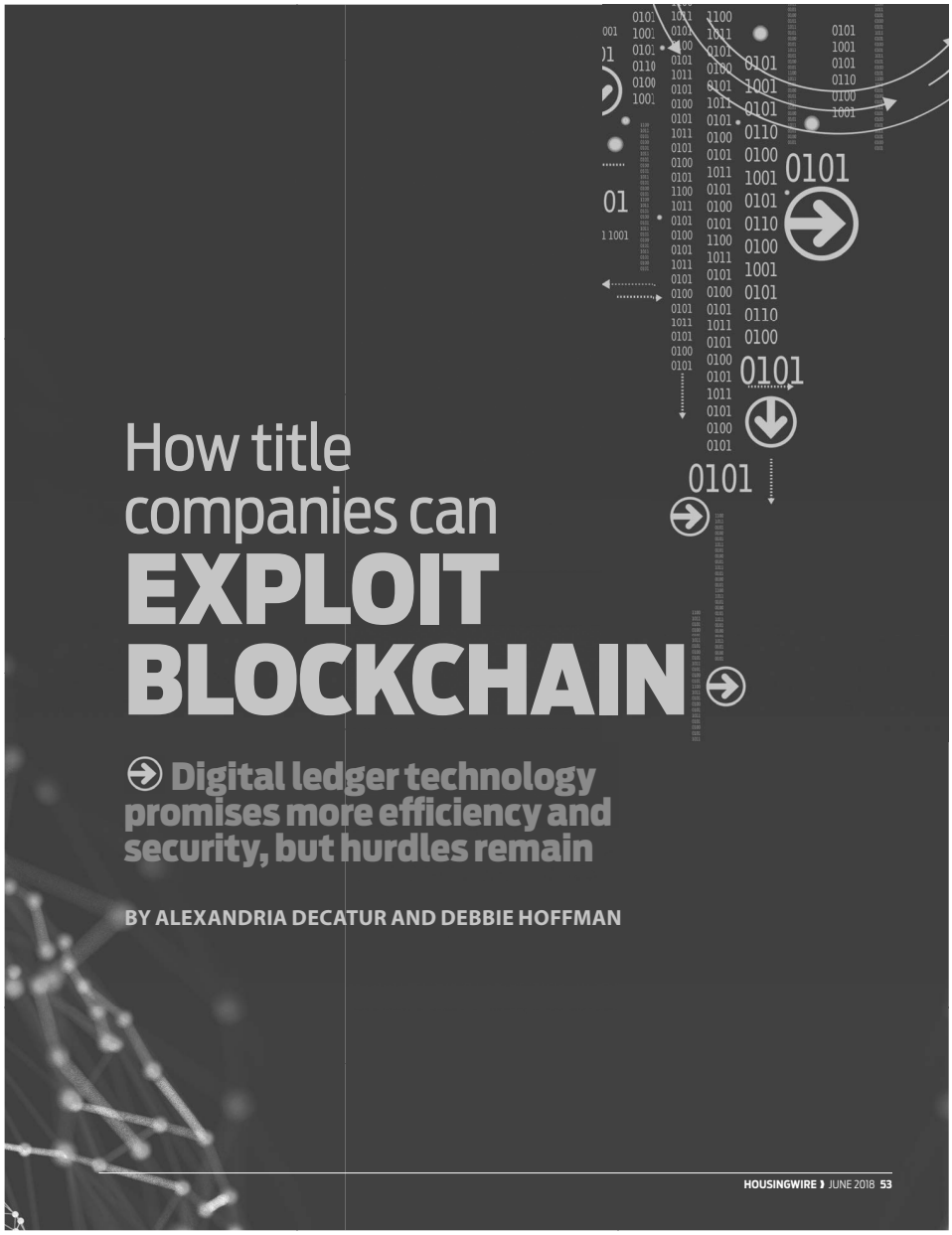
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How title companies can EXPLOIT BLOCKCHAIN

Digital ledger technology promises more efficiency and security, but hurdles remain

BY ALEXANDRIA DECATUR AND DEBBIE HOFFMAN



NOT LONG AGO it was routine for title companies and attorneys to travel to various land recording offices across the country, work with local clerks, and obtain Xerox copies of the history of properties.

Today, in most cases, land records can be obtained from across the United States simply using a computer to access the digital records of the relevant recorder's office. In the past 20 or so years, there has been a complete transformation in the way business is conducted from paper to digital records. Another transformation in land records may occur as a result of blockchain technology.

Initially used as the underlying technology for bitcoin when it was introduced in 2009, blockchain is the foundational digital ledger system for cryptocurrency transactions that allows the movement of bitcoin to occur securely, efficiently, and, in certain cases, anonymously. Blockchain, or distributed ledger technology (DLT), is no longer simply limited to a means of protocol for digital payments; it is now being used in some capacity in nearly all industries.

The multiple characteristics of blockchain make it an incredibly attractive mechanism across industries. It provides an unchangeable, time-stamped ledger that allows for real-time and simultaneous input. It is the perfect setup for industries where transactions are routinely moved from entity to entity or business to business and where records need to be verified and audited.

Naturally, therefore, in the world of title and real estate, blockchain provides an incredibly innovative platform, which would allow for land records to be added to a system of recordation that would permit access to such records in a more efficient, secure and transparent manner.

THE BASICS OF BLOCKCHAIN

Many people hear the term "blockchain" and do not understand the details of the technology. This process can be broken down into four steps as follows.

First, a user utilizing the DLT ledger makes an input transaction intended to add to the ledger. This value can be either a new transaction or a change to amend a prior transaction.

Next, the request is broadcast to every computer, or "node" as they are called, in the distributed group of computers on the blockchain network. This may consist of hundreds of different nodes and is not linked to just one server. Each node is not necessarily one person; it is not uncommon for companies to own an entire data room with computers (or "minors") automatically working on a blockchain system.

Then, each node on the network must validate the transaction by using a series of algorithms, which will verify the encryptions on the transaction by checking its validity. The validation occurs electronically on the nodes, and not through one individual working on a computer scribbling down various mathematical equations.

Finally, once the distributed network approves the proposed transaction, a new block is added to the blockchain. This new block becomes an unalterable, permanent record. The only way to modify it is by adding another transaction; the history of the prior transaction, however, will never disappear from the ledger.

The entire process occurs without any physical transmission of documents or transfer of any paper currencies. While the earliest of blockchain transactions could take several seconds to complete, the newer DLTs are becoming faster.

PROPERTY TRANSFERS

There are several characteristics of blockchain that make this technology an ideal ledger and record-keeping system for property transfer, title and ultimately land recording. DLT technology permanently records the times and dates of every change made to the ledger.

In addition, the encryption method used for blockchain technology allows for very secure record-keeping, which is less susceptible to cyber breaches than other virtual tools. It would take a hack of more than 51% of the



distributed network, occurring at the exact same time, for such a breach to occur. Finally, blockchain permits for central real-time access so that multiple people can access the same document online simultaneously.

The concept of distributed ledger technology generally means that there does not have to be an intermediary involved in the transaction and that such matter could be done in a "peer-to-peer" manner. For example, to effectuate payment, one could make payment directly without the need for an institution – like a bank, credit card company or a fintech solution such as PayPal.

As homes are sold, title is verified, and transactions are recorded, a process in which all of the information could be stored on a blockchain. If implemented, DLT would provide a streamlined process as these records are more efficiently retrieved and utilized, rather than transferred, among all of the various parties to the real estate purchase transaction. Ideally, the DLTs could include the Realtors, purchasers, lenders, title agencies, appraisers, home inspectors and all others involved through and including the land records offices.

The challenge is that blockchain is not intended to be implemented in a vacuum: It works best when there is an ecosystem of users that take advantage of a technology. In this ecosystem, there would be no need to transfer files. Those who need to review the ledger are able to access it – in some cases with "permissioned access" — and in others with complete transparency to all.

Therefore, the best use cases for blockchain implementation are for companies who are willing to invest in either being the first to move the market, or who are willing to become partners or vendors when the market movers are ready. This is similar to the way digital mortgage has grown to become a staple in the mortgage industry.

LAND RECORDS

Understanding the characteristics of DLT, one can envision a property being recorded on the chain and having this technology act as a centralized land records database for property owners and title companies. The concept works in theory, however, in the United States, with over 3,000 land record offices that are often in small municipalities, the implementation is not practical.

In addition, with U.S. property history going back hundreds of years, blockchain doesn't easily allow for this land history to be built into the chain.

But the technology has advantages that can be utilized in our current land recordation process going forward. The best implementation of blockchain at this point in time is to utilize the technology starting from today's records and developing it into a robust system.

As the technology grows, so too will the ability to determine how to add in historical data. Twenty-five years ago county recorders offices were all paper. Perhaps 25 years from now (or sooner), county recordation offices could be interconnected via blockchain.

USE CASES

Although blockchain technology is new, there are two prominent use cases that tested the use of blockchain for land records. The first was in Cook County in Chicago, followed by application in the South Burlington, Vermont, area.

In October 2016, velox.RE, a blockchain record keeping company, announced a pilot program in collaboration with Chicago's Cook County Recorder of Deeds. The program essentially allowed users to digitally transfer bitcoin tokens, which represented the physical transfer of deed to real estate, thereby allowing for digitalized real estate transactions.

Title information for a property was put onto a fraction of a bitcoin, called a "colored coin," and included digital title and deed information about the property being transferred. Ownership was effectively transferred by the seller sending the coin to the buyer's bitcoin wallet. This conveyance was simultaneously recorded on the municipality's public land records using this bitcoin blockchain.

The Cook County project used the bitcoin blockchain to immediately and directly transfer ownership of the property to the buyer using this as an electronic deed transfer system by allowing the blockchain deed to replace the paper deed. This differed from other international test cases due to the use of bitcoin blockchain, instead of a private blockchain.

While other programs were used to back up existing records on blockchain, this Cook County pilot allowed for new property ownership transfers to be conducted directly from buyer to seller.

Beginning in January 2018, another blockchain title project was launched in South Burlington, Vermont, to use the DLT technology to record real estate conveyances in the jurisdiction. This collaborative program between the South Burlington City Clerk's Office and Propy, Inc., a California-based real estate marketplace, utilizes a decentralized title registry system to transfer property.

The South Burlington pilot program was launched on Feb. 20, 2018, and allowed Katherine Purcell, an individual with property in Burlington, Vermont, to use

technology introduced by the program to transfer this property to her limited liability company for a nominal amount.

It demonstrated how the technology can be used for large-scale digital property transfers in the future because Purcell was able to do so rather simply across different entities in different locations. The town and the technology company are optimistic that this provides a manner of property record-keeping that will be both permanent and secure.

INTERNATIONAL LAND RECORDS

Outside of the U.S., several jurisdictions are either piloting or implementing blockchain as the technology used for land records, including Dubai and the Republic of Georgia. It should be noted, however, that many jurisdictions making these implementations do not have a comparable history of land recordings to that of the U.S.

"Dubai aims to be the first government in the world to completely adopt blockchain technology."

Dubai officially introduced its "Smart Dubai" Initiative in December 2016. According to the website for the Initiative, its purpose is to "explore and evaluate the latest technology innovations that demonstrate an opportunity to deliver more seamless, safe, efficient, and impactful city experiences," with the ultimate goal being to run all government transactions using blockchain technology by 2020. The Dubai Land Department (DLD) has stated that Dubai aims to be the first government in the world to completely adopt blockchain technology.

To realize this goal, the DLD has essentially set three different distinct phases. Dubai has already begun implementing the first phase as all land deeds are now being recorded on a central blockchain.

The next step is for the DLD to use blockchain to record all real estate agreements, lease or rental contracts, and property-related tax and water bills. The third phase will involve implementing a system that allows both citizens and investors to make electronic payments to any government entity at any time from any place.

In its formative stages, there is also a program for real estate titling designed and developed for the Republic of Georgia. A San Francisco-based blockchain technology company, The BitFury Group, is working with the Republic of Georgia's National Agency of Public Registry and Hernan De Soto, a Peruvian economist, to create the program. Together, they are developing a blockchain-based property registry that can be used by the government for purposes of titling.

This system can be used to register property securely, but transparently, on the blockchain. The information added to this ledger will then be used to ensure that all property owned in the area is correctly titled so that the ownership of these properties can be legally enforced.

In addition to Dubai and Georgia, similar blockchain land registry programs have been developed for use by municipalities across the world, including Sao Paulo, Brazil, Moscow, Russia, and Kumasi, Ghana. While some of these programs have been more successful than others, they have all worked to bring innovative technology to land recordation.

Brazil, for instance, faces many challenges in implementing widespread blockchain-based technology in land-titling systems because the country's population is extremely large and has many ongoing land disputes, including disputes between indigenous peoples who claim long-standing inherited rights to land and businessmen trying to now claim this land. However, Ghana's Land Commission wants to solve the longstanding problem of land ownership transparency and thus, the commission has been very willing and helpful in implementing a blockchain land titling system.

THE CHANGING ROLE OF TITLE AGENTS

As blockchain transforms the land records industry, the question arises as to what this means for the change in the role of title insurance, agents and the industry as a whole. While this is not an easy question, clearly there may be a transformative change which would alter, but not eliminate, the role of those in the title industry.

The most innovative companies will get ahead of the curve, commence implementing DLT pilot programs, and determine how they can be front and center in this land recording ecosystem.



The initial implementation of blockchain would most likely be forward looking, thus there will still need to be title analysis done on the history for all historical liens and defects.

Could blockchain eliminate the actual need for title insurance because the entire property history would be transparent on this technology – and thus not require insurance? Yes, theoretically the use of blockchain could eliminate a need for title insurance, but that would be far in the future when the entire ecosystem is on the DLT and our entire infrastructure has changed drastically.

Until then, title agents are still needed to dig deep for land history until the day when all the history and ownership of property is safely and securely placed on a blockchain ledger that could be assessed by the various parties to the transaction.

In the meantime, if those in the title industry embrace this technology to make their businesses more efficient, the roles and jobs may change, but they will not be eliminated. For example, the task of searching land records on a county recorder's website may mean that the title underwriter must take a look on the blockchain and confirm that there is a complete record.

Title companies can still be front and center if they are able to continue to bring value to the consumer by providing assurance that the property record is clear and complete.

What about escrow officers who could potentially have their roles eliminated by smart contracts? Escrow officers essentially hold requisite documents and currencies needed for the completion of a transaction. In the case of real estate transactions, the title company often acts as the escrow agent as it only releases the required documents and funds, when necessary, according to the instructions provided by the party on whose behalf the title company is acting.

Since these holding services would not be required for future contracts, this role would likely evolve to encompass work associated with new features of a blockchain land titling system that will allow consumers to put their money directly in a blockchain escrow account. The role of escrow agents may slowly evolve into new roles needed in the areas of the real estate transaction process, including virtual real estate transaction coordination.

HOME PURCHASES USING CRYPTOCURRENCY

In addition to using blockchain, title companies are now having to address inquiries where home purchasers ask about buying or selling properties in cryptocurrencies. While it is not essential to use cryptocurrency in conjunction with blockchain-based real estate titling systems, it does further expedite and simplify the process, allowing for a more seamless digital transaction.

It is currently possible to purchase a home using cryptocurrency. The main requirement for a transaction of this nature to occur in a residential real estate transaction is the agreement between the buyer and the seller to exchange the cryptocurrency for the sale transaction of the specific property in question.

Bitcoins have been a possible currency for home sales and have been used in these transactions since about 2014. With a growing demand for this type of real estate transaction, a website called Open Listings has developed a means of browsing that makes it relatively easy to find properties that can be purchased using bitcoins or other forms of cryptocurrency. Open Listings is a free real estate listing website that allows prospective homebuyers to shop listings in their desired area, schedule private tours to visit the homes in which they are interested, submit online offers, and ultimately purchase their homes.

Despite the benefits to using bitcoin in home purchases, including its efficiency and clear and indisputable transfer, some major barriers to using bitcoins in real estate transactions remain.

Mainly, consumers worry about the unstable and ever-changing value of cryptocurrency in relation to different global currencies. However, after the bitcoin transaction has occurred, it is possible to almost immediately thereafter exchange the bitcoins received for cash to avoid the potential longer term risk associated with the fluctuating values of cryptocurrencies. Therefore, the barriers of using bitcoin for these type of large real property transactions can ultimately be overcome.

LOOKING FORWARD

As with any new technology, it will take time to understand and implement blockchain's role in morphing businesses and industries. The introduction of DLT is still new; everyday there are emerging blockchain developments, infrastructures and use cases. One thing is certain – the use of this technology is here to stay. Those that embrace it are going to be ahead of the curve, front and center, and critical to the ecosystems and customers around them. ■

Alexandria Decatur is president of the Business Law Society at Albany Law School. Debbie Hoffman is the CEO and founder of Symmetry Blockchain Advisors.

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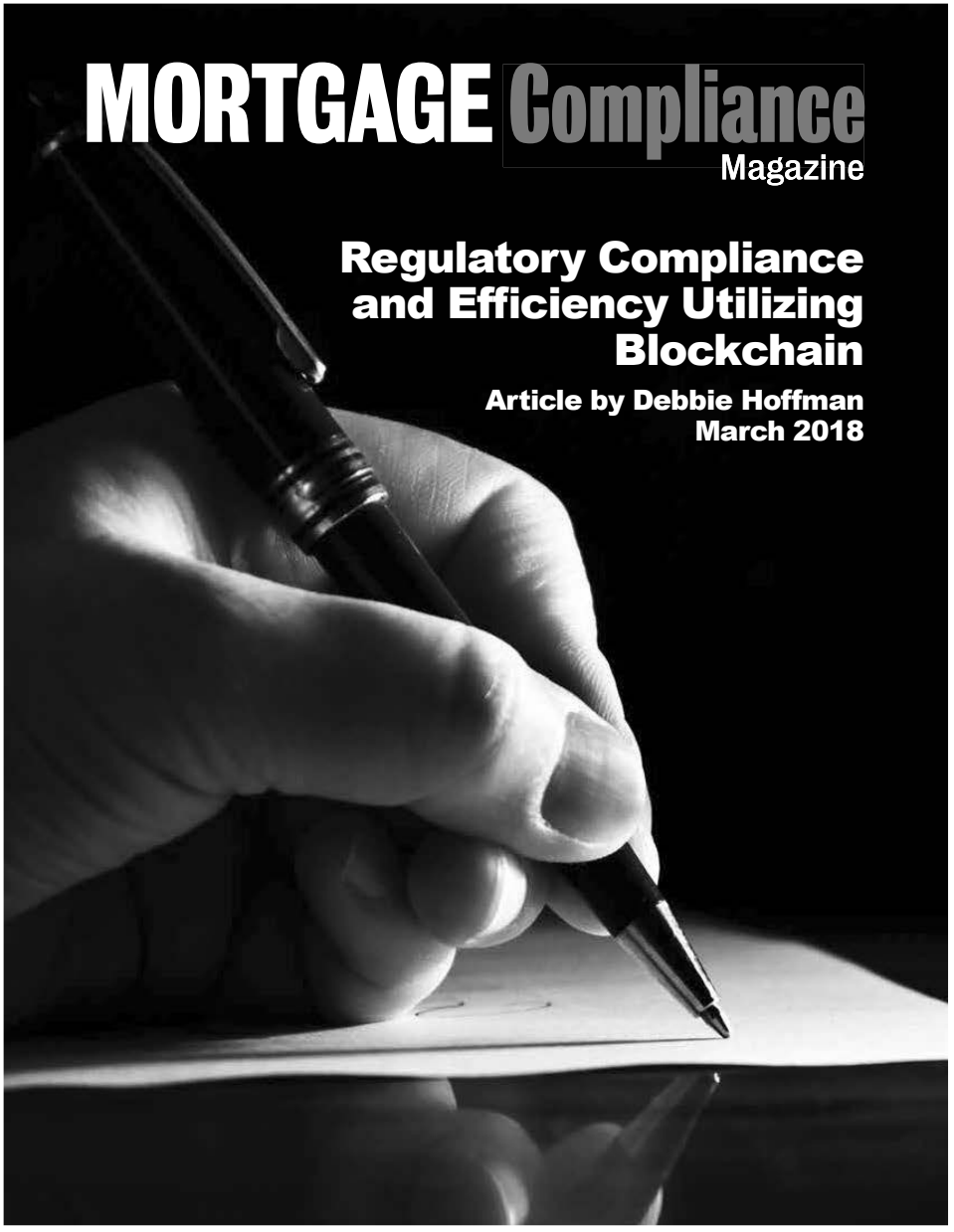
Regulatory Compliance and Efficiency Utilizing Blockchain, Mortgage Compliance Magazine (March 2018)

Deborah Hoffman

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As seen in Mortgage Compliance Magazine.


MORTGAGE Compliance
Magazine
Regulatory Compliance and Efficiency Utilizing Blockchain
Article by Debbie Hoffman
March 2018



Regulatory Compliance and Efficiency Utilizing Blockchain

BY DEBBIE HOFFMAN



Debbie Hoffman

Not only has blockchain been used as the base technology for hundreds of other cryptocurrencies and tokens, it is transforming every industry, including healthcare, supply chain, entertainment, and financial services.

Bitcoin. It's a hot topic, but much more important is the underlying technology used by the cryptocurrency: blockchain. This technology was introduced, along with bitcoin, in 2008; however, a majority of proofs of concept (PoC) and use case scenarios have only recently emerged. Not only has blockchain, or "distributed ledger technology" (DLT), as it is commonly called, been used as the base technology for hundreds of other cryptocurrencies and tokens, it is transforming every industry, including healthcare, supply chain, entertainment, and financial services.

The innate characteristics of blockchain, which include a seamless flow of both payment and documentation along a ledger, are critical to the development of electronic currency. However, while blockchain was initially used as a means of completing digital financial transactions, it has additional properties that make it extremely suitable for establishing efficient audit records that will aid with regulatory compliance in the mortgage industry.

UNDERSTANDING BLOCKCHAIN

To understand how blockchain can be applied in regulatory compliance, it is useful to appreciate how it works. First, a user on the blockchain inputs a transaction—it can be either a new transaction or a change to a prior entry on the blockchain ledger. This proposed change creates a "block" which details the request. Such request is then sent to all computers or "nodes" in the distributed network which, unlike a server, are not all located in one centralized location.

Each node uses multiple algorithms to verify the transaction and checks to make sure that this change should be added to the blockchain. When the transaction is approved by the nodes, the transaction is then added to the ledger.

This revised ledger reflects the approved transaction and a new block is added to the chain, completing the transaction. While in its current form, DLT transactions can take several seconds to complete, the technology is consistently being developed to enhance the speed.

Blockchain keeps reliable records that have time and date stamps and show every time a "block" is added to the blockchain. DLT is also less susceptible to cyber security breaches due to its encryption. The technology also allows for central, real-time access of deposits and records, which can be retrieved by different entities from diverse locations simultaneously.

One of the well-recognized benefits of this technology is its decentralized nature. There is no need for an intermediary and information can be transmitted directly from one party to another. While there are concerns that this technology could mean the elimination of intermediary organizations, it is actually an opportunity for such institutions to remain at the center, while streamlining processes. For example, as the credit agency currently is at the center of the credit of borrowers, it could continue to be at the helm while utilizing DLT to verify borrower credit more directly.

Lastly, but certainly one of the more incredible aspects to this technology, is the manner in which it allows for smart contracts. What this means essentially is that there are "if/then" scenarios built into the rules. It is ideally suited for a mortgage process because it means that there could be embedded rules and compliance requirements in whatever process is being contemplated, whether origination or transfer. While some critics state that this does not allow for subjectivity, it could provide various threshold factors to be satisfied before moving on to the next stage.

USING BLOCKCHAIN IN REGULATORY COMPLIANCE

There are important aspects of DLT that make it ideal in the regulatory compliance space, including ➢

formation of an audit trail and the characteristic of immutability once added to the ledger. Therefore, the blockchain ledger: (1) shows undeniable proof of the transaction; (2) ensures an audit trail without having any need to duplicate steps; (3) can be used as proof of transfer; and (4) is a record of all actions taken. In a loan audit, for instance, loan files would not have to be duplicated to supply to the regulator, but rather the regulator could be provided access to the blockchain to view in real time from any location. This also means that there would be no need to host a regulator in a side office at the company's headquarters and it eliminates the need to bring a thumb drive, or worse, a stack of paper files, for the regulator to review for days on end.

Never before has there been technology with such transparency. Blockchain tracks all verified transactions; therefore, there is no need for regulators to question the authenticity of the record. The fact that the blockchain provides the original document, and not multiple copies of a document, should allow the regulator to have more comfort that the information being viewed is documentation of the actual transaction.

Never before has there been technology with such transparency.

In addition to regulatory audits, blockchain can and is playing a critical role in improving the onboarding of customers (and auditing thereof) with respect to KYC (Know Your Customer) and AML (Anti-Money Laundering) requirements. Using a secured ledger that cannot be tampered with could eliminate several steps of the KYC process, namely validation, confirmation, and verification of borrowers.

REGTECH

While blockchain is being used by both large and small financial institutions in a variety of PoCs and greater endeavors, there are also a number of smaller entrepreneurial companies (RegTechs) utilizing this technology in the regulatory space. For example, Tradle, a European company, promotes a DLT platform for banking and insurance to aid in management of the KYC process. A Luxembourg-based company, Scorechain, advertises that it has a tool that helps with regulatory compliance related to cryptocurrency activity as well as for conducting forensics. Other companies, such as New York-based Chainalysis and UK's Elliptic, offer services which are focused to help companies monitor the activities on the blockchain to identify illicit activity.

While these RegTech companies are not yet incorporating blockchain in the mortgage process itself, there are other companies, including New York-based FinZat and Orlando-based Symmetry Blockchain Advisors, which are both working on DLT endeavors to develop utilization of blockchain in the residential mortgage process.

LEAPING FORWARD

Critics of using blockchain in the mortgage industry are concerned that it would be very difficult and complicated to use the process in the mortgage lifecycle since there are several different stages and entities involved. However, the entire process does not need to be completed at the onset. Instead, it can be developed one element at a time by choosing a starting point and then gradually adding to it.

Perhaps the solution for implementing blockchain in mortgage lending is to have a consortium of various players that contribute to the lending lifecycle so that eventually it could become a more integrated process. In the meantime, there will be the market movers, the big lenders, the large vendors, and RegTechs, that will push forward. Those companies that are not working on incorporating blockchain into their processes will be left behind and will have to scramble to catch-up as this technology provides an opportunity for the industry to make giant leaps forward. MCM

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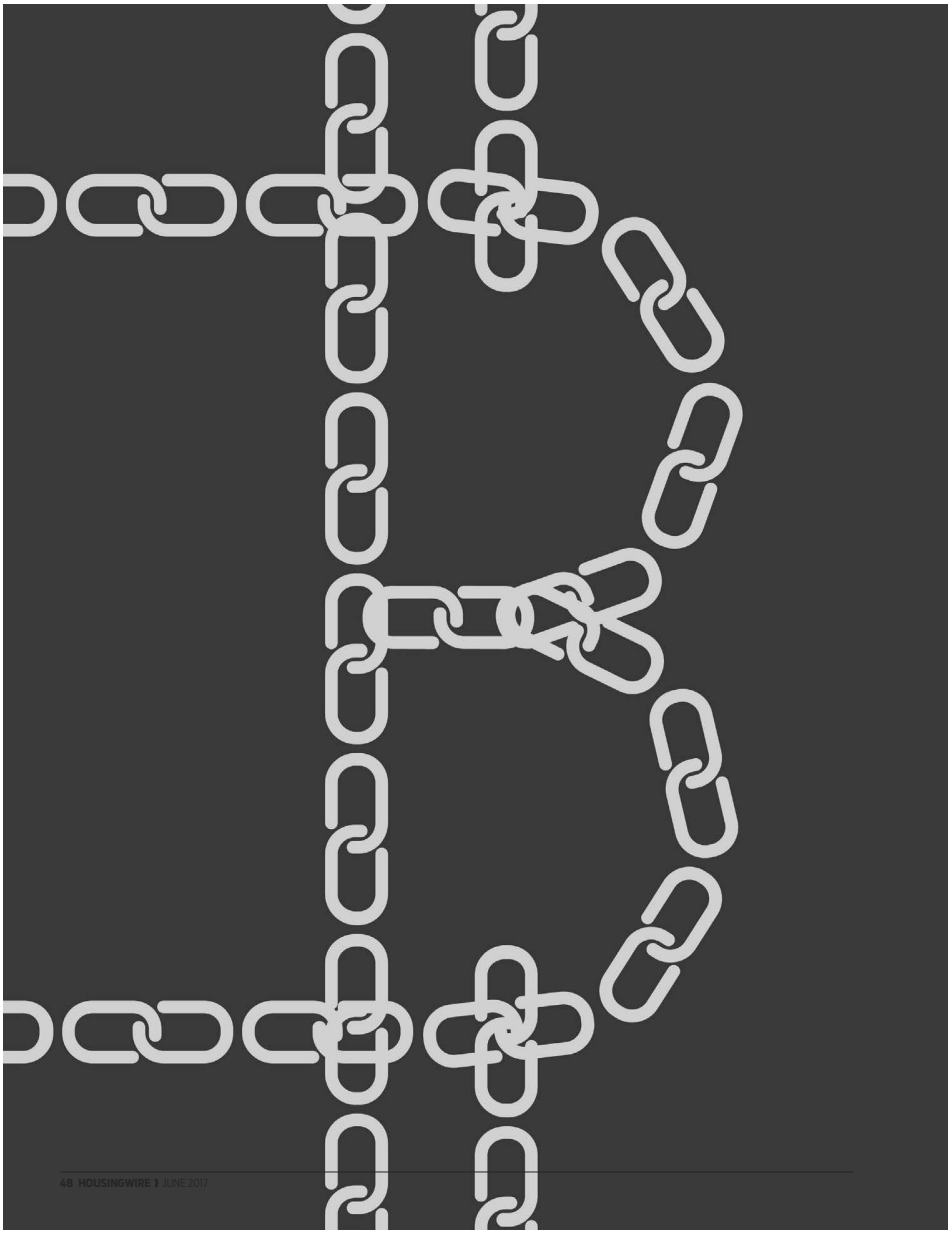
Debbie Hoffman and Matt Oguz,
From Bitcoin to Blockchain, How It Will Pay in the Mortgage Industry, Housingwire Magazine (June 2017)

Submitted by:
Deborah Hoffman

Symmetry Blockchain Advisors, Inc.

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Andrea Hall, SVP, Operations at United Wholesale Mortgage



FROM *Bitcoin* TO Blockchain

How it will pay in the mortgage industry

BY DEBBIE HOFFMAN, CHIEF LEGAL OFFICER, DIGITAL RISK
& MATT OGUZ, FOUNDING PARTNER, VENTURE-SCIENCE

Bitcoin — that is what most people think of when they hear the term blockchain. However, blockchain has morphed into an incredible technology tool that can be utilized across industries in a variety of capacities, including in mortgage lending. Blockchain is a ledger system stored on a decentralized database which can consist of one or multiple owners across many computers or "nodes" linked together. Records are linked in the form of time-stamped blocks. It was originally utilized in the technology used by bitcoin – the electronic cash system. When the open source code for bitcoin was released in January 2009, the technology of blockchain was brought forth.

"Entries on a blockchain ledger become time-stamped blocks which means that there cannot be hidden alterations to the chain."

This technology allows for documents to be stored and transferred in a process that cannot be altered or tampered with, enables validation and is less error-prone than current processes. The decentralized nature of blockchain can result in increased productivity since multiple parties can access the network and are able to work on files simultaneously.

What does blockchain have to offer?

Blockchain promises many advantages; two of the most important ones are cyber breach protection and document security, both critical to the mortgage process. For mortgage lending, this could mean saving millions of dollars.

First, in addition to a more streamlined and technology workflow, there could be a reduction in the cost of using third-party vendors due to automation. Second, blockchain allows for transparency in the storage of data. Entries on a blockchain ledger become time-stamped blocks which means that there cannot be hidden alterations to the chain. By using blockchain for document management, such immutable data could help in regulatory compliance tracking and ultimately in customer confidence because of the transparency of such data.

Another benefit to using blockchain is the characteristic of document authentication which confirms that data being placed upon the network belongs there. When data is placed on the network, the document blocks are



coded with specific hash sequences which must match the specific hash sequence of the network. If the sequence does not match, the data will not be saved onto the blockchain.

Blockchain technology is highly versatile and can be applied to many industries, including those that utilize payment and money transfers, stock trading, voting capabilities and reliance on secure storage of data. Such industries include law, healthcare, insurance, car leasing and sales, online music, stock trading, supply chain management, storage and, of course, mortgage lending.

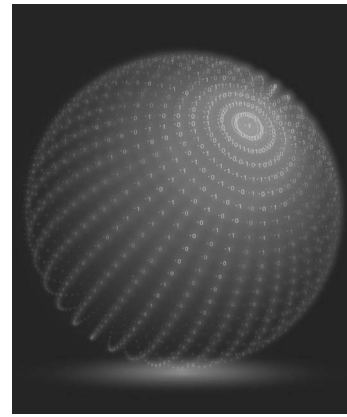
The downside to blockchain

While blockchain offers many advantages, there are a few factors that need to be considered, including the "51% attack," energy consumption of the networks and regulatory oversight. The proposition that blockchain offers a secure network relies on the principal that the network cannot be tampered with by cyber criminals unless they have the energy resources to hack into a majority, or 51%, of the computers on the network to gain control of the blockchain.

Thus data and records that are stored on each computer that has access to a particular blockchain would not be very valuable to a cyber thief. While an attack on a full network of computer nodes is unlikely, private blockchains have an added layer of security by requiring credentials and permissions to gain access to nodes. Should a cyber attacker have the computing power and time to gain control of the nodes, these permissions and credentials further the difficulty needed to enter the network and manipulate the blockchain.

In a 51% attack, the majority of the computing power on the network is attacked and hackers are able to interfere with the process of recording new blocks. The interference prevents other users of the blockchain from completing new blocks, allowing these cyber attackers to monopolize the input of data on the blockchain. While this type of attack could be devastating, the amount of computing power a hacker would need to possess in order to launch an attack on a blockchain is massive.

With regard to energy consumption, the distributed nature of the network calls for continued power in the multiple locations housing the nodes. According to environmental researcher Sebastiaan Deetman, the blockchain network that bitcoin is housed upon is expected to consume energy somewhere between an amount equal to the output of a small power plant and the consumption



of a small country such as Denmark by the year 2020. Deetman's study further cites that the bitcoin network currently consumes enough electricity to power 280,000 homes in America.

Given that blockchain is an emerging technology, there are not yet formal regulations pertaining to it, however there is guidance that addresses its characteristics, such as privacy and security, as well as governance of its use and implementation. U.S. regulators, including the Securities and Exchange Commission and the Treasury Department have indicated that there are risks and uncertainties, such as cybersecurity and regulatory oversight associated with blockchain which will need to be monitored.

The Treasury Department's Financial Crimes Enforcement Network issued a guidance in 2013 that discusses the applicability of the Bank Secrecy Act regulations to blockchain and individuals distributing, exchanging or transmitting virtual currency. While the Consumer Finance Protection Bureau has not yet made a statement about the use of blockchain, it has issued warnings to consumers regarding risks associated with bitcoin.

Transaction processing time is also a concern among those developing blockchain networks. Currently the size of a block is one megabyte and the blocks are mined every 10 minutes. With the limited size of the blocks

and mining time of 10 minutes, this means that only about seven transactions per second can be recorded. The limited number of transactions may be a barrier to entry for the blockchain network in the mortgage industry; however as the technology advances, blocks with larger storage capacity and increased computing power in mining blocks should make blockchain a more attractive option for the industry.

Use of blockchain in mortgages

In the mortgage industry, blockchain can be utilized across the entire loan lifecycle from origination to audit and all the way through servicing. First, blockchain allows for document authentication, tracking and correction on data inputs and data storage. These features capture the borrower's data points throughout the life of the mortgage more accurately than the conventional process. Thus, if blockchain technology was adopted across the mortgage lifecycle at application, through origination, fulfillment, servicing and secondary functions, it would create an efficient, streamlined and accurate process for a mortgage to be processed. The challenge, however, is the complexity of the mortgage lending infrastructure, including all the various type of industry participants – lenders, loan purchasers, servicers, title companies, county recorders and others.

Since the blockchain process helps prevent altercation or falsification, there will be fewer data input errors. When inputting data, each transaction is verified by "miners" or the individual users that control the network from each of the decentralized network of nodes on the blockchain. Through various algorithms used for entry of the transactions and verification, if a transaction is entered incorrectly, such transaction will not appear or will not display correctly on the blockchain. This alerts the user immediately, whether unintentional or fraudulent, and the user can fix or investigate the error and re-enter the transaction on the block accurately.

Another significant benefit to using blockchain is document verification. The verification process is used to determine if the data input on the blockchain actually belongs on it. This works by assigning a hash sequence to each block placed on the network. When subsequent blocks are placed on the blockchain the hash sequence needs to match the previous block or the data is rejected.

In summary, incorporating blockchain into the lending process inherently will create more automation in the mortgage loan lifecycle and less reliance on third parties,

"The challenge, however, is the complexity of the mortgage lending infrastructure, including all the various type of industry participants – lenders, loan purchasers, servicers, title companies, county recorders and others."

thus resulting in a lower cost to the lender in mortgage production. In addition, the lender will have more control of the entire process, utilizing an in-house approach, and less reliance on third party intermediaries. A 2015 study by Capgemini Group estimated that if blockchain was utilized, based upon the average cost for a $200,000 mortgage loan of $4,350 in lender processing fees per loan, there would have been a reduction ranging from $480 to $960 per loan in fees. The report, which utilizes 2015 data prior to the implementation of TRID, which increased the cost of processing fees per loan, concludes that lenders could have saved $1.5 billion during 2015 on loan processing.

Market participants

While the concept of blockchain is relatively new to the financial and lending industry, there are already several participants that are moving forward in such endeavors. Companies such as Factom, Mphasis, ThoughtMachine, HSBC, Context Labs, Coin and Chain are paving the way.

Factom promises data validation and data audit solutions to the mortgage industry, and the company has developed the Factom blockchain, a decentralized open-source public network that the company uses to secure its applications and data. Factom markets that this network can be used for auditing, data and systems integrity, IoT security protections (such as protections against denial-of-service or "DoS" attacks) and public infrastructure testing. Factom also offers an audit and due diligence room to aid in collecting data which can assist in regulatory compliance, quality control and servicing.

Mphasis, a technology services provider, has created the first center of excellence for blockchain-based services

and solutions in India. The focus is on enterprise solutions based on private/permissioned blockchain. Mphasis' center is primarily experimenting with different platforms and horizontal integrations for financial services. Use cases initially developed are in the areas or industries of trade finance, loyalty, mortgage, pharmaceutical, airline and insurance. Mphasis has developed three use cases to be used in the mortgage industry including: storing loan origination data to the Mphasis blockchain, authenticity of documents, and record keeping and fraudulent transaction detection.

ThoughtMachine markets that it is creating Vault OS, a technology seeking to provide an end-to-end banking system that can manage loans, mortgages and other financial products. Furthermore, the company promotes that the Vault OS systems utilizes smart contracts – self-executing electronic contracts – to enable parties to digitally sign contracts that are securely coded onto the blockchain.

There are many entities developing new ways to utilize blockchain that parallel the mortgage industry. HSBC has partnered with the Bank of China to implement blockchain technologies for property valuation services. JPMorgan Chase and Citigroup have completed a blockchain trial where the technology was used in tracking credit-swap defaults. Barclays and Santander Bank have joined fintech startup R3 to investigate different use cases to tackle payments and securities settlements.

Attorneys discussing blockchain are intrigued by the benefits that it potentially has to offer in the legal profession, including authentication and timestamp validation. For example, this could be extremely beneficial to a litigator who needs to tackle discovery and evidentiary burdens, particularly because of the transparency into who has access to the blockchain, the time period and what is stored on it.

The uses of blockchain are being explored worldwide in China, India, Europe, Central America and the Middle East. The Dubai government announced that it has recently launched the Dubai Blockchain Strategy and plans to use the technology for all government documents to make the government more efficient while achieving global leadership in the blockchain technology field.

Factom has partnered with the Honduran government and title software firm Epigraph. The partnership aims to develop a secure and permanent land title record system in the hope of curbing the alleged corruption and mismanagement within the Latin American country's government over land rights.



The United Kingdom's government has launched a blockchain competition seeking distributed ledger technologies and has offered to award up to 15 million pounds to companies that develop technology to increase productivity and performance.

Blockchain is quickly expanding across the globe and in a variety of industries. The mortgage industry has not historically been one that embraces technology advancements ahead of other industries, but it finally seems to be catching up as the cost savings are irrefutable. The question is whether now, as the lending industry embraces technology development, it is also able to take a giant leap forward and take hold of a new technology that has across the board advantages in the mortgage lifecycle for document storage and transmittal as the industry knows it today. ■

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Supreme Court Spring 2019 Agenda

Jennifer Bennett
Karla Gilbride
Public Justice

Below is a list of selected cases on—or potentially on—the Supreme Court's docket this term that could impact the consumer financial services sector.

MERITS CASES

Henry Schein Inc. v. Archer and White Sales Inc., No. 17-1272

Question Presented: Whether the Federal Arbitration Act permits a court to decline to enforce an agreement delegating questions of arbitrability to an arbitrator if the court concludes the claim of arbitrability is "wholly groundless."

Status: Decided January 8, 2019

Holding: Courts may not decline to enforce arbitration agreements delegating questions of arbitrability to an arbitrator on the basis that the claim of arbitrability is "wholly groundless."

Lamps Plus Inc. v. Varela, No. 17-988:

Question Presented: Whether the Federal Arbitration Act forecloses a state-law interpretation of an arbitration agreement that would authorize class arbitration based solely on general language commonly used in arbitration agreements.

Status: Argued October 29, 2018

Obduskey v. McCarthy & Holthus LLP, No. 17-1307

Question Presented: Whether the Fair Debt Collection Practices Act applies to non-judicial foreclosure proceedings.

Status: Argued January 7, 2019

Home Depot U.S.A. Inc. v. Jackson, No. 17-1471

Questions Presented: (1) Whether an original defendant to a class-action claim can remove the class action if it otherwise satisfies the jurisdictional requirements of the Class Action Fairness Act when the class action was originally asserted as a counterclaim against a co-defendant. (2) Should the Supreme Court's holding in *Shamrock Oil & Gas Corp. v. Sheets*, 313 U. S. 100 (1941)—that an original plaintiff may not remove a counterclaim against it—extend to third-party counterclaim defendants?

Status: Argued January 15, 2019

PDR Network, LLC v. Carlton & Harris Chiropractic Inc., No. 17-1705

Question Presented: Whether the Hobbs Act required the district court in this case to accept the FCC's legal interpretation of the Telephone Consumer Protection Act.

Status: Not yet scheduled for argument

PENDING PETITIONS FOR CERTIORARI

Zappos.com v. Stevens, No. 18-225

Question Presented: Whether individuals whose personal information is held in a database breached by hackers have Article III standing simply by virtue of the breach even without concrete injury, as the Third, Sixth, Seventh, Ninth, and D.C. Circuits have held, or whether concrete injury as a result of the breach is required for Article III standing, as the First, Second, Fourth, and Eighth Circuits have held.

State National Bank of Big Spring v. Mnuchin, No. 18-307

Questions presented: (1) Whether Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act violates the Constitution's separation of powers by creating the Bureau of Consumer Financial Protection as an independent agency that exercises expansive executive authority over private citizens but is led by a single director that the president cannot remove from office for policy reasons, is exempted from Congress' power of the purse and accompanying congressional oversight, and has no internal checks or balances (such as those afforded by a deliberate multi-member commission structure) to mitigate this lack of accountability and restraint; (2) whether *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), should be overturned; and (3) whether the Appropriations Clause, in conjunction with the Constitution's separation of powers, permits Congress to create perpetual, on-demand funding streams for executive agencies that are unreviewably drawn from the coffers of other independent agencies.

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Schein, Inc., et al. v. Archer & White Sales, Inc., No. 17-1272, Slip. Op. (U.S. Jan. 8, 2019)

Submitted by:
Jennifer Bennett
Public Justice

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.,* 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

HENRY SCHEIN, INC., ET AL. *v.* ARCHER & WHITE SALES, INC.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 17–1272. Argued October 29, 2018—Decided January 8, 2019

Respondent Archer & White Sales, Inc., sued petitioner Henry Schein, Inc., alleging violations of federal and state antitrust law and seeking both money damages and injunctive relief. The relevant contract between the parties provided for arbitration of any dispute arising under or related to the agreement, except for, among other things, actions seeking injunctive relief. Invoking the Federal Arbitration Act, Schein asked the District Court to refer the matter to arbitration, but Archer & White argued that the dispute was not subject to arbitration because its complaint sought injunctive relief, at least in part. Schein contended that because the rules governing the contract provide that arbitrators have the power to resolve arbitrability questions, an arbitrator—not the court—should decide whether the arbitration agreement applied. Archer & White countered that Schein's argument for arbitration was wholly groundless, so the District Court could resolve the threshold arbitrability question. The District Court agreed with Archer & White and denied Schein's motion to compel arbitration. The Fifth Circuit affirmed.

Held: The "wholly groundless" exception to arbitrability is inconsistent with the Federal Arbitration Act and this Court's precedent. Under the Act, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms. *Rent-A-Center, West, Inc.* v. *Jackson*, 561 U. S. 63, 67. The parties to such a contract may agree to have an arbitrator decide not only the merits of a particular dispute, but also "'gateway' questions of 'arbitrability.'" *Id.*, at 68–69. Therefore, when the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless.

Syllabus

That conclusion follows also from this Court's precedent. See *AT&T Technologies, Inc.* v. *Communications Workers*, 475 U. S. 643, 649–650.

Archer & White's counterarguments are unpersuasive. First, its argument that §§3 and 4 of the Act should be interpreted to mean that a court must always resolve questions of arbitrability has already been addressed and rejected by this Court. See, *e.g.*, *First Options of Chicago, Inc.* v. *Kaplan*, 514 U. S. 938, 944. Second, its argument that §10 of the Act—which provides for back-end judicial review of an arbitrator's decision if an arbitrator has "exceeded" his or her "powers"—supports the conclusion that the court at the front end should also be able to say that the underlying issue is not arbitrable is inconsistent with the way Congress designed the Act. And it is not this Court's proper role to redesign the Act. Third, its argument that it would be a waste of the parties' time and money to send wholly groundless arbitrability questions to an arbitrator ignores the fact that the Act contains no "wholly groundless" exception. This Court may not engraft its own exceptions onto the statutory text. Nor is it likely that the exception would save time and money systemically even if it might do so in some individual cases. Fourth, its argument that the exception is necessary to deter frivolous motions to compel arbitration overstates the potential problem. Arbitrators are already capable of efficiently disposing of frivolous cases and deterring frivolous motions, and such motions do not appear to have caused a substantial problem in those Circuits that have not recognized a "wholly groundless" exception.

The Fifth Circuit may address the question whether the contract at issue in fact delegated the arbitrability question to an arbitrator, as well as other properly preserved arguments, on remand. Pp. 4–8.

878 F. 3d 488, vacated and remanded.

KAVANAUGH, J., delivered the opinion for a unanimous Court.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 17–1272

HENRY SCHEIN, INC., ET AL., PETITIONERS *v.* ARCHER AND WHITE SALES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

[January 8, 2019]

JUSTICE KAVANAUGH delivered the opinion of the Court.

Under the Federal Arbitration Act, parties to a contract may agree that an arbitrator rather than a court will resolve disputes arising out of the contract. When a dispute arises, the parties sometimes may disagree not only about the merits of the dispute but also about the threshold arbitrability question—that is, whether their arbitration agreement applies to the particular dispute. Who decides that threshold arbitrability question? Under the Act and this Court's cases, the question of who decides arbitrability is itself a question of contract. The Act allows parties to agree by contract that an arbitrator, rather than a court, will resolve threshold arbitrability questions as well as underlying merits disputes. *Rent-A-Center, West, Inc.* v. *Jackson*, 561 U. S. 63, 68–70 (2010); *First Options of Chicago, Inc.* v. *Kaplan*, 514 U. S. 938, 943–944 (1995).

Even when a contract delegates the arbitrability question to an arbitrator, some federal courts nonetheless will short-circuit the process and decide the arbitrability question themselves if the argument that the arbitration agreement applies to the particular dispute is "wholly

groundless." The question presented in this case is whether the "wholly groundless" exception is consistent with the Federal Arbitration Act. We conclude that it is not. The Act does not contain a "wholly groundless" exception, and we are not at liberty to rewrite the statute passed by Congress and signed by the President. When the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract. We vacate the contrary judgment of the Court of Appeals.

I

Archer and White is a small business that distributes dental equipment. Archer and White entered into a contract with Pelton and Crane, a dental equipment manufacturer, to distribute Pelton and Crane's equipment. The relationship eventually soured. As relevant here, Archer and White sued Pelton and Crane's successor-in-interest and Henry Schein, Inc. (collectively, Schein) in Federal District Court in Texas. Archer and White's complaint alleged violations of federal and state antitrust law, and sought both money damages and injunctive relief.

The relevant contract between the parties provided:

> "Disputes. This Agreement shall be governed by the laws of the State of North Carolina. Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of [Schein]), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association [(AAA)]. The place of arbitration shall be in Charlotte, North Carolina." App. to Pet. for Cert. 3a.

After Archer and White sued, Schein invoked the Federal Arbitration Act and asked the District Court to refer the

parties' antitrust dispute to arbitration. Archer and White objected, arguing that the dispute was not subject to arbitration because Archer and White's complaint sought injunctive relief, at least in part. According to Archer and White, the parties' contract barred arbitration of disputes when the plaintiff sought injunctive relief, even if only in part.

The question then became: Who decides whether the antitrust dispute is subject to arbitration? The rules of the American Arbitration Association provide that arbitrators have the power to resolve arbitrability questions. Schein contended that the contract's express incorporation of the American Arbitration Association's rules meant that an arbitrator—not the court—had to decide whether the arbitration agreement applied to this particular dispute. Archer and White responded that in cases where the defendant's argument for arbitration is wholly groundless—as Archer and White argued was the case here—the District Court itself may resolve the threshold question of arbitrability.

Relying on Fifth Circuit precedent, the District Court agreed with Archer and White about the existence of a "wholly groundless" exception, and ruled that Schein's argument for arbitration was wholly groundless. The District Court therefore denied Schein's motion to compel arbitration. The Fifth Circuit affirmed.

In light of disagreement in the Courts of Appeals over whether the "wholly groundless" exception is consistent with the Federal Arbitration Act, we granted certiorari, 585 U. S. ___ (2018). Compare 878 F. 3d 488 (CA5 2017) (case below); *Simply Wireless, Inc.* v. *T-Mobile US, Inc.*, 877 F. 3d 522 (CA4 2017); *Douglas* v. *Regions Bank*, 757 F. 3d 460 (CA5 2014); *Turi* v. *Main Street Adoption Servs., LLP*, 633 F. 3d 496 (CA6 2011); *Qualcomm, Inc.* v. *Nokia Corp.,* 466 F. 3d 1366 (CA Fed. 2006), with *Belnap* v. *Iasis Healthcare*, 844 F. 3d 1272 (CA10 2017); *Jones* v. *Waffle*

House, Inc., 866 F. 3d 1257 (CA11 2017); *Douglas*, 757 F. 3d, at 464 (Dennis, J., dissenting).

II

In 1925, Congress passed and President Coolidge signed the Federal Arbitration Act. As relevant here, the Act provides:

> "A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U. S. C. §2.

Under the Act, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms. *Rent-A-Center,* 561 U. S., at 67. Applying the Act, we have held that parties may agree to have an arbitrator decide not only the merits of a particular dispute but also "'gateway' questions of 'arbitrability,' such as whether the parties have agreed to arbitrate or whether their agreement covers a particular controversy." *Id.,* at 68–69; see also *First Options*, 514 U. S., at 943. We have explained that an "agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce, and the FAA operates on this additional arbitration agreement just as it does on any other." *Rent-A-Center*, 561 U. S., at 70.

Even when the parties' contract delegates the threshold arbitrability question to an arbitrator, the Fifth Circuit and some other Courts of Appeals have determined that the court rather than an arbitrator should decide the threshold arbitrability question if, under the contract, the argument for arbitration is wholly groundless. Those courts have reasoned that the "wholly groundless" excep-

tion enables courts to block frivolous attempts to transfer disputes from the court system to arbitration.

We conclude that the "wholly groundless" exception is inconsistent with the text of the Act and with our precedent.

We must interpret the Act as written, and the Act in turn requires that we interpret the contract as written. When the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract. In those circumstances, a court possesses no power to decide the arbitrability issue. That is true even if the court thinks that the argument that the arbitration agreement applies to a particular dispute is wholly groundless.

That conclusion follows not only from the text of the Act but also from precedent. We have held that a court may not "rule on the potential merits of the underlying" claim that is assigned by contract to an arbitrator, "even if it appears to the court to be frivolous." *AT&T Technologies, Inc.* v. *Communications Workers*, 475 U. S. 643, 649–650 (1986). A court has "'no business weighing the merits of the grievance'" because the "'agreement is to submit all grievances to arbitration, not merely those which the court will deem meritorious.'" *Id.,* at 650 (quoting *Steelworkers* v. *American Mfg. Co.*, 363 U. S. 564, 568 (1960)).

That *AT&T Technologies* principle applies with equal force to the threshold issue of arbitrability. Just as a court may not decide a merits question that the parties have delegated to an arbitrator, a court may not decide an arbitrability question that the parties have delegated to an arbitrator.

In an attempt to overcome the statutory text and this Court's cases, Archer and White advances four main arguments. None is persuasive.

First, Archer and White points to §§3 and 4 of the Federal Arbitration Act. Section 3 provides that a court must

stay litigation "upon being satisfied that the issue" is "referable to arbitration" under the "agreement." Section 4 says that a court, in response to a motion by an aggrieved party, must compel arbitration "in accordance with the terms of the agreement" when the court is "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue."

Archer and White interprets those provisions to mean, in essence, that a court must always resolve questions of arbitrability and that an arbitrator never may do so. But that ship has sailed. This Court has consistently held that parties may delegate threshold arbitrability questions to the arbitrator, so long as the parties' agreement does so by "clear and unmistakable" evidence. *First Options*, 514 U. S., at 944 (alterations omitted); see also *Rent-A-Center*, 561 U. S., at 69, n. 1. To be sure, before referring a dispute to an arbitrator, the court determines whether a valid arbitration agreement exists. See 9 U. S. C. §2. But if a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator, a court may not decide the arbitrability issue.

Second, Archer and White cites §10 of the Act, which provides for back-end judicial review of an arbitrator's decision if an arbitrator has "exceeded" his or her "powers." §10(a)(4). According to Archer and White, if a court at the back end can say that the underlying issue was not arbitrable, the court at the front end should also be able to say that the underlying issue is not arbitrable. The dispositive answer to Archer and White's §10 argument is that Congress designed the Act in a specific way, and it is not our proper role to redesign the statute. Archer and White's §10 argument would mean, moreover, that courts presumably also should decide frivolous merits questions that have been delegated to an arbitrator. Yet we have already rejected that argument: When the parties' contract assigns a matter to arbitration, a court may not

resolve the merits of the dispute even if the court thinks that a party's claim on the merits is frivolous. *AT&T Technologies*, 475 U. S., at 649–650. So, too, with arbitrability.

Third, Archer and White says that, as a practical and policy matter, it would be a waste of the parties' time and money to send the arbitrability question to an arbitrator if the argument for arbitration is wholly groundless. In cases like this, as Archer and White sees it, the arbitrator will inevitably conclude that the dispute is not arbitrable and then send the case back to the district court. So why waste the time and money? The short answer is that the Act contains no "wholly groundless" exception, and we may not engraft our own exceptions onto the statutory text. See *Exxon Mobil Corp.* v. *Allapattah Services, Inc.*, 545 U. S. 546, 556–557 (2005).

In addition, contrary to Archer and White's claim, it is doubtful that the "wholly groundless" exception would save time and money systemically even if it might do so in some individual cases. Archer and White assumes that it is easy to tell when an argument for arbitration of a particular dispute is wholly groundless. We are dubious. The exception would inevitably spark collateral litigation (with briefing, argument, and opinion writing) over whether a seemingly unmeritorious argument for arbitration is *wholly* groundless, as opposed to groundless. We see no reason to create such a time-consuming sideshow.

Archer and White further assumes that an arbitrator would inevitably reject arbitration in those cases where a judge would conclude that the argument for arbitration is wholly groundless. Not always. After all, an arbitrator might hold a different view of the arbitrability issue than a court does, even if the court finds the answer obvious. It is not unheard-of for one fair-minded adjudicator to think a decision is obvious in one direction but for another fair-minded adjudicator to decide the matter the other way.

Fourth, Archer and White asserts another policy argument: that the "wholly groundless" exception is necessary to deter frivolous motions to compel arbitration. Again, we may not rewrite the statute simply to accommodate that policy concern. In any event, Archer and White overstates the potential problem. Arbitrators can efficiently dispose of frivolous cases by quickly ruling that a claim is not in fact arbitrable. And under certain circumstances, arbitrators may be able to respond to frivolous arguments for arbitration by imposing fee-shifting and cost-shifting sanctions, which in turn will help deter and remedy frivolous motions to compel arbitration. We are not aware that frivolous motions to compel arbitration have caused a substantial problem in those Circuits that have not recognized a "wholly groundless" exception.

In sum, we reject the "wholly groundless" exception. The exception is inconsistent with the statutory text and with our precedent. It confuses the question of who decides arbitrability with the separate question of who prevails on arbitrability. When the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract.

We express no view about whether the contract at issue in this case in fact delegated the arbitrability question to an arbitrator. The Court of Appeals did not decide that issue. Under our cases, courts "should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so." *First Options,* 514 U. S., at 944 (alterations omitted). On remand, the Court of Appeals may address that issue in the first instance, as well as other arguments that Archer and White has properly preserved.

The judgment of the Court of Appeals is vacated, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

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Santander, Press Release, Santander Supports Launch of United Nations Principles for Responsible Banking (November 26, 2018)

Submitted by:
Joy Feigenbaum
Santander US

Santander

Santander supports launch of United Nations Principles for Responsible Banking

- A draft of the Principles for Responsible Banking launched for global public consultation at the UN's Global Roundtable in Paris today.

- Santander and 27 other banks from five continents have developed the principles to align the sector with the UN Sustainable Development Goals (SDGs) and the Paris Climate Agreement.

Madrid, 26 November 2018 - PRESS RELEASE

Today at its Global Roundtable in Paris, the UN Environment Finance Initiative (UNEP FI), together with 28 banks including Santander, launched the Principles for Responsible Banking for global public consultation[1] .

The Principles will define the banking industry's role and responsibilities in shaping a sustainable future. By committing to the new framework, banks will be aligning their business with the objectives of the Sustainable Development Goals (SDGs) and the Paris Climate Agreement.

Ana Botin, executive chairman of Banco Santander, said "Responsible banking is not a new concept — but this initiative acknowledges how important a concept it is, especially today. Because banking can only fulfill its purpose — creating financial empowerment, jobs and economic growth — if it treats customers, shareholders and society with the respect they deserve. This is profit with purpose; this is the heart of responsibility."

The Principles set the global standard for what it means to be a responsible bank and will ensure that banks create value for both their shareholders and society. They provide the first global framework that guides the integration of sustainability across all business areas of a bank, from strategic to portfolio to transaction level.

By signing the Principles for Responsible Banking, banks will commit to being publicly accountable for their social, environmental and economic impacts. They agree to set public targets on addressing their most significant negative impacts and broadening their positive impacts. Investors, policy makers, regulators, clients and civil society will be able to compare banks and hold them accountable for their contribution to society's goals.

The Principles now enter a six-month global public consultation period before they will be signed by banks from around the world at the United Nations General Assembly in New York in September 2019. Banks and stakeholders around the world are invited to provide feedback and input to guide their further development, and to signal their support by becoming Endorsers of the Principles for Responsible Banking.

[1] Access Bank (Nigeria), AAIB (Egypt), Banco Pichincha (Ecuador), Banorte (Mexico), Barclays (United Kingdom), BBVA (Spain), BNP Paribas (France), Bradesco (Brazil), CIB (Egypt), CIMB Bank (Malaysia), First Rand (South Africa), Garanti Bank (Turkey), Golomt Bank (Mongolia), Hana Financial Group (South Korea), ICBC (China), ING (Netherlands), KCB Group (Kenya), Land Bank (South Africa), NAB (Australia), Nordea (Sweden), Piraeus Bank (Greece), Santander (Spain), Shinhan Financial Group (South Korea), Societe Generale (France), Standard Bank (South Africa), Triodos Bank (Netherlands), Westpac (Australia), YES Bank (India)

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U.S. Department of Justice, Office of Legislative Affairs, Office of the Assistant Attorney General, Letter from Stephen E. Boyd, Assistant Attorney General to Hon. Ted Budd (September 25, 2018)

Submitted by:
Joy Feigenbaum
Santander US

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

SEP 25 2018

The Honorable Ted Budd
U.S. House of Representatives
Washington DC 20515-0001

Dear Congressman Budd:

This responds to your letter dated June 20, 2018, regarding website accessibility for public accommodations under the Americans with Disabilities Act (ADA). We apologize for our delay in responding your letter.

As you may know, on December 26, 2017, the Department of Justice (the Department) published a Notice of Withdrawal of Four Previously Announced Rulemaking Actions in the Federal Register. 82 Fed. Reg. 60932 (Dec. 26, 2017). Two of the withdrawn rulemakings were related to the accessibility of web information and services under the ADA. The first withdrawn rulemaking (RIN 1190-AA61) covered accessibility of web information and services of public accommodations. The second withdrawn rulemaking (RIN 1190-AA65) covered accessibility of web services of state and local governments.

As indicated in the Notice of Withdrawal, the Department is evaluating whether promulgating specific web accessibility standards through regulations is necessary and appropriate to ensure compliance with the ADA. The Department will also continue to review its entire regulatory landscape and associated agenda, pursuant to the regulatory reform provisions of Executive Order 13771, "Reducing Regulation and Controlling Regulatory Costs" and Executive Order 13777, "Enforcing the Regulatory Reform Agenda."

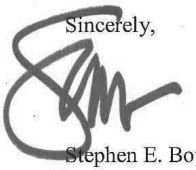
The Department first articulated its interpretation that the ADA applies to public accommodations' websites over 20 years ago. This interpretation is consistent with the ADA's title III requirement that the goods, services, privileges, or activities provided by places of public accommodation be equally accessible to people with disabilities.

Additionally, the Department has consistently taken the position that the absence of a specific regulation does not serve as a basis for noncompliance with a statute's requirements.[1] Absent the adoption of specific technical requirements for websites through rulemaking, public accommodations have flexibility in how to comply with the ADA's general requirements of nondiscrimination and effective communication. Accordingly, noncompliance with a voluntary technical standard for website accessibility does not necessarily indicate noncompliance with the ADA.

We very much appreciate the concerns regarding the impact that the risk of litigation has on covered entities. The Department remains committed to safeguarding accessibility for individuals with disabilities while also working with covered entities to ensure that compliance with the ADA is feasible and sustainable. Given Congress' ability to provide greater clarity through the legislative process, we look forward to working with you to continue these efforts.

We hope this information is helpful. Please do not hesitate to contact this office if we may provide additional assistance regarding this or any other matter.

Sincerely,



Stephen E. Boyd
Assistant Attorney General

[1] In *Robles v. Dominos Pizza,* which you referenced in your letter, the court did not dispute that websites of public accommodations that provide goods or services are subject to the ADA's accessibility requirements. Rather, the *Robles* court took issue with the plaintiff's position that compliance with a specific technical standard for web accessibility was necessary to comply with the ADA's requirements.

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TCPA Update: Litigation and Regulatory Trends (Outline) (January 11, 2019)

Arjun P. Rao

Stroock & Stroock & Lavan LLP

A. RELEVANT STATUTORY FRAMEWORK

1. 47 U.S.C. § 227(a) contains definitions. Notably, an "automatic telephone dialing system," or ATDS, is defined as "equipment which has the capacity (A) to store or produce telephone numbers to be called, using a random or sequential number generator; and (B) to dial such numbers." 47 U.S.C. § 227(a)(1).
2. 47 U.S.C. § 227(b)(1) contains restrictions on the "use of automated telephone equipment." This section regulates calls, text messages and messages sent to a facsimile machine.
3. 47 U.S.C. § 227(b)(2) initially states that the Federal Communications Commission, or FCC, "shall prescribe regulations to implement the requirements of this subsection." The subsection goes on to direct the FCC to either require or consider various exemptions and regulations, many of which are codified at 47 C.F.R. § 64.1200.
4. 47 U.S.C. § 227(b)(3) contains an express private right of action, permitting a person or entity to bring an action "in an appropriate court of that State" based on a violation of subsection 227(b) and seek an injunction, either actual monetary loss or $500, whichever is greater, or both remedies. This provision also permits the court to "increase the amount of the award to an amount equal to not more than 3 time the amount[,]" upon a finding that the violation was willful or knowing.
5. 47 U.S.C. § 227(c) requires the FCC to establish the national do-not-call database. This provision contains its own private right of action.

B. LITIGATION TRENDS

1. What systems constitute an ATDS? After the D.C. Circuit's decision in ACA International, various Courts of Appeal and District Courts have come to differing conclusions as to what constitutes an ATDS.
2. Can contract provisions modify TCPA restrictions? While the majority of courts and the FCC have stated that consent may later be revoked by a consumer, the Second Circuit's decision in Reyes has led to litigation over whether contractual terms may limit, or entirely eliminate, a consumer's ability to subsequently revoke consent. In addition, contracts have been used to form the basis of cross-claims where a customer fails to notify the calling party after abandoning a number previously provided to it.

3. Class certification. Most class certification decisions rise and fall with an analysis of consent. We will review recent decisions and the facts that led to the ultimate outcome.

4. How will the United States Supreme Court's decision in PDR Network impact TCPA litigation? In PDR Network, the Supreme Court will address whether the Hobbs Act required the district court to accept the FCC's legal interpretation of the TCPA.

C. REGULATORY TRENDS

1. The FCC has already established a database of recycled numbers. Will the FCC also consider a safe harbor for calling parties that utilize that database?

2. The FCC is also poised to address how it defines an ATDS.

3. State AGs and local DAs are increasingly using the enforcement provision of the TCPA as well as TCPA complaints as the basis of investigations, actions and enforcement.

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Marks v. Crunch San Diego, LLC,
904 F.3d 1041 (9th Cir. 2018)

Submitted by:
E. Michelle Drake

Berger & Montague, P.C.

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KeyCite Yellow Flag - Negative Treatment
Disagreed With by Maes v. Charter Communication, W.D.Wis., October 30, 2018

904 F.3d 1041
United States Court of Appeals, Ninth Circuit.

Jordan MARKS, individually and on behalf of all others similarly situated, Plaintiff-Appellant,
v.
CRUNCH SAN DIEGO, LLC, Defendant-Appellee.

No. 14-56834
|
Argued and Submitted December 6, 2016
|
Submission Vacated December 14, 2016
|
Resubmitted September 13, 2018 Pasadena, California
|
Filed September 20, 2018
|
Rehearing and Rehearing En Banc Denied October 30, 2018

Synopsis

Background: Gym patron brought putative class action against gym operator alleging violations of the Telephone Consumer Protection Act (TCPA) based on operator's alleged use of an automatic telephone dialing system (ATDS) to send unwanted text messages to gym patron's cellular telephone. The United States District Court for the Southern District of California, No. 3:14-cv-00348-BAS-BLM, Cynthia A. Bashant, J., 55 F.Supp.3d 1288, granted summary judgment to operator and, 2014 WL 6632810, denied patron's motion for reconsideration. Patron appealed.

Holdings: The Court of Appeals, Ikuta, Circuit Judge, held that:

an automatic dialing function subject to TCPA is not limited to devices with the capacity to call numbers produced by a random or sequential number generator, and

genuine issue of fact existed as to whether the platform was an automatic telephone dialing system subject to TCPA.

Vacated and remanded.

Attorneys and Law Firms

***1043** Seyed Abbas Kazerounian (argued) and Jason A. Ibey, Kazerouni Law Group APC, Costa Mesa, California; Joshua B. Swigart, Hyde & Swigart, San Diego, California; for Plaintiff-Appellant.

Ian C. Ballon (argued), Lori Chang, Nina D. Boyajian, and Justin A. Barton, Greenberg Traurig LLP, Los Angeles, California, for Defendant-Appellee.

Shay Dvoretzky, Jeffrey R. Johnson, and Vivek Suri, Jones Day, Washington, D.C., for Amicus Curiae Sirius XM Radio Inc.

Brian Melendez, Barnes & Thornburg LLP, Minneapolis, Minnesota, for Amicus Curiae ACA International.

Stuart T. Rossman and Carolyn Carter, National Consumer Law Center, Boston, Massachusetts; Ira Rheingold, National Association of Consumer Advocates, Washington, D.C.; for Amici Curiae National Consumer Law Center and National Association of Consumer Advocates.

Appeal from the United States District Court for the Southern District of California, Cynthia A. Bashant, District Judge, Presiding, D.C. No. 3:14-cv-00348-BAS-BLM.

Before: Consuelo M. Callahan, Carlos T. Bea, and Sandra S. Ikuta, Circuit Judges.

OPINION

IKUTA, Circuit Judge:

Jordan Marks appeals the grant of summary judgment to Crunch Fitness on his claim that three text messages he received from Crunch violated the Telephone Consumer Protection Act (TCPA), 47 U.S.C. § 227. The district court held that the automatic text messaging system that had sent the messages was not an automatic telephone dialing system (ATDS) under the TCPA, because it lacked the present or potential capacity "to store or produce telephone numbers to be called, using a random or sequential number generator." *Id.* § 227(a)(1). In light of the D.C. Circuit's recent opinion in *ACA International v. Federal Communications Commission*, 885 F.3d 687 (D.C. Cir. 2018) (which was decided after the district court ruled), and based on our own review of the TCPA, we conclude that the statutory definition of ATDS includes a device that stores telephone numbers to be called, whether or not those numbers have been generated by a random or sequential number generator. Therefore, we reverse the district court's grant of summary judgment.

I

A

By the early 1990s, telemarketing was in its golden age. Telemarketing sales had "skyrocketed to over $435 million in 1990," which was a "fourfold increase since 1984." 137 Cong. Rec. S16,971 (daily ed. June 27, 1991) (statement of Rep. Pressler). "This marketing success ha[d] created an industry in which over 300,000 telemarketing solicitors call[ed] more than 18 million Americans every day." *Id.* In part, this was due to the advent of machines that "automatically dial a telephone number and deliver to the called party an artificial or prerecorded voice message." S. Rep. No. 102-178, at 2 (1991). Advertisers found these autodialers highly efficient because they could "ensure that a company's message gets to potential customers in the exact same way, every time, without incurring the normal cost of human intervention." H.R. Rep. No. 102-317, at 6 (1991). At that time, a single autodialer could cause as many as 1,000 phones to ring and then deliver a prerecorded message to each. *Id.* at 10.

***1044** The dark side of this success story caught Congress's attention. As Senator Fritz Hollings complained, "[c]omputerized calls are the scourge of modern civilization. They wake us up in the morning; they interrupt our dinner at night; they force the sick and elderly out of bed; they hound us until we want to rip the telephone right out of the wall." 137 Cong. Rec. S16,205 (daily ed. Nov. 7, 1991) (statement of Sen. Hollings). Recipients deemed that "automated telephone calls that deliver an artificial or prerecorded voice message are more of a nuisance and a greater invasion of

privacy than calls placed by 'live' persons." S. Rep. No. 102-178, at 4. Among other reasons, "[t]hese automated calls cannot interact with the customer except in preprogrammed ways, do not allow the caller to feel the frustration of the called party" and deprive customers of "the ability to slam the telephone down on a live human being." *Id.* at 4 & n.3 (citation omitted). Congress also noted surveys wherein consumers responded that the two most annoying things were (1) "[p]hone calls from people selling things" and (2) "phone calls from a computer trying to sell something." H.R. Rep. No. 102-317, at 9.

The volume of automated telemarketing calls was not only an annoyance but also posed dangers to public safety. S. Rep. No. 102-177, at 20 (1991). "Due to advances in autodialer technology," the machines could be programmed to call numbers in large sequential blocks or dial random 10-digit strings of numbers. *Id.* This resulted in calls hitting hospitals and emergency care providers "and sequentially delivering a recorded message to all telephone lines." *Id.* And because some autodialers would "not release [the line] until the prerecorded message is played, even when the called party hangs up," H.R. Rep. No. 102-317, at 10, there was a danger that the autodialers could "seize" emergency or medical assistance telephone lines, rendering them inoperable, and "dangerously preventing those lines from being utilized to receive calls from those needing emergency services," H.R. Rep. No. 101-633, at 3 (1990). Representative Marge Roukema noted that it was "not just calls to doctors' offices or police and fire stations that pose a public health hazard." 137 Cong. Rec. H35,305 (daily ed. Nov. 26, 1991) (statement of Rep. Roukema). She recounted "the sheer terror" of a New York mother who, when she tried to call an ambulance for her injured child, "picked up her phone only to find it occupied by a computer call that would not disconnect." *Id.* at 35,305–06.

In light of these and other concerns, Senator Hollings introduced a bill to amend the Communications Act of 1934, in order to "protect the privacy interests of residential telephone subscribers by placing restrictions on unsolicited, automated telephone calls to the home and to facilitate interstate commerce by restricting certain uses of facsimile (fax) machines and automatic dialers." S. Rep. No. 102-178, at 1. This bill became the Telephone Consumer Protection Act of 1991.

As originally enacted, the TCPA placed restrictions on the use of automated telephone equipment, including automatic telephone dialing systems and telephone facsimile machines. The statute defined "automatic telephone dialing systems" (ATDS) as follows:

> (1) The term 'automatic telephone dialing system' means equipment which has the capacity—
>
> (A) to store or produce telephone numbers to be called, using a random or sequential number generator; and
>
> (B) to dial such numbers.

Pub. L. No. 102-243, § 227, 105 Stat. 2394, 2395. This language established Congress's intent to regulate equipment that is "automatic," and that has "the capacity" to function in two specified ways: "to ***1045** store or produce telephone numbers to be called, using a random or sequential number generator" and "to dial" those telephone numbers. Although the TCPA has been amended several times since its original enactment, Congress has never revised the definition of an ATDS. Therefore, Congress's decision to regulate only those devices which have the aforementioned functions, capacity, and ability to function automatically remains unchanged.

The TCPA prohibited the use of an ATDS to make "any call (other than a call made for emergency purposes or made with the prior express consent of the called party) using any automatic telephone dialing system or an artificial or prerecorded voice" to emergency telephone lines, hospital rooms or other health care facilities, and paging and cellular telephones. 47 U.S.C. § 227(b)(1)(A) (1991). It also prohibited the use of an ATDS "in such a way that two or more telephone lines of a multi-line business are engaged simultaneously." *Id.* § 227(b)(1)(D).

As required by the TCPA, *id.* § 227(b)(2), in 1992 the FCC promulgated rules to implement the statute. *See Rules & Regulations Implementing the Tel. Consumer Prot. Act of 1991*, 7 FCC Rcd. 8752, 8753 (1992). The FCC did not elaborate on the functions of an ATDS and its definition merely tracked the statutory definition. *Id.* at 8755 n.6, 8792. [1]

B

It was not until ten years later that the FCC realized that "the telemarketing industry ha[d] undergone significant changes in the technologies and methods used to contact consumers," and such marketplace changes warranted modifications to the existing rules. *Rules & Regulations Implementing the Tel. Consumer Prot. Act of 1991*, 18 FCC Rcd. 14,014, 14,017 (2003) (*2003 Order*). In particular, the FCC was concerned about the proliferating use of the predictive dialer, which is "an automated dialing system that uses a complex set of algorithms to automatically dial consumers' telephone numbers in a manner that 'predicts' the time when a consumer will answer the phone and a telemarketer will be available to take the call." *Id.* at 14,022 n.31. Unlike the automated telemarketing devices prevalent in the early 1990s, which dialed a random or sequential block of numbers, predictive dialers generally automatically dialed a list of numbers that had been preprogrammed and stored in the dialer, or were downloaded from a computer database. *Id.* at 14,090.

In order to determine whether the TCPA applied to this new technology, the FCC had to assess whether the predictive dialer qualified as an ATDS. This required consideration of the statutory definition: whether the equipment was "automatic" and whether it had the capacity to function in the two relevant ways.

In a series of rulings, from 2003 to 2015, the FCC determined that predictive dialers and other new technology qualified as an ATDS, even if they did not generally generate or store random or sequential numbers. In its 2003 ruling, the FCC reasoned that a predictive dialer may have the "capacity" to dial random and sequential numbers, even if it was not currently being used for such a purpose. *Id.* at 14,091. The FCC acknowledged the telemarketing industry's argument that predictive dialers do not fall within the statutory ***1046** definition of ATDS because they "do not dial numbers 'randomly or sequentially,' " but nevertheless concluded that predictive dialers' "hardware, when paired with certain software, ha[d] the capacity to store or produce numbers and dial those numbers at random, in sequential order, or from a database of numbers." *Id.* at 14,090–91. In its later 2015 order, the FCC went even further, and determined that a device could have the requisite capacity if it had any potential to be configured for that purpose. *Rules & Regulations Implementing the Tel. Consumer Prot. Act of 1991*, 30 FCC Rcd. 7961, 7974 (2015) (*2015 Declaratory Ruling*) (holding that "the capacity of an autodialer is not limited to its current configuration but also includes its potential functionalities").

Second, the FCC suggested that a device could qualify as an ATDS even if it entirely lacked the capacity to dial numbers randomly or sequentially. Thus in its 2012 ruling, the FCC stated that the definition of an ATDS "covers any equipment that has the specified *capacity* to generate numbers and dial them without human intervention regardless of whether the numbers called are randomly or sequentially generated or come from calling lists." *Rules & Regulations Implementing the Tel. Consumer Prot. Act of 1991*, 27 FCC Rcd. 15,391, 15,392 n.5 (2012) (*2012 Declaratory Ruling*). The FCC's subsequent 2015 ruling, however, made the contrary suggestion that a device would not meet the definition of an ATDS unless it had the capacity to dial random or sequential numbers. *See 2015 Declaratory Ruling*, 30 FCC Rcd. at 7971–72 ("We reaffirm our previous statements that dialing equipment generally has the capacity to store or produce, and dial random or sequential numbers (and thus meets the TCPA's definition of 'autodialer') even if it is not presently used for that purpose, including when the caller is calling a set list of consumers.").

The FCC relied on policy and legislative history to support its application of the definition of ATDS to new technology. The FCC reasoned that "through the TCPA, Congress was attempting to alleviate a particular problem—an increasing number of automated and prerecorded calls to certain categories of numbers," and therefore Congress intended for any device that had the basic function of being automatic, i.e., had "the *capacity* to dial numbers without human intervention," *2003 Order*, 18 FCC Rcd. at 14,092, to be regulated under the TCPA. [2] Further, the FCC thought that

it was clear "that Congress anticipated that the FCC, under its TCPA rulemaking authority, might need to consider changes in technologies." *Id.* Accordingly, the FCC concluded that an interpretation of the statutory definition of ATDS which excluded new technology that could automatically dial thousands of numbers merely because it "relies on a given set of numbers would lead to an unintended result" and fail to effectuate the purpose of the statutory requirement. *Id.*

C

After the FCC's 2015 ruling, a large number of regulated entities challenged the FCC's definition of an ATDS in the D.C. and Seventh Circuits, and the petitions were consolidated in the D.C. Circuit. *See* Consolidation Order, *ACA Int'l v. FCC*, 885 F.3d 687 (D.C. Cir. 2018) (***1047** No. 15-1211). Among other things, petitioners had sought clarification from the FCC on how the TCPA applied to new technologies, including cloud-based dialing options and smartphone apps. *2015 Declaratory Ruling*, 30 FCC Rcd. at 7970. In challenging the 2015 order, petitioners argued that they had not received the clarification they sought, asserting specifically that the FCC erred in concluding that equipment that merely had the potential future capacity to function as an autodialer, taking into account possible upgrades or modifications, met the statutory definition of ATDS. *ACA Int'l*, 885 F.3d at 696. They also challenged the FCC's conclusion that equipment qualifies as an ATDS so long as it can automatically dial from a list of numbers, even if it does not have the capacity to store or produce random or sequential numbers. *Id.* at 694.

The D.C. Circuit first asked whether it had jurisdiction to consider all of the FCC's rulings on this issue, including those that predated the 2015 order. Although normally all challenges to an FCC rule must be made within 60 days after its entry, 28 U.S.C. § 2344, a petition for a rulemaking may reopen consideration of prior rulemakings, *see Pub. Citizen v. Nuclear Regulatory Comm'n*, 901 F.2d 147, 151–52 (D.C. Cir. 1990). "An agency's reconsideration of a rule in a new rulemaking constitutes a reopening when the original rule is 'reinstated' so as to have renewed effect." *Biggerstaff v. FCC*, 511 F.3d 178, 185 (D.C. Cir. 2007) (quoting *Pub. Citizen*, 901 F.2d at 152). The D.C. Circuit concluded that the parties' 2015 rulemaking petition to the FCC reopened consideration of the definition of ATDS established in the FCC's 2003 order, as well as its subsequent rulings. *ACA Int'l*, 885 F.3d at 701.

On the merits, the D.C. Circuit invalidated the FCC's interpretation of the two key questions raised by the statutory definition of an ATDS, namely: "(i) when does a device have the 'capacity' to perform the two enumerated functions; and (ii) what precisely are those functions?" *Id.* at 695.

Turning first to the FCC's interpretation of "capacity," the D.C. Circuit concluded it was overbroad. According to the court, the "straightforward understanding of the Commission's ruling is that all smartphones qualify as autodialers because they have the inherent 'capacity' to gain ATDS functionality by downloading an app." *Id.* at 700. Because "[i]t cannot be the case that every uninvited communication from a smartphone infringes federal law, and that nearly every American is a TCPA-violator-in-waiting, if not a violator-in-fact," *id.* at 698, the D.C. Circuit concluded that the FCC's interpretation "is an unreasonably, and impermissibly, expansive one," *id.* at 700.

Turning to the second issue, the D.C. Circuit concluded that the FCC's explanation of the functions of an ATDS was inadequate. The court explained that "[a] basic question raised by the statutory definition is whether a device must *itself* have the ability to generate random or sequential telephone numbers to be dialed," or whether it would be "enough if the device can call from a database of telephone numbers generated elsewhere." *Id.* at 701. The FCC had stated that a device qualified as an ATDS *only if* it could generate random or sequential numbers to be dialed, but also indicated that a device which could only dial numbers from a stored list also qualified as an ATDS. *Id.* at 701–02. While "[i]t might be permissible for the Commission to adopt either interpretation," the D.C. Circuit held that "the Commission cannot, consistent with reasoned decisionmaking, espouse both competing interpretations in the same order." *Id.* at 703. The D.C. Circuit also noted that the 2015 ruling lacked clarity on whether an autodialer ***1048** must dial numbers without human intervention. Although the FCC indicated that "the 'basic function[ ]' of an autodialer is to 'dial numbers without

human intervention,' " it declined a request to clarify that a dialer must have such a feature. *Id.* (alteration in original) (quoting *2015 Declaratory Ruling*, 30 FCC Rcd. at 7975). Because "[t]he order's lack of clarity about which functions qualify a device as an autodialer compounds the unreasonableness of the Commission's expansive understanding of when a device has the 'capacity' to perform the necessary functions," the court "set aside the Commission's treatment of those matters." *Id.*

II

We now turn to the facts of this case. The device at issue in this appeal is called the Textmunication system, which is a web-based marketing platform designed to send promotional text messages to a list of stored telephone numbers. [3] Phone numbers are captured and stored in one of three ways: An operator of the Textmunication system may manually enter a phone number into the system; a current or potential customer may respond to a marketing campaign with a text (which automatically provides the customer's phone number); or a customer may provide a phone number by filling out a consent form on a Textmunication client's website. A client of Textmunication can then design a marketing campaign that, for example, offers customers free passes and personal training sessions, provides appointment reminders and class updates, or sends birthday greetings, and the Textmunication system will automatically send the desired messages to the stored phone numbers at a time scheduled by the client.

Crunch Fitness communicates with its prospective and current gym members by sending text messages through this Textmunication system. When Crunch wants to send a text message to its current or prospective customers, a Crunch employee logs into the Textmunication system, selects the recipient phone numbers, generates the content of the message, and selects the date and time for the message to be sent. The Textmunication system will then automatically send the text messages to the selected phone numbers at the appointed time.

Jordan Marks signed up for a gym membership with Crunch Fitness in 2012. After joining the gym, Marks received three text messages from Crunch over a period of eleven months. Marks's phone carrier charged him incoming tolls for each of these text messages. In February 2014, Marks filed a putative class action complaint against Crunch, alleging violations of § 227(b) of the TCPA. He claimed that Crunch "negligently contact[ed] [him] on [his] cellular telephone, in violation of the [TCPA], thereby invading [his] privacy." Marks alleged that the text messages were sent using an ATDS which has "the capacity to send text messages to cellular telephone numbers from a list of telephone numbers automatically and without human intervention."

The district court granted summary judgment in favor of Crunch on the ground that the Textmunication system did not qualify as an ATDS because it presently lacked a random or sequential number generator, and did not have the potential capacity to add such a feature. Because it defined an ATDS as necessarily including a random or sequential number generator, the court did not consider the declaration ***1049** of Marks's expert witness, Jeffrey Hansen, stating that the Textmunication system called numbers from a stored list. The court therefore denied Crunch's motion to exclude Hansen's testimony as moot. Marks timely appealed. We vacated submission of Marks's appeal pending the issuance of *ACA International*.

III

A

After *ACA International* was issued, we ordered supplemental briefing to address the impact of the D.C. Circuit's opinion on this case. Under the Hobbs Act, an appellate court "has exclusive jurisdiction to enjoin, set aside, suspend (in whole

or in part), or to determine the validity of—(1) all final orders of the [FCC] made reviewable by [47 U.S.C § 402(a)]," 28 U.S.C. § 2342, so long as the appeal is timely, meaning that it was brought within sixty days from when the FCC releases the final order to the public, *see* 28 U.S.C. § 2344. [4] Here, various parties timely challenged the FCC's 2015 order in both the Seventh and D.C. Circuits; these challenges were consolidated and assigned to the D.C. Circuit, which then became "the sole forum for addressing ... the validity of the FCC's" order. *MCI Telecomms. Corp. v. U.S. W. Commc'ns*, 204 F.3d 1262, 1267 (9th Cir. 2000) (quoting *GTE South, Inc. v. Morrison*, 199 F.3d 733, 743 (4th Cir. 1999)). Because the D.C. Circuit exercised its authority to set aside the FCC's interpretations of the definition of an ATDS in the 2015 order, 28 U.S.C. § 2342, and any prior FCC rules that were reinstated by the 2015 order, *see Biggerstaff*, 511 F.3d at 185 (quoting *Pub. Citizen*, 901 F.2d at 152), we conclude that the FCC's prior orders on that issue are no longer binding on us. *See King v. Time Warner Cable Inc.*, 894 F.3d 473, 476–77 (2d Cir. 2018) (holding that *ACA International* "invalidated that [FCC 2015 Declaratory Ruling] and thereby removed any deference we might owe to the views the FCC expressed in it"); *Dominguez ex rel. Himself v. Yahoo, Inc.*, 894 F.3d 116, 119 (3d Cir. 2018) (holding that in light of the D.C. Circuit's holding, the court was free to interpret the statutory definition of an autodialer as it had prior to the issuance of the FCC's 2015 order).

We review a district court's grant of summary judgment de novo, viewing the evidence in the light most favorable to the nonmoving party in order to determine whether there are any genuine issues of material fact. *Thomas v. Ponder*, 611 F.3d 1144, 1149–50 (9th Cir. 2010). The district court had jurisdiction under 28 U.S.C. § 1331. We have jurisdiction under 28 U.S.C. § 1291.

B

Because the D.C. Circuit vacated the FCC's interpretation of what sort of device qualified as an ATDS, only the statutory definition of ATDS as set forth by Congress in 1991 remains. *See* 47 U.S.C. § 227(a). [5] Accordingly, we must begin ***1050** anew to consider the definition of ATDS under the TCPA.

We "begin [our analysis] with the plain language of the statute." *Guido v. Mount Lemmon Fire Dist.*, 859 F.3d 1168, 1170 n.1 (9th Cir. 2017) (alteration in original) (quoting *Negusie v. Holder*, 555 U.S. 511, 542, 129 S.Ct. 1159, 173 L.Ed.2d 20 (2009)). "If the 'statutory text is plain and unambiguous[,]' we 'must apply the statute according to its terms.' " *Id.* (alteration in original) (quoting *Carcieri v. Salazar*, 555 U.S. 379, 387, 129 S.Ct. 1058, 172 L.Ed.2d 791 (2009)). If the language of a statute is ambiguous, "we may use canons of construction, legislative history, and the statute's overall purpose to illuminate Congress's intent." *Ileto v. Glock, Inc.*, 565 F.3d 1126, 1133 (9th Cir. 2009) (quoting *Jonah R. v. Carmona*, 446 F.3d 1000, 1005 (9th Cir. 2006)). "It is also 'a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.' " *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133, 120 S.Ct. 1291, 146 L.Ed.2d 121 (2000) (quoting *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 809, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989)). "In ascertaining the plain meaning of [a] statute, the court must look to the particular statutory language at issue, as well as the language and design of the statute as a whole." *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291, 108 S.Ct. 1811, 100 L.Ed.2d 313 (1988); *see also United States v. Lewis*, 67 F.3d 225, 228–29 (9th Cir. 1995) ("Particular phrases must be construed in light of the overall purpose and structure of the whole statutory scheme.").

As the D.C. Circuit noted, the definition of ATDS "naturally raises two questions: (i) when does a device have the 'capacity' to perform the two enumerated functions; and (ii) what precisely are those functions?" *ACA Int'l*, 885 F.3d at 695. We start by addressing the second question regarding functions. The TCPA defines ATDS as "equipment which has the capacity—(A) to store or produce telephone numbers to be called, using a random or sequential number generator; and (B) to dial such numbers." 47 U.S.C. § 227(a)(1). The question is whether, in order to be an ATDS, a device must dial numbers generated by a random or sequential number generator or if a device can be an ATDS if it merely dials

numbers from a stored list. We must also determine to what extent the device must function without human intervention in order to qualify as an ATDS.

Marks and Crunch offer competing interpretations of the language of § 227(a)(1)(A), but both parties fail to make sense of the statutory language without reading additional words into the statute.

Marks points out that a number generator is not a storage device; a device could not use "a random or sequential number generator" to store telephone numbers. Therefore, Marks asserts, it does not make sense to read "store" in subdivision (A) as applying to "telephone numbers to be called, using a random or sequential number generator." 47 U.S.C. § 227(a)(1)(A). Instead, Marks contends that we should read the definition as providing that an ATDS is "equipment which has the capacity (A) to [i] store [telephone numbers to be called] or [ii] produce telephone numbers to be called, using a random or sequential number generator; and (B) to dial such numbers." In other words, a piece of equipment qualifies as an ATDS if it has the capacity to store telephone numbers and then dial them.

Crunch, in turn, argues that due to the placement of the comma in the statute, the phrase "using a random or sequential number generator" modifies both "store" and "produce." Therefore, Crunch argues ***1051** that the best reading of the statute defines an ATDS as "equipment which has the capacity (A) to store [telephone numbers produced using a random or sequential number generator]; or [to] produce telephone numbers to be called, using a random or sequential number generator; and (B) to dial such numbers." As such, to qualify as an ATDS, according to Crunch, a device must store telephone numbers that have been produced using a random or sequential number generator.

After struggling with the statutory language ourselves, we conclude that it is not susceptible to a straightforward interpretation based on the plain language alone. Rather, the statutory text is ambiguous on its face. [6] The D.C. Circuit apparently agreed, stating that "[i]t might be permissible" for the FCC to adopt an interpretation that a device had to generate random or sequential numbers in order to be an ATDS, or that a device could be an ATDS if it was limited to dialing numbers from a stored list. *ACA Int'l*, 885 F.3d at 702–03. We therefore turn to other aids in statutory interpretation.

C

Because the statutory language is ambiguous, we look at the context and the structure of the statutory scheme. The structure and context of the TCPA as originally enacted indicate that Congress intended to regulate devices that make automatic calls. Although Congress focused on regulating the use of equipment that dialed blocks of sequential or randomly generated numbers—a common technology at that time—language in the statute indicates that equipment that made automatic calls from lists of recipients was also covered by the TCPA.

This conclusion is supported by provisions in the TCPA allowing an ATDS to call selected numbers. For instance, the TCPA permitted use of autodialers for a call "made with the prior express consent of the called party." 47 U.S.C. § 227(b)(1)(A) (1991). To take advantage of this permitted use, an autodialer would have to dial from a list of phone numbers of persons who had consented to such calls, rather than merely dialing a block of random or sequential numbers. [7] Congress's 2015 amendment to the TCPA provides additional information about Congress's views on the scope of the definition of ATDS. After the FCC issued its 2015 order, Congress added language to § 227(b)(1)(A)(iii), exempting the use of an ATDS to make calls "solely to collect a debt owed to or guaranteed by the United States." Bipartisan Budget Act of 2015, Pub. L. No. 114-74, § 301, 129 Stat. 584, 588 (codified at ***1052** 47 U.S.C. § 227(b)(1)(A)(iii)). Like the exception allowing the use of an autodialer to make calls "with the prior express consent of the called party," this debt collection exception demonstrates that equipment that dials from a list of individuals who owe a debt to the United States is still an ATDS but is exempted from the TCPA's strictures. Moreover, in amending this section, Congress left the definition of ATDS untouched, even though the FCC's prior orders interpreted this definition to include devices

that could dial numbers from a stored list. We "presume that when Congress amends a statute, it is knowledgeable about judicial decisions interpreting the prior legislation." *Porter v. Bd. of Trs. of Manhattan Beach Unified Sch. Dist.*, 307 F.3d 1064, 1072 (9th Cir. 2002). Because we infer that Congress was aware of the existing definition of ATDS, its decision not to amend the statutory definition of ATDS to overrule the FCC's interpretation suggests Congress gave the interpretation its tacit approval. *See Lorillard v. Pons*, 434 U.S. 575, 580, 98 S.Ct. 866, 55 L.Ed.2d 40 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.").

Despite the ambiguity of the statutory definition of ATDS, reading the definition "in [its] context and with a view to [its] place in the overall statutory scheme," *Brown & Williamson Tobacco Corp.*, 529 U.S. at 133, 120 S.Ct. 1291, we conclude that the statutory definition of ATDS is not limited to devices with the capacity to call numbers produced by a "random or sequential number generator," but also includes devices with the capacity to dial stored numbers automatically. Accordingly, we read § 227(a)(1) to provide that the term automatic telephone dialing system means equipment which has the capacity—(1) to store numbers to be called or (2) to produce numbers to be called, using a random or sequential number generator—and to dial such numbers. [8]

We also reject Crunch's argument that a device cannot qualify as an ATDS unless it is fully automatic, meaning that it must operate without any human intervention whatsoever. By referring to the relevant device as an "*automatic* telephone *dialing* system," Congress made clear that it was targeting equipment that could engage in automatic *dialing*, rather than equipment that operated without any human oversight or control. 47 U.S.C. § 227(a)(1) (emphasis added); *see ACA Int'l*, 885 F.3d at 703 (" '[A]uto' in autodialer—or, equivalently, 'automatic' in 'automatic telephone dialing system,' 47 U.S.C. § 227(a)(1)—would seem to envision non-manual dialing of telephone numbers."). Common sense indicates that human intervention of some sort is required before an autodialer can begin making calls, whether turning on the machine or initiating its ***1053** functions. Congress was clearly aware that, at the very least, a human has to flip the switch on an ATDS. *See The Automated Telephone Consumer Protection Act of 1991, Hearing Before the Subcomm. on Commc'ns of the Comm. on Commerce, Sci., and Transp.*, 102nd Cong. 15 (1991) (statement of Robert Bulmash, President, Private Citizen, Inc.) (describing a pitch for autodialers in a telemarketing magazine as stating: "You come home from work[, and] turn on the machine, just like turning on a radio."). Crunch does not dispute that the Textmunication system dials numbers automatically, and therefore it has the automatic dialing function necessary to qualify as an ATDS, even though humans, rather than machines, are needed to add phone numbers to the Textmunication platform.

D

Because we read § 227(a)(1) to provide that the term "automatic telephone dialing system" means equipment which has the capacity—(1) to store numbers to be called or (2) to produce numbers to be called, using a random or sequential number generator—and to dial such numbers automatically (even if the system must be turned on or triggered by a person), we conclude there is a genuine issue of material fact as to whether the Textmunication system is an ATDS. The evidence in the record shows that the Textmunication system stores numbers and dials them automatically to send text messages to a stored list of phone numbers as part of scheduled campaigns. This is sufficient to survive summary judgment. [9] Because the district court did not have the benefit of *ACA International* or our construction of the definition of ATDS, we vacate the district court's ruling and remand it for further proceedings. [10] Each party shall bear its own costs on appeal.

VACATED AND REMANDED.

All Citations

904 F.3d 1041, 18 Cal. Daily Op. Serv. 9509, 2018 Daily Journal D.A.R. 9564

Footnotes

1 As originally promulgated, 47 C.F.R. § 64.1200(f)(1) (1992) provided:

> (f) As used in this section:
>
> (1) The terms automatic telephone dialing system and autodialer mean equipment which has the capacity to store or produce telephone numbers to be called using a random or sequential number generator and to dial such numbers.

The same definition is in force today.

2 In the 2003 order, the FCC also confirmed that the TCPA applied to both voice calls and "text calls to wireless numbers" including short message service (SMS) calls, which "provide[ ] the ability for users to send and receive text messages to and from mobile handsets with maximum message length ranging from 120 to 500 characters." *2003 Order*, 18 FCC Rcd. at 14,115 & n.606 (citation omitted).

3 We have concluded that the TCPA applies to text messages because it is "a form of communication used primarily between telephones." *Satterfield v. Simon & Schuster, Inc.*, 569 F.3d 946, 953–54 (9th Cir. 2009).

4 An appellate court lacks authority to consider a challenge to an FCC order that is brought after sixty days from the date when the FCC releases the final order to the public. *See* 28 U.S.C. § 2344; *see also U.S. W. Commc'ns, Inc. v. Jennings*, 304 F.3d 950, 958 n.2 (9th Cir. 2002) (stating that "[p]roperly promulgated FCC regulations currently in effect must be presumed valid" for purposes of a case not brought pursuant to a petition under the Hobbs Act).

5 Although the FCC had promulgated a regulation defining ATDS, the "regulation does little more than restate the terms of the statute itself," and "the existence of a parroting regulation does not change the fact that the question here is not the meaning of the regulation but the meaning of the statute." *Gonzales v. Oregon*, 546 U.S. 243, 257, 126 S.Ct. 904, 163 L.Ed.2d 748 (2006).

6 Our statement in *Satterfield* that "the statutory text is clear and unambiguous" referred to only one aspect of the text: whether a device had the "***capacity*** 'to store or produce telephone numbers ....' " 569 F.3d at 951 (emphasis in original).

7 Other provisions in the statute prohibited calls to specified numbers. For instance, the statute authorized the FCC to establish and use a national database "to compile a list of telephone numbers of residential subscribers who object to receiving telephone solicitations" and who could not be called by telemarketers. *Id.* § 227(c)(3). It likewise prohibited calls to emergency telephone lines, *id.* § 227(b)(1)(A)(i), patient rooms in hospitals or other health care facilities, *id.* § 227(b)(1)(A)(ii), and paging services and cellular phones, *id.* § 227(b)(1)(A)(iii). In order to comply with such restrictions, an ATDS could either dial a list of permitted numbers (as allowed for autodialed calls made with the prior express consent of the called party) or block prohibited numbers when calling a sequence of random or sequential numbers. In either case, these provisions indicate Congress's understanding that an ATDS was not limited to dialing wholly random or sequential blocks of numbers, but could be configured to dial a curated list.

8 Therefore, we decline to follow the Third Circuit's unreasoned assumption that a device must be able to generate random or sequential numbers in order to qualify as an ATDS. *Dominguez ex rel. Himself v. Yahoo, Inc.*, 894 F.3d 116, 120 (3d Cir. 2018) (stating, without explanation, that the plaintiff's claims against Yahoo failed because he "cannot point to any evidence that creates a genuine dispute of fact as to whether [Yahoo's device] had the present capacity to function as an autodialer by generating random or sequential telephone numbers and dialing those numbers"). In making this assumption, the Third Circuit failed to resolve the linguistic problem it identified in an unpublished opinion in the same case, where it acknowledged that "it is unclear how a number can be *stored* (as opposed to *produced*) using 'a random or sequential number generator.' " *Dominguez v. Yahoo, Inc.*, 629 F. App'x 369, 372 n.1 (3d Cir. 2015). Because the Third Circuit merely avoided the interpretive questions raised by the statutory definition of ATDS, its published opinion is unpersuasive.

9 Because we vacate the district court's decision on this ground, we decline the reach the question whether the device needs to have the current capacity to perform the required functions or just the potential capacity to do so. *Cf. Meyer v. Portfolio Recovery Assocs. LLC*, 707 F.3d 1036, 1043 (9th Cir. 2012); *Satterfield*, 569 F.3d at 951.

10 We also vacate the district court's dismissal of Crunch's motion to exclude Hansen's declaration as moot. The district court based its ruling on its conclusion that there was no dispute of material fact as to whether the Textmunication system was an ATDS, and Hansen's declaration could not help create one. To the extent Hansen's declaration addresses whether the Textmunication system calls automatically from a stored list, it is relevant to the question whether the system qualifies as an ATDS.

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We **DENY** Marks's motion for judicial notice of two newspaper articles. We "may judicially notice a fact that is not subject to reasonable dispute because it: (1) is generally known within the trial court's territorial jurisdiction; or (2) can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b). Because Marks has not pointed to any judicially noticeable facts in these articles, we decline to take judicial notice.

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Developments in Personal Jurisdiction Jurisprudence

Amy E. Keller
DiCello Levitt & Casey LLC

Re: What's Trending Now: Cutting Edge Consumer Financial Services Updates

Developments in Personal Jurisdiction Jurisprudence

Enclosed are selected recent cases regarding personal jurisdiction since the Supreme Court's decision in *Bristol-Myers Squibb v. Superior Court*, 137 S. Ct. 1773 (2017) ("*BMS*"), in which the Court held that courts cannot assert jurisdiction over claims brought by nonresident plaintiffs unless each plaintiff can establish a connection between the nonresident defendant's conduct in the forum and their own specific claims.

- *Beaton v. SpeedyPC Software*, 907 F.3d 1018 (7th Cir. 2018). Relying on the Supreme Court's *BMS* decision, the defendant argued that the district court lacked personal jurisdiction over the claims of class members from states other than Illinois. The Seventh Circuit declined to opine on the issue, and invited the defendant to explain how *BMS* applies to class certification on remand.
- *Molock v. Whole Foods*, 317 F. Supp. 3d 1 (D.D.C. 2018). The district court certified a question to the D.C. Circuit for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) as to whether *BMS* applies to class actions.
- *Practice Management Support Servs., Inc. v. Cirque du Soleil, Inc.*, No. 14 C 2032, 201 WL 3659349 (N.D. Ill. Aug. 2, 2018). The district court found that the *BMS* decision applied to class litigation, finding that the court lacked specific jurisdiction over claims of prospective class members who did not reside in Illinois.
- *In re Morning Song Bird Food Litig.*, No. 12 cv 01592, 2018 WL 1382746 (S.D. Cal. Mar. 19, 2018). The court found that *BMS* was inapplicable to nationwide class actions because, while the claims of non-resident plaintiffs were pertinent to the issue of specific jurisdiction in *BMS*, claims of unnamed class members are irrelevant to the question of specific jurisdiction.
- *Sloan v. General Motors LLC*, 287 F. Supp. 3d 840 (N.D. Cal. 2018). Defendant argued that the district court could not exercise personal jurisdiction over nonresident plaintiffs' claims, where they had purchased vehicles in states other than California. The court, in finding that defendant had waived certain challenges to personal jurisdiction by litigating the case, also found that it could exercise "pendent personal jurisdiction" over the defendant with respect to claims by nonresident consumers.

- *Sanchez v. Launch Technical Workforce Solutions, LLC*, 297 F. Supp. 3d 1360 (N.D. Ga. 2018). The court examined the *BMS* decision's impact on exercising personal jurisdiction over a nationwide class claim, finding that *BMS* did not change the law, and did not require dismissal of class claims where the court had personal jurisdiction over the defendant as to the named plaintiff's claim.

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Bristol-Myers Squibb Company v. Superior Court of California, San Francisco County, et al., 137 S.Ct.1773 (U.S. June 19, 2017)

Submitted by:
Amy E. Keller

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137 S.Ct. 1773
Supreme Court of the United States

BRISTOL–MYERS SQUIBB COMPANY, Petitioner
v.
SUPERIOR COURT OF CALIFORNIA, SAN FRANCISCO COUNTY, et al.

No. 16–466.
|
Argued April 25, 2017.
|
Decided June 19, 2017.

Synopsis
Background: Consumers brought products liability action against prescription drug manufacturer in California state court. The Superior Court, City and County of San Francisco, JCCP. No. 4748, John E. Munter, J., entered an order denying manufacturer's motion to quash service of summons on nonresident consumers' claims. Manufacturer petitioned for a writ of mandate, which the Court of Appeal summarily denied. Manufacturer petitioned for review, which the Supreme Court of California granted, transferring matter back to the Court of Appeal. The Court of Appeal denied petition, and manufacturer petitioned for review. The Supreme Court of California granted review, superseding the opinion of the Court of Appeal. The Supreme Court of California, Cantil-Sakauye, C.J., 1 Cal.5th 783, 206 Cal.Rptr.3d 636, 377 P.3d 874, affirmed. Certiorari was granted.

The Supreme Court, Justice Alito, held that due process did not permit exercise of specific personal jurisdiction in California over nonresident consumers' claims.

Reversed and remanded.

Justice Sotomayor filed a dissenting opinion.

***1775** *Syllabus*[*]

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

A group of plaintiffs, most of whom are not California residents, sued Bristol–Myers Squibb Company (BMS) in California state court, alleging that the pharmaceutical company's drug Plavix had damaged their health. BMS is incorporated in Delaware and headquartered in New York, and it maintains substantial operations in both New York and New Jersey. Although it engages in business activities in California and sells Plavix there, BMS did not develop, create a marketing strategy for, manufacture, label, package, or work on the regulatory approval for Plavix in the State. And the nonresident plaintiffs did not allege that they obtained Plavix from a California source, that they were injured by Plavix in California, or that they were treated for their injuries in California.

The California Superior Court denied BMS's motion to quash service of summons on the nonresidents' claims for lack of personal jurisdiction, concluding that BMS's extensive activities in the State gave the California courts general jurisdiction. Following this Court's decision in *Daimler AG v. Bauman,* 571 U.S. ——, 134 S.Ct. 746, 187 L.Ed.2d 624 the State Court of Appeal found that the California courts lacked general jurisdiction. But the Court of Appeal went on to find that the California courts had specific jurisdiction over the claims brought by the nonresident plaintiffs. Affirming, the State Supreme Court applied a "sliding scale approach" to ***1776** specific jurisdiction, concluding that BMS's "wide ranging" contacts with the State were enough to support a finding of specific jurisdiction over the claims brought by the nonresident plaintiffs. That attenuated connection was met, the court held, in part because the nonresidents' claims were similar in many ways to the California residents' claims and because BMS engaged in other activities in the State.

Held : California courts lack specific jurisdiction to entertain the nonresidents' claims. Pp. 1779 – 1784.

(a) The personal jurisdiction of state courts is "subject to review for compatibility with the Fourteenth Amendment's Due Process Clause." *Goodyear Dunlop Tires Operations, S.A. v. Brown,* 564 U.S. 915, 918, 131 S.Ct. 2846, 180 L.Ed.2d 796. This Court's decisions have recognized two types of personal jurisdiction: general and specific. For general jurisdiction, the "paradigm forum" is an "individual's domicile," or, for corporations, "an equivalent place, one in which the corporation is fairly regarded as at home." *Id.,* at 924, 131 S.Ct. 2846. Specific jurisdiction, however, requires "the suit" to "aris[e] out of

or relat[e] to the defendant's contacts with the forum." *Daimler, supra,* at ——, 134 S.Ct., at 754 (internal quotation marks omitted).

The "primary concern" in assessing personal jurisdiction is "the burden on the defendant." *World–Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 292, 100 S.Ct. 559, 62 L.Ed.2d 490. Assessing this burden obviously requires a court to consider the practical problems resulting from litigating in the forum, but it also encompasses the more abstract matter of submitting to the coercive power of a State that may have little legitimate interest in the claims in question. At times, "the Due Process Clause, acting as an instrument of interstate federalism, may ... divest the State of its power to render a valid judgment." *Id.,* at 294, 100 S.Ct. 559. Pp. 1779 – 1781.

(b) Settled principles of specific jurisdiction control this case. For a court to exercise specific jurisdiction over a claim there must be an "affiliation between the forum and the underlying controversy, principally, [an] activity or an occurrence that takes place in the forum State." *Goodyear, supra,* at 919, 131 S.Ct. 2846 (internal quotation marks and brackets omitted). When no such connection exists, specific jurisdiction is lacking regardless of the extent of a defendant's unconnected activities in the State. The California Supreme Court's "sliding scale approach"—which resembles a loose and spurious form of general jurisdiction—is thus difficult to square with this Court's precedents. That court found specific jurisdiction without identifying any adequate link between the State and the nonresidents' claims. The mere fact that *other* plaintiffs were prescribed, obtained, and ingested Plavix in California does not allow the State to assert specific jurisdiction over the nonresidents' claims. Nor is it sufficient (or relevant) that BMS conducted research in California on matters unrelated to Plavix. What is needed is a connection between the forum and the specific claims at issue. Cf. *Walden v. Fiore,* 571 U.S. ——, 134 S.Ct. 1115, 188 L.Ed.2d 12. Pp. 1780 – 1782.

(c) The nonresident plaintiffs' reliance on *Keeton v. Hustler Magazine, Inc.,* 465 U.S. 770, 104 S.Ct. 1473, 79 L.Ed.2d 790, and *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628, is misplaced. *Keeton* concerned jurisdiction to determine *the scope of a claim* involving in-state injury and injury to residents of the State, not, as here, jurisdiction to entertain claims involving no in-state injury and no injury to residents of the forum ***1777** State. And *Shutts,* which concerned the due process rights of *plaintiffs,* has no bearing on the question presented here. Pp. 1782 – 1783.

(d) BMS's decision to contract with McKesson, a California company, to distribute Plavix nationally does not provide a sufficient basis for personal jurisdiction. It is not alleged that BMS engaged in relevant acts together with McKesson in California or that BMS is derivatively liable for McKesson's conduct in California. The bare fact that BMS contracted with a California distributor is not enough to establish personal jurisdiction in the State. Pp. 1783 – 1784.

(e) The Court's decision will not result in the parade of horribles that respondents conjure up. It does not prevent the California and out-of-state plaintiffs from joining together in a consolidated action in the States that have general jurisdiction over BMS. Alternatively, the nonresident plaintiffs could probably sue together in their respective home States. In addition, since this decision concerns the due process limits on the exercise of specific jurisdiction by a State, the question remains open whether the Fifth Amendment imposes the same restrictions on the exercise of personal jurisdiction by a federal court. Pp. 1783 – 1784.

1 Cal.5th 783, 206 Cal.Rptr.3d 636, 377 P.3d 874, reversed and remanded.

ALITO, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, THOMAS, GINSBURG, BREYER, KAGAN, and GORSUCH, JJ., joined. SOTOMAYOR, J., filed a dissenting opinion.

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Opinion

Justice ALITO delivered the opinion of the Court.

More than 600 plaintiffs, most of whom are not California residents, filed this civil action in a California state court against Bristol–Myers Squibb Company (BMS), asserting a variety of state-law claims based on injuries allegedly caused by a BMS drug called Plavix. The California Supreme Court held that the California courts have specific jurisdiction to entertain the nonresidents' claims. We now reverse.

I

A

BMS, a large pharmaceutical company, is incorporated in Delaware and headquartered in New York, and it maintains substantial ***1778** operations in both New York and New Jersey. 1 Cal.5th 783, 790, 206 Cal.Rptr.3d 636, 377 P.3d 874, 879 (2016). Over 50 percent of BMS's work force in the United States is employed in those two States. *Ibid.*

BMS also engages in business activities in other jurisdictions, including California. Five of the company's research and laboratory facilities, which employ a total of around 160 employees, are located there. *Ibid.* BMS also employs about 250 sales representatives in California and maintains a small state-government advocacy office in Sacramento. *Ibid.*

One of the pharmaceuticals that BMS manufactures and sells is Plavix, a prescription drug that thins the blood and inhibits blood clotting. BMS did not develop Plavix in California, did not create a marketing strategy for Plavix in California, and did not manufacture, label, package, or work on the regulatory approval of the product in California. *Ibid.* BMS instead engaged in all of these activities in either New York or New Jersey. *Ibid.* But BMS does sell Plavix in California. Between 2006 and 2012, it sold almost 187 million Plavix pills in the State and took in more than $900 million from those sales. 1 Cal.5th, at 790–791, 206 Cal.Rptr.3d 636, 377 P.3d, at 879. This amounts to a little over one percent of the company's nationwide sales revenue. *Id.,* at 790, 206 Cal.Rptr.3d 636, 377 P.3d, at 879.

B

A group of plaintiffs—consisting of 86 California residents and 592 residents from 33 other States—filed eight separate complaints in California Superior Court, alleging that Plavix had damaged their health. *Id.,* at 789, 206 Cal.Rptr.3d 636, 377 P.3d, at 878. All the complaints asserted 13 claims under California law, including products liability, negligent misrepresentation, and misleading advertising claims. *Ibid.* The nonresident plaintiffs did not allege that they obtained Plavix through California physicians or from any other California source; nor did they claim that they were injured by Plavix or were treated for their injuries in California.

Asserting lack of personal jurisdiction, BMS moved to quash service of summons on the nonresidents' claims, but the California Superior Court denied this motion, finding that the California courts had general jurisdiction over BMS "[b]ecause [it] engages in extensive activities in California." App. to Pet. for Cert. 150. BMS unsuccessfully petitioned the State Court of Appeal for a writ of mandate, but after our decision on general jurisdiction in *Daimler AG v. Bauman,* 571 U.S. ——, 134 S.Ct. 746, 187 L.Ed.2d 624 (2014), the California Supreme Court instructed the Court of Appeal "to vacate its order denying mandate and to issue an order to show cause why relief sought in the petition should not be granted." App. 9–10.

The Court of Appeal then changed its decision on the question of general jurisdiction. 228 Cal.App.4th 605, 175 Cal.Rptr.3d 412 (2014). Under *Daimler,* it held, general jurisdiction was clearly lacking, but it went on to find that the California courts had specific jurisdiction over the nonresidents' claims against BMS. 228 Cal.App.4th 605, 175 Cal.Rptr.3d, at 425–439.

The California Supreme Court affirmed. The court unanimously agreed with the Court of Appeal on the issue of general jurisdiction, but the court was divided on the question of specific jurisdiction. The majority applied a "sliding scale approach to specific jurisdiction." 1 Cal.5th, at 806, 206 Cal.Rptr.3d 636, 377 P.3d, at 889. Under this approach, "the more wide ranging the defendant's forum contacts, the more readily is shown a connection between

the forum contacts and the claim." *Ibid.* (internal ***1779** quotation marks omitted). Applying this test, the majority concluded that "BMS's extensive contacts with California" permitted the exercise of specific jurisdiction "based on a less direct connection between BMS's forum activities and plaintiffs' claims than might otherwise be required." *Ibid.* This attenuated requirement was met, the majority found, because the claims of the nonresidents were similar in several ways to the claims of the California residents (as to which specific jurisdiction was uncontested). *Id.,* at 803–806, 206 Cal.Rptr.3d 636, 377 P.3d, at 887–889. The court noted that "[b]oth the resident and nonresident plaintiffs' claims are based on the same allegedly defective product and the assertedly misleading marketing and promotion of that product." *Id.,* at 804, 206 Cal.Rptr.3d 636, 377 P.3d, at 888. And while acknowledging that "there is no claim that Plavix itself was designed and developed in [BMS's California research facilities]," the court thought it significant that other research was done in the State. *Ibid.*

Three justices dissented. "The claims of ... nonresidents injured by their use of Plavix they purchased and used in other states," they wrote, "in no sense arise from BMS's marketing and sales of Plavix in California," and they found that the "mere similarity" of the residents' and nonresidents' claims was not enough. *Id.,* at 819, 206 Cal.Rptr.3d 636, 377 P.3d, at 898 (opinion of Werdegar, J.). The dissent accused the majority of "expand[ing] specific jurisdiction to the point that, for a large category of defendants, it becomes indistinguishable from general jurisdiction." *Id.,* at 816, 206 Cal.Rptr.3d 636, 377 P.3d, at 896.

We granted certiorari to decide whether the California courts' exercise of jurisdiction in this case violates the Due Process Clause of the Fourteenth Amendment. 580 U.S. ——, 137 S.Ct. 827, 196 L.Ed.2d 610 (2017).[1]

[1] California law provides that its courts may exercise jurisdiction "on any basis not inconsistent with the Constitution ... of the United States," Cal. Civ. Proc. Code Ann. § 410.10 (West 2004); see *Daimler AG v. Bauman,* 571 U.S. ——, ——, 134 S.Ct. 746, 753, 187 L.Ed.2d 624 (2014).

II

A

It has long been established that the Fourteenth Amendment limits the personal jurisdiction of state courts. See, *e.g., Daimler, supra,* at —— – ——, 134 S.Ct., at 753–757; *World–Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 291, 100 S.Ct. 559, 62 L.Ed.2d 490 (1980); *International Shoe Co. v. Washington,* 326 U.S. 310, 316–317, 66 S.Ct. 154, 90 L.Ed. 95 (1945); *Pennoyer v. Neff,* 95 U.S. 714, 733, 24 L.Ed. 565 (1878). Because "[a] state court's assertion of jurisdiction exposes defendants to the State's coercive power," it is "subject to review for compatibility with the Fourteenth Amendment's Due Process Clause," *Goodyear Dunlop Tires Operations, S.A. v. Brown,* 564 U.S. 915, 918, 131 S.Ct. 2846, 180 L.Ed.2d 796 (2011), which "limits the power of a state court to render a valid personal judgment against a nonresident defendant," *World–Wide Volkswagen, supra,* at 291, 100 S.Ct. 559. The primary focus of our personal jurisdiction inquiry is the defendant's relationship to the forum State. See *Walden v. Fiore,* 571 U.S. ——, —— – ——, 134 S.Ct. 1115, 1121–1123, 188 L.Ed.2d 12 (2014); *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 806–807, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985).

Since our seminal decision in *International Shoe,* our decisions have recognized ***1780** two types of personal jurisdiction: "general" (sometimes called "all-purpose") jurisdiction and "specific" (sometimes called "case-linked") jurisdiction. *Goodyear,* 564 U.S., at 919, 131 S.Ct. 2846. "For an individual, the paradigm forum for the exercise of general jurisdiction is the individual's domicile; for a corporation, it is an equivalent place, one in which the corporation is fairly regarded as at home." *Id.,* at 924, 131 S.Ct. 2846. A court with general jurisdiction may hear *any* claim against that defendant, even if all the incidents underlying the claim occurred in a different State. *Id.,* at 919, 131 S.Ct. 2846. But "only a limited set of affiliations with a forum will render a defendant amenable to" general jurisdiction in that State. *Daimler,* 571 U.S., at ——, 134 S.Ct., at 760.

Specific jurisdiction is very different. In order for a state court to exercise specific jurisdiction, "the *suit* " must "aris[e] out of or relat[e] to the defendant's contacts with the *forum*." *Id.,* at ——, 134 S.Ct., at 754 (internal quotation marks omitted; emphasis added); see *Burger King Corp. v. Rudzewicz,* 471 U.S. 462, 472–473, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985); *Helicopteros Nacionales de Colombia, S.A. v. Hall,* 466 U.S. 408, 414, 104 S.Ct. 1868, 80 L.Ed.2d 404 (1984). In other words, there must be "an affiliation between the forum and the underlying controversy, principally, [an] activity or an occurrence that takes place in the forum State and is

therefore subject to the State's regulation." *Goodyear,* 564 U.S., at 919, 131 S.Ct. 2846 (internal quotation marks and brackets omitted). For this reason, "specific jurisdiction is confined to adjudication of issues deriving from, or connected with, the very controversy that establishes jurisdiction." *Ibid.* (internal quotation marks omitted).

B

In determining whether personal jurisdiction is present, a court must consider a variety of interests. These include "the interests of the forum State and of the plaintiff in proceeding with the cause in the plaintiff's forum of choice." *Kulko v. Superior Court of Cal., City and County of San Francisco,* 436 U.S. 84, 92, 98 S.Ct. 1690, 56 L.Ed.2d 132 (1978); see *Daimler, supra,* at —— – ——, n. 20, 134 S.Ct., at 762, n. 20; *Asahi Metal Industry Co. v. Superior Court of Cal., Solano Cty.,* 480 U.S. 102, 113, 107 S.Ct. 1026, 94 L.Ed.2d 92 (1987); *World–Wide Volkswagen,* 444 U.S., at 292, 100 S.Ct. 559. But the "primary concern" is "the burden on the defendant." *Id.,* at 292, 100 S.Ct. 559. Assessing this burden obviously requires a court to consider the practical problems resulting from litigating in the forum, but it also encompasses the more abstract matter of submitting to the coercive power of a State that may have little legitimate interest in the claims in question. As we have put it, restrictions on personal jurisdiction "are more than a guarantee of immunity from inconvenient or distant litigation. They are a consequence of territorial limitations on the power of the respective States." *Hanson v. Denckla,* 357 U.S. 235, 251, 78 S.Ct. 1228, 2 L.Ed.2d 1283 (1958). "[T]he States retain many essential attributes of sovereignty, including, in particular, the sovereign power to try causes in their courts. The sovereignty of each State ... implie[s] a limitation on the sovereignty of all its sister States." *World–Wide Volkswagen,* 444 U.S., at 293, 100 S.Ct. 559. And at times, this federalism interest may be decisive. As we explained in *World–Wide Volkswagen,* "[e]ven if the defendant would suffer minimal or no inconvenience from being forced to litigate before the tribunals of another State; even if the forum State has a strong interest in applying ***1781** its law to the controversy; even if the forum State is the most convenient location for litigation, the Due Process Clause, acting as an instrument of interstate federalism, may sometimes act to divest the State of its power to render a valid judgment." *Id.,* at 294, 100 S.Ct. 559.

III

A

Our settled principles regarding specific jurisdiction control this case. In order for a court to exercise specific jurisdiction over a claim, there must be an "affiliation between the forum and the underlying controversy, principally, [an] activity or an occurrence that takes place in the forum State." *Goodyear,* 564 U.S., at 919, 131 S.Ct. 2846 (internal quotation marks and brackets in original omitted). When there is no such connection, specific jurisdiction is lacking regardless of the extent of a defendant's unconnected activities in the State. See *id.,* at 931, n. 6, 131 S.Ct. 2846 ("[E]ven regularly occurring sales of a product in a State do not justify the exercise of jurisdiction over a claim unrelated to those sales").

For this reason, the California Supreme Court's "sliding scale approach" is difficult to square with our precedents. Under the California approach, the strength of the requisite connection between the forum and the specific claims at issue is relaxed if the defendant has extensive forum contacts that are unrelated to those claims. Our cases provide no support for this approach, which resembles a loose and spurious form of general jurisdiction. For specific jurisdiction, a defendant's general connections with the forum are not enough. As we have said, "[a] corporation's 'continuous activity of some sorts within a state ... is not enough to support the demand that the corporation be amenable to suits unrelated to that activity.' " *Id.,* at 927, 131 S.Ct. 2846 (quoting *International Shoe,* 326 U.S., at 318, 66 S.Ct. 154).

The present case illustrates the danger of the California approach. The State Supreme Court found that specific jurisdiction was present without identifying any adequate link between the State and the nonresidents' claims. As noted, the nonresidents were not prescribed Plavix in California, did not purchase Plavix in California, did not ingest Plavix in California, and were not injured by Plavix in California. The mere fact that *other* plaintiffs were prescribed, obtained, and ingested Plavix in California—and allegedly sustained the same injuries as did the nonresidents—does not allow the State to assert specific jurisdiction over the nonresidents' claims. As we have explained, "a defendant's relationship with a ... third

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party, standing alone, is an insufficient basis for jurisdiction." *Walden,* 571 U.S., at ——, 134 S.Ct., at 1123. This remains true even when third parties (here, the plaintiffs who reside in California) can bring claims similar to those brought by the nonresidents. Nor is it sufficient—or even relevant—that BMS conducted research in California on matters unrelated to Plavix. What is needed—and what is missing here—is a connection between the forum and the specific claims at issue.

Our decision in *Walden, supra,* illustrates this requirement. In that case, Nevada plaintiffs sued an out-of-state defendant for conducting an allegedly unlawful search of the plaintiffs while they were in Georgia preparing to board a plane bound for Nevada. We held that the Nevada courts lacked specific jurisdiction even though the plaintiffs were Nevada residents and "suffered foreseeable harm in Nevada." *Id.,* at ——, 134 S.Ct., at 1124. Because the "*relevant* conduct occurred ***1782** entirely in Georgi[a] ... the mere fact that [this] conduct affected plaintiffs with connections to the forum State d [id] not suffice to authorize jurisdiction." *Id.,* at ——, 134 S.Ct., at 1126 (emphasis added).

In today's case, the connection between the nonresidents' claims and the forum is even weaker. The relevant plaintiffs are not California residents and do not claim to have suffered harm in that State. In addition, as in *Walden,* all the conduct giving rise to the nonresidents' claims occurred elsewhere. It follows that the California courts cannot claim specific jurisdiction. See *World–Wide Volkswagen, supra,* at 295, 100 S.Ct. 559 (finding no personal jurisdiction in Oklahoma because the defendant "carr[ied] on no activity whatsoever in Oklahoma" and dismissing "the fortuitous circumstance that a single Audi automobile, sold [by defendants] in New York to New York residents, happened to suffer an accident while passing through Oklahoma" as an "isolated occurrence").

B

The nonresidents maintain that two of our cases support the decision below, but they misinterpret those precedents.

In *Keeton v. Hustler Magazine, Inc.,* 465 U.S. 770, 104 S.Ct. 1473, 79 L.Ed.2d 790 (1984), a New York resident sued Hustler in New Hampshire, claiming that she had been libeled in five issues of the magazine, which was distributed throughout the country, including in New Hampshire, where it sold 10,000 to 15,000 copies per month. Concluding that specific jurisdiction was present, we relied principally on the connection between the circulation of the magazine in New Hampshire and damage allegedly caused within the State. We noted that "[f]alse statements of fact harm both the subject of the falsehood and the readers of the statement." *Id.,* at 776, 104 S.Ct. 1473 (emphasis deleted). This factor amply distinguishes *Keeton* from the present case, for here the nonresidents' claims involve no harm in California and no harm to California residents.

The nonresident plaintiffs in this case point to our holding in *Keeton* that there was jurisdiction in New Hampshire to entertain the plaintiff's request for damages suffered outside the State, *id.,* at 774, 104 S.Ct. 1473 but that holding concerned jurisdiction to determine *the scope of a claim* involving in-state injury and injury to residents of the State, not, as in this case, jurisdiction to entertain claims involving no in-state injury and no injury to residents of the forum State. *Keeton* held that there was jurisdiction in New Hampshire to consider the full measure of the plaintiff's claim, but whether she could actually recover out-of-state damages was a merits question governed by New Hampshire libel law. *Id.,* at 778, n. 9, 104 S.Ct. 1473.

The Court's decision in *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), which involved a class action filed in Kansas, is even less relevant. The Kansas court exercised personal jurisdiction over the claims of nonresident class members, and the defendant, Phillips Petroleum, argued that this violated the due process rights of these class members because they lacked minimum contacts with the State.[2] According to the defendant, the out-of-state class members should not have been kept in the case unless they affirmatively opted in, instead of merely failing to opt out after ***1783** receiving notice. *Id.,* at 812, 105 S.Ct. 2965.

[2] The Court held that the defendant had standing to argue that the Kansas court had improperly exercised personal jurisdiction over the claims of the out-of-state class members because that holding materially affected the defendant's own interests, specifically, the res judicata effect of an adverse judgment. 472 U.S., at 803–806, 105 S.Ct. 2965.

Holding that there had been no due process violation, the Court explained that the authority of a State to entertain the claims of nonresident class members is entirely different from its authority to exercise jurisdiction over an out-of-state defendant. *Id.,* at 808–812, 105 S.Ct. 2965.

Since *Shutts* concerned the due process rights of *plaintiffs,* it has no bearing on the question presented here.

Respondents nevertheless contend that *Shutts* supports their position because, in their words, it would be "absurd to believe that [this Court] would have reached the exact opposite result if the petitioner [Phillips] had only invoked its own due-process rights, rather than those of the non-resident plaintiffs." Brief for Respondents 28–29, n. 6 (emphasis deleted). But the fact remains that Phillips did not assert that Kansas improperly exercised personal jurisdiction over it, and the Court did not address that issue.[3] Indeed, the Court stated specifically that its "discussion of personal jurisdiction [did not] address class actions where the jurisdiction is asserted against a *defendant* class." *Shutts,* *supra,* at 812, n. 3, 105 S.Ct. 2965.

[3] Petitioner speculates that Phillips did not invoke its own due process rights because it was believed at the time that the Kansas court had general jurisdiction. See Reply Brief 7, n. 1.

C

In a last ditch contention, respondents contend that BMS's "decision to contract with a California company [McKesson] to distribute [Plavix] nationally" provides a sufficient basis for personal jurisdiction. Tr. of Oral Arg. 32. But as we have explained, "[t]he requirements of *International Shoe* ... must be met as to each defendant over whom a state court exercises jurisdiction." *Rush v. Savchuk,* 444 U.S. 320, 332, 100 S.Ct. 571, 62 L.Ed.2d 516 (1980); see *Walden,* 571 U.S., at ——, 134 S.Ct., at 1123 ("[A] defendant's relationship with a ... third party, standing alone, is an insufficient basis for jurisdiction"). In this case, it is not alleged that BMS engaged in relevant acts together with McKesson in California. Nor is it alleged that BMS is derivatively liable for McKesson's conduct in California. And the nonresidents "have adduced no evidence to show how or by whom the Plavix they took was distributed to the pharmacies that dispensed it to them." 1 Cal.5th, at 815, 206 Cal.Rptr.3d 636, 377 P.3d, at 895 (Werdegar, J., dissenting) (emphasis deleted). See Tr. of Oral Arg. 33 ("It is impossible to trace a particular pill to a particular person.... It's not possible for us to track particularly to McKesson"). The bare fact that BMS contracted with a California distributor is not enough to establish personal jurisdiction in the State.

IV

Our straightforward application in this case of settled principles of personal jurisdiction will not result in the parade of horribles that respondents conjure up. See Brief for Respondents 38–47. Our decision does not prevent the California and out-of-state plaintiffs from joining together in a consolidated action in the States that have general jurisdiction over BMS. BMS concedes that such suits could be brought in either New York or Delaware. See Brief for Petitioner 13. Alternatively, the plaintiffs who are residents of a particular State—for example, the 92 plaintiffs from Texas and the 71 from Ohio—could probably sue together in their home States. In addition, since our decision concerns the due process limits on the ***1784** exercise of specific jurisdiction by a State, we leave open the question whether the Fifth Amendment imposes the same restrictions on the exercise of personal jurisdiction by a federal court. See *Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co.,* 484 U.S. 97, 102, n. 5, 108 S.Ct. 404, 98 L.Ed.2d 415 (1987).

* * *

The judgment of the California Supreme Court is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

Justice SOTOMAYOR, dissenting.

Three years ago, the Court imposed substantial curbs on the exercise of general jurisdiction in its decision in *Daimler AG v. Bauman,* 571 U.S. ——, 134 S.Ct. 746, 187 L.Ed.2d 624 (2014). Today, the Court takes its first step toward a similar contraction of specific jurisdiction by holding that a corporation that engages in a nationwide course of conduct cannot be held accountable in a state court by a group of injured people unless all of those people were injured in the forum State.

I fear the consequences of the Court's decision today will be substantial. The majority's rule will make it difficult to aggregate the claims of plaintiffs across the country whose claims may be worth little alone. It will make it impossible to bring a nationwide mass action in state court against defendants who are "at home" in different

States. And it will result in piecemeal litigation and the bifurcation of claims. None of this is necessary. A core concern in this Court's personal jurisdiction cases is fairness. And there is nothing unfair about subjecting a massive corporation to suit in a State for a nationwide course of conduct that injures both forum residents and nonresidents alike.

I

Bristol–Myers Squibb is a Fortune 500 pharmaceutical company incorporated in Delaware and headquartered in New York. It employs approximately 25,000 people worldwide and earns annual revenues of over $15 billion. In the late 1990's, Bristol–Myers began to market and sell a prescription blood thinner called Plavix. Plavix was advertised as an effective tool for reducing the risk of blood clotting for those vulnerable to heart attacks and to strokes. The ads worked: At the height of its popularity, Plavix was a blockbuster, earning Bristol–Myers billions of dollars in annual revenues.

Bristol–Myers' advertising and distribution efforts were national in scope. It conducted a single nationwide advertising campaign for Plavix, using television, magazine, and Internet ads to broadcast its message. A consumer in California heard the same advertisement as a consumer in Maine about the benefits of Plavix. Bristol–Myers' distribution of Plavix also proceeded through nationwide channels: Consistent with its usual practice, it relied on a small number of wholesalers to distribute Plavix throughout the country. One of those distributors, McKesson Corporation, was named as a defendant below; during the relevant time period, McKesson was responsible for almost a quarter of Bristol–Myers' revenue worldwide.

The 2005 publication of an article in the New England Journal of Medicine questioning the efficacy and safety of Plavix put Bristol–Myers on the defensive, as consumers around the country began to claim that they were injured by the drug. The plaintiffs in these consolidated cases are 86 people who allege they were injured by Plavix in California and several hundred others who say they were injured by ***1785** the drug in other States.[1] They filed their suits in California Superior Court, raising product-liability claims against Bristol–Myers and McKesson. Their claims are "materially identical," as Bristol–Myers concedes. See Brief for Petitioner 4, n. 1. Bristol–Myers acknowledged it was subject to suit in California state court by the residents of that State. But it moved to dismiss the claims brought by the nonresident plaintiffs—respondents here—for lack of jurisdiction. The question here, accordingly, is not whether Bristol–Myers is subject to suit in California on claims that arise out of the design, development, manufacture, marketing, and distribution of Plavix—it is. The question is whether Bristol–Myers is subject to suit in California only on the residents' claims, or whether a state court may also hear the nonresidents' "identical" claims.

1 Like the parties and the majority, I refer to these people as "residents" and "nonresidents" of California as a convenient shorthand. See *ante,*at 1778; Brief for Petitioner 4–5, n. 1; Brief for Respondents 2, n. 1. For jurisdictional purposes, the important question is generally (as it is here) where a plaintiff was injured, not where he or she resides.

II

A

As the majority explains, since our pathmarking opinion in *International Shoe Co. v. Washington,* 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945), the touchstone of the personal-jurisdiction analysis has been the question whether a defendant has "certain minimum contacts with [the State] such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.' " *Id.,* at 316, 66 S.Ct. 154 (quoting *Milliken v. Meyer,* 311 U.S. 457, 463, 61 S.Ct. 339, 85 L.Ed. 278 (1940)). For decades this Court has considered that question through two different jurisdictional frames: "general" and "specific" jurisdiction. See *Helicopteros Nacionales de Colombia, S.A. v. Hall,* 466 U.S. 408, 414, nn. 8–9, 104 S.Ct. 1868, 80 L.Ed.2d 404 (1984). Under our current case law, a state court may exercise general, or all-purpose, jurisdiction over a defendant corporation only if its "affiliations with the State are so 'continuous and systematic' as to render [it] essentially at home in the forum State." *Goodyear Dunlop Tires Operations, S.A. v. Brown,* 564 U.S. 915, 919, 131 S.Ct. 2846, 180 L.Ed.2d 796 (2011).[2]

[2] Respondents do not contend that the California courts would be able to exercise general jurisdiction over Bristol–Myers—a concession that follows directly from this Court's opinion in *Daimler AG v. Bauman,* 571 U.S. ——, 134 S.Ct. 746, 187 L.Ed.2d 624 (2014). As I have explained, I believe the restrictions the Court imposed on general jurisdiction in *Daimler* were ill advised. See *BNSF R. Co. v. Tyrrell,* 581 U.S. ——, ——, 137 S.Ct. 1549, —— L.Ed.2d —— (2017) (SOTOMAYOR, J., concurring in part and dissenting in part); *Daimler,* 571 U.S., at ——, 134 S.Ct. at 772–773 (SOTOMAYOR, J., concurring in judgment). But I accept respondents' concession, for the purpose of this case, that Bristol–Myers is not subject to general jurisdiction in California.

If general jurisdiction is not appropriate, however, a state court can exercise only specific, or case-linked, jurisdiction over a dispute. *Id.,* at 923–924, 131 S.Ct. 2846. Our cases have set out three conditions for the exercise of specific jurisdiction over a nonresident defendant. 4A C. Wright, A. Miller, & A. Steinman, Federal Practice and Procedure § 1069, pp. 22–78 (4th ed. 2015) (Wright); see also *id.,* at 22–27, n. 10 (collecting authority). First, the defendant must have " 'purposefully avail[ed] itself of the privilege of conducting activities within the forum State' " or have purposefully directed its conduct into the forum State. *J. McIntyre Machinery, Ltd.* ***1786** *v. Nicastro,* 564 U.S. 873, 877, 131 S.Ct. 2780, 180 L.Ed.2d 765 (2011) (plurality opinion) (quoting *Hanson v. Denckla,* 357 U.S. 235, 253, 78 S.Ct. 1228, 2 L.Ed.2d 1283 (1958)). Second, the plaintiff's claim must "arise out of or relate to" the defendant's forum conduct. *Helicopteros,* 466 U.S., at 414, 104 S.Ct. 1868. Finally, the exercise of jurisdiction must be reasonable under the circumstances. *Asahi Metal Industry Co. v. Superior Court of Cal., Solano Cty.,* 480 U.S. 102, 113–114, 107 S.Ct. 1026, 94 L.Ed.2d 92 (1987); *Burger King Corp. v. Rudzewicz,* 471 U.S. 462, 477–478, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985). The factors relevant to such an analysis include "the burden on the defendant, the forum State's interest in adjudicating the dispute, the plaintiff's interest in obtaining convenient and effective relief, the interstate judicial system's interest in obtaining the most efficient resolution of controversies, and the shared interest of the several States in furthering fundamental substantive social policies." *Id.,* at 477, 105 S.Ct. 2174 (internal quotation marks omitted).

B

Viewed through this framework, the California courts appropriately exercised specific jurisdiction over respondents' claims.

First, there is no dispute that Bristol–Myers "purposefully avail[ed] itself," *Nicastro,* 564 U.S., at 877, 131 S.Ct. 2780 of California and its substantial pharmaceutical market. Bristol–Myers employs over 400 people in California and maintains half a dozen facilities in the State engaged in research, development, and policymaking. *Ante,* at 1777 – 1778. It contracts with a California-based distributor, McKesson, whose sales account for a significant portion of its revenue. *Supra,* at 1784 – 1785. And it markets and sells its drugs, including Plavix, in California, resulting in total Plavix sales in that State of nearly $1 billion during the period relevant to this suit.

Second, respondents' claims "relate to" Bristol–Myers' in-state conduct. A claim "relates to" a defendant's forum conduct if it has a "connect[ion] with" that conduct. *International Shoe,* 326 U.S., at 319, 66 S.Ct. 154. So respondents could not, for instance, hale Bristol–Myers into court in California for negligently maintaining the sidewalk outside its New York headquarters—a claim that has no connection to acts Bristol–Myers took in California. But respondents' claims against Bristol–Myers look nothing like such a claim. Respondents' claims against Bristol–Myers concern conduct materially identical to acts the company took in California: its marketing and distribution of Plavix, which it undertook on a nationwide basis in all 50 States. That respondents were allegedly injured by this nationwide course of conduct in Indiana, Oklahoma, and Texas, and not California, does not mean that their claims do not "relate to" the advertising and distribution efforts that Bristol–Myers undertook in that State. All of the plaintiffs—residents and nonresidents alike—allege that they were injured by the same essential acts. Our cases require no connection more direct than that.

Finally, and importantly, there is no serious doubt that the exercise of jurisdiction over the nonresidents' claims is reasonable. Because Bristol–Myers already faces claims that are identical to the nonresidents' claims in this suit, it will not be harmed by having to defend against respondents' claims: Indeed, the alternative approach—litigating those claims in separate suits in as many as 34 different States—would prove far more burdensome. By contrast, the plaintiffs' "interest in obtaining convenient and effective relief," *Burger King,* 471 U.S., at 477, 105 S.Ct. 2174 (internal quotation marks omitted), ***1787** is obviously furthered by participating in a consolidated proceeding in one State under shared

counsel, which allows them to minimize costs, share discovery, and maximize recoveries on claims that may be too small to bring on their own. Cf. *American Express Co. v. Italian Colors Restaurant,* 570 U.S. ——, ——, 133 S.Ct. 2304, 2316, 186 L.Ed.2d 417 (2013) (KAGAN, J., dissenting) ("No rational actor would bring a claim worth tens of thousands of dollars if doing so meant incurring costs in the hundreds of thousands"). California, too, has an interest in providing a forum for mass actions like this one: Permitting the nonresidents to bring suit in California alongside the residents facilitates the efficient adjudication of the residents' claims and allows it to regulate more effectively the conduct of both nonresident corporations like Bristol–Myers and resident ones like McKesson.

Nothing in the Due Process Clause prohibits a California court from hearing respondents' claims—at least not in a case where they are joined to identical claims brought by California residents.

III

Bristol–Myers does not dispute that it has purposefully availed itself of California's markets, nor—remarkably—did it argue below that it would be "unreasonable" for a California court to hear respondents' claims. See 1 Cal.5th 783, 799, n. 2, 206 Cal.Rptr.3d 636, 377 P.3d 874, 885, n. 2 (2016). Instead, Bristol–Myers contends that respondents' claims do not "arise out of or relate to" its California conduct. The majority agrees, explaining that no "adequate link" exists "between the State and the nonresidents' claims," *ante,* at 1781 – 1782—a result that it says follows from "settled principles [of] specific jurisdiction," *ante,* at 1780 – 1781. But our precedents do not require this result, and common sense says that it cannot be correct.

A

The majority casts its decision today as compelled by precedent. *Ibid.* But our cases point in the other direction.

The majority argues at length that the exercise of specific jurisdiction in this case would conflict with our decision in *Walden v. Fiore,* 571 U.S. ——, 134 S.Ct. 1115, 188 L.Ed.2d 12 (2014). That is plainly not true. *Walden* concerned the requirement that a defendant "purposefully avail" himself of a forum State or "purposefully direc[t]" his conduct toward that State, *Nicastro,* 564 U.S., at 877, 131 S.Ct. 2780 not the separate requirement that a plaintiff's claim "arise out of or relate to" a defendant's forum contacts. The lower court understood the case that way. See *Fiore v. Walden,* 688 F.3d 558, 576–582 (C.A.9 2012). The parties understood the case that way. See Brief for Petitioner 17–31, Brief for Respondent 20–44, Brief for United States as *Amicus Curiae* 12–18, in *Walden v. Fiore,* O.T. 2013, No. 12–574. And courts and commentators have understood the case that way. See, *e.g.,* 4 Wright § 1067.1, at 388–389. *Walden* teaches only that a defendant must have purposefully availed itself of the forum, and that a plaintiff cannot rely solely on a defendant's contacts with a forum resident to establish the necessary relationship. See 571 U.S., at ——, 134 S.Ct., at 1122 ("[T]he plaintiff cannot be the only link between the defendant and the forum"). But that holding has nothing to do with the dispute between the parties: Bristol–Myers has purposefully availed itself of California—to the tune of millions of dollars in annual revenue. Only if its language is taken out of context, *ante,* at 1781 – 1782, can *Walden* be made to seem relevant to the case at hand.

***1788** By contrast, our decision in *Keeton v. Hustler Magazine, Inc.,* 465 U.S. 770, 104 S.Ct. 1473, 79 L.Ed.2d 790 (1984), suggests that there should be no such barrier to the exercise of jurisdiction here. In *Keeton,* a New York resident brought suit against an Ohio corporation, a magazine, in New Hampshire for libel. She alleged that the magazine's nationwide course of conduct—its publication of defamatory statements—had injured her in every State, including New Hampshire. This Court unanimously rejected the defendant's argument that it should not be subject to "nationwide damages" when only a small portion of those damages arose in the forum State, *id.,* at 781, 104 S.Ct. 1473; exposure to such liability, the Court explained, was the consequence of having "continuously and deliberately exploited the New Hampshire market," *ibid.* The majority today dismisses *Keeton* on the ground that the defendant there faced one plaintiff's claim arising out of its nationwide course of conduct, whereas Bristol–Myers faces many more plaintiffs' claims. See *ante,* at 1782 – 1783. But this is a distinction without a difference: In either case, a defendant will face liability in a single State for a single course of conduct that has impact in many States. *Keeton* informs us that there is no unfairness in such a result.

The majority's animating concern, in the end, appears to be federalism: "[T]erritorial limitations on the power of the respective States," we are informed, may—and today do—trump even concerns about fairness to the parties. *Ante,* at 1780. Indeed, the majority appears to concede that this is not, at bottom, a case about fairness but instead a case about power: one in which " 'the defendant would suffer minimal or no inconvenience from being forced to litigate before the tribunals of another State; ... the forum State has a strong interest in applying its law to the controversy; [and] the forum State is the most convenient location for litigation' " but personal jurisdiction still will not lie. *Ante,* at 1780 – 1781 (quoting *World–Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 294, 100 S.Ct. 559, 62 L.Ed.2d 490 (1980)). But I see little reason to apply such a principle in a case brought against a large corporate defendant arising out of its nationwide conduct. What interest could any single State have in adjudicating respondents' claims that the other States do not share? I would measure jurisdiction first and foremost by the yardstick set out in *International Shoe*—"fair play and substantial justice," 326 U.S., at 316, 66 S.Ct. 154 (internal quotation marks omitted). The majority's opinion casts that settled principle aside.

B

I fear the consequences of the majority's decision today will be substantial. Even absent a rigid requirement that a defendant's in-state conduct must actually cause a plaintiff's claim,[3] the upshot of today's opinion is that plaintiffs cannot join their claims together and sue a defendant in a State in which only some of them have ***1789** been injured. That rule is likely to have consequences far beyond this case.

[3] Bristol–Myers urges such a rule upon us, Brief for Petitioner 14–37, but its adoption would have consequences far beyond those that follow from today's factbound opinion. Among other things, it might call into question whether even a plaintiff *injured* in a State by an item identical to those sold by a defendant in that State could avail himself of that State's courts to redress his injuries—a result specifically contemplated by *World–Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 297, 100 S.Ct. 559, 62 L.Ed.2d 490 (1980). See Brief for Civil Procedure Professors as *Amici Curiae* 14–18; see also *J. McIntyre Machinery, Ltd. v. Nicastro,* 564 U.S. 873, 906–907, 131 S.Ct. 2780, 180 L.Ed.2d 765 (2011) (GINSBURG, J., dissenting). That question, and others like it, appears to await another case.

First, and most prominently, the Court's opinion in this case will make it profoundly difficult for plaintiffs who are injured in different States by a defendant's nationwide course of conduct to sue that defendant in a single, consolidated action. The holding of today's opinion is that such an action cannot be brought in a State in which only some plaintiffs were injured. Not to worry, says the majority: The plaintiffs here could have sued Bristol–Myers in New York or Delaware; could "probably" have subdivided their separate claims into 34 lawsuits in the States in which they were injured; and might have been able to bring a single suit in federal court (an "open ... question"). *Ante,* at 1783 – 1784. Even setting aside the majority's caveats, what is the purpose of such limitations? What interests are served by preventing the consolidation of claims and limiting the forums in which they can be consolidated? The effect of the Court's opinion today is to eliminate nationwide mass actions in any State other than those in which a defendant is " 'essentially at home.' "[4] See *Daimler,* 571 U.S., at ——, 134 S.Ct., at 754. Such a rule hands one more tool to corporate defendants determined to prevent the aggregation of individual claims, and forces injured plaintiffs to bear the burden of bringing suit in what will often be far flung jurisdictions.

[4] The Court today does not confront the question whether its opinion here would also apply to a class action in which a plaintiff injured in the forum State seeks to represent a nationwide class of plaintiffs, not all of whom were injured there. Cf. *Devlin v. Scardelletti,* 536 U.S. 1, 9–10, 122 S.Ct. 2005, 153 L.Ed.2d 27 (2002) ("Nonnamed class members ... may be parties for some purposes and not for others"); see also Wood, Adjudicatory Jurisdiction and Class Actions, 62 Ind. L.J. 597, 616–617 (1987).

Second, the Court's opinion today may make it impossible to bring certain mass actions at all. After this case, it is difficult to imagine where it might be possible to bring a nationwide mass action against two or more defendants headquartered and incorporated in different States. There will be no State where both defendants are "at home," and so no State in which the suit can proceed. What about a nationwide mass action brought against a defendant not headquartered or incorporated in the United States? Such a defendant is not "at home" in any State. Cf. *id.,* at —— – ——, 134 S.Ct., at 772–773 (SOTOMAYOR, J., concurring in judgment). Especially in a world in which defendants are subject to general jurisdiction in only a handful of States, see *ibid.,* the

effect of today's opinion will be to curtail—and in some cases eliminate—plaintiffs' ability to hold corporations fully accountable for their nationwide conduct.

The majority chides respondents for conjuring a "parade of horribles," *ante,* at 1783, but says nothing about how suits like those described here will survive its opinion in this case. The answer is simple: They will not.

* * *

It "does not offend 'traditional notions of fair play and substantial justice,' " *International Shoe,* 326 U.S., at 316, 66 S.Ct. 154 to permit plaintiffs to aggregate claims arising out of a single nationwide course of conduct in a single suit in a single State where some, but not all, were injured. But that is exactly what the Court holds today is barred by the Due Process Clause.

This is not a rule the Constitution has required before. I respectfully dissent.

All Citations

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NOTES

NOTES

37

Beaton v. SpeedyPC Software,
907 F.3d 1018 (7th Cir. Nov. 28, 2018)

Submitted by:
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907 F.3d 1018
United States Court of Appeals, Seventh Circuit.

Archie BEATON, Plaintiff-Appellee,
v.
SPEEDYPC SOFTWARE, a British Columbia Company, Defendant-Appellant.

No. 18-1010
|
Argued May 30, 2018
|
Decided October 31, 2018
|
Rehearing and Rehearing En Banc Denied November 28, 2018

Synopsis

Background: Consumer brought putative class action against software seller, alleging that software, which promised to improve computer speed and performance, failed to perform as advertised. The United States District Court for the Northern District of Illinois, No. 13 C 8389, Andrea R. Wood, J., 2017 WL 4740628, granted consumer's motion to certify class. Seller appealed.

Holdings: The Court of Appeals, Wood, Chief Judge, held that:

district court's decision to certify class for consumer's two implied warranty claims, even though that legal theory was not spelled out in complaint, was not reversible error;

consumer would not be unfairly advantaged if not estopped from arguing that British Columbia law, rather than Illinois law, applied to his warranty claims;

consumer satisfied commonality requirement for class certification;

consumer satisfied typicality requirement;

district court did not abuse its discretion in concluding that consumer was adequate class representative;

district court did not abuse its discretion in concluding that consumer satisfied predominance requirement; and

class action was superior way to resolve consumer's action.

Affirmed.

***1021** Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 13 C 8389—**Andrea R. Wood**, *Judge*.

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Before Wood, Chief Judge, and Sykes and Hamilton, Circuit Judges.

Opinion

Wood, Chief Judge.

When Archie Beaton's laptop started misbehaving, he looked for an at-home fix. An internet search turned up a product from SpeedyPC Software ("Speedy") that offered both a diagnosis and a cure. Beaton took advantage of Speedy's free trial, which warned that his device was in bad shape and encouraged him to purchase its software solution: SpeedyPC Pro. He did. But he was disappointed with the outcome: despite Speedy's promises, the software failed to improve his laptop's performance.

Beaton became convinced that he was the victim of a scam. He filed a consumer class action against Speedy, raising both contract and tort theories. The district court certified a nationwide class and an Illinois subclass of software purchasers. Hoping to dodge the consumer class action, Speedy turned to this court for relief. See FED. R. CIV. P. 23(f). Because we find no abuse of discretion in the district court's certification orders, we affirm.

I

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The ad for SpeedyPC Pro that Beaton found in August 2012 promised that Speedy's software would fix common problems affecting computer speed and performance and unleash the device's "true potential." It also offered a free scan to detect any problems. Beaton decided to give it a try, and so he downloaded and ran the free trial. After assessing the laptop's health across five modules, the program told Beaton that his computer was in critical ***1022** condition as a result of hundreds of serious errors.

The free trial prompted Beaton to buy the licensed version of the software, which (he was promised) would fix the identified problems. Beaton was sold. Using his personal business's credit card, he purchased SpeedyPC Pro and ran it on his laptop. It began by scanning his device, just as the free trial had done. The program then told Beaton to click on "Fix All." Beaton dutifully did so. Yet nothing happened. Beaton ran the software a few more times, to no avail.

Feeling ripped off, and suspecting that his experience was not unique, Beaton sued Speedy in 2013 on behalf of a class of consumers defined as "All individuals and entities in the United States who have purchased SpeedyPC Pro." Despite Speedy's lofty pledges, Beaton claimed, the software failed to perform as advertised. Instead, it indiscriminately and misleadingly warned *all* users that their devices were in critical condition, scared them into buying SpeedyPC Pro, and then ran a functionally worthless "fix." The district court had jurisdiction over this putative class action under the Class Action Fairness Act, 28 U.S.C. § 1332(d)(2).

Speedy twice tried, and twice failed, to get the lawsuit thrown out. The district court first rejected its effort to have the complaint dismissed for failure to state a claim on which relief could be granted. Speedy then tried a motion to dismiss on *forum non conveniens* grounds, based on the fact that the software's End User License Agreement ("the Agreement") contained a choice-of-law provision selecting the law of British Columbia (Canada) to govern any claims arising from it. The district court, however, decided to retain the case without definitively resolving the choice-of-law issue at that juncture.

Four years after the suit was filed, Beaton moved to certify a class and subclass of software purchasers. Beaton's proposed class definition was narrower than the one in his complaint. It included "[a]ll individuals living in the United States who downloaded a free trial of SpeedyPC Pro and thereafter purchased the full version between October 28, 2011 and November 21, 2014." He also proposed a subclass of class members "who reside in Illinois" and several other states.

The district court certified Beaton's class claims for breaches of the implied warranties of fitness for a particular purpose and merchantability. On behalf of a subclass consisting only of Illinois residents, the court certified claims for fraudulent misrepresentation under the Illinois Consumer Fraud and Deceptive Business Practices Act (ICFA). It rejected the proposed subclass insofar as it included residents from other states, because Beaton failed to identify the relevant consumer-protection laws of those states.

The court had the benefit of dueling expert testimony before it at the time it made these certification decisions. Beaton's expert, Craig Snead, described how the free trial operated across devices. Speedy's expert, Monty Myers, disputed Snead's account. Although the court had not yet issued its ruling on the parties' cross-motions to exclude the testimony of each other's expert, it ultimately denied both motions (with minor exceptions) roughly two months later. See FED. R. EVID. 702. In that order, the court noted that it had "considered the challenged expert testimony for purposes of class certification only to the extent consistent with the rulings stated."

At that point, Speedy filed and we granted a petition for interlocutory appeal of the class certification decisions. See FED. R. CIV. P. 23(f). We note that Speedy's petition may have been untimely, but Beaton chose not to press the issue. The time ***1023** limit for an appeal under Rule 23(f) is not statutory, and so a failure to abide by it does not affect our jurisdiction. See *Bowles v. Russell,* 551 U.S. 205, 210–11, 127 S.Ct. 2360, 168 L.Ed.2d 96 (2007); *McReynolds v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 672 F.3d 482, 485 (7th Cir. 2012) (holding that Rule 23(f)'s 14-day limitations period is not jurisdictional), *abrogated on other grounds by Phillips v. Sheriff of Cook Cnty.*, 828 F.3d 541 (7th Cir. 2016).

II

Before we reach the heart of this appeal—the district court's Rule 23 decisions—we address Speedy's more substantial preliminary objections.

A

Speedy complains that the class definitions and legal theories covered by the court's certification orders impermissibly differ from those outlined in the original complaint. Speedy first attacks the narrowing of the class from everyone in the United States who had purchased SpeedyPC Pro, to individual persons (not entities) who downloaded the free trial and purchased the licensed software over roughly a three-year period. This is nothing like what we faced in *Supreme Auto Transport, LLC v. Arcelor Mittal USA, Inc.*, 902 F.3d 735, 741 (7th Cir. 2018), where the later proposed class greatly expanded the scope of the litigation beyond what the defendants could have imagined. We see no reason here why Speedy is prejudiced by the narrower certified definition. Speedy complains that it would have conducted discovery differently had it known about the narrowed class. See *Chessie Logistics Co. v. Krinos Holdings, Inc.*, 867 F.3d 852, 859 (7th Cir. 2017). But it has not told us, either in its briefs or at oral argument, what exactly would have changed. Speedy's position is further weakened by the fact that the district court allowed additional merits discovery following its certification decision. District courts may amend class definitions either on motion or on their own initiative. See FED. R. CIV. P. 23(c)(1)(C); *Chapman v. First Index, Inc.*, 796 F.3d 783, 785 (7th Cir. 2015); *Abbott v. Lockheed Martin Corp.*, 725 F.3d 803, 807 (7th Cir. 2013). We are satisfied that the court reasonably exercised its discretion in adopting its class definition.

We similarly find no reversible error in the district court's decision to certify Beaton's two implied warranty claims. It is immaterial that these legal theories were not spelled out in the initial complaint. See *Chessie Logistics Co.*, 867 F.3d at 860. As the Supreme Court and this court constantly remind litigants, plaintiffs do not need to plead legal theories. *Johnson v. City of Shelby*, —— U.S. ——, 135 S.Ct. 346, 346–47, 190 L.Ed.2d 309 (2014) (per curiam); *BRC Rubber & Plastics, Inc. v. Cont'l Carbon Co.*, 900 F.3d 529, 540–41 (7th Cir. 2018); *King v. Kramer*, 763 F.3d 635, 642 (7th Cir. 2014). Rule 8 requires only that a complaint must set forth plausible facts that, if true, would support a claim for relief. See *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007); FED. R. CIV. P. 8(a)(2). Even where a plaintiff initially asserts particular theories of recovery, unless the change unfairly harms the defendant she is allowed to switch course and pursue other avenues of relief as litigation progresses. *Chessie Logistics Co.*, 867 F.3d at 859; *Whitaker v. Milwaukee Cnty.*, 772 F.3d 802, 808 & n.18 (7th Cir. 2014). Here, the court's certification of the implied warranty claims was permissible as long as Beaton's allegations were plausible and Speedy had fair notice of what this suit was about. See ***1024** *Runnion ex rel. Runnion v. Girl Scouts of Greater Chi. & Nw. Ind.*, 786 F.3d 510, 517 (7th Cir. 2015). We note as well that applicable law is no longer in dispute, as the parties now agree that the implied warranty claims derive from the Agreement, which chooses the law of British Columbia.

Beaton's complaint describes Speedy as a company that sells software products. He alleges that it marketed SpeedyPC Pro in the hope of persuading consumers to purchase the software to fix their computers. And he asserts that customers relied on the company's expertise and representations that the software would improve their devices. For present purposes, this is enough to provide fair notice that he intends to pursue warranty claims under the law of British Columbia. See R.S.B.C. 1996, ch. 410, § 18(a)–(b). It is hard to imagine how Speedy suffered any "unfair surprise," given that the "legal basis for liability is based on the same allegations" about the sale of worthless software. *Whitaker*, 772 F.3d at 809 & n.19. Though Speedy insists that it is worse off because it cannot move to dismiss on the ground that the Agreement expressly disclaimed these implied warranties, there is no final judgment in this case. Nothing prevents Speedy from pursuing this point on remand.

B

Next, we briefly consider Speedy's assertion that Beaton is judicially estopped from seeking relief under the law of British Columbia because initially he argued for Illinois law. Equitable estoppel requires that: (1) the party's later position is clearly inconsistent with her earlier one; (2) the party successfully persuaded the court to adopt her first position; and (3) the party would be unfairly advantaged if not estopped. *Janusz v. City of Chi.*, 832 F.3d 770, 776 (7th Cir. 2016).

Speedy forfeited its estoppel argument by not raising it before the district court. *1st Source Bank v. Neto*, 861 F.3d 607, 611–12 (7th Cir. 2017). It merely acknowledged that Beaton changed his position on whether British Columbia or Illinois law controlled his contract claims.

Even on the merits, Speedy's estoppel theory falls short. It is true that Beaton flip-flopped his position on the source of his implied warranty claims, and so the first

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criterion for estoppel may be met. In his opposition to the motion to dismiss for *forum non conveniens*, Beaton argued that "[n]one of [his] claims are based upon [the Agreement]." But by the time he sought class certification, he sang a different tune, conceding that the implied warranty "claims derive from the End User License Agreement." Still, the other two factors necessary for estoppel are missing. Beaton may have defeated Speedy's motion to dismiss for *forum non conveniens*, but he did not persuade the district court that Illinois law controlled. The court thought that British Columbia law *may* not apply to Beaton's contract claims because they "have little or nothing to do with the terms of the [Agreement]." But ultimately the court found that this question did not matter for class certification and so could safely be postponed. And in any event, we cannot see how Beaton could derive an unfair advantage by agreeing to apply the substantive law that Speedy wanted all along.

C

Speedy also contends that the district court lacks personal jurisdiction over the claims of class members from states other than Illinois. Its argument relies on the Supreme Court's decision in *Bristol-Myers Squibb Co. v. Superior Court of Cal., San Francisco Cnty.*, —— U.S. ——, 137 S.Ct. 1773, 198 L.Ed.2d 395 (2017). In that ***1025** mass-tort action, there was no connection between the forum and the specific claims at issue. Under those circumstances, the Supreme Court held that a state court lacks specific jurisdiction over non-resident plaintiffs' claims against non-resident defendants. *Id.* at 1781–82. Speedy seems to be asking us to extend *Bristol-Myers Squibb* to nationwide class actions.

While briefing the issue now before us—class certification—in the district court, neither party raised personal jurisdiction. Thus, we have no need to opine on this question, because it does not bear directly on our determination. See *Abelesz v. OTP Bank*, 692 F.3d 638, 652–53 (7th Cir. 2012) (a court's personal jurisdiction and class certification decisions were "only tangentially related" and so the former could not be evaluated on a Rule 23(f) appeal (quoting *Poulos Caesars World, Inc.*, 379 F.3d 654, 671–72 (9th Cir. 2004))). On remand, Speedy is free to explain if and how it preserved this point and how *Bristol-Myers Squibb* applies in these circumstances. For his part, Beaton will be free to contend that Speedy waived this defense through its conduct. See, *e.g.*, *H-D Mich., LLC v. Hellenic Duty Free Shops S.A.*, 694 F.3d 827, 848 (7th Cir. 2012). On a Rule 23(f) appeal, it is not for us to take the first bite of this apple.

III

Now we turn to the main event: the district court's decision to certify the nationwide class and the Illinois subclass. To certify a class under Federal Rule of Civil Procedure 23, a district court must rigorously analyze whether the plaintiff satisfies the rule's requirements. *Blow v. Bijora, Inc.*, 855 F.3d 793, 806 (7th Cir. 2017). Rule 23(a) sets forth four universal requirements for class actions: "numerosity, typicality, commonality, and adequacy of representation." *Messner v. Northshore Univ. HealthSys.*, 669 F.3d 802, 811 (7th Cir. 2012). Rule 23(b) then identifies particular types of classes, which have different criteria. Where, as here, certification is sought under Rule 23(b)(3), common questions of law or fact must predominate over individual inquiries, and class treatment must be the superior method of resolving the controversy. *Id.*

In evaluating these factors, the court must go beyond the pleadings and, to the extent necessary, take evidence on disputed issues that are material to certification. *Bell v. PNC Bank, Nat'l Ass'n*, 800 F.3d 360, 377 (7th Cir. 2015); *Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 675–76 (7th Cir. 2001). At this early stage in the litigation, the merits are not on the table. *Abbott*, 725 F.3d at 810 (describing class definition as a "tool of case management"); *Messner*, 669 F.3d at 811 (class certification should not be turned into a "dress rehearsal for the trial on the merits"). Beaton bears the burden of showing that each requirement is met by a preponderance of the evidence. *Steimel v. Wernert*, 823 F.3d 902, 917 (7th Cir. 2016).

We review the district court's class certification orders deferentially, leaving considerable room for the exercise of judgment unless the factual determinations are clearly erroneous or there are errors of law. *Reliable Money Order, Inc. v. McKnight Sales Co., Inc.*, 704 F.3d 489, 498 (7th Cir. 2013).

A

Speedy complains generically that the district court failed to give its evidence adequate attention. We see no basis for that accusation. The court referred to Beaton's pleadings in providing the case's background, and then it considered evidence submitted by Beaton and Speedy. A district court may abuse its discretion by omitting key factual and legal analysis. See ***1026** *Priddy v. Health Care Serv. Corp.*, 870 F.3d 657, 661 (7th Cir. 2017). But it has no obligation to describe every part of the record.

Speedy also specifically challenges the district court's findings on commonality, typicality, and adequacy of representation for purposes of Rule 23(a). (It concedes that numerosity is not at issue.) We consider each of these in turn.

B

To satisfy the commonality requirement found in Rule 23(a)(2), there needs to be one or more common questions of law or fact that are capable of class-wide resolution and are central to the claims' validity. *Bell*, 800 F.3d at 374. The district court identified several such issues:

- Can the customers avail themselves of any implied warranties, or is the Agreement's disclaimer valid?
- What functions did the marketing materials represent that the software would perform?
- Did the software perform those functions?

Speedy takes exception to some of these questions, but most are amenable to class-wide resolution. See *Nikka Traders Inc. v. Gizella Pastry Ltd.* (2012), D.L.R. 4th 120, para. 65 (Can. B.C. Sup. Ct.) (describing the elements of claim for the implied warranty for fitness for a particular purpose); *Dream Carpets Ltd. v. Sandhedrai*, [2009] B.C.W.L.D 5070, para. 68 (Can. B.C. Prov. Ct.) (elements for implied warranty of merchantability); *Dubey v. Pub. Storage, Inc.*, 395 Ill.App.3d 342, 353, 335 Ill.Dec. 181, 918 N.E.2d 265 (2009) (same for ICFA). And we can see additional common questions, including whether Speedy typically deals in goods related to this software and whether a reasonable consumer would be deceived by the advertisements' representations. Commonality is easily satisfied.

C

Second, we consider typicality. See Rule 23(a)(3); *Oshana v. Coca-Cola Co.*, 472 F.3d 506, 514 (7th Cir. 2006). This requires us to evaluate whether Beaton's claims arise from the same events or course of conduct that gives rise to the putative class members' claims. The individual claims may feature some factual variations as long as they "have the same essential characteristics." *Id.* (citation omitted).

The district court thought this requirement satisfied because Beaton "appears to have seen the same representations as the other users of Speedy's free software, and the software appears to operate in the same way on each computer." Unlike Speedy, we do not take exception with the court's use of the word "appears" to describe the match between Beaton's claim and that of the other class members. This semantic choice suggests only that the court's determinations are preliminary, as they should be. See *Messner*, 669 F.3d at 811.

On the merits, neither of the court's findings reflects an abuse of discretion. We begin with the finding that Beaton saw the same representations as other users. Speedy emphasizes that some customers bought the software through third-party platforms, which could advertise as they saw fit. Yet the advertisements in the record, drawn from various sites, feature almost identical language. The class members were thus exposed to the same message (and promises) from Speedy.

Next, we turn to the court's determination that the free trial operated the same way across devices. Based on a review of the free trial's source code, Beaton's expert, Snead, concluded that the software was programmed to operate uniformly on all PCs, independent of any differences ***1027** among individual devices. He asserted that the software universally reported "problems" and "errors," mislabeled innocuous and routine features, and issued a low performance rating before any scan had begun. In his view, the scan failed to account for factors that do influence a device's performance, and it incorporated factors that have no impact. Speedy's senior director of technical operations confirmed that the scan identified as problems characteristics that might not affect performance.

Speedy asks us to reject this evidence because Snead examined only the source code for the free trial's scanning portion, as opposed to the scanning or repair portions of the licensed software. It is not clear how similar the two scanning programs are, but that does not matter for our purposes. The district court was entitled to credit the evidence indicating that the free trial scan

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software did not differentiate between devices before declaring them to be in "critical condition." This is sufficient to show that Beaton's claims are typical. He focuses on Speedy's uniform (alleged) misrepresentation of computer health to induce users to buy its product. Though Speedy issued 19 different versions of the software during the class period, Snead opined that "the primary features and functionality remained consistent" across versions. Speedy's expert, Myers, disagreed with Snead's conclusions, and the company pointed to positive survey responses and third-party reviews to argue that Beaton's experience was atypical. But that just indicates that there are merits issues to be resolved. For class certification purposes, the district court needed only to find by a preponderance of the evidence that the software scanned Beaton's device in the same way as it scanned other class members' computers. We see no reason to reject its conclusion.

But, Speedy argues, the district court did not say out loud that it weighed both expert reports and found Snead's conclusions more persuasive. In fact, the court did not mention Myers's report at all. Speedy sees this as a glaring omission because the court had yet to rule on the Rule 702 cross-motions. It points out that a district court should not certify a class, and thereby raise the stakes of the litigation, based on faulty opinion evidence. Instead, it "must conclusively rule on any challenge to the expert's qualifications or submissions prior to ruling on a class certification motion," if the "expert's report or testimony is critical to class certification." *Am. Honda Motor Co., Inc. v. Allen*, 600 F.3d 813, 814–15 (7th Cir. 2010). Speedy concludes that the court erred by not doing so.

If this was error (a point we need not resolve), it was harmless. See *Messner*, 669 F.3d at 814. In its Rule 702 ruling, the district court made clear that it had considered only the expert testimony it later deemed admissible. Speedy gives us no reason to doubt the district court's assurance. And it is also worth recalling that the district court permitted additional merits discovery after its certification decision. Had Speedy wished to pursue the expert qualifications issue further, it could have done so. We thus find no abuse of discretion in the court's ruling on typicality.

D

The last requirement is adequate representation. See FED. R. CIV. P. 23(a)(4). A named plaintiff must be a member of the putative class and have the same interest and injury as other members. *Conrad v. Boiron, Inc.*, 869 F.3d 536, 539 (7th Cir. 2017). A representative might be inadequate if he is subject to a substantial defense unique to him. ***1028** *CE Design Ltd. v. King Architectural Metals, Inc.*, 637 F.3d 721, 726, 728 (7th Cir. 2011).

The district court generously characterized Speedy's adequacy challenge as "scattershot." We need not catalog every objection Speedy raises, but we have considered all of them, and we will mention a few. First, Speedy claims Beaton is not actually a class member because he did not purchase the software as an individual. It cites the credit card statement billing the charge to Beaton's business, Chlorine Free Products Association, for which he was the sole shareholder. But Beaton averred in his declaration that he purchased the software for a laptop that he personally owned and used for primarily personal reasons. The software subscription was in Beaton's name. The district court did not clearly err in finding that Beaton purchased the software in his personal capacity.

Next, Speedy accuses Beaton of spoliating evidence—an act that (it says) makes him an inadequate representative. But spoliation is a harsh word for what happened (or so the district court could conclude). Beaton deleted a potentially useful email and took his laptop to an IT professional for repairs, where his data were lost when the hard drive was reformatted. The district court rejected Speedy's interpretation of this incident when it denied Speedy's motion for sanctions. It found as a fact that Beaton did not intend to destroy evidence. Speedy offers no reason for us to revisit that conclusion.

Speedy also launches a multipart attack on Beaton's credibility. It makes much ado of Beaton's decades-old manslaughter conviction. But assaults on the credibility of a named plaintiff must be supported by *admissible* evidence. *Id.* at 728. Wholly unrelated criminal history does not fit that bill. See FED. R. EVID. 609(b) (a conviction's probative value must substantially outweigh its prejudicial effect in order to introduce it to impeach a witness over 10 years after his release); *e.g.*, *United States v. Rogers*, 542 F.3d 197, 201 (7th Cir. 2008).

Beaton's various "lies" during discovery underlie Speedy's next attempt to discredit him. Some of these alleged discrepancies are minor, such as his omitting a marijuana conviction when asked about his criminal background. Beaton's supposed inconsistency in describing his laptop usage—that he uses his laptop primarily for personal reasons but also for business ones—is nothing of the sort; in fact, his statements are consistent. Speedy does, however, point out one relevant

discrepancy. In both the complaint and his first set of interrogatories, Beaton professed to have purchased the software for $39.94, while his credit card statement says that he paid only $9.97. The district court did not abuse its discretion, however, in concluding that Beaton's credibility was not *severely* undermined by this detail. See *CE Design*, 637 F.3d at 728. We see no reason to disturb the court's determination that Beaton was an acceptable class representative.

Speedy also throws barbs at plaintiff's counsel, Edelson PC, citing allegations of wrongdoing made against the firm in another case. Yet Speedy points to no evidence that Edelson is unqualified, has created a conflict between the firm and the putative class, or has violated a specific ethical rule. Speedy may dislike Edelson PC, and we can assume it is not a fan of class actions, but "general distaste for the class-action device" will not preclude certification. *Mejdrech v. Met-Coil Sys. Corp.*, 319 F.3d 910, 912 (7th Cir. 2003). Nothing in this record persuades us to consider Speedy's request for sanctions under Federal Rule of Appellate Procedure 38. The request is, in any event, procedurally irregular: Rule 38 requires sanctions requests to be filed in separate motions, see ***1029** *Vexol, S.A. de C.V. v. Berry Plastics Corp.*, 882 F.3d 633, 638 (7th Cir. 2018), and it does not contemplate sanctions against *appellees*.

IV

After clearing the hurdles posed by Rule 23(a), a person wishing to bring a class action must also demonstrate that the action fits under one of the three subsections of Rule 23(b). As we said, the only one that applies to Beaton is Rule 23(b)(3), the common-question variant. It requires the putative class representative to show that questions of law or fact common to the class members predominate, and that the class device is the superior method for adjudicating those claims.

A

The guiding principle behind predominance is whether the proposed class's claims arise from a common nucleus of operative facts and issues. *Messner*, 669 F.3d at 815. This requires more than a tally of common questions; the district court must consider their relative importance. *Parko v. Shell Oil Co.*, 739 F.3d 1083, 1085 (7th Cir. 2014). On the other hand, not every issue must be amenable to common resolution; individual inquiries may be required after the class phase. *Kleen Prods. LLC v. Int'l Paper Co.*, 831 F.3d 919, 922 (7th Cir. 2016).

Speedy identified 10 individual issues that allegedly defeated predominance. The district court was not persuaded. It found that some were best addressed on a class-wide basis, and they outweighed the remaining individualized inquiries.

The district court did not abuse its discretion in so concluding. For example, it will be easy to ascertain from whom the class members purchased the software. The court found that they all bought it through the portal at the end of the free trial that redirected customers to two payment platforms. Similarly, the court found that users saw the same representations about the software's capabilities, and so a common answer to the question whether a reasonable customer would be deceived is possible. And based on the court's preliminary determination that the software's diagnostic mechanisms operated uniformly across devices, the trier of fact could reach a single answer on the software's functionality and value. Speedy insists that the court needs to inquire individually about each customer's level of satisfaction with the product. But dissatisfaction is not an element of any of the certified claims. If the product truly serves none of its functions, its users' subjective satisfaction is likely evidence of misrepresentation, not that the users were not harmed. See *In re Aqua Dots Prods. Liab. Litig.*, 654 F.3d 748, 750–51 (7th Cir. 2011) (purchasers suffered financial loss by paying more for products than they would have had they known the products' true quality).

Admittedly, some individualized questions remain. For instance, what was the class member's purpose (business or personal?) in buying the software? Did the class member seek a refund? What are each customer's damages? Speedy reminds us that we have frowned upon class treatment as a poor fit for warranty and fraud claims because they can involve so many individualized issues. See *Szabo*, 249 F.3d at 674. But these theories do not automatically fail the predominance test. See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997) (certain consumer-fraud cases readily establish predominance); *Suchanek v. Sturm Foods, Inc.*, 764 F.3d 750, 759–60 (7th Cir. 2014) (the fact that "[e]very consumer fraud case involves individual elements" does not preclude class actions). Speedy misreads Supreme Court precedent in arguing that

liability with regard to all class members must be resolved in a single stroke. See ***1030** *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350, 131 S.Ct. 2541, 180 L.Ed.2d 374 (2011) (requiring resolution in "one stroke" of a "common contention" central to the common claim); see also *Suchanek*, 764 F.3d at 759–60; *Pella Corp. v. Saltzman*, 606 F.3d 391, 394 (7th Cir. 2010).

The district court recognized that individualized inquiries could be handled through "streamlined mechanisms" such as affidavits and proper auditing procedures. We agree. Defendants' due process rights are not harmed by such case-management tools. *Mullins v. Direct Dig., LLC*, 795 F.3d 654, 667–72 (7th Cir. 2015). Speedy's attempts to distinguish *Mullins* as merely about proving class membership, and not liability, are unavailing. The company makes the obvious point that it can neither cross-examine an affidavit nor depose every class member. But Speedy will still have the opportunity to challenge the class members' credibility. See *Mullins*, 795 F.3d at 671. It can obtain the testimony of a representative sample of the class members and, if necessary, present evidence contradicting statements found in particular affidavits.

Speedy also contends that there is a fatal lack of uniformity in the purpose for which each person acquired its software. We do not see that as a barrier to class treatment, however. It is true that the law of British Columbia insists that a particular purpose be brought clearly to the seller's attention. Compare *Kobelt Mfg. Co. v. Pac. Rim Engineered Prods. (1987) Ltd.* (2011), 84 B.L.R 4th 189, para. 104 (Can. B.C. Sup. Ct.) (leaky brakes did not violate an implied warranty because no implied communication that purchasers intended to use the brakes on drawworks), with *Wharton v. Tom Harris Chevrolet Oldsmobile Cadillac Ltd.* (2002), 97 B.C.L.R. 3d 307, para. 59–60 (Can. B.C. App. Ct.) (buzzing sound system violated implied warranty where salesman knew purchasers wanted a luxury vehicle). But we do not see that flaw here. The people who used the free trial and then bought SpeedyPC Pro were all concerned about the health and performance of their computers. Why they owned a computer is beside the point. To the extent it is relevant, each user's specific reason for buying the software can be established through affidavits, subject to the defendant's right to challenge them with evidence.

B

Finally, the district court had several reasons for concluding that a class action was the superior way to resolve this dispute. All are well-supported. First, common questions of fact and law predominate. Speedy insists that we should categorically reject class treatment for implied warranty and consumer fraud claims because of the choice-of-law clause. See, *e.g.*, *Szabo*, 249 F.3d at 674; *In re Bridgestone/Firestone, Inc.*, 288 F.3d 1012, 1020 (7th Cir. 2002). But that makes no sense here, since all parties agree that British Columbia law controls for the nationwide class and Illinois law for the subclass. And there is no risk of inconsistent rules with respect to recognition of the contractual choice-of-law clause, because that follows the forum, Illinois. See *Martin v. Reid*, 818 F.3d 302, 308 (7th Cir. 2016).

Second, the amount of damages to which each plaintiff would be entitled is so small that no one would bring this suit without the option of a class. *Suchanek*, 764 F.3d at 759–60. "Rule 23(b)(3) was designed for situations such as this, in which the potential recovery is too slight to support individual suits, but injury is substantial in the aggregate." *Murray v. GMAC Mortg. Corp.*, 434 F.3d 948, 953 (7th Cir. 2006). The fact that others have not sued over this software is more likely because "only a lunatic or a fanatic sues for $30," ***1031** *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004), than it is because the software is flawless. Consumer class actions are a crucial deterrent against the proliferation of bogus products whose sticker price is dwarfed even by a court filing fee (now $400 for a civil case in federal district court). Though punitive damages may also deter, few litigants would risk filing suit on the off-chance that punitive damages would be recovered after years of litigation. See *Hughes v. Kore of Ind. Enter., Inc.*, 731 F.3d 672, 677–78 (7th Cir. 2013). The district court did not abuse its discretion in finding the class-action device superior.

V

Defendants spend much time and money fighting Rule 23 certifications to the hilt. Yet "certification is largely independent of the merits ... and a certified class can go down in flames on the merits." *Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010). We say this not to imply that the merits in this case favor either party, but simply to remind defendants that the class-action glass is sometimes half-full: dismissed claims of a certified class end litigation once and for all. That, after all, is why

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settlement classes are so popular.

Finding no abuse of discretion in the district court's decisions to certify the nationwide class and the Illinois subclass, we AFFIRM the court's certification orders.

All Citations

907 F.3d 1018, 102 Fed.R.Serv.3d 13

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NOTES

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Molock, et al. v. Whole Foods Market Group, Inc., 317 F.Supp.3d 1 (D.D.C. June 11, 2018)

Submitted by:
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317 F.Supp.3d 1
United States District Court, District of Columbia.

Michael MOLOCK, et al., Plaintiffs,
v.
WHOLE FOODS MARKET GROUP, INC.,
Defendant.

Case No. 16–cv–02483 (APM)
|
Signed 06/11/2018

Synopsis
Background: Current and former employees of grocery store chain brought putative class action against chain under District of Columbia and various states' laws, alleging that chain abused program under which chain awarded bonuses to employees whose departments came in under budget, by shifting labor costs to store departments that were underperforming, thus reducing or negating bonuses that would have been owed to employees in over-performing departments. Chain moved to dismiss, and the District Court, Amit P. Mehta, J., 297 F.Supp.3d 114, granted motion in part and denied motion in part. Chain moved to certify that order for interlocutory appeal.

Holdings: The District Court, Mehta, J., held that:

order involved controlling question of law, as required for certification for interlocutory appeal;

order included substantial ground for difference of opinion, as required for certification for interlocutory appeal; and

granting certification for interlocutory appeal would materially advance ultimate termination of litigation, as required for eligibility for certification.

Motion granted.

Attorneys and Law Firms

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MEMORANDUM OPINION

Amit P. Mehta, United States District Judge

This putative class action arises from a controversy surrounding a profit-sharing plan implemented by Defendant Whole Foods Market Group, Inc. ("WFMG"), known as the "Gainsharing program," which awarded bonuses to Whole Foods store employees whose departments came in under budget. Pls.' Second Am. Compl., ECF No. 28, ¶ 15. Plaintiffs, who are current and former employees of WFMG, allege that WFMG abused the Gainsharing program on a nationwide scale by "shifting labor costs" to store departments that were underperforming, thus reducing or negating the bonuses that would have been owed to employees in an over-performing department. *Id.* ¶ 18. Plaintiffs' claims arise solely under District of Columbia or state law.

On March 15, 2018, this court granted in part and denied in part Defendant's Motion to Dismiss Plaintiffs' Second Amended Class Action Complaint. *See* Mem. Op. & Order, ECF No. 34. As relevant to the instant motion, the court rejected Defendant's assertion that the Supreme Court's recent decision in *Bristol–Myers Squibb Co. v. Superior Court of California*, —— U.S. ——, 137 S.Ct. 1773, 198 L.Ed.2d 395 (2017), required dismissal of the claims of unnamed putative class members who reside outside of the District of Columbia for lack of personal jurisdiction. In *Bristol–Myers Squibb*, the Supreme Court held, in the context of a mass tort action, that the Due Process Clause of the Fourteenth Amendment did not permit a California state court to exercise specific jurisdiction over the tort claims of nonresident plaintiffs. *See id.* at 1781–82. WFMG now urges this court to certify its March 15, 2018 order for interlocutory appeal under 28 U.S.C. § 1292(b) to allow the D.C. Circuit to weigh in on whether the jurisdictional limits proscribed in *Bristol–Myers Squibb* extend to unnamed, nonresident members of a putative nationwide class in federal court. *See* Def.'s Mot. to Certify for Interlocutory Appeal, ECF No. 37; Def.'s Mem. in Supp., ECF No. 37–1 [hereinafter Def.'s Mem.]. Plaintiffs oppose certification. *See* ***4** Pls.'

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Mem. in Opp'n, ECF No. 38 [hereinafter Pls.' Mem.].

For the reasons discussed below, the court finds that "[a]n immediate appeal would conserve judicial resources and spare the parties from possibly needless expense if it should turn out that this Court's ruling[ ] [is] reversed." *APCC Servs., Inc. v. Sprint Commc'ns Co.*, 297 F.Supp.2d 90, 100 (D.D.C. 2003). Accordingly, Defendant's motion to certify is granted.

I.

Under 28 U.S.C. § 1292(b), the certification of an order for interlocutory appeal is appropriate when "(1) the order involves a controlling question of law; (2) a substantial ground for difference of opinion concerning the ruling exists; and (3) an immediate appeal would materially advance the litigation." *APCC Servs.*, 297 F.Supp.2d at 95. The party seeking interlocutory review "bears the burden of showing that exceptional circumstances justify a departure from the basic policy of postponing appellate review until after the entry of final judgement." *Virtual Def. & Dev. Int'l Inc. v. Republic of Moldova*, 133 F.Supp.2d 9, 22 (D.D.C. 2001) (internal quotation marks omitted). Given the "strong congressional policy against piecemeal reviews, and against obstructing or impeding an ongoing judicial proceeding by interlocutory appeals," certification is only appropriate in the court's discretion and upon satisfaction of the elements of section 1292(b). *Judicial Watch, Inc. v. Nat'l Energy Policy Dev. Grp.*, 233 F.Supp.2d 16, 20 (D.D.C. 2002) (quoting *United States v. Nixon*, 418 U.S. 683, 690, 94 S.Ct. 3090, 41 L.Ed.2d 1039 (1974)). The issue WFMG seeks to certify satisfies all three elements.

A.

As to the first element—whether the order involves a "controlling question of law"—there is no genuine dispute. *See* 28 U.S.C. § 1292(b). Indeed, Plaintiffs offer no argument to the contrary. *See* Pls.' Mem. at 5–12. A controlling question of law is "one that would require reversal if decided incorrectly or that could materially affect the course of litigation with resulting savings of the court's or the parties' resources." *Judicial Watch*, 233 F.Supp.2d at 19 (quoting *In re Vitamins Antitrust Litigation*, Civ. A. No. 99-197, 2000 WL 673936, at *2 (D.D.C. Jan. 27, 2000)). "The resolution of an issue need not necessarily terminate an action in order to be controlling, but instead may involve a procedural determination that may significantly impact the action." *APCC Servs.*, 297 F.Supp.2d at 96 (internal quotations and citation omitted).

Here, whether *Bristol–Myers Squibb* applies to claims of unnamed, nationwide putative class members in a federal court is a threshold jurisdictional question. If this court's decision is correct, the court may exercise specific jurisdiction over the claims of thousands of unnamed, nonresident putative class members. On the other hand, if the court is wrong and it lacks specific jurisdiction over such claims, this court could not entertain a nationwide class action and the most Plaintiffs could seek to certify is a District of Columbia class. The difference in scope of these two scenarios need not be belabored. Quite obviously, a nationwide class action would place far greater demands on this court and Defendant than would a case that goes forward with only a geographically limited class. For that reason, the order from which Defendant seeks interlocutory review involves a "controlling question of law."

***5** B.

The court also is satisfied that the second element—that there exist a substantial ground for difference of opinion—is present in this case. "A substantial ground for difference of opinion is often established by a dearth of precedent within the controlling jurisdiction and conflicting decisions in other circuits." *APCC Servs.*, 297 F.Supp.2d at 97. It is not necessarily enough, however, that there are conflicting decisions in other circuits. Instead, a court "must analyze the strength of the arguments in opposition to the challenged ruling to decide whether the issue is truly one on which there is a substantial ground for dispute." *Id.* at 98.

There is no controlling or persuasive precedent in this jurisdiction, and no circuit authority elsewhere, that addresses *Bristol–Myers Squibb*'s application to nationwide class actions in federal courts. There are only district court cases, and among them there is a near even split on the question. Defendant points to nine cases that it characterizes as having reached a different conclusion than this court did. Def.'s Mem. at 6–7 & n.3; Def.'s Ltr. Br., ECF No. 41, at 1–2; *see, e.g., McDonnell v. Nature's*

Way Prods., LLC, No. 16-C-5011, 2017 WL 4864910, at *4 (N.D. Ill. Oct. 26, 2017) (dismissing nonresident putative class members' claims for lack of a connection to the forum).[1] Plaintiffs, on the other hand, identify nine other cases that have gone the other way and are in agreement with this court. Pls.' Mem. at 7 n.2; *see, e.g., Feller v. Transam. Life Ins. Co.*, No. 2:16-cv-01378, 2017 WL 6496803, at *17 (C.D. Cal. Dec. 11, 2017) (recognizing that "there are important differences between mass tort and class actions for the purposes of personal jurisdiction over defendants" and concluding that *Bristol–Myers Squibb*'s reasoning "does not reach so far as to bar the nonresident unnamed class members"). In light of these numbers, there can be no dispute, as one court has put it, that the question "whether *Bristol–Myers* extends to class actions is a question that has divided courts across the country." *Chavez v. Church & Dwight Co.*, No. 17-C-1948, 2018 WL 2238191, at *10 (N.D. Ill. May 16, 2018).[2]

1 Plaintiffs argue that some of the cases that Defendant cites do not actually support its position or merely address the issue in dicta. Pls.' Mem. at 7; Pls.' Ltr. Br., ECF No. 43, at 1–2. Even if Plaintiffs' reading of these cases is correct, there are still several district court judges who have expressly held that *Bristol–Myers Squibb* extends to nationwide class actions brought in federal court.

2 Plaintiffs attempt to downplay the division by pointing out (correctly) that most of the district courts that reached a decision different than this court come from one district—the Northern District of Illinois. *See* Pls.' Mem. at 7; Pls.' Ltr. Br., ECF No. 43, at 3. However, that fact does not, for the reasons explained below, diminish the strength of the rationale that those courts have advanced in reaching a different conclusion.

This court's task is not, however, to "keep score" and determine which side has more decisions in its favor, but instead is to analyze the reasoning in those decisions and the "strength of the arguments in opposition" in order to decide whether there is a substantial ground for dispute. *APCC Servs.*, 297 F.Supp.2d at 98. And here there is. The cases holding that *Bristol–Myers Squibb* applies to claims of nationwide class members are well-reasoned and do not lack persuasive power. In brief, those courts that have taken an opposing view have highlighted the Supreme Court's holding in *Bristol–Myers Squibb* that due process requires there be some relationship between the defendant and the plaintiff's claim to the forum state to establish specific jurisdiction. *See, e.g.,* ***6** *Practice Mgmt. Support Servs., Inc. v. Cirque du Soleil, Inc.*, 301 F.Supp.3d 840, 860–63, 2018 WL 1255021, at *15–17 (N.D. Ill. 2018); *Greene v. Mizuho Bank, Ltd.*, 289 F.Supp.3d 870, 873–75 (N.D. Ill. 2017). They also have emphasized the Supreme Court's conclusion that even the presence of similar claims from resident plaintiffs is not enough to satisfy due process. *See id.* These jurisdictional limitations, although made in the context of a mass tort action in state court, have obvious parallels to the nationwide class action in federal court. Moreover, some courts have responded to the concern that extending *Bristol–Myers Squibb* to class actions would gut Rule 23. They have reasoned that Rule 23 cannot grant jurisdiction where the due process clause does not allow it, citing the Supreme Court's statement in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 613, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997), that "Rule 23's class action requirements must be interpreted in keeping with Article III constraints, and with the Rules Enabling Act, [28 U.S.C. § 2072(b)] which instructs that the federal court rules of procedure shall not abridge, enlarge, or modify any substantive right." *See Practice Mgmt. Support Servs.*, 301 F.Supp.3d at 861, 2018 WL 1255021, at *16 (alterations and internal quotation marks omitted); *see also In re Dental Supplies Antitrust Litigat.*, No. 16–Civ–696, 2017 WL 4217115, at *9 (E.D.N.Y. Sept. 20, 2017) ("The constitutional requirements of due process do[ ] not wax and wane when the complaint is individual or on behalf of a class. Personal jurisdiction in class actions must comport with due process just the same as any other case."). These are not insubstantial arguments. And reasonable jurists can, and have, disagreed about them.

Although this court remains unpersuaded by these contrary interpretations of *Bristol–Myers Squibb*, it does not find the reasoning employed in those cases to be lacking merit, leading this court to conclude that there is a "substantial ground for a difference of opinion" on the issue. *See* 28 U.S.C. § 1292(b).

C.

Finally, this court must address whether an immediate appeal of its order will "materially advance the ultimate termination of the litigation." 28 U.S.C. § 1292(b). To satisfy this element a movant need not show that a reversal on appeal would actually end the litigation. Instead, the relevant inquiry is whether reversal would hasten or at least simplify the litigation in some material way, such as by significantly narrowing the issues, conserving judicial resources, or saving the parties from needless expense. *See APCC Servs.*, 297 F.Supp.2d at 100

(noting that an immediate appeal would materially advance the ultimate termination of the litigation as it had the potential to save the parties from protracted litigation and massive discovery costs); *cf. U.S. House of Representatives v. Burwell*, No. 14-1967, 2015 WL 13699275, at *1 (D.D.C. Oct. 19, 2015) (denying a motion for interlocutory appeal because reversal of the court's order would not shorten the length of the litigation since the case could be decided in "a matter of months" regardless).

Discovery in this case, in its present form, promises to be drawn out, complex, and expensive. At the hearing on this matter, Plaintiffs' counsel conceded that, in order to establish a class consisting of current and former WFMG employees, and presumably to determine damages, he might demand more than a decade's worth of payroll records from well over two hundred Whole Foods grocery stores operated by WFMG. *See* Jt. Initial Scheduling Conf. Hr'g Tr. (draft), June 1, 2018, at 25–27. Furthermore, counsel stated that it is his ***7** belief that the Gainsharing program abuse goes beyond WFMG and infects other Whole Foods operating companies. *Id.* at 25–26. WFMG is one of multiple companies that operate Whole Foods grocery stores throughout the country. WFMG's stores are located primarily on the eastern seaboard. *Id.* at 11–12. Plaintiffs' counsel intends to take discovery that will show that abuse of the Gainsharing program was sanctioned at the highest corporate levels and was commonplace throughout the country. If Plaintiffs can make such a showing, counsel explained, they intend to amend the complaint to add the other operating companies, so that Plaintiffs can certify a true nationwide class that covers the current and former employees of every Whole Foods store in the country. *See id.* at 22–23. There are nearly 500 such stores. *Id.* at 13. Thus, if Plaintiffs succeed in their plan, they will ask for discovery concerning nearly 500 Whole Foods grocery stores and the thousands of people employed in those stores. The potential time and expense of obtaining such discovery is staggering.

On the other hand, if the court is wrong about *Bristol–Myers Squibb*, this case becomes simpler and discovery far more manageable. Plaintiffs could not certify in this district court a class of all WFMG employees, let alone a true nationwide class. At most, Plaintiffs would be able to certify a District of Columbia class, consisting of employees who worked in the District's five Whole Foods stores operated by WFMG. In addition, if a nationwide class action cannot be brought here, the court will not face the potential of grappling with the laws of the 43 states in which Whole Foods does business. The court would rather avoid such a morass if it is in fact wrong about *Bristol–Myers Squibb*'s application in this matter.

Accordingly, given the potential of avoiding burdensome discovery costs and conserving judicial resources in the event of a reversal, this court finds that certifying its prior order for interlocutory appeal will "materially advance the ultimate termination of the litigation." 28 U.S.C. § 1292(b).

II.

Before concluding, the court notes that litigation will not cease pending resolution of the interlocutory appeal. Section 1292(b) provides "[t]hat application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order." 28 U.S.C. § 1292(b). As described further in the Scheduling Order filed herewith, pending resolution of the interlocutory appeal, the court stays all discovery with respect to certification of a nationwide class. The case shall, however, proceed with respect to all Whole Foods stores operated by WFMG in the District of Columbia, Maryland,[3] and any other store at which a plaintiff in the closely related case of *Vasquez v. Whole Foods Market Services, Inc.*, 17–cv–00112–APM (D.D.C.), was employed.

[3] The court did not dismiss Plaintiffs' claims under Maryland law; therefore, discovery as to those stores will be permitted to go forward. However, if the D.C. Circuit were to disagree with this court on the application of *Bristol–Myers Squibb*, this court may not have personal jurisdiction over a Maryland sub-class.

III.

Accordingly, for the reasons stated above, the court grants Defendant's Motion to Certify for Interlocutory Appeal, ECF No. 37. A separate Order accompanies this Memorandum Opinion.

All Citations

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NOTES

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Practice Management Support Services, Inc. v. Cirque Du Soleil Inc., et al., No. 14 C 2032, 2018 WL 3659349 (N.D. Ill. Aug. 2, 2018)

Submitted by:
Amy E. Keller

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2018 WL 3659349
Only the Westlaw citation is currently available.
United States District Court, N.D. Illinois, Eastern Division.

PRACTICE MANAGEMENT SUPPORT SERVICES, INC., an Illinois corporation, individually and as the representative of a class of similarly-situated persons, Plaintiff,
v.
CIRQUE DU SOLEIL INC., Cirque du Soleil (US), Inc., and John Does 1-10, Defendants.

No. 14 C 2032
|
Signed 08/02/2018

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER

Honorable Thomas M. Durkin, United States District Judge

***1** In this class action lawsuit, plaintiff Practice Management Support Services, Inc. challenges the alleged practice of defendants Cirque du Soleil, Inc., and Cirque du Soleil (US), Inc., of using a fax broadcasting service to advertise theatrical shows without providing sufficient instructions about how to opt out, in violation of the Telephone Consumer Protection Act ("TCPA"), 47 U.S.C. § 227. On March 12, 2018, the Court granted in part Practice Management's motion for class certification. R. 162. A few months later, on June 11, 2018, the Supreme Court decided *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800 (2018), which resolved a circuit split regarding the application of the equitable tolling doctrine set forth in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 554 (1974), to untimely successive class actions. The *China Agritech* Court held "that *American Pipe* does not permit a plaintiff who waits out the statute of limitations to piggyback on an earlier, timely filed class action." 138 S. Ct. at 1806. In light of *China Agritech*, defendants have moved to decertify the class, arguing that Practice Management's class claims in this third successive class action are untimely. For the reasons explained below, the Court grants defendants' motion (R. 171) and decertifies the class. Because it is decertifying the class, the Court denies as moot Practice Management's motion for partial reconsideration of the Court's order granting class certification (R. 166).

Background

This is the third successive class action case filed against Cirque du Soleil entities by the same counsel (Anderson + Wanca) based on the same fax transactions. Because one of Practice Management's arguments against decertification raises the issue of its counsel's diligence, the Court recounts the relevant history of this sprawling litigation here, which began nearly three and a half years before this Court joined the bench.

On August 27, 2009, Anderson + Wanca filed a class action in federal court on behalf of a different named plaintiff (G.M. Sign) against Groupe Cirque du Soleil, Inc., Cirque du Soleil America, Inc., and unnamed Cirque entities. *G.M. Sign, Inc. v. Cirque du Soleil, Inc.*, 09 C 7692, Dkt. 1-1, Dkt. 30 (N.D. Ill.). On September 28, 2010, the court set a February 28, 2011 deadline to add additional parties and a March 18, 2011 class discovery cutoff. *Id.* Dkt. 35. On March 21, 2011, several weeks after the deadline for adding parties and three days after the close of fact discovery, G.M. Sign moved for an extension of time to complete discovery and to reopen the period to add additional parties. *Id.* Dkt. 41. The court denied that motion on April 19, 2011. *Id.* Dkt. 48.

The day before the federal court's ruling, on April 18, 2011, Anderson + Wanca filed a second class action in state court against Cirque du Soleil, Inc. and Cirque du Soleil (US) (the same defendants named in this case), as well as unnamed Cirque entities. R. 47-7. Meanwhile, back in the federal case, G.M. Sign filed a motion in August 2011—five months after the close of discovery—to compel documents it claimed were relevant

to establishing the certification requirements. *G.M. Sign*, 09 C 7692, Dkt. 68. The federal court denied that motion for, among other reasons, inexcusable delay. *Id.* Dkt. 86 at 4-5. Then, before the federal court ruled on G.M. Sign's perfunctory, four-page motion for class certification (*id.* Dkt. 83), G.M. Sign requested that the court dismiss the case without prejudice, in part because the court had "denied Plaintiff the ability to add any other of the 'Cirque' entities as additional defendants." *Id.* Dkt. 92 at 2. The court granted the motion to voluntarily dismiss, conditioned on G.M. Sign's payment of defendants' fees and costs. *Id.* Dkt. 94. On March 28, 2012, G.M. Sign moved to dismiss with prejudice instead of paying fees. *Id.* Dkt. 99. The court granted that motion and dismissed the case with prejudice on April 4, 2012. *Id.* at Dkt. 102.

***2** Nearly two years later, on March 20, 2014, the state court granted summary judgment for defendants on *res judicata* grounds, finding "no genuine issue of material fact as to whether the defendants in the Lake County action[ ] are privies of the defendants in the federal court action ... [for] the purposes of *res judicata*." R. 47-16 at 20-21. The next day, on March 21, 2014, Anderson + Wanca filed this case in federal court, asserting the same TCPA claim based on the same fax against the same defendants, but this time naming Practice Management as class representative. R. 1.

On November 12, 2015, this Court denied defendants' motion for summary judgment based on the four-year statute of limitations. R. 63. The Court applied the Supreme Court's decision in *American Pipe*, 414 U.S. at 554, and the Seventh Circuit's opinion construing *American Pipe* in *Sawyer v. Atlas Heating & Sheet Metal Works, Inc.*, 642 F.3d 560 (7th Cir. 2011), to find that Practice Management's claims were tolled until the first federal class action was dismissed on April 4, 2012. R. 63 at 7-14. This meant that the filing of this case fell within the four-year statute of limitations window. *Id.*

Practice Management subsequently moved for class certification, and on March 12, 2018, this Court certified the following class:

> All persons who are residents of Illinois and all entities located in Illinois who were successfully sent a facsimile in Illinois containing the "Cirque du Soleil" trade name from January 29, 2009, through July 8, 2009, offering tickets for sale to the following performances: "Saltimbanco" at Rockford MetroCentre, Rockford, Illinois, opening February 25, 2009; and "A New Twist on Vaudeville" at Chicago Theatre, Chicago, Illinois, opening November 19, 2009.

R. 162 at 46. On March 20, 2018, this Court granted defendants' motion to stay the case pending the Supreme Court's decision in *China Agritech*. R. 165. The Supreme Court decided *China Agritech* on June 11, 2018 (138 S. Ct. 1800), and this Court lifted the stay on June 15, 2018. R. 170. Defendants subsequently moved to decertify based on *China Agritech*. R. 171.

Standard

Under Federal Rule of Civil Procedure 23(c)(1)(C), "[a]n order that grants or denies class certification may be altered or amended before final judgment." After granting certification, the court "remains under a continuing obligation to review whether proceeding as a class action is appropriate." *Shurland v. Bacci Cafe & Pizzeria on Ogden, Inc.*, 271 F.R.D. 139, 142 (N.D. Ill. 2010). When a party moves to decertify a class, "the party seeking class certification bears the burden of producing a record demonstrating the continued propriety of maintaining the class action." *Farmer v. DirectSat USA, LLC*, 2013 WL 2457956, at *2 (N.D. Ill. June 6, 2013).

Discussion

It is undisputed that Practice Management did not file this case within the applicable four-year statute of limitations set forth in 28 U.S.C. § 1658. Practice Management filed this case in 2014 based on faxes sent in 2009. R. 1; R. 68 ¶ 4. This means that Practice Management's claims are untimely unless a tolling doctrine applies.

This Court's November 2015 summary judgment opinion applied then-governing Seventh Circuit precedent in *Sawyer* to find *American Pipe* tolling applicable to successive class claims. *See* R. 63 at 7-9. *American Pipe*

established that "the commencement of the original class suit tolls the running of the statute [of limitations] for all purported members of the class who make timely motions to intervene after the court has found the suit inappropriate for class action status." 414 U.S. at 553. The Seventh Circuit in *Saywer* expressly rejected a distinction based on whether "the second suits were brought as individual litigation" or "as a class action," finding that *American Pipe* tolling could apply in either situation. 642 F.3d at 563.

***3** The Supreme Court in *China Agritech* abrogated this reasoning in *Sawyer* and similar cases by drawing a clear distinction between successive individual suits and successive class actions. The *China Agritech* Court explained that "*American Pipe* ... addressed only putative class members who wish to sue individually after a class-certification denial." 138 S. Ct. at 1806. But *American Pipe* did not "so much as hint[ ] that tolling extends to otherwise time-barred class claims." *Id.*

The Court grounded this distinction in policy rationale. Equitable tolling is available for individual claims, the Court explained, "because economy of litigation favors delaying those claims until after a class-certification denial." *Id.* at 1806. "If certification is granted, those claims will proceed as a class and there [is] no need for the assertion of any claim individually." *Id.* Only "[i]f certification is denied" is it "necessary to pursue claims individually." *Id.* at 1807. But the " 'efficiency and economy of litigation' that support tolling of individual claims do not support maintenance of untimely successive class actions; any additional *class* filings should be made early on, soon after the commencement of the first action seeking class certification." *Id.* at 1806 (quoting *American Pipe*, 414 U.S. at 553). That way, all "would-be representatives ... come forward" early on, and "the district court can select the best plaintiff with knowledge of the full array of potential class representatives and class counsel." *Id.* at 1807. The Court found support for this rationale in Fed. R. Civ. P. 23, which "evinces a preference for preclusion of untimely successive class actions by instructing that class certification should be resolved early on." *Id.*

The Court also identified "a [second] distinction between the individual-claim tolling established by *American Pipe* and tolling for successive class actions." *Id.* at 1809. Whereas "[t]he time to file individual actions once a class action ends is finite, extended only by the time the class suit was pending," "the time for filing successive class suits, if tolling were allowed, could be limitless." *Id.* "Endless tolling of a statute of limitations," the Court explained, "is not a result envisioned by *American Pipe.*" *Id.* Based on these policy rationale, the *China Agritech* Court created a bright-line rule: "*American Pipe* does not permit a plaintiff who waits out the statute of limitations to piggyback on an earlier, timely filed class action." *Id.* at 1806.

A straightforward application of *China Agritech* to this case compels the conclusion that Practice Management's untimely class claims cannot be tolled under *American Pipe*. "*American Pipe* does not permit the maintenance of a follow-on class action past expiration of the statute of limitations." *Id.* at 1804. This case is a follow-on class action that was filed well after the four-year statute of limitations expired. 28 U.S.C. § 1658. For this reason, the Court agrees with defendants that the class should be decertified and the class claims dismissed.

The Court is not persuaded by any of Practice Management's three arguments in opposition to decertification. *First*, Practice Management argues that *China Agritech* does not address situations like this one where class certification was never decided in a prior class action. Practice Management claims that this Court remains bound by *Sawyer*, which held that class claims are tolled where a plaintiff has been denied a "full and fair opportunity to litigate the question whether a class action is proper." 642 F.3d at 564.

***4** It is true that the *China Agritech* Court framed the "question presented" early in its opinion as: "*Upon denial of class certification*, may a putative class member, in lieu of promptly joining an existing suit or promptly filing an individual action, commence a class action anew beyond the time allowed by the applicable statute of limitations?" 138 S. Ct. at 1804 (emphasis added). But the Court purported to resolve a "division of authority among the Courts of Appeals" over a broader question: "whether otherwise-untimely successive class claims may be salvaged by *American Pipe* tolling." *Id.* at 1805. And the Supreme Court repeatedly stated its holding in clear terms that were in no way qualified based on how the prior class action lawsuit was resolved. *See id.* at 1804 ("*American Pipe* does not permit the maintenance of a follow-on class action past expiration of the statute of limitations."); *id.* at 1806 ("We hold that *American Pipe* does not permit a plaintiff who waits out the statute of limitations to piggyback on an earlier, timely filed class action"); *id.* at 1811 ("it is the rule we adopt today: Time to file a class action falls outside the bounds of *American Pipe*").

If the Supreme Court wanted to make its holding contingent on the reason why the earlier class action was dismissed, it would have done so. It was fully cognizant of the varying approaches taken by the courts of appeals,

some of which had conditioned their holdings on how the prior class action was resolved. *See* *id.* at 1805-06 (collecting cases).[1]

[1] As defendants note, the *China Agritech* Court cited approvingly the Eleventh Circuit's decision in *Ewing Indus. Corp. v. Bob Wines Nursery, Inc.*, 795 F.3d 1324 (11th Cir. 2015). 138 S. Ct. at 1808. In *Ewing*, the prior class action lawsuit was resolved on a motion for summary judgment, and the "state court never ruled on the issue of class certification." 795 F.3d at 1325. The Eleventh Circuit determined that the lack of a prior class certification ruling was irrelevant, applying instead a bright-line rule like the one ultimately adopted by the Supreme Court in *China Agritech*. 795 F.3d at 1326-28. Like the Eleventh Circuit, the Court finds that this litigation "illustrates the wisdom of the rule against piggybacked class actions" regardless of why the prior cases were dismissed, where many years after the original lawsuit was filed, "class action issues are still being litigated." *Id.* at 1328.

Nor do the Supreme Court's two policy rationales supporting its distinction between successive individual and class lawsuits depend on class certification having been decided in the predecessor class action. The Court's desire to incentivize all "would-be representatives" to "come forward" early on so the "district court can select the best plaintiff with knowledge of the full array of potential class representatives" (*id.* at 1807) is not served if plaintiff's counsel can voluntarily dismiss a case at any time prior to a class certification decision and re-file with a new representative. This would allow the "time for filing successive class suits" to "be limitless"—the prospect that concerned the Supreme Court in its second policy rationale—so long as the prior class actions were all dismissed before a class certification decision. *Id.* at 1809.

If any doubt remained as to the scope of the eight-Justice majority's holding in *China Agritech*, Judge Sotomayor's concurrence makes it plain. Justice Sotomayor advocated for "a more tailored approach," such as holding that "tolling only becomes unavailable for future class claims where class certification is denied for a reason that bears on the suitability of the claims for class treatment." *Id.* at 1814 (Sotomayor, J., concurring). Instead, as Justice Sotomayor explained, the majority adopted "a blanket no-tolling-of-class-claims-ever rule." *Id.* Under that rule, Practice Management's claims were not tolled under *American Pipe*, regardless of how the prior class actions were resolved.

Second, Practice Management maintains that even if *China Agritech* applies to this case, this Court should not apply it retroactively because Practice Management acted in reliance on controlling Seventh Circuit precedent in *Sawyer* and other cases when failing to file its class claims sooner. But as the Supreme Court explained in *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993), "[w]hen this Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate our announcement of the rule." *Id.* at 97.

***5** Practice Management cites *Suesz v. Med-1 Sols., LLC*, 757 F.3d 636, 649 (7th Cir. 2014), for the proposition that in some circumstances, a Supreme Court ruling may be given prospective-only effect. The *Suesz* court cited Justice Kennedy's concurrence in *Harper* for the proposition that "[t]he Supreme Court has ... left itself some room to give its rulings in civil cases only prospective effect, at least 'to avoid injustice or hardship to civil litigants who have justifiably relied on prior law.' " *Id.* (quoting *Harper*, 509 U.S. at 110 (Kennedy, J., concurring in part and concurring in the judgment)). But as the Seventh Circuit in *Suesz* explained, a change in the law can be given prospective effect only if "the law had been so well settled before the ruling that it had been unquestionably prudent for the community to rely on the previous legal understanding." *Id.* at 650. This was not the case in *Suesz*; the Seventh Circuit declined to give prospective-only effect to its ruling in that case. *Id.* at 649-50.

It is also not the case here. *China Agritech* did not even change Supreme Court law. It did not overrule *American Pipe*. Rather, it "clarif[ied] *American Pipe*'s reach." 138 S. Ct. at 1810. Moreover, far from being "well settled" (*Suesz*, 757 F.3d at 650), the issue of whether *American Pipe* tolling applies to save untimely class—as opposed to individual—claims has been very much in dispute across the country for years. *See, e.g.*, *China Agritech*, 138 S. Ct. at 1805-06 (collecting cases); *see also* *Suesz*, 757 F.3d at 649-50 ("a prior decision of one intermediate appellate court does not create the degree of certainty concerning an issue of federal law that would justify reliance so complete as to justify applying a decision only prospectively in order to protect settled expectations"). It was not "unquestionably prudent" for Practice Management to rely on prior, evolving case law to wait until well after the expiration of the statute of limitations to file its class claims. *See* *Suesz*, 757 F.3d at 650.

This conclusion is confirmed by the fact that the Supreme Court in *China Agritech* reversed and remanded for "proceedings consistent with [its] opinion,"

notwithstanding the fact that the plaintiffs had acted in reliance on prior, contradictory Ninth Circuit precedent. 138 S. Ct. at 1811; *see also* R. 173-1 (plaintiffs' opening brief before the Ninth Circuit in *China Agritech*). The Supreme Court has held that "it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so." *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529, 540 (1991). It would be error to refuse to apply *China Agritech* retroactively here.

Third, Practice Management suggests that a different tolling doctrine, such as fraudulent concealment or equitable estoppel, could be applied to toll its claims. But "equitable estoppel, also called fraudulent concealment, applies only when plaintiffs act with reasonable diligence to discover and file their claims." *Sidney Hillman Health Ctr. of Rochester v. Abbott Labs., Inc.*, 782 F.3d 922, 931 (7th Cir. 2015). The Court finds Practice Management's argument that it was diligent foreclosed by the reasoning in *China Agritech* itself. The *China Agritech* Court explained that "[a] would-be class representative who commences suit after expiration of the limitation period ... can hardly qualify as diligent in asserting claims and pursuing relief. Her interest in representing the class as lead plaintiff, therefore, would not be preserved by the prior plaintiff's timely filed class suit." 138 S. Ct. at 1808.

As this reasoning shows, Practice Management is not a diligent class representative. It asserts claims based on faxes sent in 2009, and it waited until 2014 to file this case. It had "every reason to file a class action early, and little reason to wait in the wings, giving another plaintiff first shot at representation." *Id.* This is especially true given that Practice Management has been represented by Anderson + Wanca in other lawsuits dating back to 2008. *See* R. 47-18; R. 47-19.

***6** In support of its diligence argument, Practice Management points to this Court's previous finding that "the multiple suits [in this litigation] were in part ... due to the array of corporate entities defendants have established ..., which resulted in the current defendants not being sued in the first federal action." R. 162 at 22-23. As the Court further explained, however, "the multiple suits were in part putative class counsel's doing." *Id.* at 22. Practice Management does not claim that fraudulent concealment on the part of defendants was what caused Anderson + Wanca to fail to miss both the discovery deadline to gather evidence needed to support class certification and the deadline for adding new parties in the first federal class action. The procedural history recited above shows that Anderson + Wanca was not diligent in the first federal class action, and then sought to rectify the situation by filing successive class actions. The Supreme Court's decision in *China Agritech* deliberately aims to eradicate this type of conduct. Because of Practice Management and its counsel's lack of diligence, the Court finds that Practice Management cannot benefit from any alternative tolling doctrine.

* * *

Allowing the same counsel to litigate three successive class actions over nine years is exactly the abuse of tolling that *China Agritech* seeks to prevent. Just like the third successive class action that the Supreme Court found untimely in *China Agritech*, *id.* at 1805-09, Practice Management's class claims in this third successive action are untimely. As a result, the class must be decertified, and the class claims dismissed.

Conclusion

For the foregoing reasons, the Court grants defendants' motion to decertify the class and dismisses the class claims as untimely based on the Supreme Court's recent decision in *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800 (2018) (R. 171). The Court denies as moot Practice Management's motion for partial reconsideration of the Court's order granting class certification (R. 166). Practice Management's individual claims survive.

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NOTES

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In Re Morning Song Bird Food Litigation, Lead Case No.: 12CV01592 JAH-AGS, 2018 WL 1382746 (S.D. Cal. Mar. 19, 2018)

Submitted by:
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United States District Court, S.D. California.

IN RE MORNING SONG BIRD FOOD LITIGATION,

Lead Case No.: 12cv01592 JAH-AGS
|
Signed 03/19/2018

ORDER DENYING SCOTTS DEFENDANTS' MOTION TO DISMISS AND DENYING DEFENDANT HAGEDORN'S MOTION FOR RECONSIDERATION

JOHN A. HOUSTON, United States District Judge

***1** Pending before the Court is Defendants The Scotts Miracle-Gro Company ("SMG") and The Scotts Company LLC's ("Scotts LLC") (collectively "Scotts Defendants") motion to dismiss or, in the alternative, motion for partial judgment on the pleadings and Defendant James Hagedorn's motion for reconsideration, or in the alternative, motion for judgment on the pleadings. The motions are fully briefed by the parties. Upon review of the parties' submissions, and for the reasons discussed below, the Court DENIES the Scotts Defendants' motion and DENIES Defendant Hagedorn's motion.

I. Scotts Defendants' Motion

The Scotts Defendants move to dismiss the out-of-state Plaintiffs' and class member's claims, including Counts V-VII and IX in their entirety and Counts I, VII, X and XI in part for lack of personal jurisdiction based upon the holding in Bristol-Myers Squibb Co. v. Superior Court of California, 137 S.Ct 1773 (2017). They further seek an order limiting any further proceedings to the California Plaintiffs and appropriate class members.

In opposition, Plaintiffs argue Defendants have waived any challenge to personal jurisdiction, and, even assuming there is no waiver, Bristol-Myers is not applicable.

Defendants maintain their motion is procedurally proper because Federal Rule of Civil Procedure 12(g)(2) permits a defendant to file a second motion to dismiss when it raises a defense or objection that was not available to the party at the time its earlier motion to dismiss was made. Defendants contend an intervening change in Supreme Court jurisprudence made a new personal jurisdiction defense available that was unavailable at the time they filed their first Rule 12 motion. They maintain Bristol-Myers significantly restricts the circumstances under which specific personal jurisdiction may be exercised by this Court over the Scotts Defendants with respect to the out-of-state Plaintiffs' claims with insufficient connections to California.

Plaintiffs argue Defendants waived any personal jurisdiction challenge when they failed to assert such a defense in their Rule 12 motion filed at the outset of the case. Plaintiffs contend Defendants had at least five different opportunities in the past five years to challenge this Court's jurisdiction but did not. They argue, by appearing before this Court for the past five years and filing numerous motions seeking this Court's protection and adjudication of Plaintiffs' claims on the merits, Defendants have either waived or should be estopped from now raising any challenge to this Court's exercise of personal jurisdiction over them.

Additionally, Plaintiffs argue Bristol-Myers does not constitute an intervening change in controlling law. They maintain the Court in Bristol-Myers expressly stated that it was not changing the law. Further, they contend Defendants fail to identify any relevant binding Ninth Circuit or Supreme Court precedent that foreclosed the personal jurisdiction challenge they now say is purportedly available under Bristol-Myers. Plaintiffs maintain it is not enough for Defendants to say they believed any such challenge would have been futile because Defendants know how to preserve an issue.

***2** In reply, Defendants maintain Bristol-Myers changed the reach of California's long-arm statute by rejecting the "sliding scale" methodology for personal jurisdiction and abrogated pendent personal jurisdiction. They contend they "promptly" filed this motion after the Bristol-Myers decision was published.

A party waives the defense of lack of personal jurisdiction if it omits it from a previous motion filed under Rule 12

or fails to raise the issue in its responsive pleading. FED.R.CIV.P. 12(h); see also Benny v. Pipes, 799 F.2d 489, 492 (9th Cir. 1986). There is no dispute the Scotts Defendants did not raise lack of personal jurisdiction in their initial motion to dismiss. Defendants, however, claim Bristol-Myers is an intervening change in controlling law permitting them to raise the issue for the first time in the pending motion. Bristol-Myers involved a mass tort action with over 600 individual plaintiffs, most of whom were not residents of California, seeking relief under state law for injuries allegedly caused by the drug Plavix. 137 S.Ct at 1777. The Court analyzed the assertion of jurisdiction by the state court and its compatibility with the due process clause of the Fourteenth Amendment, and determined California courts did not have specific jurisdiction to entertain the nonresident plaintiffs' claims.

This Court finds Bristol-Myers is not an intervening change in controlling law. In reaching its decision, the Court explicitly stated "settled principles regarding specific jurisdiction control[led] the case" and further described its holding as a "straightforward application" of those settled principles. 137 S.Ct at 1781, 1783. The Court noted the California court's use of a sliding scale was not supported by precedent, including the Supreme Court's decision in Goodyear Dunlop Tires Operations, S.A. v. Brown, 564 U.S. 915 (2011), which required a connection between the forum and underlying controversy to support specific jurisdiction. Id. at 1781. Contrary to Defendants' assertion, the Court did not change personal jurisdiction jurisprudence but applied "settled principles" in reaching its decision.

Furthermore, Defendants were not prevented from asserting lack of jurisdiction as to the named nonresident Plaintiffs prior to the ruling in Bristol-Myers. See Abrams Shell v. Shell Oil Co., 165 F.Supp.2d 1096, 1107 n.5 (C.D. Cal. 2001) ("Notwithstanding the relaxation of venue and personal jurisdiction requirements as to unnamed members of a plaintiff class, it is by now well settled that these requirements to suit must be satisfied for each and every named plaintiff for the suit to go forward."). Therefore, the defense was available to them at the time they filed their original motion.

Accordingly, Defendants have waived a personal jurisdiction challenge by failing to raise the issue in their initial motion to dismiss. Bristol-Myers does not afford Defendants any new relief under specific jurisdiction jurisprudence. Defendants' motion to dismiss, or in the alternative, motion for a judgment on the pleadings is DENIED.

II. Defendant Hagedorn's Motion

Defendant Hagedorn seeks an order reconsidering the Court's denial of his motion to dismiss for lack of personal jurisdiction in light of the Supreme Court's ruling in Bristol-Myers. In the alternative, he seeks dismissal of claims brought by non-California Residents who do not allege their injuries occurred in California.

***3** In opposition, Plaintiffs argue Bristol-Myers is not an intervening change in controlling law warranting reconsideration of the Court's prior order denying Defendant Hagedorn's motion to dismiss for lack of jurisdiction. They further argue Defendant is not entitled to judgment on the pleadings because Bristol-Myers is inapplicable.

A. Motion for Reconsideration

Defendant seek reconsideration of the Court's previous order denying his motion to dismiss for lack of personal jurisdiction pursuant to Rule 54(b). Under Rule 54(b), district courts have the inherent authority to reconsider interlocutory rulings at their discretion until a final judgment is entered. A number of judicial doctrines have evolved to guide courts when reviewing issued interlocutory orders. The "law of the case" doctrine, as well as public policy, dictates that the efficient operation of the judicial system requires the avoidance of re-arguing questions that have already been decided. See Pyramid Lake Paiute Tribe of Indians v. Hodel, 882 F.2d 364, 369 n.5 (9th Cir. 1989). Most courts, thus, adhere to a fairly narrow standard by which to reconsider their interlocutory opinions and orders. This standard requires that the party show: (1) an intervening change in the law; (2) additional evidence that was not previously available; or (3) that the prior decision was based on clear error or would work manifest injustice. Pauite Tribe, 882 F.2d at 369 n.5.

This district's Local Rules require a motion for reconsideration "be filed within twenty-eight (28) days after the entry of the ruling, order or judgment sought to be reconsidered." CivLR 7.1.i.2. Defendant recognizes he filed his motion beyond the deadline, however, he contends it was filed within 28 days of the decision in Bristol-Myers, which he argues is an intervening change in controlling law. He further asserts this purported change in the controlling law requires reversal of the Court's prior decision. As discussed above, the Court

finds Bristol-Myers is not an intervening change in controlling law. As such, Defendant' motion for reconsideration is untimely.

Additionally, Defendant does not assert the existence of additional evidence not previously available, and as discussed below, Defendant fails to demonstrate the prior decision was based on clear error or is necessary to prevent manifest injustice. Accordingly, the motion for reconsideration is DENIED.

B. Judgment on the Pleadings

In the alternative, Defendant seeks judgment on the pleadings for lack of personal jurisdiction. Under Federal Rule of Civil Procedure 12(c), a party may move for judgment on the pleadings "[a]fter the pleadings are closed but within such time as not to delay the trial." FED.R.CIV.P. 12(c). Judgment on the pleadings is proper only when there is no unresolved issue of fact and no question remains that the moving party is entitled to a judgment as a matter of law. Hal Roach Studios, Inc. v. Richard Feiner & Co., 896 F.2d 1542, 1550 (9th Cir. 1989); Honey v. Distelrath, 195 F.3d 531, 532-33 (9th Cir. 1999). The standard applied on a Rule 12(c) motion is essentially the same as that applied on Rule 12(b)(6) motions. See Hal Roach Studios, Inc., 896 F.2d at 1550. Thus, the allegations of the non-moving party are accepted as true, and all inferences reasonably drawn from those facts must be construed in favor of the responding party. Id.

***4** Defendant contends the decision in Bristol-Myers requires the claims against him be dismissed for lack of personal jurisdiction because it clarified that a state's long arm statute cannot confer specific personal jurisdiction over a non-resident defendant with respect to claims brought by non-resident plaintiffs, where the defendant's relevant conduct did not occur in the subject forum and the non-resident plaintiffs did not suffer harm in the subject forum. He maintains this Court relied on his alleged involvement during an October 2007 meeting, which took place in Ohio in determining personal jurisdiction in the previous motion and Bristol-Myers demonstrates the Court's analysis was mistaken. He maintains absent a showing that non-California Plaintiffs suffered injury or economic loss arising from his conduct in California, this Court cannot exercise specific personal jurisdiction over him with regard to the non-resident Plaintiffs' claims and with regard to non-resident class member claims.

Additionally, Defendant argues this Court has no specific personal jurisdiction over him with respect to claims brought by California residents. He contends the Court engaged in the sliding scale approach rejected by Bristol-Myers in reaching its prior decision.

In opposition, Plaintiffs maintain it is the law in the Ninth Circuit that there must be a "but for" link between the claims and the forum and this Court explicitly found Defendant purposefully directed his conduct towards California and that the claims result from Defendant's forum-related activities. Thus, they argue, this Court carefully considered the relevant law and arguments before rejecting Defendant's prior jurisdictional challenge. They maintain Defendant's current motion seeks to rehash his personal jurisdiction arguments that this Court previously considered and rejected.

Plaintiffs contend, even assuming Bristol-Myers changed the law, it is not applicable here. They maintain while Bristol-Myers involved an appeal from a non-class action case brought on behalf of mostly non-residents in a California state court for state law claims only, here, the parties are in federal court and litigating a nationwide federal Racketeer Influenced and Corrupt Organizations Act ("RICO") class claim. They further maintain the Supreme Court specifically left open the question of whether the Fifth Amendment imposes the same restrictions on the exercise of personal jurisdiction by a federal court. Plaintiffs argue, under its express limitation to state court cases, Bristol-Myers has no application to this federal court case. Additionally, Plaintiffs contend Bristol-Myers has no bearing on the RICO class claim. They maintain Defendant tries to bootstrap Bristol-Myers to argue the Court lacks personal jurisdiction as to claims by non-named class members who are not residents of California, but, they argue, this is not supported by Bristol-Myers or prior jurisprudence which determined that federal court jurisdiction does not query the residence of unnamed class members in class actions.

Plaintiffs maintain the only claim pending against Defendant Hagedorn is a federal RICO class claim brought by California class representatives, Laura and Milt Cyphert, and the Second Amended Consolidated Complaint alleges, among other things, the Cypherts purchased their SMG Wild Bird Food products in this District. They contend this Court found Plaintiffs allege Defendant was specifically informed of the illegal pesticide use in October 16, 2007, and continued to make and sell millions of bags of the bird food in this district and elsewhere, as a result of Defendants' illegal scheme and conspiracy. Plaintiffs and the class purchased a product that contained bird poison in this district and

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throughout California. Plaintiffs argue, under these facts and circumstances, Defendants' (including Defendant Hagedorn's) California-related conduct, including Defendant Hagedorn's, gave rise to the Cypherts' RICO class claim. Accordingly, they argue, this Court may exercise personal jurisdiction over Hagedorn with respect to the RICO class claim.

***5** In reply, Defendant argues Plaintiffs have never identified any activity by Defendant Hagedorn that occurred in California, from which any of Plaintiffs' claims arose. Defendant contends due process under the Fourteenth Amendment is at issue here because the only potential basis for personal jurisdiction is the California long arm statute, which is limited by the Fourteenth Amendment. As such, he argues this case falls squarely within the confines of Bristol-Myers' ruling regarding due process under the Fourteenth Amendment, and does not implicate the "open question" regarding Fifth Amendment due process. Even if the Fifth Amendment was at issue here, he maintains, the Ninth Circuit has explicitly treated the due process analysis for personal jurisdiction under the Fifth Amendment and the Fourteenth Amendment the same. Defendant further maintains Plaintiffs' contention that Bristol-Myers is inapplicable to class members' claims is meritless.

In its order granting in part and denying in part Defendant Hagedorn's motion to dismiss for lack of personal jurisdiction and failure to state a claim, this Court granted the motion as to the state law claims for failure to state a claim and denied the motion as to the RICO claim. Considering Plaintiffs' allegations of Defendant's direct involvement in the illegal wild bird food enterprise, including his involvement in wild bird food sales and marketing strategies directed to California, and periodic updates to investors during the class period, the Court found the allegations demonstrate he was a participant in the alleged wrongdoing and purposefully directed his conduct toward California. The Court further found the claims resulted from his forum-related activities and the exercise of jurisdiction was reasonable. Defendant suggests this Court utilized the "sliding scale approach" the majority in Bristol Myers, found "difficult to square with [its] precedents." Bristol-Myers, 137 S.Ct at 1781. According to the Bristol-Myers Court, the "sliding scale approach" involved relaxing "the strength of the requisite connection between the forum and the specific claims at issue" if the defendant has other extensive contacts with the forum unrelated to the claim. Id. This Court specifically found the claims resulted from Defendant's alleged wrongful forum-related activities.

Additionally, the Court finds Bristol-Myers is inapplicable to this case. Bristol-Myers involved a state court's exercise of personal jurisdiction over a non-resident defendant as to non-resident named plaintiffs in a mass tort case. The Court in Bristol-Myers, specifically limited its ruling to the exercise of jurisdiction by a state court and left open the question of whether "the Fifth Amendment imposes the same restrictions on the exercise of personal jurisdiction by a federal court." Id. at 1784. Defendant argues the specific jurisdiction analysis here implicates Fourteenth Amendment due process because the Court must look to California's long-arm statute. California's law arm statute permits the exercise of jurisdiction within limits set by federal due process. Daimler AG v. Bauman, 571 U.S. 117, 134 S.Ct 746, 753 (2014). "[T]he jurisdictional analyses under California state law and federal due process are the same." Axiom Foods, Inc. v. Acerchem International, Inc., 874 F.3d 1064, 1068 (9th Cir. 2017) (quoting Mavrix Photo, Inc. v. Brand Techs., Inc., 647 F.3d 1218, 1223 (9th Cir. 2011)). Bristol-Myers is arguably instructive to federal courts evaluating the exercise of personal jurisdiction under California law.

Nevertheless, the Court finds Bristol-Myers inapplicable to this suit which involves a class action. Bristol-Myers was a mass tort action and it determined the court's exercise of jurisdiction to hear claims by named non-resident plaintiffs. While the claims of the non-resident named plaintiffs were pertinent to the issue of specific jurisdiction in Bristol-Myers, "claims of unnamed class members are irrelevant to the question of specific jurisdiction." AM Trust v. UBS AG, 78 F.Supp.3d 977, 986 (N.D. Cal. 2015). Furthermore, Justice Sotomayor notes, in her dissent, that the majority left open the question of the decision's applicability to class actions. 137 S.Ct. at 1789 n.4 ("The Court today does not confront the question whether its opinion here would also apply to a class action in which a plaintiff injured in the forum State seeks to represent a nationwide class of plaintiffs, not all of whom were injured there."). This Court declines to extend the holding of Bristol-Myers to this case involving a class action.

***6** Therefore, the Court finds Defendant is not entitled to judgment on the pleadings and this motion is DENIED.

CONCLUSION AND ORDER

Based on the foregoing, IT IS HEREBY ORDERED:

1. The Scotts Defendant's motion to dismiss or, in the alternative, motion for partial judgment on the pleadings (Doc. No. 344) is DENIED;

2. Defendant Hagedorn's motion for reconsideration or, in the alternative, motion for judgment on the pleadings (Doc. No. 345) is DENIED.

All Citations

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Sloan, et al. v. General Motors LLC, Order Granting in Part and Denying in Part Defendant's Motion to Dismiss Second Amended Complaint, Case No. 16-cv-07244-EMC, Dkt. No. 70 (N.D. Cal. Feb. 7, 2018)

Submitted by:
Amy E. Keller
DiCello Levitt & Casey LLC

United States District Court
For the Northern District of California

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

MONTEVILLE SLOAN, et al., Plaintiffs, v. GENERAL MOTORS LLC, Defendant.	Case No. 16-cv-07244-EMC **ORDER GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION TO DISMISS SECOND AMENDED COMPLAINT** Docket No. 70

Plaintiffs allege that Defendant General Motors (GM) manufactured and sold a car engine that, due to several internal defects, consumes excessive amounts of oil, resulting in engine damage that presents a safety risk of sudden shutdowns or engine fires. GM moves to dismiss on several grounds which can broadly be grouped under challenges to personal jurisdiction for the out-of-state plaintiffs; failure to plead an unreasonable safety hazard or pre-sale knowledge that gives rise to a duty to disclose in support of the consumer protection and fraud claims; failure to adequately plead reliance on the omission; failure to allege the defect manifested during the implied warranty period; and various statute of limitations or pre-suit notice issues.

As explained below, Defendant's motion is **GRANTED IN PART** and **DENIED IN PART**.

I. FACTUAL AND PROCEDURAL HISTORY

Plaintiffs allege that the Gen IV Vortec 5300 engine suffers from an "inherent" "Oil Consumption Defect." SAC ¶ 7. The engine was installed in each of the Class Vehicles: the 2010-2014 Chevrolet Avalanche; 2010-2012 Chevrolet Colorado; 2010-2013 Chevrolet Express; 2010-2013 Chevrolet Silverado; 2010-2014 Chevrolet Suburban; 2010-2014 Chevrolet Tahoe; 2010-2013 GMC Canyon; 2010-2013 GMC Savana; 2010-2013 GMC Sierra; 2010-2014 GMC

Yukon; and the 2010-2014 GMC Yukon XL. *Id.* ¶ 2.

Plaintiffs identify five defects that "contribute" to the overall "Oil Consumption Defect." First, the "primary cause" are "piston rings . . . [that] do not maintain sufficient tension to keep oil in the crankcase." SAC ¶ 8. Second, the Active Fuel Management (AFM) system "contributes" to the defect by "spraying oil directly at the piston skirts," which "overloads and fouls the defective piston rings, triggering oil migration past the rings." SAC ¶ 9. Third, the PCV system "vacuums oil from the valvetrain into the intake system, where it is ultimately burned in the combustion chambers" contributing to excessive oil combustion. SAC ¶ 10. Fourth, the defective "Oil Life Monitoring System" does not monitor oil level, but rather, engine conditions like revolutions and temperature to predict oil quality. SAC ¶ 11. Because it does not take oil *level* into account, the system "directs drivers to travel thousands of miles with inadequate engine lubricity levels, wearing out and damaging moving internal engine components." *Id.* Fifth, the oil pressure gauge "*does not* provide any indication as to when the oil pressure . . . falls to levels low enough to damage internally lubricated parts or cause engine failure" and the oil canister symbol does not illuminate "until well past the time when the Class Vehicles are critically oil starved." SAC ¶ 13.

Plaintiffs also discuss the impact of the alleged defect on their own vehicles and on other consumers. The nature of these allegations is discussed in detail in the relevant sections below.

The chart below identifies each named plaintiff, the state of purchase, the date of purchase, and the vehicle purchased.

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Chart of Named Plaintiffs in SAC

Name	State of Purchase	Car	Date of Purchase
Raul Siqueiros	California	2011 Chevrolet Silverado	N/A
Joseph Brannan	Alabama	2010 GMC Yukon	2011
Larry Goodwin	Arkansas	2011 Chevrolet Silverado	2010
Marc Perkins	Delaware	2011 Chevrolet Avalanche	2011
Donald Ludington	Florida	2010 Chevrolet Tahoe	2012
Thomas Shorter	Florida	2011 Chevrolet Silverado	N/A
Derick Bradford	Georgia	2010 Chevrolet Silverado	2014
Gabriel Del Valle	Idaho	2013 Chevrolet Avalanche	2/2016
Kevin Hanneken	Illinois	2011 GMC Sierra 1500	2011
Dan Madson	Kansas	2013 Chevrolet Silverado	12/2013
James Faulkner	Kentucky	2011 GMC Sierra	2015
Joseph Olivier	Louisiana	2013 GMC Sierra	N/A
Scott Smith	Massachusetts	2011 GMC Yukon	2012
Ross Dahl	Minnesota	2010 Chevrolet Silverado	2010
Drew Peterson	Minnesota	2013 Chevrolet Silverado	12/2012
Michael Ware	Mississippi	2013 Chevrolet Silverado	2016
Steve Kitchen	Missouri	2013 Chevrolet Silverado	07/2013
Barbara Molina	New Mexico	2012 Chevrolet Avalanche	N/A
Steven Ehrke	North Carolina	2013 Chevrolet Silverado	2/2016
Thomas Gulling	Ohio	2013 Chevrolet Silverado	N/A
Ronald Jones	Ohio	2013 Chevrolet Silverado	N/A
Mike Warpinski	Oklahoma	2012 Chevrolet Express	2014
John Graziano	Pennsylvania	2012 Chevrolet Silverado	12/2011
Monteville Sloan	California	2013 Chevrolet Silverado	08/2014
Joshua Byrge	Tennessee	2012 Chevrolet Silverado	2016
Rudy Sanchez	Texas	2013 Chevrolet Silverado	07/2013
Christopher Thacker	Virginia	2010 Chevrolet Silverado	06/2014
Randy Clausen	Washington	2012 Chevrolet Suburban	2013
James Robertson	West Virginia	2010 GMC Sierra 1500	2010
Jonas Bednarek	Wisconsin	2010 Chevrolet Suburban	2010
Todd & Jill Cralley	California	2010 Chevrolet Suburban	N/A
Edwin & Katelyn Doepel	Illinois	2013 GMC Yukon	N/A
Dennis Vita	New York	2013 GMC Sierra	N/A
William Martel	Oregon	2011 Chevrolet Silverado	2011
Kelly Harris	N/A (Received from employer)	2012 Chevrolet Silverado	2012

II. LEGAL STANDARD

In considering a Rule 12(b)(6) motion to dismiss, a court must take all allegations of fact as true and construe them in the light most favorable to the nonmoving party, although "conclusory allegations of law and unwarranted inferences are insufficient to avoid a Rule

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12(b)(6) dismissal." *Cousins v. Lockyer,* 568 F.3d 1063, 1067 (9th Cir. 2009). While "a complaint need not contain detailed factual allegations . . . it must plead 'enough facts to state a claim to relief that is plausible on its face.'" *Id.* "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal,* 556 U.S. 662, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009); *see also Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 556, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than sheer possibility that a defendant acted unlawfully." *Id.*

Claims sounding in fraud or mistake are subject to the heightened pleading requirements of Federal Rule of Civil Procedure 9(b), which requires that a plaintiff alleging fraud "state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b); *see Kearns v. Ford Motor Co.,* 567 F.3d 1120, 1124 (9th Cir. 2009) (holding that nondisclosure claims sound in fraud and are subject to Rule 9(b)). To satisfy the heightened standard under Rule 9(b), the allegations must be "specific enough to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." *Semegen v. Weidner,* 780 F.2d 727, 731 (9th Cir. 1985). The plaintiff must set forth "what is false or misleading about a statement, and why it is false." *In re Glenfed, Inc. Sec. Litig.,* 42 F.3d 1541, 1548 (9th Cir.1994) (en banc), *superseded by statute on other grounds as stated in Ronconi v. Larkin,* 253 F.3d 423, 429 n. 6 (9th Cir. 2001).

III. DISCUSSION

Defendant raises numerous challenges to Plaintiffs' Second Amended Complaint ("SAC"), including whether:

- there is personal jurisdiction for the out-of-state plaintiffs;
- the fraud and consumer protection claims have been adequately pleaded;
- the implied warranty claims fail for failure to allege the vehicles were unfit for use; and
- various statute of limitations or pre-suit notice procedural challenges bar Plaintiffs' implied warranty, unjust enrichment, and consumer protection claims.

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Each challenge is analyzed below.

A. Personal Jurisdiction

Defendant argues that *Bristol-Myers Squibb Co. v. Sup. Ct. of Cal.*,137 S.Ct. 1773 (2017), requires dismissal for lack of personal jurisdiction of all claims by non-California named plaintiffs who did not purchase their cars in California. Plaintiffs argue this challenge has been waived because Defendant made general appearances and did not object to personal jurisdiction in a timely fashion. Defendant filed its first motion to dismiss on April 10, 2017, Docket No. 47, but the hearing was held on July 5, 2017, Docket No. 60, after the Supreme Court decided *Bristol-Myers* on June 19, 2017. Defendant counters that there was no waiver, and, even if there were, it would not apply to the new plaintiffs who were added only to the Second Amended Complaint and for whom this motion is the first opportunity to challenge personal jurisdiction. The Court requested, and the parties have filed, supplemental briefing. *See* Docket Nos. 87 and 88.

As explained below, Defendant failed to raise its challenge to personal jurisdiction at the first available opportunity with respect to 27 non-California plaintiffs.[1] However, this is Defendant's first opportunity to challenge personal jurisdiction with respect to five named plaintiffs who were added to the case in the Second Amended Complaint: the Doepels (Illinois), Vita (New York), Martell (Oregon), and Harris (Washington).

1. Waiver of Challenge to Personal Jurisdiction as to Original Plaintiffs Already in Case

Rule 12 permits a party to request dismissal on the basis that a court lacks personal jurisdiction. *See* Rule 12(b)(2). However, that defense is "waive[d]" if a party "fail[s] to . . . (i) make it by motion under this rule; or (ii) include it in a responsive pleading or in an amendment allowed by Rule 15(a)(1) as a matter of course." Fed. R. Civ. P. 12(h)(1). This "strict waiver

[1] There are only 5 named plaintiffs who reside in California or who purchased vehicles in California, and for whom Defendant has not challenged personal jurisdiction (Sloan, Siqueiros, Del Valle, and the Cralleys). Thus, the waiver applies to 27 plaintiffs who were previously named and for whom timely challenges were not made (Brannan, Goodwin, Perkins, Ludington, Shorter, Bradford, Hanneken, Madson, Faulkner, Olivier, Smith, Dahl, Peterson, Ware, Kitchen, Molina, Ehrke, Gulling, Jones, Warpinski, Graziano, Byrge, Sanchez, Thacker, Clausen, Robertson, and Bednarek).

rule" "extends only to defenses 'then available.'" *Glater v. Eli Lilly & co.*, 712 F.2d 735, 738 (1983) (quoting Fed. R. Civ. P. 12(g)). To show a defense was not previously available, a defendant must demonstrate that it "would have been directly contrary to controlling precedent in this Circuit." *Gucci Am., Inc. v. Weixing Li*, 768 F.3d 122, 135-36 (2d Cir. 2014).

Defendant did not challenge personal jurisdiction over the claims of the original Plaintiffs at the first opportunity. Though the issue had been percolating (the appeal of *Bristol-Myers* to the U.S. Supreme Court was already pending), Defendant failed to challenge personal jurisdiction over those Plaintiffs. Then, *Bristol-Myers* was decided approximately two weeks *before* the hearing on Defendant's first motion to dismiss. Defendant could have filed a notice of supplemental authority or could have requested leave from the Court to submit supplemental briefing, but it failed to do so. Moreover, Defendant did not object to personal jurisdiction at the hearing on its motion. Accordingly, the argument was waived.

Defendant has not shown that the exception for an argument previously "unavailable" applies here. Contrary to Defendant's contention, *Bristol-Myers* did not reverse any Ninth Circuit precedent foreclosing Defendant's challenge. Indeed, the Supreme Court expressly stated that its decision did not inaugurate a change in law. *See Bristol-Myers*, 137 S.Ct. at 1781 ("Our settled principles . . . control this case."); *id.* at 1783 ("Our straightforward application in this case of settled principles of personal jurisdiction will not result in the parade of horribles that respondents conjure up."). Further, the Supreme Court limited its holding and expressly stated that the very question raised by Defendant's challenge here was not addressed in *Bristol-Myers*. *Id.* at 1783-84 ("[S]ince our decision concerns the due process limits on the exercise of specific jurisdiction *by a State*, we leave open the question whether the Fifth Amendment imposes the same restrictions on the exercise of personal jurisdiction by a federal court." (emphasis added)).

Moreover, Defendant has not identified a single Ninth Circuit case overturned by *Bristol-Myers*. *See Alvarez v. Nbty, Inc.*, 2017 WL 6059159, at *4, n.2 (S.D. Cal. Dec. 6, 2017) (holding that personal jurisdiction defense was previously available because *Bristol-Myers* did not overturn controlling precedent). Nor has Defendant identified controlling precedent in the Ninth Circuit directly precluding its jurisdictional argument. Rather, Defendant's sole argument is that the

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Supreme Court reversed the California Supreme Court and Defendant should not have been expected to take a position contrary to *that* court. This argument is unpersuasive for two reasons.

First, the California Supreme Court's decision in *Bristol-Myers* did not control Defendant's available defenses. Though a federal court looks to the long-arm statute of the state in which it resides to determine whether it may exercise personal jurisdiction over an out-of-state defendant, California law permits the exercise of personal jurisdiction to the maximum extent permitted under the U.S. constitution's due process clause. *See* Cal. Civ. Proc. Code § 410.10. Thus, the outer boundaries of California personal jurisdiction (and therefore this Court's) concerned a federal question over which the Ninth Circuit and U.S. Supreme Court had ultimate authority, not a question of state law over which the California Supreme Court's decisions controlled. The California Supreme Court's decision did not constitute controlling Ninth Circuit authority.

Second, the California Supreme Court's opinion was sharply divided in a four-three vote with a published dissent, *see Bristol-Myers Squibb Co. v. Sup. Ct.*, 1 Cal.5th 783 (2016), and the U.S. Supreme Court granted certiorari on January 19, 2017, *see* 137 S.Ct. 827 (2017). Thus, it is not credible to suggest that by the time Defendant filed its first motion to dismiss four months later on April 10, 2017, *see* Docket No. 47, it felt so constrained by the California Supreme Court's divided opinion that it could not have been expected to raise or at the very least preserve a personal jurisdiction challenge in this case. And even to the extent Defendant felt constrained by the California Supreme Court, that does not explain why Defendant did not take advantage of a two-week window between *Bristol-Myers* and the hearing on its first motion to dismiss to notify the Court it intended to challenge personal jurisdiction.

Finally, Defendant has argued that the waiver of personal jurisdiction is discretionary. The Court is not persuaded. Rule 12's language is mandatory, not discretionary. *See* Fed. R. Civ. P. 12(g)(2) (a party making a motion "*must not* make another motion under this rule raising a defense or objection that was available to the party but omitted from its earlier motion" (emphasis added)); Fed. R. Civ. P. 12(h)(1) ("A party *waives* any defense listed in Rule 12(b)(2)-(5) by: (A) omitting it from a motion in the circumstances described in Rule 12(g)(2) . . . ." (emphasis added)).

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Defendant cites only one case to support this contention, *Greene v. Mizuho Bank, Ltd.*, 2017 U.S. Dist. LEXIS 202802 (D. Ill. Dec. 11, 2017), but *Greene* is distinguishable. There, the defendant filed a motion to dismiss for lack of personal jurisdiction *before* the Supreme Court's decision in *Bristol-Myers*, and sought reconsideration afterwards. In those circumstances, the court excused the fact that Defendant's initial personal jurisdiction challenge was based on a different theory and explained that it "retain[ed] the independent power to identify and apply the proper construction of governing law, even where the parties fail to advert to the applicable rule in their own briefing." *Id.* at *18 (quotations, citations, and alterations omitted). Importantly, there had been no waiver because the defendant had actually challenged personal jurisdiction before *Bristol-Myers.* In contrast, here, Defendant did not attempt to challenge personal jurisdiction prior to the present motion.

Even if the Court could exercise its discretion to excuse the waiver, however, such an excuse would be unwarranted. Defendant has not explained why it could not have alerted the Court to its intention to challenge personal jurisdiction at the hearing on its initial motion to dismiss. Moreover, the purpose of Rule 12(g)'s requirement that all challenges be presented in a single motion to dismiss is "to eliminate unnecessary delay at the pleading stage." Fed. Prac. & Proc. § 1384 (3d ed.). By failing to notify the Court that it intended to challenge personal jurisdiction at that initial hearing, Defendant forced the court to adjudicate plaintiffs' claims on the merits before considering a potentially dispositive threshold issue.

Because Defendant's challenge to personal jurisdiction with respect to the original named plaintiffs was not raised at the first available opportunity. Defendant's jurisdictional challenge to these Plaintiffs has been waived.

2. The Court Has Personal Jurisdiction Over the New Out-of-State Named Plaintiffs' Claims

Nevertheless, this motion is Defendant's first opportunity to challenge personal jurisdiction with respect to the plaintiffs *newly* named in the SAC, so that challenge must be considered on the merits. This challenge applies to Plaintiffs Mr. and Mrs. Doepel (Illinois), Plaintiff Vita (New York), Plaintiff Martell (Oregon), and Plaintiff Harris (Washington). Their claims only involve

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two new states (New York and Oregon) because Plaintiffs Hanneken and Clausen, with respect to whom the personal jurisdiction challenge has been waived, also bring claims under Illinois and Washington law, respectively.

Whether the Court may assert specific jurisdiction over a nonresident defendant "focuses on the relationship among the defendant, the forum, and the litigation." *Axiom Foods, Inc. v. Acerchem Int'l, Inc.*, 874 F.3d 1064, 1068 (9th Cir. 2017) (quotation and citation omitted). "[T]he defendant's suit-related conduct must create a substantial connection with the forum State." *Id.* (quotation and citation omitted). Three requirements must be met: "(1) the defendant must either purposefully direct his activities toward the forum or purposefully avail himself of the privileges of conducting activities in the forum; (2) the claim must be one which arises out of or relates to the defendant's forum-related activities; and (3) the exercise of jurisdiction must comport with fair play and substantial justice, i.e., it must be reasonable." *Id.* (quotation and citations omitted).

a. The Supreme Court's Holding in *Bristol-Myers*

Defendant challenges personal jurisdiction on the basis of *Bristol-Myers*, which relates to the second prong, whether "the claim . . . arises out of or relates to the defendant's forum-related activities." *Id.* In *Bristol-Myers*, plaintiffs from around the country sued Bristol-Myers Squibb Company (BMS) in California state court, alleging that its drug Plavix damaged their health and violated, *inter alia*, California products liability, negligent misrepresentation, and misleading advertising laws. BMS itself was an out-of-state defendant, incorporated in Delaware and headquartered in New York. It sold Plavix in California and engaged in other business activities there, but it "did not develop Plavix in California, did not create a marketing strategy for Plavix in California, and did not manufacture, label, package, or work on the regulatory approval of the product in California." 137 S.Ct. at 1778. The California Supreme Court had nevertheless reasoned that the exercise of specific jurisdiction over the out-of-state plaintiffs' claims was reasonable under its "sliding scale approach to specific jurisdiction" under which "the more wide ranging the defendant's forum contacts, the more readily is shown a connection between the forum contacts and the claim" because the claims by all plaintiffs were "based on the same allegedly defective product and the assertedly misleading marketing and promotion of that product." *Id.* at

1779 (quotations and citations omitted).

The U.S. Supreme Court disagreed. That Court emphasized that the interests to be considered in determining whether personal jurisdiction exists include "the interests of the forum State and of the plaintiff in proceeding with the cause in the plaintiff's forum of choice," but that the "primary concern is the burden on the defendant." *Id.* at 1780 (quotations and citations omitted). This analysis "obviously requires a court to consider the practical problems resulting from litigating in the forum, but it also encompasses the more abstract matter of submitting to the coercive power of a State that may have little legitimate interest in the claims in question." *Id.* As the Supreme Court explained, the principle of personal jurisdiction is in part "a consequence of territorial limitations on the power of the respective States," as "[t]he sovereignty of each State . . . implie[s] a limitation on the sovereignty of all its sister states." *Id.* at 1780 (citations and quotations omitted). These federalism concerns underpinned *Bristol-Myers*.

Because of these significant interstate federalism concerns, the Supreme Court rejected the notion that mere factual or legal *similarity* between the California plaintiffs' claims and the non-resident plaintiffs' claims somehow sufficed to create personal jurisdiction. "The mere fact that *other* plaintiffs were prescribed, obtained, and ingested Plavix in California—and allegedly sustained the same injuries as did the nonresidents—does not allow the State to assert specific jurisdiction over the nonresidents' claims." *Bristol-Myers*, 137 S.Ct. at 1781. Rather, "[w]hat is needed . . . is a connection between the forum and the specific claims at issue." *Id.* The plaintiffs could not demonstrate such a connection with respect to the out-of-state plaintiffs because defendant had not done anything related to *their* claims in California. Accordingly, the Supreme Court held that California state courts lacked specific personal jurisdiction over out-of-state defendants for claims brought by out-of-state plaintiffs, where there were no sufficient contacts between defendants' conduct in connection with those claims and the forum state, California. 137 S. Ct. at 1782-83. This conclusion was driven by the limitations of state sovereignty. Indeed, before analyzing the lack of a connection between California and the nonresident plaintiffs' claims, the Supreme Court emphasized that "at times, [the] federalism interest may be decisive" in the personal jurisdiction analysis. *Id.* at 1780 (quotation omitted). It noted that, "[e]ven if the

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defendant would suffer minimal or no inconvenience from being forced to litigate before the tribunals of another State; even if the forum State has a strong interest in applying its law to the controversy; even if the forum State is the most convenient location for litigation, the Due Process Clause, *acting as an instrument of interstate federalism*, may sometimes act to divest the State of its power to render a valid judgment." *Id.* at 1780-81 (quoting *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 293 (1980) (alteration in original, emphasis added)).

b. Defendant's Challenge Under *Bristol-Myers*

Defendant contends that *Bristol-Myers* applies in a straight-forward manner to this case because the out-of-state plaintiffs cannot allege any act in California that touches on their claims. Plaintiffs do not allege, for example, that the defective vehicles were designed or manufactured in California, that the decision not to disclose the defect was made in California, or that marketing materials omitting the defect and used nationwide were designed in or promulgated from California to their states. *Compare Bristol-Myers Squibb*, 137 S.Ct. at 1778 (noting that "[defendant] did not develop Plavix in California, did not create a marketing strategy for Plavix in California, and did not manufacture, label, package, or work on the regulatory approval of the product in California").

The Court agrees, and Plaintiffs appear to concede, that the out-of-state plaintiffs have not shown an independent relationship between their claims under the laws of Illinois, New York, Washington, and Oregon, and Defendant's contacts with the State of California which could satisfy *Bristol-Myers*. Plaintiffs argue, however, that *Bristol-Myers* does not apply to federal courts and that despite the lack of an independent connection between the out-of-state claims and Defendant's California contacts, the Court may exercise its discretion under the circumstances here to apply the doctrine of "pendent personal jurisdiction," citing *Action Embroidery Corp. v. Atl. Embroidery, Inc.*, 368 F.3d 1174 (9th Cir. 2004).

The Court will first address the question whether *Bristol-Myers* applies straightforwardly to federal courts and second whether the doctrine of pendent personal jurisdiction permits the out-of-state Plaintiffs' claims to be heard in this Court, at least under the particular facts of the instant case.

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i. Does *Bristol-Myers* Apply to Federal Courts?

Bristol-Myers expressly left open the question whether its holding extended to federal courts. *Id.* at 1783-84. The Court is not persuaded that such a categorical extension is warranted. *Bristol-Myers* was animated by unique interstate federalism concerns. Indeed, the Supreme Court emphasized that, when analyzing the power of a state court to exercise personal jurisdiction, the inquiry regarding the prospective burden on an out-of-state defendant "encompasses the more abstract matter of submitting [the defendant] to the coercive power of a State that may have little legitimate interest in the claims in question." *Id.* at 1790. It noted that in certain cases this interest could be "decisive," irrespective of whether the exercise of jurisdiction by the state imposes a burden on the defendant. *Id.* at 1780-81 (quotation omitted). Thus, the Supreme Court's analysis in *Bristol-Myers* must be understood through the lens of those interstate federalism concerns, which the Court incorporated into its due process analysis.

As the Supreme Court has previously explained:

> [i]t is true that we have stated that the requirement of personal jurisdiction, as applied to state courts, reflects an element of federalism and the character of state sovereignty vis-à-vis other States. [. . .] The restriction on state sovereignty power . . . however, must be seen as ultimately a function of the individual liberty interest preserved by the Due Process Clause. That Clause is the only source of the personal jurisdiction requirement and the Clause itself makes no mention of federalism concerns.

Ins. Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee, 456 U.S. 694, 702, n. 10 (1982) (citations omitted). This passage make clear that the due process analysis encompasses the question of state sovereignty, but also that the due process analysis differs fundamentally when a case is pending in federal court and no such concerns are raised. *Id.* (discussing "the requirement of personal jurisdiction, *as applied to state courts*") (emphasis added).

In *Bristol-Myers*, the Supreme Court did not address the question of whether BMS would face any undue burden in California court; rather, the Court's analysis focused exclusively on the unfairness of submitting BMS to the jurisdiction to a foreign sovereign (California) with respect to claims having no independent connection to that sovereign. *Bristol-Myers*, 137 S.Ct. at 1780. The focus of the Court's analysis, as well as its preface that interstate sovereignty concerns may be

"decisive" even when a defendant faces no burden, *id.* at 1780-81, provide the backdrop against which *Bristol-Myers*' import must be understood.

In contrast to *Bristol-Myers*, the due process right does not obtain here in the same manner because all federal courts, regardless of where they sit, represent the same federal sovereign, not the sovereignty of a foreign state government. There is no risk of a state court exceeding the bounds of its state's sovereignty and subjecting residents of another state to the coercing power of its courts. Therefore, where a federal court presides over litigation involving a federal question,[2] the due process analysis does not incorporate the interstate sovereignty concerns that animated *Bristol-Myers* and which may be "decisive" in a state court's analysis. *Id.* Without those interstate federalism concerns, the due process analysis falls back on whether "the maintenance of the suit . . . offend[s] 'traditional notions of fair play and substantial justice,'" *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945) (citation omitted), which itself focuses on the burden on the defendant (other than a concern about subjecting it to the power of a foreign sovereign).[3]

The Court thus returns to the traditional three-part test summarized above: "(1) the

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[2] Plaintiffs have brought a claim under the Magnuson Moss Warranty Act, which confers the Court with federal question jurisdiction. The Court does not address whether and how *Bristol-Myers* would apply if jurisdiction arose exclusively on the basis of diversity.

[3] Ford has cited a number of federal district court cases applying *Bristol-Myers* to dismiss the claims of out-of-state plaintiffs, however, those cases do not analyze or discuss this crucial distinction and are therefore unpersuasive. *See Jordan v. Bayer Corp.*, 2017 U.S. Dist. LEXIS 109206, *8-11, 2017 WL 3006993, *4 (E.D. Mo. July 14, 2017) (dismissing out-of-state plaintiffs' claims without considering whether *Bristol-Myers* applies to federal courts in the same way); *Turner v. Boehringer Ingelheim Pharms, Inc.*, 2017 WL 3310696, *2 (E.D. Mo. Aug. 3, 2017) (same); *In re Dental Supplies Antitrust Litig.*, 2017 WL 4217115, *9, 2017 U.S. Dist. LEXIS 153265, *37-38 (E.D.N.Y. Sept. 20, 2017) (same); *Spratley v. FCA US LLC*, 2017 WL 4023348 (N.D.N.Y. Sept. 12, 2017) (same); *McDonnell v. Nature's Way Prods.*, LLC, 2017 U.S. Dist. LEXIS 177892, *10-12, 2017 WL 4864910 (N.D. Ill. Oct. 26, 2017) (the court applied *Bristol-Myers*' analysis to dismiss claims that an Illinois plaintiff sought to bring on behalf of out-of-state putative class members under out-of-state statutes, however, this analysis appears to conflate standing with personal jurisdiction). Ford also cited several other cases but they are inapposite for other reasons. *Ferrari v. Mercedes-Benz USA, LLC*, 2017 WL 3115198, *2 (N.D. Cal. July 21,2017) (inapposite because it does not discuss *Bristol-Myers* and how it applies to out-of-state plaintiffs in federal courts); *Andrew v. Radiancy, Inc.*, 2017 WL 2692840, *6–7 (M.D. Fla. June 22, 2017) (same); *Demedicis v. CVS Health Corp.*, 2017 U.S. Dist. LEXIS 19589, *10-12, 2017 WL 569157 (N.D. Ill. Feb. 13, 2017) (single plaintiff case without discussion of *Bristol-Myers*).

defendant must either purposefully direct his activities toward the forum or purposefully avail himself of the privileges of conducting activities in the forum; (2) the claim must be one which arises out of or relates to the defendant's forum-related activities; and (3) the exercise of jurisdiction must comport with fair play and substantial justice, i.e., it must be reasonable." *Axiom Foods*, 874 F.3d at 1068 (quotation and citations omitted).

Here it is undisputed that GM has availed itself of the privilege of conducting business in the state of California, so the first prong is not at issue. The Court will therefore proceed to analyze the second and third prongs below.

ii. Do the Nonresident Plaintiffs' Claims Arise Out of GM's Suit-related Contacts?

Plaintiffs concede that the out-of-state plaintiffs cannot demonstrate an *independent* connection between their claims and Defendant's contacts with California. Instead, they rely on the doctrine of "pendent personal jurisdiction," as elaborated by the Ninth Circuit in *Action Embroidery*. *See* 368 F.3d 1174. In *Action Embroidery*, the district court had dismissed the plaintiffs' California Cartwright Act claims against out-of-state defendants in the absence of any related contacts with California. The plaintiffs' federal Sherman Act claims were permitted to proceed because that statute creates nationwide personal jurisdiction by virtue of permitting nationwide service of process. *See* 15 U.S.C. § 22. On appeal, the Ninth Circuit reversed. It re-affirmed the principle that "[p]ersonal jurisdiction must exist for each claim asserted against a defendant," and recognized that California's long-arm statute "would not allow the exercise of personal jurisdiction over the[] state-law claims if they were standing alone." *Id.* However, the Ninth Circuit observed that several other circuits had adopted the doctrine of "pendent personal jurisdiction" in which "a court may assert pendent personal jurisdiction over a defendant with respect to a claim for which there is no independent basis of personal jurisdiction so long as it arises out of a common nucleus of operative facts with a claim in the same suit over which the court does have personal jurisdiction." *Id.* Adopting the doctrine, the Ninth Circuit held that "[w]hen a defendant must appear in a forum to defend against one claim, it is often reasonable to compel that defendant to answer other claims in the same suit arising out of a common nucleus of

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operative facts." *Id*. at 1181. It found that "judicial economy, avoidance of piecemeal litigation, and overall convenience of the parties is best served by adopting this doctrine." *Id*. Whether to exercise pendent personal jurisdiction is afforded to the discretion of the district court. *Id*. In essence, *Action Embroidery* holds that a claim that itself lacks an independent connection to the federal forum nevertheless may have a sufficient nexus for purposes of the personal jurisdiction analysis if it arises out of a common nucleus of operative facts with other claims properly before the court.

To be sure, the relationship between the claims at issue in *Action Embroidery* and the forum state were arguably closer than those at issue here because the same plaintiffs already before the court asserted them in *Action Embroidery*. In contrast, here, the out-of-state plaintiffs ask the Court to exercise pendent personal jurisdiction over their claims based on its jurisdiction over the California plaintiffs' claims—a situation analogous to *Bristol-Myers*. Although the Court is mindful of these factual dissimilarities, the Ninth Circuit did not limit its holding in *Action Embroidery* to situations involving the same parties. Rather, it focused on whether the new *claims* arose out of the same nucleus of operative facts, not whether the claims belonged to the same plaintiffs. *See Action Embroidery*, 368 F.3d at 1181 ("[w]hen a defendant must appear in a forum to defend against one claim, it is often reasonable to compel that defendant to answer other *claims* in the same suit arising out of a common nucleus of operative facts" (emphasis added)); *see also id.* ("a court may assert pendent personal jurisdiction over a defendant with respect to a *claim* for which there is no independent basis of personal jurisdiction so long as it arises out of a common nucleus of operative facts with a *claim* in the same suit over which the court does have personal jurisdiction" (emphasis added)). Thus, the Ninth Circuit has not limited the doctrine of pendent personal jurisdiction to when a relationship is shown to "other claims by the same *plaintiff*" but rather to "other claims in the same *suit*," *id*. (emphasis added).[4]

[4] The Court is aware that some district courts around the country have declined to apply the doctrine of pendent personal jurisdiction to bootstrap one plaintiff's personal jurisdiction to another's, but those cases were not interpreting or applying the Ninth Circuit's standard in *Action Embroidery*. *See*, *e.g.*, *Spratley v. FCA US LLC*, 2017 WL 4023348, at *7 (N.D.N.Y. Sep. 12, 2017) (rejecting theory of "pendent personal jurisdiction" and dismissing claims against of out-of-state plaintiffs' state-law claims against Chrysler alleging concealing of a known safety defect);

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Despite the broad language of *Action Embroidery*, it may be argued that the nexus between the claims in suit and the forum state are typically more attenuated where a different non-resident plaintiff asserts the new claims than when the same resident plaintiff asserts new claims. Applying pendent personal jurisdiction to such a plaintiff's claims therefore constitutes a factual extension of *Action Embroidery*; the calculus may differ, particularly in light of *Bristol-Myers*' holding that a common nucleus of operative facts was not in and of itself sufficient to justify the exercise of a state court's sovereign power over an out-of-state defendant. Thus, it is by no means clear whether *Action Embroidery*'s pendent personal jurisdiction doctrine extends categorically to claims brought by different plaintiffs. However, there are several case-specific factors that weigh in favor of finding a requisite nexus and hence personal jurisdiction here.

First, this is a putative nationwide class action. The Court may well have jurisdiction over absent class members (including the named out-of-state plaintiffs) who are non-forum residents in any event. *See*, *e.g.*, *Fitzhenry-Russell v. Dr. Pepper Snapple Grp., Inc.*, 2017 WL 4224723 (N.D. Cal. Sep. 22, 2017) (rejecting the argument that *Bristol-Myers* precludes a court from exercising personal jurisdiction over the claims of absent class members who are out-of-state);[5] *In re Chinese-Manufactured Drywall Prods. Liability Litig.*, 2017 WL 5971622, at *12-13 (E.D. La. Nov. 30, 2017) (same); *cf. Swamy v. Title Source, Inc.*, Case No. 17-01175 WHA, 2017 WL 5196780 (N.D. Cal. Nov. 10, 2017) (rejecting the argument that *Bristol-Myers* precludes a court from exercising personal jurisdiction over the claims of out-of-state opt-in plaintiffs in a collective

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DeMaria v. Nissan N. Am., Inc., 2016 WL 374145, *8 (S.D. Ill. Feb. 1, 2016) (finding no personal jurisdiction for out-of-state plaintiffs "where each plaintiff's claim is predicated on the law of the particular state where he or she purchased a car and the claims of the other plaintiffs as alleged remain unrelated to anything that transpired in Illinois"); *Plumbers' Local Union No. 690 Health Plan v. Apotex Corp.*, 2017 WL 3129147, at *9 (E.D. Penn. Jul. 24, 2017) (finding no personal jurisdiction for out-of-state plaintiffs' claims under non-forum state laws because they "do not arise out of or relate to any of [defendants'] conduct within the forum state").

[5] Although *Fitzhenry-Russell* rejected the plaintiffs' argument that *Bristol-Myers*' reasoning was inherently limited to state courts because "federal courts routinely apply the specific jurisdiction analysis to defendants in cases that are before them solely on the basis of diversity," *id.* at *4, that case involved only claims under California state law, so arguably implicated interstate federalism concerns. It did not address a situation where, like here, subject matter jurisdiction is also premised on a federal question under the Magnuson Moss Warranty Act. *See* 15 U.S.C. § 2310(d). In any event, *Fitzhenry-Russell* did not fully analyze the federalism concerns which underpin *Bristol-Myers* but which are absent here.

action proceeding under the Fair Labor Standards Act). They are not strangers to this litigation.

Second, as discussed in more detail in the following section, the exercise of personal jurisdiction over the non-resident Plaintiffs' claims in this case will impose only a *de minimis* burden on GM. Because the Court has found a waiver of personal jurisdiction with respect to the non-California plaintiffs previously named in this suit, the Court's application of the pendent personal jurisdiction doctrine permits inclusion of only 5 additional Plaintiffs asserting claims under the laws of 2 additional states to this litigation. Those new claims overlap substantially with the claims (including federal claims) already before this Court, arising out of the same nucleus of operative facts.

Third, if the Court were to decline to exercise jurisdiction, GM would face piecemeal litigation and would have to defend itself in several different courts on nearly identical issues. Because the claims at issue arise out of the same nucleus of operative facts, the adjudication of facts in those disparate proceedings would be likely to overlap and possibly to conflict with proceedings in this case.

These factors weigh in favor of applying the doctrine of pendent personal jurisdiction as explicated in *Action Embroidery* to the non-resident plaintiffs in this case. The Court is satisfied that under *Action Embroidery* and the absence of interstate sovereignty concerns present in *Bristol-Myers*, there is a sufficient nexus between the claims of the 5 out-of-state plaintiffs and GM's contacts with California over which this Court has jurisdiction.

iii. Is the Exercise of Jurisdiction Reasonable and Does It Comport With Fair Play and Substantial Justice?

This does not end the inquiry. The Court still must consider the third factor of the traditional test for specific personal jurisdiction which focuses on whether the exercise of jurisdiction is reasonable and comports with fair play and substantial justice. *See Axiom Foods*, 874 F.3d at 1068; *Int'l Shoe*, 326 U.S. at 316; *Bristol-Myers*, 137 S.Ct. at 1780 (noting that "the primary concern" continues to be "the burden on the defendant"); *Action Embroidery*, 368 F.3d at 1181 (focusing on whether it is "reasonable to compel [the] defendant to answer other claims in the same suit arising out of a common nucleus of operative facts). This focuses principally on the

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burden on the defendant.

At the hearing, the Court asked GM to identify what prejudice it would suffer if it were required to litigate the out-of-state plaintiffs' claims in this Court. GM stated that it could not credibly suggest that it lacked resources to litigate in this district, but noted that a federal court sitting in Florida, for example, might be more familiar with Florida law than a federal court sitting in California. Though that may be the case, it is not clear how that translates into a burden, let alone an unreasonable one. In any case, the argument is unpersuasive because federal courts are frequently called upon to interpret the laws of the several States. *See*, *e.g.*, *Rabinowitz v. Samsung Electronics Am., Inc.*, Case No. 14-cv-00801-JCS, 2014 WL 5422576, at *7 (N.D. Cal. Oct. 10, 2014) (explaining that "federal courts have an equal ability to address claims arising out of state law" and "[d]istrict courts regularly apply the law of states other than the forum state" (citations and quotations omitted)). Furthermore, GM's argument is undercut by its own proposal that the Court transfer the claims of the out-of-state and California plaintiffs to a single court, the Eastern District of Michigan, which would similarly be called upon to apply non-Michigan state law. *See* Docket No. 90 at 10-12. Defendant therefore has not identified a legitimate burden.

Further, the Court is hard-pressed to find any unreasonable burden on the facts of this case. As discussed above, because the Court already has jurisdiction over the 5 California plaintiffs' claims and those of 27 nonresident plaintiffs, the sole question here is whether it would be unreasonably burdensome on Defendant for this Court to also exercise personal jurisdiction over the claims of 5 new plaintiffs, which introduce claims under only 2 additional states' laws (New York and Oregon). That burden is de minimis, particularly because the alternative would be for those plaintiffs to file new, separate cases under their states' laws.[6] Moreover, GM has not

[6] Another reason why the exercise of pendent personal jurisdiction here would not be unreasonable is that if each plaintiff were instead to file a separate case and then successfully petition to consolidate the cases in an MDL, then Defendant would still be required to litigate the same claims in whatever court is selected by the MDL panel. Although the MDL process does not relieve a plaintiff of the burden of demonstrating personal jurisdiction (the transferee court would analyze its personal jurisdiction according to whether each transferor court possessed it), it does suggest that it is not unreasonable, per se, to require Defendant to litigate the out-of-state plaintiffs' claims in this Court. It cannot be that the burden imposed on Defendant here is so unreasonable as to be a due process violation but that an effectively identical burden resulting from consolidation pursuant to the MDL statute would not be. Although a defendant might be

explained how it would be less burdensome to answer to those plaintiffs' claims in New York, Washington, Oregon, and Illinois rather than San Francisco, as those plaintiffs would likely be able to exercise personal jurisdiction over GM in their home states.

In addition, the overarching circumstances meriting the exercise of pendent personal jurisdiction—"judicial economy, avoidance of piecemeal litigation, and overall convenience of the parties," *Action Embroidery*, at 1181—counsel in favor of jurisdiction. Judicial economy is better served by having the claims of all plaintiffs heard in this Court where they involve similar legal issues and all arise out of a common nucleus of operative facts relating principally to whether GM's engine was defective, whether the defect was material or posed an unreasonable safety risk, and when GM became aware of the defect. The alternative to hearing those claims in a single forum is to populate the dockets of up to fifty federal courts with nearly identical legal and factual issues.[7] Additionally, there is an interest in avoiding piecemeal litigation, particularly since Plaintiffs request injunctive relief and certification of a nationwide class. Having the same question proceed in different courts creates the possibility of overlapping nationwide classes, inconsistent outcomes, *cf.* Fed. R. Civ. P. 23(b)(2), and an obvious waste of judicial resources. Finally, the overall convenience of the parties—including Defendant's—is much better served by having the claims heard in a single forum rather than fifty.

In sum, under the particular facts of *this* case, all three prongs of the test for specific

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expected to argue that the MDL cases should be consolidated in the district of its headquarters (*i.e.*, in a forum where it is subject to general personal jurisdiction), the MDL panel regularly transfers them elsewhere, without due process concerns. *See*, *e.g.*, *In re Chrysler-Dodge-Jeep EcoDiesel Mktg. Sales Practices and Prods. Liability Litig.*, --- F.Supp.3d, 2017 WL 1282901 (J.P.M.L. Apr. 5, 2017) (consolidating cases in Northern District of California—not the home state of any defendant); *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, and Prods. Liability Litig.*, 148 F.Supp.3d 1367 (J.P.M.L. 2015) (centralizing cases in Northern District of California despite defendant's preference for Eastern District of Michigan).

[7] Though Plaintiffs would have the option of filing a single consolidated case in the Eastern District of Michigan because Defendant is subject to general jurisdiction in that state, they would not be required to do so because jurisdiction may lie in other courts of their choosing where personal jurisdiction may also obtain. *See Lou v. Belzberg*, 834 F.2d 730, 739 (9th Cir. 1987) (noting that "great weight is generally accorded plaintiff's choice of forum"), *cert. denied*, 485 U.S. 993 (1988). Moreover, even if a party were to request consolidation by the Judicial Panel on Multidistrict Litigation, there is no guarantee that such requests would be granted and, in any case, that procedure itself creates additional burdens on the parties.

personal jurisdiction have been satisfied here. *See Axiom Foods*, 874 F.3d at 1068. It is undisputed that GM has availed itself of the privileges of conducting business in California, satisfying the first prong. In the absence of any particular federalism concerns, there is a sufficient nexus between the additional non-California claims and GM's contacts with California to satisfy the second prong. The exercise of personal jurisdiction over the 5 new out-of-state plaintiffs' claims would not offend fair play or substantial justice, satisfying the third prong. Moreover, all factors that inform the due process analysis are present here: judicial economy, the avoidance of piecemeal litigation, the overall convenience of the parties, and the minimal additional burden on Defendant all counsel strongly in favor of exercising pendent personal jurisdiction over the 5 new plaintiffs' claims under the facts of this case.

B. Fraud and Consumer Protection Claims

Plaintiffs bring fraud and consumer protection claims under the laws of several states alleging Defendant unlawfully failed to disclose the excessive oil consumption defect to consumers. Defendant's motion to dismiss is argued pursuant to California law on the basis that it is the most developed.[8] Because the parties have focused on California law and Defendant has not argued that the laws of any other state would preclude a claim viable under California law, the Court's analysis also focuses on California authorities.[9]

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[8] The cases cited by Defendant do not appear to apply a standard different from California law. *See McCabe v. Daimler AG*, 948 F.Supp.2d 1347, 1368 (N.D. Ga. 2013) (safety defects were material facts for which a duty to disclose existed under Georgia law); *In re Takata Airbag Products Liability Litig*., 193 F.Supp.3d 1324, 1338 (S.D. Fla. 2016) (holding that under Florida and Pennsylvania law plaintiffs sufficiently alleged a duty to disclose additional facts about the safety of vehicles); *In re General Motors Ignition Switch Litig.* 2017 WL 2839154, *25, 46, 51 (S.D. N.Y. Aug. 9, 2017) (at motion to dismiss stage, finding that material omission was adequately pleaded with respect to claims under Alabama law); *In re General Motors Ignition Switch Litig.*, 2016 WL 3920353, *34, 38 (S.D.N.Y. July 15, 2016) (permitting failure to disclose claim to proceed under Missouri and Oklahoma law where plaintiffs alleged the omitted information pertained to safety defect); *Zwiercan v. General Motors Corp.*, 2003 WL 1848571, *2 (Pa. Ct. of Common Pleas, Mar. 18, 200) ("This Court's holding in *Zwiercan* is limited to finding a duty to disclose known and serious life-threatening latent defects."). Moreover, Defendant has not argued that the laws of any other state differ in any material respect, or that a claim permitted by California law would not be permitted in another state.

[9] The parties are advised that in future briefing, to the extent they ask the Court to decide matters on the basis of several states' laws, they must squarely address whether there are material variations in state law. This will also be mandatory with respect to any motion for class certification in order to enable the Court to adequately analyze questions of predominance under

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Plaintiffs' California claims are brought pursuant to the California Consumer Legal Remedies Act ("CLRA"), Cal. Civ. Code §§ 1750, *et seq.*, the Unfair Competition Law ("UCL"), Cal. Bus. & Profs. Code §§ 17200, *et seq*, and under the common law for fraudulent omission or concealment. The CLRA forbids "unfair methods of competition and unfair or deceptive acts or practices undertaken by any person in a transaction intended to result or which results in the sale or lease of goods or services to any consumer." Cal. Civ. Code § 1770(a). The UCL prohibits "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising." Cal. Bus. & Profs. Code § 17200.

A common law fraudulent omission claim requires demonstrating that:

> (1) the defendant must have concealed or suppressed a material fact, (2) the defendant must have been under a duty to disclose the fact to the plaintiff, (3) the defendant must have intentionally concealed or suppressed the fact with the intent to defraud the plaintiff; (4) the plaintiff must have been unaware of the fact and would not have acted as he did if he had known of the concealed or suppressed fact, and (5) as a result of the concealment or suppression of the fact, the plaintiff must have sustained damage.

Hahn v. Mirda, 147 Cal.App.4th 740, 748 (2007) (quotation and citation omitted).

1. Duty to Disclose

The first question is whether Defendant had a duty to disclose. *See Falk v. Gen. Motors Corp.*, 494 F.Supp.2d 1088, 1094 (N.D. Cal. 2007). That duty may arise "(1) when the defendant is in a fiduciary relationship with the plaintiff; (2) when the defendant had exclusive knowledge of material facts not known to the plaintiff; (3) when the defendant actively conceals a material fact from the plaintiff; and (4) when the defendant makes partial representations but also suppresses some material fact." *Id.* (quoting *LiMandri v. Judkins*, 52 Cal.App.4th 326, 337 (1997)).

Plaintiffs argue that GM had a duty to disclose the defect based on the second and third

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Rule 23(b)(3). *See In re Hyundai and Kia Fuel Economy Litig.*, --- F.3d ----, 2018 WL 505343, at *12-13 (9th Cir. Jan. 23, 2018) (holding that district court in finding that predominance was satisfied when certifying a settlement class abused its discretion "by failing to acknowledge . . . that the laws in various states were materially different than those in California, and that these variations prevented the court from applying only California law," and "failing to make a final ruling as to whether the material variations in state law defeated predominance under Rule 23(b)(3)").

prongs: *i.e.*, that GM either had a duty to disclose because it had exclusive knowledge of the defect (a material fact), or because it actively concealed that fact from Plaintiffs. GM disputes both of these points. The Court first analyzes whether Plaintiffs adequately plead that GM had pre-sale knowledge of the defect and that the defect was material. As to whether Defendant had exclusive knowledge of the defect (assuming pre-sale knowledge is established) and whether Plaintiff knew of the material facts, those facts are not disputed. As to whether Defendant actively concealed a material fact, that is discussed below in connection with fraudulent concealment, *see infra* at 53-54.

2. Pre-Sale Knowledge of Defect

To be liable for a failure to disclose, a defendant must have pre-sale knowledge of the defect. The Court previously concluded Plaintiffs had failed to plead such pre-sale knowledge for four reasons. First, the mere fact that GM subsequently re-designed its engine was not probative where the whole engine was re-designed, rather than just the allegedly defective low-tension oil rings. Docket No. 62 at 11. Second, the Court found 81 consumer complaints to the National Highway Traffic Safety Administration ("NHTSA") and consumer forums did not demonstrate knowledge because they did not explicitly state that the cause of the oil consumption was the Low-Tension Oil Ring Defect, and a majority of the complaints were posted in 2014 or later, after the marketing and sale of the 2010-2013 Class Vehicles. *Id.* at 12. Third, Plaintiffs failed to allege that 81 complaints posted over the course of 7 years was an unusually high number. *Id.* at 13. Fourth, the single Technical Safety Bulletin ("TSB") identified by Plaintiffs did not show knowledge of a low-tension oil ring defect (the sole defect previously alleged by Plaintiffs) where it explicitly identified other causes for the excessive oil consumption (the AFM and PCV systems). *Id.*

However, in the SAC, Plaintiffs have broadened their allegations concerning the nature of the defect. They no longer allege that the low-tension oil ring defect was the sole problem that caused excessive oil consumption. Rather, they allege an "Oil Consumption Defect" to which there were several contributing factors, including defective piston rings, a defective AFM system, a defective PVC system, and defective oil warning lights/pressure gauges. In addition to this

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broader definition, Plaintiffs have bolstered the complaint with additional consumer complaints and other allegations Plaintiffs contend support an inference of pre-sale knowledge.

The revised allegations alter the analysis. Most compellingly, Plaintiffs allege that Defendant issued two TSBs specifically related to two of the components they allege contributed to the overconsumption defect: the AFM and PCV systems. With respect to the AFM system, GM issued a TSB in August 2010 that "acknowledged that the AFM system's oil pressure relief valve contributed to oil consumption and carbon buildup on the piston rings." SAC ¶ 227. With respect to the PCV system, GM issued a TSB in March 2011 that "acknowledged [the] system contributed to oil consumption." SAC ¶ 231. Because Plaintiffs' class period covers sales from 2010-2013, these two TSBs—issued relatively early in the Class Period in mid-2010 and early-2011—permit the plausible inference that Defendant had knowledge prior to the Class Period. *Cf. In re MyFord Touch*, 46 F.Supp.3d at 958 ("[I]t is still reasonable to infer that, if Ford had issued four TSBs and two updates in 2012 alone, Ford should have known of problems with MFT by around 2011, *i.e.*, before it could recommend what repairs or updates needed to be done. Presumably, the TSBs and updates were [preceded] by an accretion of knowledge by Ford."); *MacDonald*, 37 F.Supp.3d at 1093-94 (TSBs issued five and nine months after purchase, even if only dealing with a particular model vehicle, support plausible inference of knowledge of defect prior to sale of other vehicles including same defective cooling pump); *Philips*, 2015 WL 4111448, at *9-10 (same).

With respect to the consumer complaints, Plaintiffs not only present a significantly larger number,[10] but also allege that the number of complaints far exceeds the number of similar complaints for competitor vehicles. *See* SAC ¶ 279 (only zero to five complaints regarding oil consumption with respect to 7 competitor vehicles in the 2007-2013 model years). Thus, unlike before, the Court now has a baseline upon which to conclude that Plaintiffs have plausibly pled an

[10] Plaintiffs identify a large number of consumer complaints about oil consumption on carcomplaints.com. *See* SAC ¶¶ 258-262(68 re: 2007 Chevrolet Silverados, 33 re: 2008 Chevrolet Silverados, 43 re: 2009 Chevrolet Silverados, 12 re: 2010 Chevrolet Silverados, 180 re: 2007 Chevrolet Suburbans, 34 re: 2008 Chevrolet Suburbans, 17 re: 2009 Chevrolet Suburbans, 68 re: 2007 Chevrolet Avalanches, 13 re: Chevrolet Avalanches, 8 re: 2007 Chevrolet Tahoes, 10 re: 2008 Chevrolet Tahoes, 15 re: 2009 Chevrolet Tahoes, 22 re: 2007 GMC Yukons and Yukon XLs, 9 re :2007 GMC Sierra 1500).

unusual number of complaints.

It is true, as Defendant points out, that a number of the complaints relate to non-Class Vehicles (models of the same vehicles preceding the Class Period or other vehicles altogether). However, all the vehicles are equipped with the same allegedly defective engine and thus bolster the plausibility of inferring Defendant's general knowledge of the over-consumption problem associated with that engine. *Cf. MacDonald*, 37 F.Supp.3d at 1093-94 (TSB issued with respect to only one vehicle model permits plausible inference with respect to knowledge of same defective component in other vehicle model). Additionally, since the focus is on *pre*-sale knowledge with respect to Class Vehicles, the emphasis is rightly on complaints that arose prior to sale of the Class Vehicles. Thus, it is reasonable that complaints associated with earlier model years (several dating as far back as 2008), *see* SAC ¶ 249, support a plausible inference of knowledge with respect to later model years equipped with the same allegedly defective component.

That the complaints do not specifically identify the low-tension oil rings is no longer an issue because Plaintiffs now allege that there were various failing parts associated with the Gen IV Vortec 5300 engine that contributed to overconsumption. Where the complaints all relate to the same phenomenon (excessive oil consumption), the number is unusually high, and all complaints pertain to a group of vehicles with a common component (the engine), one plausible inference is that GM was generally aware of the over-consumption problem with the engine even if it had not yet isolated a specific cause for or solution to the problem. An inference of knowledge is further supported by several consumer complaints which state that the dealers to whom vehicles were presented for repair asserted that it was a "known" problem or common issue.[11]

To be sure, other inferences might plausibly be drawn from the complaints. For example,

[11] *See, e.g.,* SAC ¶ 255 (two consumers told that overconsumption was "normal" in 2014 and 2015); ¶ 256 (owner of 2007 Chevy Silverado told overconsumption was "normal"); ¶ 258 (dealer told vehicle owner in 2010 that "Chevy had sent emails to them regarding this problem"); ¶ 259 (owner of truck purchased in 2008 told "several times" by GM that consumption was "normal"); ¶ 260 (owner of 2009 Silverado told consumption was "normal"); ¶ 267 (owner of 2007 Chevy Tahoe told that excessive consumption was a "known issue"); ¶ 269 (owner of 2009 Chevy Tahoe told this was "a known problem, and not specific to [that] car"); ¶ 271 (owner of 2007 GMC Sierra 1500 says "every dealer I talked to says its normal"); *id.* (owner reports that "[t]he dealership ignored [the problem] and told me it was normal").

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since more complaints appear to be associated with earlier models of the vehicles, another plausible inference could be that the defect was substantially repaired or resolved with respect to later vehicles. However, "[t]hat [GM] is able to identify competing inferences from the same set of facts does not mean that Plaintiffs' claims should be dismissed." *MacDonald*, 37 F.Supp.3d at 1093.

At this pleading stage, Plaintiffs have included sufficient allegations to support a plausible inference that Defendant was aware of the oil consumption defect with respect to the Class Vehicles prior to their sale. Moreover, Defendant has not identified any basis to believe that Plaintiffs could have been aware of the severity of the defect before purchasing the vehicles, so Plaintiffs' allegations support a plausible inference that the details about the cause, extent, and resolvability *vel non* of the defect were within Defendant's exclusive knowledge.

3. Materiality of Defect

Defendant argues that Plaintiffs fail to adequately plead that the information was material because they have not shown it pertained to an unreasonable safety risk. The Court previously dismissed Plaintiffs' allegation of a material defect on two grounds. First, the Court held that as a matter of law Plaintiffs must plead an unreasonable safety hazard under California law in order to demonstrate the defect was material. *See* Docket No. 62 at 9. Second, the Court held that Plaintiffs had failed to plead an unreasonable safety hazard because "no facts in this case suggest that the risk of excess oil consumption causes a safety risk," and "Plaintiffs admit that there [was] a functioning oil level gauge that will give advance warning of low levels." Docket No. 62 at 10-11. Moreover, "not a single plaintiff allege[d] that his or her vehicle experienced any damage due to excessive oil consumption;" no complaints of "sudden loss of power" were made; and Plaintiffs did not establish a "risk of sudden failure." *Id.*

In re-visiting the issue on this motion to dismiss the SAC, the Court notes that both parties in both rounds of briefing overlooked a crucial distinction California law makes with respect to defects arising in-warranty and those arising post-warranty. In its prior holding, the Court treated both situations in an identical fashion, relying on language in *Wilson v. Hewlett-Packard* stating that a "manufacturer's duty to consumers is limited to its warranty obligations absent either an

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affirmative misrepresentation or a safety issue." 668 F.3d 1136, 1143-44 (9th Cir. 2012). The Court also relied on language in *Williams v. Yamaha Motor Co.* cited by the parties stating that a plaintiff must allege "the existence of an unreasonable safety hazard" to state a failure to disclose claim. 851 F.3d 1015, 1025 (9th Cir. 2017) (quoting *Apodaca v. Whirlpool Corp.*, No. 13-00725 JVS (ANx), 2013 WL 6477821, at *9 (C.D. Cal. Nov. 8, 2013)). However, these quotations were specific to the facts of both cases. A pivotal fact in both *Wilson* and *Williams* was that the alleged defect did not manifest until *after* the warranty period. *See Wilson*, 668 F.3d at 1138 (laptop charging defect did not arise until after expiration of two-year limited warranty); *Williams*, 851 F.3d at 1019 (explaining that the premature corrosion defect "will not manifest until the three-year warranty period has expired"). Indeed, *Wilson* made clear that a safety issue must be alleged only when it arises *after* the warranty period. *See* 668 F.3d at 1142, n.1 and 1144 (distinguishing cases that found materiality in the absence of a safety defect on the basis that the defects arose "*within* the express warranty period").

Thus, as *Apodaca*—the same case quoted by the Ninth Circuit in *Williams* for the legal standard for claims alleging a failure to disclose—explains, the materiality analysis turns on whether the defect arises *during or after* an express warranty period:

> First, a manufacturer has a duty to disclose *any* defects that fall *within* the warranty period, *whether relating to safety or to costly repairs*, that would have caused the consumer to not purchase the car if they had been disclosed. Second, the manufacturer also has a duty to disclose *safety issues* that fall *outside* of the warranty period.

Apodaca, 2013 WL 6477821, at *7 (quoting *Decker v. Mazda Motor of Am., Inc.*, No. 11-cv-0873, 2011 WL 5101705, at *4 (C.D. Cal. Oct. 24, 2011)) (emphasis added).[12] Although neither party

[12] It appears that post-*Wilson* California authority may permit an omission-based claim to proceed after the expiration of a warranty even without an allegation of an unreasonable safety hazard, at least when the omission is contrary to representations made by the defendant and material. *See Rutledge v. Hewlett-Packard Co.*, 238 Cal.App.4th 1164, 1171-76 (2015) (holding that plaintiff adequately pled materiality with respect to faulty inverter that caused laptop screen to dim even without safety issues and rejecting "argument that the expiration of the warranty period precludes a claim for fraudulent concealment under the UCL"). However, the Ninth Circuit continues to require that post-warranty omission claims allege a safety defect. *See Williams v. Yamaha Motor Co.*, 851 F.3d 1015, 1025 (9th Cir. 2017) (in absence of affirmative misrepresentation, duty to disclose arises post-warranty only if plaintiff alleges "existence of an unreasonable safety hazard"). The Court is obligated to follow the Ninth Circuit's more recent authority. *Mohamed v. Uber Techs., Inc.*, 848 F.3d 1201, 1211 (9th Cir. 2016).

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briefed the issue, the Court finds it necessary to analyze the viability of this claim separately with respect to in-warranty and post-warranty claims.

a. Warranty Period Claims

As a preliminary matter, the Class Vehicles in this case consist of 2010-2014 model years. Several plaintiffs allege they experienced excessive oil consumption during the warranty period. See, e.g., SAC ¶ 58 (Plaintiff Shorter); SAC ¶¶ 154-155 (Plaintiff Martell); SAC ¶ 202 (Plaintiff Bednarek). Consumer complaints also indicate that excessive oil consumption was experienced within the warranty period. *See*, *e.g.*, SAC ¶¶ 255, 258, 265, 271, 272. GM provides Class Vehicles with a three-year, 36,000 miles "bumper to bumper" warranty and a five-year, 100,000 mile powertrain warranty. *See* SAC ¶¶ 223-31; *see also* ECF Docket No. 48-22 to 48-29.

Thus, Plaintiffs have plausibly alleged that the defect may arise during the limited warranty period. To state a claim for failure to disclose the defect in these circumstances, Plaintiffs need only allege that the defect "would have caused [them] to not purchase the car if [it] had been disclosed" to show that it was material. *Apodaca*, 2013 WL 6477821, at *7 (quotation and citation omitted). Plaintiffs have done so. *See*, *e.g.*, SAC ¶¶ 20, 394-395, 411, 443-444, 460. Thus, Plaintiffs have adequately pleaded materiality for the in-warranty claims.

b. Post-Warranty Period Claims

With respect to defects that manifested only after the warranty period, Plaintiffs must allege that the defect poses an unreasonable safety hazard. As explained above, the purpose of this limitation in the post-warranty context is to protect against the de facto extension of a warranty.

Whether the defect poses an unreasonable safety hazard is a two-step inquiry. "Where a plaintiff alleges a sufficiently close nexus between the claimed defect and the alleged safety issue, the injury risk need not have come to fruition." *Williams*, at 1028. However, if the nexus is not "sufficiently close," then a plaintiff must allege examples of the safety risk coming to fruition to plausibly plead an unreasonable safety hazard. *Id.* (explaining that "a party's allegations of an unreasonable safety hazard must describe more than merely conjectural and hypothetical injuries") (citation and quotation omitted). A "sufficiently close nexus" exists when the causal chain

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between the alleged defect and the ultimate safety hazard is adequately explained.[13] The nexus is not sufficiently close, however, where the connection is not explained or appears illogical.[14]

Here, Plaintiffs adequately allege a sufficiently close nexus and have also provided examples of injury that make their allegations of an unreasonable safety hazard plausible. Plaintiffs allege the Oil Consumption Defect can lead to engine damage and engine failure, exposing drivers to the risk of suddenly inoperable vehicles. SAC ¶ 245. They allege in detail that the various defects cause excessive oil consumption. For example, the piston rings "fail to achieve their intended purpose of keeping oil in the crankcase and out of the combustion chamber," resulting in "excessive oil consumption." *Id.* ¶ 218; *see* SAC ¶¶ 214-222. Additionally, the AFM system "overwhelm[s] the independently defective piston rings" by "spray[ing] oil directly into the piston skirts (undersides) in quantities that the rings cannot control" and therefore "allow[ing] excessive quantities of oil in the combustion chambers where it is burned." SAC ¶¶ 223-225. The PCV system "also contributes to oil consumption and engine

[13] *See*, *e.g.*, *Apodaca v. Whirlpool Corp.*, 2013 WL 6477821, at *9 (C.D. Cal. Nov. 8, 2013) (plaintiff did not need to "wait until his dishwasher actually catches fire" to establish a sufficient nexus; although "catching fire would be the extreme result of th[e] causal chain, the [complaint] sufficiently alleges its possibility as a logical outcome"); *Ehrlich v. BMW of N. Am., LLC*, 801 F.Supp.2d 908, 918 (C.D. Cal. 2010) (sufficient nexus where defective windshield susceptible to cracking posed safety hazard because windshield was part of vehicle's safety restraint system, and cracked windshields could become dislodged, "compromising roof-crush resistance and causing serious head and neck injuries, failure of the passenger side airbag to deploy, or the ejection of passengers from the vehicle"); *Herremans v. BMW of N. Am., LLC*, 2014 WL 5017843, at *15 (C.D. Cal. Oct. 3, 2014) (sufficient nexus where water pump defect could cause engine to overheat, overheating could occur at any time, and if it happened while vehicle was being driven, it would experience failures that render vehicle unable to accelerate and cause steering and braking problems); *Cholakyan v. Mercedes-Benz USA, LLC*, 796 F.Supp.2d 1220, 1236-37 (C.D. Cal. 2011) (safety risk adequately alleged where "[i]t is not implausible that the 'electrical faults' described in the TSB could give rise to the safety concerns alleged," insofar as water leak defect could cause "sudden and unexpected engine failure that could result in personal injury or death"); *Marsikian v. Mercedes Benz USA, LLC*, 2009 WL 8379784, at *6 (C.D. Cal. 2009) (holding that "[i]t is not implausible that the flooding [of a climate control system] would cause catastrophic engine and electrical system failure while the car is on the road" (quotation omitted)).

[14] *See*, *e.g.*, *Wilson*, 668 F.3d at 1144-45 (plaintiffs did "not allege *how* the weakening or loss of the connection between the power jack and the motherboard causes the Laptops to ignite," and "it [was] difficult to conceive (and the complaint [did] not explain) how the Laptops could ignite if they [were] 'unable to receive an electrical charge'") (emphasis added, citation omitted); *Elias v. Hewlett-Packard Co.*, 903 F.Supp.2d 843, 857 (N.D. Cal. 2012) (no sufficient nexus where "Plaintiff does not allege any explanation for how a lack of sufficient power causes laptops to catch fire" and "provides no explanation that clearly links the alleged insufficient power of the laptops to their catching fire").

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damage by vacuuming oil from the valvetrain," which it is not supposed to do, further contributing to excessive oil consumption. SAC ¶¶ 228-231.

The excessive consumption of oil, in turn, results in insufficient oil and lubricity. SAC ¶ 244. Low oil levels potentially cause the engine to seize or shut down unexpectedly (causing accidents or stranding occupants), to overheat and catch fire, or to produce engine misfires that cause sluggish throttle response, placing occupants in harm's way by undermining their ability to navigate traffic. SAC ¶¶ 244-46. Fouled spark plugs may also cause engine misfires, ignition failure, and sluggish throttle response, undermining drivers' ability to accelerate out of harm's way or even to drive at all. *Id.* ¶ 246.

Standing alone, these allegations would likely be insufficient to support a finding of unreasonable safety risk not for lack of a causal chain, but because, as the Court previously explained, arguably "there is no more of a safety concern [here] than where, *e.g.*, a car gets less gas mileage than advertised," as "the more rapid consumption of gas might lead to a driver running out of fuel on a freeway or other dangerous location, [but] the driver has a fuel gauge to warn him or her of low fuel." *See* Docket No. 62 at 10, n.2.

Unlike in their prior complaint, however, Plaintiffs now specifically allege in the SAC that the vehicle's warning systems are inadequate and therefore fail to warn drivers before oil levels are dangerously low. For example, Plaintiffs allege that "the oil pressure gauge in the Class Vehicles fails to provide any indication as to when a vehicle is dangerously low on oil" and "do not indicate a dangerously low oil level until the vehicles have no oil pressure," which is "well beyond the point at which a lack of oil, and oil pressure, will damage or destroy an engine." SAC ¶ 235. Further, Plaintiffs allege that "the oil canister symbol will not illuminate, and the Class Vehicles will not provide *any* low oil pressure warning, until well past the time when the Class Vehicles are critically low on oil." *Id.* ¶ 236 (emphasis added). In particular, Plaintiffs claim they performed testing demonstrating that the low oil pressure indicator does not illuminate until the oil pressure drops below six PSI, below GM's minimum oil specification of 24 PSI. *Id.* According to Plaintiffs, "[a]n engine generating six PSI of oil pressure will suffer immediate internal destruction if put under operating loads." *Id.* Thus, "the Class Vehicles communicate *no* visible or audible

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warnings of destructive oil pressure levels until the engines internally seize or disintegrate." *Id.* (emphasis added). Several Plaintiffs also allege that they suffered various forms of engine damage without a warning from the vehicle.[15]

In light of these more detailed allegations including the lack of adequate warning, Plaintiffs have pled a sufficiently close nexus between the alleged defects (overconsumption of engine oil and a failure to provide adequate warning) and the safety risk (engine disintegration or failure or engine fire) to plead an unreasonable safety hazard. Though Defendant argues that the existence of its warning systems should preclude liability here, the cases Defendant cites are all decided at the summary judgment or trial stage.[16] Plaintiffs have included sufficient allegations to create a plausible assertion as to the inadequacy of the warning system and hence the existence of safety risk.

The plausibility of the causal chain between the defect and the safety hazard is bolstered by allegations that consumers, including Plaintiffs, have reported virtually every problem on the way to the ultimate safety hazard. For example, Plaintiff Perkins alleges that as a result of the Oil Consumption Defect and resulting loss of lubricity, the lifters in his vehicle's engine collapsed. SAC ¶ 47. Plaintiffs Mr. and Mrs. Doepel allege that their vehicle's engine exhibited loud knocking and emitted white smoke from the tail pipe as a result of the over-consumption of oil. *Id.* ¶ 78. Plaintiffs Bradford, Kitchen, and Warpinski experienced failures with their lifters and cam shafts, and Warpinski experienced engine knocking, shaking, and running through. *Id.* ¶¶ 64,

[15] *See* SAC ¶¶ 33-34 (the Cralleys had to replace their engine due to damage from excessive oil consumption but they "never saw a low oil warning light illuminate or appear in their vehicle"); *id.* ¶ 42 (Goodwin's vehicle "has been two quarts low on oil, without a low oil warning ever illuminating on his vehicle"); *id.* ¶¶ 78-79 (excessive oil consumption caused knocking sounds and white smoke, requiring purchase of new engine, yet the Doepels "never saw a low oil warning illuminate or appear in their vehicle"); *id.* ¶ 107 (Dahl noticed excessive consumption when his oil screen clogged and mechanic informed him his vehicle was low on oil, "although a low oil warning never illuminated").

[16] *See Gauthier v. AMF, Inc.*, 788 F.2d 634, 635-36 (9th Cir. 1986) (because Montana law had adopted Restatement position on warnings, failure to instruct jury on the legal effect of the adequacy of defendant's warnings, if jury were to find they were adequate, was abuse of discretion); *Rodriguez v. JLG Indus.*, 2012 WL 12883784, at *20-21 (C.D. Cal. Aug. 3, 2012) (denying defendant's motion for summary judgment in strict product liability case where jury could reasonably come to either conclusion on whether warnings were adequate).

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124, 149. Plaintiffs' allegations are supplemented by a multitude of consumer complaints alleging a variety of similar problems. *See*, *e.g.*, SAC ¶ 276 (car "started smoking really bad whenever I would start it"); ¶ 278 ("[A]fter turning feels like the throttle goes flat"); ¶ 258 ("Traction control problems, engine reduced power, this problem cripples the vehicle").[17] A number of consumer complaints also allege that their vehicles' operability became impaired.[18]

Defendant argues that the consumer complaints carry little weight because they did not involve Class Vehicles. However, the complaints involve the same alleged problem (overconsumption of oil), the same types of intermediate problems (spark plugs, smoke, etc.), and the same allegedly defective engine (Gen IV Vortec 5300). Although it is plausible the problems experienced by the non-Class Vehicles were caused by something other than the alleged engine defect, it is at least equally plausible that the engine common to all the vehicles was the common cause. *See Starr v. Baca*, 652 F.3d 1202, 1216 (9th Cir. 2011) ("If there are two alternative explanations, one advanced by defendant and the other advanced by plaintiff, both of which are plausible, plaintiff's complaint survives a motion to dismiss under Rule 12(b)(6). Plaintiff's complaint may be dismissed only when defendant's plausible explanation is so convincing that plaintiff's explanation is *implausible*." (emphasis in original)).

Finally, the Court must consider whether this safety risk was "unreasonable" such that the

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[17] *See also* SAC ¶ 33 (spark plug fouling); ¶ 90 (spark plugs); ¶ 101 (spark plug, cam, and lifters failed); ¶ 108 (spark plugs); ¶ 133 (spark plugs); ¶ 155 (spark plugs, rough idle, engine shaking); ¶ 180 (spark plugs and smoke emission); ¶¶ 190-91 (spark plugs and misfiring); ¶ 256 (consumer claims vehicle "would continue to drive sluggish"); ¶ 261 (spark plugs fouled); ¶ 262 (observing "blue smoke when we start [the car]" and "terrible knocking" by the engine); ¶ 264 (noting "more serious symptoms of loud engine tapping and black smoke"); ¶ 268 (smoke coming out of exhaust); ¶ 269 (reporting that car "feels sluggish and seems to miss[fire?] at times but no check engine light"); ¶ 270 ("[e]ngine is making rattle noises"); 271 (reporting bad rings); 272 (reporting "spark plugs burning out or failing sluggish engine clicking noise in engine"); *id.* (stating "truck is running like crap").

[18] *See* SAC ¶ 262 (2007 Chevy Suburban owner states that "[t]he vehicle was miss [sic] firing and running rough, so much so you could not drive it. . . . It turned out to be two plugs fowled [sic] with oil."); ¶ 266 (2008 Chevy Avalanche owner reported "while on the highway, the engine started making a loud banging noise, oil pressure dropped off again, and lights came back on. Had to have it towed to a repair shop on a Saturday"); ¶ 277 (Re 2010 Chevy Crew Cab z71, "[a] fouled no 1 cylinder spark plug left me on the side of the road . . . ."); *See* SAC ¶ 269 (2009 Chevy Tahoe owner stated that "[t]he engine light came on . . . and the car was sluggish at stops. We took it to the dealership right away . . . .").

omission may be considered material even for post-warranty claims, and thus may give rise to a duty to disclose. In considering this question, the Court is mindful that, in *Williams*, the Ninth Circuit rejected a claim that a boat motor experiencing premature corrosion posed an "unreasonable safety hazard" because of the plaintiffs' "own characterization of the defect" as one which "merely accelerates the *normal* and *expected* process of corrosion." *Williams*, 851 F.3d at 1028 (emphasis in original). The Ninth Circuit reasoned that "[w]ere we to conclude that [plaintiffs'] allegations of premature but otherwise normal wear and tear plausibly establish an unreasonable safety hazard, we would effectively open the door to claims that *all* of Yamaha's outboard motors eventually pose an unreasonable safety hazard." *Id.* (emphasis in original). Thus, "the nature of the alleged defect as being primarily one of accelerated timing rather than the manifestation of a wholly abnormal condition weighs against its characterization as 'unreasonable.'" *Id.* Arguably, the consumption of oil is normal and expected, and the excessive consumption of oil is another way of stating that such consumption is simply an accelerated but otherwise normal process.[19]

Williams might appear to stand for the proposition that a claim based on what is essentially premature or accelerated wear-and-tear that is otherwise normal or expected is categorically precluded. Such a broad interpretation, however, would conflict with prior Ninth Circuit precedent. In *Daniel v. Ford Motor Co.*, for example, the plaintiffs alleged that a rear suspension defect caused "premature tire wear," yet the Ninth Circuit held that "[a] reasonable fact finder could infer that a vehicle that experiences premature and more frequent tire wear would pose an unreasonable safety risk . . . ." 806 F.3d 1217, 1226 (9th Cir. 2015). Because *Williams* does not cite or discuss *Daniel*, the Court cannot infer that *Williams* announced a broad rule new rule and

[19] That seems to be the case even though the various defects causing overconsumption are not themselves "normal." For example, the piston rings failed to seal oil in the crankcase to keep it out of the combustion chamber (SAC ¶ 218), the AFM system sprays oil directly into the piston skirts in quantities that the rings cannot control (SAC ¶ 225), and the PCV system is solely intended to circulate fresh air to the engine's combustion chambers but inadvertently vacuums oil from the valvetrain into the combustion chamber too (SAC ¶¶ 229-30). The warning systems do not function normally because they do not inform drivers about insufficient oil levels until *after* engine damage or damage to other components like spark plugs and piston rings have already started to occur. SAC ¶¶ 235-236.

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silently overturned prior precedent.

Regardless of how one might reconcile *Williams* and *Daniel*, the alleged facts in this case present a situation where safety risks, even if due to a gradual (and not sudden) process, may not be discovered in time to prevent harm. Plaintiffs have alleged enough detail to suggest that a reasonable jury on these allegations could conclude the safety risk was unreasonable in light of the inadequate warning system. In light of these allegations, the issue of unreasonableness is a question of fact more appropriately resolved at summary judgment or trial rather than on the pleadings. *See In re MyFord Touch Consumer Litig.*, 46 F.Supp.3d 936, 960 (N.D. Cal. 2014); *Daniel*, 806 F.3d at 1226.

In sum, assuming as the Court must that Plaintiffs' allegations concerning the failure of the warning systems and the severity of the overconsumption defect are true, a jury could conclude there was an unreasonable safety hazard for post-warranty claims, and that there was a material defect for in-warranty claims.

4. Reliance

Defendant also argues that Plaintiffs do not adequately plead reliance because they do not plead with specificity that they reviewed or relied upon GM's advertising materials, such that omission of the material information could have influenced their purchasing decisions. Mot. at 11-12. Plaintiffs instead generally plead that they "relied on the omissions of GM with respect to the quality and reliability of the Class Vehicles" and "would not have purchased or leased" the vehicles "but for" the omissions. *See*, *e.g.*, SAC ¶ 411 (similar allegations are made with respect to the relevant counts).

"An essential element for a fraudulent omission claim is actual reliance." *Daniel*, 806 F.3d at 1225. "To prove reliance on an omission, a plaintiff must show that the defendant's nondisclosure was an immediate cause of the plaintiff's injury-producing conduct." *Id.* One way to do so is "by simply proving that, had the omitted information been disclosed, one would have been aware of it and behaved differently." *Id.* (quotation and citation omitted). Thus, reliance has two components. The first relates to whether one would have behaved differently, which "can be presumed, or at least inferred, when the omission is material." *Id.* (citation omitted); *see also In re*

Tobacco II Cases, 46 Cal.4th 298, 327 (2009) ("[A] presumption, or at least an inference, of reliance arises wherever there is a showing that a misrepresentation was material. A misrepresentation is judged to be 'material' if a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question, and as such materiality is generally a question of fact . . . .") (quotations omitted); *McAdams v. Monier, Inc.*, 182 Cal.App.4th 174, 184 (2010) (failure to disclose information "which would have been material to any reasonable person who purchased" the product permits a presumption of reliance). As explained above, Plaintiffs have demonstrated that the defect was material, so this component of reliance can be inferred at this stage. In any case, Plaintiffs have explicitly pled that they "would not have purchased . . . and/or paid as much for" the vehicles if they had been aware of the omitted information. *See*, *e.g.*, SAC ¶ 411.

The second component of reliance requires showing that Plaintiffs "would have been aware of a disclosure by [the defendant]." *Id.* at 1226. This component of the reliance analysis is different for omission and concealment than affirmative misrepresentation. In an affirmative misrepresentation case, a plaintiff obviously must plead that they in fact viewed or were exposed to the misleading misrepresentation; otherwise, they could not have relied on it. In contrast, the very premise of an omission case is that the plaintiff was never exposed to certain information that should have been disclosed.[20] Thus, the reliance analysis proceeds from a very different starting point. Here, the parties dispute the meaning of this distinction in an omission case. GM argues Plaintiffs must allege what advertisements they viewed to plead reliance; this argument appears to confuse the reliance analysis for affirmative misrepresentation with that for omission. Plaintiffs, on the other hand, argue that they are not required to plead what advertisements they viewed with specificity under Rule 9(b) in an omissions case; while Plaintiffs' argument is correct, the main issue, which Plaintiffs do not quite articulate, is that an omissions case does not necessarily require a plaintiff to have viewed an advertisement at all. Rather, a plaintiff's ultimate burden at trial is to

[20] Indeed, it would hardly make sense to hold that a plaintiff in an omission case must always plead that they viewed an advertisement to satisfy the reliance requirement, because such a categorical rule would overlook the possibility that a defendant who has not engaged in any advertising whatsoever may nevertheless have an obligation to disclose certain information.

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present sufficient evidence to "establish a plausible method of disclosure and to establish that they *would have been aware* of information disclosed using that method." *Id.* at 1227 (emphasis added). For example, in *Daniel*, the plaintiffs met that burden at summary judgment by introducing evidence "that they interacted with and received information from sales representatives at authorized Ford dealerships prior to purchasing their Focuses." *Id.* at 1226. That was sufficient even though "Ford presented evidence that conclusively establishes that Plaintiffs did not view any advertising materials produced by Ford prior to purchase." *Id.* To the extent what advertisements Plaintiffs saw may have some relevance as to what channels of disclosure were available to the Defendant disabuse consumers of the omission, *Daniel* makes clear that the actual viewing of advertisements is not required in an omission case.

In *Daniel*, Ford had argued that the plaintiffs could not simply show that they could have received the information through dealerships, but had to demonstrate that the dealerships were contractually obligated to pass on disclosures from Ford or would have done so voluntarily. The Ninth Circuit disagreed. Rather, it was sufficient "that Ford communicates indirectly through its authorized dealerships," that the plaintiffs "received information about the 'characteristics,' 'benefits,' and 'quality,' of the Ford Focus from Ford's dealerships," that the warranty required plaintiffs "to return to Ford dealerships to perform warranty repairs," and that Ford "circulated its special service messages and technical service bulletins when issues arose with the Focus." *Id.* at 1227. Based on that evidence, the Ninth Circuit held "a reasonable fact finder could conclude that Ford knew that its customers depended at least in part on its authorized dealerships for information about its vehicles and that Ford's authorized dealerships would have disclosed the alleged rear suspension defect to consumers if Ford had required it." *Id.*

The proper focus in an omission case such as this is, therefore, what channels of information customers depend upon and whether the defendant could have taken action to disseminate information through those channels (*e.g.*, by requiring dealerships to disclose it as in *Daniel*). This analysis is consistent with the fact that an omission-based fraud claim is premised on the defendant's affirmative *duty* to disclose. *See*, *e.g.*, *LiMandri*, 52 Cal.App.4th at 337; *Daugherty v. Am. Honda Motor Co*., Inc., 144 Cal.App.4th 824, 838 (2006). A defendant must

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exercise "reasonable care" to bring the information to the plaintiff's attention when under such a duty. *See* Restatement (Second) of Torts § 551, Comment on Subsection (2) (1977) ("If reasonable care is exercised, the fact that the information does not reach the person entitled to it does not subject [the defendant] to liability."); *Hoffman v. 162 North Wolfe LLC*, 228 Cal.App.4th 1178, 1187, n.11 (2014) (noting that "Section 551 of the Restatement Second of Torts has been cited with approval and relied upon by several California courts"). Thus, focus is on whether the Defendant *could have* disclosed the information to Plaintiffs through the exercise of reasonable care, and whether Plaintiffs *would have* received it had Defendant done so. What matters in an omission case under *Daniel* is whether the plaintiff had an *opportunity* to receive and therefore rely on the omitted information, not whether they actually received some other, irrelevant information. Although the actual receipt of some information from a defendant might tend to demonstrate that the plaintiff had an opportunity to receive additional information, it is not necessarily the only way to establish such an opportunity.

Here, the Plaintiffs who purchased their vehicles (both new and used[21]) directly from authorized GM dealerships have adequately pleaded that they had an opportunity to receive the information at the dealerships had it been disclosed to them. Although they have not specifically alleged that they interacted with and received information from sales representatives at the dealerships, it is plausible to infer that they did so (at least at the pleading stage) because it would be highly improbable for a person to walk into a dealership and purchase a vehicle without interacting with a sales representative.

Further, it is fair to treat Plaintiffs' opportunity to receive information from GM's authorized dealerships as an opportunity to receive the information directly from GM because an agency relationship has plausibly been pled. Though Plaintiffs have not explicitly alleged an agency relationship, the complaint includes allegations from which an agency relationship may

[21] Defendant argued that plaintiffs who purchased used vehicles (Bradford, Del Valle, the Doepels, Faulkner, Ware, Ehrke, Warpinski, Sloan, Byrge, and Thacker) failed to allege that they viewed GM marketing materials or had direct contact with GM, but several of them purchased used vehicles from GM dealerships. As explained above, the more relevant question is not whether the vehicle was new or used, but whether it was purchased from an authorized GM dealership or some other entity.

plausibly be inferred. For example, the complaint alleges that GM "instructed" dealerships how to respond to excessive oil complaints. *See* SAC ¶¶ 15, 18. Moreover, the express warranties submitted by Defendant state that "GM requests that the vehicle be returned to the selling dealer for all warranty repairs," and that "[i]f you are unable to return to the selling dealer, contact a GM dealer in the United States or Canada for warranty service." *See, e.g.,* Oxford Decl., Ex. 22 at 1 (Docket No. 48-22) (2010 Chevrolet Limited Warranty).[22] Thus, for pleading purposes, Plaintiffs have adequately alleged an agency relationship between the dealerships and GM. *Cf. In re MyFord Touch*, 46 F.Supp.3d at 956 (holding that "the scope of the agency is a factual one for the jury to resolve, especially as information about Ford's precise relationship with its dealers . . . is largely within Ford's possession, custody or control" and holding that allegations that Ford sent instructions to dealers about how to repair vehicle defect was sufficient at pleading stage). Because Plaintiffs have adequately pled an agency relationship between GM and its authorized dealerships, Plaintiffs' interactions with the dealerships are sufficient under *Daniel* to constitute the opportunity through which they would have received the omitted information from GM had GM undertaken reasonable steps to disseminate it through its dealerships.

However, a small number of Plaintiffs alleged that they purchased vehicles from an entity other than a GM dealership.[23] The inference that effective disclosure would have been made by Defendant cannot be drawn as to those Plaintiffs because it is not clear what relationship, if any, those dealerships had with GM and whether or not they generally passed information from GM on to consumers, as in *Daniel*. The Court acknowledges that Plaintiffs make general allegations concerning GM's advertising campaigns targeting the public, including through brochures, online, television, radio, and print advertisements, annual reports, and so on. *See* SAC ¶¶ 281-302. At least some of those could plausibly have been possible channels for GM to disclose the omitted information. However, Plaintiffs do not allege that they would have received the disclosed

[22] Though the warranty is not attached to the complaint, it may be incorporated by reference.

[23] These are Plaintiffs the Doepels (Toyota dealer, SAC ¶ 76); Ware (Barnes Crossing Hyundai Mazda, SAC ¶ 117); Warpinski (Toyota dealer, SAC ¶ 146); Byrge (Honda dealer, SAC ¶ 168); and Thacker (Ford dealer, SAC ¶ 178).

information if it had been disclosed through those mediums, and the Court cannot draw that inference from the pleadings without more specific allegations as to, *e.g.*, the likelihood that GM's disclosure channels would have found their way through these non-GM entities or the pervasiveness of that advertising or other public dissemination which would have reached consumers. *Compare In re Tobacco II Cases*, 46 Cal.4th 298, 327 (2009) (explaining that where "a plaintiff alleges exposure to a long-term advertising campaign, the plaintiff is not required to plead with an unrealistic degree of specificity that the plaintiff relied on particular advertisements or statements") *with Mazza v. American Honda Motor Co., Inc.*, 666 F.3d 581, 595-96 (9th Cir. 2012) (holding that a presumption of reliance is not justified where "it is likely that many class members were never exposed to the allegedly misleading advertisements, insofar as advertising of the challenged system was very limited," and interpreting *Tobacco II* "in the context of a 'decades-long' tobacco advertising campaign where there was little doubt that almost every class member had been exposed to defendants' misleading statements"). The Court dismisses their claims with leave to amend.

In dismissing those claims with leave to amend, the Court rejects Defendant's argument that Rule 9(b) requires Plaintiffs to allege with specificity in what particular advertisements the omitted information should have been included. Claims based on an omission "can succeed without the same level of specificity required by a normal fraud claim." *Cooper v. Pickett*, 137 F.3d 616, 627 (9th Cir. 1997). As Judge Tigar has observed, "[t]his is because a plaintiff alleging an omission-based fraud will not be able to specify the time, place, and specific content of an omission as would a plaintiff in a false representation claim." *MacDonald v. Ford Motor Co.*, 37 F.Supp.3d 1087, 1096 (N.D. Cal. 2014). In this context, as in *MacDonald*, the "whom" is GM, the "what" is the oil consumption defect, the "when" is prior to the sale of class vehicles, and the "where" is the "various channels of information through which Ford sold Class Vehicles." *Id.* What the non-dealership Plaintiffs are missing is a plausible allegation that they would have received the information if disclosed through those various channels of information.

Defendant relies on *Marolda v. Symantec Corp.*, 672 F.Supp.2d 992 (N.D. Cal. 2009) in arguing to the contrary. In *Marolda*, the plaintiff had identified a particular advertisement as

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misleading or deceptive but failed to include any identifying information about that advertisement or its purported omissions in the complaint. The court held that "[i]n this case" more detail had to be pled about the particular advertisement. *Id.* at 1002.

Virtually every court to consider of *Marolda* where there are claims like the instant case—alleged omission regarding a material safety defect in a vehicle—has rejected its applicability. *See*, *e.g.*, *MacDonald*, 37 F.Supp.3d at 1096 (distinguishing *Marolda* as "dissimilar" because it "concerned an alleged omission within a particular advertisement, which the plaintiff had failed to produce or adequately describe"); *Philips v. Ford Motor Co.*, Case No. 14-CV-02989-LHK, at *12 (N.D. Cal. 2015) (stating that "*Marolda* involved an alleged fraudulent omission within a particular advertisement produced by the defendant" and agreeing its requirements were not appropriate for all cases, siding instead with *MacDonald*); *Velasco v. Chrysler Grp. LLC*, 2014 WL 4187796, at * (C.D. Cal. Aug. 22, 2014) (distinguishing *Marolda* and following *MacDonald* to conclude that reliance met Rule 9(b) requirements despite failure to identify a particular advertisement in undisclosed safety defect automobile case).[24] However, one court, *Parenteau v. GM, LLC*, 2015 WL 1020499, at *7 (C.D. Cal. Mar. 5, 2015), is an outlier case that follows *Marolda* in an omission context, but is inconsistent with the Ninth Circuit's holding in *Daniel* that the focus should be on the defendant's opportunity to disseminate the information to the plaintiff, *not* whether the plaintiff has in fact viewed any advertisements. *See Daniel*, 806 F.3d at 1226 (holding that jury's finding of reliance adequate even though "Ford presented evidence that conclusively establishes that Plaintiffs did not view any advertising materials produced by Ford prior to purchase").

Accordingly, as in *MacDonald*, *Philips*, and *Velasco*, the non-dealership Plaintiffs would likely meet their burden under Rule 9(b) even without specifically identifying a particular

[24] Defendant also relies on *Weaver v. Chrysler Corp.*, 172 F.R.D. 96, 102 (S.D.N.Y. 1997), but that is distinguishable for the same reason as *Marolda*. There, the plaintiffs had alleged "reliance on representations, advertisements and other promotional materials prepared and approved" by the defendant, but "fail[ed] to specify the period during which he read, saw, or heard [those] representations, advertisements and promotional materials." *Id.* In contrast, Plaintiffs here have not failed to be specific about which advertisements they read and relied on because they do not allege that they did so.

advertisement in which the omitted information should have been included, so long as they provide plausible allegations, consistent with *Daniel*, that they would have received the information in some way had Defendant exercised reasonable care.[25] The dealership Plaintiffs have met their burden because the mere fact that they purchased their vehicles from an authorized dealership supports a plausible inference under *Daniel* that they interacted with a sales agent and would have received the material information during the purchase process.

5. Conclusion Regarding Fraud and Consumer Protection Claims

Plaintiffs have adequately pleaded a claim for fraudulent omission. The omission was material for the in-warranty claims because Plaintiffs allege that they would not have purchased the vehicle if they had known, and it is material for the post-warranty claims because it related to an unreasonable safety hazard. The safety hazard is adequately pleaded because there is a sufficient nexus between the alleged defect and the safety risk and because Plaintiffs have adequately supported their allegation with several factual assertions of engine damage and other reliability or operability problems. Most importantly, Plaintiffs have adequately alleged that there was no adequate warning system before potentially catastrophic damage (and therefore safety issues) could arise.

However, only the dealership Plaintiffs have adequately pled reliance at this stage. The non-dealership Plaintiffs have not, for reasons explained above, so the Court **GRANTS** Defendant's motion to dismiss with respect to Plaintiffs the Doepels, Ware, Warpinski, Byrge, and

[25] The other cases cited by Defendant do not require otherwise. In *Asghari v. Volkswagen Grp. Of Am., Inc.*, 42 F.Supp.3d 1306, 1325-26 (C.D. Cal. 2013), another safety defect case involving excessive oil consumption, the court held that Rule 9(b) was satisfied where the "what" was the excessive oil defect, the "why" was selling more vehicles at a higher price and misleading owners to avoid warranty repairs, and the "how" was denying the problem by asserting it was normal upon receiving a complaint. Thus, *Asghari* supports this Court's holding. In *Davidson v. Apple, Inc.*, 2017 WL 976048 (N.D. Cal. Mar. 14, 2017), the alleged omission pertained to defective touchscreens on iPhones. The court rejected the applicability of *Marolda* but found that a Plaintiff's statement that he "purchased an iPhone 6 Plus from a Best Buy store in Illinois" without information about the date of the purchase or the specific store, or any allegation that he was exposed to any information about iPhones whatsoever before making the purchase, failed to satisfy Rule 9(b). *Id. Davidson* did not hold that a plaintiff must plead actual exposure to information, nor did it analyze *Daniel*.

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Thacker with leave to amend.

C. Implied Warranty Claims

Plaintiffs bring claims for breach of the implied warranty of merchantability under the Magnuson-Moss Act (Count 1), California's Song-Beverly Act, § 1791.1 (Count 4), and UCC section 2-314 as enacted in 22 other states (Counts 9, 14, 19, 28, 33, 42, 47, 58, 63, 67, 72, 77, 82, 87, 97, 102, 117, 122, 127, 136). The UCC provides that "a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind" and that "[g]oods to be merchantable must be at least such as . . . are fit for the ordinary purposes for which such goods are used." UCC § 2-314.

Defendant challenges these claims on the basis that (1) Plaintiffs fail to plead the vehicles were not fit for ordinary use because none claim they could not use them; (2) Plaintiffs did not suffer harm or damage to their vehicles within the durational period for implied warranty; (3) lack of privity under New York and Oregon law; (4) non-cognizability of Ohio "implied warranty in tort" under Magnuson-Moss; and (5) failure to provide pre-suit notice. Each is discussed below.

1. Fit For Ordinary Use

To state a claim for breach of the implied warranty of merchantability, a plaintiff must plead that "the product did not possess even the most basic degree of fitness for ordinary use." *Mocek v. Alfa Leisure, Inc.*, 114 Cal.App.4th 402, 406 (2003). Defendant argues that Plaintiffs cannot make that showing because none of them allege they were forced to stop driving their cars or that vehicle operation was drastically undermined. However, whether a defect is so severe that "the cars at issue could not be said to provide safe, reliable transportation" is a question of fact for the jury. *In re MyFord Touch*, 46 F.Supp.3d at 980. In light of the Court's holding above that Plaintiffs have adequately pled an unreasonable safety hazard, including several examples of engine damage, fouled spark plugs, engine misfires, emission of white smoke, and so on, Plaintiffs have created a fact question for the jury regarding the reliability and safety of the vehicles. *Id.*

Defendant's cases do not support the proposition that a vehicle is fit for ordinary use so long as it continues to provide transportation, irrespective of safety concerns. *American Suzuki Motor Corp. v. Sup. Ct.*, cited by Defendant, reversed class certification in a case where plaintiffs

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alleged the vehicle design created an unreasonable risk of vehicle roll-over but failed to allege a single example of such a roll-over, thus leading the court to conclude the alleged risk was "speculative." 37 Cal.App.4th 1291, 1295-96 (1995). Here, the safety risk has been plausibly alleged for purposes of Rule 12(b)(6). Moreover, later California authority has distinguished *American Suzuki* and explicitly "reject[ed] the notion that merely because a vehicle provides transportation from point A to point B, it necessarily does not violate the implied warranty of merchantability. A vehicle that smells, lunches, clanks, and emits smoke over an extended period of time is not fit for its intended purpose." *Isip v. Mercedes-Bens USA, LLC*, 155 Cal.App.4th 19, 27 (2007). Similarly, here, a finder of fact based on the allegations of the SAC could reasonably conclude that vehicles in which spark plugs and lifters fail unexpectedly, white smoke is emitted, or engines become sluggish or suddenly shut down are not fit for ordinary use.[26]

By pleading a material safety-related defect, Plaintiffs have adequately pled that the vehicle was unfit for ordinary use.[27] The Court **DENIES** GM's request to dismiss on this basis.

2. Durational Limit on Implied Warranty Claims

Defendant also argues that Plaintiffs' implied warranty claims fail because none of them allege that the harms they suffered occurred within the one-year warranty period of merchantability. *See* Cal. Civ. Code § 1791.1(c). California appellate courts, however, have held

[26] The other cases cited by Defendant are also distinguishable because they do not involve safety or other defects that impair vehicle operability. *See Avedisian v. Mercedes-Benz USA, LLC*, 43 F.Supp.3d 1071, 1079 (C.D. Cal. 2014) (recognizing that "a defect need not render a vehicle inoperable to establish a breach of implied warranty" so long as the vehicle is "in safe condition and substantially free of defects," and concluding that peeling chrome "did not impact the operability of Plaintiff's vehicle"); *Lee v. Toyota Motor Sales, U.S.A., Inc.*, 992 F.Supp.2d 962, 980 (C.D. Cal. 2014) (no breach of implied warranty where premium automatic braking feature achieved only "negligible" reduction in speed, but vehicle otherwise was fully functional and operator could still brake and no safety risk was shown); *Kent v. Hewlett-Packard Co.*, 2010 U.S. Dist. LEXIS 76818, *12 (N.D. Cal. Jul. 10, 2010) (plaintiffs alleged that computers froze and locked up with frequency due to defect, but failed to state claim for breach of implied warranty where they did "not allege that they have been forced to abandon the use of their computers completely, that the computers freeze multiple times per day, or that they in fact have lost data as a result of the malfunctions," nor "how often [their] computers exhibit the subject problems").

[27] GM also states in a footnote that Count 51 under La. Civ. Code Art. 2524 fails for the same reasons because the statute only requires that "the thing sold must be reasonably fit for its ordinary use." GM does not cite any caselaw suggesting that this standard differs from California law on the breach of implied warranty.

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that this durational limit "does not create a deadline for discovering latent defects or for giving notice to the seller." *Mexia v. Rinker Boat Co., Inc.*, 174 Cal.App.4th 1297, 1301 (2009). Rather, "[i]n the case of a latent defect, a product is rendered unmerchantable, and the warranty of merchantability is breached, by the existence of the unseen defect, not by its subsequent discovery." *Id.* at 1305. Therefore, that the engine damage was not discovered within the one-year period is not determinative because the underlying defect was already allegedly present before the discovery.

Defendant cites *Valencia v. Volkswagen Grp. of Am., Inc.* to argue for a "limited reading" of *Mexia*. 119 F.Supp.3d 1130, 1139-40 (N.D. Cal. 2015) (holding that plaintiffs failed to plead brake defect manifested within one year of purchase, and vaguely alleging that they experienced "symptoms" within one year was insufficient). However, the Ninth Circuit has expressly disapproved of *Valencia*, holding that *Mexia*—as the highest state court authority—"must be followed." *Daniel v. Ford Motor Co.*, 806 F.3d 1217, 1223 (9th Cir. 2015) (reversing district court's grant of summary judgment with respect to late discovery of latent defect). All the other federal district court cases cited by Defendant pre-date *Daniel*.

Thus, Plaintiffs' claims are not barred by failure to specify that the harms manifested within 1 year of purchasing new vehicles or 3 months of purchasing used vehicles. They allege the defect was inherent to the engine design and, therefore, existed at the time of purchase. That is a "latent" defect arising at the time of purchase and cognizable under *Mexia*.

Defendant also cursorily asserts that Plaintiffs "do not allege manifestation within the unspecified implied warranty periods under their States' laws," Mot. at 9, but does not discuss the laws of any state other than California. The question whether those states' laws differ from California's with respect to latent defects is therefore inadequately briefed and waived on this motion. *See*, *e.g.*, *Parrish v. Mabus*, 679 Fed.Appx. 620, 621 (9th Cir. Mar. 9, 2017) ("A bare assertion in a brief with no supporting argument, or an argument made only in passing, is insufficient to avoid waiver.").

The Court **DENIES** Defendant's request to dismiss Plaintiffs' implied warranty claims for failure to assert manifestation of the defect within the limitations period.

3. Privity Under New York and Oregon Law

GM argues that New York and Oregon law require privity of contract as an essential element of an implied warranty claim unless a plaintiff alleges personal injury. *See, e.g.*, *Prue v. Fiber Composites, LLC*, 2012 U.S. Dist. LEXIS 54027, *30-32 (E.D.N.Y. Apr. 17, 2012), citing *Arthur Jaffee Assocs. v. Bilsco Auto Serv.*, 89 A.D.2d 785 (1982); *Davis v. Homasote*, 281 Ore. 383, 386 (1978). GM argues that Plaintiff Vita (New York) and Plaintiff Martell (Oregon) therefore fail to state a claim because they purchased their vehicles from dealers and do not allege personal injuries. *See* SAC ¶¶ 130, 152.

Plaintiffs counter that New York law finds privity where dealerships act as GM's sales agent. *See Gordon v. Ford Motor Co.*, 239 A.D. 2d 156 (N.Y. App. Div. May 6, 1997) (denying motion to dismiss because "privity would exist if the dealerships with which plaintiffs dealt were defendant's sales or leasing agents"). Defendant points out, however, that Plaintiffs fail to allege that the dealership acted as GM's sales agent in the complaint. That is true, but as explained above, Plaintiffs have pleaded sufficient information to permit a plausible inference of such an agency relationship in light of allegations that GM instructed dealers how to respond to excessive oil consumption complaints and its warranty requires presentation to a dealership. *See supra* at 36-37.

Defendant's request to dismiss Plaintiff Vita's implied warranty claim under New York law is **DENIED**.

Plaintiffs also counter that Oregon law permits "a plaintiff within the normal distribution chain [to] recover property damages from a seller with whom he is not in privity based on breach of an implied warranty." *McFadden v. Dryvit Sys., Inc.*, 2004 WL 2278542, at *8 (D. Or. Oct. 8, 2004).[28] However, as Defendant points out, *McFadden* distinguishes property damage and personal injury from mere economic loss. *Id.* Privity is not required for the former, but is required for the latter. *Id.* Plaintiff Martell therefore cannot proceed on a claim for economic loss because of lack of privity. Although he claims that his engine has been damaged, SAC ¶ 155, that

[28] Plaintiffs do not argue that privity exists by virtue of an agency relationship under Oregon law.

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does not appear to be the type of property damage that gives rise to a cognizable claim. *See East River S.S. Corp. v. Transamerica Delaval*, 476 U.S. 858 (1986) ("In the traditional 'property damage' cases, the defective product damages *other* property." (emphasis added)). *See also McFadden*, 2004 WL 2278542, at *6 (plaintiffs were "seeking damages to repair their homes, not simply to replace the defective EIFS [which leaked and trapped water, causing physical damage to their homes]"). Thus, because Plaintiff Martell fails to establish privity or allege cognizable property damage, GM's request to dismiss his implied warranty claim under Oregon law is **GRANTED** with leave to amend only if he can plausibly allege he was in privity with GM.

4. Implied Warranty In Tort

Defendant argues that Ohio Plaintiffs Gulling and Jones' claims for "implied warranty in tort," SAC Count 92 ¶¶ 1241-47, must be dismissed because the Magnuson Moss Warranty Act does not cover such claims.

The Magnuson-Moss Warranty Act, 15 U.S.C. § 2300, *et seq.*, sets forth minimum federal standards for express and implied warranties for consumer products, and creates federal jurisdiction over civil actions premised on violations of those standards or failure to comply with "a written warranty, implied warranty, or service contract," when certain amount-in-controversy thresholds are satisfied. *See* 15 U.S.C. § 2310(d)(1), (d)(3). Plaintiffs do not respond to Defendant's contention that a claim for implied warranty in tort (as opposed to contract) may not proceed under the Magnuson-Moss Warranty Act. Nevertheless, Defendant appears to be correct that a non-contract implied warranty claim may not proceed under Magnuson Moss. *See In re Porsche Cars, N. Am., Inc. Plastic Coolant Tubes Prods. Liab. Litig.*, 880 F.Supp.2d 801, 819-20 (S.D. Ohio 2012) ("Although Ohio courts recognize two forms of implied warranty claims—implied warranty in tort and implied warranty of merchantability (contract)—only the latter can form the basis of a Magnuson-Moss claim."). The Court therefore **GRANTS** GM's request to dismiss Count 92.

Defendant also argues that Plaintiffs Clausen, Harris, Ludington, Shorter, Bednarek, Hanneken, and the Doepels do not bring implied warranty claims under their states' laws, so their Magnuson-Moss claims should be dismissed because they have abandoned express warranty

claims except for purposes of a future appeal in light of the Court's prior ruling regarding express warranty. *See* SAC at 59, n. 40. Plaintiffs do not respond to this request, and Defendant's assertion that these Plaintiffs have not brought a separate implied warranty claim in the SAC is correct. In the absence of either an express or implied warranty claim, Plaintiffs have not identified any other actionable claim under the Magnuson-Moss Warranty Act. *See* 15 U.S.C. § 2310(d) (permitting cause of action only for "a consumer who is damaged by the failure of a supplier, warrantor, or service contractor to comply with any obligation under this chapter, or under a written warranty, implied warranty, or service contract"). The Court therefore **GRANTS** GM's request to dismiss Magnuson-Moss Act claims of Plaintiffs Clausen, Harris, Ludington, Shorter, Bednarek, Hanneken, and the Doepels.

5. UCC § 2-607: Pre-Suit Notice

Defendant argues that seven Plaintiffs' implied warranty claims are barred because they failed to make notice to the seller within a reasonable time after discovering the alleged breach, a necessary step under their states' laws. *See* UCC § 2-607(3). Plaintiff responds that Plaintiff Ludington provided GM with notice on behalf of the class on October 27, 2016, and therefore, sufficient notice has been made. *See* SAC ¶ 303. No case-law is cited by either side regarding the sufficiency of class-wide notice under the laws of the states in question. Although the parties addressed this question in a categorical fashion, the Court analyzes it on a state-by-state basis.

a. Alabama (Ala. Code § 7-2-607) – Plaintiff Brannan

Alabama law requires direct notice from the buyer to the manufacturer where the manufacturer (and not the seller) is being sued. *See Hobbs v. Gen. Motors Corp.*, 134 F.Supp.2d 1277, 1285 (M.D. Ala. 2001); *see also In re MyFord Touch*, 46 F.Supp.3d at 974. Additionally, the filing of a lawsuit does not constitute sufficient notice under Alabama law. *Hobbs*, 134 F.Supp.2d at 1285 (stating that the notice must "precede the filing of the complaint" in cases involving economic harm).

The question therefore is whether Plaintiff Luddington's class-wide notice suffices. Generally speaking, the sufficiency of notice is "tested in light of the facts of the particular case" to determine whether it is "sufficient to inform the seller of the breach and its possible

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ramifications," unless notice is inadequate as a matter of law. *Page v. Camper City and Mobile Home Sales*, 292 Ala. 562, 565 (1974). Class-wide notice provided by a plaintiff in another state likely is insufficient as a matter of law. Courts applying Alabama law have refused, for example, to accept the argument that notice is not required where a manufacturer is already "aware" of alleged defects. *See*, *e.g.*, *Smith v. Apple*, No. 08-AR-1498-S, 2009 WL 3958096, at *1 (N.D. Ala. Nov. 4, 2009) ("[A] general awareness on Apple's part of alleged defects in its iPhone does not extinguish the purpose of the notice requirement, nor does it substitute for that requirement under Alabama law."). The purpose of pre-suit notice under Alabama law is to provide the seller an opportunity to cure the defect or the parties an opportunity to settle. Notice provided by a person in another state that purports to be made on behalf of all purchasers around the country—perhaps numbering in the hundreds of thousands—does not create a meaningful opportunity for the seller to cure or settle. Indeed, how would Plaintiff Ludington's notice have made GM aware that Plaintiff Brannan in particular was experiencing problems with his vehicle?

The Court therefore **GRANTS** GM's request to dismiss Plaintiff Brannan's implied warranty claim for failure to give pre-suit notice under Alabama law.

b. Arkansas (Ark. Code § 4-2-607) – Plaintiff Goodwin

Under Arkansas law, notice is required before suit can be brought for implied warranties. *See Hartness v. Nuclkes*, 475 S.W.3d 558, 563 (Ark. 2015) (notice unreasonable when given for first time in lawsuit). The class-wide notice is insufficient here too. A "[r]easonable notice by [the buyer] would have informed [the seller] exactly how the vehicle failed to live up to [the buyer's] expectations." *Id.* at 563. It "would have given [the seller] an opportunity to cure any defects and would have allowed [it] to mitigate any damages." *Id.* And it would "give[] both parties an opportunity to document the condition of the car once the restoration was complete."

Although "[t]he requirements of notification are not stringent" and "[n]o particular form of notice is required," the notice must still "be sufficient to inform the seller that the transaction is claimed to involve a breach and thus to open the way for negotiation of a normal settlement." *Jarrett v. Panasonic Corp. of N. Am.*, 8 F.Supp.3d 1074, 1083 (E.D. Ar. 2013). Plaintiff Ludington's class-wide notice does nothing to inform GM that Plaintiff Goodwin claims his

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transaction involved a breach. Thus, a reasonable jury could not conclude that notice by a person in another state that does not specifically identify Plaintiff Goodwin or his vehicle afforded GM such an opportunity as guaranteed by Arkansas law. Accordingly, the Court **GRANTS** GM's request to dismiss Plaintiff Goodwin's claim for breach of implied warranty.

c. Georgia (Ga. Stat. § 11-2-607) – Plaintiff Bradford

Georgia law also requires notice before a breach arises, but it does not appear to preclude, as a matter of law, the giving of notice through a lawsuit. *See Wal-Mart Stores, Inc. v. Wheeler*, 262 Ga.App. 607, 609-611 (2003). "[T]he question of reasonableness of notice is ordinarily a factual one[.]" *Great Western Press, Inc. v. Atlanta Film Converting Co.*, 223 Ga.App. 861, 862 (1996). Moreover, Georgia law does not "require a buyer to do a futile and useless thing," so notice is not required when it would be futile. *BDI Distributors, Inc. v. Beaver Computer Corp.*, 232 Ga.App. 316, 317 (1998).

Plaintiffs' allegations are sufficient to create a question of fact whether the failure to provide notice separate from the lawsuit was unreasonable under Georgia law. Plaintiffs also allege that participation in informal mediation would have been futile, and that GM failed to cure the defects or all damage caused when repairs were attempted by consumers, including Plaintiffs. *See*, *e.g.*, SAC ¶¶ 340, 425. Accordingly, because Georgia law does not preclude notice to be given through a lawsuit itself and also permits a plaintiff to file suit when notice would have been futile, the Court **DENIES** GM's motion to dismiss Plaintiff Bradford's warranty claims.

d. Minnesota (Minn. Stat. § 336.2-607) – Plaintiffs Dahl and Peterson

Minnesota law requires notice of a breach, but the "bar for sufficiency is low" as long as the notice lets the seller know about the basis for the claimed breach and a delay does not prejudice the seller. *See City of Wyoming v. Procter & Gamble Co.*, 210 F.Supp.3d 1137, 1157 (D. Minn. 2016) (declining to dismiss claim where plaintiffs failed to provide notice before initiation of lawsuit where no showing of prejudice was made). Moreover, it does not appear that class-wide notice is insufficient per se where there is reason to think the defendant is already aware of similar claims. *Id.* (refusing to dismiss in part because defendant had been "locked in litigation" over the same issue "in courts all across the country" and "it could hardly be said that

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Plaintiffs' complaint was the first time Defendants received notice of the kind and type of claims raised by Plaintiffs"). Rather, notice might be "bootstrap[ed] . . . onto notices given by other persons" if they are "clearly similarly situated." *Drobnak v. Andersen Corp.*, 2008 U.S. Dist. LEXIS 1343, *16-17 (D. Minn. Jan. 8, 2008) (notice was not sufficient because it was not given by similarly situated persons).

Here, Plaintiffs Dahl and Peterson allege the same defect, the same type of legal claim, and the same type of injury as Plaintiff Luddington. Thus, Minnesota law likely permits Plaintiffs Dahl and Peterson to rely on Plaintiff Luddington's notice. Accordingly, the Court **DENIES** GM's motion to dismiss the Minnesota plaintiffs' claims.

e. New York (N.Y. U.C.C. § 2-607(3)(a)) – Plaintiff Vita

New York law does not categorically bar notice to be given through a lawsuit itself. *See Panda Capital Corp. v. Kopo Intern., Inc.*, 242 A.D.2d 690, 692 (1997) (holding that "the complaint and subsequent amended complaint in this action themselves constituted such notice" and that it was "at the very least an issue of fact as to whether reasonably timely notice of breach was given").

Plaintiff Vita does not state when he purchased his vehicle, but states that he purchased it "new" and that it was a 2013 GMC Sierra, so it is reasonable to infer he purchased it in or around 2013. SAC ¶ 130. He was first added to the Second Amended Complaint, filed Aug. 31, 2017. *See* Docket No. 67. Thus, approximately 3.5 years have passed since he purchased the vehicle. It is not clear, however, when he discovered the defect, except that he alleges he "noticed excessive oil consumption when his vehicle had approximately 80,000 miles on the odometer." *See* SAC ¶ 132. Thus, it is plausible that he did not discover the defect until well after his initial purchase. Given the lack of clarity, it is not possible to conclude, as a matter of law on the pleadings, that his notice through the lawsuit was unreasonable. *Compare Tomasino v. Estee Lauder Cos.*, 44 F.Supp.3d 251, 260-61 (E.D.N.Y. 2014) (notice unreasonable as a matter of law when provided 3 years after purchase date where defect related to cosmetic product intended for immediate consumption and cosmetic failed to produce claimed anti-aging effects). Accordingly, Plaintiff

Vita's allegations are sufficient to create a question of fact as to the reasonableness of his notice.[29]

The Court **DENIES** GM's motion to dismiss Plaintiff Vita's implied warranty claim for failure to give timely notice.

f. South Carolina (S.C. Code § 36-2-607) – Plaintiff Sloan

South Carolina appears to follow a lenient standard for notice—"virtually any notification that fairly apprises the seller of the problems will suffice." *U.S. v. So. Contracting of Charleston, Inc.*, 862 F.Supp. 107, 111 (D. S.C. 1994). So long as the buyer communicates that a problem exists, notice is sufficient and there is no need to "assert the intention to make a claim for damages or pursue any other remedy" to fulfill the requirement. *Id.* at 112 (citation and quotation omitted).

Here, Plaintiff Sloan alleges he "has complained about the excessive oil consumption to Nevado Chevrolet," apparently a dealership (but not the one he purchased from). SAC ¶ 165. The parties have not identified, and the Court has not located, South Carolina authority on whether notice to an authorized dealer other than the seller is sufficient, or whether notice to a dealer in lieu of a manufacturer is sufficient where the manufacturer is being sued. In light of the apparently lenient standard, Plaintiff Sloan's complaint to a dealership, GM's express warranty's instructions that problems be reported to a dealer, and Plaintiff Luddington's purported class-wide notice, the Court **DENIES** GM's motion to dismiss Plaintiff Sloan's implied warranty claim at this time.

D. Statutes of Limitation

Defendant raises many arguments regarding whether Plaintiffs' claims have been brought within the applicable statutes of limitation. Each argument is discussed below.

1. Implied Warranty Claims

UCC section 2-725 states that "[a]n action for breach of any contract for sale must be commenced within four years after the cause of action has accrued" and that "[a] cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the

[29] Because the filing of the complaint on Aug. 31, 2017 creates a question of fact, it is unnecessary to reach the question whether Vita may bootstrap off of Luddington's third-party notice under New York law.

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breach." UCC § 2-725. Defendant argues that the cause of action accrued at the time of initial retail sale because Plaintiffs allege an inherent defect, which itself constitutes the breach. *See MacDonald*, 37 F.Supp.3d at 1101-02. Accordingly, GM requests dismissal of 17 plaintiffs who allege a purchase date more than four years prior to the litigation and 10 plaintiffs who did not plead a purchase date.

A threshold issue concerns whether the cause of action accrues as of the time of initial retail sale or the subsequent delivery of a used vehicle. GM is correct that, for purposes of implied warranty claims against the *manufacturer*, the accrual date is the time of initial retail sale, not subsequent re-sale to purchaser of a used vehicle. *See*, *e.g.*, *Lecates v. Hertrich Pontiac Buick Co.*, 515 A.2d 163 (Del. Sup. Ct. 1963) (holding that for purpose of implied warranty claim, cause of action accrues as of original sale date of vehicle, not when used car was purchased). That is the operative date for statute of limitations purposes.

Plaintiffs argue that 10 plaintiffs who did not plead a purchase date should not have their claims dismissed because "[s]tatute of limitations is . . . an affirmative defense that a plaintiff has no obligation to plead around in his or her complaint." *MyFord Touch*, 46 F.Supp.3d at 961. However, this rule only applies when there is no "statute-of-limitations problem apparent from the face of the complaint." *Id.* The model year for certain vehicles that Plaintiffs allege they purchased new may suggest that the four-year limitations period has been exceeded; thus, although a statute of limitations is generally an affirmative defense, it is fair to address it at this time where a problem may be apparent based on Plaintiffs' allegations.

Because this inquiry is fact-specific, it is summarized with respect to each Plaintiff in the chart below. However, as explained below the chart, the doctrine of fraudulent concealment may operate to toll the statute of limitations for those Plaintiffs who failed to file timely claims.

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Implied Warranty – Chart of Statute of Limitations (Before Consideration of Tolling)

Name	Used/New	Initial Purchase	Model	Complaint	Holding
Siquieros (¶ 25)	New	N/A	2011	12/19/16	**UNTIMELY** – Implausible new MY 2011 vehicle purchased after 12/19/12
M/M Cralley (¶ 30)	New	N/A	2010	8/13/17	**UNTIMELY** – Implausible new MY 2011 vehicle purchased after 8/13/12
Brannan (¶ 37)	Used	2011	2011	12/19/16	**UNTIMELY** – Vehicle purchased before 12/19/16.
Goodwin (¶ 40)	New	2010	2010	2/27/17	**UNTIMELY** – Vehicle purchased before 2/27/12.
Perkins (¶ 45)	New	2011	2011	2/27/17	**UNTIMELY** – Vehicle purchased before 2/27/12.
Bradford (¶ 62)	Used	N/A	2010	2/27/17	**UNTIMELY** – Implausible MY 2010 vehicle originally purchased after 2/27/12.
Faulkner (¶ 87)	Used	N/A	2011	12/19/16	**UNTIMELY** – Implausible MY 2010 vehicle originally purchased after 2/19/16.
Smith (¶ 99)	New	2012	2011	2/27/17	**TIMELY** – Face of complaint does not suggest vehicle was purchased before 2/27/12.
Dahl (¶ 105)	New	2010	2010	12/19/16	**UNTIMELY** - Vehicle purchased before 12/19/12.
Molina (¶ 127)	Used	N/A	2012	12/19/16	**TIMELY** – Face of complaint does not suggest MY 2012 vehicle was purchased before 12/19/12.
Warpinski (¶ 146)	Used	N/A	2012	2/27/17	**TIMELY** – Face of complaint does not suggest MY 2012 vehicle was purchased before 2/27/13.
Martell (¶ 152)	New	N/A	2011	8/31/17	**UNTIMELY** – Implausible new MY 2011 vehicle purchased after 8/31/13.
Graziano (¶ 158)	New	2011	2012	12/19/16	**UNTIMELY** – Vehicle purchased before 12/19/12.
Byrge (¶ 168)	Used	N/A	2012	2/27/17	**TIMELY –** Face of complaint does not suggest MY 2012 vehicle purchased before 2/27/13.
Thacker (¶ 178)	Used	N/A	2010	2/27/17	**UNTIMELY** – Implausible new MY 2010 vehicle originally purchased after 2/27/13.
Robertson (¶ 194)	New	2010	2010	2/27/17	**UNTIMELY** – Vehicle purchased before 2/27/13.

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Name	Used/New	Initial Purchase	Model	Complaint	Holding
Del Valle (¶ 67)	Used	N/A	2013	12/19/16	**TIMELY** – Face of complaint does not suggest MY 2013 purchased before 12/19/12.
Olivier (¶ 94)	New	N/A	2013	2/27/17	**TIMELY** – Face of complaint does not suggest MY 2013 vehicle purchased before 2/27/13.
Peterson (¶ 111)	New	12/2012	2012	12/19/16	**UNTIMELY**– Plaintiff Peterson alleges only "December 2012" without specificity, but claim would be untimely if purchased before 12/19/12. In light of problem apparent from face of complaint, Plaintiff should clarify the purchase date.
Ware (¶ 117)	Used	N/A	2013	2/27/17	**TIMELY** – Face of complaint does not suggest MY 2013 vehicle purchased before 2/27/13.
Kitchen (¶ 121)	Used	N/A	2013	2/27/17	**TIMELY** – Face of complaint does not suggest vehicle purchased before 2/27/13.
Vita (¶ 130)	New	N/A	2013	8/31/17	**TIMELY** – Face of complaint does not suggest vehicle purchased before 8/31/13.
Ehrke (¶ 136)	Used	N/A	2013	12/19/16	**TIMELY** – Face of complaint does not suggest vehicle purchased before 12/19/12.
Gulling ¶ 139	N/A	N/A	2013	12/19/16	**TIMELY** – Face of complaint does not suggest vehicle purchased before 12/19/12.
Jones ¶ 142	N/A	N/A	2013	12/19/16	**TIMELY** – Face of complaint does not suggest vehicle purchased before 12/19/12.
Sloan ¶ 163	Used	N/A	2013	12/19/16	**TIMELY** – South Carolina has a 6 year statute of limitations, so vehicle purchased after 12/19/10. *See* S.C. Code Ann. § 36-2-725; *Green v. Bradley Co.*, 194 F.Supp.3d 479, 484 (D.S.C. 2016).

Though claims by Plaintiffs Siquieros, the Cralleys, Brannan, Goodwin, Perkins, Bradford, Faulkner, Dahl, Martell, Graziano, Thacker, Robertson and Peterson appear to be untimely, Plaintiffs argue that all the implied warranty claims are tolled pursuant to the fraudulent concealment doctrine. *See* SAC ¶¶ 308-313. This doctrine applies when a defendant's "own

deception, has caused a claim to become stale and a plaintiff dilatory." *Regents of Univ. of Cal. v. Super. Ct.*, 20 Cal.4th 509, 533 (Cal. 1999).[30] To toll the statute of limitations under the doctrine, a plaintiff must plead "(a) the substantive elements of the fraud, and (b) an excuse for late delivery of the facts." *Sater v. Chrysler Grp., LLC*, 2015 WL 736273, at *9 (C.D. Cal. Feb. 20, 2015) (fraudulent concealment adequately pled where defendant "intentionally kept" plaintiff ignorant of information, "continued to manufacture" product without disclosing defect, and delay in discovery was reasonable at least until vehicle was recalled); *see also Roberts v. Electrolux Home Prods., Inc.*, 2013 WL 7753579, at *8 (C.D. Cal. Mar. 4, 2013) (fraudulent concealment adequately pled where manufacturer failed to disclose material facts about the dryer's defect within its exclusive knowledge and late discovery was excused by such exclusive knowledge).

Plaintiffs sufficiently plead fraudulent concealment. As explained above, they adequately allege that Defendant knew about the defect by the beginning of the Class Period, as demonstrated in part by the issuance of two TSBs to dealers specifically identifying two components allegedly contributing to the overall defect. Additionally, Plaintiffs allege that several different dealerships informed separate individuals across the span of several years that the oil consumption was "normal." Though Defendant points out these were statements by the dealer and not necessarily the manufacturer, Plaintiffs have adequately pled an agency relationship as explained above to create a question of fact for discovery. Additionally, Defendant continued to sell the allegedly defective engines without any disclosure. It is plausible that Plaintiffs' delayed discovery, in the absence of any manufacturer recall and given the active concealment by Defendant of the alleged defect, was reasonable.

The Court therefore holds that the statute of limitations for the otherwise untimely claims has been tolled (for purposes of Rule 12(b)(6)) under the doctrine of fraudulent concealment. Defendant's motion to dismiss the implied warranty claims on statute of limitations grounds is thus **DENIED**.

[30] Defendant has not challenged cases cited by Plaintiffs to demonstrate that the doctrine is recognized under the laws of other states as well. *See* Opp. at 19, n. 15.

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2. Consumer Protection Claims

Defendant challenges the consumer protection claims as untimely. GM's arguments fall into three categories: (1) some Plaintiffs' states do not recognize the discovery rule; (2) some do, but the conditions for invoking the rule are inadequately pleaded; and (3) some Plaintiffs do not satisfy other conditions for the statute of limitations. Each argument is discussed below.

a. No Discovery Rule States

Louisiana (Olivier): Louisiana does not recognize the discovery rule for claims under the Louisiana Unfair Trade Practices Act, La. Rev. State. § 51:1401, *et seq*. *See Morris v. Sears, Roebuck & co.*, 765 So. 2d 419, 422 (La. App. 2000) ("Any claims that plaintiffs may have had under the LUPTA ceased one year after they came into existence without regard to plaintiffs' knowledge of or ability to act on the alleged cause of action."). Plaintiffs maintain that the statute of limitations cannot run, however, "until a continuing violation ceases." *CheckPoint Fluidic Sys. Int'l, Ltd. v. Guccione*, 888 F.Supp.2d 780 (E.D. La. 2012). However, Defendant correctly points out that *CheckPoint* applied the continuing violation rule reluctantly under binding Fifth Circuit precedent, but pointed out that more recent Louisiana appellate authority had held that the continuing violation doctrine does not apply to LUTPA claims. *See CheckPoint*, 888 F.Supp.2d at 792 ("Although this Court concludes that the better view of Louisiana statutory law and jurisprudence is that the continuing violation doctrine does not apply under LUTPA, if La. R.S. 51:1409(E) is preemptive, the Louisiana Supreme Court has not ruled squarely on the issue, and the Fifth Circuit's opinion to the contrary has not been overruled."). Because this Court is not bound by the Fifth Circuit, it will follow more recent Louisiana appellate authority as the highest state authority on the issue. *See Glod v. Baker*, 899 So.2d 642, 646-49 (La. Ct. App. 2005) (holding that LUTPA is a peremptive statute because it creates a right and specifies the time in which the right must be exercised, so the continuing violation doctrine does not apply). Further, Plaintiffs have not argued or identified, and the Court has not located, a case that permits the LUTPA statute of limitations to be tolled by the defendant's fraudulent concealment. GM's request to dismiss Plaintiff Olivier's LUTPA claim is therefore **GRANTED** because he purchased a new 2013 GMC Sierra and did not bring a cause of action until February 28, 2017, after the one-

year statute of limitations.

Florida (Shorter and Luddington): Florida does not recognize the discovery rule under the Florida Deceptive and Unfair Trade Practices Act, Fla. Stat. § 502.201, *et seq.*, either. *See Yusuf Mohamed Excavation v. Ringhaver Equip. Co.*, 793 So. 2d 1127, 1128 (Fla. App. 2001) (holding that the "delayed discovery" rule does not apply to FDUTPA and that the four-year statute of limitations applies). However, the doctrine of fraudulent concealment, discussed above, can toll FDUTPA claims. *In re Takata Airbag Prods. Liab. Litig.*, 193 F.Supp.3d 1324, 1344, 1346 (S.D. Fla. 2016). Thus, the Court **DENIES** GM's motion to dismiss Plaintiff Shorter and Ludington's consumer protection claims.[31]

Kansas (Madison): Kansas does not recognize the discovery rule, so the three year statute of limitations applies. *See* Kan. Stat. § 50-623 *et seq.*; Kan. Stat. § 60-512; *Louisburg Bldg. & Dev. Co. v. Albright*, 252 P.3d 597, 607 (Kan. App. 2011), *aff'd in pertinent part* 393 Kan. 1107 (2012) (three-year limitations period "starts running with the occurrence of the alleged conduct constituting the violation, not the discovery of the violations"). However, Kansas recognizes the doctrine of fraudulent concealment. *See Freebird, Inc. v. Merit Energy Co.*, 883 F.Supp.2d 1026, 1034-36 (D. Kans. 2012). The Court thus **DENIES** GM's motion to dismiss Plaintiff Madison's consumer protection claim.[32]

New York (Vita): Similarly, claims under the New York General Business Law, § 349 are not "dependent upon any date when discovery of the alleged deceptive practice is said to occur." *Marshall v. Hyundai Motor Am.*, 51 F.Supp.3d 451, 461-62 (S.D.N.Y. 2014). However, New York permits tolling of these claims by the doctrine of fraudulent concealment. *See State ex rel. Spitzer v. Daicel Chemical Industries, Ltd.*, 42 A.D.3d 301, 303 (N.Y. Sup. Ct. 2007). The Court **DENIES** GM's motion to dismiss Plaintiff Vita's consumer protection claim.[33]

[31] Plaintiff Shorter bought a new 2011 Chevrolet Silverado but did not file a claim until December 19, 2016. Plaintiff Ludington bought a used 2010 Chevrolet Tahoe in 2012 but did not assert a claim until December 19, 2016. No date of discovery is alleged.

[32] Plaintiff Madison purchased a vehicle in December 2013 but did not make a claim until February 28, 2017.

[33] Plaintiff Vita bought a new 2013 GMC Sierra but did not assert a claim until August 31, 2017.

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Ohio (Jones and Gulling): Similarly, under Ohio law, "the statute of limitations begins to run when the violation occurs, not when the consumer discovers the violation." *Quetot v. M&M Homes, Inc.*, 2013 Ohio 752, ¶ 12 (Ohio App. 2013); *see also* Ohio Rev. Code § 1345.01 (Ohio Consumer Sales Practices Act); Ohio Rev. Code § 1345.10(C) (providing for two-year statute of limitations). However, Ohio also recognizes the doctrine of fraudulent concealment. *See Thornton v. State Farm Mut. Auto. Ins. Co.*, 2006 WL 3359448, at *6-7 (N.D. Ohio Nov. 17, 2006). Thus, the Court **DENIES** GM's motion to dismiss Plaintiff Jones and Gulling's consumer protection claims.[34]

Wisconsin (Bednarek): Wisconsin law provides for a three-year statute of limitations, also not dependent upon the date of discovery. *See* Wis. Stat. § 100.18(11)(b)(3); *Selzer v. Brusnell Bros*., 652 N.W.2d 806, 815 (Wis. App. 2002). However, under Wisconsin law the statute of limitations is tolled in the case of a continuing violation. *See Werner v. Pittway Corp.*, 90 F.Supp.2d 1018, 1033-34 (W.D. Wis. 2000) (plaintiff alleging misleading advertisements failed to state continuing violation where they did not "demonstrate that they received one of defendants' allegedly misleading statements" and "relied" on it). Plaintiff Bednarek bought his vehicle in 2010 and did not file a claim until February 2017; however, because Plaintiffs allege that Defendant's concealment of the defect has continued to the present, the Court **DENIES** the request to dismiss Plaintiff Bednarek's consumer protection claim.

To summarize, the Court **GRANTS** the request to dismiss Plaintiff Olivier's consumer protection claim under Louisiana law because tolling is not permitted, but **DENIES** the request to dismiss the claims of Plaintiffs Shorter and Luddington (Florida), Madison (Kansas), Vita (New York), Jones and Gulling (Ohio), and Bednarek (Wisconsin) because the fraudulent concealment or continuing violation doctrine tolls their claims.

b. Inadequate Pleading for Discovery Rule

Defendant argues that six plaintiffs fail to allege the time of discovery or that reasonable diligence would not have permitted earlier discovery, as required. *See Gerstle v. Am. Honda*

[34] Plaintiffs Jones and Gulling bought 2013 Silverados but did not assert claims until over two years later, on December 19, 2016.

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Motor Co., 2017 U.S. Dist. LEXIS 62809, at *19 (N.D. Cal. Apr. 17, 2017) (plaintiffs are required to "plead facts which show (1) the time and manner of discovery and (2) the inability to have made earlier discovery despite reasonable diligence"). "The burden of pleading and proving belated discovery of a cause of action falls on the plaintiff." *Investors Equity Life Holding Co. v. Schmidt*, 195 Cal.App.4th 1519, 1533 (2011). Plaintiffs must show they acted "reasonably and diligently" to benefit from the discovery rule. *Gerstle*, 2017 U.S. Dist. LEXIS 62809 at *21.

Plaintiffs claim they may invoke the discovery rule because their complaint alleges generally that "Plaintiffs could not have discovered through the exercise of reasonable diligence that their Class Vehicles were defective within the time period of any applicable statutes of limitation," SAC ¶ 306, and that they "could [not] have known that the Class Vehicles are equipped with Generation IV Vortek 5300 Engines with the Oil Consumption Defect," SAC ¶ 307. These bare and conclusory allegations are insufficient for the Court to determine "the time and the manner by which each plaintiff discovered the defect." *Gerstle*, 2017 U.S. Dist. LEXIS 62809 at *21. Plaintiffs have not argued or cited cases indicating that these claims may be tolled by the doctrine of fraudulent concealment. Accordingly, the Court **GRANTS** Defendant's request to dismiss the consumer protection claims of Plaintiffs Goodwin (Arkansas), Bradford (Georgia), Hanneken (Illinois), Smith (Massachusetts), Sanchez (Texas), and Thacker (Virginia). These plaintiffs shall have leave to amend to attempt to satisfy the requirements of the discovery rule.

c. Other Conditions Under Delaware & Louisiana Law

GM contends that Plaintiff Perkins (Delaware) does not allege if or when he complained to a GM dealer about excessive oil consumption, a complaint which would have started running the three-year limitations period under 10 Del. Code § 8106. *See Stenta v. GMC*, 2009 Del. Super. LEXIS 199, *20-23 (Del. Super. May 29, 2009). However, because the statute of limitations is an affirmative defense and no problem is apparent from the face of the complaint, Plaintiff Perkins is not required to affirmatively plead when he first made a complaint that would have accrued his cause of action. Accordingly, the Court **DENIES** GM's request to dismiss Plaintiff Perkins' claim at this time.

Louisiana law recognizes a civil action for a breach of warranty against redhibitory

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defects; "a defect is redhibitory when it renders the thing useless, or its use so inconvenient that it must be presumed that a buyer would not have bought the thing had he known of the defect. The existence of such a defect gives a buyer the right to obtain rescission of the sale." *See* La. Civ. Code Art. 2520. A defect is also redhibitory "when, without rendering the thing totally useless, it diminishes its usefulness or its value so that it must be presumed that a buyer would still have bought it but for a lesser price," in which case the remedy is limited to "a reduction of the price." *Id.* However, Louisiana law requires a claim for breach of warranty against redhibitory defects to be made within one year of the buyer's discovery of the defect or four years after delivery to the buyer, whichever occurs first. *See* La. Civ. Code Art. 2534. As discussed above in the context of the implied warranty claim, Plaintiff Olivier's claim should not be dismissed on the basis of the four-year statute of limitations because the complaint does not indicate that he is outside of it. Thus, it may only be dismissed if he discovered the defect more than one year before filing the complaint. There is no indication in the complaint that he discovered the defect more than one year before filing suit, and because statute of limitations is an affirmative defense, Plaintiff Olivier was not required to plead around it. Accordingly, the Court **DENIES** GM's request to dismiss Plaintiff Olivier's redhibitory defects claim under Louisiana law.

E. Unjust Enrichment Claims

Defendant principally argues that Plaintiffs have failed to state a claim for unjust enrichment because restitution is a remedy, not a cause of action; thus, because Plaintiffs have failed to state any viable causes of action, they no longer have a basis to seek an unjust enrichment remedy. However, in light of the Court's holding denying GM's request to dismiss the consumer protection and fraud claims, it does not follow that the remedy is no longer available to them and should be dismissed. Moreover, as Plaintiffs point out, the Ninth Circuit has held that "[w]hen a plaintiff alleges unjust enrichment, a court may 'construe the cause of action as a quasi-contract claim seeking restitution.'" *Astiana v. Hain Celestial Grp., Inc.*, 783 F.3d 753, 762 (9th Cir. 2015). Thus, that restitution may be a remedy is not a basis for dismissing the unjust enrichment claims, and Defendant has not argued that a quasi-contract claim seeking restitution is insufficiently pled or precluded as a matter of law. The Court declines to dismiss on this basis.

Defendant also argues that 22 plaintiffs' claims are barred by the applicable statute of limitations for unjust enrichment in their state. Plaintiffs do not dispute Defendant's representations regarding each state's statute of limitations except for Alabama and New York (discussed in footnotes), *see* Mot. at 23, nn. 12, 13, 14, but argue that the claims are tolled by virtue of the delayed discovery rule or fraudulent concealment. For the same reasons as above, however, Plaintiffs have failed to adequately plead tolling under the delayed discovery rule. They have, however, adequately pleaded fraudulent concealment.

The table below summarizes the Court's holding with respect to each Plaintiff based on the foregoing.

Statutes of Limitation for Unjust Enrichment Claims

Plaintiff	Purchase Date	Limitations Period	Filing Date	Tolling Permitted?	Holding on Motion to Dismiss
Siqueiros (¶ 25)	New MY 2011	3 years (CA)	12/19/16	Discovery rule	**GRANT**
M/M Cralley (¶ 30)	New MY 2010	3 years (CA)	8/31/17	Discovery rule	**GRANT**
Brannan (¶ 37)	2011	6 years (AL)[35]	12/19/16		**DENY** – not clear that claim was not brought within 6 years
Goodwin (¶ 40)	2010	3 years (AR)	2/27/17	Fraudulent concealment	**DENY**
Perkins (¶ 45)	2011	3 years (DE)	2/27/17	Fraudulent concealment	**DENY**
Ludington (¶ 50)	2012	4 years (FL)	12/19/16	Delayed discovery	**GRANT**
Shorter (¶ 56)	New MY 2011	4 years (FL)	12/19/16	Delayed discovery	**GRANT**

[35] Plaintiffs and Defendant cite the same Alabama case, but disagree whether a two or six year statute of limitations period applies. The distinction turns on whether the unjust enrichment claim sounds in tort (2 years) or contract (6 years). *See Auburn Univ. v. IBM Corp.*, 716 F.Supp.2d 1114, 1118 (M.D. Ala. 2010). Here, Plaintiff Brannan's unjust enrichment claim arises from GM's alleged "selling and leasing at an unjust profit defective Class Vehicles that had artificially inflated prices due to GM's concealment of the Oil Consumption Defect." SAC ¶ 447 (Count 11). This claim may sound in either tort (fraud) or contract (implied and express warranty). At this stage and in the absence of authorities to the contrary, the Court relies on the 6-year statute of limitations at this stage.

United States District Court
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Plaintiff	Purchase Date	Limitations Period	Filing Date	Tolling Permitted?	Holding on Motion to Dismiss
Hanneken (¶ 71)	2011	5 years (IL)	2/27/17	Delayed discovery	**GRANT**
Madison (¶ 82)	2013	3 years (KS)	2/27/17	Delayed discovery	**GRANT**
Smith (¶ 99)	2012	3 years (MA)	2/27/17	Delayed discovery	**GRANT**
Dahl (¶ 105)	2010	6 years (MN)	12/19/16	Fraudulent concealment	**DENY**
Molina (¶82)	Used MY 2012	4 years (NM)	12/19/16	Delayed discovery	**GRANT**
Vita (¶ 130)	New MY 2013	6 years (NY)[36]	8/31/17	Delayed discovery	**DENY** – 6 year SOL applies, not 3 years
Warpinski (¶ 146)	2014	2 years (OK)	2/27/17	Delayed discovery	**GRANT**
Martell (¶ 152)	2011	2 years (OR)	8/31/17	Delayed discovery	**GRANT**
Graziano (¶ 158)	2011	4 years (PA)	12/19/16	Delayed discovery	**GRANT**
Sanchez (¶ 172)	2013	2 years (TX)	2/27/17	Delayed discovery	**GRANT**
Clausen (¶ 183)	2013	3 years (WA)	2/27/17	Delayed discovery	**GRANT**
Harris (¶ 189)	2012	3 years (WA)	8/31/17	Delayed discovery	**GRANT**
Robertson (¶ 194)	2010	5 years (WV)	2/27/17	Delayed discovery	**GRANT**
Bednarek (¶ 199)	2010	6 years (WI)	2/27/17	Delayed discovery	**GRANT**

IV. CONCLUSION

In sum, the Court:

- **DENIES** Defendant's motion to dismiss claims by the out-of-state plaintiffs for

[36] Defendant maintains that unjust enrichment claims based on tortious conduct are subject to a three-year limitations period rather than six under New York law. *See Maya NY, LLC v. Hagler*, 106 A.D.3d 583, 585 (2013). *Maya*, in fact, does not make that statement, but rather, as Plaintiffs point out, explains that "[u]nder New York law, there is no identified statute of limitations period within which to bring a claim for unjust enrichment, but where, as here, the unjust enrichment and breach of contract claims are based upon the same facts and pleaded in the alternative, a six-year statute of limitations applies." *Id.* at 585. Defendant does not contest that statement. Accordingly, the Court follows New York law's six-year general statute of limitations. *See* N.Y. C.P.L. § 213(2) (for actions based "upon a contractual obligation or liability") and § 213(8) (for actions "based upon fraud").

lack of personal jurisdiction because the challenge is waived with respect to the original named plaintiffs and the exercise of personal jurisdiction over the new named plaintiffs' claims is permitted under the pendent personal jurisdiction doctrine;

- **DENIES** Defendant's motion to dismiss the fraud and consumer protection claims because Plaintiffs have adequately pled materiality, pre-sale knowledge, and reliance, except with respect to the non-dealership Plaintiffs the Doepels, Ware, Warpinski, Byrge, and Thacker, for whom GM's motion is **GRANTED**, with leave to amend;
- **GRANTS** Defendant's request to dismiss the consumer protection claims on statute of limitations grounds as follows:
  - Where tolling is unavailable under the relevant state law (Plaintiff Olivier);
  - Delayed discovery rule tolling is available but inadequately pled (Plaintiffs Goodwin, Bradford, Hanneken, Smith, Sanchez, and Thacker), with leave to amend;
- **DENIES** Defendant's request to dismiss consumer protection claims on statute of limitations grounds because tolling is available for Plaintiffs Shorter, Luddington, Madison, Vita, Jones, Gulling, and Bednarek.
- **DENIES** Defendant's request to dismiss the implied warranty claims for Plaintiffs Smith, Molina, Warpinski, Byrge, Del Valle, Olivier, Peterson, Ware, Kitchen, Vita, Ehrke, Gulling, Jones, and Sloan because the face of the complaint does not demonstrate their claims are time-barred;
- **DENIES** Defendant's request to dismiss the implied warranty claims for Plaintiffs Siquieros, the Cralleys, Brannan, Goodwin, Perkins, Bradford, Faulkner, Dahl, Martell, Graziano, Thacker, Robertson because, although they failed to bring their claims within the applicable limitations period, their claims may be tolled by the fraudulent concealment doctrine;
- **GRANTS** Defendant's request to dismiss the implied and express warranty claims of Plaintiff Martell (Oregon), with leave to amend, because Oregon law requires privity, which has not been demonstrated;
- **GRANTS** Defendant's request to dismiss the Magnuson Moss Warranty Act

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claims of:

- Plaintiffs Clausen, Harris, Ludington, Shorter, Bednarek, Hanneken, and the Doepels because they do not bring implied warranty claims, and the express warranty claims are pled only to preserve them on appeal, having been previously dismissed by the Court;
- Plaintiffs Gulling and Jones' claims for "implied warranty in tort" under Ohio law;

- **GRANTS** Defendant's request to dismiss claims of Plaintiffs Brannan and Goodwin for failure to give pre-suit notice, but **DENIES** the request for Plaintiffs Bradford, Dahl, Peterson, Vita, Sloan, due to the variations in state law discussed above;
- **GRANTS** Defendant's request to dismiss unjust enrichment claims as time-barred, with leave to amend, because Plaintiffs Siquieros, the Cralleys, Ludington, Shorter, Hanneken, Madison, Smith, Molina, Warpinski, Martell, Graziano, Sanchez, Clausen, Harris, Robertson, and Bednarek fail to adequately plead delayed discovery;
- **DENIES** Defendant's request to dismiss the unjust enrichment claims on statute of limitations grounds for Plaintiffs Brannan and Vita because the claims are brought within the statute of limitations, and for Plaintiffs Goodwin, Perkins, and Dah because tolling is permitted and adequately pleaded under the fraudulent concealment doctrine.

This order disposes of Docket No. 70. Consistent with this order, Plaintiffs may file an amended complaint within 30 days.

IT IS SO ORDERED.

Dated: February 7, 2018

EDWARD M. CHEN
United States District Judge

NOTES

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Sanchez v. Launch Technical Workforce Solutions, LLC, 297 F.Supp.3d 1360, No. 1:17-CV-01904-ELR (N.D. Ga. Feb. 14, 2018)

Submitted by:
Amy E. Keller

DiCello Levitt & Casey LLC

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297 F.Supp.3d 1360
United States District Court, N.D. Georgia, Atlanta Division.

David SANCHEZ, on behalf of himself and all others similarly situated, Plaintiff,
v.
LAUNCH TECHNICAL WORKFORCE SOLUTIONS, LLC, Defendant.

1:17–CV–01904–ELR
|
Signed 02/14/2018

Synopsis
Background: Unsuccessful job applicant brought putative class action against prospective employer for violation of Fair Credit Reporting Act (FCRA) based on employer's withdrawal of conditional employment offer before providing FCRA summary of rights or copy of consumer report that falsely stated that applicant had criminal record. Employer, which was a non-resident of forum state, moved to dismiss complaint as to class members who also were not residents of forum state.

The District Court, Eleanor L. Ross, J., adopted the opinion of Alan J. Baverman, United States Magistrate Judge, and held that due-process did not preclude district court's exercise of personal jurisdiction over employer with regard to claims of non-resident class members.

Motion denied.

Attorneys and Law Firms

***1361** Andrew Weiner, Jeffrey Sand, The Weiner Law Firm, LLC, Atlanta, GA, Matthew Wessler, Gupta Wessler, PLLC, Washington, DC, for Plaintiff.

Laura M. Davis, Scott M. Paler, DeWitt, Ross & Stevens, S.C., Madison, WI, John R. Hunt, Stokes Wagner, ALC, Brenton Sewell Bean, Freeman Mathis & Gary, LLP, Atlanta, GA, for Defendant.

ORDER

Eleanor L. Ross, United States District Judge

This case is before the Court on Magistrate Judge Alan J. Baverman's Non–Final Report and Recommendation ("R & R"). The Court "may accept, reject, or modify, in whole or in part, the findings or recommendations made by the magistrate judge." 28 U.S.C. § 636(b)(1); FED. R. CIV. P. 72(b)(3). No objections to the Magistrate Judge's R & R have been filed, and therefore, the Court has reviewed the R & R for clear error. See ***1362** Thomas v. Arn, 474 U.S. 140, 154, 106 S.Ct. 466, 88 L.Ed.2d 435 (1985); Macort v. Prem, Inc., 208 Fed.Appx. 781, 784 (11th Cir. 2006); Tauber v. Barnhart, 438 F.Supp.2d 1366, 1373 (N.D. Ga. 2006). The Court finds no error in the R & R.

Accordingly, the Court **ADOPTS** the R & R [Doc. 41] as the opinion of this Court. For the reasons stated in the R & R, the Court **DENIES** Defendant's Partial Motion to Dismiss as to Non–Resident Class Members [Doc. 16].

SO ORDERED, this 14th day of February, 2018.

UNITED STATES MAGISTRATE JUDGE'S NON–FINAL REPORT AND RECOMMENDATION

ALAN J. BAVERMAN, UNITED STATES MAGISTRATE JUDGE

This matter is presently before the Court on a partial motion to dismiss the complaint as to non-resident class members, [Doc. 16], filed by Defendant Launch Technical Workforce Solutions, LLC ("Launch"), pursuant to Rule 12(b)(2) of the Federal Rules of Civil Procedure. For the reasons set forth below, the undersigned **RECOMMENDS** that the motion, [Doc. 16], be **DENIED**.

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I. Background

In the complaint, Plaintiff, on behalf of himself and all others similarly situated, asserts a claim against Launch for violations of the Fair Credit Reporting Act ("FCRA"), 15 U.S.C. § 1681, *et seq.* [Doc. 1 at ¶¶ 1, 106–10 (Fourth Claim for Relief)]. He alleges that Launch made him a conditional offer of employment, pending the successful completion of a background check; ordered a consumer report in conjunction with the background check; received a consumer report falsely stating that Plaintiff had a criminal record; and, without providing Plaintiff a copy of the report or a written description of his FCRA rights, withdrew the offer of employment. [*Id.* ¶¶ 6, 9, 25–69, 106–10]. He contends that "Launch typically does not provide job applicants or employees with a copy of their consumer report or a copy of their rights under the FCRA before taking adverse employment action against them based on information in such reports," [*id.* ¶ 65], and he therefore seeks to assert a claim under 15 U.S.C. § 1681b(b)(3)[1] on his own behalf and on behalf of

> All employees or prospective employees of Launch in the United States (including all territories and political subdivisions of the United States) who were the subject of a consumer report procured by Launch (or that Launch caused to be procured), which contained any negative (derogatory) information about them, and for whom Launch failed to provide that employee or prospective employee with a copy of their consumer report and/or FCRA summary of rights before Launch took adverse employment action against them, within the period prescribed by the FCRA, 15 U.S.C. § 1681p, prior to filing this action.

[*Id.* ¶ 70].

1 Section 1681b(b)(3) provides, in relevant part, that

> in using a consumer report for employment purposes, before taking any adverse action based in whole or in part on the report, the person intending to take such adverse action shall provide to the consumer to whom the report relates—
>
> (i) a copy of the report; and
>
> (ii) a description in writing of the rights of the consumer under this subchapter, as prescribed by the Bureau under section 1681g(c)(3) of this title.

15 U.S.C. § 1681b(b)(3).

On August 7, 2017, Launch filed a partial motion to dismiss the complaint as to the members of the plaintiff class that are not Georgia residents, arguing that the ***1363** Court cannot exercise personal jurisdiction over non-resident claims.[2] [Doc. 16]. On September 5, 2017, Plaintiff filed a response brief in opposition to the partial motion to dismiss, [Doc. 29], and on September 27, 2017, Launch filed a reply brief in support of its motion, [Doc. 34]. On October 30, 2017, and December 21, 2017, Plaintiff filed notices of supplemental authority in support of his opposition to Launch's partial motion to dismiss, [Docs. 38, 40].[3] With briefing complete, the undersigned now considers the motion.

2 The deadline for Plaintiff to file a motion for class certification is stayed until after the Court's ruling on this partial motion to dismiss. [Doc. 23]. Although there has been no class certification, the Court will, for simplicity's sake, hereinafter refer to the members of the proposed plaintiff class as "the plaintiff class."

3 Launch has not opposed Plaintiff's filing of the supplemental authority, (*see* Dkt.), and the filing of persuasive authority issued after briefing is, of course, a well-established practice that is helpful to the Court, *Hornor, Townsend, & Kent, Inc. v. Hamilton*, No. Civ. A. 1:01 CV 2979 J, 2004 WL 2284503, at *11 (N.D. Ga. Sept. 30, 2004) (Carnes, J.). This is especially true in a case such as this that presents a dispute over the interpretation and application of a recent opinion of the United States Supreme Court. [*See* Doc. 16]. The Court therefore accepts and has considered Plaintiff's proffer of supplemental authority, [Docs. 38, 40].

II. Discussion

Launch moves to dismiss the claims of the non-Georgia class members, arguing that *Bristol–Myers Squibb Co. v. Superior Court of Cal., San Francisco Cnty.*, —— U.S. ——, 137 S.Ct. 1773, 198 L.Ed.2d 395 (2017), bars their claims. [Doc. 16 at 1–2]. Plaintiff argues that *Bristol–Myers* does not apply to bar the claims because *Bristol–Myers* concerned a mass action asserting state claims in state court and is therefore inapposite to the federal class-action claims asserted here in federal court. [Doc. 29 at 2–3]. In reply, Launch concedes that

Bristol–Myers is not on all fours with this case and does not dictate the outcome of its motion, but it contends that under the logic of *Bristol–Myers*, principles of due process preclude the assertion of a nationwide class action in any state other than a state where Launch is subject to general personal jurisdiction. [Doc. 34 at 1, 2, 11].

Bristol–Myers concerned a Fourteenth Amendment due-process challenge to claims asserted by non-Californian plaintiffs in a mass civil action filed against Bristol–Myers Squibb Company in a California state court for injuries allegedly caused by a drug called Plavix. *Bristol–Myers Squibb Co.*, 137 S.Ct. at 1777–79, 1787, 1789. Bristol–Myers Squibb, a citizen of Delaware and New York, challenged the California Supreme Court's application of a "sliding scale approach to specific jurisdiction"[4] under which it held that although general jurisdiction was lacking in California; Bristol–Myers Squibb did not develop Plavix in California, create a marketing strategy for Plavix in California, manufacture, label, or package Plavix in California, or work on the regulatory approval of Plavix in California; and the non-resident plaintiffs did not allege that they obtained Plavix through California physicians or ***1364** other California sources, were injured by Plavix in California, or were treated for their injuries in California, the California state court could nevertheless exercise personal jurisdiction over Bristol–Myers Squibb as to the claims of the non-resident plaintiffs as well as the resident plaintiffs because the company's " 'extensive contacts with California' permitted the exercise of specific jurisdiction 'based on a less direct connection between [Bristol–Myers Squibb's] forum activities and plaintiffs' claims than might otherwise be required.' " *Id.* at 1778–79 (quoting *Bristol–Myers Squibb Co. v. Superior Court of Cal., San Francisco Cnty.*, 1 Cal.5th 783, 803–06, 206 Cal.Rptr.3d 636, 377 P.3d 874, 887–89 (2016)). The United States Supreme Court found that the California approach amounted to a "loose and spurious form of general jurisdiction" and held that because the California approach had allowed for claims to proceed against Bristol–Myers despite the lack of a connection between the forum and the specific claims at issue, the approach did not comport with "settled principles of personal jurisdiction" and exceeded the due process limits of the Fourteenth Amendment to the United States Constitution. *Bristol–Myers Squibb Co.*, 137 S.Ct. at 1781–83. The Supreme Court stated, however, that "since [its] decision concern[ed] the due process limits on the exercise of specific jurisdiction by a State, [it] le[ft] open the question whether the Fifth Amendment imposes the same restrictions on the exercise of personal jurisdiction by a federal court." *Id.* at 1783–84 (citing *Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co.*, 484 U.S. 97, 102 n.5, 108 S.Ct. 404, 98 L.Ed.2d 415 (1987)).

[4] The Due Process Clause of the Fourteenth Amendment to the United States Constitution limits the personal jurisdiction of state courts. *Bristol–Myers Squibb Co.*, 137 S.Ct. at 1779; *Daimler AG v. Bauman*, 571 U.S. 117, 134 S.Ct. 746, 751, 187 L.Ed.2d 624 (2014). There are two types of personal jurisdiction: "general" jurisdiction, sometimes called "all-purpose," where the defendant may be fairly regarded as "home" and the defendant is amenable to suit upon any claim, or "specific" or "case-linked" jurisdiction, where claims that may be heard are only those arising out of or relating to the defendant's contacts with the forum. *Bristol–Myers Squibb Co.*, 137 S.Ct. at 1780.

Here, the parties do not dispute that the Court may not exercise general personal jurisdiction over Launch but that the Court may exercise specific personal jurisdiction over Launch in adjudicating the claims of the named plaintiff. Launch, a Delaware limited-liability company, [Doc. 1 ¶ 21], with a single office located at its headquarters in Illinois, [Doc. 16–1 (Declaration of Jean Rollo, Launch's Chief Operating Officer ("Rollo Decl.")) ¶ 7], contends that it lacks contacts with Georgia sufficient to establish general jurisdiction, [Doc. 16 at 2–3, 5–7], and that the Court would not have specific jurisdiction over individual claims asserted by the unnamed class plaintiffs because there is no connection between their individual claims and Launch's few activities within the state of Georgia, [Doc. 16–1 at 2, 7–10]. Plaintiff does not rebut the arguments, thus inherently conceding the issues. *See Kramer v. Gwinnett Cnty.*, 306 F.Supp.2d 1219, 1221 (N.D. Ga. 2004) (Evans, J.) (explaining that where a party fails to respond to any portion of a motion, that portion, claim, or defense is waived).[5] Launch does admit, ***1365** however, that Plaintiff "appears to properly assert specific jurisdiction," as his claims "arguably arose within this jurisdiction." [Doc. 34 at 9]. Thus, the question presented to the Court is whether, in light of the due-process concerns driving dismissal of the claims of the non-resident plaintiffs in *Bristol–Myers*, personal jurisdiction may be had over Launch with regard to the claims of the non-resident class members on the strength of the Court's specific jurisdiction over the claims of the named plaintiff.

[5] Had Plaintiff pursued the issue, the Court would not have found that Launch is subject to general jurisdiction in Georgia. *Compare Carmouche v. Tamborlee Mgmt., Inc.*, 789 F.3d 1201, 1204 (11th Cir. 2015) (finding no general jurisdiction in Florida over a corporation that had a Florida bank account, two Florida addresses (one of which was a post-office box), and insurance from Florida companies; had filed a financing statement with the Florida Secretary of State;

> had joined a non-profit trade organization based in Florida; and had consented to Florida jurisdiction in an agreement with a third party) *with* Rollo Decl. ¶¶ 8–16 (testimony that Launch does not own property, maintain bank accounts, have an office, solicit business, or have a designated agent in the state of Georgia; that it has only one employee in Georgia, who works remotely from his home; and that a small percentage of its business and revenue come from clients in Georgia). Likewise, there does not appear to be any factual basis for a determination that the individual claims of the non-Georgia class members arise out of or are related to Launch's contacts with Georgia and that the Court might therefore exercise specific jurisdiction over Launch as to those claims. [*See generally* Doc. 1].

After careful review, the Court concludes that due-process concerns do not foreclose its exercise of personal jurisdiction over Launch as to the claims of the resident named plaintiff both on his own behalf and on behalf of the unnamed non-resident plaintiffs. Launch's argument that *Bristol–Myers* is analogous to this case is not without logical appeal: California's "sliding-scale" approach to specific jurisdiction does bear some resemblance to a court's exercise of jurisdiction over the defendant as to the claims of unnamed non-resident members of the plaintiff class by allowing the unnamed non-resident plaintiff class members to ride the coattails of the named plaintiff's assertion of specific jurisdiction over the defendant as to the named plaintiff's claims. Acceptance of the analogy would require, however, that the Court, like Launch, disregard material differences between mass actions and class actions.[6]

[6] Launch repeatedly mischaracterizes *Bristol–Myers*—both in the brief it filed in support of its motion to dismiss and in its reply brief—as a class-action lawsuit, [Doc. 16 at 1–2, 4, 8; Doc. 34 at 2–3], when it was not a class-action suit but rather was a mass tort action, *Bristol–Myers Squibb Co.*, 137 S.Ct. at 1777, 1787, 1789.

In a mass tort action such as *Bristol–Myers*, each plaintiff is a real party in interest, meaning that each plaintiff is personally named and required to effect service. *See Bristol–Myers Squibb*, 137 S.Ct. at 1778 (reviewing the claims of the non-resident plaintiffs on a motion to quash service of summons). In contrast, claims asserted in a class action, such as those in the action presently before the Court, are prosecuted through representatives on behalf of absent class members. *See Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 155, 102 S.Ct. 2364, 72 L.Ed.2d 740 (1982) ("The class-action device was designed as 'an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only.' " (quoting *Califano v. Yamasaki*, 442 U.S. 682, 700–01, 99 S.Ct. 2545, 61 L.Ed.2d 176 (1979))); *Hansberry v. Lee*, 311 U.S. 32, 40–41, 61 S.Ct. 115, 85 L.Ed. 22 (1940) (further explaining that class action was an invention of equity to allow a court to proceed to decree in suits where the number of those interested in the litigation was too great to permit joinder). As Launch correctly notes in its reply brief, [Doc. 34 at 2], individual members of a plaintiff class, aside from named representatives, need not satisfy the "minimum contacts" test in order for a the forum court to exercise personal jurisdiction over them, *see Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985). This depends in large part upon due-process protections provided by class-action procedural requirements:

> The plaintiff must receive notice plus an opportunity to be heard and participate in the litigation, whether in person or through counsel. The notice must be the best practicable, "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane* [*v. Central Hanover Bank & Tr.*], 339 U.S. [306, 314–15, 70 S.Ct. 652, 94 L.Ed. 865 (1950)]; *cf.* ***1366** *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 174–75, 94 S.Ct. 2140, 40 L.Ed.2d 732 ... (1974). The notice should describe the action and the plaintiffs' rights in it. Additionally, ... due process requires at a minimum that an absent plaintiff be provided with an opportunity to remove himself from the class by executing and returning an "opt out" or "request for exclusion" form to the court. Finally, the Due Process Clause of course requires that the named plaintiff at all times adequately represent the interests of the absent class members. *Hansberry*, 311 U.S., at 42–43, 45, 61 S.Ct. 115.

Shutts, 472 U.S. at 812, 105 S.Ct. 2965. Launch fails to recognize, however, that Rule 23 of the Federal Rules of Civil Procedure also sets forth certification procedures that protect the defendant's due-process rights: in particular, the requirements that there be "questions of law or fact common to the class" and that "the claims ... of the representative parties are typical of the claims ... of the class." Fed. R. Civ. P. 23(a)(2), (3).[7] Additionally, to assert a class action under Rule 23(b)(2) or 23(b)(3), as Plaintiff seeks to do here, the Federal Rules require that the plaintiff also show that "the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole," Fed. R. Civ. P. 23(b)(2), or prove to the presiding court that "questions of law or fact common to class

members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy," considering matters such as "the desirability or undesirability of concentrating the litigation of the claims in the particular forum" and "the likely difficulties in managing a class action," Fed. R. Civ. P. 23(b)(3). Thus, in contrast to a mass action like *Bristol–Myers*, which may—and likely would—present significant variations in the plaintiffs' claims, the requirements of Rule 23 class certification ensure that the defendant is presented with a unitary, coherent claim to which it need respond only with a unitary, coherent defense. Because of the unitary nature of that class claim, the Court perceives no unfairness in haling the defendant into court to answer to it in a forum that has specific jurisdiction over the defendant based on the representative's claim. Also, if due process was not offended in *Shutts*, a class-action in State court with absent non-resident plaintiff class members, 472 U.S. at 808, 105 S.Ct. 2965, it is not offended by a potential class-action in federal court where the plaintiff class is made up in part with non-resident members.

7 Plaintiff does argue in his reply brief that Rule 23 of the Federal Rules of Civil Procedure does not temper due process unfairness. However, the Court finds no citations to supportive case law in either of his briefs, and the one apparently on-point article he attempts to proffer is not properly cited, is misquoted in Plaintiff's brief, is thirty years old, and, and despite being authored by the now-Chief Judge of the U.S. Court of Appeals for the Seventh Circuit, is a law-journal article and therefore presents, at best, only persuasive authority. [*See* Doc. 34 at 8 (citing Diane P. Wood, *Adjudicatory Jurisdiction & Class Actions*, 62 Ind. L.J. 597 (1987))].

Launch's position also rests on federalism concerns that are not at issue here in federal court. As a sister district court recently explained, *Bristol–Myers* protects the well-rooted principle that " 'the States, through their courts, [may] not reach out beyond the limits imposed on them by their status as coequal sovereigns in a federal system.' " ***1367** *In re: Chinese–Manufactured Drywall Prods. Liability Litig.*, Civ. Action MDL No. 09-2047, 2017 WL 5971622, at *20 (E.D. La. Nov. 30, 2017) (quoting *World–Wide Volkswagen v. Woodson*, 444 U.S. 286, 290, 100 S.Ct. 580, 62 L.Ed.2d 490 (1980)). Our sister district also went on to explain the importance of distinguishing the structure of the *Bristol–Myers* multi-plaintiff litigation from the Congressionally authorized class-action structure in the suit before it:

> In this case, federalism concerns do not apply. [*Bristol–Myers*] is about limiting a state court's jurisdiction when it tried to reach out-of-state defendants on behalf of out-of-state plaintiffs in a mass action suit. That scenario is inapplicable to nationwide class actions in federal court .... Specifically, while [*Bristol–Myers*] involves non-resident plaintiffs forum-shopping in California to reach a non-resident defendant with insufficient contacts, the ... litigation [before the court] involves Defendants that have made enough contacts to the forum states to hold them liable there in nationwide class actions. ... Congress ... enabled class actions because Congress recognizes the need for efficiency—for plaintiffs and defendants as well as the judicial system—in managing such mass filings. Class action promotes "efficiency and economy of litigation." *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345, 349, 103 S.Ct. 2392, 76 L.Ed.2d 628 (1983). Therefore, a nationwide class action in federal court is not about a state's overreaching, but rather relates to the judicial system's handling of mass claims involving numerous ... parties.

Chinese–Manufactured Drywall Prods. Liability Litig., 2017 WL 5971622 at *20.

Recognizing in its reply brief that *Bristol–Myers* is, at best, analogous to this matter, [Doc. 34 at 1], Launch suggests that by referencing *Omni Capital* in *Bristol–Myers*, the Supreme Court was "tipping its hand, at least tacitly implying that *Bristol–Myers*' principles and logic apply in a Fifth Amendment case such as this one," [*see id.* at 3]. The Court rejects this argument. First, by stating that because the Court's decision "concern[ed] the due process limits on the exercise of specific jurisdiction by a State, [it] le[ft] open the question whether the Fifth Amendment imposes the same restrictions on the exercise of personal jurisdiction by a federal court," *Bristol–Myers*, 137 S.Ct. at 1784, the Supreme Court was doing just that: not expressing an opinion on a question

that was not before it.[8] Second, *Omni Capital*, like *Bristol–Myers*, did not concern class-action claims. *See Omni Capital*, 484 U.S. at 99, 108 S.Ct. 404 (describing each of the parties to the suit). Thus, the argument amounts to an invitation to apply inapposite dicta to preclude Congressionally authorized class claims.

[8] Notably, the Solicitor General explained in its brief in *Bristol–Myers* that the case "d[id] not present any question concerning whether a state court may entertain class actions, under established rules, to resolve claims arising from conduct in multiple jurisdictions." U.S. Amicus Br. Supporting Petitioner Bristol–Myers, *Bristol–Myers Squibb Co. v. Superior Court of Cal., San Francisco Cnty.*, No. 16-466, 2017 WL 1046237, at *32 n.5 (U.S. Mar. 8, 2017); *see also Bristol–Myers*, 137 S.Ct. 1773 at 1789 n.4 (Sotomayor, J., dissenting) ("The Court today does not confront the question whether its opinion here would apply to a class action in which a plaintiff injured in the forum State seeks to represent a nationwide class of plaintiffs, not all of whom were injured there."). As Plaintiff points out, [Doc. 29 at 10 n.2], if that was true for state class actions, it was certainly also true for federal class actions.

Moreover, Launch does not acknowledge authority holding that unnamed non-resident members of a plaintiff class will not detract from a named plaintiff's ability to establish specific personal jurisdiction over the defendant on behalf of the class, much less seek to distinguish it or argue that it was wrongly decided. *See, e.g.,* ***1368** *Chinese–Manufactured Drywall Prods. Liability Litig.*, 2017 WL 5971622 at *19–20 (holding that the court had personal jurisdiction over defendant as to nationwide class claims where specific jurisdiction had been established as to the named plaintiffs); *Day v. Air Methods. Corp.*, No. 5:17-183-DCR, 2017 WL 4781863, at *2 (E.D. Ky. Oct. 23, 2017) (holding that claims of non-resident unnamed class members did not destroy personal jurisdiction because "the inquiry for personal jurisdiction lies with the named parties of the suit asserting their various claims against the defendant, not the unnamed proposed class members"); *Thomas v. Kellogg Co.*, Case No. C13-5136RBL, 2017 WL 5256634, at *1 (W.D. Wash. Oct. 17, 2017) (denying defendant's motion to dismiss opt-ins' claims, explaining that it is "not at all clear that *Bristol Myers* even applies" to cases concerning federal class claims in federal court); *Fitzhenry–Russell v. Dr. Pepper Snapple Grp., Inc.*, Case No. 17-cv-00564 NC, 2017 WL 4224723, at *5 (N.D. Cal. Sept. 22, 2017) (holding that although eighty-eight percent of the class members were not residents of the forum state, the court had jurisdiction over defendant as to the claims of the putative nationwide class by virtue of the specific jurisdiction established by the named plaintiff's claims); *AM Trust v. UBS AG*, 78 F.Supp.3d 977, 986 (N.D. Cal. Jan. 29, 2015) (stating that "claims of unnamed class members are irrelevant to the question of specific jurisdiction" but dismissing the complaint for lack of specific jurisdiction as to the claims of the named class members).[9]

[9] The Court is aware, based on its own research, that there are cases where district courts have found that *Bristol–Myers* precludes a finding of personal jurisdiction over the claims of non-resident plaintiff class members, but they contain little analysis and the Court therefore does not find them persuasive. *See, e.g., McDonnell v. Nature's Way Prods., LLC*, No. 16 C 5011, 2017 WL 4864910, at *4 (N.D. Ill. Oct. 26, 2017) (presuming that *Bristol–Myers* requires dismissal of non-residents class members' claims without explaining why *Bristol–Myers* would apply in a class-action suit); *Wenokur v. AXA Equitable Life Ins. Co.*, No. CV-17-000165-PHX-DLR, 2017 WL 4357916, at *4 n.4 (D. Ariz. 2017) (stating, without analysis, that in light of *Bristol–Myers*, the court lacked personal jurisdiction over the non-resident claims and therefore would not be able to certify a nationwide class); *Spratley v. FCA US LLC*, No. 3:17-CV-0062, 2017 WL 4023348, at *7 (N.D.N.Y. Sept. 12, 2017) (presuming that *Bristol–Myers* requires dismissal of non-residents class members' claims without explaining why *Bristol–Myers* would apply in a class-action suit).

It also bears noting that unnamed members of plaintiff classes have been held distinct from named plaintiffs in that the unnamed members' status as a "party" is seen not as "an absolute characteristic, but rather a conclusion about the applicability of various procedural rules that may differ based on context." *Devlin v. Scardelletti*, 536 U.S. 1, 10, 122 S.Ct. 2005, 153 L.Ed.2d 27 (2002); *accord Smith v. Bayer Corp.*, 564 U.S. 299, 313, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011) (describing the argument that a non-named class member is a party to the litigation before the class is certified as "novel and surely erroneous"). And while courts have held that an unnamed member of a certified class may be "considered a party" for certain purposes, such as tolling a statute of limitations, *Am. Pipe & Contr. Co. v. Utah*, 414 U.S. 538, 540–60, 94 S.Ct. 756, 38 L.Ed.2d 713 (1974), being bound by a judgment, *Shutts*, 472 U.S. at 814, 105 S.Ct. 2965, or appealing an adverse judgment, *Smith*, 564 U.S. at 313, 131 S.Ct. 2368, courts have also held that such a person may not be considered a "party" for other purposes, such as establishing specific personal jurisdiction over a defendant, ***1369** *Greene v. Mizuho Bank, Ltd.*, 169 F.Supp.3d 855, 866 (N.D. Ill. 2016); *Matthews v. Brookstone Stores, Inc.*, 469 F.Supp.2d 1056, 1067 & n.17 (S.D. Ala. 2007) (determining diversity of

citizenship); *Devlin*, 536 U.S. at 10, 122 S.Ct. 2005 (explaining that "nonnamed class members cannot defeat complete diversity" because the "[e]ase of administration would be compromised by having to consider the citizenship of all class members"), conducting discovery, *Wainwright v. Kraftco Corp.*, 54 F.R.D. 532, 534 (N.D. Ga. 1972) ("Since discovery by written interrogatories pursuant to Rule 33 and by motions for orders compelling production of documents pursuant to Rule 34 may be had only against 'parties,' the court does not believe such discovery may be had from the class members in this action, other than the Atlanta and Rome boards, which are party-plaintiffs."), or challenging entry of a final judgment, *Day v. Persels & Assocs., LLC*, 729 F.3d 1309, 1316 (11th Cir. 2013) (holding that "absent class members are not 'parties' whose consent is required for a magistrate judge to enter a final judgment under [28 U.S.C.] § 636(c)")).

In sum, the undersigned concludes that because *Bristol–Myers* simply reaffirms controlling due-process law and does not apply to federal class actions and because Launch has not otherwise presented persuasive authority in support of its motion, Launch has shown no reason that this Court may not continue to exercise jurisdiction over a nationwide class claim on the strength of its specific personal jurisdiction over the defendant as to the named plaintiff's claim. Accordingly, it is hereby **RECOMMENDED** that the District Judge **DENY** Launch's partial motion to dismiss the complaint as to non-resident plaintiff class members.

III. Conclusion

For the reasons discussed above, the undersigned **RECOMMENDS** that the partial motion to dismiss be **DENIED**, [Doc. 16].

IT IS SO RECOMMENDED, this the 26th day of January, 2018.

All Citations

297 F.Supp.3d 1360

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NOTES

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Titus v. Zestfinance, Inc., et al., Order on Defendants' Motions to Compel Arbitration, Case No. 3:18-cv-05373-RJB (W.D. Wash. Oct. 18, 2018)

Submitted by:
Deepak Gupta
Matthew Wessler
Gupta Wessler PLLC

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

TERESA TITUS, as an individual and as a representative of the class, Plaintiff, v. ZESTFINANCE, INC., BLUECHIP FINANCIAL, and DOUGLAS MERRILL, Defendants.	CASE NO. 18-5373 RJB ORDER ON DEFENDANTS' MOTIONS TO COMPEL ARBITRATION

THIS MATTER comes before the Court on the Defendant BlueChip Financial's ("BlueChip") Motion to Compel Arbitration and to Dismiss or Stay Proceedings Herein (Dkt. 27), Defendants ZestFinance, Inc., and Dougals Merrill's (collectively "Zest") Motion to Compel Arbitration (Dkt. 30), and BlueChip's Objection to and Motion to Strike Improper Surreply Brief Filed by Plaintiff (Dkt. 43). The Court has considered the pleadings filed regarding the motions, the remaining filed and oral argument on 11 October 2018.

This putative class action arises from a series of loans Defendants made to Plaintiff, which Plaintiff alleges carry triple digit interest rates (sometimes exceeding 400%), that violate Washington State usury law, RCW 19.52.030, the Washington Consumer Protection Act, RCW 19.86.020, *et seq*. ("WCPA"), and unjustly enriches Defendants. Dkt. 1. Plaintiff also makes a claim against Defendants for violation of Racketeer Influenced Corrupt Organizations Act, 18 U.S.C. § 1962, *et seq*. ("RICO"), asserting that the Defendants "associated for the common purpose of profiting off of the collection [of] unlawful debt by offering and collecting on loans to consumers throughout the United States . . ." Dkt. 1, at 18.

Defendants now move to compel arbitration. Dkts. 27 and 30. For the reasons provided below, the motions (Dkts. 27 and 30) should be denied.

I. FACTS, FACTUAL ANALYSIS, AND PENDING MOTIONS

In her Complaint, Plaintiff alleges that Defendant BlueChip "is purportedly a tribal corporation . . . incorporated under the laws of the Turtle Mountain Band of Chippewa Indians" ("Tribe"). *Id.,* at 9. Plaintiff alleges that "in an effort to avoid state usury laws," Defendant Zest affiliated with the Tribe, and directed the Tribe to create BlueChip, "to serve as a front to disguise" Zest's role in making usurious loans. *Id.*, at 6.

In December of 2015, Plaintiff applied online for, and received, a loan of $800.00 from BlueChip (doing business as Spotloan). Dkt. 28-1, at 4-10. The loan had an annual interest rate of 390%. *Id.* Plaintiff applied for and received three additional loans from BlueChip: in June of 2016 ($600), November 2016 ($800), and April 2017 ($800), with annual interest rates ranging from 420% to 460%. Dkt. 28-1, at 16-22, 28-34, and 40-46.

Each time Plaintiff received a loan from BlueChip, she electronically signed a document entitled "Loan Agreement." Dkt. 28-1, at 4-10, 16-22, 28-34, and 40-46. A copy of this "Loan

Agreement" is attached to this Order as Exhibit A. These loan agreements are not the model of clarity. As is relevant here, each of the Loan Agreements provides that:

> **Disputes.** Any dispute under this Agreement will be decided under the terms set forth in the Binding Arbitration and Jury Trial Waiver below unless you decide to opt out. . .
>
> **Governing Law**. Spotloan is organized under the laws of the Turtle Mountain Band of Chippewa Indians (the "Tribe"). Your Loan Agreement becomes a binding contract with us when we accept it at our offices on the Turtle Mountain Indian Reservation. By signing this Loan Agreement, you agree that the laws of the Tribe will apply to the Loan Agreement, and understand that United States state law does not apply to the Loan Agreement in any way. You also agree to be subject to the jurisdiction of the Tribe. . .

Dkt. 28-1, at 5, 9, 17, 21, 29, 33, 41 and 45. The Loan Agreements are internally inconsistent. While the "Governing Law" provision provides that "state law does not apply to the Loan Agreement in any way," later, the "Binding Arbitration Clause and Jury Trial Waiver," provides that "[i]f a court finds that [the Federal Arbitration Act ("FAA")] doesn't apply, and the finding can't be appealed, then your state's law governs. . ." and that "[a] party may file the Arbiter's award with the Washington state court for enforcement against any party." Dkt. 28-1, at 5-7, 17-19, 29-31, and 42-43. So, state laws do apply to the contract in some ways.

In the "Binding Arbitration Clause and Jury Trial Waiver," the following appears: "[t]he arbiter must apply substantive law consistent with the FAA. The Arbiter must follow statutes of limitation and privilege claims. . ." Dkt. 28-1, at 6, 18, 30 and 41. The contract is silent on whether those provisions refer to tribal law, federal law, or state law.

Under the heading, "Fair Lending Policy Statement" the Loan Agreements states, that BlueChip "is providing you the following information in a manner consistent with principles under applicable United States federal law." It further provides:

> It is [BlueChip's] policy to make credit products and loan support services available to all qualified applicants without discriminating on the basis of race, color, religion, national origin, sex, marital status, age (provided that the applicant is of legal age and has the legal capacity to enter into a binding contract), veteran status, disability, genetics, sexual orientation, gender identity, gender expression, or any other status or condition protected by law; income derived from any public assistance program; or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. We will not discourage a consumer from making or pursuing an application for credit on a prohibited basis. [BlueChip] treats all consumers in a fair, equitable, and consistent manner on an equal opportunity basis.

Dkt. 28-1, at 9, 21, 32-33, and 45. This statement does not give authority to bring suit under any federal law, and appears to be only a non-discrimination and anti-retaliation aspirational statement.

The next clause of the Loan Agreements entitled, "Transfer of Rights/Maintenance of Register," states:

> We may assign or transfer this Agreement, or any of our rights, without notice or your consent. This Agreement shall remain exclusively subject to the laws and courts of the Turtle Mountain Band of Chippewa Indians.

Dkt. 28-1, at 9, 21, 33, and 45.

The "Binding Arbitration Clause" requires arbitration of any disputes, and specifically waives many rights that are inconsistent with the arbitration clause and the Loan Agreement. It contains an opt-out provision that the Plaintiff did not invoke.

Construing the contract as a whole, giving meaning to each provision, it appears that the intent of the contract is that the Turtle Mountain Band of Chippewa Indians law applies, to the exclusion of federal and state law, except where those laws are specifically mentioned as

applying to the contract. Specifically or by implication all other state and federal laws are waived, including those referenced in the "Fair Lending Policy Statement" aspirational paragraph.

Defendants BlueChip and Zest now move for an order compelling Plaintiff to arbitrate. Dkts. 27 and 30. BlueChip argues that: the arbitration clause is valid and enforceable, Plaintiff's claims fall squarely within the arbitration clause, and Plaintiff's claims must proceed to arbitration on an individual basis, and so the case should be dismissed or stayed pending completion of arbitration. Dkt. 27. Zest argues that it is a third-party beneficiary of the arbitration agreements, Plaintiff is equitably estopped from refusing to arbitrate her claims against Zest even though Zest is a non-signatory to the Loan Agreements, and maintain that arbitration must proceed on an individual basis. Dkt. 30.

The Plaintiff opposes the motions and argues that the arbitration agreement is unenforceable because the only reasonable construction of the contract is that it implicitly forbids the application of state and federal law. Dkt. 36. She asserts that the contract is invalid because it prospectively waives a consumer's state and federal statutory rights under the "effective vindication" exception to arbitration. *Id.* The effective vindication exception "serves to harmonize competing federal policies" by allowing courts to invalidate arbitration agreements that "operate as a waiver of a party's right to pursue statutory remedies." *Am. Exp. Co. v. Italian Colors Rest*., 570 U.S. 228, 235 (2013). Plaintiff further maintains that the Defendants' effort to force this arbitration demonstrates how the contract is designed to circumvent federal and state law and is invalid, and so the motion should be denied. Dkt. 36.

BlueChip replies, and argues that arbitration should be compelled because the "effective vindication" exception does not apply here because it only applies to the waiver of federal rights

and the Agreements permit the application of federal law, the Agreements indicate the certain federal law applies, Plaintiff relies on one sentence, taken out of context, and the loan website clarifies that they "comply with applicable tribal lending laws and federal lending laws that do not conflict with our Tribe's sovereignty." Dkt. 39.

Zest replies, and joins in BlueChip's arguments. Dkt. 40. It argues, additionally, that the arbitrator must decide the choice of law applicable to Plaintiff's loan agreements and even if the choice of law provision is invalid, the proper remedy is that the choice of law provision should be severed and the agreement to arbitrate remains. *Id.*

On September 28, 2018, the Plaintiff filed a surreply (Dkt. 42) and on October 1, 2018, BlueChip filed a motion to strike Plaintiff's surreply, asserting that the arguments Plaintiff makes are responses to arguments in the replies and not proper under the Local Rules of the Western District of Washington (Dkt. 43).

This opinion will first address BlueChip's motion to strike Plaintiff's surreply. Dkt. 43. It will then address the motions to compel arbitration (Dkts. 27 and 30) and whether the exception to the general policy favoring arbitration – the effective vindication exception - applies.

II. DISCUSSION

A. MOTION TO STRIKE

Under Local Rule of W.D. Wash. 7 (g),

> Requests to strike material contained in or attached to submissions of opposing parties shall not be presented in a separate motion to strike, but shall instead be included in the responsive brief, and will be considered with the underlying motion. The single exception to this rule is for requests to strike material contained in or attached to a reply brief, in which case the opposing party may file a surreply requesting that the court strike the material, subject to the following:

> (1) That party must file a notice of intent to file a surreply as soon after receiving the reply brief as practicable.
>
> (2) The surreply must be filed within five days of the filing of the reply brief, and shall be strictly limited to addressing the request to strike. Extraneous argument or a surreply filed for any other reason will not be considered. . .

BlueChip's motion to strike the Plaintiff's surreply (Dkt. 43) should be granted. In her surreply, the Plaintiff does not move to strike material contained in or attached to Defendant's reply briefs, but substantively responds to arguments in the Defendants' reply briefs. Accordingly, the Plaintiff's surreply (Dkt. 42) will not be considered.

B. STANDARD ON MOTIONS TO COMPEL ARBITRATION

The FAA establishes "a liberal federal policy favoring arbitration agreements." *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1621 (2018). Under section two of the FAA, "a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 "The final clause of § 2, generally referred to as the savings clause, permits agreements to arbitrate to be invalidated by generally applicable contract defenses, such as fraud, duress, or unconscionability, but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue." *Poublon v. C.H. Robinson Co*., 846 F.3d 1251, 1259 (9th Cir. 2017)(*internal quotation marks and citations omitted*). The FAA's primary purpose is that "of ensuring that private agreements to arbitrate are enforced according to their terms." *Munro v. Univ. of S. California*, 896 F.3d 1088, 1092 (9th Cir. 2018). Generally, "[e]ven claims arising under a statute designed to further important social policies may be arbitrated because, so long as the prospective litigant effectively may vindicate [their federal] statutory

cause of action in the arbitral forum, the statute serves its functions." *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 90 (2000)(*internal quotation marks and citation omitted*).

"Under the FAA, the basic role for courts is to determine (1) whether a valid agreement to arbitrate exists and, if it does, (2) whether the agreement encompasses the dispute at issue." *Knutson v. Sirius XM Radio Inc*., 771 F.3d 559, 564–65 (9th Cir. 2014). "Any doubts about the scope of arbitrable issues, including applicable contract defenses, are to be resolved in favor of arbitration." *Poublon v. C.H. Robinson Co*., 846 F.3d 1251, 1259 (9th Cir. 2017)(*internal quotation marks and citations omitted*).

The arbitration clauses of the Loan Agreements here are enforceable unless the "effective vindication" exception applies.

C. VALIDITY OF THE AGREEMENT TO ARBITRATE AND THE "EFFECTIVE VINDICATION" EXCEPTION

The policy favoring arbitration does not, however, "extend to a substantive waiver of federally protected statutory rights in an arbitration agreement." *Hayes v. Delbert,* 811 F.3d 666 (4th Cir. 2016). Under the "effective vindication" exception, arbitration agreements that "operate as a prospective waiver of a party's right to pursue statutory remedies" are invalid under the FAA's § 2 "public policy grounds." *Am. Exp. Co. v. Italian Colors Rest*., 570 U.S. 228, 235 (2013); *Mohamed v. Uber Technologies, Inc.,* 8484 F.3d 1201, 1213 (9th Cir. 2016); *Chavarria v. Ralphs Grocery Co*., 733 F.3d 916, 927 (9th Cir. 2013)(holding administrative and filing cost of arbitration precluded the effective vindication of the plaintiff's statutory rights and so, the arbitration agreement was invalid). In the event the choice-of-forum and choice-of-law clauses operate "in tandem as a prospective waiver of a party's right to pursue statutory remedies," the agreement is invalid "as against public policy." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc*., 473 U.S. 614, 637, n. 19 (1985). Accordingly, an agreement that is "a

substantive waiver" of federal statutory rights will not be upheld. *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247, 273 (2009).

The Defendants' motions to compel arbitration (Dkts. 27 and 30) should be denied. Their choice-of-forum and choice-of-law clauses "operate as a prospective waiver of a party's right to pursue [federal] statutory remedies" and so the arbitration clause is invalid. Being mindful that a contract is to be interpreted "as a whole and every part . . . with reference to the whole," and that "[t]he various provisions of a contract or statute must be so construed (if possible) as to give force and effect to every part thereof,"(*Idaho v. Coeur d'Alene Tribe*, 794 F.3d 1039, 1045 (9th Cir. 2015)(*internal quotation marks and citations omitted*)), the only reasonable way to interpret the Loan Agreement is to conclude that Tribal law applies, barring application of federal law except where it is expressly included. By implicitly excluding all other federal law, there is an implicit, prospective waiver of federal rights.

While the Defendants assert that this construction is improbable given the contract's reference to other federal laws, that argument is not persuasive. If mere reference to a federal law was sufficient to save the contract, then it would render the "effective vindication" exception meaningless.

The Defendants argue that the Defendants' website says that federal law applies. The Defendants point to no authority that an alleged statement on a website somehow saves this contract.

In 2016, the Fourth Circuit Court of Appeals considered a situation similar (although not exactly) like the case at bar. *Hayes v. Delbert,* 811 F.3d 666 (4th Cir. 2016). In *Hayes*, the Plaintiff took out a payday loan from a lender owned by a member of the Cheyenne River Sioux Tribe. *Id.* Hayes signed a loan agreement which provided, in part:

> This Loan Agreement is subject solely to the exclusive laws and jurisdiction of the Cheyenne River Sioux Tribe, Cheyenne River Indian Reservation. By executing this Loan Agreement, you, the borrower, hereby acknowledge and consent to be bound to the terms of this Loan Agreement, consent to the sole subject matter and personal jurisdiction of the Cheyenne River Sioux Tribal Court, and that no other state or federal law or regulation shall apply to this Loan Agreement, its enforcement or interpretation.

Id., at 670. The loan agreement in that case also contained an agreement to arbitrate, which permitted the borrower to select the AAA or JAMS to administer the arbitration. *Id.* The Fourth Circuit held that "[t]his arbitration agreement fails for the fundamental reason that it purports to renounce wholesale the application of any federal law to the plaintiffs' federal claims." *Id.* The *Hayes* Court noted that, "while the Court has affirmed [that] the FAA gives parties the freedom to structure arbitration in the way they choose, it has repeatedly cautioned that this freedom does not extend to a substantive waiver of federally protected civil rights in an arbitration agreement." *Id.,* at 674 (*internal citations omitted*). It continued, "the arbitration agreement here almost surreptitiously waives a potential claimant's federal rights through the guise of a choice of law clause." *Id.,* at 675. "This arbitration agreement uses its choice of law provision to waive all of a potential claimant's federal rights." *Id.* "Because the arbitration agreement takes this plainly forbidden step," the arbitration agreement was held "invalid and unenforceable." *Id.*

Like the agreement in *Hayes*, the arbitration agreement here uses a choice of law provision, which, when construed with the other provisions in the Loan Agreement, prospectively waives most federal statutory remedies. Although the language in this case is not as specific as it was in *Hayes*, it implicitly achieves the same results. *See Dillion v. BMO Harris Bank, N.A.,* 856 F.3d 330 (4th Cir. 2017) (holding arbitration clause in another internet payday loan agreement (involving a tribal lender), which declared that tribal law applied and that state and federal law did not apply, was invalid). The choice of forum – arbitration - "surreptitiously

waives a potential claimant's federal rights through the guise of a choice of law clause." *Hayes,* at 675; *Dillion,* at 336. Where an arbitration clause compels the surrender of federal statutorily mandated rights, the arbitration clause contravenes the federal statute at issue, and so the arbitration clause is invalid. *Graham Oil Co. v. ARCO Products Co.,* 43 F.3d 1244, 1248 (9th Cir. 1994)(holding that an arbitration clause that forced forfeiture of the federal statutory right to recover exemplary damages, the right to recover attorneys' fees, and reduced the applicable statute of limitations was invalid). Accordingly, the agreement to arbitrate here should be held to be invalid and unenforceable.

Zest raises two new arguments in its reply. Although ordinarily the Court does not consider new arguments raised for the first time in the reply, it will address these two arguments for the sake of finality.

First, Zest argues that the arbitrator, rather than the Court, should decide if the choice of law clause is invalid. Dkt. 40. Zest cites *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445-46 (2006) for the proposition that: "an arbitration provision is severable from the remainder of the contract . . . [and] unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instant." Dkt. 40. The Court in *Buckeye* held that because the plaintiff was asserting that the contract as a whole was unconscionable due to the usury interest rates it charged on a loan, and not asserting that the arbitration clause itself was unconscionable, the arbitrator should make the decision as to the validity of the contract.

"Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." *AT & T Techs., Inc. v. Commc'ns Workers of Am*., 475 U.S. 643, 649 (1986). Further, in the Ninth Circuit, "[t]he

question of arbitrability is for the court to decide regardless of whether the specific challenge to the arbitration clause is raised as a distinct claim in the complaint so long as the plaintiff's challenge to the validity of an arbitration clause is a distinct question from the validity of the contract as a whole." *Smith v. Jem Grp., Inc*., 737 F.3d 636, 639 (9th Cir. 2013). Plaintiffs need not plead the validity or invalidity of an arbitration clause in their complaint; it is "sufficient that they raised that issue in their response to the motion to compel." *Id.*, at 640.

The arbitration agreement is invalid here because creates a conflict between the FAA's requirement that contracts to arbitrate are to be enforced on their terms and the enforcement provisions of federal statutes that Plaintiff could not now, under the contract, pursue - like her RICO claim. Plaintiff's core arguments in her Response go to the delegation clause of the arbitration agreement and the arbitration agreement itself. These facts are sufficient in the Ninth Circuit to justify the Court deciding the question of arbitrability. *Smith,* at 640. Moreover, "a federal court has a duty to determine whether a contract violates federal law before enforcing it." *Kaiser Steel Corp. v. Mullins*, 455 U.S. 72, 83 (1982). This Court should determine whether the arbitration clause here is valid, not an arbitrator.

Second, Zest asserts that even if the choice of law provision is invalid, the proper remedy is that the choice of law provision should be severed and the agreement to arbitrate remains. Dkt. 40.

The *Hayes* court considered and rejected this argument. It held that the agreement's "errant" provisions were not severable. *Hayes,* at 675. The Fourth Circuit noted that:

> It is a basic principle of contract law that an unenforceable provision cannot be severed when it goes the "essence" of the contract. Here, the offending provisions go to the core of the arbitration agreement. It is clear that one of the animating purposes of the arbitration agreement was to ensure that [the Tribal lender] and its allies could engage in lending and collection practices free from the strictures of any federal law.

> And although our focus must be on the arbitration agreement, not the underlying loan agreement, it is only natural for us to interpret the arbitration agreement in light of the broader contract in which it is situated. As noted above, provisions in the loan agreement starkly proclaim that "no United States state or federal law applies to this Agreement." The brazen nature of such statements confirms that [the lender's] arbitration agreement is little more than an attempt to achieve through arbitration what Congress has expressly forbidden.

Id., at 675-676.

Similarly, in finding another payday loan agreement with a tribal lender that contained a forum selection clause was "an integral, non-severable part of the arbitration agreement," the Third Circuit concluded that the entire arbitration agreement was unenforceable. *MacDonald v. CashCall, Inc*, 883 F.3d 220, 232 (3rd Cir. 2018).

The Fourth and Third Circuits' reasoning is persuasive. The "offending provisions" of this arbitration agreement in this case go to the essence of the contract and are intended to "achieve through arbitration what Congress has expressly forbidden," *Hayes,* at 676, - that is a prospective waiver of federal statutory rights. "Good authority counsels that severance should not be used when an agreement represents an integrated scheme to contravene public policy." *Id.*

D. CONCLUSION

The Defendants' motions to compel arbitration (Dkts. 27 and 30) should be denied. The Defendants make reference to various other defenses, including a defense of sovereign immunity for BlueChip (as an entity of the Tribe) and a lack of personal jurisdiction as to the other Defendants. The Defendants did not move for dismissal on these grounds and they are not considered in this order.

III. ORDER

It is **ORDERED** that,

- Defendant BlueChip Financial's motion to strike the Plaintiff's surreply (Dkt. 43) **IS GRANTED;** and
- Defendant BlueChip Financial's Motion to Compel Arbitration and to Dismiss or Stay Proceedings Herein (Dkt. 27) and Defendants ZestFinance, Inc., and Dougals Merrill's Motion to Compel Arbitration (Dkt. 30) **ARE DENIED**.

The Clerk is directed to send uncertified copies of this Order to all counsel of record and to any party appearing *pro se* at said party's last known address.

Dated this 18th day of October, 2018.

ROBERT J. BRYAN
United States District Judge

NOTES

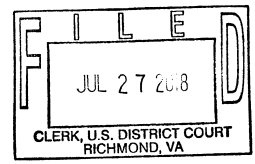
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Williams, et al. v. Big Picture Loans, LLC, et al., Civil Action No. 3:17-cv-461 (E.D. Va. July 27, 2018)

Submitted by:
Deepak Gupta
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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division



LULA WILLIAMS, et al.,
on behalf of themselves and all
individuals similarly situated,

Plaintiffs,

v. Civil Action No. 3:17-cv-461

BIG PICTURE LOANS, LLC, et al., **PUBLIC VERSION**[1]

Defendants.

MEMORANDUM OPINION

This matter is before the Court on DEFENDANTS BIG PICTURE LOANS AND ASCENSION TECHNOLOGIES' MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION (ECF No. 22). Big Picture Loans, LLC ("Big Picture") and Ascension Technologies, Inc. ("Ascension") argue that the Court lacks subject matter jurisdiction over all claims asserted against them because they qualify as arms of the Lac Vieux Desert Band of Lake Superior Chippewa Indians ("the

[1] This opinion was initially filed under seal on July 3, 2018. See Memorandum Op. (ECF No. 130). The Clerk provided copies of the sealed opinion to Plaintiffs, Big Picture, and Ascension, who were given fourteen days to request that certain information in the public version of the opinion remain sealed. See ECF No. 131 at 1-2. Following that order, Big Picture and Ascension indicated that the majority of the documents cited or discussed in the opinion could be unsealed, or could remain sealed with only limited redactions that would not affect the opinion. See Response to July 3 Order (ECF No. 133) at 4-9. The Court agreed with their proposed approach, and minor changes have been made to the opinion to account for the unsealing and re-filing of certain documents. See ECF No. 143.

Tribe") and are thereby entitled to tribal sovereign immunity. For the reasons set forth below, the motion was denied. See ECF No. 124.

BACKGROUND

A. Factual Background

1. Tribal Regulatory Structure

The Tribe is a federally recognized Indian tribe, and its members reside close to their ancestral homeland near Watersmeet, Michigan. 25 U.S.C. § 1300h(1)-(2). Its status as an "independent tribal entity" has consistently been reaffirmed. See id. § 1300h-2(a). As a result, the Tribe is a sovereign entity that can create its own laws and regulations.

To that end, the Tribe adopted its current constitution on May 14, 1992 ("the LVD Constitution") for the Tribe's "government, protection and common welfare." ECF No. 23-1 at 1, 19. Among other things, the LVD Constitution established the Tribe's council ("the LVD Council"), granting it the authority to, inter alia, enact law, including ordinances and regulations; manage the Tribe's economic affairs; and "promote and protect the health, safety, education, and general welfare of the [Tribe] and its members." Id. art. IV, § 1(a)-(b), (f). The Council could also charter organizations and delegate them with

the authority to manage the Tribe's economic affairs. Id. § 1(j).

The Tribe initially pursued economic self-sufficiency by opening a casino in the late 1990s. The casino provided significant revenue for the Tribe until 2008, when the recession severely limited the casino's revenue stream and forced the Tribe to explore other avenues to improve its finances. One of these steps was to start tribal businesses in certain areas, such as online lending, that would yield profits for the Tribe. Hazen Aff. (ECF No. 34-1) ¶¶ 2-5.

On July 8, 2011, the LVD Council enacted the Tribal Consumer Financial Services Regulatory Code ("the Code"), which legalized online lending by the Tribe. July 8, 2011 Resolution (ECF No. 23-5) at 1; Nov. 18, 2011 Resolution (ECF No. 23-3) at 1-2. The purpose of the Code was, inter alia: (1) to "[d]iversify and expedite the development of the [Tribe's] economy" in order to "improve the Tribe's economic self-sufficiency [and] to enable the Tribe to better serve the social, economic, educational, and health and safety needs of its members and visitors"; (2) to "[e]nsure that all consumer financial services profits are used for the benefit of the Tribe and [it]s community"; and (3) to "[e]nsure that the Tribe provides a Tribal-based forum for the fair and orderly

resolution of consumer financial services disputes consistent with the Tribe's preservation of sovereign immunity." Code (ECF No. 23-4) §§ 1.1(a), 1.2(a), (c), (g). The Code required that all entities offering tribal consumer financial services obtain licenses through a particular licensing process, as part of which licensees had to certify that they would "abide by all applicable Tribal and Federal laws, regulations and policies." Id. §§ 1.3(d), 5-7, 5.2(b)(8). It also established specific rules for certain financial services transactions, including small loans transactions. See id. § 11.

The Code also created the Tribal Financial Services Regulatory Authority ("the TFSRA") to enforce the Code and regulate licensees. Id. § 4.1. As a governmental subdivision of the Tribe, the TFSRA was "under the direction and control of the [LVD] Council." Id. § 4.4. However, the Code granted the TFSRA certain independent powers, including, as relevant here, the powers: (1) to "promulgate, adopt, and enforce regulations and rules furthering the purpose and provisions of the th[e] Code"; (2) to discipline licensees and other persons "by ordering immediate compliance, issuing fines and sanctions, and suspending or revoking any [l]icense pursuant to the hearings and due process required by Section 4.18 of th[e] Code"; and (3) to investigate any licensee or person engaging in consumer

financial services within the Tribe's jurisdiction. Id. § 4.13(a)-(d), (h)-(i); id. §§ 4.14, 4.16, 4.18.

In addition, the Code placed the TFSRA at the center of a three-tiered dispute resolution process for loan borrowers from tribal licensees. First, consumers that are "aggrieved" by a licensee's action must submit a written complaint to the licensee. The licensee must respond in writing within thirty days, and if it does not, it may be fined by the TFSRA in an amount equivalent to the greater of the outstanding principal loan amount or $1,500. Id. § 9.2(a)-(b). Second, consumers dissatisfied with a licensee's response (or who receive no response at all) may submit a written request for administrative review to the TFSRA within ninety days of the licensee's determination. The TFSRA may then "investigate the dispute in any manner it chooses," including by granting an administrative hearing. If such a hearing occurs, consumers can be represented by counsel at their own expense, and the TFSRA can conduct matters before and during the hearing in a quasi-judicial manner. After any hearing, the TFSRA must issue a written decision that contains its factual findings and conclusions of law, and "may grant or deny any relief as the [TFSRA] determines

appropriate."[2] Consumers can then request rehearing, which the TFSRA may grant or deny at its discretion. Id. § 9.3(a)-(g). Finally, consumers may appeal adverse TFSRA decisions by filing a written petition for review with the Tribal Court ("the LVD Court") within ninety days of the TFSRA's decision. The LVD Court's review is limited to the TFSRA's administrative record, and the Court must give deference to the TFSRA's interpretations and applications of the Code. It can only reverse a decision that is "arbitrary and capricious, or that . . . is not supported by the evidence," and must not reverse because of "[m]ere disagreement with the [TFSRA]'s factual findings." The LVD Court's subsequent opinion is final and cannot be appealed. Id. § 9.4.

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[2] Plaintiffs allege that the TFSRA's powers with regard to a hearing are constrained by TFSRA Regulation 1.1. Compl. ¶¶ 79-81. That regulation states that the TFSRA "will adhere to the dispute resolution procedures set out under section 9.3 of the Code." However, the regulation also indicates that the TFSRA: (1) "[m]ay grant a fair opportunity to be heard about the dispute if . . . the [TFSRA] finds the existence of a material issue as to whether or not the alleged act or practice is unfair or deceptive, or in violation of existing tribal consumer finance laws or regulations"; (2) "[w]ill not grant the consumer an opportunity to be heard if the only allegation contained in [a] consumer complaint is an allegation that the consumer finance service provided is illegal in a jurisdiction outside the jurisdiction of the Tribe"; and (3) "[m]ay resolve the dispute in favor of the consumer upon a finding that the [l]icensee has violated a law or regulation of the Tribe."

The latest development in the Tribe's history of economic regulation occurred on August 26, 2014, when the LVD Council enacted the Business Entity Ordinance ("the Business Ordinance"). Aug. 28 Resolution (ECF No. 23-6) at 1-2. The Business Ordinance created comprehensive procedures for the creation, operation, and dissolution of various tribal entities, including limited liability companies ("LLCs"). See generally Business Ordinance (ECF No. 23-7). Relevant to this dispute, the Ordinance stated that a tribally-owned LLC with the Tribe as its sole member would "be considered a wholly owned and operated instrumentality of the Tribe and . . . have all the privileges and immunities of the Tribe, including but not limited to the Tribe's sovereign immunity from suit, except as explicitly waived by the [LVD] Council." Id. Ch. 5, § 8(E). The Ordinance further indicated that those LLCs would be subject to the LVD Court's jurisdiction, but that such provision would not waive any claim to sovereign immunity in state or federal court. Id. Ch. 1, § 3(A), (D).

2. Beginning of Tribal Lending Operations

Soon after the Code was enacted, the Tribe began operating in the online lending arena when the LVD Council organized Red Rock Tribal Lending, LLC ("Red Rock") as a tribally-owned LLC on September 14, 2011. See Sept. 14, 2011 Resolution (ECF No. 23-

8). The company was managed by two members of the Tribe, and the Tribe was Red Rock's sole member. Red Rock Arts. of Organization (ECF No. 23-9), Art. 7; Hazen Aff. ¶¶ 6-7. The Complaint alleges that Matt Martorello ("Martorello")—along with Bellicose Capital, LLC ("Bellicose")[3] and Bellicose's general counsel, Daniel Gravel ("Gravel")—associated with the Tribe to form Red Rock. Compl. (ECF No. 1) ¶¶ 13, 29. Martorello, however, states that he was never a manager or member of Red Rock, nor were any of the companies that he owned or managed. Martorello Decl. (ECF No. 106-1) ¶¶ 18-21. Red Rock provided loans to consumers from its offices on the Reservation, and its employees, computers, and records were all located there. Moreover, as a tribal business, Red Rock was regulated by the TFSRA. Hazen Aff. ¶¶ 8-9.

Red Rock subsequently decided to contract with an outside entity to better learn the lending industry. The Tribe had identified Martorello as a potential consultant in mid-2011, but he was not involved in the creation of Red Rock. Martorello Decl. ¶¶ 14, 17. Then, on October 25, 2011, Red Rock contracted with Bellicose VI, LLC ("Bellicose VI")—a subsidiary of Bellicose—for it to provide Red Rock with vendor management

[3] Martorello was the founder and chief executive officer of Bellicose. Compl. ¶ 14.

services, compliance management assistance, marketing material development, and risk modeling and data analytics development. Hazen Aff. ¶ 10; Servicing Agm't[4] (ECF No. 83-2) at 1. On April 15, 2012, Bellicose VI assigned its interest in the contract to SourcePoint VI, LLC ("SourcePoint"), another Bellicose subsidiary. Hazen Aff. ¶ 12; Servicing Agm't at 1.

The Servicing Agreement detailed the revenue distribution structure for Red Rock's lending business and each party's duties as to that business. Under the contract, revenues were distributed first to Red Rock, which received 2% of all gross revenues "plus bad debt recoveries minus the sum of charge backs and bad debt charge-offs." Servicing Agm't §§ 2.25, 6.4.1. The remainder was then distributed in the following order: (1) to SourcePoint, to reimburse it for advances made to Red Rock and for servicing expenses; (2) to any of Red Rock's creditors, to pay outstanding debt that was then due; and (3) to SourcePoint, to pay its monthly servicing fee. Id. § 6.4.2-.5. The servicing fee was a variable performance-based fee equivalent to whatever cash basis revenue remained after the distributions above, and was at a minimum $20,000. Id. § 3.5.1. Martorello claims that

[4] The parties have not provided the original servicing agreement between Red Rock and Bellicose VI, but there is no indication that its provisions were substantially different than those in the Servicing Agreement between Red Rock and SourcePoint.

the Tribe itself suggested this revenue split because it guaranteed monthly income for the Tribe's general fund while also incentivizing SourcePoint to help the Tribe grow its businesses. Martorello Decl. ¶ 36. In addition, aside from these distributions, Red Rock received and retained ownership of all intellectual property developed under the Servicing Agreement by SourcePoint. Id. ¶ 35.

The Agreement also assigned specific responsibilities to SourcePoint. For instance, after noting that SourcePoint was being engaged as Red Rock's "independent contractor" to perform the services noted, the Agreement granted to SourcePoint "the authority and responsibility over all communication and interaction whatsoever between [Red Rock] and each service provider, lender and other agents of [Red Rock]." Id. § 3.1. The contract also prevented Red Rock from operating its lending business anywhere without using SourcePoint to provide its management and consulting services for those operations. Id. § 3.3.1. In addition, the Servicing Agreement required SourcePoint to select a bank account to store all funds generated by Red Rock's lending, and gave SourcePoint—unless otherwise agreed between Red Rock and SourcePoint—the "sole signatory and transfer authority over such bank accounts," as well as "sole authority to sweep monies from such bank accounts"

to distribute revenues under the priority structure. Id. § 4.4. Finally, the Agreement gave SourcePoint numerous other duties concerning the day-to-day functioning of Red Rock's lending business, such as: (1) "[s]creening of and selecting service providers and lenders, and negotiating agreements with such service providers and lenders on behalf of [Red Rock]"; (2) "[d]evelopment and promotion of sound and positive business relationships on behalf of [Red Rock] with the designated service providers and lenders"; (3) preparation of regulatory, compliance, training, education, financial reporting and accounting, website content, and marketing standards; (4) "providing pre-qualified leads to [Red Rock] and providing the necessary credit-modeling data and risk assessment strategies" to Red Rock; and (5) "training and monitoring [Red Rock] employees . . . that operate [Red Rock]'s call center." Id. § 4.2.1.[5]

However, the Servicing Agreement also limited the ultimate authority of SourcePoint over Red Rock's management decisions.

[5] Based, presumably, on the Servicing Agreement, Plaintiffs allege that: Bellicose funded and underwrote Red Rock's loans; the money loaned was transferred from a bank account controlled by Bellicose and Martorello, which tribal officials could not access; Bellicose accepted consumer payments directly; and the only funds that Red Rock, Big Picture, or the Tribe ever received or handled was the specified revenue percentage under the Servicing Agreement. Compl. ¶¶ 30-32, 36-37.

For instance, the provision allowing SourcePoint to provide leads and credit-modeling data to Red Rock also said that "[t]he criteria used to extend funds to individual borrowers will remain within the sole and absolute discretion of [Red Rock] and [Red Rock] shall execute all necessary loan documentation." Id. § 4.2.1(i). Similarly, SourcePoint "ha[d] no authority to engage in origination activities, execute loan documentation, or approve the issuance of loans to third parties. Final determination as to whether to lend to a consumer rest[ed] with [Red Rock]." Id. § 4.1.1. SourcePoint also needed the Tribe's written consent "to do any of the following: (1) to borrow, pledge, assign, convey, encumber, grant security interest in, guaranty, or otherwise restrict the assets of [Red Rock]; (2) to sell or otherwise dispose of all or substantially all of the assets of [Red Rock]; [or] (3) to waive the sovereign immunity of [Red Rock]." Id. § 4.1.2. In other words, SourcePoint's duties, although numerous, were to be limited to providing "reasonable measures for the orderly administration and management" of Red Rock. Id. § 4.2.1.

Some evidence also indicates that Red Rock's role under the Servicing Agreement was more substantial than Plaintiffs suggest. Red Rock's co-manager, Michelle Hazen ("Hazen"), says that, "[w]hile Red Rock received advice and consulted with

Bellicose about operations, all final decisions about operations were made by Red Rock's managers." Hazen Aff. ¶ 11; see also ECF No. 83-4 (e-mail from SourcePoint employee to tribal members recommending adoption of direct mail campaign prepared by SourcePoint). Similarly, Martorello indicates that, as a consultant,[6] he "made suggestions and offered advice to Red Rock's co-managers," but "Red Rock's co-managers were ultimately responsible for all decisions regarding Red Rock's operation." Furthermore, Martorello, Bellicose, and SourcePoint never, on Red Rock's behalf, made lending decisions; originated a consumer loan; purchased a loan originated by Red Rock; or took any action to collect a Red Rock loan. Instead, Red Rock always made the final decision to lend to a particular consumer, and Red Rock's co-managers, including Hazen, always reviewed and approved marketing materials, including the prescreening of credit reports.[7] Finally, Bellicose's and SourcePoint's access to

[6] As permitted by the Servicing Agreement, SourcePoint hired Bellicose employees, including Martorello, to perform certain services for Red Rock. Martorello Decl. ¶ 31.

[7] Plaintiffs cite Big Picture's interrogatory response to assert that Red Rock's role in the lending process was limited to "final verification of the applicant's information in the loan agreement," including "the applicant's e-signature, the due dates, the payment schedule, [and] the applicant's bank information." Big Picture Interrogatory Responses (ECF No. 91-4) ¶ 24. This statement is misleading. First, the response addressed Big Picture's loan evaluation procedure, and thus had

Red Rock's bank accounts was limited by deposit access control agreements provided by Red Rock, which Red Rock or the Tribe could terminate at any time. Furthermore, although Martorello was a signatory on certain Red Rock accounts, he claims that he was listed that way only "to facilitate accounts payable, and never without express contractual or delegated authority." Martorello Decl. ¶¶ 22-28.

Red Rock then began making loans to consumers, including some in New York. In February 2013, the New York Department of Financial Services ("the Department") sent cease-and-desist letters to a number of lending entities, including the Tribe, accusing them of "using the Internet to offer and originate illegal payday loans to New York consumers, in violation of New York's civil and criminal usury laws."[8] Otoe-Missouria Tribe of Indians v. N.Y. State Dep't of Fin. Servs., 974 F. Supp. 2d 353, 356 (S.D.N.Y. 2013) (internal quotations omitted). The Department also sent letters to third parties that credit and debit payday loan payments, advising them that the Department

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nothing to do with Red Rock. Second, the response did not concern Big Picture's relationship with third parties, and even noted that "[n]o third party participates in Big Picture's [loan] evaluation." Id.

[8] New York prohibits annual interest above 16% on loans greater than $250,000, N.Y. Gen. Obligations Law § 5-501; N.Y. Banking Law § 14-a(1), and criminalizes annual interest above 25%, N.Y. Penal Law § 190.40.

would pursue enforcement actions against lenders that refused to cease and desist. Id. at 356-57. This threat of regulatory enforcement caused the lending entities' business partners to limit or end their relationship with the entities, which in turn led the entities to seek a preliminary injunction preventing the Department from enforcing New York's anti-usury statutes against them—in part because any regulation would infringe on the entities' tribal sovereignty. See id. at 357-58. However, the court denied the entities' request, finding that they had not shown a likelihood of success on the merits because their online lending to New York consumers constituted off-reservation activity, and could therefore be properly regulated under New York's non-discriminatory anti-usury laws. See id. at 360-61. The Second Circuit affirmed this decision in October 2014. See Otoe-Missouria Tribe of Indians v. N.Y. State Dep't of Fin. Servs., 769 F.3d 105 (2d Cir. 2014). The Tribe's response to these decisions is unknown.

3. Expansion of Tribal Lending Business

After 2011, through its operation of Red Rock and relationship with Bellicose and Martorello, the Tribe gained knowledge of the online lending industry. Hazen Aff. ¶ 13; Martorello Decl. ¶¶ 47-48. The Tribe wanted to apply that knowledge to expand its online lending platform and increase

profitability for the Tribe, employ more tribal members, and acquire its vendors' businesses so that the Tribe would earn more money. Hazen Aff. ¶ 13. As part of that strategy, the LVD Council organized Big Picture on August 26, 2014. Aug. 26, 2014 Resolution (ECF No. 23-10). Big Picture was formed "as a wholly owned and operated instrumentality of the Tribe," and was managed by two tribal members, Hazen and James Williams ("Williams"). Id. at 2-3. Big Picture was meant to serve as an independent tribal lending entity that would "ultimately consolidate the business" of the Tribe's other lending entities, Red Rock and Duck Creek Tribal Financial, LLC. Id. at 1.

On February 5, 2015, the LVD Council formed another entity, Tribal Economic Development Holdings, LLC ("TED"), to operate the Tribe's current and future lending companies. Feb. 5, 2015 TED Resolution (ECF No. 23-13). The Tribe was the sole member of TED, and Hazen and Williams were designated as its co-managers. Id. at 3; TED Arts. of Organization (ECF No. 23-14), Arts. 8-9. Big Picture's membership was also restructured so that TED became its sole member. Big Picture Arts. of Organization (ECF No. 23-13), Arts. 8-9. Then, also on February 5, the LVD Council formed Ascension as a subsidiary of TED "for the purpose of engaging in marketing, technological and vendor services" to support the Tribe's lending entities. Feb. 5, 2015 Ascension

Resolution (ECF No. 23-16) at 1. Ascension was created "as a wholly owned and operated instrumentality of the Tribe," with TED as its sole member, and was managed by Hazen and Williams. Id. at 2-3; Ascension Arts. of Organization (ECF No. 23-17), Arts. 8-9. Hazen and Williams named Brian McFadden ("McFadden") as Ascension's President. Feb. 5, 2015 Ascension Resolution at 3.

4. Tribe's Acquisition of Bellicose

Since 2012, Martorello and the Tribe had engaged in multiple conversations about the potential sale of Martorello's consulting companies to the Tribe, which would allow the Tribe to engage in online lending without relying on outside vendors for support services. The creation of TED and Ascension and reorganization of Big Picture in February 2015 were undertaken to enable the Tribe to more easily purchase Bellicose, in part because those steps added layers to protect the Tribe from liability. Martorello Decl. ¶¶ 49-50; Martorello Sept. 11, 2015 E-mail (ECF No. 83-8) at LVD-DEF00014697. In addition, around that time, the LVD Council formed Tribal Acquisition Company, LLC ("TAC"), with TED as its sole member and Hazen and Williams as co-managers, for the sole purpose of acquiring Bellicose without creating a nexus between TED and Delaware. Sept. 14,

2015 Merger Resolution (ECF No. 34-2) ("the Merger Resolution") at 2; Martorello Sept. 11, 2015 E-mail at LVD-DEF00014697.

In early 2015, the parties agreed on the basic framework of the merger: a seller-financed transaction with non-fixed payments over a seven-year term, with any outstanding amount due being forgiven at the end of that term. According to Martorello, the Tribe requested this structure because it would enable the Tribe to accomplish its goals of economic self-sufficiency more easily. Martorello Decl. ¶ 51. The seller-financier would be Eventide Credit Acquisitions, LLC ("Eventide"), a company managed and majority-owned by multiple entities of which Martorello was the president. Merger Resolution at 3; Eventide Operating Agm't, Sched. A (ECF No. 91-11). Eventide would provide a $300 million loan to TED, which TED would then use to purchase Bellicose. Merger Resolution at 3. After this structure was set, Martorello continued negotiating with the Tribe over the next several months. Martorello Decl. ¶ 52. The parties reached a final agreement on September 14, 2015, memorializing the terms of the deal in a loan agreement ("the Loan Agreement") and a promissory note ("the Note"). Merger Resolution at 7-9; see generally Loan Agreement (ECF No. 83-17); Note (ECF No. 83-11). As part of the transaction, the LVD Council approved a limited waiver of TED's and Big Picture's sovereign immunity in

connection with TED's repayment of the Eventide loan during its seven-year term. See Sept. 14, 2015 Immunity Waiver Resolution (ECF No. 34-3) at 2-8. On January 26, 2016, the Tribe finally completed its purchase of Bellicose, including subsidiaries like SourcePoint, and acquired all of Bellicose's data, software, and corporate goodwill. Martorello Decl. ¶ 53; Hazen Aff. ¶ 22.

Under the Note, revenues from Big Picture's lending business are distributed monthly in several steps. First, Big Picture makes a distribution to TED of Big Picture's gross revenues. Note § 1.2(a); Martorello Decl. ¶ 57. TED then distributes 2% of those gross revenues to the Tribe, until half of the total loan amount has been paid, at which time the distribution percentage increases from 2% to 4%. Note § 1.2(b)(1). The parties agreed to increase the monthly distribution from 2% to 3% in or around September 2016.[9] Note Addendum (ECF No. 91-18); Martorello Decl. ¶ 57. If TED defaults under the Loan Agreement, then the monthly distribution to the Tribe reduces to zero. Note § 1.2(b)(1); see also Loan Agreement § 6.1 (describing events triggering default). Second, TED pays an additional 2% of gross revenues to the Tribe to be

[9] That agreement also indicated that the percentage distribution would increase from 3% to 6% when half the loan had been repaid. Note Addendum; Martorello Decl. ¶ 57.

reinvested "in growing the loan portfolio."[10] Note § 1.2(b)(2). That reinvestment amount must "stay in equity within [TED] or [Big Picture] conducting lending" until the Note and Loan Agreement terminate. As with the first distribution, this payment reduces to zero if TED defaults. Note § 1.2(b)(2). Third, TED and Big Picture must pay any interest and principal due to other creditors. Id. § 1.2(b)(3).

Fourth, an amount is deducted to pay "[o]rdinary and necessary business expenses" incurred in connection with Big Picture's lending business, including payments to tribal and non-tribal vendors.[11] Id. § 1.2(b)(4); Martorello Decl. ¶ 57. Those expenses may not exceed reasonable rates for particular services, and TED and Big Picture have a fiduciary duty to Eventide to ensure that they do not "undermine the [p]arties' intent to maximize the cash flows directed to retire the Note as soon as possible." Note § 1.2(b)(4). Accordingly, TED must

[10] The initial reinvestment amount was $1.3 million, but the amount was reduced to 2% of gross revenues for each month thereafter. Note § 1.2(b)(2).

[11] The Note also identifies certain "[n]on-deductible expenses," which are taken instead from the Tribe's 2% monthly distribution or the 2% reinvestment amount at TED's choice. These include: (1) any tax, fine, or licensing fee charged by the Tribe, except for certain regulatory fees or fines charged by the TFSRA; (2) any attorneys' fees award from a suit related to the Bellicose merger documents; or (3) any ordinary and necessary expenses that Eventide does not agree to pay and that, in the aggregate, exceed $25,000 per year. Note § 1.2(b)(5).

submit a monthly budget and expense report to Eventide, which Eventide uses to ensure that the expenses are reasonable and not inflated to deprive Eventide of payments it will receive under the Note. Id. § 1.2(c); Martorello Decl. ¶ 59. The Note allows expenses based on a "reasonable expansion" of Big Picture's lending operations in light of "industry climate and norms." Note § 1.2(b)(4)(b). Nonetheless, Eventide must approve a budget for such expansion to ensure that TED's repayment of the loan is not affected. Id. Martorello claims that Eventide has "never unreasonably withheld its consent to expenses, nor has it objected to the reasonable expansion of the business—even when expansion created additional debt for Big Picture which meant smaller (or no) payments to Eventide." Martorello Decl. ¶ 60.

Finally, TED pays to Eventide the "Net Cash Available"—that is, Big Picture's gross revenues minus all the distributions and deductions above. That amount is applied first to any unpaid principal, and then to unpaid interest.[12] Note § 1.2. As Martorello explains, because Eventide receives payments last under the Note's distribution structure, it is possible that Eventide will not receive a principal payment in some months

[12] The Note carries a fixed interest rate of 1.8% per year, Note at 1, which Martorello claims is "significantly below the rate at which [the Tribe] could go into the marketplace and borrow funds," Martorello Decl. ¶ 64.

because TED has no net income from which to make a payment. This situation has occurred on at least five occasions. TED, on the other hand, has always received all of Big Picture's net income, and is guaranteed to receive its 3% distribution and reinvestment amount every month. Martorello Decl. ¶ 63.

Each payment to Eventide under the waterfall structure is accompanied by a payment schedule. Note § 1.2(c). Based on these schedules, and other financial statements, Martorello states that TED has consistently paid down its principal under the Note, such that the Tribe has been receiving an equity interest in the lending support services that it acquired through Bellicose. He notes that, since the close of the acquisition, Eventide's Note payments have amounted to $21,375,922.10, whereas the total economic consideration obtained by the Tribe under the Note has been $28,184,007.69. Martorello Decl. ¶ 63; McFadden Aff. (ECF No. 106-17) ¶ 17. However, the exact basis of those figures is unclear. In fact, Plaintiffs cite two documents with different numbers than those provided by Martorello. One indicates that, as of June 2017, the cumulative repayment to Eventide was $17,968,528.36, and the cumulative amount to TED was $4,924,930.94 ($1,963,708.81 in distributions, and $2,961,222.13 in reinvestments). Pls. Opp. (ECF No. 90) at 11, 21-22. The second shows slightly higher numbers than those

through December 2017. See id. Those figures are consistent with Big Picture's assertion that, by September 2017, TED had distributed approximately $20.5 million in loan payments to Eventide and nearly $5 million to the Tribe ($3,035,374.90 in distributions, and $1,948,999.53 in reinvestments). Big Picture Suppl. Interrogatory Responses (ECF No. 102-3) ¶ 1. Martorello's calculations might include amounts not accounted for in those spreadsheets, such as the economic value of Bellicose's data or corporate goodwill, but that is hard to discern. In any event, the Note is fixed to expire seven years after its execution date—thus, by September 14, 2022—at which time "the remaining balance is forgiven." Note § 1.3.

The Tribe finished restructuring its lending businesses soon after the Bellicose purchase. TAC dissolved in late January 2016 after control of Bellicose had been transferred to TED. Arts. of Dissolution (ECF No. 91-9). Around the same time, Bellicose's assets were assigned to Ascension and its liabilities were assigned to Big Picture, and Bellicose ceased to exist. Shortly thereafter, on February 16, 2016, Big Picture engaged Ascension as an independent contractor to provide Big Picture with the servicing support services that Ascension had carried over from Bellicose. Intratribal Servicing Agm't (ECF No. 91-17) § 3.1; see also McFadden Feb. 24, 2015 Letter (ECF

No. 91-30) (noting that all Bellicose VI positions and operations would be merged into Ascension).

The Intratribal Servicing Agreement is similar to the earlier Servicing Agreement between Red Rock and SourcePoint. In particular, the contract requires that Ascension "develop and recommend to [Big Picture] . . . reasonable measures for the orderly administration and management of [Big Picture] in the areas of financial reporting, financing, regulatory compliance, marketing, human resources, development of vendor relationships, collections and risk assessment," and then describes most of the same day-to-day operational responsibilities that SourcePoint had. Intratribal Servicing Agm't § 4.2.1; see also Servicing Agm't § 4.2.1. Ascension also receives a monthly fee, which is the sum of the following: (1) "[m]anpower charges," which are Ascension's salary costs, payroll taxes, and other employment expenses; (2) internal expenses, which are capped by Ascension's servicing budget; (3) overhead expenses, in different amounts based on whether Big Picture is the beneficiary of such expenses; and (4) a bonus plan for Ascension's employees. Intratribal Servicing Agm't § 3.4.

Big Picture, however, retains the same managerial authority as Red Rock. To that end, the Intratribal Servicing Agreement specifically provides that "[t]he criteria used to extend funds

to individual borrowers will remain within the sole and absolute discretion of [Big Picture] . . . and [Big Picture] . . . shall execute all necessary loan documentations." Id. § 4.2.1(k). Likewise, Ascension "has no authority to engage in origination activities, execute loan documentation, or approve the issuance of loans to consumers. Final determination as to whether to lend to a consumer rests with [Big Picture] . . . ." Id. § 4.1. In addition, even though McFadden and Simon Liang ("Liang"), Ascension's controller, were added as authorized signers for Big Picture's bank accounts, ECF No. 83-23, their authority is bound by deposit account control and lockbox agreements, Intratribal Servicing Agm't §§ 4.4, 4.7. The only real limitation on Big Picture's authority is the Loan Agreement, which prevents TED or Big Picture from amending or terminating the Intratribal Servicing Agreement during the loan's seven-year term without Eventide's written consent. Loan Agm't § 5.12.

On the same day that Big Picture contracted with Ascension, the LVD Council also authorized Red Rock to assign the majority of its consumer loans and obligations to Big Picture. Hazen Aff. ¶ 23; Feb. 16, 2016 Assignment Resolution (ECF No. 23-23) at 2-3; see generally Assignment Agm't (ECF No. 23-24). All unassigned loans were written off as bad debt, and Red Rock subsequently dissolved. Hazen Aff. ¶ 23; Red Rock Arts. of

Dissolution (ECF No. 23-27); Feb. 16, 2016 Dissolution Resolution (ECF No. 23-26). Hazen, as co-manager of Red Rock, gave the appropriate notice of dissolution to the TFSRA and to any party that might have claims against Red Rock. See ECF Nos. 23-28, 23-29. Big Picture then sent a notice of assignment to all consumers whose loans it had received, instructing them that Big Picture would begin collecting their loan payments effective February 17, 2016. ECF No. 23-25.

5. Current Management of Big Picture and Ascension

TED now oversees both Big Picture and Ascension. All three entities have their headquarters on the Reservation. TED Operating Agm't (ECF No. 23-33) § 1.3; Big Picture Operating Agm't (ECF No. 23-30) § 1.3; Ascension Operating Agm't (ECF No. 23-18) § 1.3. Big Picture currently employs fifteen individuals on the Reservation. Ascension employs thirty-one individuals, most of whom work outside the Reservation at Ascension's satellite offices, Hazen Aff. ¶¶ 24-25, which appear to be in (at least) Atlanta, Mississippi, and Puerto Rico, Compl. ¶¶ 50-53. Hazen and Williams, both LVD Council members, co-manage all three companies. Hazen Aff. ¶¶ 2, 15, 18-20; Williams Aff. (ECF No. 23-36) ¶¶ 1, 11-13. That position grants them the broad authority to, in the case of Big Picture, "perform all actions as may be necessary or appropriate to carry out the business of

[Big Picture] including but not limited to the power to enter into contracts for services, to manage vendor relationships, to manage personnel issues and affairs of [Big Picture]." Big Picture Operating Agm't § 5.1(a).[13] Where the managers' power is limited by the operating agreements, the ultimate authority resides in the LVD Council. See id. § 5.2. Similarly, all three entities must submit quarterly reports to either the LVD Council (for TED) or TED (for Big Picture and Ascension). Id. § 5.8; TED Operating Agm't § 4.7; Ascension Operating Agm't § 5.8.

Hazen has been Big Picture's CEO since December 2015. Hazen Aff. ¶ 20. However, as for Ascension, Hazen and Williams have delegated to McFadden: (1) the "approval of Ascension strategic direction," which must be communicated at least quarterly to the co-managers; (2) "authority to execute documents on behalf of Ascension"; (3) "authority to open and maintain bank accounts"; (4) "authority to adopt, terminate, or change employee benefit plans or programs"; and (5) "authority regarding all matters necessary for . . . day to day management." Ascension Delegation of Authority Policy (ECF No. 91-13) § 1.4. McFadden must report regularly to Hazen and Williams about the authority exercised

[13] Hazen and Williams are granted similarly broad management authority under nearly identical provisions in TED's and Ascension's operating agreements. See TED Operating Agm't § 5.1(a); Ascension Operating Agm't § 5.1(a).

under those provisions and any matters that might fall under their purview. Id. § 1.5. McFadden also must obtain co-manager approval "for changes in operations, personnel, and distributions." McFadden Aff. ¶ 8.

Martorello asserts that he has had limited contact with the Tribe since it purchased Bellicose in January 2016. As he states, he has never been involved in TED's operations, made any decisions on its behalf, provided any consulting services to it, or solicited any investors on its behalf. Likewise, he has never provided any consulting services to Big Picture or Ascension; suggested marketing strategies, underwriting criteria, or other policies to them; accessed any of their software systems, databases, bank accounts, or records; or hired or fired their employees. Martorello has interacted with Hazen and Williams when they have requested Eventide's permission to undertake expenses for Big Picture that exceeded budgeted expenses under the Note, but Martorello never proposed that they incur those expenses, nor did he object to their requests. Martorello Decl. ¶¶ 70-97; see also McFadden Aff. ¶¶ 13-16. Furthermore, says McFadden, neither Eventide nor Martorello participates in Ascension's day-to-day operations, and Ascension does not seek Eventide's or Martorello's consent for those operations, except if Ascension needs to expand its budget. Even in that case,

explains McFadden, he would first obtain Hazen's or Williams' approval before contacting Eventide. McFadden Aff. ¶¶ 10-12.

Big Picture operates in some ways as an independent financial entity. It maintains its operating account with a regional bank, where it funds all its loans, receives all consumer payments, pays all payroll and vendors, deposits all its investments, and makes distributions to TED and the Tribe.[14] Big Picture relies on private investors to fund its lending operation, including the loans themselves. These investments are made through traditional loan agreements and promissory notes, under which Big Picture is responsible to each investor. Hazen Aff. ¶¶ 26-27. The Tribe itself has invested over $7 million. Williams Aff. ¶ 8.

Moreover, Big Picture's lending operation has yielded concrete financial benefits for the Tribe. Any profits that Big Picture earns are allocated to its sole member, TED, which in turn allocates those profits to the Tribe. Big Picture Operating Agm't § 6.1; TED Operation Agm't § 6.1.[15] If Big Picture's cash

[14] As with Red Rock, Plaintiffs allege that Big Picture does not ever handle the money loaned to or paid by consumers. See Compl. ¶¶ 30-32, 36-37.

[15] Ascension has an identical provision in its operating agreement, Ascension Operating Agm't § 6.1, but Ascension does not generate any profit that it could allocate.

account balance exceeds $500, it must declare an immediate distribution and transfer the excess to TED. Big Picture Operating Agm't § 6.2. It is unclear if this always occurs, as e-mails from Liang to Martorello about repayment of Eventide's loan contain language indicating that Big Picture's cash balance was greater than $500, but that Big Picture "would like to keep [the balance] for lead acquisition and loan origination in future months." See, e.g., ECF No. 83-24 at MARTORELLO_000218. In any event, beyond the profits obtained through the Note's revenue distributions, the Tribe also receives interest payments as a substantial investor in Big Picture. Proceeds from Big Picture's business now comprise more than 10% of the Tribe's general fund, and those profits could possibly fund more than 30% of the Tribe's budget over the next few years. Williams Aff. ¶¶ 9-10.

The Tribe relies on Big Picture's funds for governmental programs and services. Id. ¶ 10. Specifically, Big Picture's revenues have been used to, in whole or in part: meet requirements necessary to secure $14.1 million in financing for the Tribe's new health clinic; refinance casino debt; fund college scholarships and pay for educational costs for members such as student housing, books, school supplies and equipment; create home ownership opportunities for members through

tribally-purchased homes; subsidize tribal members' home purchases and rentals; provide a bridge loan to complete the new tribal health clinic that offers services to the regional community; fund new vehicles for the Tribe's Police Department; fund an Ojibwe language program and other cultural programs; provide foster care payments for eligible children, propane purchase assistance, and assistance for family care outside of the community; cover burial and other funeral expenses for members' families; fund renovations and new office space for the Tribe's Social Services Department; fund youth activities; renovate a new space for the LVD Court and bring in telecom services for remote court proceedings; and fund tribal elder nutrition programs and tribal elder home care and transport services. Hazen Aff. ¶ 31.

6. Big Picture's Lending Process

As noted, Big Picture has its principal place of business on the Reservation, and its employees are all located there. The servers for Big Picture's websites are also stored on the Reservation. And, because all loan applications are approved by Big Picture employees on the Reservation, all consumer loans are originated there. Id. ¶¶ 28, 30(a).

To obtain a loan from Big Picture, consumers must log onto the company's website and complete and submit an application.

Big Picture then conducts a review using a software-based underwriting process and either accepts or denies the application. Id. ¶ 30(a)-(b). That software consolidates consumer credit data from third-party service providers to verify applicants' information and determine creditworthiness. Big Picture Interrogatory Responses ¶ 24. An applicant receives a notice of denial if the application is denied. Hazen Aff. ¶ 30(d).

Even if an application is accepted, the consumer must complete several more steps before the loan is finalized. First, the website prompts applicants to select their desired loan amount, which may be as high as $5,000. Second, applicants must select the term of the loan, and Big Picture in turn provides an estimated annual percentage rate ("APR") based on the underwriting software's determination of an applicant's repayment ability. Third, applicants must review Big Picture's standard loan agreement, which includes the loan's APR and repayment schedule. Fourth, applicants must acknowledge their review of, and agree to, the loan agreement—including the choice-of-law, forum-selection, and jury trial waiver clauses—and Big Picture's privacy disclosures. Finally, applicants must select their payment method. Id. ¶ 30(c)(1)-(6).

Once a consumer signs the loan agreement, the contract goes to Big Picture for its employees' review. Employees on the Reservation perform a final verification of the applicant's information in the loan agreement and other details. If there are no issues, the reviewing employee manually enters the date of disbursal of funds, which authorizes electronic approval of the agreement. This action also causes the loan to be originated and triggers the transmission of instructions for the particular application to a third-party payment processor, which then disburses the funds to the consumer. Id. ¶ 30(c)(7)-(8).

7. Tribe's Lending Activities in Virginia

The parties have not provided evidence regarding Red Rock's or Big Picture's lending activities in Virginia specifically. However, the Complaint alleges that Martorello and Gravel intentionally chose Virginia as a place where Red Rock and Big Picture would offer loans and collect payments, and they proceeded with this plan notwithstanding their knowledge that the loans would be illegal under Virginia's usury laws. Certain defendants then began marketing, initiating, and collecting loans in Virginia. Consumers were required to electronically sign the form loan agreement described above. Under the terms of that contract, the loans were subject to an APR that was much higher than 12%. However, neither the Tribe nor any of the

defendants had a consumer finance license permitting them to charge interest at such a high rate, and they never attempted to obtain such a license. Compl. ¶¶ 54-57, 60.

Lula Williams, Gloria Turnage ("Turnage"), George Hengle ("Hengle"), Dowin Coffy ("Coffy"), and Felix Gillison, Jr. ("Gillison"; with Lula Williams, Turnage, Hengle, and Coffy, collectively, "Plaintiffs") all entered into loans with Big Picture, and their loan agreements with Big Picture specified that interest would be charged at greater than 12% APR. Lula Williams' loan was subject to an APR of 649.8%; Turnage's loan was subject to an APR of 693.2%; Hengle's and Coffy's loans were subject to an APR of 607.5%; and Gillison's loan was subject to an APR of 627.2%. Based on those rates, Plaintiffs paid various amounts to Big Picture, most of which were credited as payment for interest or other loan-related fees. Id. ¶¶ 58-59, 62-65.

The loan agreements also contained the following provisions:

> GOVERNING LAW AND FORUM SELECTION: This Agreement will be governed by the laws of the Lac Vieux Desert Band of Lake Superior Chippewa Indians ("Tribal law"), including but not limited to the [Tribal Consumer Financial Services Regulatory] Code as well as applicable federal law. All disputes shall be solely and exclusively resolved pursuant to the Tribal Dispute Resolution Procedure set forth in Section 9 of the Code

and summarized below for your convenience. . . .

TRIBAL DISPUTE RESOLUTION PROCEDURE: The Tribe has established a Tribal Dispute Resolution Procedure (the "Procedure") to review and consider any and all types of complaints made by You or on Your behalf relating to or arising from this Agreement. The Procedure is found at Section 9 of the Code. You can find the Code at [Big Picture's] website, . . . or You may request a physical copy by written request mailed . . . to the Tribal Financial Services Regulatory Authority, P.O. Box 249, Watersmeet, Michigan 49969. The Tribe and [Big Picture] intend and require, to the extent permitted by Tribal law, that any complaint lodged, filed, or otherwise submitted by you or on your behalf to follow the Procedure. Under the Procedure, a consumer who, in the course of his otherwise lawful and proper use of [Big Picture]'s business believes himself to be harmed by some aspect of the operation of any part of [Big Picture]'s business, shall direct his concerns or dispute to [Big Picture] in writing. A person's complaint to [Big Picture] shall be considered similar in nature to a petition for redress submitted to a sovereign government, without waiver of sovereign immunity and exclusive jurisdiction, and does not create any binding procedural or substantive rights for a petitioner. [Big Picture] will investigate the complaint and respond as soon as reasonably practicable, but no later than thirty (30) days from the receipt of the complaint. In the event that the consumer is dissatisfied with [Big Picture]'s determination, he may initiate Formal Dispute Resolution by requesting an administrative review of [Big Picture]'s determination by submitting such request in writing to the Tribal Financial Services

> Regulatory Authority ("Authority"), P.O. Box 249, Watersmeet, MI 49969, no later than ninety (90) days after receiving [Big Picture]'s determination.

ECF No. 1-1 at 4-5; see also Compl. ¶¶ 70-71. These are the choice-of-law and forum-selection provisions referenced above.

B. Procedural Background

On June 22, 2017, Plaintiffs brought suit against Big Picture, Ascension, Martorello, Williams, Gertrude McGeshick, Susan McGeshick, Giiwegiizhigookway Martin,[16] and Gravel. They asserted five class claims:

(1) COUNT ONE, Declaratory Judgment, against all defendants, stating that the choice-of-law and forum-selection provisions in all loan agreements made by Big Picture or Red Rock to Virginia residents are void and unenforceable;

(2) COUNT TWO, Violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1962(c), against all defendants;

[16] Williams, the McGeshicks, and Martin (collectively, "the LVD Officers") are all members of the LVD Council: Williams is the Chairman, Gertrude McGeshick is the Secretary, Susan McGeshick is the Treasurer, and Martin is the Vice-Chairwoman. Compl. ¶¶ 17-20.

(3) COUNT THREE, Violations of RICO, 18 U.S.C. § 1962(d), against all defendants;[17]

(4) COUNT FOUR, Violations of Virginia Usury Laws, against Big Picture, Martorello, Ascension, and Gravel; and

(5) COUNT FIVE, Unjust Enrichment, against Big Picture, Martorello, Ascension, and Gravel.

Compl. ¶¶ 84-139.

After some defendants indicated that they would seek dismissal of the Complaint on the basis of, among other grounds, lack of subject matter jurisdiction and personal jurisdiction, the Court ordered the parties to conduct jurisdictional discovery. ECF No. 17. Following discovery disputes, the Court ordered Defendants to produce some documents that it had previously withheld as privileged. ECF No. 49. That same day, the Court granted Plaintiffs' and Gravel's joint motion to dismiss Gravel from the action without prejudice. ECF Nos. 46, 50. The Court later granted the LVD Officers' motion to dismiss the claims against them on Rule 12(b)(6) grounds, and Plaintiffs chose not to file an Amended Complaint. ECF Nos. 117, 122.

[17] For Counts Two and Three, Plaintiffs seek injunctive relief only as to the LVD Officers, and both damages and injunctive relief as to Big Picture, Ascension, and Martorello. Compl. ¶ 95 n.8.

Accordingly, Big Picture and Ascension are the only remaining defendants besides Martorello.

DISCUSSION

I. Legal Standard

Fed. R. Civ. P. 12(b)(1) tests whether the court has subject matter jurisdiction to resolve the claims before it.[18] Sovereign immunity issues are generally considered jurisdictional in nature and, as a result, are appropriately resolved in the context of a Rule 12(b)(1) motion. See United States v. Jones, 225 F.3d 468, 469 (4th Cir. 2000) ("Sovereign immunity deprives a court of jurisdiction."); Best Med. Belgium, Inc. v. Kingdom of Belgium, 913 F. Supp. 2d 230, 236 (E.D. Va. 2012) ("Subject matter jurisdiction encompasses the scope of sovereign immunity."). When a defendant seeks dismissal under Rule 12(b)(1), the plaintiff bears the burden of proving subject matter jurisdiction. Richmond, Fredericksburg & Potomac R. Co. v. United States, 945 F.2d 765, 768 (4th Cir. 1991); see also Lucas v. Henrico Cty. School Bd., 822 F. Supp. 2d 589, 599 (E.D. Va. 2011). Nonetheless, as explained below, there is some

[18] Big Picture and Ascension also assert that the Court lacks personal jurisdiction over them, but they spend little time arguing this point given the Fourth Circuit's broad reading of RICO's nationwide service of process provision. See ESAB Grp., Inc. v. Centricut, Inc., 126 F.3d 617, 627 (4th Cir. 1997). Thus, the Court will not address any personal jurisdiction issues in this opinion.

disagreement here about which party bears the burden with respect to tribal sovereign immunity.

Two types of Rule 12(b)(1) motions exist:

> First, a 12(b)(1) motion may attack the complaint on its face, asserting that the complaint fails to state a claim upon which subject matter jurisdiction can lie. In such a challenge, a court assumes the truth of the facts alleged by plaintiff, thereby functionally affording the plaintiff the same procedural protection he or she would receive under Rule 12(b)(6) consideration.
>
> However, a 12(b)(1) motion may also . . . challenge the existence of subject matter jurisdiction in fact, apart from the pleadings. In such a challenge, no presumptive truthfulness attaches to the plaintiff's allegations, and the existence of disputed material facts will not preclude the trial court from evaluating for itself the merits of jurisdictional claims.

Lucas, 822 F. Supp. 2d at 599 (internal citations omitted). Moreover, in the latter situation—including where, as here, a defendant asserts sovereign immunity—the court "may consider evidence outside the pleadings without converting the proceeding to one for summary judgment." White Tail Park, Inc. v. Stroube, 413 F.3d 451, 459 (4th Cir. 2005) (internal quotations omitted); see also Blitz v. Napolitano, 700 F.3d 733, 736 n.3 (4th Cir. 2012) ("[On] a Rule 12(b)(1) motion to dismiss, the district court may regard the pleadings as mere evidence on the issue and may consider evidence outside the pleadings . . . ." (second

alteration in original) (internal quotations omitted)). The court then must "weigh[] the evidence to determine its jurisdiction." Adams v. Bain, 697 F.2d 1213, 1219 (4th Cir. 1982).

II. Tribal Sovereign Immunity

A. Legal Standard

1. In General

Federally-recognized Indian tribes are "separate sovereigns pre-existing the Constitution" that, "unless and until Congress acts, . . . retain their historic sovereign authority." Michigan v. Bay Mills Indian Cmty., 572 U.S. ___, 134 S. Ct. 2024, 2030 (2014) (internal quotations omitted). "Among the core aspects of sovereignty that tribes possess . . . is the common-law immunity from suit traditionally enjoyed by sovereign powers," which shields tribes from liability "absent congressional authorization (or a waiver)." Id. at 2030-31 (citing Kiowa Tribe of Okla. v. Mfg. Techs., Inc., 523 U.S. 751, 756 (1998)). The Supreme Court has on multiple occasions refused to "confine [tribal] immunity . . . to transactions on reservations and to governmental activities." Kiowa, 523 U.S. at 754-55; see also Bay Mills Indian Cmty., 134 S. Ct. at 2036 (declining to revisit Kiowa and recognize "any exceptions for commercial or off-reservation conduct"). Thus, even though this broad scope of

immunity may have "unfortunate consequences," it is "settled law." Everette v. Mitchem, 146 F. Supp. 3d 720, 723 (D. Md. 2015) (citing Bay Mills Indian Cmty., 134 S. Ct. at 2052 (Thomas, J., dissenting) ("In the wake of Kiowa, tribal immunity has also been exploited in new areas that are often heavily regulated by States. For instance, payday lenders . . . often arrange to share fees or profits with tribes so they can use tribal immunity as a shield for conduct of questionable legality.")); see also Kiowa, 523 U.S. at 756 (acknowledging that tribal immunity is "settled law," even if "[t]here are reasons to doubt the wisdom of perpetuating the doctrine").[19]

Consistent with the idea that "an arm or instrumentality of the State generally enjoys the same immunity as the sovereign itself," Lewis v. Clarke, 581 U.S. ___, 137 S. Ct. 1285, 1290 (2017), courts in other circuits have universally held that "an

[19] The Supreme Court has not addressed whether, under Kiowa, "immunity should apply in the ordinary way if a tort victim, or other plaintiff who has not chosen to deal with a tribe, has no alternative way to obtain relief for off-reservation commercial conduct." Bay Mills Indian Cmty., 134 S. Ct. at 2036 n.8; see also Kiowa, 523 U.S. at 758 ("[I]mmunity can harm those who are unaware that they are dealing with a tribe, who do not know of tribal immunity, or who have no choice in the matter, as in the case of tort victims."). However, Plaintiffs willingly chose to contract with Big Picture when obtaining their loans, and Big Picture's association with the Tribe (and possible protection by sovereign immunity) was obvious from the face of Big Picture's loan agreements, so none of those hypothetical situations present themselves here.

entity that functions as an arm of a tribe shares in the tribe's immunity," Alabama v. PCI Gaming Auth., 801 F.3d 1278, 1287-88 (11th Cir. 2015); see also White v. Univ. of Cal., 765 F.3d 1010, 1025 (9th Cir. 2014); Breakthrough Mgmt. Grp., Inc. v. Chukchansi Gold Casino & Resort, 629 F.3d 1173, 1183 (10th Cir. 2010); Ninigret Dev. Corp. v. Narragansett Indian Wetuomuck Hous. Auth., 207 F.3d 21, 29 (1st Cir. 2000); Hagen v. Sisseton-Wahpeton Cmty. Coll., 205 F.3d 1040, 1043 (8th Cir. 2000); In re IntraMTA Switched Access Charges Litig., 158 F. Supp. 3d 571, 575 (N.D. Tex. 2015). Although the Fourth Circuit has implicitly approved of this conclusion, it has never affirmatively adopted it. See United States v. Bly, 510 F.3d 453, 465 (4th Cir. 2007) (Motz, J., concurring); Aleman v. Chugach Support Servs., Inc., 485 F.3d 206, 213 (4th Cir. 2007). Nonetheless, several courts in the Fourth Circuit have taken the consensus approach. See Howard v. Plain Green, LLC, No. 2:17CV302, 2017 WL 3669565, at *3 (E.D. Va. Aug. 7, 2017), report and recommendation adopted, 2017 WL 3669096 (E.D. Va. Aug. 24, 2017); Everette, 146 F. Supp. 3d at 723; Madewell v. Harrah's Cherokee Smokey Mountains Casino, No. 2:10CV8, 2010 WL 2574079, at *3 (W.D.N.C. May 3, 2010), report and recommendation adopted, 730 F. Supp. 2d 485 (W.D.N.C. 2010).

The parties do not dispute that Big Picture and Ascension would be immune from suit if they qualify as arms of the Tribe, so the sole question here is whether they do so. Federal and state courts have employed several tests to determine if an entity is an arm of a tribe, but the most common was laid out in Breakthrough. See 629 F.3d at 1187-88 & n.10; Howard, 2017 WL 3669565, at *3 ("Federal courts have not settled on a uniform test, but the Tenth Circuit's analysis is the most comprehensive . . . ."). Under that framework, courts consider six factors to decide if the relationship between tribes and entities is close enough to justify immunity: "(1) [the entities'] method of creation; (2) their purpose; (3) their structure, ownership, and management, including the amount of control the tribe has over the entities; (4) whether the tribe intended for the entities to have tribal sovereign immunity; (5) the financial relationship between the tribe and the entities; and (6) whether the purposes of tribal sovereign immunity are served by granting immunity to the entities."[20] Breakthrough

[20] The court did "not conclude[] that those factors constitute an exhaustive listing or that they will provide a sufficient foundation in every instance for addressing the tribal-immunity question." Breakthrough Mgmt., 629 F.3d at 1187 n.10 (emphasis in original). However, the parties do not suggest that the Court should rely on any factors other than those listed, so this limitation is not meaningful here.

Mgmt., 629 F.3d at 1183, 1187-88. Courts should apply these factors only to the entity claiming tribal immunity, but the entity's "prior operations under [different] names may shed light on the inquiry." People ex rel. Owen v. Miami Nation Enters., 386 P.3d 357, 376 (Cal. 2016).[21] The central question "'is not whether the activity may be characterized as a business, which is irrelevant under Kiowa, but whether the entity acts as an arm of the tribe so that its activities are properly deemed to be those of the tribe.'" In re IntraMTA, 158 F. Supp. 3d at 576 (quoting Allen v. Gold Country Casino, 464 F.3d 1044, 1046 (9th Cir. 2006)). In resolving that issue, courts should "take[] into account both formal and functional considerations—in other words, not only the legal or organizational relationship between the tribe and the entity,

[21] Big Picture and Ascension criticize Plaintiffs' frequent citations to Miami Nation on the basis that the case's discussion of tribal immunity tried to align Breakthrough with California law, not federal law. But tribal immunity is a common-law immunity that operates the same way in state and federal court, so the location of the underlying lawsuit in Miami Nation does not make that case any less helpful here. Indeed, Breakthrough itself relied heavily on cases from state courts, including California courts. See 629 F.3d at 1187-88. Moreover, the Tenth Circuit, which authored Breakthrough, has agreed with Miami Nation's more practical view of tribal immunity (albeit to require more jurisdictional discovery, and not to decide the ultimate immunity question). See Finn v. Great Plains Lending, LLC, 689 F. App'x 608, 611 (10th Cir. 2017). Thus, Miami Nation can help explain the Breakthrough factors even if the tests in those cases are different.

but also the practical operation of the entity in relation to the tribe." Miami Nation, 386 P.3d at 365. "These functional considerations illuminate the degree to which imposition of liability on the entity would practically impair tribal self-governance." Id. at 371.

2. Burden of Proof

Before turning to the merits of the jurisdictional dispute, the Court must first address which party bears the burden of proof as to a tribal arm's entitlement to sovereign immunity. Big Picture and Ascension contend that this question is easily answered because, in the Fourth Circuit, a plaintiff responding to a Rule 12(b)(1) motion must prove that subject matter jurisdiction exists. Richmond, Fredericksburg & Potomac R. Co., 945 F.2d at 768. However, this cursory assertion ignores the complexity of the jurisdictional issues raised by sovereign immunity. It is well-settled that the plaintiff bears the burden of showing subject matter jurisdiction, and that tribal immunity—like any sovereign immunity—"'deprives a court of jurisdiction'" over a defendant. Everette, 146 F. Supp. 3d at 723 (quoting Jones, 225 F.3d at 469). But those statements do not necessarily imply that tribal immunity is a matter of subject matter jurisdiction in the traditional sense—like, for instance, diversity of citizenship—or, instead, a factual issue

with jurisdictional implications. In fact, "the jurisdictional nature of tribal immunity has never been definitively settled," and has sometimes been discussed in terms of personal jurisdiction, at least in California courts. Miami Nation, 386 P.3d at 370. Federal courts have also reached differing conclusions on the point. Compare Miner Elec., Inc. v. Muscogee (Creek) Nation, 505 F.3d 1007, 1009 (10th Cir. 2007) ("Tribal sovereign immunity is a matter of subject matter jurisdiction . . . .") with In re Prairie Island Dakota Sioux, 21 F.3d 302, 305 (8th Cir. 1994) (tribal immunity "is a jurisdictional consideration separate from subject matter jurisdiction"). This categorization is important: pure subject matter jurisdictional issues, unlike tribal immunity, cannot be waived, and must be raised sua sponte by a court if it might lack the ability to hear a case. See Miami Nation, 386 P.3d at 370. Given these contrasts, it is possible that the burden for tribal immunity issues should be allocated differently than the burden for subject matter jurisdictional issues.

Moreover, even assuming that tribal immunity is a question of subject matter jurisdiction, that should not necessarily put the burden on Plaintiffs to prove that Big Picture and Ascension are not entitled to sovereign immunity. Such placement would effectively assume the truth of Big Picture's and Ascension's

assertion that they should be immune from suit in the same way as the Tribe itself. "Arm-of-the-tribe cases, however, require the court to decide an antecedent question: whether [the entities] can claim sovereign immunity in the first instance." Id. (alteration in original) (internal quotations omitted). Big Picture and Ascension may be right that Plaintiffs, having received extensive information from jurisdictional discovery, can prove that Big Picture and Ascension are not entitled to tribal immunity just as easily as those entities can prove that they are entitled to it. At the same time, even if the parties can access the same evidence, one side must present it in a way that convinces the Court to make a particular decision, and there is no reason that Big Picture and Ascension should be freed from having to do so before the Court finds that they are entitled to tribal immunity. Stated differently, it would be odd to treat Big Picture and Ascension as immune entities without making them show it first. See id. at 371 ("An entity that is formally distinct from the tribe will be immune from suit only insofar as it benefits from the tribe's own immunity. . . . But until the entity has proven it should be treated as an extension of the tribe, it is no more entitled to a presumption of immunity than any other party.").

With these considerations in mind, most courts have concluded that an entity seeking tribal immunity must show by a preponderance of the evidence that it is entitled to that immunity, either as an arm of the tribe or as the tribe itself. See Gristede's Foods, Inc. v. Unkechuage Nation, 660 F. Supp. 2d 442, 465 (E.D.N.Y. 2009); City of N.Y. v. Golden Feather Smoke Shop, Inc., No. 08-CV-3966, 2009 WL 705815, at *4 (E.D.N.Y. Mar. 16, 2009); Miami Nation, 386 P.3d at 371. But see Cash Advance & Preferred Cash Loans v. State, 242 P.3d 1099, 1113 (Colo. 2010) (requiring plaintiff to prove by a preponderance of the evidence that tribal entities are not entitled to immunity because tribal immunity "bears a substantial enough likeness to subject matter jurisdiction to be treated as such for procedural purposes"). Besides the practical aspects noted above, those courts found considerable support in cases involving arms of the state, in which courts have held that the governmental entity invoking the Eleventh Amendment must show that it qualifies as an arm of the state. See, e.g., Golden Feather, 2009 WL 705815, at *4; see also U.S. ex rel. Oberg v. Pa. Higher Educ. Assistance Agency, 745 F.3d 131, 147 (4th Cir. 2014) (Traxler, C.J., concurring in judgment in part and dissenting in part) ("[T]he circuits that have considered similar assertions of arm-of-state status have uniformly concluded that it is an affirmative defense to be

raised and established by the entity claiming to be an arm of the state."). Because the arm-of-the-tribe and the arm-of-the-state analyses are functionally identical in the sovereign immunity context, it is illogical to place the burden on different parties in each situation.

The problem here is that the Fourth Circuit has not addressed which party bears the burden on the arm-of-the-state question. Plaintiffs claim that the Fourth Circuit has held that "'arm-of-state status . . . must be treated as an affirmative defense.'" Pls. Opp. at 17 (quoting Oberg, 745 F.3d at 148 (Traxler, C.J., concurring in judgment in part and dissenting in part)). That contention is plainly wrong, as the language quoted is from Chief Judge Traxler's opinion concurring in the judgment and dissenting, which is not precedent. The majority in Oberg, however, did acknowledge that "arm-of-the-state status may well constitute an affirmative defense in the related Eleventh Amendment context." 745 F.3d at 136. Relying on that brief statement, another judge in the Court has concluded that the entity asserting sovereign immunity bears the burden of demonstrating that it is an arm of the state. Pele v. Pa. Higher Educ. Assistance Agency, 13 F. Supp. 3d 518, 522 (E.D. Va. 2014); see also Pope v. Barnwell Cty. Sch. Dist. No. 19, No. 1:16-CV-01627-JMC, 2017 WL 1148741, at *4 (D.S.C. Mar. 28,

2017). Accordingly, the arm-of-the-state framework is just as influential here in determining which side has the burden in the arm-of-the-tribe inquiry as it was in Miami Nation and Golden Feather. As a result, the Court will join those courts in concluding that the entities claiming tribal sovereign immunity—here, Big Picture and Ascension—bear the burden of establishing by a preponderance of the evidence that they are entitled to that immunity as arms of the tribe.

B. Application of Breakthrough Factors

Reviewing the six Breakthrough factors in the context of the parties' jurisdictional discovery, the Court concludes that Big Picture and Ascension have not met their burden of proof and, therefore, are not entitled to sovereign immunity.

1. Method of Creation

The first factor "focuse[s] on the law under which the entity was formed. Formation under tribal law weighs in favor of immunity, whereas formation under state law has been held to weigh against immunity." Miami Nation, 386 P.3d at 372 (internal citations omitted). Consistent with that statement, courts have found that this factor supports sovereign immunity where entities' formation documents showed that they were organized under and operated pursuant to tribal law. See White, 765 F.3d at 1025; Breakthrough Mgmt., 629 F.3d at 1191-92; Allen, 464

F.3d at 1046; Howard, 2017 WL 3669565, at *3; Everette, 146 F. Supp. 3d at 724; In re IntraMTA, 158 F. Supp. 3d at 576; Miami Nation, 386 P.3d at 376. In contrast, this factor has weighed against sovereign immunity where it was clear that the purported tribal entities were incorporated under state law. See Somerlott v. Cherokee Nation Distributors, Inc., 686 F.3d 1144, 1149 (10th Cir. 2012); J.L. Ward Assocs., Inc. v. Great Plains Tribal Chairmen's Health Bd., 842 F. Supp. 2d 1163, 1176 (D.S.D. 2012).

Applying that rationale here, this factor weighs in favor of immunity. Big Picture and Ascension were both organized through resolutions by the LVD Council, which was itself exercising the power given to it by the LVD Constitution, and the entities operated pursuant to the Tribe's Business Ordinance. See Aug. 26, 2014 Resolution at 1-2 (Big Picture); Big Picture Arts. of Organization at 1; Feb. 5, 2015 Ascension Resolution at 1-2; Ascension Arts. of Organization at 1. The same is true of Red Rock, the loans of which were assigned to Big Picture after TED acquired Bellicose. Sept. 14, 2011 Resolution at 1; Red Rock Arts. of Organization at 1. As in the cases noted above, these tribal formation documents justify Big Picture's and Ascension's claims to sovereign immunity.

Plaintiffs contend that looking only to the documents under which Big Picture and Ascension were organized fails to account

for other circumstances surrounding their formation—namely, the cease-and-desist letter issued to Red Rock by the New York Department of Financial Services, the "mounting pressure" against rent-a-tribe schemes, and Hazen's inability to explain who decided to create Big Picture. Pls. Opp. at 18. It is true that "[t]he circumstances under which the entity's formation occurred, including whether the tribe initiated or simply absorbed an operational commercial enterprise," may be relevant to this factor. Miami Nation, 386 P.3d at 372. Here, it is telling that Big Picture and Ascension were not formed until after the Tribe was denied an injunction against the New York cease-and-desist. See Otoe-Missouria, 974 F. Supp. 2d at 353. Plaintiffs have presented credible evidence that, following that decision, Martorello and the Tribe looked for ways to restructure Red Rock's lending operation in order to reduce exposure to liability. Indeed, several steps in February 2015—the formation of TED and Ascension, the reorganization of Big Picture with TED as its sole member, and the initiation of the Tribe's Bellicose purchase—were apparently taken with that very goal in mind. Moreover, although Red Rock was formed as a tribal entity, Bellicose and its subsidiaries, like SourcePoint, were a critical part of Red Rock's business. Thus, by creating Big Picture and Ascension, the Tribe was not starting an independent

lending operation but rather facilitating the absorption of Red Rock's fully-functioning lending enterprise—which had a decidedly non-tribal character, given Bellicose's involvement. Big Picture and Ascension may be right that Hazen's lack of knowledge about the decision to create Big Picture is not meaningful on its own. But, viewed in context, Hazen's unawareness teaches that the impetus behind the formation of Big Picture and Ascension was Martorello and Bellicose's desire to avoid liability, more so than the Tribe's interest in starting its own business. Consequently, these circumstances limit the extent to which this factor weighs in favor of sovereign immunity. Moreover, the real significance of this evidence is in the second Breakthrough factor: the purpose factor.

However, Plaintiffs' second assertion—that Ascension's registration as a foreign LLC in Puerto Rico also affects the formation factor—is much less persuasive. Somerlott held that the Breakthrough factors are "inapplicable to entities which are legally distinct from their members and which voluntarily subject themselves to the authority of another sovereign which allows them to be sued." Somerlott, 686 F.3d at 1149-50. Plaintiffs point out that, although Ascension may be organized under tribal law, it subjected itself to the laws and the possibility of being sued in Puerto Rico by registering as a

foreign LLC there. See P.R. Laws tit. 14, §§ 3522(a), 3806(b), 4021(a)(1). But Somerlott's holding was premised entirely on the entity's incorporation under state law, which distinguished the case from others in which entities claiming to be arms of a tribe were "organized, in some form or another, under tribal law." 686 F.3d at 1149; see also J.L. Ward, 842 F. Supp. 2d at 1176 (entity was "created by incorporation under South Dakota, rather than tribal, law" (emphasis added)). Plaintiffs' attempt to skirt this limitation is unsupported by Somerlott, which demonstrated its holding by explaining that a corporation owned by the United States but incorporated under New York law would not share the United States' sovereign immunity. 686 F.3d at 1150. Ascension's background is obviously different, as it is both owned by the Tribe and incorporated under its laws. See Rassi v. Fed. Program Integrators, LLC, 69 F. Supp. 3d 288, 291 (D. Me. 2014) (distinguishing Somerlott where tribe formed subordinate entity under similar circumstances). Thus, this argument misses the mark. As a result, the first Breakthrough factor supports a finding of sovereign immunity for both Big Picture and Ascension, albeit with the caveat noted above.

2. Purpose of Entities

The second factor "encompasses both the stated purpose for which the entity was created and the degree to which the entity

actually serves that purpose." Miami Nation, 386 P.3d at 372; see also Breakthrough Mgmt., 629 F.3d at 1192-93 (considering both elements). The initial question is whether the entity has a stated purpose that "relates to broader goals of tribal self-governance" separate from the entity's commercial activities, like developing the tribe's economy or funding governmental services, or whether "the entity was created solely for business purposes and without any declared objective of promoting the tribe's general tribal or economic development." Miami Nation, 386 P.3d at 372 (internal quotations omitted). If such a purpose exists, the inquiry then turns to the entity's "execution" of that purpose; the "fit . . . need not be exact, but the closer the fit," the more it supports tribal immunity. Id. For instance, evidence of "the number of jobs [the entity] creates for tribal members or the amount of revenue it generates for the tribe" suggests that it is an arm of the tribe, but "evidence that the entity engages in activities unrelated to its stated goals or that [it] actually operates to enrich primarily persons outside of the tribe or only a handful of tribal leaders" shows the opposite.[22] Id. at 373.

[22] Miami Nation cites no case law in support of this required "fit" between purpose and execution. See 386 P.3d at 372-73. Nonetheless, Miami Nation's conclusion makes sense logically, and Breakthrough supports the more exacting inquiry called for

The stated purposes of both Big Picture and Ascension relate to the Tribe's goal of economic self-sufficiency. Big Picture's stated purpose is "[t]o engage in the business of operating one or more Tribal lending business(es)," Big Picture Arts. of Organization, Art. 5, which it does as part of the LVD Council's "strategic economic development efforts" that are aimed at "diversify[ing] the economy of the Tribe's reservation in order to improve the Tribe's economic self-suffiency," Aug. 26, 2014 Resolution at 1. Similarly, Ascension's stated purpose is "[t]o engage in the business of operating one or more Tribal marketing, technology and vendor service business(es)," Ascension Arts. of Organization, Art. 5, which helps fulfill the same tribal economic development efforts, see Feb. 5, 2015 Ascension Resolution at 1. Those stated purposes must also be read in conjunction with that of TED, the sole member of both entities, which works "[t]o promote the economic development of the Tribe through the development of business opportunities." TED Arts. of Organization, Art. 5. Along the same lines, TED's management activities are intended "to further the economic development of the Tribe." Feb. 5, 2015 TED Resolution at 1. These goals—development and execution of an online lending

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by Miami Nation. See Breakthrough Mgmt., 629 F.3d at 1192-93 (examining entity's revenue allocation in considering purpose).

business to gain revenue for the Tribe's economic benefit—are extremely similar to those that other courts have found relate to tribal self-governance. See Breakthrough Mgmt., 629 F.3d at 1192 (casino was created to "further[] the economic prosperity of the Tribe"); Howard, 2017 WL 3669565, at *3 (stated purposes included "increase[ing] [sic] Tribal revenues and enhance[ing] [sic] the Tribe's economic self-sufficiency and self-determination" (alterations in original)); Everette, 146 F. Supp. 3d at 724 (entity's purpose was "to engage in lending related activities that will generate additional revenues for the Tribe"); Gavle v. Little Six, Inc., 555 N.W.2d 284, 294 (Minn. 1996) (stated purpose was "improv[ing] the business, financial or general welfare" of the entity and tribe (alteration in original)).

On the surface, these stated purposes seem to favor Big Picture and Ascension. However, as set out in Section II.B.1 above, the record shows that the formation of Big Picture and Ascension, and indeed, much of the tribal restructuring, was for the real purpose of helping Martorello and Bellicose to avoid liability, rather than to help the Tribe start a business. And, that finding means that Big Picture and Ascension have not carried their burden on the purpose factor.

Plaintiffs also contend that Big Picture and Ascension do not fulfill their stated purposes in practice. First, they say, Big Picture and Ascension have not provided any information about the number of jobs created for the Tribe or the amount of revenue received by the Tribe from their business. Second, they note that Ascension does not employ any tribal members and generates no revenue for the Tribe. Third, they assert that Big Picture is structured such that the primary beneficiaries are Hazen (who is paid more than the other tribal employees of Big Picture) and Martorello (given that TED uses most of Big Picture's revenue to make loan payments to Eventide).[23]

All three arguments have merit. First, Plaintiffs are wrong to claim that Big Picture and Ascension have provided no information about the revenue generated for the Tribe; Williams has explained that money from Big Picture constitutes more than 10% of the Tribe's general fund, and may contribute more than 30% of the fund within the next few years. Williams Aff. ¶ 10.

[23] Plaintiffs also argue that Red Rock's distribution of limited revenue to the Tribe in 2014 and 2015 should influence the Court's decision. However, Red Rock is a defunct entity that made distributions pursuant to a servicing agreement with another entity, SourcePoint, that also no longer exists, and that agreement has no bearing on the parties asserting tribal immunity (the relationship of which is governed by an entirely different contract). Given those differences, Red Rock's situation does not "shed light on the [purpose] inquiry" and will not affect the Court's consideration of this factor. Miami Nation, 386 P.3d at 375.

The Tribe obtains these funds both through TED's monthly 3% distributions, and as interest on its substantial investment in Big Picture's enterprise. See id. ¶¶ 8-10. Nonetheless, courts assessing an entity's execution of purpose have examined how much revenue the tribe actually received from the entity. See Breakthrough, 629 F.3d at 1192-93 (concluding that entity's business "clearly benefit[ed] the Tribe" based on percentage allocation of revenue to certain tribal governmental functions); Everette, 146 F. Supp. 3d at 724 (noting that revenue was used "to fund various tribal governmental, educational, and social services" and to provide specified "essential services"). In that regard, Hazen's statement that those funds "support LVD governmental essential services and support the LVD community" in numerous ways, Hazen Aff. ¶ 31, is far too general, as it sheds no light on how much Big Picture's revenue helped fund those services. That money might, for instance, constitute only a small, insignificant part of the funding for the services that Hazen has identified. If that is true, then Big Picture would not be effectively serving the Tribe's economic development. The evidence provided by Big Picture and Ascension, which bear the burden of proof here, is too vague to eliminate that possibility.

Furthermore, even if Big Picture's revenue is a meaningful portion of the Tribe's general fund, the revenue received by the Tribe is a sliver of Big Picture's total earnings. The entity seeking immunity in Breakthrough provided 100% of its revenue to various tribal services. 629 F.3d at 1192-93. Here, in contrast, the Note expressly limits the funds available to the Tribe to 5% of Big Picture's monthly revenue—the 3% monthly distribution and the 2% reinvestment amount, if the latter is treated as a current benefit to the Tribe.[24] See Note § 1.2. Breakthrough did not specify any revenue allocation percentage that must be reached to reflect an adequate fit between purpose and execution, but Miami Nation noted that a similarly small revenue distribution—a monthly payment of either 1% of the entity's revenue or $25,000—would not economically benefit the tribe. See 386 P.3d at 377-78. The evidence here further indicates that Big Picture has, over time, given the Tribe a little less than $5 million, whereas TED has made loan repayments to Eventide of

[24] Plaintiffs assert that this amount is not a current benefit because TED will not receive any reinvestment amount if it defaults on the loan. No evidence shows that TED is likely to default in the near future, and the Big Picture balance sheets cited by Plaintiffs appear to treat that reinvestment amount as a current asset. Plaintiffs' assertion thus relies on the wholly speculative premise that TED will, at some future date, take some action that qualifies as an event of default. See Loan Agm't § 6.1. The Court will not base its conclusion about Big Picture's purpose on a guess about the future.

about $20 million.[25] Big Picture Suppl. Interrogatory Responses ¶ 1. In other words, even under this broader view—which accounts for the months in which Eventide has not received any distribution—the Tribe has only received about 20% of Big Picture's total revenue, still a relatively small percentage. That imbalance shows that Big Picture has not served its stated purpose very well. And, even if Big Picture will not owe Eventide anything after the Note terminates in several years, Note § 1.3, the revenue distribution disparity will almost certainly have increased in that period, assuming Big Picture's revenue stream remains similar to what it has been since the parties entered into the Note.

Ascension is in a very similar position. That company supports Big Picture's lending operations and generates no revenue itself, see Intratribal Servicing Agm't § 3.4, so the purpose analysis for Big Picture applies to Ascension in much the same way. Some evidence also demonstrates that Ascension

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[25] As noted, Martorello claims that the Tribe has actually obtained more economic consideration than Eventide since the Bellicose purchase. Martorello Decl. ¶ 63. However, that assertion is based on his valuation of equity consideration from some unknown "audited financial statements." Id. Because Big Picture and Ascension have not provided those statements here, it is impossible to verify the accuracy of Martorello's statement in the face of conflicting evidence showing that the Tribe's actual economic benefit under the Note has been dwarfed by Eventide's.

fulfills its nominal purpose even less effectively than Big Picture. Whereas Big Picture's employees primarily belong to the Tribe and work on its reservation, Ascension does not employ any non-tribal members, instead relying mostly on employees that previously worked at Bellicose. That composition may have been justified when Ascension was formed in 2015 because the company needed individuals with certain technical knowledge for the required support services, and Bellicose's employees were the perfect candidates. But, in the several years since, Hazen's and Williams' testimony instructs that the Tribe has done little more than encourage tribal members to pursue educational opportunities that would allow them to work for Ascension and Big Picture in the future.[26] Thus, Ascension has failed to contribute much to the Tribe's self-governance, either directly (by supporting Big Picture's minimal revenue generation) or indirectly (by hiring tribal employees).

Finally, Big Picture's and Ascension's compensation structures underscore the companies' poor execution of their purposes. Despite what Plaintiffs claim, the evidence does not

[26] Plaintiffs' assertion that Ascension or the Tribe has not started any training programs for tribal members to work at the company assumes, without any apparent basis in the evidence, that the Tribe has both the capacity and the funds to do so. This failure to pursue some possibly unachievable hypothetical goal does not count against Ascension in the purpose analysis.

indicate that Martorello himself has received any substantial economic benefit from Big Picture, certainly not in the same sense as the non-tribal individuals in Miami Nation. See 386 P.3d at 363, 378 (noting that individuals used alleged tribal entities' checks to pay for their personal expenses). However, Plaintiffs' breakdown of the compensation of Hazen, other tribal employees of Big Picture, all employees of Ascension, and the total amount paid to Ascension by Big Picture clearly illustrates two things: (1) Hazen has profited from Big Picture's lending operation far more than any other tribal members, and (2) Ascension's employees are paid handsomely compared to Big Picture's employees. These compensation differences lead to the conclusion that Big Picture and Ascension primarily benefit individuals and entities outside the Tribe, or only one tribal leader, both of which are inconsistent with the goal of economic development. See id. at 373.

Given these circumstances—and even granting that the fit between purpose and execution need not be exact, id. at 372—Big Picture and Ascension have largely failed to fulfill their stated purposes. Accordingly, this factor weighs against sovereign immunity for both entities.

3. Structure, Ownership, and Management of Entities, Including Amount of Tribe's Control

This factor focuses primarily on the leadership of the entity claiming immunity. See Breakthrough Mgmt., 629 F.3d at 1193. "Relevant considerations include the entity's formal governance structure, the extent to which it is owned by the tribe, and the entity's day-to-day management." Miami Nation, 386 P.3d at 373. However, an entity's "outsourc[ing] management to a nontribal third party is not enough, standing alone, to tilt this factor against immunity." Id.; see also Gavle, 555 N.W.2d at 295 ("[C]ontrol of a corporation need not mean control of business minutiae; the tribe can be enmeshed in the direction and control of the business without being involved in the actual management."). In that case, the inquiry turns to the tribe's involvement despite the nontribal leadership. "Evidence that the tribe actively directs or oversees the operation of the entity weighs in favor of immunity; evidence that the tribe is a passive owner, neglects its governance roles, or otherwise exercises little or no control or oversight weighs against immunity." Miami Nation, 386 P.3d at 373.

Big Picture is an LLC that is 100% owned and operated by its sole member, TED, which in turn is 100% owned and operated by its sole member, the Tribe. Big Picture Arts. of

Organization, Arts. 8-9; TED Arts. of Organization, Arts. 8-9. Big Picture is also managed by two tribal members, Hazen and Williams, who were appointed by majority vote of the LVD Council and must be removed in the same way. Hazen Aff. ¶ 15; Williams Aff. ¶ 12; Big Picture Operating Agm't § 5.1(a), (d). As co-managers, Hazen and Williams are granted the broad authority to "bind [Big Picture] individually," and "to do and perform all actions as may be necessary or appropriate to carry out the business of [Big Picture] including but not limited to the power to enter into contracts for services, to manage vendor relationships, [and] to manage personnel issues and affairs of [Big Picture]." Big Picture Operating Agm't § 5.1(a). They are precluded only from restricting or selling Big Picture's assets or waiving its sovereign immunity, for which they must obtain TED's consent (by majority vote of the LVD Council). Id. § 5.2. Furthermore, to the extent that Hazen and Williams are not involved in the day-to-day operations of Big Picture, the Tribe has a substantial role in those operations, as the entity employs a number of tribal members and conducts all of its operations on the Reservation. Hazen Aff. ¶ 24. Finally, the executive leadership of Big Picture preserves the Tribe's influence, as Hazen is the company's CEO. Id. ¶ 20; see also Breakthrough, 629 F.3d at 1193 (factor weighed both for and

against immunity where directors of entity were all tribal members but some executive officers were non-tribal members). This general structure is to assure that Big Picture is answerable to the Tribe at every level, which supports immunity. See Howard, 2017 WL 3669565, at *4; Everette, 146 F. Supp. 3d at 724-25; In re IntraMTA, 158 F. Supp. 3d at 577; J.L. Ward, 842 F. Supp. 2d at 1176-77.

Plaintiffs claim, however, that Big Picture's formal structure is overcome in practice by Ascension's substantial role. In support of this assertion, Plaintiffs highlight the Intratribal Servicing Agreement,[27] which, they contend, confers significant day-to-day responsibilities on Ascension and permits little oversight by Big Picture. They acknowledge that the Agreement does not grant Ascension the authority to "engage in origination activities, execute loan documentation, or approve the issuance of loans to consumers." Intratribal Servicing Agm't § 4.1. However, they note, the Agreement assigns to Ascension the duties to give "pre-qualified leads" to Big Picture and to provide "the necessary credit-modeling data and

[27] Plaintiffs are correct that the Intratribal Servicing Agreement and the Servicing Agreement delegate nearly identical responsibilities to Ascension and SourcePoint, respectively. See Intratribal Servicing Agm't § 4.2.1; Servicing Agm't § 4.2.1. However, it is unclear how this similarity affects the control inquiry, as Plaintiffs do not explain how the Servicing Agreement limited the Tribe's control over Red Rock.

risk assessment strategies" used by Big Picture to decide whether to issue a loan. Id. § 4.2.1(k). Because Ascension generally identifies potential loan applicants by prescreening credit reports and then directs mass mailings to those consumers, Plaintiffs say, Big Picture's role is limited to verifying details at the loan approval stage. This minimal involvement is further shown by Williams' lack of knowledge about entities owned by Big Picture.

Plaintiffs' argument relies on two underlying contentions: (1) that the Tribe's formal oversight of Big Picture is meaningless given Ascension's dominant role in Big Picture's lending operations; and (2) that, assuming Ascension has such a role, that entity is not controlled by the Tribe. Both arguments are persuasive. As to the first assertion, it is true that the Intratribal Servicing Agreement also states that "[t]he criteria used to extend funds to individual borrowers will remain within the sole and absolute discretion" of Big Picture, and that Big Picture "shall execute all necessary loan documentation." Id. Nonetheless, considering that Ascension's responsibilities allow it to identify borrowers based on Ascension's own credit-modeling system and then prepare mass mailings to those consumers, it does not appear that Big Picture has much discretion to exercise when it receives recommendations or

documents from Ascension. Indeed, Ascension's actions in effect reduce Hazen's and William's responsibilities in the loan process to pro forma review and approval of key business decisions. See ECF No. 91-3; see also Big Picture Interrogatory Responses ¶ 24. Viewed in conjunction with Ascension's numerous other responsibilities under Section 4.2.1, this control is too limited to support a finding of tribal immunity. See Miami Nation, 386 P.3d at 373.

Moreover, evidence that Williams is not familiar with three Big Picture subsidiaries shows that Hazen and Williams do little to oversee Big Picture's operations as co-managers. Big Picture and Ascension point to several documents that, they say, suggest just the opposite: that those individuals "actively direct[] or oversee[] the operation of [Big Picture]." Id. For instance, Hazen and Williams have discussed items like Big Picture's operating budget and employee handbook, ECF Nos. 102-15, 102-16; and approved forms sent by employees concerning, inter alia, company policies and procedures, compliance management, and personnel decisions, ECF No. 106-13. This evidence reflects that Hazen and Williams exercise some managerial oversight over Big Picture's operations. However, Williams' testimony about other issues, like his non-involvement in Big Picture's day-to-day and lack of knowledge about customer service representatives'

responsibilities operations, demonstrates that such oversight is narrow in both scope and depth. Consequently, Big Picture has not shown by a preponderance of the evidence that the Tribe, through Hazen and Williams, controls Big Picture, so this factor weighs against immunity for that entity.

The question of Ascension's tribal control is not as close. Just like Big Picture, Ascension is an LLC that is 100% owned and operated by its sole member, TED. Ascension Arts. of Organization, Arts. 8-9. Hazen and Williams also manage Ascension, and the operating agreement gives them the same broad powers as with Big Picture and requires an LVD Council vote for their appointment and removal. Hazen Aff. ¶ 19; Williams Aff. ¶ 13; Ascension Operating Agm't §§ 5.1-5.2. At the same time, as in Breakthrough, the Tribe's control is diminished by the appointment of a non-tribal member, McFadden, as Ascension's president. See 629 F.3d at 1193. Likewise, Ascension conducts most activities outside the Reservation and employs only non-tribal members. In light of this non-tribal management, the Court must consider whether the Tribe is an active or passive owner. See Miami Nation, 386 P.3d at 373. Here, that inquiry revolves around the extent of Hazen and Williams' oversight of Ascension and the influence of non-tribal actors on Ascension's decisions.

Ascension has presented evidence that McFadden must obtain Hazen's or Williams' approval for "changes in operations, personnel, or distributions," McFadden Aff. ¶ 8, and that Ascension employees have submitted request and approval forms to Hazen and Williams for certain business decisions, ECF No. 106-13. Ascension's operating agreement also reserves primary oversight of the company's actions for Hazen and Williams. See Ascension Operating Agm't § 5.1(a). Nonetheless, those assertions of oversight are undercut materially because Hazen and Williams have delegated to McFadden the authority to approve Ascension's "strategic direction, goals and targets"; execute documents on the company's behalf; open and maintain Ascension's bank accounts; adopt, terminate, or change employee benefit plans; and oversee "all matters necessary for the day to day management of Ascension." Ascension Delegation of Authority Policy § 1.4. These actions are all important managerial ones that can significantly affect an entity's directions and its decisions. And, the evidence tends to show that the real management function lies not with Hazen and Williams, but with McFadden. On balance, that evidence augurs against Ascension's immunity claim.

Plaintiffs make much of provisions in the Loan Agreement that prevent TED and Ascension from modifying the Intratribal

Servicing Agreement or terminating or replacing any managers or officers of Ascension, among other entities, without Eventide's consent. Loan Agreement §§ 5.12, 5.14. Although there is no evidence that these rights have been exercised, their mere presence is evidence that goes against a finding of immunity because they confer on Eventide, and hence Martorello, significant control mechanisms over significant aspects of Ascension's operations. On balance, the control factor slightly favors a finding against immunity. At best for Big Picture and Ascension, it is neutral, and thus does not aid them in meeting their burden of proof.

4. Tribe's Intent with Respect to Sharing of Sovereign Immunity

Big Picture's and Ascension's formation documents show that the Tribe intended for both entities to share its immunity. The resolutions organizing each company state:

> [T]he [LVD] Council believes it to be in the best interest of the Tribe to create such an entity which, as a wholly owned and operated instrumentality of the Tribe, shall be possessed of all the privileges of the Tribe, including but not limited to the sovereign immunity of the Tribe which shall not be waived unless authorized by the [LVD] Council . . . .

Aug. 26 2014 Resolution at 2; Feb. 5, 2015 Ascension Resolution at 2. Each entity's articles of organization reiterate that

"[t]he sovereign immunity of the [entity] shall remain intact unless waived by [TED] pursuant to a duly authorized resolution of the [LVD] Council." Big Picture Arts. of Organization, Art. 7; Ascension Arts. of Organization, Art. 7. Other courts have found similar language sufficient for this factor to support tribal immunity. See Breakthrough, 629 F.3d at 1193-94; Howard, 2017 WL 3669565, at *4; Everette, 146 F. Supp. 3d at 725.

Plaintiffs concede that this factor weighs in Big Picture's and Ascension's favor, but argue that the Court should accord it the least weight out of all the factors. Plaintiffs are right that the intent factor "reveals little about 'whether the entity acts as an arm of the tribe so that its activities are properly deemed to be those of the tribe,'" Miami Nation, 386 P.3d at 379 (emphasis in original) (quoting Allen, 464 F.3d at 1046), but they mistake the significance of that statement. Miami Nation simply held that tribal intent "cannot, without more, . . . tip the balance in favor of immunity" where that factor is the only one to point "unequivocally" in that direction. Id. (internal quotations omitted). Big Picture and Ascension do not ascribe to this factor such outsized importance in the immunity analysis; indeed, they discuss it the least of any Breakthrough factor. Moreover, neither Miami Nation nor any other case holds that the

intent factor should be given any less weight. Therefore, the Court will consider this factor as it would any other.

But here the intent factor must be assessed in perspective of the context in which Big Picture and Ascension were created. As explained above, the record shows that those entities were intended to be vehicles that would shield Martorello and Bellicose from liability. Then, on this record, the intent factor weighs against a finding of immunity because to do otherwise is to ignore the driving force for the Tribe's intent to share its immunity. Here, the Tribe's intent no doubt was, in part, to help the Tribe, but to do so by providing its immunity to shelter outsiders from the consequences of their otherwise illegal actions.

5. Financial Relationship Between Tribe and Entities

The "starting point" for this factor is "whether a judgment against the entity would reach the tribe's assets." Miami Nation, 386 P.3d at 373; see also J.L. Ward, 842 F. Supp. 2d at 1176 (factor weighed against immunity because "[a] suit against [the entity] would not appear to affect, at least not directly, any particular tribe's fiscal resources"). However, "direct tribal liability . . . is neither a threshold requirement for immunity nor a predominant factor in the overall analysis." Miami Nation, 386 P.3d at 373; see also Breakthrough Mgmt., 629

F.3d at 1187 ("Although . . . the financial relationship between a tribe and its economic entities is a relevant measure of the closeness of their relationship, . . . it is not a dispositive inquiry.").[28] After all, "[s]ome tribes rely on [an entity's] business revenues to an extent that a judgment against the entity could effectively strike a blow against the tribal treasury, regardless of whether the tribe is directly liable." Miami Nation, 386 P.3d at 373. Consequently, courts consider the extent of the tribe's dependence on the entity "'for revenue to fund its governmental functions, its support of tribal members, and its search for other economic development opportunities.'" Id. (quoting Breakthrough Mgmt., 629 F.3d at 1195). Accordingly, "[i]f a significant percentage of the entity's revenue flows to the tribe, or if a judgment against the entity would significantly affect the tribal treasury, this factor will weigh in favor of immunity even if the entity's liability is formally limited." Id.

[28] Miami Nation specifically rejected holdings by other state courts that the tribe's direct liability (or lack thereof) was dispositive of the financial relationship factor. See 386 P.3d at 373 (citing Sue/Perior Concrete & Paving, Inc. v. Lewiston Golf Course Corp., 25 N.E.3d 928, 935 (N.Y. 2014); Runyon ex rel. B.R. v. Ass'n of Vill. Council Presidents, 84 P.3d 437, 440-41 (Alaska 2004)). Given that Sue/Perior and Runyon represent the minority approach on this issue, the Court will not follow them here.

The Tribe would not be directly affected by any judgment against Big Picture or Ascension. Each entity's operating agreement contains a liability limitation provision that makes the entity's "debts, liabilities, and obligations" its own. Big Picture Operating Agm't § 4.3; Ascension Operating Agm't § 4.3. The entities' interrogatory responses confirm that the Tribe would not be liable for any judgment against the entities because they are LLCs. Big Picture Interrogatory Responses ¶ 23; Ascension Interrogatory Responses (ECF No. 83-13) ¶ 18. Accordingly, neither company can satisfy this aspect of the financial relationship factor.

Other evidence further establishes that Big Picture and Ascension lack a strong financial connection to the Tribe. The structure of the Note ensures that the Tribe's monthly gains will only consist of, at most, 5% of Big Picture's revenue. Thus, as described above, the Tribe has received a little less than 20% of the total revenue distributed under the Note. Because the Tribe receives a very small part of Big Picture's revenue, this factor does not cut the same way as in cases where "all of [the entity's] profits inure[d] to the benefit of the Tribe." Howard, 2017 WL 3669565, at *4; see also Breakthrough Mgmt., 629 F.3d at 1195 ("One hundred percent of the Casino's revenue goes to the Authority and then to the Tribe.").

Furthermore, the other evidence that Big Picture and Ascension claim weighs in favor of immunity is unconvincing. First, notwithstanding the interest payments that the Tribe receives as an investor in Big Picture, Williams Aff. ¶¶ 8-9, the total distributions to the Tribe under the Note are limited. Consequently, although it might be true in theory that "any reduction in [Big Picture]'s revenue that could result from an adverse judgment against it would therefore reduce the Tribe's income," Breakthrough Mgmt., 629 F.3d at 1195, the actual effect on the Tribe appears to be insubstantial. Second, Big Picture's revenue does not play as important a role in the Tribe's general fund as in other cases where this factor supported immunity. See Breakthrough Mgmt., 629 F.3d at 1195 (tribe "depend[ed] heavily on the [entity]" for funding); Everette, 146 F. Supp. 3d at 724. As noted, Big Picture has not provided an exact breakdown of revenue allocation to different tribal services, so it is impossible to discern how the Tribe would be affected, if at all, if a judgment harmed Big Picture's operations. Third, there is evidence that Big Picture does not comply with its operating agreement's mandatory cash distribution requirement when balances exceed $500. See, e.g., ECF No. 83-24 at MARTORELLO_000218; see also Big Picture Operating Agmt' § 6.2. If Big Picture does not transfer its funds to TED when it

should, then the Tribe likely does not need that money on a timely basis. Given these circumstances, this factor weighs against Big Picture.

Ascension's financial relationship with the Tribe is not very different. By its own admission, Ascension does not generate revenue for itself or for the Tribe, so a judgment against Ascension could not possibly affect the Tribe's revenue directly. However, given that Ascension performs critical services for Big Picture, any judgment that limited Ascension's operations or forced it to close would, by extension, drastically reduce Big Picture's revenue. This potential indirect effect on the Tribe's general fund is important in the financial relationship framework. See Breakthrough Mgmt., 629 F.3d at 1195; Miami Nation, 386 P.3d at 373. Yet, for the reasons detailed above, any reduction in Big Picture's revenue would not be felt strongly by the Tribe itself. Consequently, this factor also weighs against immunity for Ascension.

6. Fulfillment of Purposes Underlying Tribal Immunity

The final factor assesses "the policies underlying tribal sovereign immunity and its connection to tribal economic development, and whether those policies are served by granting immunity to the economic entities." Breakthrough Mgmt., 629 F.3d at 1187. "Those policies include protection of the tribe's

monies, as well as preservation of tribal cultural autonomy, preservation of tribal self-determination, and promotion of commercial dealings between Indians and non-Indians." Id. at 1188 (internal citations and quotations omitted); cf. Okla. Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Okla., 498 U.S. 505, 510 (1991) (federal statutes affirming tribal immunity "reflect Congress' desire to promote the goal of Indian self-government, including its overriding goal of encouraging tribal self-sufficiency and economic development" (internal quotations omitted)).

At first glance, granting sovereign immunity to Big Picture and Ascension would appear to serve these purposes. As noted, more than 10% of the Tribe's general fund comes from Big Picture's revenue, and that percentage will increase to more than 30% in the next few years. In addition, Hazen has stated that those funds "are used to provide a variety of social services and other benefits for the Tribe." Howard, 2017 WL 3669565, at *4. Even though Ascension does not make any money itself, it necessarily contributes to Big Picture's revenues by providing crucial technical and marketing services. As a result, both entities seem to "promote and fund the Tribe's self-determination through revenue generation and the funding of

diversified economic development." Breakthrough Mgmt., 629 F.3d at 1195; see also Everette, 146 F. Supp. 3d at 725.

However, a closer look reveals that neither Big Picture nor Ascension fulfills those goals very well, if at all. The inadequacies of Hazen's general statements about the Tribe's use of Big Picture's revenues are detailed above. Because the extent to which the Tribe has actually used Big Picture's funds for the services noted by Hazen is unclear, the Court cannot tell whether granting immunity here "directly protects the . . . Tribe's treasury, which is one of the historic purposes of sovereign immunity in general." Allen, 464 F.3d at 1047. Moreover, even assuming that Big Picture's lending operation and Ascension's support have contributed to the Tribe's economic self-development to some extent, those entities' actions have primarily enriched non-tribal entities like Eventide and, possibly, individuals like Martorello. The Bellicose purchase, and the resulting Note and Loan Agreement, have undoubtedly yielded some benefits for the Tribe. Yet, by limiting the Tribe's monthly distribution to a very small percentage of Big Picture's revenue, the Note forces the Tribe to receive those benefits at substantial cost—a reality that is illustrated by the sharp disparity in distributions received by the Tribe and Eventide since TED began repaying the loan.

Consequently, as Plaintiffs note, granting immunity here might have the unintended consequence of preventing the Tribe from obtaining favorable terms in future business transactions, as non-tribal entities would not be inclined to offer repayment above a certain rate. Thus, even if the Tribe is not bound by the Note's distribution structure forever, the example will have been set. Therefore, although Big Picture and Ascension serve the core purposes of tribal immunity to some extent, these circumstances cause this factor to weigh against immunity for both entities.

C. Weight of Factors

For the reasons discussed above, Big Picture and Ascension have the burden to prove arm-of-the-tribe immunity by a preponderance of the evidence. That means the weighing of factors must permit a finding of immunity. On this record, that balance actually falls the other way, and weighing everything on the balance, the Court finds that neither entity qualifies as an arm of the Tribe. Therefore, Big Picture and Ascension are not immune from suit here.

CONCLUSION

For the foregoing reasons, DEFENDANTS BIG PICTURE LOANS AND ASCENSION TECHNOLOGIES' MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION (ECF No. 22) was denied.

It is so ORDERED.

/s/ REP
Robert E. Payne
Senior United States District Judge

Richmond, Virginia
Date: July 27, 2018

NOTES

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Consumer Federation of America, Report, Missing in Action? Consumer Financial Protection Bureau Supervision and the Military Lending Act (November 1, 2018)

Christopher L. Peterson

Consumer Federation of America
University of Utah



Consumer Federation of America

Report

Missing in Action? Consumer Financial Protection Bureau Supervision and the Military Lending Act

Christopher L. Peterson

November 1, 2018

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Executive Summary

The Consumer Financial Protection Bureau ("CFPB"), under the leadership of Acting Director Mick Mulvaney, recently announced plans to end supervisory examinations for violations of the Military Lending Act, a statute designed to protect military servicemembers and their families from predatory lending. Congress passed the Military Lending Act ("MLA") in 2006, in response to evidence that predatory loans targeted at servicemembers were undermining not only the morale and financial stability of our troops, but also the nation's military readiness in general. The MLA caps the interest on all loans made to servicemembers and their families at 36 percent per year and prohibits the extension of payday loans, vehicle title loans, and other types of harmful credit products to military personnel. Since 2012, the CFPB has conducted supervisory examinations of large banks, payday lenders, and other financial companies to ensure compliance with the MLA.

The Trump Administration, however, has recently decided to end the CFPB's supervision of MLA violations. Acting Director Mick Mulvaney has expressed the belief that the CFPB lacks the statutory authority to include MLA compliance in its supervisory work. While servicemember advocates, veteran's rights groups, members of Congress, and state attorneys general have all voiced concern over the CFPB's decision to cripple its MLA enforcement program, CFPB leadership maintains that, under federal law, the Bureau may not cover MLA compliance in its supervisory exams.

This report is the first publicly available legal analysis of the CFPB's authority to include MLA compliance within its supervisory exams. This analysis concludes that the CFPB has ample legal authority under both its enabling statute, the Consumer Financial Protection Act ("CFPA"), as well as the MLA itself to include the MLA within supervisory exams. The CFPB has this legal authority for at least four reasons. First, violations of the MLA render servicemembers' loans void, thereby triggering concurrent violations of federal consumer financial laws that the CFPB must already cover within its exams. Second, the CFPB may use its supervisory exams to obtain information about MLA compliance because such information is pertinent to business practices already subject to CFPB enforcement under the CFPA. Third, under the CFPA, the CFPB can cover MLA violations within its exams for the purpose of detecting and assessing risks to consumers. And fourth, the text of the MLA itself requires the CFPB to enforce the MLA in the same way that the CFPB enforces the Truth in Lending Act – which includes supervisory exams. This report should give the Bureau confidence that it has the discretion – indeed, the duty – to honor the sacrifices made by military servicemembers and their families by protecting them through its supervisory powers.

Report

Care for us! True, indeed! They ne'er cared for us yet: suffer us to famish, and their store-houses crammed with grain; make edicts for usury, to support usurers; repeal daily any wholesome act established against the rich, and provide more piercing statutes daily, to chain up and restrain the poor. If the wars eat us not up, they will; and there's all the love they bear us.

-William Shakespeare, *Coriolanus* (c. 1605).

Introduction

Americans of all political persuasions agree that we owe a debt of gratitude to our nation's military servicemembers. Our men and women in uniform along with their families make special sacrifices for our freedom and national security. In recognition of this sacrifice, Congress passed the Talent-Nelson amendments in the John Warner National Defense Authorization Act for Fiscal Year 2007.[1] These amendments – now commonly referred to as the Military Lending Act ("MLA") – established a national usury limit for servicemembers and their dependents. The MLA was Congress' response to evidence that high-cost lending to military service members and their dependents "undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all volunteer fighting force."[2] Members of Congress expressed concern that "[p]redatory lenders" were "blatantly targeting our military personnel, undermining their financial stability and tarnishing their service records."[3] Characterizing triple-digit interest rate loans to service members as "absolutely reprehensible," Congress acted to place a limit on interest rates of no more than 36 percent per annum.[4]

Congress provided for the enforcement of the Military Lending Act by empowering an array of federal financial regulators to use their existing authority and staff to stop MLA violations. Congress sensibly relied upon these financial regulators to enforce the Military Lending Act in order to allow the Department of Defense ("DOD") – the agency statutorily tasked with administering the MLA – to focus on its core mission of protecting the country.

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[1] Talent-Nelson Amendment, enacted as section 670 of the John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, 120 Stat. 2266-2269 (2006) (codified at 10 U.S.C. § 987).

[2] U.S. DEPT. OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 9 (2006), http://www.dtic.mil/dtic/tr/fulltext/u2/a521462.pdf.

[3] *A Review of the Department of Defense's Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents: Hearing Before the S. Comm. on Banking, Housing, and Urban Aff.,* 109th Cong., 2d Sess., S. Hrg. 109-1081, at 218-397 (Sept. 14, 2006) (Statement of Senator Elizabeth Dole).

[4] *Id.* (statement of Senator Jack Reed).

After the 2008 financial crisis, Congress reorganized the enforcement of federal consumer finance law when it established the Bureau of Consumer Financial Protection ("CFPB," "BCFP," or "the Bureau"). Congress tasked the CFPB with protecting all Americans from harmful or abusive consumer finance products. Although the MLA was not a focal point within the reforms that followed the home mortgage foreclosure crisis, Congress eventually recognized that the CFPB was particularly well-suited to enforcement of the Military Lending Act. In 2012 Congress amended the MLA to task the CFPB with MLA enforcement alongside the other financial regulators that possessed this authority from the original Act.[5] Since then, the CFPB has routinely engaged in MLA enforcement activities including supervisory examinations of large banks, payday lenders, and other financial companies to ensure compliance with the MLA.

However, in recent months, the Trump Administration has reversed direction by announcing plans to end the CFPB's supervisory examinations for MLA violations. CFPB leadership, under Acting Director Mick Mulvaney, has publicly expressed the belief that the Bureau lacks the statutory authority to conduct these routine examinations. Moreover, internal CFPB documents obtained by national press outlets reportedly reflect a Bureau decision to stop including MLA compliance within the Bureau's supervisory work. Military service member support organizations, veterans' rights groups, as well as members of Congress and state attorneys general have all voiced their concern over the Bureau's decision to weaken its MLA enforcement program.[6] But Bureau leadership has continued to maintain that, in effect, the Bureau's hands are tied because they believe that federal law does not allow the CFPB to cover MLA compliance within its routine examinations.

This report is the first publicly available legal analysis of the CFPB's authority to include MLA compliance within its supervisory exams. This analysis concludes that the CFPB has ample legal authority under both its enabling statute, the Consumer Financial Protection Act ("CFPA"), as well as the MLA itself to include MLA compliance within its exams. This report begins with a brief background discussion of the creation of the Military Lending Act and the CFPB's MLA enforcement responsibilities. Second, this report presents evidence that CFPB leadership made an about-face on military servicemember protection in supervisory examinations through an irregular and flawed process. Third, multiple subsections within the CFPA provide a strong statutory basis upon which Bureau leaders could conclude that they have the legal authority to include the MLA in supervisory exams. And fourth, along with the CFPA, the text of the 2012 amendments to the MLA itself also provides an independent and sufficient basis for Bureau leaders to include the MLA within supervisory exams. This report also includes, as an appendix, two letters that shed doubt on the Bureau's current position.

[5] *See* National Defense Authorization Act for Fiscal Year 2013, Pub. L. 112-239, 126 Stat. 1786 (assigning enforcement of 10 U.S.C. § 987 to "the agencies specified in section 108 of the Truth in Lending Act") (codified as 10 U.S.C. § 987(f)(6)). The CFPB is one of the agencies specified in the Truth in Lending Act as "enforcing agencies." 15 U.S.C. § 1607(a)(6).

[6] *See, e.g.,* Karen Jowers, *Advocates to Mattis: Don't waver in protecting troops against predatory lenders,* MIL. TIMES (Aug. 23, 2018), https://www.militarytimes.com/pay-benefits/2018/08/23/advocates-to-mattis-dont-waver-in-protecting-troops-against-predatory-lenders/; Mark Huffman, *Attorneys General call for strict enforcement of the Military Lending Act,* CONSUMER AFF. (Oct. 25, 2018), https://www.consumeraffairs.com/news/attorneys-general-call-for-strict-enforcement-of-the-military-lending-act-102518.html.

The first letter, from the Bureau's own Assistant Director for Military Servicemember Affairs, concludes that the CFPB does have the legal authority to include MLA within supervisory exams. The second letter, from the Department of Defense, shows that the Bureau has reversed its position on MLA supervision without consulting the DOD.

Background

Usury Law and Military Servicemembers

For most of American history, state usury laws prohibited lenders from charging triple-digit interest rates. All thirteen original colonies adopted usury limits of between five and twelve percent.[7] Most of these statutes predate the U.S. Constitution. In the early twentieth century states began relaxing their usury laws to allow licensed and regulated lenders to develop the consumer credit products now common in America's mainstream consumer economy.[8] By the mid-twentieth-century, state usury laws evolved into a complex patchwork of limitations on various types of credit charged by different lenders.[9] Nevertheless, through the 1960s, every state in the Union retained a usury limit effectively prohibiting triple-digit interest rate loans.[10] The most common price limit for small loans throughout the second half of the twentieth century were usury caps of 36 percent per annum.

In the 1980s and 1990s, many states relaxed their traditional interest rate limits. States made these changes in response to a variety of factors. High inflation in the late 1970s and early 1980s increased lenders' cost of funds.[11] As prevailing rates approached state usury limits it became temporarily difficult for banks and others to profitably lend at legally permissible rates. Some states abolished their interest rate limits altogether while others created new exceptions or pegged permissible rates to a fluctuating index.[12] Moreover, a controversial Supreme Court decision interpreting the National Bank Act authorized national banks to export interest rates from the bank's home state to consumers in states with higher interest rate limits.[13] This sparked a race to the bottom, with a series of reactive laws effectively preempting the application of traditional usury limits as applied to banks but not to other nondepository lenders.[14]

In the 1990s non-bank check cashing businesses lobbied state legislatures around the country to permit "deferred presentment" of consumers' personal checks. In these transactions, which have come to be known as "payday loans," a check casher agrees to hold

[7] Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1117-118 (2008).
[8] *Id.* at 1119.
[9] *Id.* at 1121.
[10] *Id.*
[11] Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*, 66 Ohio St. L.J. 653, 672 (2005).
[12] *Id.* at 672–73.
[13] *See* Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299, 309–313 (1978).
[14] Peterson, *supra* note 7 at 1121.

a borrower's personal check for a few weeks in exchange for a fee.[15] In effect, if not originally in name, these transactions were high-cost, short-term loans. However, evidence soon mounted that the vast majority of consumers did not use payday loans on a one-time basis.[16] Rather, most consumers were unable to retire their payday loans within the first few weeks. For these borrowers, payday loans become a debt trap where they "roll over" their loan again and again. "Over 80% of payday loans are rolled over or followed by another loan within 14 days."[17] Most consumers are forced to turn to family or friends before escaping from the triple-digit interest rate loan.[18] Storefront payday lender locations exploded nationwide as more and more low- to moderate-income Americans began using a newly available credit product with average interest rates of over 400 percent per annum.

The erosion of state usury limits had a profound effect on military service members. One study of states with large military populations found overwhelming evidence that triple-digit interest rate payday lenders clustered around military bases to target enlisted personnel.[19] Following a *New York Times* expose, Congress directed the Department of Defense to study whether high-cost credit products were harming the military.[20] The Pentagon responded in 2006 with a detailed report to Congress concluding that "predatory lenders market to the military through their ubiquitous presence around military installations" with the goal of "seek[ing] out young and financially inexperienced borrowers."[21] These borrowers are "less likely to weigh the predatory loan against other opportunities and are less likely to be concerned about the consequences of taking the loan."[22] At the time of the report, "[f]orty-eight percent of enlisted Service members [were] less than 25 years old, typically without a lot of experience in managing finances, and without a cushion of savings to help them through emergencies."[23] The Pentagon concluded that high-cost credit products, such as payday loans and similar forms of credit not only hurt servicemembers by "undermin[ing] troop readiness, morale, and quality of life," but also disrupted military operations when servicemembers'

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[15] *See* Consumer Federation of America, *How Payday Loans Work*, PAYDAYLOANINFO.ORG (last accessed Aug. 27, 2018), https://paydayloaninfo.org/facts (defining payday loan as a loan secured by "the borrower's personal check held for future deposit or on electronic access to the borrower's bank account.").

[16] *See* PETER SKILLERN, CMTY. REINVESTMENT ASS'N OF N.C., SMALL LOANS, BIG BUCK$: AN ANALYSIS OF THE PAYDAY LENDING INDUSTRY IN NORTH CAROLINA 4 (2002), *available at* http://www.cra-nc.org/small%20loans%20big%20bucks.pdf (finding 85 percent of payday lender revenue comes from borrowers with over five loans per year).

[17] CONSUMER FIN. PROTECTION BUREAU, CFPB DATA POINT: PAYDAY LENDING 4 (2014) https://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.

[18] CONSUMER FIN. PROTECTION BUREAU, *supra* note 16 (finding that half of all payday loans "are in a sequence at least 10 loans long" and that most payday borrowing "involves multiple renewals following an initial loan, rather than multiple distinct borrowing episodes separated by more than 14 days.").

[19] Graves & Peterson, *supra* note 12 at 659.

[20] *See* National Defense Authorization Act for Fiscal Year 2006, Pub. L. 109-163, 119 Stat. 3276 (requiring the Secretary of Defense to submit "a report on predatory lending practices directed at members of the Armed Forces and their families.").

[21] U.S. DEPT. OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 4 (2006), http://www.dtic.mil/dtic/tr/fulltext/u2/a521462.pdf.

[22] *Id.*

[23] *Id.*

financial troubles resulted in the revocation of their security clearances.[24] In response to these trends, the Pentagon's study endorsed reestablishing a traditional usury limit of 36 percent on loans to service members and their dependents.[25]

Later that year, Senators Jim Talent of Missouri and Bill Nelson of Florida sponsored an amendment to the Defense Authorization Act for 2007 that would establish a new usury limit on loans to service members and their dependents. After Congress adopted the legislation with overwhelming bipartisan support, President George W. Bush signed the bill into law. [26] Under the statute, a lender may not "impose an annual percentage rate of interest greater than 36 percent" on "consumer credit" offered to military servicemembers and their dependents.[27] In addition to this interest rate cap, the MLA also prohibits creditors from using forced arbitration clauses in consumer credit contracts offered to military personnel and their dependents. This prohibition would guarantee that service members have the right to a day in court regarding consumer credit disputes.[28] In addition, the MLA requires creditors to make mandatory disclosures to servicemembers of any APR charged, as well as disclosures required under the Truth in Lending Act, and to provide a "clear description of the payment obligations of the [service]member or [their] dependent."[29] The MLA also prohibits entirely the extension of certain types of credit to servicemembers, including payday loans,[30] vehicle title loans,[31] and any loan where "the borrower is required to waive [their] right to legal recourse,"[32] or "is prohibited from prepaying the loan or is charged a penalty or fee for prepaying."[33]

Congress divided executive branch responsibility for the MLA between the Department of Defense and other banking regulators and law enforcement agencies. The statute tasked DOD with adopting regulations to implement the statute. Congress also required DOD to periodically consult with the Federal Trade Commission ("FTC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCUA"), and the Treasury Department.[34] Knowingly violating the MLA is a federal misdemeanor crime subject to prosecution by the Department

[24] *Id.* at 45 (citing the fact that "[f]inancial issues account for 80 percent of security clearance revocations and denials for Navy personnel").
[25] *Id.* at 50.
[26] The Military Lending Act, which was part of the John Warner National Defense Authorization Act for Fiscal Year 2007, passed the U.S. House of Representatives 398 to 23. OFFICE OF THE CLERK OF THE U.S. HOUSE OF REPS., FINAL VOTE RESULTS FOR ROLL CALL 510 (2006), http://clerk.house.gov/evs/2006/roll510.xml.
[27] 10 U.S.C. § 987(a)–(b) (2016).
[28] *Id.* § 987(e)(3).
[29] *Id.* § 987(e)(1).
[30] *Id.* § 987(e)(1) (prohibiting the extension of any credit in which "the creditor rolls over, renews, repays, refinances, or consolidates any consumer credit extended to the borrower, by the same creditor with the proceeds of other credit extended to the same covered member or a dependent"); 10 U.S.C. § 987(e)(5) (prohibiting the extension of any credit where "the creditor uses a check or other method of access to a deposit, savings, or other financial account maintained by the borrower").
[31] 10 U.S.C. § 987(e)(5).
[32] *Id.* § 987(e)(2).
[33] *Id.* § 987(e)(7).
[34] 10 U.S.C. § 987(h)(3).

of Justice.[35] Loans made in violation of the act are void from their inception[36] and subject the lender to civil liability for actual damages of no less the $500 for each violation,[37] appropriate punitive damages,[38] equitable or declaratory relief,[39] and costs.[40]

The CFPB's Military Lending Act Responsibilities

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in response to the 2008 financial crisis. Among a variety of reforms, Title Ten of the Dodd-Frank Act, called the Consumer Financial Protection Act of 2010 ("CFPA"), established a new federal agency designed to focus on consumer protection in financial services.[41] Congress recognized that the OCC, FDIC, and NCUA, in addition to their consumer protection responsibilities, all have the important responsibility of maintaining the solvency of banks and credit unions. The Federal Reserve shares this responsibility and is also tasked with conducting monetary policy as well as operating critical financial infrastructure such as the Automated Clearing House system and the FedWire wire transfer system. And although the FTC is focused on consumer law enforcement, it also has antitrust law responsibilities (along with the Department of Justice) and enforces other unfair competition practices in non-financial markets. The CFPB is the one federal agency exclusively focused on consumer financial protection.

In the CFPA, Congress gave the CFPB jurisdiction over "federal consumer financial law." This phrase encompasses jurisdiction over 18 enumerated consumer protection statutes (such as the Truth in Lending Act and Fair Debt Collection Practices Act),[42] the CFPA itself, including its prohibition of "unfair, deceptive, or abusive acts and practices" in consumer finance, and any regulation the CFPB issues in implementing these statutes.[43] Under the

[35] *Id.* § 987(f)(1).
[36] *Id.* § 987(f)(3).
[37] *Id.* § 987(f)(5)(A)(i).
[38] *Id.* § 987(f)(5)(A)(ii).
[39] *Id.* § 987(f)(5)(A)(iii).
[40] *Id.* § 987(f)(5)(B).
[41] 12 U.S.C. § 5491(a).
[42] 12 U.S.C. § 5481(a)(12) (transferring the implementation of these 18 enumerated consumer protection statutes away from the Federal Reserve and other agencies and to the CFPB).
[43] *Id.* at § 5481(a)(14). The definition reads:

> The term "Federal consumer financial law" means the provisions of this title, the enumerated consumer laws, the laws for which authorities are transferred under subtitles F and H, and any rule or order prescribed by the Bureau under this subchapter, an enumerated consumer law, or pursuant to the authorities transferred under subtitles F and H. The term does not include the Federal Trade Commission Act.

12 U.S.C. § 5481(a)(14). In turn, the 18 enumerated consumer laws include:

- The Alternative Mortgage Transaction Parity Act of 1982, Public L. No. 97-320, 96 Stat. 1545 (codified as amended at 12 U.S.C. ch. 39);
- The Consumer Leasing Act of 1976, Pub. L. No. 94-240, 90 Stat. 257 (codified as amended at 15 U.S.C. §§ 1667-1667f);
- The Electronic Fund Transfer Act, Pub. L. No. 90-321, 92 Stat. 3728 (codified as amended at 15 U.S.C. ch. 41, subch. 6);

CFPA, the CFPB's jurisdiction extends to any "covered person" that "engages in offering or providing a consumer financial product or service."[44]

The CFPA tasked the Bureau with enforcing federal consumer financial law through two primary mechanisms. First, the CFPA established within the Bureau an Office of Enforcement charged with enforcing federal consumer financial laws either through administrative enforcement procedures[45] or through the CFPB's authority to litigate in federal court.[46] This enforcement authority extends to all nondepository covered persons as well as any bank or credit union with more than $10 billion in assets.[47] The Bureau's litigation authority is independent from the Department of Justice[48] and authorizes the Bureau to seek a wide variety of equitable and monetary remedies.[49]

Second, the CFPA directed the Bureau to establish a supervision program that is separate from the Bureau's Office of Enforcement. Unlike law enforcement actions,

- The Equal Credit Opportunity Act, Pub. L. No. 90-321, 88 Stat. 1521 (codified as amended at 15 U.S.C. ch. 41, subch. 4);
- The Fair Credit Billing Act, Pub. L. No. 93-495, 88 Stat. 1511 (codified as amended at 15 U.S.C. ch. 41, subch. 1, pt. D);
- The Fair Credit Reporting Act, Pub. L. No. 90-321, 84 Stat. 1128 (codified as amended at 15 U.S.C. ch. 41, subch. 3) (excluding §§ 615(e), 628, 15 U.S.C. §§ 1681m(e), 1681w);
- The Home Owners Protection Act of 1998, Pub. L. No. 105-216, 112 Stat. 897 (codified as amended at 12 U.S.C. ch. 49);
- The Fair Debt Collection Practices Act, Pub. L. No. 90-321, 91 Stat. 874 (codified as amended at 15 U.S.C. ch. 41, subch. 5);
- Federal Deposit Insurance Act § 43(b)-(f), 64 Stat. 873 (codified as amended 12 U.S.C. §§ 1831t(c)–(f));
- Gramm-Leach-Bliley Act, Pub. L. No. 106-102, §§ 502-09, 113 Stat. 1338 (codified as amended at 15 U.S.C. §§ 6802-6809) (excluding § 505 as it applies to § 501(b));
- The Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-200, 89 Stat. 1125 (codified as amended at 12 U.S.C. ch. 29);
- The Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended at to various parts of Truth in Lending Act, particularly 15 U.S.C. §§ 1601-02, §§1639-41);
- The Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533, 88 Stat. 1724 (codified as amended at 12 U.S.C. ch. 27);
- The S.A.F.E. Mortgage Licensing Act of 2008, Pub. L. No. 110-289, 122 Stat. 2810 (codified as amended at 12 U.S.C. ch. 51);
- The Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (codified as amended at 15 U.S.C. ch. 41, subch. 1);
- The Truth in Savings Act, Pub. L. No. 102-242, 105 Stat. 2334 (codified as amended at 12 U.S.C. ch. 44);
- Omnibus Appropriations Act, 2009, Pub. L. No. 111-8, § 626, 123 Stat. 524 (codified as amended at 15 U.S.C. § 1638); and
- The Interstate Land Sales Full Disclosure Act, Pub. L. No. 90-448, 82 Stat. 590 (codified as amended at 15 U.S.C. ch. 42).

12 U.S.C. § 5481(a)(12).

[44] 12 U.S.C. § 5481(a)(6)(A).

[45] 12 U.S.C. § 5563(a).

[46] 12 U.S.C. § 5564(a).

[47] 12 U.S.C. §§ 5514(c); 5515(c).

[48] 12 U.S.C. § 5564(b) ("[t]he Bureau may act in its own name and through its own attorneys . . . in any action, suit, or proceeding to which the Bureau is a party.").

[49] 12 U.S.C. § 5565(a)(2).

supervisory examinations are audits designed to assess compliance with the law, obtain information about activities, procedures, and compliance systems, as well as detect and assess risks to consumers and to markets.[50] Whereas law enforcement actions are carried out in open court or a public administrative proceeding, supervisory exams are confidential, though they can lead to an enforcement action when the exam uncovers evidence of a serious violation of the law. The Bureau's supervisory jurisdiction is similar to, but somewhat narrower than, its enforcement jurisdiction. As with enforcement, the Bureau's supervisory jurisdiction covers all large banks and credit unions with total assets over $10 billion. In addition, Congress authorized the Bureau to supervise a list of specific types of nondepository covered persons that includes mortgage originators, mortgage servicers, lenders offering private student loans, and payday lenders.[51] The CFPA also authorizes the Bureau to assert supervisory jurisdiction over other large or especially risky nonbank covered persons by issuing regulations.[52] Under this authority the Bureau has issued "larger participant" rules creating supervisory jurisdiction over large nondepository financial services businesses including consumer reporting agencies, debt collection businesses, student loan servicers, international remittance providers, and automobile finance companies.[53]

Supervisory exams are important because, unlike enforcement actions, they facilitate comprehensive review of a supervised business's activities and management systems.[54] In CFPB exams, examiners generally seek relatively unrestricted review of businesses records, interviews of key employees, and access to management systems.[55] Examinations can help a supervised company to restructure their business practices and change corporate culture to prevent violations of the law before they occur. Moreover, supervisory exams can identify violations of the law that would have otherwise gone unnoticed. Many of the Bureau's most important public enforcement actions arose out of confidential supervisory exams.[56]

Because the Military Lending Act predates the existence of the CFPB, the original MLA did not contemplate enforcement by or consultation with the Bureau. Moreover, the Dodd-Frank Act did not explicitly address the MLA, and the MLA is not listed as one of the 18 enumerated statutes that were transferred to the Bureau from other federal agencies. Nevertheless, in the National Defense Authorization Act for Fiscal Year 2013, Congress amended the MLA itself to give the CFPB enforcement authority over the MLA and to add the Bureau to the list of agencies the DOD must consult in exercising its rulemaking

[50] CONSUMER FIN. PROTECTION BUREAU, CFPB SUPERVISION AND EXAMINATION PROCESS, 3 (2012), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/032017_cfpb_examination-process-overview_supervision-and-examination-manual.pdf.
[51] 12 U.S.C. § 5514(a)(1).
[52] *Id.*
[53] *See* 12 C.F.R. § 1090.104-.107 (2018).
[54] *See* Jean Braucher & Angela Littwin, *Examination as a Method of Consumer Protection*, 58 ARIZ. L. REV. 34, 68-71 (2016).
[55] Eric J. Mogilnicki, *Preparing for CFPB Examinations*, 2013 BUS. L. TODAY 1, 1 (2013).
[56] The CFPA also established an Office of Fair Lending that works hand-in-hand with enforcement and supervisory staff to enforce the Equal Credit Opportunity Act. ECOA prohibits discriminating against a list of protected classes of people in the provision of financial services. *See* 15 U.S.C. § 1691.

authority.[57] Specifically, since 2013, the MLA as amended authorizes public enforcement of the MLA by "the agencies specified in section 108 of the Truth in Lending Act ("TILA")."[58] Since the financial crisis, the CFPB has been the regulatory authority implementing TILA, which is one of the CFPA's enumerated statutes.[59] The CFPB is, without question, one of the "enforcing agencies" with respect to the MLA for any person subject to the Bureau's enforcement authority.[60] Since the enactment of Dodd-Frank, the CFPB has become the nation's primary consumer protection agency with regard to consumer finance, and plays an essential role in enforcing the Military Lending Act and every other federal consumer financial protection law.

Soon after the 2013 National Defense Authorization Act amendments to the MLA, the CFPB began assuming its MLA responsibilities. For example, when the Department of Defense published an advanced notice of proposed rulemaking contemplating revisions to the scope of the MLA's implementing regulations in Junes 2013,[61] the CFPB consulted with the Department extensively. Among other activities, the CFPB published a detailed report on strategies some banks and nondepository companies were using to circumvent the DOD's MLA regulations.[62] The CFPB's report identified over fifty thousand military servicemembers that received so-called "Deposit Advance Products" from banks with average effective interest rates of over 300 percent APR.[63] Banks had structured these loans as open-ended lines of credit in order to circumvent the DOD's regulations.[64] By 2015, after extensive consultation with the CFPB and the other federal agencies with MLA authority, the Department of Defense amended its MLA implementing regulations to close these loopholes.[65]

About-Face: The CFPB Decided to Abandon Military Servicemember Protection in its Supervisory Examinations Through an Irregular and Flawed Process

At the beginning of the Trump administration, the CFPB's supervisory authority appeared to be well-settled and uncontroversial. The CFPB has engaged in its MLA enforcement and supervisory work for years "without any significant legal opposition," and

[57] *See* National Defense Authorization Act for Fiscal Year 2013, Pub. L. 112-239, 126 Stat. 1786. (codified at 10 U.S.C. § 987(h)(3)(E)).
[58] 10 U.S.C. § 987(f)(6).
[59] 15 U.S.C. § 1604(a).
[60] 15 U.S.C. § 1607(a)(6).
[61] *See* Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 78 Fed. Reg. 36134 (June 17, 2013) (to be codified at 32 C.F.R. 232).
[62] CONSUMER FIN. PROTECTION BUREAU, THE EXTENSION OF HIGH-COST CREDIT TO SERVICEMEMBERS AND THEIR FAMILIES 8–10 (2014), https://files.consumerfinance.gov/f/201412_cfpb_the-extension-of-high-cost-credit-to-servicemembers-and-their-families.pdf.
[63] *Id.* at 5–7 ("The deposit advances [the CFPB] analyzed [were] substantially similar in structure and purpose to payday loans").
[64] *Id.*
[65] *See* 32 C.F.R. § 232.12(a).

without lenders themselves "challenging [Bureau oversight] based on the law."[66] The Bureau arrived at its supervisory procedures after a long and detailed interagency process conducted through the auspices of Federal Financial Institutions Examination Council (FFIEC), a council of financial regulators established by Congress to facilitate efficient and uniform supervisory exams.[67] Indeed, no bank, credit union, or other financial business has ever legally challenged the Bureau's authority to include MLA compliance within supervisory exams. And when a supervisory exam uncovered evidence of violations of the MLA by a national payday lending chain, the lender quickly settled without contesting the Bureau's MLA authority. The lender, Cash America International, Inc., agreed to provide $14 million in restitution to the service members and their dependents that had been charged illegal interest rates in excess of 36 percent APR.[68] The Department of Defense has not called on the Bureau to stop including MLA compliance issues within supervisory exams, nor have the other FFIEC financial regulators publicly expressed any reservations with the CFPB exercising its MLA responsibilities within supervisory exams.

Nevertheless, in recent months, reports have surfaced that the CFPB has made an about-face in exercising its MLA responsibilities. In August of 2018 the *New York Times* obtained a copy of an internal CFPB document indicating that Acting Director Mick Mulvaney is directing the agency's professional staff to stop covering Military Lending Act compliance within the Bureau's supervisory exams.[69] Acting Director Mulvaney has concluded that the CFPB "might not have the legal authority to actively go looking for [MLA] violations" because this authority "is not explicitly laid out" in the Military Lending Act itself.[70] According to reports, the decision came about following "a comprehensive review" of the CFPB's activities to assess "whether those activities align with its statutory authority."[71] Acting Director Mulvaney's position is nuanced – he concedes that the Bureau has the authority to bring enforcement actions for MLA violations, but maintains that the Bureau may not include MLA compliance issues within supervisory exams (which the Bureau uses to identify violations that

[66] Glenn Thrush, *Mulvaney Looks to Weaken Oversight of Military Lending,* N. Y. TIMES (Aug. 10, 2018), https://www.nytimes.com/2018/08/10/us/politics/mulvaney-military-lending.html; Evan Weinberger, *Senate Dems Blast CFPB Changes to Military Lending Supervision*, BLOOMBERG BNA (Aug. 16, 2018), https://www.bna.com/senate-dems-blast-n73014481811/.

[67] Congress established the FFIEC on March 10, 1979, in title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRIRCA), Public Law 95-630. The CFPB sits on the FFIEC along with the Federal Reserve Board, the OCC, the FDIC, and the NCUA. FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, ANNUAL REPORT at *iii* (2017), https://www.ffiec.gov/PDF/annrpt17.pdf. The FFIEC also includes a state liaison committee made up of representatives from state regulatory agencies that supervise financial institutions. *Id.* at 13.

[68] *In re Cash America International, Inc.*, 2013-CFPB-0008 (Nov. 21, 2013), https://files.consumerfinance.gov/f/2013-cfpb_0008_consent-order.pdf.

[69] *E.g.*, Thrush, *supra* note 66; Chris Arnold, *White House Takes Aim at Financial Protections for Military*, NPR (Aug. 13, 2018, 5:00 AM); Neil Haggerty, *Senate Dems to CFPB's Mulvaney: Don't end military lending exams,* AM. BANKER (Aug. 15, 2018, 6:07 PM), https://www.americanbanker.com/news/reed-warns-cfpbs-mulvaney-on-military-lending-act-exams; Emily Birnbaum, *Trump administration mulls changes to financial protections for military members: report,* HILL (Aug. 13, 2018, 1:04 PM), https://thehill.com/policy/finance/401555-trump-administration-poised-to-roll-back-financial-protections-for-military; Paola Chavez, *NYT: Mulvaney to weaken military oversight,* CNN (Aug. 11, 2018, 12:14 PM), https://www.cnn.com/2018/08/11/politics/mulvaney-military-lending/index.html.

[70] Thrush, *supra* note 66.

[71] Weinberger, *supra* note 66.

can, in turn, lead to law enforcement cases). According to press reports, under the new approach the Bureau contemplates that it may bring enforcement actions against lenders who violate the MLA, but it will identify MLA violations through methods other than supervisory exams. Now, according to sources identified by the *Military Times*, the CFPB plans to "rely on complaints from service members and their families" to identify Military Lending Act violations.[72]

This change in policy implemented by the Trump Administration's political leaders overruled the recommendations and past practices of the CFPB's career professional staff in two different internal CFPB offices with responsibility for the CFPB's MLA work. First, the CFPB's political leadership under the Trump Administration overruled the CFPB's own Assistant Director for Military Servicemember Affairs. Included in the appendix to this report is a May 9, 2018 letter from Col. (ret.) Paul Kantwill, the CFPB's Assistant Director of Service Member Affairs, to the Consumer Federation of America.[73] In this correspondence, Assistant Director Kantwill stated that, "[t]he Bureau expects institutions to ensure servicemembers and other eligible consumers are receiving the consumer protections afforded by the MLA. Accordingly, the Bureau is committed to enforcing the MLA through its *supervisory* and enforcement work…."[74] Assistant Director Kantwill's letter goes on to detail the Bureau's plans to task supervisory examiners with "assessing the quality of the institution's implementation of policies and procedures as well as compliance risk management systems."[75] The letter assured that "going forward, the Bureau plans to conduct MLA reviews in several markets."[76] Thus, the decision to exclude MLA issues from supervisory examinations occurred after May of 2018 and apparently was made over the objection of the highest-ranking Bureau official assigned to focus exclusively on military servicemembers and veterans.

Similarly, the CFPB's political leadership under the Trump Administration overruled career professional staff within the Bureau's Office of Supervision Policy. The Office of Supervision Policy develops supervision strategy and provides subject-matter expertise to the CFPB's examination staff on legal and policy issues. This office has the responsibility of producing the CFPB's Examination Manual which guides Bureau examiners and supervised institutions on expectations in supervisory exams. With respect to the MLA, the Bureau's Office of Supervision Policy has produced detailed examination procedures on how to cover the MLA in supervisory exams. Most explicitly, for over five years the Bureau's examination

[72] Karen Jowers, *Senators urge consumer protection agency not to 'abandon' duty to protect troops, families,* MILITARY TIMES (Aug. 16, 2018), https://www.militarytimes.com/pay-benefits/2018/08/16/senators-urge-consumer-protection-agency-not-to-abandon-duty-to-protect-troops-families/. *See also,* Thrush *supra*, note 2 ("[i]nstead of conducting examinations . . . the [B]ureau will now rely solely on complaints funneled through its website, hotlines, the military and people who believe they have been victims of abuse.").

[73] Prior to serving at the CFPB, Col. (ret.) Kantwill served as Director in the Office of Legal Policy within the Office of the Under Secretary of Defense for Personnel & Readiness at the Pentagon where he led DOD's team on Military Lending Act regulatory implementation. *See* Consumer Fin. Protection Bureau, Press Release, CFPB Announces Changes to Senior Leadership (January 6, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-changes-to-senior-leadership/.

[74] Letter from Paul Kantwill, Assistant Director of Servicemember Affairs, Bureau of Consumer Financial Protection to the Consumer Federation of America 1 (May 9, 2018) (emphasis added) (included Appendix A *infra*).

[75] *Id.*

[76] *Id.* at 2.

manual for small dollar lenders has stated: "Examiners will review for MLA violations and their related risks to consumers."[77] Despite the CFPB political leadership's publicly announced decision, as of the date of this report the Bureau's own examination manual continues to directly contradict Acting Director Mulvaney's public statements on exam procedures for payday lenders and similar businesses.[78]

Furthermore, the CFPB's political leadership arrived at the decision to exclude MLA issues from supervisory exams in direct contradiction with the outcome of a longstanding interagency process coordinated through the FFIEC to create uniform MLA supervisory procedures. The FFIEC is authorized to make decisions on examination policy for businesses subject to each agency's supervisory jurisdiction. In this respect, the FFIEC is a formal interagency body that prescribes uniform principles, standards, and report forms for conducting supervisory exams.[79] The FFIEC facilitates interagency cooperation and training of examiners at each of the body's member agencies.[80] As recently as 2016, the FFIEC "convened an interagency effort to comprehensively revise the interagency MLA examination procedures to reflect the 2015 DOD regulatory amendments. . . ."[81] This effort included not only CFPB's career, professional staff, but also professional staff from all of the FFIEC member organizations. During this process the CFPB continued to conclude that it had the authority to include MLA compliance issues within supervisory exams. In September of 2016, a task force of the FFIEC member organizations unanimously adopted updated examination procedures that included CFPB MLA examination procedures.[82] Not only the Bureau, but every other FFIEC member apparently concluded that the CFPB has the legal authority to include MLA issues within supervisory exams.

To date, no other federal regulatory agency that sits on the FFIEC has publicly objected to the Bureau's past practice of covering MLA issues in supervisory examinations. Based on this collective understanding, in late 2016 the FFIEC trained over 5,600 examiners on uniform MLA exam procedures that included CFPB MLA examinations.[83] Moreover, in 2016, when the Bureau announced the revisions to its MLA supervisory policies that reflected the DOD's amended 2015 final rule, the widely-anticipated step provoked little coverage by the press and

[77] Consumer Fin. Protection Bureau, *Examination Procedures: Short-Term Small-Dollar Lending*, in SUPERVISION AND EXAMINATION MANUAL, at 4 (September 2013), https://files.consumerfinance.gov/f/201309_cfpb_payday_manual_revisions.pdf.
[78] *Id.* (last viewed October 10, 2018.)
[79] *About the FFIEC*, FED. FIN. INST. EXAM. COUNCIL (last accessed Aug. 28, 2018), https://www.ffiec.gov/about.htm (explaining that the FFIEC "is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB).")
[80] FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, ANNUAL REPORT 5 (2017), https://www.ffiec.gov/PDF/annrpt17.pdf.
[81] FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, ANNUAL REPORT 13 (2016), https://www.ffiec.gov/PDF/annrpt16.pdf.
[82] *Id.*
[83] *Id.*

little or no backlash from supervised banks, credit unions, or nondepository lenders.[84] Presumably, if the CFPB does exclude the MLA from its examinations, the FFIEC will need to undergo another interagency consultation process, which would likely include the pointless retraining of thousands of examiners on the respective responsibilities of each agency. The Bureau's strange about-face reflects a process that was contrary to the Congressional declaration of purpose for the FFIEC which directs that "[t]he Council's actions shall be designed to promote consistency in such examination and to insure progressive and vigilant supervision"[85] The decision by the Bureau's political leadership to exclude MLA issues from CFPB exams was an unexplained and bizarre unilateral reversal of the FFIEC's longstanding, careful interagency process.

Ironically, the decision to exclude MLA compliance from supervisory exams also occurred outside the very process established by the CFPB's new political leadership to gather information on potential policy reform. Beginning in January of 2018 Acting Director Mulvaney initiated a "call for evidence" comprised of a dozen Federal Register Requests for Information ("RFIs").[86] The Bureau's press release on the process explained that the series of RFIs were designed to "ensure the Bureau is fulfilling its proper and appropriate functions to best protect consumers."[87] The series of RFIs addressed a broad array of topics and asked for public feedback on numerous detailed questions. Four of the RFIs addressed the Bureau's supervisory and enforcement mission including RFIs on the civil investigative demands,[88] administrative adjudications,[89] enforcement processes,[90] and the supervision program.[91] Despite all of these opportunities to solicit feedback on possible changes to Bureau supervisory and enforcement policies, not a single question specifically asked about supervision in the context of the MLA. Had the Bureau asked questions about MLA supervision in its RFI process, members of Congress, other administrative agencies including DOD, FTC, the Federal Reserve, OCC, FDIC, and NCUA, as well as military service member organizations, veterans' rights groups, and consumer organizations could have weighed in on the importance and legality of supervisory exams covering the MLA. Instead, the Bureau's

[84] Press Release, Consumer Fin. Protection Bureau, CFPB Releases Updated Exam Procedures for Military Lending Act, (Sept. 30, 2016), https://www.consumerfinance.gov/about-us/newsroom/cfpb-releases-updated-exam-procedures-military-lending-act/.
[85] 12 U.S.C. § 3301.
[86] Consumer Fin. Protection Bureau, Call for Evidence (2018), https://www.consumerfinance.gov/policy-compliance/notice-opportunities-comment/archive-closed/call-for-evidence/ (listing the twelve RFIs included within the "call for evidence").
[87] Consumer Fin. Protection Bureau, Press Release, Acting Director Mulvaney Announces Call for Evidence Regarding Consumer Financial Protection Bureau Functions: Seeks Public Input on Ways to Better Fulfill Statutory Obligations (January 17, 2018), https://www.consumerfinance.gov/about-us/newsroom/acting-director-mulvaney-announces-call-evidence-regarding-consumer-financial-protection-bureau-functions/.
[88] Consumer Fin. Protection Bureau, *Request for Information Regarding Bureau Civil Investigative Demands and Associated Processes*, 83 FED. REG. 3686 (January 26, 2018).
[89] Consumer Fin. Protection Bureau, *Request for Information Regarding Bureau Rules of Practice for Adjudication Proceedings*, 83 FED. REG. 5055 (February 5, 2018).
[90] Consumer Fin. Protection Bureau, *Request for Information Regarding Bureau Enforcement Processes*, 83 FED. REG. 5999 (February 12, 2018).
[91] Consumer Fin. Protection Bureau, *Request for Information Regarding the Bureau's Supervision Program*, 83 FED. REG. 7166 (February 20, 2018).

political leadership overruled its own career, professional staff without the benefit of the public comments they could have obtained through the very process they had created for just such feedback.

Furthermore, the CFPB appears to have withheld its plans to change direction on MLA supervision from the Department of Defense, the agency Congress tasked with implementing the MLA.[92] Apart from Congress, DOD is the most important institution for the CFPB's political leadership to consult on any changes to MLA policy. All active duty servicemembers protected by the MLA are employees of the Department of Defense and DOD's Manpower Data Center in Monterey, California operates the MLA database that creditors use as an optional safe harbor to identify whether loan applicants are covered borrowers protected by the law.[93] Nevertheless, correspondence between the Pentagon and Senator Bill Nelson—one of two original sponsors of the MLA itself—shows that the CFPB did not consult the DOD on its plans to refuse to include MLA issues within its exams prior to changing the Bureau's policy. The Pentagon's letter, included within the Appendix to this report, states:

> Although the CFPB's acknowledgment of its intent to suspend MLA supervisory examinations has been documented in the media, the Department has not received any official notification from the CFPB in this regard. Additionally, the Department did not discuss this specific change with the CFPB.[94]

General norms of competent governance suggest that the CFPB's leadership should have carefully coordinated its about-face on MLA supervision with the Pentagon. The DOD needs up-to-date information on MLA policy because it is responsible for implementing the statute. The DOD also provides a financial education curriculum to over two million DOD employees.[95] For example, newly enlisted soldiers receive financial readiness training related to issues addressed by the MLA in connection with their boot camp.[96] And yet, the CFPB's political leadership failed to consult—or indeed to even *notify*—DOD of its change in MLA supervisory policy. This failure demonstrates that the Bureau used a defective and irregular process to exclude MLA issues from its supervisory exams.

In sum, the CFPB reached its decision to exclude MLA compliance from supervisory exams over the objections of its qualified career professional staff, without coordinating its changes through the FFIEC, with no public comment despite an active process to provide public comments on this type of change, and without consulting or even notifying the Department of Defense. America's military servicemembers and their families deserve a more

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[92] 10 U.S.C. § 987(h)(1).
[93] See, e.g., DEFENSE MANPOWER DATA CENTER, MILITARY LENDING ACT (MLA) WEBSITE VERSION 4.4 USERS GUIDE at 3-4 (September 20, 2018).
[94] Letter of Stephanie Barma, Performing the Duties of the Under Secretary of Defense for Personnel and Readiness to Senator Bill Nelson at 1 (September 7, 2018) (included in Appendix B *infra*).
[95] *See, e.g.,* Military One Source, *Are You Financially Fit? How to Make Financial Wellness Happen* (2018), https://www.militaryonesource.mil/-/are-you-financially-fit-how-to-make-financial-wellness-happen.
[96] *See, e.g.,* William Skimmyhorn, *Assessing Financial Education: Evidence From Boot Camp,* working paper (August 28, 2015), https://www.usma.edu/sosh/SiteAssets/SitePages/Faculty/Publications/skimmyhorn-manuscript.pdf (studying the effectiveness of the U.S. Army's Personal Financial Management Course (PFMC) for new enlistees).

careful and reflective process prior to executive decisions that can affect their legal rights and financial wellbeing.

The Consumer Financial Protection Act Authorizes the Bureau to Include Military Lending Act Compliance within Its Supervisory Exams

Despite its currently reported misgivings, the CFPB has the legal authority under the Consumer Financial Protection Act to cover Military Lending Act issues in the Bureau's supervisory exams. If the CFPB were ever challenged in court for including the MLA within an exam, it is likely that the "thoroughness evidence in [the Bureau's] consideration" and the "validity of its reasoning" would persuade a court to adopt the Bureau's interpretation of the CFPA encompassing the MLA within the scope of supervisory exams.[97]

If challenged in court, the CFPB's interpretation of the CFPA allowing the Bureau to include the MLA within its supervisory exams would likely receive "the lesser degree of deference prescribed by *Skidmore v. Swift & Co.*," because this interpretation is confined to the Bureau's internal examination manual.[98] Agency interpretations in internal manuals and enforcement guidelines "lack the force of law" and thus "do not warrant *Chevron*-style deference."[99] Rather, interpretations contained in agency manuals and enforcement guidelines are entitled to deference "only to the extent that those interpretations have the 'power to persuade.'"[100] Accordingly, a court evaluating the CFPB's assertion of supervisory authority over the MLA would likely look to the agency's "'body of experience and informed judgment' for guidance to the extent that its position is persuasive."[101]

Under *Skidmore*, the persuasiveness of an agency's interpretation would "depend on the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it the power to persuade."[102]

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[97] Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944).
[98] Bank of N.Y. v. F.D.I.C., 453 F. Supp. 2d 82, 94 (D.D.C. 2006) (citing Wells Fargo Bank, N.A. v. F.D.I.C., 310 F.3d 202, 208 (D.C. Cir. 2002).
[99] Christensen v. Harris County, 529 U.S. 576, 587 (2000) ("interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron*-style deference."). The familiar two-step framework of *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 842–843 (1984), where courts determine "whether Congress has directly spoken to the precise question at issue," and the court "must give effect to the unambiguously expressed intent of Congress" or, if "the statute is silent or ambiguous with respect to the specific issues," thus requiring the court to determine "whether the agency's answer is based on a permissible construction of the statute," does not apply to the CFPB's interpretation of its own examination manual. The examination manual lacks the force of law because it was not promulgated via an exercise of the Bureau's rulemaking or adjudicatory authority. *See U.S. v. Mead*, 533 U.S. 218, 226 (2001) ("administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.").
[100] *Christensen,* 529 U.S. at 587 (quoting *Skidmore*, 323 U.S. at 140).
[101] *Wells Fargo Bank.*, 310 F.3d at 208 (quoting *Skidmore,* 323 U.S. at 140).
[102] *Skidmore,* 323 U.S. at 140.

For example, in *Wells Fargo Bank, N.A. v. F.D.I.C.*, the D.C. Court of Appeals applied *Skidmore* deference when upholding the FDIC's interpretation of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), contained in an opinion letter, determining that FIRREA requirements applicable to banks that acquire savings associations "continue to apply when such banks are in turn acquired by other banks."[103] Noting that the FDIC was "charged with administering [the FIRREA's] highly detailed regulatory scheme," the court looked to the FDIC's experience and judgment in deciding that the agency's interpretation of the FIRREA was the "most reasonable" given the evidence of Congress's intent.[104] Under *Wells Fargo*, Courts would likely defer to the CFPB's experience administering the CFPA's highly detailed regulatory scheme and evaluate the thoroughness of the Bureau's consideration and validity of its reasoning for including the MLA in its exams.

Under this standard of review, the Bureau can make a persuasive and reasonable case that the federal law establishing the CFPB's supervisory authority authorizes including the MLA in its exams. The Bureau's authority to conduct supervisory examinations is set forth in two related sections of the Consumer Financial Protection Act. Section 1024(b)(1) of the CFPA provides the Bureau's authority to supervise nondepository businesses and Section 1025(b)(1) sets out the Bureau's authority to supervise large banks and credit unions.[105] The statutory language in both sections is nearly identical except that section 1025 on bank and credit union supervision includes the additional language indicated below in brackets:

> (1) In General. The Bureau shall [have exclusive authority to] require reports and conduct examinations on a periodic basis of persons described in subsection (a) for purposes of --
>
> (A) assessing compliance with the requirements of Federal consumer financial law;
>
> (B) obtaining information about the activities [subject to such laws] and [the associated] compliance systems or procedures of such persons; and
>
> (C) detecting and assessing [associated] risks to consumers and to markets for consumer financial products or services.[106]

Discussed below, each of the three subparagraphs within Sections 1024(b)(1) and 1025(b)(1) provide independent justifications authorizing the Bureau to include MLA within supervisory exams.

[103] *Wells Fargo Bank*, 310 F.3d at 204.
[104] *Id.* at 208–209. *See also Bank of N.Y.,* 453 F. Supp. 2d at 94–99 (applying *Skidmore* deference to another non-force-of-law FDIC interpretation of the FIRREA and adopting the FDIC's interpretation on the basis of the agency's "consistent and soundly reasoned judgment.").
[105] 12 U.S.C. §§ 5514(b)(1), 5515(b)(1).
[106] *Compare* 12 U.S.C. § 5514(b)(1) *with* 12 U.S.C. § 5515(b)(1).

Assessing Compliance with Federal Consumer Financial Law Necessitates Evaluation of Related Military Lending Act Violations

Subparagraph (b)(1)(A) of Sections 1024 and 1025 provides that the Bureau can conduct examinations for the purpose of "assessing compliance with the requirements of federal consumer financial law."[107] Although the Military Lending Act itself is not defined as a federal consumer financial law, violations of the MLA almost certainly risk triggering derivative or concurrent violations of federal consumer financial laws. Far from a novel occurrence, it is very common for violations of one consumer protection law to trigger or occur concurrently with violations of another related law. For example, the Bureau has often brought enforcement actions alleging that descriptions of credit that violate the Truth in Lending Act concurrently violate the Consumer Financial Protection Act's prohibition of deceptive practices.[108] Similarly, an untruthful representation by a debt collector may violate both the Fair Debt Collection Practices Act and the CFPA's prohibition of unfair, deceptive, and abusive practices ("UDAAP").[109] It is unsurprising that consumer protection violations can arise concurrently because a variety of federal consumer financial laws share underlying policy objectives such as creating expectations of accuracy and truthfulness. In the case of the MLA, a violation of the statute is likely to trigger or occur concurrently with violations of at least four other federal consumer financial laws – the Consumer Financial Protection Act, the Truth in Lending Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act – that are all clearly within the scope of the Bureau's examination authorities.

First, it is impossible for the CFPB to conduct a legally reliable supervisory exam without including the MLA because a lender who violates the MLA will simultaneously violate the Consumer Financial Protection Act. An exam under the CFPA *necessitates* evaluating MLA compliance because violating the MLA will trigger violations of the CFPA's prohibition of deceptive, unfair and abusive (UDAAP). Because the CFPA is itself defined as a "federal consumer financial law," the CFPB has supervisory authority to assess compliance with the CFPA's UDAAP prohibition.[110] In *CFPB v. CashCall*, the federal district court for the Central District of California held that collecting debts rendered void through violation of a state usury limit is a prohibited deceptive practice under a federal consumer financial law.[111] Akin to many

[107] *Id.*

[108] *See, e.g.,* In re Triton Management Group, Inc., 2018–BCFP–0005, 1 (Jul. 19, 2018), https://files.consumerfinance.gov/f/documents/bcfp_triton-management-group_consent-order_2018-07.pdf; In re RMK Fin. Corp., 2015–CFPB–0007, 1 (Apr. 9, 2015), https://files.consumerfinance.gov/f/201504_cfpb_consent-order_rmk-financial-corporation.pdf.

[109] *See, e.g.,* In re Pressler & Pressler, LLP, et. al., 2016–CFPB–0009, 8–10 (Apr. 25, 2016); Complaint at 9–10, CFPB v. Frederick J. Hanna & Assoc., et. al., No. 1:14–cv–02211–AT (Jul. 14, 2014).

[110] 12 U.S.C. § 5481(a)(14) ("The term 'federal consumer financial law' means the provisions of this title . . . .")

[111] Consumer Financial Protection Bureau v. CashCall, Inc., 2016 WL 4820635, at *9–*10 (C.D. Cal., 2016) ("The Court concludes that the CFPB has established that the Western Sky loans are void or uncollectible under the laws of most of the Subject States. . . . Based on the undisputed facts, the Court concludes that CashCall and Delbert Services engaged in a deceptive practice prohibited by the CFPA. By servicing and collecting on Western Sky loans,

state usury laws, under the MLA, "[a]ny credit agreement, promissory note, or other contract prohibited under this section is void from the inception of such contract."[112] If state usury violations can trigger violations of a federal consumer financial law, surely it is a bridge no further to suggest that violations of the federal usury limit protecting military families can as well. There is no serious question that collection of a void debt—which is to say, collection of money that consumers do not owe—will in almost every instance involve a "representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances."[113] A creditor that characterizes a transaction made in violation of the MLA as a debt a servicemember owes misrepresents the most basic nature of the parties' commercial relationship. Taken to the extreme, holding otherwise could place Bureau examiners in the preposterous position of allowing a noncompliant lender to mislead military borrowers with impunity. Courts would be unlikely to conclude that the plain meaning of the Dodd-Frank Act requires such an absurd reading.[114]

Thus, under subparagraph (b)(1)(A) of both Sections 1024 and 1025 of the CFPA, a Bureau supervisory examination can lawfully assess whether a creditor has committed a violation by collecting a debt rendered void under the MLA. In this view, even if one accepts the strained interpretation that the Bureau cannot assess MLA compliance *per se*, the Bureau could still lawfully assess compliance with the UDAAP prohibition established in a federal consumer financial law that is affected by the MLA's remedial provisions. Similarly, even if one takes the strained view that the Bureau does not have the related authority to order corrective action for MLA violations within a supervisory MOU, there is no reasonable basis for believing that the Bureau could not order corrective action for deceptively, unfairly, or abusively collecting debts rendered void by the MLA. At most, under this theory, the remedial provisions at the disposal of the Bureau's supervisory staff would be limited to those afforded by the CFPA, rather than those of the MLA. But even under this view, if the Bureau's staff believed that the MLA's penalties provided a superior measure of relief or if the lender were unwilling to agree to a voluntary resolution of the exam on those terms, the supervisory staff could simply refer the matter to the Bureau's Office of Enforcement which has explicit and direct MLA enforcement authority including the full array of MLA-specific relief. The result is the same, any credible supervisory examination *necessitates* including the MLA lest examiners fail to identify deceptive, unfair, or abusive collection of debts that military families do not owe as a matter of law.

Second, Bureau examiners could conclude that violations of the MLA trigger related violations of the Truth in Lending Act.[115] TILA requires a variety of disclosures to help consumers compare the cost of credit. If a lender extends credit in violation of the MLA's

CashCall and Delbert Services created the 'net impression' that the loans were enforceable and that borrowers were obligated to repay the loans in accordance with the terms of their loan agreements.").

[112] 10 U.S.C. § 987(f)(3).

[113] FTC POLICY STATEMENT ON DECEPTION, *Appended to* Cliffdale Associated, Inc. 103 F.T.C. 110, 174 (1984).

[114] *See, e.g.,* Chemical Manufacturers Association v. NRDC, 470 U.S. 116 (1985) (where literalistic reading of statutory language would lead to absurd results, statutory language has no plain meaning).

[115] 15 U.S.C. 1601 *et seq.*

usury limit, then the "credit agreement . . . is void from the inception of such contract."[116] And yet, TILA requires that that the requisite price disclosures accurately characterizing the cost of credit "shall be made before the credit is extended."[117] Because a contract made in violation of the MLA is void from its inception, it is reasonable to conclude that a lender fails to provide accurate TILA disclosures whenever those disclosures do not account for the *void ab initio* status of the transaction.[118] As with other federal consumer financial laws, Bureau examiners cannot meaningfully assess a creditor's TILA compliance in a vacuum. Indeed, enforcement of TILA—an enumerated federal consumer financial law—"would be seriously undercut by an interpretation of the Act which recognized an implied exception for usurious loans."[119] Conducting a successful audit of a lender's TILA compliance *by its nature* requires the ability to determine whether an MLA violation has rendered a lender's TILA disclosures inaccurate.

Third, a third-party debt collector that collects debts rendered void by the MLA is also likely to violate the Fair Debt Collection Practices Act (FDCPA).[120] Under current regulations, the Bureau has supervisory jurisdiction to conduct examinations of larger participants in the debt collection industry if the debt collector's "annual receipts resulting from consumer debt collection are more than $10 million."[121] In assessing a larger debt collector's compliance with the FDCPA, Bureau examiners would naturally determine whether the debt collector has reasonable procedures to prevent "the false representation of the character, amount, or legal status of any debt."[122] Because any extension of credit prohibited under the MLA "is void from [its] inception,"[123] a debt collector actively collecting a debt rendered void by the MLA would almost certainly have falsely represented the legal status of the covered borrower's obligations. Bureau examiners must not be placed in the absurd position of ignoring FDCPA violations committed against military families simply because those violations arose out of a misrepresentation triggered by an MLA violation.

Finally, creditors or debt collectors that inaccurately furnish delinquency information concerning debts rendered void under the MLA may violate the Fair Credit Reporting Act (FCRA).[124] Creditors or debt collectors that furnish information to credit reporting agencies have certain accuracy obligations under the FCRA. In particular, Congress requires that furnishers "shall not furnish any information relating to a consumer to any consumer reporting agency if the person knows or has reasonable cause to believe that the information in

[116] 10 U.S.C. § 987(f)(3).
[117] 15 U.S.C. § 1638(b)(1).
[118] Courts have long held that TILA applies in full force to loans rendered *void ab initio* because they are illegal on other grounds. *See, e.g.,* Williams v. Public Fin. Corp., 598 F.2d 349, 355 (5th Cir. 1979) (declining to "give special lenient treatment to lenders who violate two laws instead of just one" after lender argued TILA should not apply to a loan rendered *void ab initio* under Georgia law).
[119] *Id.* at 356.
[120] 15 U.S.C. 1692 *et seq.*
[121] 12 C.F.R. § 1090.105(b).
[122] 15 U.S.C. § 1692e(2).
[123] 10 U.S.C. § 987(f)(3).
[124] 15 U.S.C. 1681 *et seq.*

inaccurate."[125] The Bureau's examination procedures sensibly require examiners to assess compliance with this provision.[126] It would presumably violate the FCRA for a creditor or debt collector to knowingly furnish information indicating that a military borrower owed a debt rendered void by the MLA to a credit reporting agency. In order to determine whether a creditor or debt collector is violating this provision of the FCRA, Bureau examiners would need to be free to determine whether the debts in question violate the MLA. Again, the Bureau could reasonably instruct examiners not to assess compliance with the MLA for its own sake, but rather to determine whether FCRA violations have arisen from policies or procedures that do not prevent furnishing of inaccurate credit information because of MLA violations. Either way, a successful audit of a lender or debt collector for FCRA compliance by its very nature requires examiners to cover MLA issues.

In sum, the Bureau's ability to execute its statutory mandate under Sections 1024(b)(1)(A) and 1025(b)(1)(A) of the CFPA by assessing compliance with federal consumer financial laws *necessitates* that it supervise for violations of the Military Lending Act. While the MLA itself is not a federal consumer financial law under the CFPA, violation of the MLA will almost certainly trigger violations of the CFPA's ban on unfair, deceptive, and abusive acts and practices, the Truth in Lending Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act, all of which are part of the CFPA's enumerated federal consumer financial laws. Therefore, a reading of the CFPA that requires Bureau examiners to ignore MLA violations would likely produce the absurd result of allowing lenders to violate these other federal consumer financial laws with respect to military borrowers. A reviewing court would disfavor a reading of the CFPA that "would lead to absurd results" or "thwart the obvious purpose of the statute."[127] Accordingly, the CFPB has a persuasive and reasonable basis for examining for violations of federal consumer financial law triggered by MLA noncompliance.

The CFPB's Supervisory Power to Obtain Information on Activities, Compliance Systems, and Procedures Provides the Legal Authority to Include the Military Lending Act within Examinations

Under subparagraph (b)(1)(B) of both Sections 1024 and 1025 of the CFPA, the Bureau's supervisory staff can require reports and conduct examinations for purposes of "obtaining information about the activities" and "compliance systems or procedures" of supervised businesses. Courts could reasonably conclude that subparagraph (b)(1)(B) establishes an independent basis for supervisory authority because it allows examiners to look for violations of the MLA for the purpose of making referrals to the Office of Enforcement.

[125] 15 U.S.C. § 1681s-2(a)(1)(A).

[126] Consumer Financial Protection Bureau, *Examination Procedures--Debt Collection*, CFPB SUPERVISION AND EXAMINATION MANUAL, at 20 (August 2018), available at: https://www.consumerfinance.gov/policy-compliance/guidance/supervision-examinations/.

[127] C.I.R. v. Brown, 380 U.S. 563, 571 (1965) (stating the proposition that "[u]nquestionably the courts, in interpreting a statute, have some 'scope for adopting a restricted rather than a literal or usual meaning of its words where acceptance of that meaning would lead to absurd results . . . or would thwart the obvious purpose of the state.'") (quoting Helvering v. Hammel, 311 U.S. 504, 510–511 (1941)).

Because the Bureau has enforcement authority under the MLA, the Bureau could reasonably argue that under subparagraph (b)(1)(B) its examiners are "obtaining information about the activities" of the covered person, bank, or credit union for the purpose of determining whether to refer the activities to the Office of Enforcement for an investigation of MLA violations. In this view, the Bureau's supervisory staff can legally obtain information about MLA-related activities, compliance systems, and procedures because they are directly relevant to the Bureau's MLA enforcement authority.

This argument holds with equal weight for both depository and nondepository supervised businesses. With respect to supervision of depository banks and credit unions, in Section 1025(b)(1)(B) the Bureau's examiners are tasked with "obtaining information about the activities subject to such laws …."[128] Presumably "such laws" refers to the federal consumer financial laws referred to in Section 1025(b)(1)(A). One of those federal consumer financial laws is the Consumer Financial Protection Act itself which established the Bureau's Office of Enforcement and its related authorities. The CFPA itself is a federal consumer financial law that, among other things, authorizes the Bureau to conduct investigations, issue civil investigative demands, conduct investigative hearings, litigate in federal court or within an administrative enforcement action, and other similar enforcement functions.[129] In this respect, the Bureau's supervisory office should be free to "obtain information" about MLA violations because those violations relate to "activities subject to" the consumer financial law that established the Bureau's Office of Enforcement.[130] With respect to supervised, nondepository covered persons, the Bureau's supervisory office should be free to "obtain[ ] information" about "compliance systems or procedures" both as they relate to the MLA and to compliance systems and procedures associated with Part E of the CFPA.

This basis for including the MLA within supervisory exams is not dependent upon a concurrent violation of an enumerated statute or the CFPA's UDAAP provision. Rather, under this argument, the authority for including the MLA is simply within subparagraphs (b)(1)(B) of both Sections 1024 and 1025 as a direct consequence of the plain meaning of those sections. It is legally appropriate for examiners to "obtain[ ] information about the activities" of supervised businesses that are subject to the CFPA's sections establishing the CFPB enforcement authorities.[131] Any covered person that violates the MLA is subject to the Bureau's enforcement authorities in Part E because Congress granted CFPB MLA enforcement authority in 10 U.S.C. Section 987(f)(6). This, in turn, establishes supervisory authority for obtaining information on activities related to enforcement within supervisory

[128] *Compare* 12 U.S.C. § 5515(b)(1)("The Bureau shall have exclusive authority to require reports and conduct examinations on a periodic basis of persons described in subsection (a) for purposes of (A) assessing compliance with the requirements of Federal consumer financial laws [and] (B) obtaining information about the activities *subject to such laws* and the associated compliance systems or procedures of such persons") *with* 12 U.S.C. 5514(b)(1)("The Bureau shall require reports and conduct examinations on a periodic basis of persons described in subsection (a)(1) for purposes of (A) assessing compliance with the requirements of Federal consumer financial law [and] (B) obtaining information about the activities and compliance systems or procedures of such person").
[129] *See* 12 U.S.C. §§ 5561-5567.
[130] 12 U.S.C. § 5515(b)(1).
[131] 12 U.S.C. §§ 5515(b)(1)(C), 5515(b)(1)(C).

exams. Although supervisory exams are not mere fact-finding missions for potential enforcement, the law contemplates that in some instances—including the MLA—they can be.

The CFPB's Supervisory Power to Detect and Assess Risks to Consumers and Markets Authorizes the Bureau to Include the Military Lending Act within Examinations

Under subparagraph (b)(1)(C) of both Sections 1024 and 1025 of the CFPA, the Bureau's supervisory staff can require reports and conduct examinations for the purpose of "detecting and assessing" "risks to consumers and to markets" for consumer finance products.[132] In the context of the Military Lending Act, one glaring "risk[ ] to consumers" is that creditors will collect higher interest rates than permitted under federal law from servicemembers and their families. Nothing in the plain language of Sections 1024 and 1025 precludes conducting an exam for the purpose of detecting this type of risk. Indeed, it makes sense that the Bureau would include the risk posed to consumers from MLA noncompliance in its "detecting and assessing" of risks to consumers, since the CFPB's own Office of Enforcement is charged with bringing enforcement actions to remediate and deter the harms associated with those risks.

Furthermore, even placing the Bureau's authority to "detect[ ] and assess[ ]" the risk of MLA violations aside, compliance management systems that permit MLA violations are likely to be statistically correlative of *other* violations of federal consumer financial laws. For example, in detecting and assessing risk to consumers from a financial institution's practices, it is within the Bureau's authority to look for proxy variables that would tend to be correlative of violations of federal consumer financial laws. The process of detecting and assessing risk must "account[ ] for a broad range of factors that predict the likelihood of specific consumer harm."[133] The Bureau's staff could reasonably conclude that a lender who violates the national usury limit on loans to military families may have weak compliance management systems. Such weak compliance management and procedures make a lender more likely to harm consumers by violating federal consumer financial laws including the 18 enumerated statutes, the CFPA itself, or any of the CFPB's regulations. Under this view, a Bureau examination can lawfully identify MLA violations as an instrumental method of detecting and assessing risks to consumers and to markets.

Moreover, the "risk-based supervision program" established in 1024(b)(2) reinforces the view that the CFPB can include detecting and assessing the risks of MLA violations within supervisory exams. In that subparagraph Congress stated:

> (2) Risk-based supervision program—The Bureau shall exercise its authority under paragraph (1) in a manner designed to ensure that such exercise, with

[132] 12 U.S.C. §§ 5514(b)(1)(C), 5515(b)(1)(C).
[133] Consumer Fin. Protection Bureau, Prepared Remarks of CFPB Deputy Director Steve Antonakes at the Exchequer Club (Feb. 18, 2015), https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-of-cfpb-deputy-director-steven-antonakes-at-the-exchequer-club/.

> respect to persons described in subsection (a)(1), is based on the assessment by the Bureau of the risks posed to consumers in the relevant product markets and geographic markets, and taking into consideration, as applicable--
>
> (A) the asset size of the covered person;
>
> (B) the volume of transactions involving consumer financial products or services in which the covered person engages;
>
> (C) the risks to consumers created by the provision of such consumer financial products or services;
>
> (D) the extent to which such institutions are subject to oversight by State authorities for consumer protection; and
>
> (E) any other factors that the Bureau determines to be relevant to a class of covered persons.[134]

This subparagraph provides at least five mutually reinforcing arguments that support including the risk of MLA violations within Bureau supervisory exams. First, the fact that Congress explicitly directed the Bureau to exercise its supervisory authority through a risk-based program suggests that assessing the risk of MLA violations within exams is consistent with the CFPA's overall statutory framework. Congress could have created a more rigid supervisory framework that reduced the Bureau's work to a formulaic approach limited to checking for compliance with each section or subsection of each federal consumer financial law. Instead, the law contemplates, and indeed explicitly directs, the Bureau's staff to exercise judgement in scheduling and designing exams in a way that will efficiently deploy resources to minimize the risk of illegal activity to the public. The notion that Bureau examiners should wear blinders with respect to special risks faced by military consumers is anathema to this approach. A primary job function of examiners is identifying risks of violations that can be referred to the Bureau's Office of Enforcement where appropriate. Given that Congress clearly tasked the Bureau with enforcing the MLA, it would be exasperatingly inefficient for examiners to ignore the exact MLA violations Congress tasked the Bureau with stopping. While shackling examiners in this way might benefit payday lenders and other businesses collecting interest at rates above 36 percent from servicemembers and their families, it is inconsistent with legislative history suggesting the Bureau was established "to protect consumers from abusive financial services practices."[135]

Second, the fact that the law contemplates designing the Bureau's supervisory program "based on the assessment by the Bureau of risks posed to consumers in the relevant product market" suggest that the Bureau should be able to consider MLA violations in product markets where the MLA is most directly applicable. Specifically, in paragraph (a) of Section 1024, Congress expressly instructed the Bureau to supervise any covered person who "offers or provides to consumers a payday loan"[136] And through the MLA, Congress passed legislation explicitly protecting servicemembers and their families from the interest rates included in virtually all payday loan contracts. Because subparagraph (b)(2) requires the Bureau to

[134] 12 U.S.C. § 5514(b)(2).
[135] S. Rep. 111-176, at 1 (Aug. 30, 2010).
[136] 12 U.S.C. 5514(a)(1)(E).

supervise covered persons who provide payday loans in a way that is conscious of the "risks posed to consumers in [that] relevant product market," it strains credulity to suggest that the Bureau must nonetheless ignore the special risks in the payday lending market posed to military families. Moreover, the fact that the Bureau is the only federal agency with supervisory authority over nondepository payday lenders suggests that Congress did not intend to forbid the Bureau from including MLA compliance within payday lender exams. Otherwise, this stilted caricature of federal law would create an especially protected pocket of anonymity and lawlessness with respect to a class of borrowers who have sacrificed so much for the country and a class of lenders Congress held up for special supervisory scrutiny. Surely Congress did not intend to create a system where national banks, state banks, and federal credit unions are all audited for MLA compliance, but payday lenders are not, even when government employees actively examine those payday lenders on other related topics. In this respect, the Trump administration's approach to MLA supervision of the nondepository payday lending market would ironically treat payday lenders making illegal triple-digit interest rate loans to service members more favorably than any other type of financial institution.

Third, the geographic dimension of a risk-based supervisory program suggests Congress did not intend to forbid MLA compliance. In subparagraph (b)(2) Congress directed the Bureau to exercise its risk-based supervisory authority "based on" the Bureau's assessment "of the risks posed to consumers in the relevant . . . geographic markets."[137] Congress adopted the Military Lending Act itself after careful consideration of geographic evidence suggesting that payday lenders cluster around military bases in order to target servicemembers and their families. For example, in a key Senate Banking Committee hearing, Senator Elizabeth Dole of North Carolina presented evidence that in North Carolina, "the counties with the greatest number of payday lenders . . . are areas with significant military presence."[138] Upon review of the DOD's 2006 report on payday lending to military families, Senator Dole explained that "it is apparent that some unscrupulous payday lenders are clustering around military bases across the nation."[139] Senator Dole's conclusion was based on empirical research conclusively demonstrating that "payday lender location patterns unambiguously show greater concentrations per capita near military populations."[140] A meaningful risk-based supervisory program based on geographic factors would by necessity require consideration of the risks particular to the military families that dominate these locations. The statutory directive to the Bureau to implement a supervisory program that is guided by geographic risk implies that

[137] 12 U.S.C. 5514(b)(2).

[138] *A Review of the Department of Defense's Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents: Hearing Before the S. Comm. on Banking, Housing, and Urban Aff.,* 109th Cong., 2d Sess., S. Hrg. 109-1081, at 218-397 (Sept. 14, 2006) (Statement of Senator Elizabeth Dole). "The county with the [North Carolina's] highest concentration" of payday lenders "was Wayne County, home of Seymour Johnson Air Force Base. Cumberland County, where Fort Bragg and Pope Air Force Base are located, has the third-highest concentration, and Craven County, the site of the Marine Corps Air Station at Cherry Point, has the fourth." *Id.* "In 2005 . . . in the entire three-mile zone surrounding the perimeter of Bragg and Pope, the ratio was four banks to every five payday lenders." *Id.*

[139] *Id.*

[140] *See* Graves & Peterson, *supra* note 12 at 832 ("conclusively demonstrat[ing] that payday lenders target military personnel" through a survey of "20 states, 1,516 counties, 13,253 ZIP codes, nearly 15,000 payday lenders, and 109 military bases").

Congress intended the Bureau to consider compliance issues that are particularly relevant to military towns.

Fourth, subparagraph (b)(2)(C) provides another independent basis of support for concluding that the Bureau can include the risk to service members from MLA violations in Bureau exams. In deciding how to exercise its authority to require examinations and reports, Congress required the Bureau to take into consideration "the risks to consumers created by the provision of such consumer financial products or services." Payday loans and other forms of credit with interest rates in excess of 36 percent are a consumer financial product or service within the meaning of 12 U.S.C. Section 5481(a)(15),[141] and service members and their families are obviously consumers. It would be odd for Congress to explicitly require the Bureau to "take[ ] into consideration" risks imposed by payday loans to military families, but then somehow preclude identification of legal violations arising out of those within an actual exam. Such a reading is especially strained in light of the fact that Congress prohibited making these loans to servicemembers precisely because it concluded those loans carry special risks for military families and for the nation's military readiness.[142]

Fifth, in subparagraph (b)(2)(E) Congress required the Bureau to exercise its supervisory authority "based on the assessment by the Bureau of the risks posed to consumers . . . taking into consideration" "*any other factor* that *the Bureau determines to be relevant to a class of covered persons.*"[143] Accordingly, one factor Congress empowered the CFPB to take into consideration in deciding how to exercise its authority is the application of the Military Lending Act to lenders that extend credit to servicemembers and their families. Congress appears to have granted the Bureau considerable discretion both by empowering it to consider "*any*" factor and by explicitly empowering the CFPB itself to be the institution that determines whether that factor is relevant to the exercise of its supervisory authority. Surely one factor that is relevant to the class of covered persons offering triple digit interest rate loans is the fact that their products are illegal to provide to our men and women in uniform. A Congress intent on closely limiting the scope of the Bureau's supervisory examinations would surely not have used such broad and flexible language in setting the parameters of how to engage in identifying risks to consumers.

Moreover, elsewhere in the CFPA Congress directed Bureau leadership to pay special attention to the needs of military service members and their families. Indeed, Congress explicitly established the Office of Military Service Member Affairs within the Bureau "in order to monitor complaints by service members and their families and responses to those

[141] 12 U.S.C. § 5481(a)(15) ("The term 'financial product or service' means—(1) extending credit and servicing loans . . . .").
[142] *See* S. Hrg. 109-1081, 109th Cong. 218-397 (2006) (Statement of Senator Richard Shelby) ("As long as certain unscrupulous lenders continue to employ predatory practices, our servicemen and women suffer and the toll on our readiness will increase.").
[143] 12 U.S.C. 5514(b)(2)(E) (emphasis added).

complaints by the Bureau . . . ."[144] Because Congress created an office within the Bureau "to serve as a watchdog" for servicemembers, it makes sense that servicemember wellbeing would qualify as a permissible risk factor for the Bureau to consider in exercising its supervisory authority.[145] It strains credulity to suggest that those military servicemember rights under the MLA and monitored by the Office of Servicemember Affairs Congress itself created cannot qualify as a factor the Bureau may consider in administering its risk-based supervision.

The Military Lending Act Itself Directs the CFPB to Include the MLA Within Supervisory Exams

Even if one takes the improbable view that the CFPA itself does not authorize the Bureau to include the MLA within supervisory exams, the plain language of the Military Lending Act still does. The administrative enforcement authorization of the Military Lending Act states in full:

> The provisions of this section (other than paragraph (1) of this subsection) shall be enforced by the agencies specified in section 108 of the Truth in Lending Act (15 U.S.C. 1607) in the manner set forth in that section or under any other applicable authorities available to such agencies by law.[146]

This cross reference within the MLA to the Truth in Lending Act refers to the following passage in federal law:

> (a) Enforcing agencies. Subject to subtitle B of the Consumer Financial Protection Act of 2010 [12 U.S.C. 5511 et seq.], compliance with the requirements imposed under this subchapter shall be enforced under— …
>
> > (6) subtitle E of the Consumer Financial Protection Act of 2010 [12 U.S.C. 5561 et seq.], by the Bureau, with respect to any person subject to this subchapter.[147]

Subtitle B of the CFPA, codified at 12 U.S.C. §§ 5511 to 5519, establishes the "general powers of the Bureau" and includes sections on the purpose, objectives, and functions of the Bureau; rulemaking authority; review of regulations; and, most relevant for purposes of this discussion, the Bureau's supervisory powers and limitations. Subtitle E of the CFPA, which is codified at 12 U.S.C. §§ 5561 to 5567, establishes the Bureau's enforcement powers. The enforcement

[144] *See* Dodd-Frank Act, Pub. L. No. 111-203, Section 1013(e)(1). *See also* Consumer Fin. Protection Bureau, Office of Service member Affairs: Charting our Course through the Military Lifecycle 8 (May 2017), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201705_cfpb_OSA_Military-Lifecycle-Report.pdf.
[145] Press Release, Reed: Strengthening Military Lending Act will Offer Better Financial Protections for Those who Protect Our Nation (July 21, 2015), https://www.reed.senate.gov/news/releases/reed-strengthening-military-lending-act-will-offer-better-financial-protections-for-those-who-protect-our-nation ("Senator Reed . . . wrote the law creating the Office of Servicemember Affairs within the Consumer Financial Protection Bureau (CFPB) to serve as a watchdog for military personnel.").
[146] 10 U.S.C. § 987(f)(6).
[147] 15 U.S.C. § 1607(a).

power subtitle includes sections on conducting investigations, adjudication proceedings, the Bureau's independent litigation authority, relief available in enforcement actions, criminal referrals, and employee protections.

The most contextually sensible reading of these provisions suggests that the MLA itself authorizes the Bureau to include MLA issues within its supervisory exams. First, the administrative enforcement provision of the MLA contemplates that the Bureau will enforce the MLA "in the manner set forth" in the administrative enforcement provision within TILA. Of course, the CFPB has always included TILA within the scope of its supervisory exams because TILA is one of the 18 enumerated laws that are included within "federal consumer financial law." If the Bureau does not include MLA issues within its exams, then it is not enforcing the law in the manner set forth in Section 108 of TILA because that section is in turn "subject to" the Bureau's supervisory authorities set out in Subtitle B of the CFPA. The manner in which CFPB is instructed to enforce the MLA is subject to the general supervisory powers of the Bureau. While Congress could have spoken with more precision, the manner in which the CFPB enforces Section 108 of TILA is a process that is subject to and thereby includes supervisory exams.

Furthermore, even disregarding the former argument, the MLA disjunctively instructs the Bureau that it "shall" enforce the MLA under "any other applicable authorities available to such agencies by law."[148] The CFPB could persuasively conclude that one "other applicable authority" available to the Bureau for requiring compliance is its supervisory authority over large depository institutions and supervised covered persons. Use of the word "*any*" with respect to other applicable authorities suggests that Congress intended for the Bureau to use the full breadth of its powers. One might respond that supervision is not an "applicable" authority that is available to the Bureau "under law." But a more sensible reading of this limitation is simply that the Bureau and other agencies are not authorized to disregard other explicit and specific statutory limitations to their jurisdiction. For example, Congress likely did not intend to upset the Bureau's jurisdictional limitations by granting the Bureau enforcement authority over small banks or credit unions with less than $10 billion in assets. Rather, the plainest reading of the phrase "any other applicable authority" is a direction to the Bureau to use its complete set of tools, including supervision, in protecting service members and their families from illegal activity by businesses within CFPB's purview.

Consistent with this view, the Department of Defense has taken a regulatory posture that appears to favor the CFPB including MLA violations within supervisory exams. The DOD, rather than the CFPB, is the regulatory authority charged by Congress with issuing the regulations that implement the MLA.[149] The Department has not squarely addressed whether the CFPB has the authority to include MLA violations in supervisory exams. Nevertheless, the DOD has indirectly suggested that supervised financial institutions should be covered by the MLA's requirements. In response to the Department's September 2014 Notice of Proposed Rulemaking, some banks argued that they should be exempt from the scope of the MLA. For example, one bank asked the department to "craft a specific exclusion for insured depository

[148] 10 U.S.C. § 987(f)(6).
[149] 10 U.S.C. § 987(h)(1).

institutions, . . . because they are highly regulated by their prudential regulators, and already prohibited from engaging in abusive practices."[150] The fact that the Department declined to provide such an exemption suggests that DOD supports supervisory examination for MLA requirements. In the preamble to its 2015 final rule, DOD noted:

> [S]upervision to assess compliance by an insured depository institution or insured credit union with safety-and-soundness principles or requirements (or other applicable laws) could provide meaningful benefits to borrowers that are the object of the protections of the MLA. And supervision by the Bureau of covered persons who extend credit for compliance with requirements of applicable federal consumer financial laws is conducted with a view towards providing meaningful benefits to borrowers.[151]

While this passage was not written in contemplation of the current policy dispute, it does clearly show that the DOD recognizes the benefits of supervisory exams. This also makes the CFPB's failure to consult the DOD before changing its policy on MLA supervision all the more problematic. This passage, in combination with the Department's recent letter to Congress expressing surprise at the CFPB's decision to forego supervising for MLA compliance, suggests that DOD had long ago concluded CFPB has ample authority to include MLA issues within supervisory exams.

In sum, the administrative enforcement provision of the MLA instructs that the CFPB "shall" enforce the MLA "in the same manner" that the CFPB requires compliance with TILA. The CFPB's manner of requiring compliance with TILA is subject to and makes use of the Bureau's supervisory powers. To follow Congressional intent with respect to the MLA, the Bureau should be deploying the same types of tools, including supervision, that it uses to require compliance with TILA. Moreover, to prevent any doubt, Congress also stated that the Bureau "shall" enforce the MLA with "any other applicable authorities available to such agencies" which should include supervisory examination.

Conclusion

Under the Trump Administration, the CFPB's political leadership reversed its prior decision to include Military Lending Act issues within supervisory exams through a flawed and irregular process. In particular, the Bureau's political leadership has weakened protection of military families: over the objections of its qualified career professional staff; without coordinating its changes through the Federal Financial Institutions Examination Council; with no public comment despite an active process to provide public comments on this type of change; and without consulting or even notifying the Department of Defense.

[150] Department of Defense, *Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule*, 80 FED. REG. 43560, 43568 (July 22, 2015).
[151] *Id.* (citations omitted).

This flawed process produced a substantive policy change on servicemember rights that is at odds with nearly a dozen different passages in federal law that give the CFPB apparent authority to include MLA issues within supervisory exams. The CFPB has the legal authority to include MLA issues within supervisory exams for at least four basic reasons. First, MLA violations render servicemembers' loans void, thereby triggering concurrent violations of the federal consumer financial laws that the CFPB must already cover within its exams. Second, the Bureau may use its supervisory exams for the purpose of "obtaining information" about MLA compliance because it pertains to the compliance systems and procedures subject to the enforcement provisions in Part E of the CFPA. Third, the CFPB can cover MLA issues within its exams "for the purpose of detecting and assessing risks to consumers." Under the Bureau's risk-based supervisory program examiners can take into consideration the MLA because, among other reasons, they are authorized to consider "*any other factor"* that "*the Bureau determines to be relevant to a class of covered persons*." And finally, the MLA itself directs the CFPB to enforce the MLA in the same manner—including supervisory exams—that the Bureau uses to ensure compliance with Truth in Lending Act. Indeed, the MLA orders that the Bureau "*shall*" use "*any* other applicable authorities available," to the Bureau to require MLA compliance.

Given all of this, perhaps the most compelling argument in favor of the view that MLA issues can be included in Bureau supervisory exams comes from the fact that Congress did not forbid it. Had Congress, for some inexplicable, inefficient, and unpatriotic reason, intended for the Bureau to not include MLA violations within supervisory exams, it could have easily done so. Congress could simply have included a provision in the law stating that the Bureau "shall not require reports or conduct examinations with respect to section 987 of title 10." Together with the strong affirmative statutory language detailed in this report, the fact that no such a provision, nor anything like it, can be found anywhere in federal law should give the Bureau confidence that it has the discretion to protect our military servicemembers and their families through its supervisory powers.

Appendix A.

May 9, 2018

Michelle Styczynski, Research Advocate
Consumer Federation of America
1620 I Street, NW – Suite 200
Washington, DC 20006

Dear Ms. Styczynski,

Thank you for your letter of December 14, 2017 regarding the Military Lending Act (MLA) and its implementing regulation.[1] You have requested information regarding the Bureau of Consumer Financial Protection's commitment to enforcing the MLA and protecting military families from illegal conduct.

The Bureau expects institutions to ensure servicemembers and other eligible consumers are receiving the consumer protections afforded by the MLA. Accordingly, the Bureau is committed to enforcing the MLA through its supervisory and enforcement work, and, through its Office of Servicemembers Affairs, to carrying out its statutory mission to: see that military personnel and their families are educated and empowered to make better-informed consumer decisions; monitor servicemember complaints about consumer financial products and services; and coordinate the efforts of federal and state agencies to improve consumer financial protection measures for military families.[2]

In 2015, the Department of Defense (Department) promulgated amendments to the MLA's implementing regulation. The amended rule expanded the types of credit products that are covered under the protections of the MLA. In 2016, in conjunction with the other members of the Federal Financial Institutions Examinations Council, the Bureau developed and disseminated interagency examination procedures for the amended rule.[3] It also worked with these agencies to conduct information sessions for examiners regarding the MLA, and for lenders regarding the procedures.

The Interagency Exam Procedures include guidelines to examiners with respect to achieving examination objectives of: determining the institution's compliance with the provisions of the Department's MLA rule, as amended; assessing the quality of the institution's implementation policies and procedures as well as compliance risk management systems; determining the reliance that can be placed on the institution's internal controls and compliance monitoring procedures; and determining corrective action when violations of law are identified or when the institution's policies, procedures, or internal controls are deficient.[4]

[1] 10 USC 987; 32 CFR Part 232.
[2] *See* 12 USC 5493(e) (1).
[3] *See* CFPB Supervision and Examination Manual, Military Lending Act Interagency Examination Procedures – 2015 Amendments, at MLA 1.
[4] *See id.* at Procedures 1.

In particular, the Bureau is reviewing the institutions' implementation plans, including actions taken to update policies, procedures, and processes, train appropriate staff, and handle early implementation challenges. Going forward, the Bureau plans to conduct MLA reviews in several markets.

In 2013, as you note in your letter, the Bureau took public action against a payday lender, Cash America, for extending payday loans to servicemembers or their dependents in violation of the MLA regulations in effect at that time.[5] The Bureau has not yet brought any public enforcement actions under the Department's amended rule. The Bureau is monitoring risks to consumers resulting from MLA violations and will exercise its enforcement authority in appropriate cases.

In addition to its supervision and enforcement work, the Bureau's Office of Servicemember Affairs (OSA) acts as the voice of servicemembers and works with stakeholders within and without the Bureau to continue to monitor MLA issues closely. It monitors complaints and shares reports from the field with Bureau colleagues. Through the work of the OSA, the Bureau coordinates with other organizations, such as the Military Services' Legal Assistance Communities and the Department of Justice, providing a valuable forum for information sharing and coordination.

OSA outreach efforts to military communities provide the Bureau with insight into consumer financial issues affecting servicemembers, and regularly include State and local agencies. These outreach events also inform OSA's educational efforts, allowing OSA to augment the Department's educational program through the provision of timely and relevant resources to assist servicemembers and their families at all stages of their military lifecycle.

Finally, the Bureau also maintains a close working relationship with the Department, consulting regularly with the Department and the other enumerated interagency partners in the MLA and other financial issues affecting military readiness. Bureau staff participates regularly in the Department's MLA working group.

Thank you for your continued interest in the Bureau's work regarding the MLA and on behalf of servicemembers and their families.

Best Regards,

Paul Kantwill
Assistant Director
Office of Servicemember Affairs
Bureau of Consumer Financial Protection

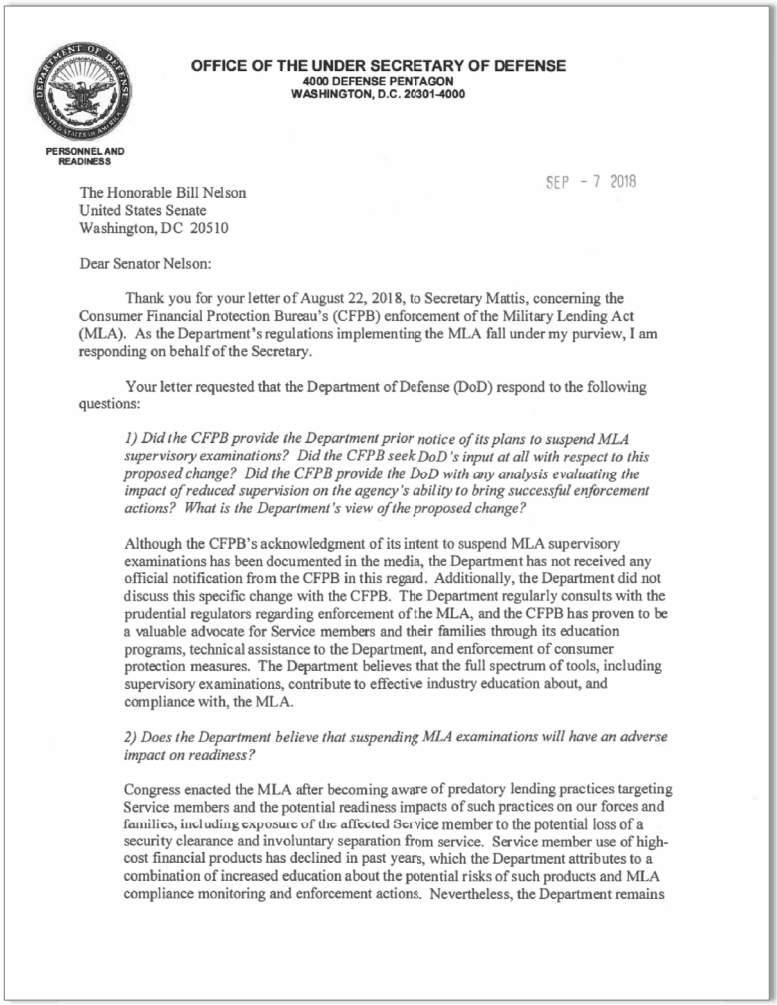
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[5] *See* Consent Order, *In the Matter of Cash America International, Inc.*, 2013-CFPB-0008 (Nov. 20, 2013).

Cc:

The Retired Enlisted Association
National Military Family Association
Air Force Sergeants Association
Chief Warrant & Warrant Officers Association, U.S. Coast Guard
Commissioned Officers Association of the U.S. Public Health Service

Appendix B.



OFFICE OF THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-4000

PERSONNEL AND READINESS

SEP - 7 2018

The Honorable Bill Nelson
United States Senate
Washington, DC 20510

Dear Senator Nelson:

Thank you for your letter of August 22, 2018, to Secretary Mattis, concerning the Consumer Financial Protection Bureau's (CFPB) enforcement of the Military Lending Act (MLA). As the Department's regulations implementing the MLA fall under my purview, I am responding on behalf of the Secretary.

Your letter requested that the Department of Defense (DoD) respond to the following questions:

1) Did the CFPB provide the Department prior notice of its plans to suspend MLA supervisory examinations? Did the CFPB seek DoD's input at all with respect to this proposed change? Did the CFPB provide the DoD with any analysis evaluating the impact of reduced supervision on the agency's ability to bring successful enforcement actions? What is the Department's view of the proposed change?

Although the CFPB's acknowledgment of its intent to suspend MLA supervisory examinations has been documented in the media, the Department has not received any official notification from the CFPB in this regard. Additionally, the Department did not discuss this specific change with the CFPB. The Department regularly consults with the prudential regulators regarding enforcement of the MLA, and the CFPB has proven to be a valuable advocate for Service members and their families through its education programs, technical assistance to the Department, and enforcement of consumer protection measures. The Department believes that the full spectrum of tools, including supervisory examinations, contribute to effective industry education about, and compliance with, the MLA.

2) Does the Department believe that suspending MLA examinations will have an adverse impact on readiness?

Congress enacted the MLA after becoming aware of predatory lending practices targeting Service members and the potential readiness impacts of such practices on our forces and families, including exposure of the affected Service member to the potential loss of a security clearance and involuntary separation from service. Service member use of high-cost financial products has declined in past years, which the Department attributes to a combination of increased education about the potential risks of such products and MLA compliance monitoring and enforcement actions. Nevertheless, the Department remains

concerned that predatory lending practices and high-cost credit continue to pose risks to the financial readiness of Service members and families. Absent continued monitoring and enforcement of MLA compliance, the Department and the prudential regulators may be unable to identify or respond timely to trends or early warning signs of harmful practices.

3) If the CFPB goes forward with this change, how will the Department ensure that servicemembers and their families receive all the MLA protections they deserve?

As required by title 10, U.S. Code, section 992, the Department will continue to provide comprehensive financial literacy training to our Service members throughout their military careers. This training includes education about the responsible use of credit, alternatives to high-cost credit products, consumer protections available under law, and how and where to report potential violations of one's consumer rights. In addition, the Department supplements its educational offerings with robust strategic communications efforts—all with a view to reinforcing key military consumer protections and financial literacy learning objectives across the force. Finally, the Department will continue to carry out its responsibilities under the MLA, including regular consultation with other Federal stakeholders.

I hope that you find these responses helpful. Thank you for your continued interest in ensuring the financial well-being of our Service members and their families. A similar response was provided to the other signatories to your letter.

Sincerely,

Stephanie Barna
Performing the Duties of the Under Secretary of Defense for Personnel and Readiness

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NOTES

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Closed School Discharge, 34 C.F.R. § 685.214 (July 1, 2014)

Submitted by:
Stacy M. Bardo

Bardo Law P.C.

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Code of Federal Regulations
Title 34. Education
Subtitle B. Regulations of the Offices of the Department of Education
Chapter VI. Office of Postsecondary Education, Department of Education
Part 685. William D. Ford Federal Direct Loan Program (Refs & Annos)
Subpart B. Borrower Provisions

34 C.F.R. § 685.214

§ 685.214 Closed school discharge.

Effective: July 1, 2014

Currentness

(a) General.

(1) The Secretary discharges the borrower's (and any endorser's) obligation to repay a Direct Loan in accordance with the provisions of this section if the borrower (or the student on whose behalf a parent borrowed) did not complete the program of study for which the loan was made because the school at which the borrower (or student) was enrolled closed, as described in paragraph (c) of this section.

(2) For purposes of this section—

(i) A school's closure date is the date that the school ceases to provide educational instruction in all programs, as determined by the Secretary; and

(ii) "School" means a school's main campus or any location or branch of the main campus,

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regardless of whether the school or its location or branch is considered eligible.

(b) Relief pursuant to discharge.

(1) Discharge under this section relieves the borrower of any past or present obligation to repay the loan and any accrued charges or collection costs with respect to the loan.

(2) The discharge of a loan under this section qualifies the borrower for reimbursement of amounts paid voluntarily or through enforced collection on the loan.

(3) The Secretary does not regard a borrower who has defaulted on a loan discharged under this section as in default on the loan after discharge, and such a borrower is eligible to receive assistance under programs authorized by title IV of the Act.

(4) The Secretary reports the discharge of a loan under this section to all consumer reporting agencies to which the Secretary previously reported the status of the loan, so as to delete all adverse credit history assigned to the loan.

(c) Borrower qualification for discharge.

(1) In order to qualify for discharge of a loan under this section, a borrower must submit to the Secretary a written request and sworn statement, and the factual assertions in the statement must be true. The statement need not be notarized but must be made by the borrower under penalty of perjury. In the statement, the borrower must—

(i) State that the borrower (or the student on whose behalf a parent borrowed)—

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(A) Received the proceeds of a loan, in whole or in part, on or after January 1, 1986 to attend a school;

(B) Did not complete the program of study at that school because the school closed while the student was enrolled, or the student withdrew from the school not more than 120 days before the school closed. The Secretary may extend the 120–day period if the Secretary determines that exceptional circumstances related to a school's closing justify an extension. Exceptional circumstances for this purpose may include, but are not limited to: the school's loss of accreditation; the school's discontinuation of the majority of its academic programs; action by the State to revoke the school's license to operate or award academic credentials in the State; or a finding by a State or Federal government agency that the school violated State or Federal law; and

(C) Did not complete the program of study through a teach-out at another school or by transferring academic credits or hours earned at the closed school to another school;

(ii) State whether the borrower (or student) has made a claim with respect to the school's closing with any third party, such as the holder of a performance bond or a tuition recovery program, and, if so, the amount of any payment received by the borrower (or student) or credited to the borrower's loan obligation; and

(iii) State that the borrower (or student)—

(A) Agrees to provide to the Secretary upon request other documentation reasonably available to the borrower that demonstrates that the borrower meets the qualifications for discharge under this section; and

(B) Agrees to cooperate with the Secretary in enforcement actions in accordance with paragraph (d) of this section and to transfer any right to recovery against a third party

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to the Secretary in accordance with paragraph (e) of this section.

<Text of subsection (c)(2), as amended by 81 FR 76081, effective until July 1, 2019; see 82 FR 27621; 82 FR 49114; 83 FR 6459.>

(2) The Secretary may discharge a loan under this section without an application from the borrower if the Secretary determines, based on information in the Secretary's possession, that the borrower qualifies for the discharge.

<Text of subsection (c)(2), as amended by 81 FR 76081, delayed effective July 1, 2019; see 82 FR 27621; 82 FR 49114; 83 FR 6459.>

(2) If the Secretary determines, based on information in the Secretary's possession, that the borrower qualifies for the discharge of a loan under this section, the Secretary—

(i) May discharge the loan without an application from the borrower; and

(ii) With respect to schools that closed on or after November 1, 2013, will discharge the loan without an application from the borrower if the borrower did not subsequently re-enroll in any title IV–eligible institution within a period of three years from the date the school closed.

(d) Cooperation by borrower in enforcement actions.

(1) In order to obtain a discharge under this section, a borrower must cooperate with the Secretary in any judicial or administrative proceeding brought by the Secretary to recover amounts discharged or to take other enforcement action with respect to the conduct on which the discharge was based. At the request of the Secretary and upon the Secretary's tendering to the borrower the fees and costs that are customarily provided in litigation to

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reimburse witnesses, the borrower must—

(i) Provide testimony regarding any representation made by the borrower to support a request for discharge;

(ii) Produce any documents reasonably available to the borrower with respect to those representations; and

(iii) If required by the Secretary, provide a sworn statement regarding those documents and representations.

(2) The Secretary denies the request for a discharge or revokes the discharge of a borrower who—

(i) Fails to provide the testimony, documents, or a sworn statement required under paragraph (d)(1) of this section; or

(ii) Provides testimony, documents, or a sworn statement that does not support the material representations made by the borrower to obtain the discharge.

(e) Transfer to the Secretary of borrower's right of recovery against third parties.

(1) Upon discharge under this section, the borrower is deemed to have assigned to and relinquished in favor of the Secretary any right to a loan refund (up to the amount discharged) that the borrower (or student) may have by contract or applicable law with respect to the loan or the enrollment agreement for the program for which the loan was received, against the school, its principals, its affiliates and their successors, its sureties,

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and any private fund, including the portion of a public fund that represents funds received from a private party.

(2) The provisions of this section apply notwithstanding any provision of State law that would otherwise restrict transfer of those rights by the borrower (or student), limit or prevent a transferee from exercising those rights, or establish procedures or a scheme of distribution that would prejudice the Secretary's ability to recover on those rights.

(3) Nothing in this section limits or forecloses the borrower's (or student's) right to pursue legal and equitable relief regarding disputes arising from matters unrelated to the discharged Direct Loan.

<Text of subsection (f), as amended by 81 FR 76081, effective until July 1, 2019; see 82 FR 27621; 82 FR 49114; 83 FR 6459.>

(f) Discharge procedures.

(1) After confirming the date of a school's closure, the Secretary identifies any Direct Loan borrower (or student on whose behalf a parent borrowed) who appears to have been enrolled at the school on the school closure date or to have withdrawn not more than 120 days prior to the closure date.

(2) If the borrower's current address is known, the Secretary mails the borrower a discharge application and an explanation of the qualifications and procedures for obtaining a discharge. The Secretary also promptly suspends any efforts to collect from the borrower on any affected loan. The Secretary may continue to receive borrower payments.

(3) If the borrower's current address is unknown, the Secretary attempts to locate the borrower and determines the borrower's potential eligibility for a discharge under this section by consulting with representatives of the closed school, the school's licensing

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agency, the school's accrediting agency, and other appropriate parties. If the Secretary learns the new address of a borrower, the Secretary mails to the borrower a discharge application and explanation and suspends collection, as described in paragraph (f)(2) of this section.

(4) If a borrower fails to submit the written request and sworn statement described in paragraph (c) of this section within 60 days of the Secretary's mailing the discharge application, the Secretary resumes collection and grants forbearance of principal and interest for the period in which collection activity was suspended. The Secretary may capitalize any interest accrued and not paid during that period.

(5) If the Secretary determines that a borrower who requests a discharge meets the qualifications for a discharge, the Secretary notifies the borrower in writing of that determination.

(6) If the Secretary determines that a borrower who requests a discharge does not meet the qualifications for a discharge, the Secretary notifies that borrower in writing of that determination and the reasons for the determination.

<Text of subsection (f), as amended by 81 FR 76081, delayed effective July 1, 2019; see 82 FR 27621; 82 FR 49114; 83 FR 6459.>

(f) Discharge procedures.

(1) After confirming the date of a school's closure, the Secretary identifies any Direct Loan borrower (or student on whose behalf a parent borrowed) who appears to have been enrolled at the school on the school closure date or to have withdrawn not more than 120 days prior to the closure date.

(2) If the borrower's current address is known, the Secretary mails the borrower a discharge

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application and an explanation of the qualifications and procedures for obtaining a discharge. The Secretary also promptly suspends any efforts to collect from the borrower on any affected loan. The Secretary may continue to receive borrower payments.

(3) If the borrower's current address is unknown, the Secretary attempts to locate the borrower and determines the borrower's potential eligibility for a discharge under this section by consulting with representatives of the closed school, the school's licensing agency, the school's accrediting agency, and other appropriate parties. If the Secretary learns the new address of a borrower, the Secretary mails to the borrower a discharge application and explanation and suspends collection, as described in paragraph (f)(2) of this section.

(4) If a borrower fails to submit the application described in paragraph (c) of this section within 60 days of the Secretary's providing the discharge application, the Secretary resumes collection and grants forbearance of principal and interest for the period in which collection activity was suspended. The Secretary may capitalize any interest accrued and not paid during that period.

(5) Upon resuming collection on any affected loan, the Secretary provides the borrower another discharge application and an explanation of the requirements and procedures for obtaining a discharge.

(6) If the Secretary determines that a borrower who requests a discharge meets the qualifications for a discharge, the Secretary notifies the borrower in writing of that determination.

(7) If the Secretary determines that a borrower who requests a discharge does not meet the qualifications for a discharge, the Secretary notifies that borrower in writing of that determination and the reasons for the determination.

(Approved by the Office of Management and Budget under control number 1845–0021)

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(Authority: 20 U.S.C. 1087a et seq.)

Credits

[60 FR 33345, June 28, 1995; 64 FR 58972, Nov. 1, 1999; 65 FR 65629, Nov. 1, 2000; 66 FR 34765, June 29, 2001; 78 FR 65834, Nov. 1, 2013; 81 FR 76081, Nov. 1, 2016; 82 FR 27621, June 16, 2017; 82 FR 49114, Oct. 24, 2017; 83 FR 6459, Feb. 14, 2018]

AUTHORITY: 20 U.S.C 1070g, 1087a, et seq., unless otherwise noted.

Notes of Decisions (1)

Current through Jan. 10, 2019; 84 FR 102.

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Bauer, et al. v. DeVos, et al.,
Civil Action No. 1:17-cv-01330-RDM
(D.D.C. Sept. 17, 2018)

Submitted by:
Stacy M. Bardo
Bardo Law P.C.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

MEAGHAN BAUER, *et al.*,

Plaintiffs,

v.

ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,

Defendants.

Civil Action No. 17-1330 (RDM)

MEMORANDUM OPINION AND ORDER

Having concluded that the Department of Education's various actions delaying the Borrower Defense Regulations violated the Administrative Procedure Act ("APA"), 5 U.S.C. § 701 *et seq.*, the Court turns to the issue of the appropriate remedy. The Court concludes that, as with most unlawful agency actions, the proper remedy here is vacatur. The Court will, accordingly, vacate the "Final Delay Rule," William D. Ford Federal Direct Loan Program, 83 Fed. Reg. 6,458 (Feb. 14, 2018). The Court will also vacate the "Section 705 Stay," William D. Ford Federal Direct Loan Program, 82 Fed. Reg. 27,621 (June 16, 2017), but will stay that vacatur for 30 days from the date of issuance of the Court's original opinion, *Bauer v. DeVos*, No. 17-1330, 2018 WL 4353656 (D.D.C. Sept. 12, 2018)—that is, until October 12, 2018 at 5:00 p.m., to allow the Department to attempt to remedy the deficiencies identified in the Court's original opinion.

I. BACKGROUND

On November 1, 2016, the Department of Education promulgated the Borrower Defense Regulations, a package of regulatory changes to federal student loan programs that was to

become effective on July 1, 2017. William D. Ford Federal Direct Loan Program ("Borrower Defense Regulations"), 81 Fed. Reg. 75,926 (Nov. 1, 2016). Shortly before the effective date, the California Association of Private Postsecondary Schools ("CAPPS") brought suit challenging the regulations, and, on June 2, 2017, CAPPS sought a preliminary injunction blocking the implementation of two aspects of the new rules. Dkt. 1, Dkt. 6, *CAPPS v. DeVos*, Civ. No. 17-999 (D.D.C.). But that motion was never fully briefed or decided because the Department, on its own accord, issued a stay under § 705 of the APA, postponing not only the effective date of the two changes that CAPPS had asked the Court preliminarily to enjoin, but most of the other portions of the new regulations as well. Section 705 Stay, 82 Fed. Reg. at 27,621. Separately, the Department issued an interim final rule on October 24, 2017, that delayed the effective date of the Borrower Defense Regulations to July 1, 2018. William D. Ford Federal Direct Loan Program ("Interim Final Rule"), 82 Fed. Reg. 49,114 (Oct. 24, 2017). That same day, the Department also issued a notice of proposed rulemaking ("NPRM") to further delay the effective date to July 1, 2019. William D. Ford Federal Direct Loan Program ("October 24, 2017 NPRM"), 82 Fed. Reg. 49,155 (Oct. 24, 2017). Then, on February 14, 2018, the Department issued a final rule delaying the effective date of the Borrower Defense Regulations until July 1, 2019. Final Delay Rule, 83 Fed. Reg. at 6,458.

In its earlier opinion, the Court held that the Final Delay Rule and Section 705 Stay were both unlawful. *See Bauer*, 2018 WL 4353656, at *1. With respect to the Final Delay Rule, the Court held that the Department failed to comply with the procedures prescribed by the Higher Education Act ("HEA"), 20 U.S.C. § 1070 *et seq*. In particular, the Court held that the Department's decision to dispense with the negotiated rulemaking procedures that generally apply in Title IV rulemakings, *see* 20 U.S.C. § 1098a(a), was not supported by a reasoned

invocation of the "good cause" exception, *see Bauer*, 2018 WL 4353656, at *14–18. With respect to the Section 705 Stay, the Court held that the stay was arbitrary and capricious. *See id.* at *25. As the Court explained, the Department had stayed the Borrower Defense Regulations pending the resolution of the *CAPPS* litigation on three grounds: the *CAPPS* litigation raised "serious questions" about the validity of the Borrower Defense Regulations; the delay would not cause the government any significant harm; and the Department was, in any event, reconsidering the regulations, and the delay would minimize confusion while that process proceeded. *Id.* at *22 (citing Section 705 Stay, 82 Fed. Reg. at 27,621). The Court concluded that none of the reasons withstood APA scrutiny. *Id*. The first rationale was "unsupported by any analysis" and "was at odds with the Department's prior [and unacknowledged] conclusion to the contrary." *Id.* The second and third rationales also lacked "any meaningful analysis" and were "beyond the scope of the § 705 considerations" because they were "unrelated to the pending *CAPPS* case." *Id.*

II. LEGAL STANDARD

"[W]hen a reviewing court determines that agency regulations are unlawful, the ordinary result is that the rules are vacated . . . ." *NAACP v. Trump*, 298 F. Supp. 3d 209, 243 (D.D.C. 2018) (quoting *Harmon v. Thornburgh*, 878 F.2d 484, 495 n.21 (D.C. Cir. 1989)). That rule, however, is not absolute, and a remand without vacatur may be "appropriate [if] 'there is at least a serious possibility that the [agency] will be able to substantiate its decision' given an opportunity to do so, and when vacating would be 'disruptive.'" *Radio-Television News Director Ass'n v. FCC*, 184 F.3d 872, 888 (D.C. Cir. 1999) (quoting *Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm'n*, 988 F.2d 146, 151 (D.C. Cir. 1993)). In some circumstances, moreover, a combined approach is warranted; the Court may vacate the invalid rule but stay "its

order of vacatur for a limited time to allow the agency to attempt to cure defects that the court has identified." *NAACP v. Trump*, 298 F. Supp. 3d at 244 (staying vacatur for 90 days so agency could provide more fulsome explanation for rescission of DACA); *see also, e.g.*, *Nat. Res. Def. Council, Inc. v. EPA*, 301 F. Supp. 3d 133, 145 (D.D.C. 2018) (staying vacatur of rule governing pollution level in Anacostia River until agency promulgated replacement rule). Such a combined approach falls within the Court's remedial discretion. *See Friends of the Earth, Inc. v. EPA*, 446 F.3d 140, 142, 148 (remanding to district court to vacate agency rule, but noting that the district court had "remedial discretion . . . to stay [its] order on remand"); Ronald M. Levin, *"Vacation" at Sea: Judicial Remedies and Equitable Discretion in Administrative Law*, 53 Duke L.J. 291, 324–25 (2003) ("[T]he criteria that judges use to determine whether to order a stay have evolved, and variations on those criteria have emerged in specific contexts, but the APA drafters' core premise that they were conferring an equitable power has not been controversial." (footnotes omitted)); Patricia M. Wald, *Judicial Review in Midpassage: The Uneasy Partnership Between Courts and Agencies Plays On*, 32 Tulsa L.J. 221, 236 (1996) ("[T]here are inherent powers in a reviewing court to postpone vacation until the agency has a chance to make things right."); *cf. Buckley v. Valeo*, 424 U.S. 1, 143 (1976) (staying judgment for 30 days to "afford Congress an opportunity to reconstitute the [FEC] by law or to adopt other valid enforcement mechanisms . . . ."). Vacatur with a brief stay may be warranted, for example, where the *Allied-Signal* factors are satisfied, but where a prolonged agency remand threatens to deprive one or more parties of significant rights. *See NAACP v. Trump*, 298 F. Supp. 3d at 245.

III. ANALYSIS

A. February 14, 2018 Final Delay Rule

All parties are in accord—or at least do not contest—that vacatur is the appropriate remedy with respect to the Final Delay Rule, which was promogulated without observance of the proper procedures under the HEA. At the September 14, 2018 hearing, the Department stated that, "to the extent [the Court] feels that vacatur is appropriate . . . [the Department] is not prepared . . . to oppose that." Dkt. 90 at 55. Moreover, as the Court has previously noted, the Department declined to address this issue in opposing Plaintiffs' motion for summary judgment. *See* Dkt. 58-1 at 79–80 n.28. Accordingly, the Court will vacate the Final Delay Rule.

B. Section 705 Stay

Plaintiffs and the Department disagree, however, as to the appropriate remedy with respect to the Section 705 Stay. Plaintiffs ask the Court to vacate the stay and to allow the Borrower Defense Regulations to take effect immediately. Dkt. 55-1 at 79; Dkt. 56 at 72. In the alternative, they ask the Court to allow the Borrower Defense Regulations to take immediate effect, but, if necessary, to issue a temporary restraining order ("TRO") in *CAPPS*, Civ. No. 17-999, staying the provision prohibiting predispute arbitration agreements and class action waivers—the only provision that CAPPS had previously sought to enjoin. Dkt. 90 at 48. The Department counters that the appropriate remedy is remand without vacatur, or, in the alternative, to "stay any implementation pending the [preliminary injunction] briefing" in *CAPPS*, Civ. No. 17-999. *Id.* at 41. The Department also represented that, in the event the Court orders the Borrower Defense Regulations to take immediate effect, the Department requires at least 60 days to implement the regulations. *Id.* at 56.

As an initial matter, the Court declines to adopt Plaintiffs' second suggestion. The Court cannot sua sponte issue a TRO in *CAPPS*, Civ. No. 17-999, when CAPPS itself has not requested one. The Court, accordingly, turns to the *Allied-Signal* factors to analyze whether remand without vacatur is appropriate.

The first consideration—whether the Department could substantiate the Section 705 Stay on remand—presents a close call. The Department could, "in theory," cure the deficiencies identified in the Court's earlier opinion, but it "may face practical obstacles when attempting to remedy them." *NAACP v. Trump*, 298 F. Supp. 3d at 244. To begin, given the incongruency between the scope of the Section 705 Stay (which covers 22 provisions) and the scope of relief sought in the motion for a preliminary injunction that CAPPS filed and then withdrew, *see Bauer*, 2018 WL 4353656, at *23, the Department may not be able to justify the full breadth of the Section 705 Stay. The Department would also need to explain why it believes CAPPS has raised serious questions about the lawfulness of the Borrower Defense Regulations; why it no longer ascribes to the view that the prohibition of predistpute arbitration agreements and class action waivers is lawful, as it had previously stated, *see* Borrower Defense Regulations, 81 Fed. Reg. at 76,021–24; and how that conclusion relates to other provisions of the Borrower Defense Regulations. Nevertheless, because there is a "nontrivial likelihood" that the Department could justify the Section 705 Stay on remand, *NAACP v. Trump*, 298 F. Supp. 3d at 244 (quoting *WorldCom, Inc. v. FCC*, 288 F.3d 429, 434 (D.C. Cir. 2002)), the first *Allied-Signal* factor weighs (slightly) in favor of remand without vacatur.

The second *Allied-Signal* factor—the risk of disruption—also tips in favor of remand without vacatur. In light of the *CAPPS* litigation, which is now unstayed, and the *CAPPS* plaintiff's entitlement to be heard on the merits of its preliminary injunction, the Court concludes

that vacating the Section 705 Stay, and allowing the Borrower Defense Regulations to take immediate effect, could result in an "interim change" that "may itself be changed." *Id.* at 245 (quoting *Allied-Signal*, 988 F.2d at 150–51). If the Court were, for example, to vacate the Section 705 Stay, and then conclude that CAPPS is entitled to preliminary relief, the Borrower Defense Regulations might take effect this week, only to be enjoined, at least in part, two or three weeks later. Without any advance notice and opportunity to prepare, such an abrupt change would cause regulatory vertigo. As such, the threat of disruption also weighs in favor of remand without immediate vacatur, at least for a few weeks.

Because this case is about the consequences of delay, however, the Court is mindful that, in crafting the appropriate remedy, time is of the essence. The further delay that would result from remanding the Section 705 Stay to the Department for further explanation without vacatur risks depriving Plaintiffs of meaningful relief. Accordingly, the Court will chart an intermediate course: the Court will vacate the Section 705 Stay, but stay the vacatur for 30 days from the date of its opinion declaring the Section 705 Stay unlawful. This will allow the Department to attempt to remedy the deficiencies in the Section 705 Stay while the *CAPPS* litigation proceeds in an expeditious manner; it will also curtail the harm to student borrowers that a remand without vacatur would otherwise engender.

CONCLUSION

It is hereby **ORDERED** that the Final Delay Rule, 83 Fed. Reg. 6,458, shall be immediately **VACATED**. It is further **ORDERED** that the Section 705 Stay, 82 Fed. Reg. 27,621, shall be **VACATED**, but the vacatur shall be **STAYED** until October 12, 2018 at 5:00 p.m.

SO ORDERED.

/s/ Randolph D. Moss
RANDOLPH D. MOSS
United States District Judge

Date: September 17, 2017

NOTES

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Bauer, et al. v. DeVos, et al.,
Case No. 1:17-cv-01330-RDM
(D.D.C. Sept. 12, 2018)

Submitted by:
Stacy M. Bardo
Bardo Law P.C.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

MEAGHAN BAUER, *et al.*,

Plaintiffs,

v.

ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,

Defendants.

Civil Action No. 17-1330 (RDM)

MEMORANDUM OPINION AND ORDER

Meaghan Bauer, Stephano Del Rose, and a coalition of nineteen states and the District of Columbia bring suit against the Department of Education under the Administrative Procedure Act ("APA"), 5 U.S.C. § 701 *et seq*. Plaintiffs challenge three agency actions delaying the implementation of the "Borrower Defense Regulations," a package of regulatory changes to federal student loan programs designed to "protect student loan borrowers from misleading, deceitful, and predatory practices." William D. Ford Federal Direct Loan Program ("Borrower Defense Regulations"), 81 Fed. Reg. 75,926, 75,926 (Nov. 1, 2016). The Borrower Defense Regulations were published on November 1, 2016, and were to become effective on July 1, 2017. Shortly before the effective date, however, the Californi-a Association of Private Postsecondary Schools ("CAPPS"), brought suit challenging the regulations, and, a week later, CAPPS sought a preliminary injunction blocking the implementation of two changes. That motion was never fully briefed or decided because the Department, on its own accord, issued a stay under § 705 of the APA ("Section 705 Stay"), postponing not only the effective date of the two changes that CAPPS had asked the Court preliminarily to enjoin, but most of the other

portions of the regulations as well. While the *CAPPS* litigation continued, the Department issued an interim final rule on October 24, 2017 that delayed the effective date of the Borrower Defense Regulations to July 1, 2018, and a notice of proposed rulemaking to further delay the effective date to July 1, 2019. Then, on February 14, 2018, the Department issued a final rule delaying the effective date of the Borrower Defense Regulations until July 1, 2019.

Within weeks of the issuance of the Section 705 Stay, Bauer and Del Rose (student borrowers who allege that they would benefit from the Borrower Defense Regulations) and the coalition of nineteen states and the District of Columbia filed separate suits seeking to invalidate the stay. Over the course of the last year, both sets of plaintiffs have amended their complaints to challenge the additional delay actions taken in October 2017 and February 2018. On March 1, 2018, the Court consolidated the student borrower and state cases, stayed the *CAPPS* case pending resolution of this case, and ordered a final round of summary judgment briefing.

The matter is now before the Court on cross-motions for summary judgment filed by the state plaintiffs, Dkt. 55, the student borrower plaintiffs, Dkt. 56, and the Department, Dkt. 58; Dkt. 59. In brief, the Court concludes that Plaintiffs have standing to challenge the delay actions; that the October 24, 2017 Interim Final Rule is based on an unlawful construction of the Higher Education Act of 1965; that the February 14, 2018 Final Delay Rule is procedurally invalid; that the Section 705 Stay is judicially reviewable; and that the Department's Section 705 Stay is arbitrary and capricious. The Court, accordingly, will **GRANT** the state plaintiffs' and the student borrower plaintiffs' motions for summary judgment, Dkt. 55; Dkt. 56, and will **DENY** the Department's cross-motion, Dkt. 66. Before entering a remedial decree, the Court will order the parties in this case and the parties and proposed intervenors in *CAPPS v. DeVos*,

Civil Action No. 17-999, to appear for a status conference on September 14, 2018, at 10:30 a.m. in Courtroom 21.

I. BACKGROUND

A. Borrower Defense Regulations

Title IV of the Higher Education Act of 1965 ("HEA"), 20 U.S.C. § 1070 *et seq.*, empowers the Secretary of Education "to assist in making available the benefits of postsecondary education to eligible students . . . in institutions of higher education" through various types of financial aid. *Id.* § 1070(a). The William D. Ford Federal Direct Loan Program ("Direct Loan Program") allows students who attend "participating institutions of higher education" to obtain direct loans from the federal government to pay for their educational expenses. *Id.* § 1087a(a). Those institutions of higher education that are selected to participate in the Direct Loan Program must enter into an agreement with the Secretary of Education, which may include any provisions "the Secretary determines are necessary to protect the interests of the United States and to promote the purposes of" the Direct Loan Program. *Id.* § 1087d(a)(6); *see also id.* § 1087c. Moreover, and more generally, the Secretary has authority "to make, promulgate, issue, rescind, and amend rules and regulations governing the" Direct Loan Program. *Id.* § 1221e-3. In administering the Direct Loan Program, the Secretary must also "specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a loan" made under the Direct Loan Program. *Id.* § 1087e(h).

Pursuant to these authorities, in January 1994, the Secretary issued "standards, criteria, and procedures governing the Federal Direct Student Loan . . . program." Federal Direct Student Loan Program, 59 Fed. Reg. 472, 472 (Jan. 4, 1994). Those standards included the first iteration of the borrower defense rule, which permitted a Direct Loan Program borrower to "assert as a defense against the repayment of the loan a claim based on the act or omission of the school" if

(1) that act or omission gave rise to a cause of action against the school under state law, (2) the borrower presented the "claim to the school and received no satisfaction," and (3) the borrower filed a timely claim with the Department of Education. *Id.* at 481.

In December 1994, the Secretary amended the Direct Loan Program regulations, including those governing borrower defenses. *See* William D. Ford Federal Direct Loan Program, 59 Fed. Reg. 61,664, 61,696 (Dec. 1, 1994). Under the new regulations—which remain in effect today—borrowers are permitted to assert "as a defense against repayment, any act or omission of the school attended by the [borrower] that would give rise to a cause of action against the school under applicable State law." 34 C.F.R. § 685.206(c)(1) (2016). If that defense to "repayment is successful, the Secretary notifies the borrower that the borrower is relieved of the obligation to repay all or part of the loan," and the Secretary may provide the borrower with further relief as appropriate. *Id.* § 685.206(c)(2). The Secretary may then bring a "proceeding to require the school whose act or omission resulted in the borrower's successful defense against repayment of [the] Direct Loan to pay to the Secretary the amount of the loan to which the defense applies." *Id.* § 685.206(c)(3). In short, the 1994 borrower defense rule permits a student borrower to assert his or her school's misconduct as a reason for nonrepayment, and, if successful, the regulation shifts the obligation to repay the loan from the borrower to the school.

The adequacy of the 1994 borrower defense rule was tested by "the collapse of Corinthian Colleges (Corinthian)" in May 2015. William D. Ford Federal Direct Loan Program ("June 16, 2016 Notice of Proposed Rulemaking ('NPRM')"), 81 Fed. Reg. 39,330, 39,330 (June 16, 2016). Corinthian was "a publicly traded company [that] operat[ed] numerous postsecondary schools that enrolled over 70,000 students at more than 100 campuses nationwide." *Id.* at 39,335. After Corinthian "filed for bankruptcy" and the Department found "that the college had

misrepresented its job placement rates," the Department "received thousands of claims for student loan relief from Corinthian students." *Id.* In dealing with the aftermath, the Department concluded that the 1994 borrower defense rule was outdated and was no longer adequate to deal with the changed "landscape of higher education." *Id.*

To address these perceived deficiencies, the Department commenced a rulemaking. First, pursuant to its obligations under the HEA, it "obtain[ed] the advice of and recommendations from individuals and representatives of the groups involved in student financial assistance programs under [Title IV of the HEA], such as students, legal assistance organizations that represent students, institutions of higher education, State student grant agencies, guaranty agencies, lenders, secondary markets, loan servicers, guaranty agency servicers, and collection agencies." 20 U.S.C. § 1098a(a)(1). After obtaining those recommendations, the Department published a notice of intent to engage in negotiated rulemaking regarding borrower defenses and a request for public comment on August 20, 2015.[1] Negotiated Rulemaking Committee, Public Hearings, 80 Fed. Reg. 50,588 (Aug. 20, 2015). The Department selected a committee, but after a series of meetings in early 2016, the negotiators were unable to reach consensus. June 16, 2016 NPRM, 81 Fed. Reg. at 39,333–34. As a result, the Department issued its own notice of proposed rulemaking on June 16, 2016, and invited the members of the negotiating committee, in addition to members of the public, to submit comments on a set of regulations crafted by the Department in light of the negotiations and earlier public hearings. *Id.* More than 50,000 parties

[1] Pursuant to the HEA, "[a]ll regulations pertaining to" the federal direct loan programs at issue here are "subject to [this] negotiated rulemaking (including the selection of the issues to be negotiated), unless the Secretary determines that applying such a requirement with respect to given regulations is impracticable, unnecessary, or contrary to the public interest (within the meaning of section 553(b)(3)(B) of [the APA])." 20 U.S.C. § 1098a(b)(2).

submitted comments in response to the Department's notice of proposed rulemaking. Borrower Defense Regulations, 81 Fed. Reg. at 75,928.

On November 1, 2016, the Department published the final regulations governing the Direct Loan Program. *See id.* at 75,926. In relevant part, the Borrower Defense Regulations: (1) revised the procedures for student borrowers seeking to discharge their federal loans as a result of school misconduct; (2) revised the processes for students seeking other forms of debt relief; (3) required "financially risky institutions [to be] prepared to take responsibility for the losses to the government for discharges of and repayments for [f]ederal student loans;" (4) expanded the disclosure obligations of institutions "at which the median borrower has not repaid in full, or made loan payments sufficient to reduce by at the least one dollar the outstanding balance of the borrower's loans received at the institution;" (5) altered the standard for students asserting a "borrower defense" to collection actions; (6) expanded the situations in which the Department could proactively forgive loans in groups, rather than upon individual applications; and (7) prohibited schools "participating in the Direct Loan Program from obtaining" or relying upon a borrower's "waive[r] [of] his or her right to initiate or participate in a class action lawsuit," or "from requiring students to engage in internal dispute processes before contacting accrediting or government agencies." *Id.* at 75,926–27.

The Borrower Defense Regulations were set to take effect eight months later, on July 1, 2017.

B. California Association of Private Postsecondary Schools Litigation

The California Association of Private Postsecondary Schools is an industry group that represents schools subject to provisions of the Borrower Defense Regulations. CAPPS filed suit in this Court on May 24, 2017, alleging that four aspects of the regulations were unlawful. *See* Dkt. 1 at 69–75 (Compl. ¶¶ 202–41), *CAPPS v. DeVos*, Civ. No. 17-999 (D.D.C.). In particular,

CAPPS challenged (1) changes to the procedures and options available to students seeking debt relief; (2) modifications of certain financial responsibility standards; (3) requirements that proprietary schools disclose additional information about loan repayment rates to students and prospective students; and (4) prohibitions on the inclusion of or reliance on arbitration and class action waiver provisions in contracts with students. *Id.* CAPPS sought to enjoin the Department "from implementing, applying, or taking any action whatsoever pursuant to the final regulations," and to vacate the entirety of the final rule. Dkt. 1 at 75 (Compl. ¶ 242), *CAPPS*, Civ. No. 17-1999.

On June 2, 2017, CAPPS filed a motion for preliminary injunction. Dkt. 6, *CAPPS*, Civ. No. 17-999. The relief sought in that motion, however, was more limited than that sought in the complaint; CAPPS sought preliminarily to enjoin only the provision of the Borrower Defense Regulations prohibiting predispute arbitration clauses and class action waivers. *Id.* at 1. The Court set a briefing schedule, ordering the Department to file its opposition on or before June 15, 2017. Minute Entry (June 6, 2017), *CAPPS*, Civ. No. 17-999. On June 13, 2017, the same states that are plaintiffs in the present action moved to intervene as defendants in the *CAPPS* case and were soon followed by Bauer and Del Rose. Dkt. 16, Dkt. 22, Dkt. 31, *CAPPS*, Civ. No. 17-999. The day before the Department's opposition to CAPPS's motion was due, the Department notified the Court that it was in the process of staying the implementation of the entirety of the Borrower Defense Regulations under § 705 of the APA.[2] Dkt. 20, *CAPPS*, Civ. No. 17-999. At that point, CAPPS withdrew its motion for a preliminary injunction, Dkt. 21, *CAPPS*, Civ. No.

[2] Although this is actually section 10(d) of the APA, the Court adopts the convention of referring to the provisions of the APA by their sections in title 5 of the U.S. Code. *See Trudeau v. FTC*, 456 F.3d 178, 183 n.3 (D.C. Cir. 2006).

17-999, and, on September 6, 2017, the Department filed an answer, Dkt. 52, *CAPPS*, Civ. No. 17-999. Neither party took any step thereafter to advance the *CAPPS* litigation.

C. Present Action

On July 6, 2017, shortly after the Department issued its Section 705 Stay, Plaintiffs Meaghan Bauer and Stephano Del Rose filed the present action. Dkt. 1. Bauer and Del Rose attended New England Institute of Art ("NEIA"), a for-profit college. Dkt. 53 at 10 (Compl. ¶ 35).[3] Bauer attended a filmmaking program from 2011 to 2014. *Id.* Del Rose attended the same program from 2009 to 2014. *Id.* Each borrowed more than $30,000 in federal direct loans to finance his or her attendance. *Id.* (Compl. ¶¶ 36–37). Each now owes more than $40,000 to the Department. *Id.* Bauer and Del Rose both seek loan forgiveness as a result of "NEIA's fraud and other related misconduct," *id.* at 12 (Compl. ¶ 45); they also wish to bring a class action on behalf of students at NEIA, *id.* at 11 (Compl. ¶ 40). As such, they allege that the continued delay in implementing the Borrower Defense Regulations has impaired their ability to vindicate their rights against NEIA and to obtain related relief. *Id.* at 12–17 (Compl. ¶¶ 44–62).

The state plaintiffs include nineteen states and the District of Columbia. Dkt. 80 at 1–2 (Compl.), *Massachusetts v. DeVos*, Civ. No. 17-1331 (D.D.C.).[4] The states allege that they "initiate numerous investigations and enforcement actions against proprietary and for-profit schools for violations of the States' consumer protection statutes," *id.* at 15 (Compl. ¶ 61), and that the Borrower Defense Regulations "afford[] a legally significant status to enforcement

[3] Although the operative complaint filed by Bauer and Del Rose is in fact their second amended complaint, for ease of reference, the Court simply refers to that pleading as the complaint.

[4] As with the student borrower plaintiffs, the Court refers to the state plaintiffs' second amended complaint as the complaint for ease of reference. Although the student borrower and state cases have now been consolidated, the Court will reference the Civ. No. 17-1331 matter when referring to documents filed by state plaintiffs prior to the consolidation.

actions and investigations undertaken by state attorneys general," *id.* at 22 (Compl. ¶ 77). Specifically, under the rule, "[a] successful enforcement action brought against a postsecondary institution by a state attorney general gives rise to a borrower defense to loan repayment," and "a state agency's issuance of a civil investigative demand against a school whose conduct resulted in a borrower defense will qualify as notice permitting the Secretary of Education to seek repayment from the school for any amounts forgiven." *Id.* The state plaintiffs argue that, "[b]y incorporating state enforcement actions and investigations into the Department's borrower defense framework, the Borrower Defense [Regulations] enhance the effectiveness of state enforcement efforts and the remedies available for violations of state law." *Id.* (Compl. ¶ 78). The states, moreover, argue that the Borrower Defense Regulations protect "the economic health and well-being of state residents and . . . the quality of higher education within each state." Dkt. 64 at 23.

Although the state and student borrower plaintiffs initially challenged only the Section 705 Stay, over the course of the last year, they have amended their complaints to encompass challenges to additional agency actions delaying the effective date of the Borrower Defense Regulations. *See* Dkt. 25; Dkt. 53; *see also* Dkt. 46, Dkt. 80, *Massachusetts v. DeVos*, Civ. No. 17-1331. The Court discusses each of those agency actions in turn.

1. *Section 705 Stay and Notice of Negotiated Rulemaking to Revise Borrower Defense Regulations*

On June 16, 2017, the Department published a notice in the Federal Register delaying the effective date of the Borrower Defense Regulations "until the judicial challenges to the

regulations are resolved."[5] William D. Ford Federal Direct Loan Program ("Section 705 Stay"), 82 Fed. Reg. 27,621, 27,621 (June 16, 2017). The Department premised that decision on § 705 of the APA, which authorizes an agency to "postpone the effective date of action taken by it, pending judicial review," if the "agency finds that justice so requires." 5 U.S.C. § 705. In the view of the Department, this standard was satisfied "[i]n light of the existence and potential consequences of the pending [*CAPPS*] litigation." Section 705 Stay, 82 Fed. Reg. at 27,621.

The Department identified three factors in support of its conclusion that a delay was justified under § 705. First, it found value in "preserv[ing] the regulatory status quo," because the *CAPPS* "plaintiffs ha[d] raised serious questions concerning the validity of certain provisions of the final regulations and ha[d] identified substantial injuries that could result if the final regulations [went] into effect before those questions [were] resolved." *Id.* Specifically, the Department pointed to the cost to institutions of "modify[ing] their contracts in accordance with the arbitration and class action waiver regulations, which may be contrary to their interests" and complying with the regulations' financial responsibility provisions. *Id.* On the other side of the balance, the Department found that the delay would cause little harm to student borrowers

[5] The Department, however, did permit several ministerial provisions of the Borrower Defense Regulations to take effect on July 1, 2017:

> We do not intend to postpone the effectiveness of the regulatory provisions published in 75[,]926 which: (1) Expand the types of documentation that may be used for the granting of a discharge based on the death of the borrower; (2) amend the regulations governing the consolidation of Nursing Student Loans and Nurse Faculty Loans so that they align with the statutory requirements of section 428C(a)(4)(E) of the HEA; (3) address severability; and (4) make technical corrections.

William D. Ford Federal Direct Loan Program, 82 Fed. Reg. 27,621, 27,621 (June 16, 2017).

because they could still obtain relief from the Department under the 1994 borrower defense rule, which would "remain in effect during the postponement." *Id.*

Second, the Department concluded that postponing the effective date of the Borrower Defense Regulations would cause "no significant harm" to the United States. *Id.* Rather, by delaying the implementation of provisions designed to make the discharge of federal student loans easier, the United States would stand to avoid "significant costs to the Federal government and ultimately the Federal taxpayer." *Id.* at 27,621–22 ("The final regulations were estimated to have a net budget impact in costs over the 2016–2026 loan cohorts of $16.6 billion in the primary estimate scenario, including a cost of $381 million for cohorts 2014–2016 attributable to the regulations providing for a three-year automatic closed school discharge.").

Finally, the Department stated, "[s]eparately," that it would be "announcing its plan to review and revise the regulations through the negotiated rulemaking process required under section 492 of the HEA." *Id.* at 27,622. Those potential revisions were relevant to the Section 705 Stay, because "[t]he postponement will allow the Department to consider and conduct a rulemaking process to review and revise the final regulations and ensures regulated parties will not incur costs that could be eliminated under any future regulations the Department promulgates on these matters." *Id.*

That same day, the Department published notice of its intent to establish a negotiated rulemaking committee to revise the Borrower Defense Regulations. Negotiated Rulemaking Committee; Public Hearings ("June 16, 2017 Notice of Intent"), 82 Fed. Reg. 27,640 (June 16, 2017).

2. *October 24, 2017 Interim Final Rule and Notice of Proposed Rulemaking for Final Delay Rule*

The next agency actions relevant to the pending motions occurred four months later, on October 24, 2017, when the Department published two documents. The first was an interim final rule delaying the effective date of the Borrower Defense Regulations until July 1, 2018, even if the Section 705 Stay was lifted before then.[6] William D. Ford Federal Direct Loan Program ("Interim Final Rule"), 82 Fed. Reg. 49,114 (Oct. 24, 2017). Invoking the good cause provisions of §§ 553(b)(3)(B) and (d)(3) of the APA, the Department issued the Interim Final Rule without advance notice or the opportunity for comment. *Id.* at 49,114; *see also* 5 U.S.C. § 553(b)(3)(B) (providing an exception to the notice and comment requirement when those procedures are "impracticable, unnecessary, or contrary to the public interest"); 5 U.S.C. § 553(d)(3) (providing an exception to the "required publication or service of a substantive rule . . . 30 days before its effective date" upon a finding of good cause "published with the rule"). Even though the Interim Final Rule took effect immediately, the Department nevertheless invited comments for a thirty-day period. *See* 82 Fed. Reg. at 49,115.

The Department premised the Interim Final Rule on the "Master Calendar Provision" of the HEA, 20 U.S.C. § 1089(c)(1). *See* Interim Final Rule, 82 Fed. Reg. at 49,115–16. That provision states that, except in cases of voluntary compliance, "any regulatory changes initiated

[6] As in the case of the Section 705 Stay, the Interim Final Rule exempted certain provisions of the Borrower Defense Regulations from the delay. In particular, the Department exempted each of the provisions that the Section 705 Stay had previously allowed to become effective, in addition to the portions of the Borrower Defense Regulations amending the regulations governing "Direct Consolidation Loans to allow a borrower to obtain a Direct Consolidation Loan regardless of whether the borrower is also seeking to consolidate a Direct Program or FFEL [Federal Family Education] loan, if the borrower has a loan type identified in 34 C.F.R. 685.220(b)." Interim Final Rule, 82 Fed. Reg. at 49,116–17.

by the Secretary affecting the programs under [Title IV of the HEA] that have not been published in final form by November 1 prior to the start of the award year shall not become effective until the beginning of the second award year after such November 1 date." 20 U.S.C. § 1089(c)(1). An award year begins on July 1. Interim Final Rule, 82 Fed. Reg. at 49,115. A "regulatory change," accordingly, would have to be "published in final form on or before" November 1, 2017, to become effective by July 1, 2018. *Id.* at 49,115–16.

The Department, however, did not simply rely on this November–July interval to justify the Interim Final Rule. Instead, it interpreted the Master Calendar Provision further to require that all "regulations promulgated under Title IV of the HEA have an effective date of July 1" so that institutions could "avoid incurring the costs of compliance on a rolling basis throughout the year." *Id.* at 49,116. In other words, under the Department's reading, the Master Calendar Provision allows applicable rules to take effect on only one day every year—July 1. Applied to the present circumstances, the Department posited that as soon as the Section 705 Stay delayed the effective date of the Borrower Defense Regulations beyond July 1, 2017, it lacked discretion to implement the regulations before July 1, 2018, even if the Section 705 Stay was lifted before that date. *Id.* The Department also relied on this reasoning to justify why it had good cause to forgo notice-and-comment and negotiated rulemaking; the Department concluded that because "it was impracticable" to do so between the initiation of the *CAPPS* litigation on May 24, 2017 and the July 1, 2017 effective date of the Borrower Defense Regulations, it "did not have any discretion to set an effective date earlier than July 1, 2018." *Id.*

On October 24, 2017, the Department also issued a notice of proposed rulemaking to further delay the effective date of the Borrower Defense Regulations to July 1, 2019.[7] William D. Ford Federal Direct Loan Program ("October 24, 2017 NPRM"), 82 Fed. Reg. 49,155 (Oct. 24, 2017). The Department justified this delay on two grounds. First, it asserted that delaying the effective date would "ensure that there is adequate time to conduct [a] negotiated rulemaking" to reconsider the Borrower Defense Regulations. *Id.* at 49,155. Second, it explained that, under the Master Calendar Provision, "the regulations resulting from [the] negotiated rulemaking could not be effective before July 1, 2019," because "the first negotiated rulemaking session" was not scheduled to take place until November 13–15, 2017. *Id.* at 49,156.

Although the Department provided notice and an opportunity for comment on the proposed rule, it waived the negotiated rulemaking requirement of the HEA. *Id.* at 49,157. In doing so, the Department acknowledged that "all regulations proposed . . . for programs under Title IV of the HEA are subject to negotiated rulemaking requirements," unless the Department can establish "good cause" to waive the requirement. *Id.* It also acknowledged that "the HEA . . . requires the Secretary to publish the basis for waiving negotiations in the Federal Register at the same time as the proposed regulations in question are first published." *Id.* The Department concluded that good cause existed for waiving the negotiation process because "it would not be practicable before the July 1, 2018 effective date specified in the [Interim Final Rule], to engage in negotiated rulemaking and publish final regulations" amending the Borrower Defense Regulations. *Id.*

[7] As with the other delay actions, the Department stated its intent to exempt a handful of ministerial provisions of the Borrower Defense Regulations from the delay. William D. Ford Federal Direct Loan Program, 82 Fed. Reg. at 49,156 (Oct. 24, 2017).

3. *February 14, 2018 Final Delay Rule*

On February 14, 2018, the Department issued a final rule delaying the effective date of the Borrower Defense Regulations until July 1, 2019. William D. Ford Federal Direct Loan Program ("Final Delay Rule"), 83 Fed. Reg. 6,458 (Feb. 14, 2018). In doing so, the Department addressed a number of comments regarding the proposed rule, both substantive and procedural.

Responding to concerns that further delay would harm borrowers, the Department stated that, in its view, any costs of the delay were insignificant, and, in any event, "outweighed by the administrative and transaction costs for regulated entities and borrowers of having those regulations go into effect only to be changed a short while later." *Id.* at 6,460–61. The Department stressed, for example, that the 1994 borrower defense rule would remain in effect, "as [would] the statute that allows borrowers to assert defenses to repayment." *Id.* at 6,461. On the other hand, the Department observed that the Borrower Defense Regulations' prohibition on predispute arbitration clauses and class action waivers "would require some institutions to change their policies and procedures[,] to amend their enrollment agreements," to re-train staff, and to send "notices to borrowers informing them of the changed class action waivers and pre-dispute arbitration provisions," only to "repeat or reverse these steps" in the "likely" event that the provision is rescinded or struck down. *Id.* at 6,462.

The Department was also unpersuaded by commenters' procedural objections. *Id.* at 6,463–64. The Department maintained that the October 24, 2017 NPRM "properly articulated the good cause supporting" the Department's "waiver of the HEA's negotiated rulemaking requirement." *Id.* at 6,464. According to the Department:

> The NPRM explained that the original catalyst for the delay was the *CAPPS* litigation, filed on May 24, 2017, and that it would not have been possible for the Department to engage in negotiated rulemaking and [to] publish final regulations after that date (much less after October 24, 2017, the date the NPRM was published), and prior to July 1, 2018 (the current effective date of the 2016

> final regulations). Negotiated rulemaking on this discrete issue simply was not practicable. It is a time-consuming and resource-intensive process and could not practicably be completed by July 1, 2018.

Id. (italics added). The Department also rejected the argument that it needed to identify a deficiency in the underlying Borrower Defense Regulations to justify the delay. *See id.* ("[A]n agency's rulemaking [need only] justify the particular action or actions to be taken by that rule."). Rather, the Department reiterated that its earlier cost-benefit analysis of the "net budget impact of the delay" was accurate and justified the rule, although it noted that "the delay was not proposed solely on the basis of those calculations." *Id.* Finally, the Department addressed a group of comments objecting to its use of the *CAPPS* litigation as a basis for the delay given that CAPPS had challenged only the substance of a handful of provisions in the Borrower Defense Regulations. *Id.* at 6,465. The Department responded that the *CAPPS* litigation was not the basis for the delay from July 1, 2018 to July 1, 2019, and, that in any event, CAPPS had sought relief that would have invalidated the entire rule (on grounds of non-severability). *Id.*

4. *Pending Motions for Summary Judgment*

At the time the Final Delay Rule was published in the Federal Register, the parties in the then-separate actions pending before the Court had just completed a second round of summary judgment briefing that encompassed challenges to the Section 705 Stay and the Interim Final Rule. *See, e.g.*, Dkt. 50 (Department's Reply in Support of its Cross-Motion for Summary Judgment). Following the publication of the Final Delay Rule, Plaintiffs moved to amend their respective complaints, and the Court held a status conference with the parties in all three relevant actions (Civil Action No. 17-999, Civil Action No. 17-1330, Civil Action No. 17-1331). Although Plaintiffs sought to convert their then-pending motions for summary judgment into motions for partial summary judgment on the Section 705 Stay and Interim Final Rule, *see, e.g.*, Dkt. 52 (Borrower Plaintiffs' Motion to Convert), the Court instead denied the earlier motions as

moot and ordered the parties to file renewed motions for summary judgment addressing all three delay actions. Minute Entry (Mar. 1, 2018); Minute Order (May 24, 2018). The Court also consolidated the two actions challenging the delay actions and stayed CAPPS's challenge to the Borrower Defense Regulations. Minute Entry (Mar. 1, 2018).

II. ANALYSIS

Plaintiffs seek to vacate the Section 705 Stay, the Interim Final Rule, and the Final Delay Rule. They assert that these regulatory actions were arbitrary and capricious, not in accordance with law, and taken without observance of the required procedures. Broadly, Plaintiffs argue that the Department impermissibly took these actions for the purpose of securing time to replace the Borrower Defense Regulations (functionally rescinding the earlier rule); that it did not adequately consider benefits to student borrowers lost through the delays; that it relied on internally inconsistent assumptions and omitted key considerations when justifying the delay rules; that it misinterpreted the HEA; and, that it failed to comply with the HEA's requirement that public consultation and negotiated rulemaking be conducted prior to the promulgation of rules affecting federal student loans. The Department, for its part, contests each of these assertions and argues that Plaintiffs lack standing.

On the threshold question of standing, the Court concludes that it need not decide whether the state plaintiffs have carried their burden because, as the Department concedes and as the record demonstrates, the student borrower plaintiffs have standing to seek the entirety of the relief sought by all parties to the litigation. The Court then considers Plaintiffs' challenge to the Interim Final Rule—which expired on July 1, 2018—and concludes that it is moot, except for one issue, and, as to that issue, the Court concludes that the Department's interpretation of the Master Calendar Provision is contrary to law. Next, the Court examines Plaintiffs' substantive

and procedural challenges to the Final Delay Rule and concludes that the Department failed to justify adequately its invocation of the good cause exception to the negotiated rulemaking requirement. Given that procedural flaw, the Court does not reach Plaintiffs' substantive challenges to the rule. Finally, the Court considers Plaintiffs' challenges to the Section 705 Stay and concludes that § 705 stays are subject to judicial review and that the Department failed to offer a reasoned basis to stay the implementation of the Borrower Defense Regulations.

A. Standing

"Article III limits federal judicial jurisdiction to cases and controversies." *Chamber of Commerce v. EPA*, 642 F.3d 192, 199 (D.C. Cir. 2011) (citing U.S. Const. art. III, § 2). That means that federal courts may only adjudicate those disputes in which the plaintiff has "a personal stake in the outcome of the controversy [sufficient] to warrant *his* invocation of federal-court jurisdiction." *Id.* (quoting *Summers v. Earth Island Inst.*, 555 U.S. 488, 493 (2009)). The plaintiff bears the burden of establishing standing, and, accordingly, must make "a showing of injury-in-fact, causation, and redressability." *Deutsche Bank Nat'l Tr. Co. v. FDIC*, 717 F.3d 189, 193 (D.C. Cir. 2013). Injury in fact requires "an invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical." *Id.* (citing *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 560 (1992)). Causation, in turn, requires proof of "a causal connection between the injury and the conduct complained of—the injury has to be 'fairly . . . trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court.'" *Lujan*, 504 U.S. at 560–61 (alteration in original) (quoting *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 41–42 (1976)). Finally, redressability requires "a 'substantial likelihood' that the requested relief will remedy the alleged injury in fact." *Vt. Agency of Nat. Res. v. United States ex. rel. Stevens*, 529 U.S. 765, 771 (2000).

The Department argues that the state plaintiffs lack standing to challenge the three delay actions. Dkt. 59-1 at 28–32. For purposes of resolving the pending motions, however, the Court need not reach that question. It is well-settled that, "[f]or each claim, if constitutional and prudential standing can be shown for at least one plaintiff, [the Court] need not consider the standing of the other plaintiffs to raise that claim." *Mountain States Legal Found. v. Glickman*, 92 F.3d 1228, 1232 (D.C. Cir. 1996); *Watt v. Energy Action Educ. Found.*, 454 U.S. 151, 160 (1981) ("Because we find California has standing, we do not consider the standing of the other plaintiffs."). Here, both sets of plaintiffs bring identical claims seeking identical relief: a declaratory judgment that the three delay actions were unlawful, an order vacating those actions, and immediate implementation of the Borrower Defense Regulations. *Compare* Dkt. 53 at 29–30 (Compl. Prayer for Relief), *with* Dkt. 80 at 41–42 (Compl. Prayer for Relief), *Massachusetts v. DeVos*, Civ. No. 17-1331. This means that if Del Rose and Bauer have standing, the case may proceed regardless of whether the state plaintiffs also have standing.[8] Although the Department does not challenge the student borrowers' standing to sue, the Court must consider that question *sua sponte* to ensure that it has jurisdiction. *See DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 340 (2006) (federal courts have an obligation to assure themselves that they have jurisdiction); *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 180 (2000) (same).

According to their complaint, Del Rose and Bauer attended a for-profit college in Massachusetts at different times between 2009 and 2014. Dkt. 53 at 10 (Compl. ¶ 35). They both borrowed more than $30,000 to finance their educations, and now owe more than $40,000 to the Department. *Id.* (Compl. ¶¶ 36–37). They allege that they were defrauded by their school.

[8] To the extent the state plaintiffs seek attorney's fees and costs, the Court would, presumably, need to address their standing in that separate context.

They contend, in particular, that they "relied on numerous representations made by [their school] with respect to the quality of instruction and equipment, the school's industry connections, the job prospects for . . . graduates, the school's job placement assistance, and the school's high costs, especially in comparison to its graduates' low-paying employment," but then "later learned that many of these representations were untrue." *Id.* (Compl. ¶ 38). If permitted, they intend to bring a class action in state court on the basis of these misrepresentations and have taken concrete steps to initiate that litigation. *Id.* at 10–11 (Compl. ¶ 39) (describing demand letter sent to the school). They are, however, prevented from doing so by provisions in their enrollment contracts that require arbitration and bar class actions. *Id.* at 11 (Compl. ¶ 40). Their school, moreover, has refused to waive these provisions. *Id.* (Compl. ¶ 41). If the delay actions were vacated and the Borrower Defense Regulations allowed to take effect, the school would be prohibited from relying on these provisions to keep Del Rose and Bauer from banding together with other alleged victims of the school's fraud to bring suit in state court. *Id.* at 11–12 (Compl. ¶¶ 43–44).

Bauer and Del Rose further allege that they "have also submitted 'borrower defense' applications to [the Department] seeking cancellation of their federal loans based on [their school's] fraud and other misconduct related to their education," and that these applications have now been pending for nearly three years. *Id.* at 12 (Compl. ¶ 45). If the delay rules challenged here were vacated and the Borrower Defense Regulations were allowed to take effect, Bauer and Del Rose would receive "significant new protections in the adjudication of their borrower defense applications," including "a fact-finding process" that involves additional records held by the Department and—in the event the applications were denied—written decisions including the bases for those decisions. *Id.* at 13 (Compl. ¶¶ 47–50). And, while those applications remain

pending, Bauer and Del Rose would automatically have their loans placed into forbearance, a status that Bauer has not yet been able to obtain and that Del Rose holds only subject the Department's continued agreement to renew it. *Id.* at 13–14 (Compl. ¶ 51).

Bauer and Del Rose have supported these allegations with declarations detailing the misrepresentations allegedly made by their school, their efforts to sue in Massachusetts state court, and the status of their borrower defense applications. *See* Dkt. 56-2 at 1–5; Dkt. 56-3 at 1–6. They have also attached to their motion the demand letters sent to the school and the enrollment agreement that would be affected by the Borrower Defense Regulations. *See* Dkt. 56-2 at 7–19; Dkt. 56-3 at 9, 11–23. The Department has not contested that the student borrower plaintiffs would benefit from vacatur of the delay actions, nor has it called into question any of the facts that they have alleged.

In light of these undisputed facts, the Court concludes that the student borrower plaintiffs have carried their burden with respect to standing. The Department's delay actions have deprived Bauer and Del Rose of several concrete benefits that they would have otherwise accrued under the Borrower Defense Regulations. The relief they seek in this action—immediate implementation of the Borrower Defense Regulations—would restore those benefits. That suffices to demonstrate (1) an injury in fact (2) caused by the agency actions at issue (3) that would be redressed by a favorable decision. *See Lujan*, 504 U.S. at 561–62; *Crossroads Grassroots Pol'y Strategies v. FEC*, 788 F.3d 312, 316–17 (D.C. Cir. 2015).

Finally, although neither party has raised the issue, the Court notes that Plaintiffs brought separate actions, which the Court then consolidated. Minute Entry (Mar. 1, 2018). In the cases cited above for the proposition that a single plaintiff's standing is sufficient, in contrast, the plaintiffs had joined together in bringing a single case. *See Watt*, 454 U.S. at 158; *Mountain*

States Legal Found., 92 F.3d at 1231. The Supreme Court's recent decision in *Hall v. Hall*, 138 S. Ct. 1118 (2018), suggests that this distinction might be of some import. In that case, the Court held that when actions are consolidated under Rule 42(a) of the Federal Rules of Civil Procedure—as was the case here—each "retains its independent character" in at least some respects. *Id.* at 1125. Notably, the Court explained that it has long "understood consolidation not as completely merging the constituent cases into one, but instead as enabling more efficient case management while preserving the distinct identities of the cases and the rights of the separate parties in them." *Id.* In support of this historical understanding of consolidation, the Court quoted a case from the mid-nineteenth century in which it had held that a consolidated proceeding "is in reality a mere joinder of distinct causes of action by distinct parties, arising out of a common injury, and which are heard and determined, so far as the merits are concerned, the same as in the case of separate libels [suits] for each cause of action." *Id.* at 1125–26 (quoting *Rich v. Lambert*, 53 U.S. 356, 353 (1852)). Rule 42(a) adopted, rather than superseded, this "settled understanding of consolidation"—that is, "that separate actions do not merge into one" when they are consolidated. *Id.* at 1130. All of this is to say that in consolidated cases, *Hall* might be read to call into question the application of the general rule that as long as "[a]t least one plaintiff . . . ha[s] standing to seek each form of relief requested in the complaint," the case may proceed. *Town of Chester, N.Y. v. Laroe Estates, Inc.*, 137 S. Ct. 1645, 1651 (2017).

The Court nevertheless applies that well-established rule in this case for two reasons. First, *Hall* acknowledged that "[n]one of [the Court's discussion of the meaning of consolidation] means that district courts may not consolidate cases for 'all purposes' in appropriate circumstances," leaving open the possibility that, in some situations, consolidated cases may be treated as a single action. 138 S. Ct. at 1131. This case is a prime candidate for

that treatment; the parties raise only questions of law that can be decided on the administrative record, and the two complaints (and two summary judgment motions) are mirror images of one another that could easily have been filed in the first instance as a single action (or as a single motion for summary judgment). The extent of this overlap is perhaps best captured by the fact that, even if the Court were to hold that the state plaintiffs lack standing—and, to be clear, the Court is not deciding that question—it would make no difference to the Court's consideration of the pending motions, to the relief the Court would grant, or to any other aspect of this litigation.

Second, and more importantly, this Court must follow controlling precedent until it has been overruled by a court empowered to do so. *See United States v. Torres*, 115 F.3d 1033, 1036 (D.C. Cir. 1997) (observing that the D.C. Circuit must leave to the Supreme Court "the prerogative of overruling its . . . decisions," and that "district judges, like panels of [the D.C. Circuit], are obligated to follow controlling circuit precedent until either [the Court of Appeals], sitting en banc, or the Supreme Court, overrule it" (internal quotation marks omitted)); *see also Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 484 (1989) (noting that lower courts must follow precedent that "has direct application in a case," even if it "rests on reasons rejected in some other line of decisions"); *Seegars v. Gonzales*, 396 F.3d 1248, 1254 (D.C. Cir. 2005) (holding that binding precedent must be followed even when "tension" exists in the case law). With respect to the question presented here—whether proof of one plaintiff's standing may suffice for purposes of Article III standing in an action consisting of consolidated cases—numerous decisions by the D.C. Circuit and Supreme Court have treated a showing that a single plaintiff has standing as sufficient. *See, e.g.*, *Bowsher v. Synar*, 478 U.S. 714, 721 (1986); *Sec'y of the Interior v. California*, 464 U.S. 312, 319 n.3 (1984); *Belizan v. Hershon*, 495 F.3d 686, 689, 694 (D.C. Cir. 2007); *Nuclear Energy Inst., Inc. v. EPA*, 373 F.3d 1251, 1266 (D.C. Cir.

2004); *cf. Pub. Citizen, Inc. v. Nat'l Highway Traffic Safety Admin.*, 489 F.3d 1279, 1286, 1297 (D.C. Cir. 2007) (declining to dismiss case after holding that one group of plaintiffs in consolidated case lacked standing). The Court, accordingly, concludes that it has jurisdiction and need not evaluate standing on a plaintiff-by-plaintiff basis.

B. October 24, 2017 Interim Final Rule

Plaintiffs' challenge to the Interim Final Rule delaying the effective date of the Borrower Defense Regulations also poses a threshold, jurisdictional issue—this time, mootness. All agree that the Interim Final Rule delayed the effective date of the Borrower Defense Regulations until July 1, 2018, and that July 1, 2018 has now passed. The question, then, is whether this portion of Plaintiffs' challenge still presents an "actual, ongoing controvers[y]" sufficient to sustain Article III jurisdiction. *United Bhd. of Carpenters & Joiners of Am., AFL-CIO v. Operative Plasterers' & Cement Masons' Int'l Ass'n of U.S. & Can., AFL-CIO*, 721 F.3d 678, 687 (D.C. Cir. 2013) (quoting *McBryde v. Comm. to Review Circuit Council Conduct*, 264 F.3d 52, 55 (D.C. Cir. 2001)). Federal courts must ensure not only that they have Article III jurisdiction at the outset of a case, but also that the parties' dispute—or "controversy"—remains live "at all stages of review." *Id.* (quoting *Steffel v. Thompson*, 415 U.S. 452, 459 n.10 (1974)).

When confronted with similar circumstances, the D.C. Circuit and this Court have typically dismissed challenges to regulatory actions as moot once those actions have expired or have been overtaken by other regulatory actions. *See Fund for Animals, Inc. v. U.S. Bureau of Land Mgmt.*, 460 F.3d 13, 18 (D.C. Cir. 2006) (finding challenge to expired "guidance and policy" moot); *Fund for Animals, Inc. v. Hogan*, 428 F.3d 1059, 1064 (D.C. Cir. 2005) (holding challenge to 2001 environmental assessment and the regulations based upon it moot because they "are no longer in effect"); *In re Bluewater Network*, 234 F.3d 1305, 1314 (D.C. Cir. 2000) ("Petitioners do not here challenge the 1997 temporary regulations, either for what they did or

did not do; those regulations have expired. Whatever issues could have been raised regarding their legality are moot."); *Fund for Animals v. Norton*, 512 F. Supp. 2d 49, 52–53 (D.D.C. 2007) ("A challenge to agency regulations becomes moot once those regulations expire."). To take just one example, in *People for the Ethical Treatment of Animals, Inc. v. U.S. Fish and Wildlife Service*, 59 F. Supp. 3d 91, 95 (D.D.C. 2014), the district court held that the plaintiff's challenge to fifteen Fish and Wildlife Service permits was "clearly moot," because "[t]he permits . . . [had] already expired" and, thus, "there [was] no point in this Court issuing an injunction prohibiting" their extension.

This is, in many respects, a similar case. Vacatur of a delay rule that, by its own terms, no longer purports to affect the rights or obligations of the parties would be pointless. It would also be pointless to issue a declaratory judgment that the procedures used to adopt that interim rule were unlawful, both because the Department's justification for the particular procedures employed in promulgating the Interim Final Rule was premised on the specific factual circumstances at the time of the rule's adoption and because the agency actions now preventing the implementation of the Borrower Defense Regulations were adopted pursuant to different procedures. *Compare* Interim Final Rule, 82 Fed. Reg. at 49,117 (describing promulgation of interim final rule without notice and comment or negotiated rulemaking), *with* Final Delay Rule, 83 Fed. Reg. at 6,459 (describing promulgation of final rule after notice and comment but without negotiated rulemaking), *and* Section 705 Stay, 82 Fed. Reg. at 27,621–22 (describing adoption of final rule pursuant to § 705 of the APA).

But Plaintiffs' challenge to the Interim Final Rule does present one question with continuing consequences for Plaintiffs: Plaintiffs seek a declaratory judgment that the Department's interpretation of the Master Calendar Provision—the primary basis for the Interim

Final Rule—was unlawful. Significantly, that interpretation was not limited to the Interim Final Rule; rather, the Department relied upon that interpretation of the Master Calendar Provision in the October 24, 2017 NPRM it issued that same day, and in the Final Delay Rule, which the Department issued in February 2018. In short, although announced in a rule that has now expired, the Department's interpretation of the Master Calendar Provision has carried through to a regulation that remains operative today and that is causing Plaintiffs a cognizable injury. Under these circumstances, Plaintiffs' challenge to that limited aspect of the Interim Final Rule presents a live controversy. *See Safari Club Int'l v. Jewell*, 842 F.3d 1280, 1287 (D.C. Cir. 2016) ("It is well-established that if a plaintiff challenges both a specific agency action and the policy that underlies that action . . . the challenge to the policy is not necessarily mooted merely because the challenge to the particular agency action is moot." (quoting *City of Houston, Tex. v. Dep't of Hous. and Urban Dev.*, 24 F.3d 1421, 1428 (D.C. Cir. 1994)).

That remaining live issue turns on the meaning of the HEA's Master Calendar Provision, which provides, in relevant part:

> Except as provided in paragraph (2), any regulatory changes initiated by the Secretary affecting the programs under [Title IV of the HEA] that have not been published in final form by November 1 prior to the start of the award year [i.e., July 1] shall not become effective until the beginning of the second award year after such November 1 date.

20 U.S.C. § 1089(c)(1). According to the Interim Final Rule—and as subsequently reflected in the October 24, 2017 NPRM and Final Delay Rule—two conclusions necessarily follow from this language: First, "a regulatory change" must be "published in final form on or before November 1" in order to take effect at the start of the next award year. Interim Final Rule, 82 Fed. Reg. at 49,115; Final Delay Rule, 83 Fed. Reg. at 6,459. Second, a "regulatory change . . . may take effect *only at the beginning* of the next award year," that is, "July 1 of the

next year." Interim Final Rule, 82 Fed. Reg. at 49,115–16 (emphasis added); Final Delay Rule, 83 Fed. Reg. at 6,459 (same). According to the Department, this means that, except in certain cases of voluntary compliance, *see* 20 U.S.C. § 1089(c)(2)(B), a regulatory change affecting a Title IV program may take effect *only* on July 1—if that date passes, the Department must wait until the next July 1 before the regulation may go into effect. Dkt. 58-1 at 68–73. These conclusions, moreover, are, according to the Department, compelled by the statute. *Id.* Indeed, it was because the Department concluded that the Borrower Defense Regulations could go into effect only on July 1, 2018—or July 1 of a subsequent year—that it found good cause to waive the notice and comment and negotiated rulemaking requirements for the Interim Final Rule. *See* Interim Final Rule, 82 Fed. Reg. at 49,117.

Although one can imagine considerable debate about the meaning of "a regulatory change" for purposes of the first of these conclusions,[9] at least for present purposes, Plaintiffs agree that the HEA mandates that a regulation must be published on or before November 1 to become effective on or after the following July 1. They take issue, however, with the Department's second conclusion. In their view, "[t]he plain meaning of" the Master Calendar Provision "is unambiguous," and it does not by any stretch require that all Title IV regulations take effect *on* July 1. Dkt. 55-1 at 46. Rather, they read the statute to preclude a new regulation from taking effect *before* July 1 of the following year, but to say nothing about when the regulation may take effect *after* that date. The Court agrees with Plaintiffs' reading of the statute.

[9] To take one example, which is discussed further below, the Department seems to take the view that the change of the effective date of a Title IV rule, although typically subject to notice and comment rulemaking, is not "a regulatory change" for purposes of the Master Calendar Provision.

The Court "begin[s], as usual, with the statutory text." *Maslenjak v. United States*, 137 S. Ct. 1918, 1924 (2017). Here, the text of the Master Calendar Provision compels the Court to conclude that "until" means exactly what Plaintiffs say it means—that is, "up to" or "before" a specified time, *see* 19 Oxford English Dictionary 234 (2d ed. 1989), and not, as Defendants suggest, "only at" that time, *see* Dkt. 59-1 at 39. As used in the Master Calendar Provision, "until" is a preposition and thus "indicate[s] continuance . . . of an action or condition . . . to a specified time." Merriam Webster's Collegiate Dictionary 1297 (10th ed. 1996). Thus, a shopkeeper might say, "we don't open until ten" or the new widgets are "not available until tomorrow." *Id.* Nothing in either of these examples conveys a definite point in time; a customer arriving at eleven, for example, would reasonably expect to find the store open. More generally, when used as a preposition, there is no "common usage[] of the word 'until' that [is] synonymous with the word 'on,' meaning . . . the day of an occurrence."[10] *See Claude E. Atkins Enters., Inc. v. United States*, 27 Fed. Cl. 142, 144 n.4 (1992).

The Department's arguments to the contrary are unpersuasive. The Department contends that the title of the Master Calendar Provision—"Delay of effective date of late publications," 20 U.S.C. § 1089(c)—"confirms that there is only one 'effective date' during the year" for all new regulations. Dkt. 59-1 at 52–53. As a threshold matter, this argument runs headlong into the Supreme Court's admonition that section headings "cannot limit the plain meaning of [the] statutory text." *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883, 893 (2018). But, even putting that aside, the argument has little force. The Department reads too much into

[10] When used as a conjunction, there are times when the word "until" at least comes closer to specifying a particular point in time—*e.g.*, "the game continued until it got dark," Webster's Third New International Dictionary 2513 (1993)—but, even then, the word means "up to the time that," *id.*, not "only on, and not after." In any event, "until" is used as a preposition, not as a conjunction, in the Master Calendar Provision.

Congress's use of the singular form: "effective date." It is plain that, in the context of the title, "effective date" does not reference a specific day—July 1—but rather, the date on which a new rule is to come into effect. In other words, the title simply indicates that whatever "effective date" the Department might have otherwise planned must be "delay[ed]" if the regulatory change is published "late." 20 U.S.C. § 1089(c).

The Department also purports to find textual ambiguity "in the statute's inclusion of both the word 'until,' . . . and the phrase 'beginning of the [award year].'" Dkt. 58-1 at 68. According to the Department, "Plaintiffs' interpretation [of the Master Calendar Provision] renders the words 'beginning of the' superfluous," and thus—at a minimum—gives rise to a statutory ambiguity. *Id.* Once again, the Court is unconvinced. Rather than creating ambiguity, the reference to the "beginning of the" award year adds clarity. Just as it is clearer to say, "I will not arrive until the beginning of July" than it is to say, "I will not arrive until July," it adds clarity to refer to the "beginning of" the award year. To be sure, most readers could probably figure out what Congress meant without this added clause, but that is not the test for superfluity. And even if the Department was right, the canon against surplusage, like reliance on section headings, cannot overcome clear statutory text. *See Great Lakes Comnet, Inc. v. FCC*, 823 F.3d 998, 1003 (D.C. Cir. 2016).

Nor is the Court persuaded by the Department's invocation of the "legislative history of the HEA" and its "longstanding policy and practice." Dkt. 58-1 at 69, 71. To start, neither the legislative history nor the Department's administrative practice can change the plain terms of the statute. *See Owens v. BNP Paribas, S.A.*, 897 F.3d 266, 279 (D.C. Cir. 2018) (noting that legislative history "may not be used to show an 'intent' at variance with the meaning of the text" (quoting *Matter of Sinclair*, 870 F.2d 1340, 1344 (7th Cir. 1989)); *Exportal Ltda v. United*

States, 902 F.2d 45, 50 (D.C. Cir. 1990) ("[T]he plain meaning doctrine is an interpretive norm essential to perfecting the scheme of administrative governance established by the APA."). But, in any event, nothing in the legislative history of the HEA actually supports the Department's contention that Congress set a specific day of the year on which all new Title IV regulations must take effect. To the contrary, the legislative history merely confirms that the Master Calendar Provision "drive[s]" "the effective dates of all regulations on Title IV," H.R. Rep. No. 102-447, at 77 (1992), "in order to assure adequate notification and timely delivery of student aid funds," S. Rep. No. 99-296, at 11 (1986).

The Department's description of its longstanding practice is also unhelpful. The Department, admittedly, has a history of setting effective dates on July 1. But that history does not show that the July 1 date is *required by statute*; rather, it merely shows that the Department has —for pragmatic or other reasons—used that date in the past. The one example that the Department offers to counter this understanding is unconvincing. *See* Dkt. 59-1 at 63. In that case, the Department declined to extend the comment period for final regulations combatting "troubling practices" in the "student financial products marketplace." Program Integrity and Improvement, 80 Fed. Reg. 67,126, 67,126 (Oct. 30, 2015). The Department chose to publish the final regulations on October 30, 2015, explaining that had it "extended the comment period beyond 45 days, [it] would have been unable to comply with" the November 1 deadline of "the [M]aster [C]alendar [P]rovision." *Id.* at 67,131. This, in turn, would have delayed the effective date of the regulations for one year—to July 1, 2017—thus allowing "the abuses" the Department had identified in support of the reforms "to persist an additional year." *Id.* Reading the Department's words in context, there is no indication that it contemplated July 1 as the only permissible effective date for all new regulations. Instead, the Department's explanation merely

invokes the noncontroversial proposition that the Master Calendar Provision precludes Title IV rules finalized *after* November 1 from taking effect before July 1 of the following year; that is why the Department felt compelled to issue the final rule on October 30 (before November 1), rather than extending the comment period for 45 days (after November 1).

Finally, the Department's claim that its interpretation is entitled to *Chevron* deference fails for two reasons. First, agency interpretations are not entitled to deference where the "intent of Congress is clear." *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984); *see also Arizona v. Thompson*, 281 F.3d 248, 254 (D.C. Cir. 2002). Here, the plain meaning of the Master Calendar Provision is unambiguous: regulations published after November 1 cannot take effect *before* July 1 of the following year. The statute imposes no limits on when the regulation can take effect *after* that date. Second, an agency is entitled to deference only when the agency believes that it is exercising some form of administrative discretion. Here, however, the Department believed that its hands were tied.[11] In the Interim Final Rule, Notice of Proposed Rulemaking for the Final Delay Rule, and the Final Delay Rule, the Department repeatedly explained that the Master Calendar Provision compelled it to set July 1—and only July 1—as the effective date for all regulations. *See, e.g.*, Interim Final Rule, 82 Fed. Reg. at 49,115–16 ("Under the master calendar requirement, a regulatory change . . . may take effect only . . . on July 1."); *id.* at 49,116 ("For the July 1, 2017, postponement to be *consistent with the HEA*, . . . the effective date *must* be July 1, 2018 (or July 1 of a later year)." (emphasis added));

[11] That the Department now contends the Master Calendar Provision is ambiguous, Dkt. 59-1 at 51–52, is irrelevant. What matters for present purposes is the explanation the Department gave during the regulatory process. *See FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 563 (2009); *SEC v. Chenery Corp.*, 332 U.S. 194, 196–97 (1947). That explanation had nothing to do with the Department's efforts to fill a statutory gap or to exercise its own judgment.

see also October 24, 2017 NPRM, 82 Fed. Reg. at 49,156–57 ("Under the master calendar requirement, a regulatory change . . . may take effect only . . . on July 1."); Final Delay Rule, 83 Fed. Reg. at 6,459 (same). As the D.C. Circuit has explained, this is precisely the circumstance where "deference to an agency's interpretation of a statute is not appropriate"—that is, "when the agency wrongly believes that interpretation is compelled by Congress." *Peter Pan Bus Lines, Inc. v. Fed. Motor Carrier Safety Admin.*, 471 F.3d 1350, 1354 (D.C. Cir. 2006) (internal quotation marks omitted) (quoting *PDK Labs., Inc. v. DEA*, 362 F.3d 786, 798 (D.C. Cir. 2004)).

The Court, accordingly, concludes that the plain meaning of the HEA precludes the Department's reading of the Master Calendar Provision to require that all new regulations take effect on July 1. *See Chevron*, 467 U.S. at 842–43 ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."). The Department, of course, has broad discretion to make most, if not all, Title IV regulations effective on July 1 *as a matter of policy*—at least to the extent it offers a reasoned and considered basis for doing so. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). But, that is not what the Department did here, and the reading of the Master Calendar Provision that drove its decision is contrary to law.

C. February 14, 2018 Final Delay Rule

Plaintiffs raise both procedural and substantive challenges to the February 14, 2018 Final Delay Rule. Because the Court concludes that the Department improperly invoked the good cause exception to the HEA's requirement for negotiated rulemaking, there is no need to reach Plaintiffs' substantive challenges.

All agree that the Department's Final Delay Rule was subject to the HEA's negotiated rulemaking requirement unless the Department established "good cause" for waiving the

requirement in its October 24, 2017 NPRM. *See* 82 Fed. Reg. at 49,157. In the words of the HEA:

> All regulations pertaining to [Title IV of the HEA] . . . shall be subject to a negotiated rulemaking (including the selection of the issues to be negotiated), unless the Secretary determines that applying such a requirement with respect to given regulations is impracticable, unnecessary, or contrary to the public interest (within the meaning of section 553(b)(3)(B) of Title 5) and publishes the basis for such determination in the Federal Register at the same time as the proposed regulations in question are first published.

20 U.S.C. § 1098a(b)(2). Citing to this requirement, the Department concluded that it had good cause to waive negotiated rulemaking for the Final Delay Rule because "it would not be practicable, before [the then-operative] July 1, 2018 effective date" of the Borrower Defense Regulations to "engage in negotiated rulemaking and publish final regulations." October 24, 2017 NPRM, 82 Fed. Reg. at 49,157. In Plaintiffs' view, the Department's "cursory statement" failed to establish good cause within the meaning of the HEA. The Court agrees.

In determining whether good cause exists to dispense with negotiated rulemaking under the HEA, the Department is required to apply the same legal standard that applies to waiving the notice and comment requirement under the APA. To be sure, as the Department argues, the application of that standard may yield different results under the APA than under the HEA because negotiated rulemaking is more time consuming than notice and comment. *See* Dkt. 58-1 at 61. But, in both cases, the standard itself—whether "good cause" exists to find that compliance with the usual process is "impracticable, unnecessary, or contrary to the public interest," 5 U.S.C. § 553(b)(3); 20 U.S.C. § 1098a(b)(2)—is identical, and, indeed, the HEA expressly incorporates the APA standard, *id.* The Court, accordingly, must be guided by the substantial body of case law interpreting the APA's good cause exception to the notice and comment requirement.

The D.C. Circuit has repeatedly observed that "the good cause exception" to the APA "is to be narrowly construed and only reluctantly countenanced." *Mack Trucks, Inc. v. EPA*, 682 F.3d 87, 93 (D.C. Cir. 2012) (quoting *Util. Solid Waste Activities Grp. v. EPA*, 236 F.3d 749, 754 (D.C. Cir. 2001)). That standard is "meticulous and demanding." *N.J. Dep't of Envtl. Prot. v. EPA*, 626 F.2d 1038, 1046 (D.C. Cir. 1980). The exemption excuses agencies from the notice and comment requirement—and, by extension, excuses the Department from the negotiated rulemaking requirement for Title IV regulations—only "in emergency situations, or where delay could result in serious harm." *Jifry v. FAA*, 370 F.3d 1174, 1179 (D.C. Cir. 2004) (internal citation omitted). And the otherwise applicable procedures are "[i]mpracticable" only if "the due and required execution of the agency functions would be unavoidably prevented by its undertaking public rule-making proceedings" or negotiated rulemaking. *N.J. Dep't of Envtl. Prot.*, 626 F.2d at 1046 (quoting S. Doc. No. 248, at 200 (1946)); *see also United States v. Cotton*, 760 F. Supp. 2d 116, 129 (D.D.C. 2011) (same). The Court's review of the "agency's legal conclusion of good cause is de novo," although the Court defers to the agency's "factual findings and expert judgments therefrom, unless such findings and judgments are arbitrary and capricious." *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 706 & n.3 (D.C. Cir. 2014).

The Department's invocation of the good cause exception to the negotiated rulemaking requirement did not come close to satisfying this demanding standard. As the HEA makes clear, and as the Department acknowledged in the October 24, 2017 NPRM, the waiver provision requires the Department to set forth "the basis for" its determination that good cause exists "at the same time" that that the "proposed regulations in question are first published." 82 Fed. Reg. at 49,157 (citing 20 U.S.C. § 1098a(b)(2)). Yet, when the Department published the October 24,

2017 NPRM, it said almost nothing about the basis for its decision to waive the negotiated rulemaking requirement. The Department wrote:

> For the reasons stated above, it would not be practicable, before the July 1, 2018 effective date specified in the [Interim Final Rule], to engage in negotiated rulemaking and publish final regulations. There is, therefore, good cause to waive negotiated rulemaking pertaining to this delay.

82 Fed. Reg. at 49,157. The "reasons stated above," moreover, shed little light on why the Department would have been "unavoidably prevented" from performing its functions had it complied with the negotiated rulemaking process, *N.J. Dep't of Envtl. Prot.*, 626 F.2d at 1046, or what "emergency situation[]" or risk of "serious harm" required the Department to dispense with the required process, *Jifry*, 370 F.3d at 1179. To the contrary, all that precedes the Department's waiver discussion is a discussion of the Master Calendar Provision and the timeline for completing the negotiated rulemaking process for reconsidering the Borrower Defense Regulations. The Department wrote:

> Given that the first negotiated rulemaking session is scheduled for November 13–15, 2017, we cannot complete the negotiated rulemaking process and the development of revised regulations by November 1, 201[7].[12] Under the master calendar, a regulatory change that has been published in final form on or before November 1 prior to the start of an award year—which begins on July 1 of any given year—may take effect only at the beginning of the next award year, or in other words, on July 1 of the next year. In light of this requirement, the regulations resulting from negotiated rulemaking could not be effective before July 1, 2019.

Id. at 49,156. Even liberally construed, this explanation for waiving the negotiated rulemaking requirement fails on multiple levels.

[12] The agency's notice states "November 1, 2018." October 24, 2017 NPRM, 82 Fed. Reg. at 49,156. In context, this is plainly a typographical error, and the notice meant to refer to November 1, 2017. If it were true that the agency could not complete negotiated rulemaking by November 1, 2018, then July 1, 2020 would be the first possible day the resulting regulations could be effective. *See* 20 U.S.C. § 1089(c)(1).

First, the October 24, 2017 NPRM addressed the wrong regulatory action for purposes of waiving the negotiated rulemaking requirement. The HEA, unsurprisingly, requires the Department to state in the relevant notice of proposed rulemaking why it cannot practicably comply with the negotiated rulemaking requirement *"with respect to" that rulemaking*. 20 U.S.C. § 1098a(b)(2). The Department's October 24, 2017 NPRM, however, said nothing about whether it had sufficient time to comply with the negotiated rulemaking requirement "with respect to" the Final Delay Rule. To the contrary, the *only* discussion addressed the time the Department needed to finalize its revisions, if any, to the Borrower Defense Regulations. *See* October 24, 2017 NPRM, 82 Fed. Reg. at 49,156. Because the October 24, 2017 NPRM said nothing about whether it could have conducted a negotiated rulemaking "with respect to" the delay rule, it failed to satisfy the waiver requirement.

The Department confronts this problem in its briefing before this Court and attempts to find an implicit finding of "good cause" to dispense with the negotiated rulemaking requirement. The Department asserts: "It would make little sense . . . to subject the rule delaying" the Borrower Defense Regulations "to the same negotiated procedures that created, at least in part, the need for" the delay rule "in the first place." Dkt. 58-1 at 62. That contention, however, fails to account for the Department's unstated assumption that the Master Calendar Provision applies to the ongoing rulemaking regarding the Borrower Defense Regulations but does not apply to the delay rules. Without that assumption, the Final Delay Rule would be meaningless because it was finalized on February 14, 2018, and thus, under the Master Calendar Provision, could not have taken effect before July 1, 2019, the date that rule was due to expire. It is only by assuming that the Master Calendar Provision does not apply to delay rules that the Department can avoid this fate. Yet, once it takes that step, it can no longer draw even an implicit comparison between the

discussion of the timeline for completing the substantive revisions to the Borrower Defense Regulations, which the Department discussed in the October 24, 2017 NPRM, and the timeline for completing the delay rule, which it did not.

Second, the October 24, 2017 NPRM did not identify any "emergency" or "serious harm" that would result absent a waiver. *Jifry*, 370 F.3d at 1179. Although the relevant "inquiry . . . 'is inevitably fact- or context-dependent,'" the D.C. Circuit has found good cause, by way of example, when "air travel security agencies" would have otherwise been "unable to address threats posing 'a possible imminent hazard to aircraft, persons, and property within the United States,'" or when "a rule . . . of 'life-saving importance' to mine workers in the event of a mine explosion" was at stake. *Mack Trucks, Inc*., 682 F.3d at 93 (citations omitted). Here, in contrast, the Department merely stated, without elaboration, that the purpose of the Final Delay Rule was to maintain the "status quo" while it "conduct[ed] [a] negotiated rulemaking and, as necessary, develop[ed] revised regulations." October 24, 2017 NPRM, 82 Fed. Reg. at 49,155–56. That is *all* the NPRM said, and, by any measure, that bare assertion provided insufficient cause to waive the negotiated rulemaking requirement. Indeed, if that was sufficient, it is difficult to imagine a circumstance in which an agency would be required to comply with the requirements of notice and comment and, where applicable, negotiated rulemaking, to delay the effective date of a regulation.

Nor can the Department's subsequent efforts to supplement the October 24, 2017 NPRM save the rule. Each of these efforts fails either because the required findings were not included in the proposed delay rule, as required by the HEA, 20 U.S.C. § 1098a(b)(2), or because they constituted *post hoc* justifications that appeared nowhere in the administrative record, *Chenery*, 332 U.S. at 196–97; *see also Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of*

Snohomish Cty., Wash., 554 U.S. 527, 568 (2008). In the Final Delay Rule—but not in the October 24, 2017 NPRM—for example, the Department asserted that it "typically takes . . . over 12 months to complete" a negotiated rulemaking and concluded that "it would not have been feasible" to complete that process in a timely manner, "even if the Department had [begun] on May 24, 2017, when it learned of the CAPPS litigation." Final Delay Rule, 83 Fed. Reg. at 6,494. By the time of briefing in this Court, however, the Department apparently recognized that it might, in fact, have been possible to conduct a negotiated rulemaking on the sole issue of delay in the 13 months between May 24, 2017 and July 1, 2018. It thus, once again, amended its theory of good cause, arguing that the Final Delay Rule "needed to be published well in advance of the culmination of the (still ongoing) process to revise the borrower defense regulations, as well as in advance of the July 1, 2018 date on which the [Borrower Defense Regulations] would otherwise [have] become effective." Dkt. 58-1 at 63; *cf.* Title I—Improving the Academic Achievement of the Disadvantaged—Academic Assessments, 81 Fed. Reg. 88,886 (Dec. 8, 2016) (DOE conducted negotiated rulemaking under 20 U.S.C. § 6571 in approximately 10 months). None of that analysis, however, appeared anywhere in the October 24, 2017 NPRM, and thus both theories—the "over 12 month" theory and the "well in advance" theory—lie outside the bounds of proper consideration. *See* 20 U.S.C. § 1098a(b)(2); *Am.'s Cmty. Bankers v. FDIC*, 200 F.3d 822, 835 (D.C. Cir. 2000).

The Department also posited in the Final Delay Rule that regulated parties should not have to bear the costs of complying with the Borrower Defense Regulations when those regulations might be rescinded or "changed a short while later." Final Delay Rule, 83 Fed. Reg. at 6,461. That rationale is—once again—too little, too late. It is too late for the reasons explained above. And it is too little because it is at odds with the circuit's "longstanding position

that the [good cause] exception should be 'narrowly construed and only reluctantly countenanced.'" *Mack Trucks, Inc*., 682 F.3d at 94 (quoting *Util. Solid Waste*, 236 F.3d at 754). To be sure, regulatory uncertainty that "imperil[s]" "an entire industry and its customers," *id* at 93–94 (citing *Am. Fed'n of Gov't Emps., AFL-CIO v. Block*, 655 F.2d 1153, 1157 (D.C. Cir. 1981)), or that would cause "serious harm" to the regulated parties or the public, *Jifry*, 370 F.3d at 1179, can support a waiver. Here, however, the Department has not specified any regulatory vacuum that would exist without the Final Delay Rule and has not identified any "serious harm"—only potentially unnecessary administrative costs—that the regulated parties would suffer if the Borrower Defense Regulations were permitted to take effect.

The Final Delay Rule did identify at least one actual cost, albeit in discussing the merits of the delay rule rather than the good cause exception. Specifically, the Final Delay Rule asserted: "[t]he Department thinks it is likely that the arbitration and class action waiver provision will be overturned" in the *CAPPS* litigation and that allowing that provision to take effect would sow "significant confusion [among] borrowers and schools who may have engaged in court litigation on the basis of the prohibitions as to the enforceability of those agreements." Final Delay Rule, 83 Fed. Reg. at 6,462. Allowing that provision to take effect, the Final Delay Rule added, would also require institutions to "change their policies and procedures[,] . . . amend their enrollment agreements," re-train staff, and send "notices to borrowers informing them of the changed class action waivers and pre-dispute arbitration provisions," only to "repeat or reverse these steps" in the "likely" event that the provision is rescinded or struck down. *Id.* But, even if the Court were to read this discussion as directed at the good cause requirement, and even had the Department raised it in the October 24, 2017 NPRM, as it was required to do, it would not suffice. The problem with the rationale, as discussed further below, *see infra* at 54–55, is

that it is both unexplained and directly at odds with the determination that the Department made when it finalized the Borrower Defense Regulations that the arbitration and class action rules are lawful and that the "case law gives strong support for the position that the Department has authority to impose limits of [this] kind . . . ." Borrower Defense Regulations, 81 Fed. Reg. at 76,023. The Department is, of course, entitled to change its conclusion on that question, but it cannot do so without acknowledging its prior conclusion or offering *any* explanation for its fundamental change in course. *See Fox Television Stations, Inc*., 556 U.S. at 515.

Without that example of an actual cost the Department arguably avoided by dispensing with the negotiated rulemaking requirement, the Department did little more than pay lip service to the good cause requirement. It merely asserted that allowing a rule to take effect, only to change the rule a year or so later, would "lead to a great deal of confusion and difficulty for borrowers and schools alike." Final Delay Rule, 83 Fed. Reg. at 6,464. Like the government's similar conclusion in *National Venture Capital Ass'n v. Duke*, 291 F. Supp. 3d 5 (D.D.C. 2017), adopting such an expansive view of good cause "'would swallow the rule,' as an agency could always argue that any given regulation provides clarification or guidance." *Id.* at 19 (citation omitted).

The Court, accordingly, concludes that the Final Delay Rule was procedurally defective because it improperly invoked the good cause exception to the HEA's negotiated rulemaking requirement.

D. Section 705 Stay

Plaintiffs also challenge the Department's invocation of 5 U.S.C. § 705 to stay the Borrower Defense Regulations pending the resolution of the *CAPPS* litigation. This challenge raises three distinct questions. First, is an agency's decision to stay the effective date of a rule

pursuant to § 705 subject to judicial review? Second, if so, what standard applies? Third, did the Department satisfy that standard?

1. *Reviewability*

The Department first argues that judicial review of its Section 705 Stay "is unavailable because" § 705 "commits to agency discretion the decision to postpone an effective date pending judicial review." Dkt. 58-1 at 28–32. The Department is correct that, when a "statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion," the agency's action taken pursuant to that statute is unreviewable. *Chaney*, 470 U.S. 821, 830 (1985). It is incorrect, however, that § 705 is such a provision.

The APA permits aggrieved parties to seek judicial review of final agency actions for which there is no other adequate judicial remedy. *Chaney*, 470 U.S. at 828. That waiver of sovereign immunity and cause of action, however, comes with a proviso: "before any review at all may be had, a party must first clear the hurdle of § 701(a)," which bars judicial review (1) if the applicable statute "preclude[s]" review, or (2) if the "agency action is committed to agency discretion by law." *Id.* (quoting 5 U.S.C. § 701(a)). An action is "committed to agency discretion" if "the [relevant] statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion." *Id.* at 830; *see also Citizens to Pres. Overton Park v. Volpe*, 401 U.S. 402, 410 (1971). In other words, if a statute fails to set a "meaningful standard," then there is no basis for a court to conclude that the challenged agency action was unlawful or an abuse of discretion. *Chaney*, 470 U.S. at 830. Except in cases involving enforcement decisions, allocation of lump sum appropriations, or other "categories of administrative decisions that courts traditionally have regarded as 'committed to agency discretion,'" *Lincoln v. Vigil*, 508 U.S. 182, 191 (1993), however, courts must apply a presumption in favor of judicial review and must treat § 701(a) as a "very narrow" proviso that

"applies only in 'rare instances,'" *Cody v. Cox*, 509 F.3d 606, 610 (D.C. Cir. 2007) (quoting *Citizens to Pres. Overton Park, Inc.*, 401 U.S. at 410).

In the Department's view, § 705 constitutes one of these "rare instances" for five reasons—four based on the text of § 705 and the fifth based on structure of the APA. The text of § 705 provides:

> When an agency finds that justice so requires, it may postpone the effective date of action taken by it, pending judicial review. On such conditions as may be required and to the extent necessary to prevent irreparable injury, the reviewing court, including the court to which a case may be taken on appeal from or on application for certiorari or other writ to a reviewing court, may issue all necessary and appropriate process to postpone the effective date of an agency action or to preserve status or rights pending conclusion of the review proceedings.

5 U.S.C. § 705. The Department finds a commitment of discretion, first, in the fact that the statute does not say that an agency may postpone an effective date "when justice so requires" but, rather, says that an agency may do so "when [the] *agency finds* that justice so requires." Dkt. 59-1 at 33 (emphasis added) (quoting 5 U.S.C. § 705). To this, it adds that the phrase "justice so requires" is "inherently flexible;" that § 705's use of the word "may" further confirms that Congress intended to commit stay decisions to agency discretion; and that the text distinguished between the judicially manageable standard that courts must apply—"to the extent necessary to prevent irreparable injury"—and the less definite standard applicable to agency decisions. Dkt. 59-1 at 34–35, 42–43. In support of these textual arguments, the Department relies on the Supreme Court's decision in *Webster v. Doe*, 486 U.S. 592 (1988). There, the Court held that a statute that allows the Director of the CIA to terminate CIA employees whenever the Director "shall *deem* such termination necessary or advisable in the interests of the United States" commits those discharge decisions to the Director's discretion. *Id.* at 600. Finally, relying on the APA's structure, the Department argues that, because § 705 appears in a

standalone provision of the APA, which "is entirely separate from Section 704 . . . ('[a]ctions reviewable')," it is appropriate to infer that Congress intended to make § 705 determinations "unreviewable." Dkt. 59-1 at 36 n.3.

Most of the Department's textual arguments are foreclosed by the D.C. Circuit's decision in *Dickson v. Secretary of Defense*, 68 F.3d 1396 (D.C. Cir. 1995). That case involved a statute that allowed former servicemembers to request that the Army correct "errors or injustices in their military records." *Id.* at 1399. Of relevance here, the statute set a limitations period to request such a correction, but further provided that the Army Board for Correction of Military Records ("Board") "*may* excuse a failure to file within [that period] *if it finds it to be in the interest of justice*." *Id.* (emphasis added) (quoting 10 U.S.C. § 1552(b)). Relying on this language, the district court dismissed the plaintiffs' petition for review of the Board's refusal to grant a waiver on the ground that the decision was committed to the Board's discretion and, as a result, was unreviewable. *Id.* at 1398. On appeal, the D.C. Circuit reversed, and, in the course of doing so, it rejected most of the same arguments that the Department makes here.

First, the Court of Appeals rejected the government's contention that Congress's use of the word "may"—as opposed to "shall"—signaled an intent to commit the relevant action to the agency's discretion. *Id.* at 1401. Although the Court acknowledged that the word "may" conveys an intent "to confer some discretion on the agency," it disagreed that "such language" means that "the matter is *committed* exclusively to agency discretion." *Id.* The same holds true here; indeed, under both statutes, the agency may act only if it finds that the interest of justice standard is satisfied.

The *Dickson* decision also undermines the Department's reliance on the "agency finds" and "justice so requires" language in § 705. Again, the language at issue in *Dickson*—if the

Board "finds it to be in the interest of justice"—parallels the language at issue here. *Id*. at 1402. And, again, the D.C. Circuit disagreed with the government's contention that the relevant language committed "the matter solely to agency discretion." *Id.* In reaching that conclusion, moreover, the Court of Appeals rejected the same expansive reading of *Webster* that the Department presses here. The Court found support for its conclusion in *Kreis v. Secretary of the Air Force*, 866 F.2d 1508, 1513 (D.C. Cir. 1989), a case decided the year after *Webster*. There, the Court of Appeals held that the district court was entitled to review the adequacy of the Secretary of the Air Force's explanation for denying appellant's request for a retroactive promotion. *Id.* at 1512. In *Dickson* and in *Kreis*, as in this case, the government argued that *Webster* stands for the broad proposition that a grant of authority to take an action if the agency "finds" or "deems" that action "in the interest of justice" or "in the interests of the United States" is sufficient to commit the relevant action to the discretion of the agency. *Dickson*, 68 F.3d at 1403; *Kreis*, 866 F.2d at 1508. And, in both *Dickson* and *Kreis*, the D.C. Circuit disagreed. *Id.* As the Court of Appeals explained in *Dickson*, that contention ignores the "context in which the statutory mandate [at issue in *Webster*] operated," *Dickson*, 68 F.3d at 1403 (citation omitted), and, as it stressed in *Kreis*, *Webster* involved a national security "determination particularly unsuited to judicial assessment," *Kreis*, 866 F.2d at 1514. In short, outside of the context of national security or a similar context that raises doubts about judicial competence, *Webster* lacks the broad meaning that the Department urges.

The Department's remaining arguments fare no better. Pressing its final textual argument, the Department observes that § 705 describes the standard applicable to judicial stays in different terms and argues that, by distinguishing "between agency action and court action," Congress "commit[ed] each exclusively to the province of the entity taking action." Dkt. 58-1 at

31. But the Department offers no explanation for why the difference in language—short of the reasons rejected above—shows that Congress intended to commit the decision whether to grant a stay "exclusively to the province of" the agency or the court. Nor does the fact that Congress provided both agencies and courts with the authority to stay regulations pending judicial review support the Department's view. To the contrary, as the D.C. Circuit concluded in rejecting a similar argument regarding the Clean Air Act, "[g]iven that Congress granted [courts] the power to enter a stay, it seems quite anomalous that it did not also confer upon [courts] the lesser power to review the [agency's] decision to issue a stay." *Clean Air Council v. Pruitt*, 862 F.3d 1, 7 (D.C. Cir. 2017).

The Department's structural argument is also unpersuasive. The Department contends that because § 705 falls between §§ 704 and 706, which together delineate the scope and reach of judicial review, Congress intended a § 705 stay to be "a limited form of relief" that is itself immune from review. Dkt. 74 at 12. But the Department never explains why agency action taken pursuant to § 705 does not constitute "final agency action" subject to judicial review, *see* 5 U.S.C. § 704, and does not identify where Congress might have situated § 705 to avoid any implication that its placement was "intended to make the Section 705 stay . . . unreviewable." Dkt. 58-1 at 32 n.3. A far more persuasive structure argument, moreover, points in the opposite direction. As noted above, § 701(a) contains two exceptions to judicial review under the APA: the first exception, which is not applicable here, applies where a "statute[] preclude[s] judicial review," 5 U.S.C. § 701(a)(1), and the second exception, which the Department argues is controlling here, applies where "agency action is committed to agency discretion by law," *id.* § 701(a)(2). The first of these exceptions "seems easy in application" and merely requires courts "to determine whether Congress intended to preclude judicial review," while the second applies

"even where Congress has not affirmatively precluded review." *Chaney*, 470 U.S. at 828–30. It seems improbable, to say the least, that Congress intended to preclude judicial review of agency decisions under § 705 of the APA, but did so in the roundabout way of committing those decisions to agency discretion instead of merely saying that administrative stays are not subject to judicial review.

Any remaining doubt regarding the reviewability of administrative stay decisions is put to rest by the fact that, despite the Department's arguments to the contrary, a "judicially manageable standard[] [is] available for judging how and when an agency should exercise its discretion." *Chaney*, 470 U.S. at 830; *see also Robbins v. Reagan*, 780 F.2d 37, 45 (D.C. Cir. 1985) (per curiam) (holding that "the absence of clear statutory guidelines" does not preclude judicial review "unless the statutory scheme, taken together with other relevant materials, provides absolutely no guidance" as to how an agency is to exercise its discretion). Numerous judicial decisions have confirmed that review is "judicially manageable," *see Safety-Kleen Corp. v. EPA*, No. 92-1629, 1996 U.S. App. LEXIS 2324, at *2 (D.C. Cir. Jan. 19, 1996); *Becerra v. U.S. Dep't of Interior*, 276 F. Supp. 3d 953, 964 (N.D. Cal. 2017); *California v. U.S. Bureau of Land Mgmt*., 277 F. Supp. 3d 1106, 1122 (N.D. Cal. 2017); *Sierra Club v. Jackson*, 833 F. Supp. 2d 11, 34 (D.D.C. 2012), and, as discussed below, this Court can, in fact, discern the relevant standard. Review of § 705 stay decisions sit at the opposite end of the spectrum from the review of security clearances in *Webster*. While the Supreme Court noted in *Webster* that courts are unsuited for assessing risk in the national security context, *see* 486 U.S. at 601, there can be little doubt that courts are uniquely well-suited to determine whether equitable considerations warrant staying the implementation of existing regulations pending judicial review.

The Court, accordingly, concludes that § 705 stays are subject to judicial review.

2. *Standard for Invoking Section 705*

The next question is what standard an agency must apply in deciding whether to issue a stay pursuant to § 705? The parties agree that § 705 authorizes both "court[s]" and "agenc[ies]" to grant stays pending judicial review, *see* 5 U.S.C. § 705, and they agree (or at least do not dispute) that courts must apply the four-factor test used to evaluate requests for preliminary injunctive relief, *see Cuomo v. NRC*, 772 F.2d 972, 974 (D.C. Cir. 1985); *Sierra Club*, 833 F. Supp. 2d at 30; *Affinity Healthcare Servs., Inc. v. Sebelius*, 720 F. Supp. 2d 12, 15 n.4 (D.D.C. 2010). They disagree, however, about whether agencies must apply that same four-factor test.

Plaintiffs contend that the Department's failure to apply the preliminary injunction test constitutes a legal error that renders the Section 705 Stay arbitrary and capricious. Dkt. 55-1 at 37; Dkt. 56 at 36. According to Plaintiffs, the text of § 705, its legislative history, and this Court's precedent all support the conclusion that courts and agencies are bound to apply the same standard. Dkt. 55-1 at 31–37; Dkt. 56 at 36–41. The Department, on the other hand, argues that nothing found in the text of § 705, or in any source, requires that agencies apply the judicially fashioned four-part test. Dkt. 58-1 at 38–39. Rather, in the Department's view, § 705 authorizes agencies to issue a stay when "justice so requires," 5 U.S.C. § 705—"a broad, flexible standard conferring discretion to act," Dkt. 58-1 at 33. As explained below, the Court is unpersuaded by either extreme.

As an initial matter, the Court agrees with the Department that, absent good cause, courts must avoid "engrafting their own notions of proper procedures upon agencies." *Vt. Yankee Nuclear Power Corp. v. Nat. Res. Def. Council*, 435 U.S. 519, 525 (1978). Here, nothing in the text of § 705 provides sufficient cause to require that agencies apply the same four-factor test that courts apply. The statute uses different language to describe what an agency must find in order to issue a stay—"that justice so requires"—and to describe what a court must find—that

the stay is "necessary to prevent irreparable injury." 5 U.S.C. § 705. Moreover, not even every circuit applies precisely the same four-factor test; some, for example, apply a sliding scale, while others do not, and while still others have not resolved that question. *See Sherley v. Sebelius*, 644 F.3d 388, 392–93 (D.C. Cir. 2011) (noting a split between courts, like the Fourth Circuit, which read likelihood of success on the merits as "an independent, free-standing requirement for a preliminary injunction" and those, like the Second, Ninth, and Seventh Circuits, which follow a "sliding scale" approach); *id.* (noting that the D.C. Circuit has declined to weigh in on the split). Under these circumstances, it would be odd to suggest that administrative agencies are bound to apply a particular formulation of the test.

Likewise, neither the legislative history of § 705 nor other agencies' practices compels the conclusion that the judicially crafted four-factor test necessarily applies to administrative stay determinations. The Senate Report that Plaintiffs cite describes the purpose of § 705 as follows:

> This section [§ 705, formerly 5 U.S.C. § 1009(d)] permits either agencies or courts, if the proper showing be made, to maintain the status quo . . . . The authority granted is equitable and should be used by both agencies and courts to prevent irreparable injury or afford parties an adequate judicial remedy.

APA, Pub. L. 1944-46, S. Doc. No. 248, at 277 (1946). Although this language confirms that courts and agencies are granted the same "equitable" authority to "maintain the status quo," *id.*, it is far from clear that in exercising that authority, Congress intended courts and agencies to apply the same standard. Nor is the fact that other agencies have opted to apply the four-factor test when deciding whether to issue a stay under § 705 dispositive here. *Contra Sierra Club*, 833 F. Supp. 2d at 31 (holding that the agency's failure to apply the preliminary injunction test was arbitrary and capricious because "[the agency] . . . failed entirely . . . to justify its departure from its many prior precedents applying this four-part test"). Had the Department done so, it might

have been bound to follow its own prior practice or to have explained why a different approach was warranted. But that is not the case.

On the other hand, and despite the Department's arguments to the contrary, the text and legislative history of § 705 *do* provide the Court with a framework for reviewing whether an agency's determination that a stay is "require[d]" in the interests of "justice" was arbitrary and capricious. Section 705 does not permit the Department to make its own untethered assessment of what is "just." To begin, although the language differs in minor detail, the judicial and administrative authority to grant a stay is found in a single statutory provision that addresses a single topic—"relief pending review." 5 U.S.C. § 705. The relevant standard, moreover, does not differ in significant respects. The administrative determination that "justice . . . requires" issuance of a stay, *id.*, is the same type of determination that courts make when they decide whether to grant preliminary injunctive relief. The legislative history of § 705 makes just this point. It explains that "[t]he authority granted is equitable and should be used by both agencies and courts to prevent irreparable injury or afford parties an adequate judicial remedy." S. Doc. No. 248, at 277. As such, even though an agency need not apply the same canonical four-factor test that courts do, it must—given the statute's "equitable" mandate—weigh the same equities. This includes, but is not limited to, "balanc[ing] the competing claims of injury," "consider[ing] the effect on each party of . . . granting" the stay, and "pay[ing] particular regard for the public consequences." *Winter v. Nat. Res. Def. Council*, 555 U.S. 7, 24 (2008) (first quoting *Amoco Prod. Co. v. Vill. of Gambell, Alaska*, 480 U.S. 531, 542 (1987), then quoting *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 312 (1982)). At a minimum, an agency must provide a "reasoned explanation" that is sufficient to "enable . . . court[s] to evaluate," *Dickson*, 68 F.3d at 1404 (citation omitted), whether a stay was "require[d]," 5 U.S.C. § 705, to "afford parties an

adequate judicial remedy," S. Doc. No. 248, at 277—that is, to ensure that the prevailing party in the pending litigation would ultimately obtain meaningful relief.

Most significantly, the relevant equitable considerations are not free-floating but, rather, must be tied to the underlying litigation. Section 705 expressly provides that an agency may "postpone the effective date of [agency] action . . . *pending judicial review*." 5 U.S.C. § 705 (emphasis added). This requirement is best understood in light of the relationship between § 705 and the rest of the APA framework. For present purposes, both Plaintiffs and the Department agree that § 705, at least in the usual course, does not require notice and comment (or negotiated) rulemaking. The question is, why not?

The answer lies in the purpose of a § 705 stay: unlike a rulemaking, which triggers notice and comment procedures, *see* 5 U.S.C. § 553(b), an administrative stay under § 705 is not intended to "formulat[e], amend[], or repeal[]" a rule, *id.* § 551(5), nor is the stay a "rule" "designed to implement, interpret, or prescribe law or policy," *id.* at § 551(4). Rather, just as when a court issues a stay, an agency stay under § 705 should be imposed for one—and only one—reason: to maintain the status quo in order to allow judicial review of the underlying regulation to proceed in a "just" manner. *See Sierra Club*, 833 F. Supp. 2d at 27–28. The Department, for its part, concedes as much, arguing that the Section 705 Stay in this case was "not a substantive rule" but, rather, was "purely [a] procedural device, employed for the specific purpose of temporarily postponing the effective date of agency action during the pendency of judicial review of that action." Dkt. 58-1 at 44. That is why the standard for an agency stay, like the four-part preliminary injunction test that courts apply, must be tethered to the litigation itself; to the extent the agency's action is intended to do more than preserve the status quo pending

judicial review, it would "prescribe law or policy," 5 U.S.C. § 551(4), and thus require notice and comment.

Finally, to justify a stay under § 705, an agency must do more than pay "lip service" to the pending litigation, *Sierra Club*, 833 F. Supp. 2d at 34, or merely assert, "without any specificity," that the litigation raises "serious questions concerning the validity of certain provisions of the [r]ule," *California v. Bureau of Land Mgmt*., 277 F. Supp. 3d at 1122 (citation omitted). Although the agency need not adhere to the specific contours of the four-factor preliminary injunction test, it must weigh the same kinds of equitable considerations that courts have long applied and must explain why, in light of the pending litigation, a stay is "require[d]" to ensure the parties will ultimately obtain an adequate and just judicial remedy. 5 U.S.C. § 705; S. Doc. No. 248, at 277.

3. *Substantive Defects*

Applying this standard, the Court concludes that the Department's invocation of § 705 was arbitrary and capricious. The Department offered three rationales: the *CAPPS* litigation raised "serious questions" about the validity of the Borrower Defense Regulations; the delay would not cause the government any significant harm; and the Department was, in any event, reconsidering the regulations. Section 705 Stay, 82 Fed. Reg. at 27,621. None of these reasons withstands APA scrutiny. As explained further below, the first rationale is mere boilerplate; it is unsupported by any analysis, and it is at odds with the Department's prior conclusion to the contrary. The second and third rationales also lack any meaningful analysis and, more importantly, are unrelated to the pending *CAPPS* case and are thus beyond the scope of the relevant § 705 considerations.

The Department first posited in the Section 705 Stay that the plaintiff in the *CAPPS* case "raised serious questions concerning the validity of certain provisions of the final regulations and

[has] identified substantial injuries that could result if the final regulations go into effect before those questions are resolved." *Id.* The Department then provided two examples in support of this conclusion. First, it asserted that "if the final regulations are not postponed, institutions . . . would be required, as of July 1, 2017, to modify their contracts in accordance with the arbitration and class action waiver regulations, which may be contrary to their interests." *Id.* "Postponing the final regulations," would, in the Department's view, allow schools to avoid that cost "while the regulation is subject to judicial review." *Id.* Second, it pointed out that, "if the final regulations are not postponed, institutions would be subject to financial responsibility trigger provisions that could impose substantial costs." *Id.*

The mere fact that parties would avoid the costs of complying with the existing regulations, however, is plainly insufficient to support a § 705 stay. As explained above, § 705 requires an agency to explain why, in light of the pending litigation, a stay is necessary to ensure that the parties ultimately obtain adequate and just relief. As a result, the Department's first rationale rises and falls based on the Department's reliance on the "legal uncertainty" that it contends is created by the "serious questions" *CAPPS* plaintiffs raise "concerning the validity of certain provisions" of the Borrower Defense regulations. *Id.* For the reasons explained below, that rationale fails.

As an initial matter, the Department failed to justify the scope of the Section 705 Stay. Although it covers twenty-two sections of the Borrower Defense Regulations, the Department never identifies whether a few, many, or all of these sections rest on legally questionable footing. The notion that the Department needed to stay the effective date of all twenty-two of these provisions—while exempting a handful of ministerial provisions—moreover, is difficult to square with the fact that CAPPS itself sought a preliminary injunction only with respect to the

arbitration and class action provision. Dkt. 6, *CAPPS*, Civ. No. 17-999. Although the Department was not required to apply the four-factor test that courts apply, it was required to apply something akin to it—some standard that ties the stay to ensuring that the outcome of the pending litigation affords the parties adequate and just relief and that balances the relevant equities. The Department, however, offers no explanation for why it was necessary to stay twenty-two sections of the final rule.

Moreover, the provisions of the Borrower Defense Regulations that the Department did identify are, at best, mentioned only in a perfunctory manner. The Department observed, in passing, that "if the final regulations are not postponed, institutions would be subject to financial responsibility trigger provisions that could impose substantial costs," Section 705 Stay, 82 Fed. Reg. at 27,621, but it failed to tie that observation to the litigation in any way, and it failed to consider how the public interest or the interest of student borrowers would be affected by its decision.[13] It offered slightly more detail regarding the arbitration and class action provision, but, again, the Department simply asserted, without analysis, that CAPPS had "raised serious questions concerning the validity of" the provision and that postponing the effective date would save institutions the cost of making changes to their contracts "while the regulation is subject to

[13] Although student borrowers can rely on the 1994 borrower defense rule, the Department did not consider the harm they would sustain from being denied the benefits of the new regulations, which were promulgated to address deficiencies that the Department itself found in the old rule. The Department's assertion that "the postponement of the final regulations will not prevent student borrowers from obtaining relief . . . under existing regulations," Section 705 Stay, 82 Fed. Reg. at 27,621, does not provide the type of reasoned balancing of equities that § 705 requires. To take just one example, as the Department itself later acknowledged in the Final Delay Rule, the statutes of limitations may run on student borrowers' claims before they are able to take advantage of the new regulations' prohibition on predispute arbitration agreements and class action waivers. *See* Final Delay Rule, 83 Fed. Reg. at 6,460–61. The Section 705 Stay, however, makes no mention of that cost to student borrowers or, more importantly, of any other harm student borrowers would suffer as a result of the stay.

judicial review." *Id.* The arbitrary and capricious standard of the APA, however, requires that agencies "provide an explanation that will enable the court to evaluate the agency's rationale at the time of decision." *Pension Benefit Guar. Corp. v. LTV Corp.*, 496 U.S. 633, 654 (1990). "[B]oilerplate language" like that the Department used here, however, "makes it impossible to discern [the Department's] 'path.'" *Dickson*, 68 F.3d at 1405. To justify a § 705 stay, an agency must, in short, do more than simply assert—without elaboration—that the litigation raises unspecified "serious questions" for resolution and that a stay will save regulated parties the cost of compliance. *See Sierra Club*, 833 F. Supp. 2d at 34 ("The agency cannot use section 705 of the APA to stay the effectiveness of its rules . . . simply because litigation . . . *happens to be pending*."); *see also California v. Bureau of Land Mgmt.*, 277 F. Supp. 3d at 1122.

The problem with the Department's serious-legal-questions rationale, however, runs deeper than this. As with the Final Delay Rule, the Department failed to acknowledge, much less to address, the inconsistency between its current view that those provisions stand on legally questionable footing, and its prior conclusion that they were legally sound. While the Borrower Defense Regulations were under consideration, "[s]everal commenters objected that the Department lack[ed] the legal authority to ban either mandatory predispute arbitration agreements or class action waivers." Borrower Defense Regulations, 81 Fed. Reg. at 76,021. The Department, in turn, devoted nine columns of the Federal Register to describing the legal objections and to responding to them. *Id.* at 76,021–24. It concluded that the provision were lawful and that existing "case law gives strong support for the position that the Department has authority to impose limits of the kind adopted here on the use of class action waivers and predispute arbitration agreements." *Id.* at 76,022–23. An agency is entitled, of course, to change its position, and, to do so, it need not even demonstrate that its current view is "better than [its]

old one." *Fox Television Stations, Inc.*, 556 U.S. at 515 (emphasis added). But an unacknowledged and unexplained inconsistency is the hallmark of arbitrary and capricious decision-making. *Id.* at 515; *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs*., 545 U.S. 967, 981 (2005); *Am. Wild Horse Pres. Campaign v. Perdue*, 873 F.3d 914, 923–24 (D.C. Cir. 2017); *Verizon v. FCC*, 740 F.3d 623, 636 (D.C. Cir. 2014); *Action for Children's Television v. FCC*, 821 F.2d 741, 745 (D.C. Cir. 1987); *California v. Bureau of Land Mgmt*., 286 F. Supp. 3d at 1064.

The Department does not dispute that the position it took in the Section 705 Stay is at odds with the position it took when it promulgated the Borrower Defense Regulations. It argues, however, that a Section 705 Stay is "a purely procedural device" that does not "effectuate[] a substantive change in agency policy," and thus "the Department was not required to 'display awareness that it is changing position and provide [a] reasoned explanation.'" Dkt. 58-1 at 43. Because a Section 705 Stay is temporary in nature, is often issued on short notice, and is not a substantive rule requiring notice and comment, the Court is prepared to assume—without deciding—that a less demanding standard of review should apply. But the Department's argument still goes too far, and, in effect, rehashes its contention that § 705 stays lie beyond the reach of judicial review. The unacknowledged and unexplained inconsistency that Plaintiffs raise here could not be more apparent or more central to the Department's decision. Commenters argued that the Department lacked legal authority to issue the arbitration and class action waiver ban; the Department considered those objections in detail and concluded that it had the legal authority; and, then, without acknowledging that conclusion or explaining why it believed its legal authority was questionable, the Department stayed the rule. That is, by any

measure, a fundamental and unexplained inconsistency, and, by any measure, it runs afoul of the APA's arbitrary and capricious standard.

The Department's remaining two rationales fare no better. In the Department's view, the Section 705 Stay was also appropriate because "the United States would suffer no significant harm from postponing the effectiveness of the final regulations while the litigation is pending," and, indeed, postponing the effective date would allow the federal government and taxpayers to avoid "significant costs." Section 705 Stay, 82 Fed. Reg. at 27,621–22. And, "[s]eparately," the stay would "allow the Department to consider and [to] conduct a rulemaking process to review and [to] revise the" Borrower Defense Regulations, while "ensur[ing] [that] regulated parties [would] not incur costs that could be eliminated under any future regulations the Department promulgates on these matters." *Id.* at 27,622. Both of these rationales suffer from the same defect—they are not tied to the pending litigation and thus exceed the limited scope of § 705. As the Department itself repeatedly observes, a Section 705 Stay is "a purely procedural device that operates by temporarily freezing the status quo during the pendency of judicial review," Dkt. 58-1 at 43, and "[i]t is not a substantive rule itself," *id.* at 44. But when an agency decides to delay the effective date of a rule to save the federal government money or to alleviate confusion or a burden on regulated parties while the agency decides whether to amend or to rescind the rule, its action is "designed to implement . . . policy," 5 U.S.C. § 551(4). Considerations of that type go beyond the limited reach of a § 705 stay and would have required the Department to proceed by rulemaking. As such, they cannot provide a reasoned basis for the Department's decision to issue the Section 705 Stay.

The Court, accordingly, concludes that the Department's rationale for issuing the Section 705 Stay is arbitrary and capricious.

D. Remedies

Plaintiffs contend that the appropriate remedy with respect to both the Final Delay Rule and the Section 705 Stay is immediate vacatur. Dkt. 55-1 at 79; Dkt. 56 at 72. They correctly note that, when a court concludes that a rule is unlawful, "the practice . . . is ordinarily to vacate the rule," *Ill. Pub. Telecomms. Ass'n v. FCC*, 123 F.3d 693, 693 (D.C. Cir. 1997), and they maintain that there is no reason to depart from that usual practice here. The Department, taking a risk, chose not to brief this issue and merely requested in a footnote that it be provided an opportunity to brief the issue, should the Court decide the case in Plaintiffs' favor. Dkt. 58-1 at 79–80 n.28. Because the Department had ample opportunity to respond to Plaintiffs' arguments, and because this case is, ultimately, about the lawfulness of delay, the Court will not delay matters further by setting a schedule for further briefing. It will, however, schedule a prompt status conference and will permit the parties to present oral argument regarding the appropriate remedies.

CONCLUSION

The Court will **GRANT** the state plaintiffs' and student borrower plaintiffs' motions for summary judgment, Dkt. 55; Dkt. 56, and will **DENY** the Department's cross-motion for summary judgment, Dkt. 66. It is further **ORDERED** that the parties shall appear for a status conference on September 14, 2018 at 10:30 a.m. in Courtroom 21 to address remedies.

/s/ Randolph D. Moss
RANDOLPH D. MOSS
United States District Judge

Date: September 12, 2018

NOTES

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Selected Arbitration Decisions Since January 1, 2017

Jennifer Bennett
Karla Gilbride
Public Justice

This memorandum summarizes selected arbitration decisions issued after January 1, 2017 in which plaintiffs successfully defeated forced arbitration provisions. Because of the sheer number of cases addressing challenges to the enforcement of mandatory arbitration clauses, it is not possible to present anything like a comprehensive discussion in a paper of this sort. For a comprehensive review of the case law relating to mandatory arbitration, you may wish to purchase ***Consumer Arbitration Agreements: Enforceability and Other Issues***, published by the National Consumer Law Center with assistance from the Public Justice Foundation. You can purchase it at http://www.publicjustice.net/news-events/other-publications, by calling 617-542-9595 or by e-mailing publications@nclc.org.

CASES ESTABLISHING LIMITATIONS ON APPLICABILITY OF THE FEDERAL ARBITRATION ACT

Breazeale v. Victim Services, Inc., 878 F.3d 759 (9th Cir. 2017)

The Ninth Circuit held that the Federal Arbitration Act (FAA) did not apply to a contract between the plaintiffs, who had written one or more bounced checks, and the defendant, a company that offered a diversion program the plaintiffs could enter with the promise that doing so would avoid prosecution. The defendant offered the diversion program pursuant to an agreement with the District Attorney's office and sent its notices to the plaintiffs on District Attorney letterhead. The district court, and then the Ninth Circuit, concluded that this agreement purporting to resolve criminal liability fell outside the scope of the FAA, which Congress passed to enforce privately negotiated commercial agreements to arbitrate. The court held that the FAA "does not provide any basis to compel arbitration where the underlying agreement is a plea agreement, quasi-plea agreement, or deferred prosecution agreement between an individual and a party acting on behalf of the state."

Oliveira v. New Prime, Inc., 857 F.3d 7 (1st Cir. 2017), *certiorari granted by the Supreme Court* (argued October 3, 2018)

A truck driver who brought a class action asserting that he and other drivers were misclassified as independent contractors rather than employees was able to pursue his case in court because the First Circuit held that section 1 of the FAA, which exempts from the statute "contracts of employment" for workers engaged in interstate commerce, applied to his contract with the trucking company. The trucking company

defendant argued that the applicability of the transportation worker exemption should be resolved by an arbitrator in the first instance because the contract contained a clause delegating all issues of arbitrability to the arbitrator, but the court held that the § 1 issue was not a question of arbitrability but rather an antecedent question of "whether the FAA confers authority on the district court to compel arbitration" of anything at all. Turning to the construction of the phrase "contract of employment," the court noted that the ordinary meaning of that term at the time of the FAA's enactment in 1925 was simply an agreement to do work, and that the phrase did not distinguish between whether the person doing the work was labeled as an employee or an independent contractor. Finally, neither the narrow construction given to the transportation worker exemption by the Supreme Court in *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) or the liberal federal policy favoring arbitration justified departing from the plain language of the FAA. Public Justice Staff Attorney Jennifer Bennett briefed and argued this case before the First Circuit and, after the trucking company's petition for certiorari was granted, before the U.S. Supreme Court, where oral arguments took place on October 3, 2018.

CASES INVOLVING CONTRACT FORMATION AND NON-SIGNATORY ISSUES

A.D. v. Credit One Bank, N.A., 885 F.3d 1054 (7th Cir. 2018)

The Seventh Circuit reversed a lower court opinion that had granted a bank's motion to compel a minor's claims under the Telephone Consumer Protection Act into arbitration. The minor plaintiff's mother had used her daughter's cell phone to call the credit card company, who then linked the daughter's cell number to the mother's account and began calling it to collect past-due payments. When the daughter sued over the harassing phone calls, the bank tried to invoke the arbitration provision in the mother's credit card account, claiming that the daughter was bound as an "authorized user" of the card because she had once used it to buy smoothies at the mall. The Seventh Circuit held that "authorized user" was a defined term under the credit card agreement and required the cardholder to apply for an additional card in another person's name, which the plaintiff's mother had never done. Moreover, the plaintiff lacked capacity to enter into any contract with the bank as a minor, and even if such a contract had been formed, under Nevada law, which governed according to the card agreement (or the law of California, where the plaintiff lived), she could disaffirm her obligations under any contract

she formed before she reached age eighteen. Moreover, the plaintiff was not bound to arbitrate under the doctrine of direct benefits estoppel because using her mother's card to pick up the smoothies did not establish a relationship between the plaintiff and the bank; the purchase was made in the mother's name and any benefits the plaintiff derived from the card flowed from her mother's decision to let her use it rather than from the bank or the card agreement.

Bevel v. Marine Group, LLC, 231 So.3d 1074 (Ala. 2017)

In this dispute over the sale and later repossession of a boat, the seller attempted to invoke an arbitration provision in the bill of sale, and the lower court compelled arbitration. But the Alabama Supreme Court reversed, finding that the buyer did not place his initials in the box next to the arbitration provision, despite signing and initialing in multiple other places on the bill of sale. The court concluded that a person presented with a form contract can agree to some terms of the contract while rejecting others and that the plaintiff's failure to place his initials next to the arbitration provision meant that that provision did not become part of the contract between him and the defendant.

Cullinane v. Uber Technologies, Inc., 893 F.3d 53 (1st Cir. 2018)

Applying Massachusetts law, the First Circuit held that the arbitration provision found within Uber's Terms of Service, which were made available through hyperlink as part of its registration process, was not reasonably communicated to users of the Uber app. Although the hyperlink to the Terms of Service appeared in relatively large, bold letters within a color-contrasting rectangle, making it fairly conspicuous, "the presence of other terms on the same screen with a similar or larger size, typeface, and with more noticeable attributes diminished the hyperlink's capability to grab the user's attention. If everything on the screen is written with conspicuous features, then nothing is conspicuous." Because the court found that the terms were not reasonably communicated, it did not reach the second stage of the inquiry under Massachusetts law regarding the method of acceptance.

Dasher v. RBC Bank (USA), 882 F.3d 1017 (11th Cir. 2018)

In this long-running multidistrict litigation dispute regarding the order in which banks process transactions in order to maximize overdraft fees, the defendant bank argued that an amendment to its account

agreement made three years into the litigation compelled the named plaintiff into arbitration because he did not opt out in accordance with the opt-out procedures laid out in the amendment. But the Eleventh Circuit found no meeting of the minds sufficient to establish formation of an arbitration agreement, because at the same time the plaintiff implicitly agreed to arbitration by failing to opt out, he was simultaneously resisting arbitration through counsel in the existing lawsuit. The Eleventh Circuit also found it significant that the bank failed to "direct its purportedly court-evicting proposed amendment through known litigation counsel" but sent it directly to the plaintiff instead. Applying North Carolina contract law, the court found no evidence of acceptance, and thus no contract, where the plaintiff's uncounseled response of silence upon receipt of the amendment (which the bank construed as acceptance) and his counseled response of resisting arbitration in court "were not merely equivocal, they were irreconcilably in conflict with one another."

Doe v. Columbia North Hills Hospital Subsidiary, L.P.,
521 S.W.3d 76 (Tex. App.-Fort Worth 2017)

A medical technician was sexually assaulted by a colleague while working at a hospital, and her subsequent claims against her employer were compelled into arbitration, where the arbitrator found in the employer's favor. The hospital moved to confirm the award in court despite the employee's objections that she had never been placed on notice of the arbitration provision contained on the hospital's intranet system. The employer maintained that she was on inquiry notice of the arbitration provision because as part of her onboarding process she signed two acknowledgments, one mentioning that employer policies were available on the intranet and the other stating that various topics, including "problem solving/grievance procedures," had been covered in her orientation. The employee responded in her affidavit that arbitration was never mentioned in her orientation or in any of the documents she was given, and she was unaware that such a policy existed. The appeals court reversed, holding that the document stating that policies were available on the intranet did not mention the arbitration policy by name or explain that it was binding, and the reference to problem solving and grievance procedures also did not provide adequate notice because it did not specify any of the arbitration provision's "essential, unequivocal terms."

Hall v. CVS Health Corp., 2:17-cv-00289-KOB, 2018 WL 1182603 (N.D. Ala. March 7, 2018)

The court denied CVS's motion to compel a pharmacist's age and race discrimination claims into arbitration, finding that a genuine issue of material fact existed as to whether the plaintiff had accepted the arbitration agreement. CVS introduced the arbitration policy when the plaintiff was already employed there and gave employees the option of opting out within 30 days of receiving the policy by mailing a letter to CVS's post office box in Rhode Island. The plaintiff claimed to have sent such an opt-out letter, but CVS had no record of receiving it. The court concluded that CVS had the burden of proving acceptance under Alabama law and could not meet that burden; conversely, the plaintiff, who had no copy of the letter and had not sent it via registered or certified mail, could not show that his letter had been postmarked within thirty days of receiving the policy, as required to make the opt-out effective. According to the court, these factual disputes necessitated a trial under section 4 of the FAA.

In re Henson, 869 F.3d 1052 (9th Cir. 2017)

The Ninth Circuit granted a writ of mandamus, finding that the district court committed clear error, and vacated its order granting Turn, Inc.'s motion to compel arbitration. The plaintiff alleged that Turn, a "middle man" for Internet advertisements who contracted with Verizon Wireless, had improperly installed "zombie" cookies on customers' phones which allowed their data to be collected even if users deleted the cookie. Turn had no contract with the plaintiff, but sought to compel arbitration under equitable estoppel by invoking the arbitration provision in the plaintiff's Customer Agreement with Verizon. The court first concluded that the district court committed a clear error in applying New York law under the Verizon Customer Agreement's choice-of-law provision. It found that "a choice-of-law clause, like an arbitration clause, is a contractual right and generally may not be invoked by one who is not a party to the contract in which it appears." Since the plaintiff and Turn never contracted, the law of the forum (in this case California) should apply. Applying California equitable estoppel principles, the court concluded that Turn could not enforce the arbitration clause in the Verizon Customer Agreement because the plaintiff's claims had nothing to do with, and did not rely on, the Verizon agreement. Moreover, Turn operated without Verizon's knowledge or approval, and a separate agreement between Turn and Verizon specifically provided that they "are independent of

each other." Thus there were neither allegations nor evidence of "substantially interrelated and concerted misconduct" connected with the Verizon Customer Agreement, as California law requires to establish equitable estoppel.

Hite v. Lush Internet Inc., 244 F. Supp.3d 444 (D. N.J. 2017)

The district court refused to enforce an arbitration provision in a cosmetics sales company's online Terms of Use because, applying New Jersey law, the court found that the website did not provide reasonable notice of those terms. Users of the site did not need to check a box or take any other affirmative step to indicate assent to the terms, and the link to the Terms of Use was found at the very bottom of each webpage in smaller font than surrounding links. Given all these factors, the court concluded that "the Terms of Use were not so conspicuously placed that a reasonably prudent user of Defendant's website would have been on notice of the terms contained therein." This opinion is currently on appeal to the Third Circuit.

Huckaba v. Ref–Chem, L.P., 892 F.3d 686 (5th Cir. 2018)

A former employee was allowed to pursue her claims against her former employer in court, despite an arbitration agreement, because the arbitration agreement contained signature blocks for both employer and employee and stated that "by signing this agreement the parties are giving up any right they may have to sue each other." The agreement also required any modifications of its terms to be in writing and signed by all parties. Given these references to signatures in the agreement, the lack of any signature from the employer on the document the employee signed meant that no valid contract was ever formed under the agreement's own terms, and thus there was no agreement to enforce. The employer argued that the employee accepted the agreement through her continued employment regardless of who signed it, but the court noted that the agreement referenced continued employment as a form of consideration, not as a means of acceptance.

Hudson v. Bah Shoney's Corp., 263 F. Supp.3d 661 (M.D. Tenn. 2017)

The court denied a restaurant company's motion to compel arbitration of a sexual harassment claim brought by a cashier because it found that the employee did not knowingly and voluntarily waive her right to a jury trial. The restaurant company argued that the plaintiff had agreed

to arbitrate all claims because, during the plaintiff's hiring process, she was provided with a copy of an Employee Handbook containing an arbitration agreement, and because she signed an Employee Acknowledgement waiving "the right to litigate a dispute in any other forum." The plaintiff testified that she did not know what she was signing, was not provided time to look at the documents, and was not told that she was giving up her right to go to court. The court considered whether the plaintiff's waiver was knowing and voluntary, weighing: (1) the plaintiff's experience, background and education; (2) the amount of time she had to consider whether to sign the waiver, including whether she had an opportunity to consult with a lawyer; (3) the clarity of the waiver; (4) consideration for the waiver; and (5) the totality of the circumstances. The court found that the first factor weighed in the plaintiff's favor: she had a tenth-grade education, she was desperate for any employment to support her new baby, and she testified that she did not even know what the word "forum" means. The second factor also weighed in the plaintiff's favor because she did not have time to look at the employment documents and she was merely told she had to sign everything to keep the job. The third factor, too, weighed in the plaintiff's favor because the arbitration provision was buried on pages 11 to 15 of the 50-page manual, and because the court found it "unrealistic" for a young person lacking a high school education to understand the technical language of the Employee Acknowledgment. Although the fourth factor—consideration—favored enforcing arbitration, the court determined that this factor was outweighed by the previous three factors, concluding that the plaintiff's waiver of the right to a jury trial was not knowing and voluntary. The court therefore denied the restaurant company's motion to compel arbitration and permitted the suit to go forward in court.

James v. Global TelLink Corp., 852 F.3d 262 (3d Cir. 2017)

Inmates and their family members brought suit against a provider of prison phone services, arguing that the corporation charged unconscionable rates. Users of the service could sign up and pay for the services either online or by phone using an interactive voice response system. Those who sign up online are confronted with a page containing the Terms of Use, including an arbitration provision and class action waiver, and must click a button indicating acceptance of the terms in order to continue. However, those who use the service through the phone system merely hear an audio recording informing them that their account is governed by the Terms of Use, which can be found online. The district court held that this audio notice was not sufficient to create a binding

contract and the Third Circuit agreed, holding that the terms "were neither conspicuous nor readily accessible" to the users and "we cannot say that by their actions [of continuing to use the phone service,] they manifested assent to terms contained on a website they never visited."

Massaad v. CVS RX Services, Inc., 1:17–cv–01064–JGS, 2017 WL 4271854 (N.D. Ohio Sept. 26, 2017)

The district court refused to compel a former employee's discrimination claims into arbitration because he raised a genuine dispute of material fact over whether he had opted out of the employer's arbitration policy. The plaintiff submitted a declaration attesting to the date he mailed his letter opting out of the program, along with a copy of the letter that he claimed to have sent. A CVS employee also submitted a declaration stating that she had searched the company's hard copy and electronic records and found no evidence of having received the opt-out letter. The court concluded that because the terms of the agreement stated that opt-outs were effective when mailed and said nothing about receipt, the plaintiff's declaration was sufficient to create a factual dispute about whether he had opted out. Because the court had to draw all reasonable inferences in the non-movant's favor, it denied CVS's motion to compel arbitration.

Metter v. Uber Technologies, Inc., No. 16-cv-06652-RS, 2017 WL 1374579 (N.D. Cal. Apr. 17, 2017)

In this case challenging the $5 cancellation fee charged by Uber, the district court refused to compel the dispute into arbitration because the plaintiff had raised a genuine issue of fact as to whether he was on inquiry notice of the arbitration provision's existence. Although the second step of the registration process for Uber contains a block of text indicating that pressing the "register" button will constitute agreement to Uber's Terms and Conditions, which include the arbitration clause, that is also the step where users are required to enter their credit card information to pay for Uber. Once a user activates any of the credit card-related fields, a popup keyboard appears on the smartphone screen and obscures the block of text regarding agreement to Terms and Conditions. Because entering credit card information is one of the primary purposes of this screen, the court determined that a reasonable user could interact with the registration process without ever seeing the Terms and Conditions link or the associated text. Thus "the keypad obstruction is a

fatal defect" and turned what the court would have otherwise considered "a sufficient notice process" into "a deficient one."

National Federation of the Blind v. The Container Store, Inc., 904 F.3d 70 (1st Cir. 2018)

The First Circuit affirmed a district court opinion denying the Container Store's motion to compel arbitration in a putative class action asserting state and federal discrimination claims against The Container Store for using flat-screen point-of-sale interfaces that prevent blind customers from independently entering debit and credit card PINs and other personal information when completing a purchase. Another allegation in the case, which applied to some but not all plaintiffs, was that due to the point-of-sale interface's inaccessible design, blind customers could not sign up for the Container Store's loyalty program, or make purchases as members of that program, without disclosing their email address or phone number to a cashier, within earshot of other customers, thus compromising their privacy. In a supremely ironic move, the Container Store sought to compel these plaintiffs' claims into arbitration based on terms and conditions that were displayed on the same flat-screen device that the lawsuit was challenging as discriminatory. The Massachusetts district court made short work of this argument, holding that the plaintiffs couldn't be bound to a contract if they had no idea that one was being offered to them. But for another plaintiff who signed up for the loyalty program online at home, the analysis was a bit more nuanced. The court held that the terms and conditions were not binding on her either because they contained a change-in-terms provision that allowed the Container Store to unilaterally modify any term of the program, including the arbitration provision, without notice and potentially with retroactive effect. This made the contract illusory and unenforceable, according to the district court. The First Circuit affirmed on all counts, concluding that there was nothing in the record to indicate that the plaintiffs who signed up in the store knew a contract was being offered to them. On the illusoriness issue, the First circuit concluded that under Texas law, which the Container Store had argued should apply based on the choice of law term in the agreement, illusoriness implicates a lack of consideration at the time of contract formation and thus means that no agreement ever existed. The court expanded on this reasoning in pointing out why the Container Store's suggestion that the unilateral modification provision could simply be severed, leaving the rest of the contract intact, was "absurd. In essence we would be reviving a contract we have found was never formed for its lack of consideration, omitting

the change-in-term clause that was fatal to the contract's proper formation, to therefore conclude a contract was formed. Because, again, pursuant to Texas law the issue of illusoriness goes to formation (and not to validity or enforceability), we think this would be an inappropriate exercise." Cartwright-Baron Staff Attorney Karla Gilbride briefed and argued this case before the First Circuit.

Norcia v. Samsung Telecommunications America, LLC, 845 F.3d 1279 (9th Cir. 2017)

The Ninth Circuit affirmed the district court's order denying Samsung's motion to compel arbitration of a class action complaint alleging that Samsung misrepresented the performance of its Galaxy S4 phone. Samsung argued that plaintiffs were bound by an arbitration provision contained in the "Product Safety & Warranty Information" brochure inside the Galaxy S4 box. The court held that Samsung had failed to demonstrate that any exception to the general rule in California law that "silence or inaction does not constitute acceptance of an offer" applied here. The Ninth Circuit concluded that because nothing on the outside of the box or the brochure indicated that the brochure contained bilateral contract provisions, and because warranties do not typically bind consumers to additional contract terms that have nothing to do with warranty coverage, no reasonable person would have been on notice that the brochure contained an obligation on consumers outside the scope of the warranty. Thus a customer would lack adequate notice that Samsung was offering a contract in the brochure and that the customer's mere purchase and use of the phone would be deemed to constitute acceptance, and so the brochure was not enforceable as an in-the-box contract. The court also concluded that Samsung's argument that Norcia was bound to arbitrate his claims by signing a Customer Agreement with Verizon Wireless was "meritless." Samsung was not a signatory to that agreement, but claimed to be a third-party beneficiary. However, Samsung failed to produce any evidence that Norcia and Verizon intended Samsung to benefit from the contract, as required under California law. Public Justice Cartwright-Baron Staff Attorney Karla Gilbride successfully defended this opinion from a petition for certiorari to the U.S. Supreme Court.

Ouadani v. TF Final Mile LLC, 876 F.3d 31 (1st Cir. 2017)

In an action brought by a delivery driver alleging that he and others were misclassified as independent contractors, the First Circuit affirmed a district court ruling denying the defendant, Dynamex's motion to compel

arbitration based on a contract between it and an affiliated vendor, SBS, to which the plaintiff was not a signatory. The plaintiff brought wage-and-hour claims against Dynamex after being fired. He had been interviewed and given a uniform and ID badge by Dynamex, and was told to "associate" with SBS, which had a delivery services contract with Dynamex containing the arbitration provision. At no point did the plaintiff sign a contract with either company, and he was not aware of the contractual relationship between them. Dynamex argued that the plaintiff was bound to arbitrate inasmuch as he was an agent of SBS, on the basis of equitable estoppel, and because he was a third-party beneficiary of the contract between Dynamex and SBS. Applying federal common law, the court concluded that the plaintiff was not bringing claims as an agent of SBS, and that any agency relationship between him and SBS was irrelevant to the dispute. The court further concluded that equitable estoppel did not apply because the plaintiff accrued no benefits from the contract, and could not have met the estoppel requirement of embracing the contract as he was unaware of its existence. Finally, the court held that a non-signatory must be granted specific legal rights by signatories in order to be considered a third-party beneficiary. No language in the agreement between Dynamex and SBS could be read to provide the plaintiff with such rights, nor did his claims depend on any rights in the agreement.

Serjanec v. FCA US, LLC, **No. 17-10619, 2017 WL 6407337 (E.D. Mich. Dec. 15, 2017)**

The district court refused to compel arbitration of discrimination claims that several long-time employees brought against their former employer. The employer had instituted a new dispute resolution policy in 1995, at which point all of the plaintiffs were already working there. The employer notified employees of the new policy with a letter and brochure explaining its terms and stating that "it applies to you." The court held that under Michigan and Sixth Circuit law, continued employment can constitute acceptance of a proposed arbitration agreement but only if the notice of the agreement specifies as much, and the mere statement that the new policy "applies to you" did not meet this standard of notice. Because the plaintiffs had no way of knowing what conduct on their part would manifest assent to the new dispute resolution policy, the court found that no agreement to arbitrate had been formed.

White v. Sunoco, Inc., 870 F.3d 257 (3d Cir. 2017)

The Third Circuit, over a strong dissent by Judge Roth, affirmed a district court ruling denying Sunoco's motion to compel arbitration. The plaintiff alleged that Sunoco fraudulently misrepresented that a 5¢/gallon discount on gasoline for holders of Sunoco Rewards Cards would apply at all Sunoco locations, when it actually does not apply to all stations. The Rewards Card was issued by Citibank and governed by a Card Agreement between Citibank and the plaintiff that made no mention of Sunoco and to which Sunoco was not a signatory, although account statements contained Sunoco's logo and contact information. The Card Agreement included an arbitration provision that covered "claims made by or against anyone connected" with Citibank. The court rejected Sunoco's argument that it could enforce this arbitration provision through equitable estoppel. There was no evidence that Sunoco acted in concert with Citibank regarding the gas discount. Nor did the plaintiff's fraud claims rely on any terms within the Card Agreement, as the doctrine requires. The court also rejected Sunoco's claim that promotional materials for the Rewards Card and the Card Agreement form an "integrated whole" contract between the plaintiff, Citibank, and Sunoco. Finally, the court refused to consider Sunoco as "connected" with Citibank under the terms of Citibank's arbitration provision. Sunoco's marketing relationship with Citibank did not confer a close enough relationship to be covered by the provision, and even if it did, the agreement does not give Sunoco, as a third party, the right to compel arbitration.

CASES STRIKING DOWN ARBITRATION CLAUSES AS UNCONSCIONABLE OR OTHERWISE UNFAIR

Dillon v. BMO Harris Bank, N.A., 856 F.3d 339 (4th Cir. 2017)

The Fourth Circuit affirmed a district court's order denying a motion to compel arbitration by BMO Harris in response to alleged violations of RICO. The arbitration agreement in question was part of a payday lending contract signed by the plaintiff with Great Plains Lending. The agreement contained a choice of law provision which stated that only the laws of the Otoe-Missouria Tribe and not any state or federal laws would apply in arbitration. Following the reasoning of its prior decision in Hayes v. Delbert Services, Corp., 811 F.3d 666 (4th Cir. 2016), the court ruled the choice of law provision "effects an unambiguous and categorical waiver of federal statutory rights," and is therefore unenforceable. The court also declined to grant BMO Harris'

request that the choice of law provision be severed from the arbitration agreement: "Because Great Plains did not negotiate these terms in good faith, we decline to give effect to this integrated scheme to contravene public policy."

King v. Bryant, 95 S.E.2d 340 (N.C. 2017)

In a medical malpractice action, the North Carolina Supreme Court held unenforceable an arbitration clause that a surgeon required a new patient, Robert King, to sign before his first consultation appointment for a hernia operation. Although the lower court had found the clause unenforceable on grounds of unconscionability, a majority of the North Carolina high court pursued a different, and novel, approach, holding that by seeking medical help from the surgeon and disclosing confidential health information on various other forms that he filled out the same day that he signed the arbitration agreement, Mr. King had entered into a confidential relationship with the doctor and his staff that triggered a fiduciary duty on the doctor's part to fully explain the legal significance of the arbitration clause to Mr. King. By failing to draw the clause to Mr. King's attention and simply presenting it in a pile of other paperwork he was required to complete, the court held, Dr. Bryant and his staff breached their fiduciary duty, which constitutes fraud as a matter of North Carolina law regardless of whether the doctor and his staff had any deceptive intent. Although proof of fraudulent intent is not required, proving a breach of fiduciary duty under North Carolina law does require a finding that the defendant sought to benefit himself at the expense of the other party. Here, the majority held that "defendants benefitted from Mr. King's action in signing the arbitration agreement by ensuring that any subsequent dispute between the parties would be resolved using the forum, procedures, and decision makers of their choice. As a result, defendants failed to act consistently with their fiduciary duty to Mr. King by requesting that he sign a document with substantial legal ramifications and which they believed to be of benefit to themselves without making full disclosure to Mr. King."

McGill v. Citibank, N.A., 2 Cal.5th 945 (2017)

The California Supreme Court denied a bank's attempt to compel arbitration in a putative class action because it found that, as a matter of public policy, an arbitration clause could not prevent a plaintiff from seeking public injunctive relief. The plaintiffs brought suit against Citibank for violations of California's Consumers Legal Remedies Act,

Unfair Competition Law, and False Advertising Law. The plaintiff sought monetary damages and restitution, as well as "public injunctive relief," a form of injunctive relief specifically authorized by California law "that has the primary purpose and effect of prohibiting unlawful acts that threaten injury to the general public." Citibank moved to compel individual arbitration of all claims pursuant to an arbitration provision added to the plaintiff's credit card agreement. The court held that the plaintiff could pursue her claims for public injunctive relief in court because the arbitration clause at issue purported to prevent the plaintiff from seeking public injunctive relief in any forum (court or arbitration). Such a contractual waiver of the plaintiff's right to seek public injunctive relief was, according to the court, unenforceable under California law and public policy. The waiver of the right to request public injunctive relief in any forum "would seriously compromise the public purposes [California's consumer protection] statutes were intended to serve": remedying a public wrong. The court further explained that this holding was not preempted by the Federal Arbitration Act because it fell within the FAA's "saving clause" as interpreted by the U.S. Supreme Court. California Civil Code section 3513—which provides that "a law established for a public reason cannot be contravened by a private agreement"—functioned as a generally applicable contract defense that provided grounds for revoking any contract, including an arbitration agreement. Finally, the court explained that unlike permissible provisions that determine the procedures by which parties resolve disputes—i.e., class action waivers—total waivers of public injunctive relief such as the one in the contract at issue are not enforceable because they foreclose a substantive statutory remedy rather than a specific procedural path. The court denied the motion to compel and remanded to the trial court for further proceedings.

Ramos v. Superior Court of San Francisco County, **— Cal.Rptr.3d —, 2018 WL 5730183 (Nov. 2, 2018)**

A woman with both biophysics and law degrees and experience as a patent attorney was hired by Winston & Strawn as an income partner. Ramos eventually resigned under protest after allegedly being denied opportunities for advancement, having her compensation cut, and being evaluated more harshly than male peers. She filed claims for sex discrimination, retaliation and violations of California's Equal Pay Act, and Winston & Strawn sought to enforce the arbitration provision in the Partnership Agreement she had signed when joining the firm. Ramos argued that because she lacked the control of a true partner, she should

be treated as an employee for purposes of *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal.4th 83 (2000), which established minimal procedural safeguards for employees who are required to resolve their nonwaivable statutory claims in arbitration. The trial court had found *Armendariz* inapplicable to Ramos as a partner and enforced the arbitration clause while severing two provisions the court found unconscionable, one requiring her to arbitrate in Chicago and another requiring the parties to split the costs of arbitration. Ramos sought a writ of mandate and the appellate court granted that relief, concluding that Winston & Strawm's superior bargaining position relative to Ramos, as well as the fact that she was bringing nonwaivable statutory employment claims, made *Armendariz* applicable. It then determined that a provision in the Partnership Agreement stating that the arbitration panel could not substitute its judgment or otherwise override decisions of the law firm's Executive Committee unless those decisions violated the Agreement would have interfered with Ramos's ability to prevail on her claims, limiting available remedies in violation of Armendariz. And because the taint from this unconscionable provision could not be removed without fundamentally altering or rewriting the agreement, the court declared the entire arbitration provision unenforceable instead of severing the unconscionable portions and enforcing the rest, as the lower court had done.

CASES PERMITTING PLAINTIFFS TO BRING CLASS CLAIMS IN ARBITRATION OR PERMITTING AN ARBITRATOR TO CONSIDER CLASS CLAIMS

Dish Network L.L.C. v. Ray, 900 F.3d 1240 (10th Cir. 2018)

A former employee sought to bring FLSA and Colorado minimum wage claims in arbitration on a class and collective basis, and the arbitrator concluded that the agreement with the employer allowed for such proceedings. When the employer sought judicial review, the district court held that the arbitrator had not exceeded his authority. A majority of the Tenth Circuit endorsed the approach of the Second Circuit in *Wells Fargo advisors, L.L.C. v. Sappington*, described below, by assuming without deciding that whether an arbitration clause allows for classwide arbitration is a gateway issue of arbitrability presumptively for courts to resolve. (Chief Judge Tymkovich, in a concurring opinion, disagreed with this approach and concluded that the availability of class arbitration should be decided by arbitrators in the normal course without requiring clear and unmistakable evidence of delegation.) All three judges agreed that clear and unmistakable evidence of delegation was

present in the agreement at issue, pointing to its reference to the employment dispute rules of the American Arbitration Association ("AAA"). The court rejected the reasoning of the Third, Sixth and Eighth Circuits, which require a higher standard for delegating questions of class arbitration than other arbitrability issues, holding that the reasons given for treating the two categories differently went to whether the possibility of class arbitration should be treated as a gateway issue and not the quantum of evidence for delegating that question to an arbitrator in a particular case. Finally, the Tenth Circuit concluded that the arbitrator had not exceeded his authority in finding that the arbitration agreement authorized collective and class proceedings because his decision "at least arguably interpreted the parties' contract," which is all that a reviewing court under the deferential standard of *Oxford Health Plans L.L.C. v. Sutter*, 569 U.S. 564 (2013) may assess.

Spirit Airlines, Inc. v. Maizes, 899 F.3d 1230 (11th Cir. 2018)

Several members of Spirit Airlines' $9 Fare Club brought class claims in arbitration, contending that Spirit did not keep its promises under the program. Spirit sought a declaratory judgment in court that class proceedings were not available under its arbitration agreement with its customers. The Florida district court held that the arbitrator should decide this question in the first instance because by incorporating AAA rules, the parties also incorporated the AAA's Supplementary Rules for Class Actions, which state that they apply whenever any other set of AAA rules applies. The Eleventh Circuit agreed, finding the parties' use of AAA rules to constitute clear and unmistakable evidence of their intent to delegate the class arbitration question to an arbitrator.

Varela v. Lamps Plus, Inc., 701 Fed. Appx. 670 (9th Cir. 2017), *certiorari granted by Supreme Court* (argued October 29, 2018)

In a case where a fishing scheme resulted in an employer releasing employees' personal financial information to hackers, the Ninth Circuit affirmed a district court opinion allowing class claims against the employer to proceed in arbitration. The arbitration provision did not say anything one way or the other about class claims but did require arbitration "in lieu of all lawsuits or civil legal proceedings relating to my employment." The district court and Ninth Circuit both held that this language was ambiguous and could include class proceedings within its scope, and so construed that ambiguous language against the employer, who

drafted the agreement. This opinion is currently on appeal to the U.S. Supreme Court, which heard oral argument on October 29.

Wells Fargo Advisors LLC v. Sappington, 884 F.3d 392 (2d Cir. 2018)

A group of former financial advisors brought FLSA and state law claims in arbitration for unpaid overtime, and Wells Fargo filed a declaratory action in court seeking to have a judge interpret the contract to require that their claims proceed individually and not as a class or collective action. The arbitration provision did not refer to class arbitration but did reference AAA rules. The district court and Second Circuit both held that whether the contract allowed for class proceedings should be decided by an arbitrator in the first instance. While assuming without deciding that the availability of class arbitration was a "threshold question of arbitrability" presumptively for courts to decide, the Second Circuit found clear and unmistakable evidence that the parties intended to delegate that question to an arbitrator under the terms of the agreements at issue. One subset of employees had a clause stipulating that "all" employment disputes would be resolved by an arbitrator, but which then carved out two specific types of disputes that would not be arbitrated—those involving unemployment insurance and employee benefits. In the Second Circuit's view, this strongly indicated that all disputes not listed in the carve-out, including disputes over the availability of class procedures, should be resolved by an arbitrator. Second, that provision incorporated the AAA's 1993 Rules for Securities Arbitrations, and Rule 1 of those rules specified that whatever version of the rules was in effect when the demand for arbitration was filed would govern. By the time the advisors filed their demand for arbitration, the AAA Securities Rules had been replaced by the Commercial Rules, and Commercial Rule 7 permits the arbitrator to rule on his or her jurisdiction, while the AAA's Supplementary Rules for Class Arbitrations allow arbitrators to issue clause construction awards determining whether class claims are permitted under particular arbitration provisions. The Second Circuit held that the provision's reference to the 1993 rules incorporated all of these later-enacted AAA rules and constituted further evidence of the parties' agreement to let an arbitrator decide the class arbitration issue. Finally, a second arbitration clause that applied to another subset of employees contained the following express delegation provision: Any controversy relating to your duty to arbitrate hereunder, or to the validity or enforceability of this arbitration clause, or to any defense to arbitration, shall

also be arbitrated[.]" The Second Circuit held that the availability of class procedures fell within the scope of this broad delegation language.

CASES REFUSING TO COMPEL ARBITRATION ON THE GROUNDS THAT THE CLAIMS AT ISSUE ARE OUTSIDE THE SCOPE OF AN ARBITRATION CLAUSE

Kabba v. Rent-A-Center, PWG-17-211 2017 WL 1508829 (D. Md. Apr. 27, 2017)

The plaintiff, Paul Kabba, had worked for Rent-A-Center as a store manager until 2008, when he was robbed at gunpoint and went on medical leave due to health problems resulting from the robbery, at which point Rent-A-Center terminated him. In connection to that earlier period of employment Kabba signed an arbitration agreement in 2002 that purported to cover current and future disputes regarding employment, including disputes over the interpretation or applicability of the agreement. In 2013 Kabba again applied to work for Rent-A-Center and was hired and given documents to sign, including an arbitration agreement. He chose not to sign the arbitration document and the hiring process continued, but when Rent-A-Center learned about his medical lifting restrictions towards the end of his first day of work, it terminated him, leading to the lawsuit. Rent-A-Center tried to enforce the 2002 arbitration agreement and argued that an arbitrator needed to decide in the first instance whether that agreement still applied or had been modified by Kabba's refusal to sign the 2013 arbitration agreement. But the court determined under Maryland law that Kabba's refusal to sign the 2013 arbitration agreement indicated his rejection of its terms, which were substantially similar to those in the 2002 agreement, and Rent-A-Center's decision to hire him notwithstanding his refusal to sign indicated that neither party clearly or unmistakably intended the delegation clause from the 2002 agreement to cover disputes regarding his 2013 employment. Therefore the arbitrability question was for the court to decide in the first instance, but the court concluded that it could not do so as a matter of law and that the parties should proceed to conduct discovery on the question of arbitrability. Rent-A-Center appealed and the fourth Circuit affirmed in an unpublished disposition available at 2018 WL 1778550 (4th Cir. Apr. 13, 2018).

Long v. Live Nation Worldwide, Inc., No. 2:16-cv-01961-TSZ, 2017 WL 5194978 (W.D. Wash. Nov. 9, 2017)

The district court denied Ticketmaster's motion to dismiss or to stay and compel arbitration, finding that a "clickwrap" agreement does not extend beyond the transaction or website containing the agreement. The plaintiff's claim concerned allegedly discriminatory barriers he encountered, in violation of the Americans with Disabilities Act, on an NFL ticket exchange website operated by Ticketmaster. He made no purchase on the website, and was not prompted to click on the link to, or otherwise review, the website's "Terms and Conditions," which were presented in a "browsewrap" manner. Ticketmaster did not attempt to enforce the arbitration provision on the website that the plaintiff was suing about, but argued that he was bound to arbitrate that dispute under a "clickwrap" agreement connected with his prior purchases of tickets on a different website operated by Ticketmaster (www.ticketmaster.com) between 2012 and 2017. The court held that neither the current "Terms of Use" on www.ticketmaster.com, nor an earlier version in effect in 2012 when the plaintiff purchased tickets there, encompassed the dispute over the NFL ticket exchange website. The current ticketmaster.com Terms of Use only applied to disputes involving "your use of the Site," a defined term that did not include the NFL ticket exchange website, and "products or services distributed by us or through us," which the court found not to apply to the tickets on the secondary, fan-to-fan market where the plaintiff was searching. The 2012 "Terms of Use" were more broadly worded, applying to "all disputes and claims" between Live Nation and the ticket purchaser, including "claims that may arise after the termination of this Agreement." But the court found it significant that the NFL ticket exchange website did not exist when those Terms of Use were in effect, and held that the plaintiff "will not be deemed to have agreed to arbitrate claims relating to his use of a website before the website was even created."

Munro v. University of Southern California, 896 F.3d 1088 (9th Cir. 2018)

A group of current and former employees of the university filed claims under ERISA for breach of fiduciary duties in administering their retirement plans. The university sought to enforce an arbitration provision that all employees are required to sign, which prohibited class actions. Relying on its earlier opinion in *Welch v. My Left Foot Children's Therapy*, described below, the Ninth Circuit held that just as the qui

tam relator in *Welch* could not bind the federal government to an arbitration provision she signed, the claims brought by the plan members here were brought on behalf of the plan rather than the employees themselves and thus fell outside the scope of the arbitration agreement, which only covered claims "that Employee may have against the university."

Stevens-Bratton v. Trugreen, Inc., 675 Fed. Appx. 563 (6th Cir. 2017)

In this case under the Telephone Consumer Protection Act, a woman had signed up for lawn care service but terminated the contract after one year. Eight months after the contract was terminated, the lawn care company began calling her to advertise its services, despite her phone number being on the National Do Not Call Registry. When she sued under the TCPA, the company moved to enforce the arbitration provision under the original contract, and the district court granted its motion. But the Sixth Circuit reversed, holding that the arbitration provision did not survive the expiration of the contract because the main facts and occurrences of the dispute—the unwanted phone calls—occurred after the contract had terminated and did not involve rights that vested under the contract. Moreover, because the provision entitled Contact Information–which gave TruGreen the right to contact people who had (like Ms. Stevens-Bratton) provided their cell phone numbers–was ambiguous about whether it continued to grant that right once the contract expired, the Sixth Circuit held that that provision should be construed against TruGreen, who drafted it. Public Justice Cartwright-Baron Staff Attorney Karla Gilbride successfully defended this opinion from a petition for certiorari to the U.S. Supreme Court.

United States ex rel. Welch v. My Left Foot Children's Therapy, LLC, 871 F.3d 791 (9th Cir. 2017)

The Ninth Circuit denied an employer's motion to compel arbitration of an action brought against it under the federal False Claims Act and Nevada False Claims Act by a former employee, who alleged that the company made fraudulent Medicaid claims. The relator had entered into an arbitration agreement with the employer that committed her to arbitrate "any claim, dispute, and/or controversy" that "I may have against the company" regarding the employment relationship. The district court denied arbitration on the ground that FCA claims belong to the federal and state government and not the relator, and neither Nevada nor the federal government had entered into an arbitration agreement with the

employer. But the Ninth Circuit affirmed on an alternative basis, holding that the fraud claims fell outside the scope of the arbitration provision. For one thing, most references to arbitration in the agreement referred to claims "arising out of or relating to" employment, and the court held that the relator's claims arose out of and related to the alleged tax fraud the employer was committing, which had no connection whatsoever to her employment and which she could have discovered in some other capacity besides working there. Finally, one clause in the arbitration agreement that could be interpreted more broadly because it mentioned "association" rather than employment still did not encompass the FCA claims, because those claims, which belonged to the government as the real party in interest, could not be described as claims or disputes that the relator "had against the company."

CASES HOLDING THAT CORPORATIONS WAIVED THEIR RIGHTS TO INVOKE ARBITRATION BY LITIGATING IN COURT OR BREACHING THE ARBITRATION AGREEMENT

Cain v. Midland Funding, LLC, 156 A.3d 807 (Md. 2017)

Maryland's high court ruled that debt buyer Midland Funding waived its rights to invoke the arbitration agreement between a consumer and his credit card company by previously suing him in small claims court to collect on that same credit card account. Midland had obtained a default judgment against Clifford Cain in 2009 based on a Citibank credit card debt, one of thousands of judgments Midland obtained each year in small claims court against Maryland residents. But when it obtained these judgments Midland was operating without the collection agency license that Maryland state law required it to possess (it finally got a license in January of 2010), and a Maryland appellate court later ruled that any judgment secured by a collection agency while unlicensed was void and subject to collateral attack. Mr. Cain filed a class action in 2013 seeking to invalidate the judgments obtained by Midland against him and all other Maryland residents when it was operating without a license, and seeking to have the amounts of those judgments and associated interest and costs returned to the class members under the doctrine of unjust enrichment. Midland responded that the case could not proceed as a class action, and could not proceed in court at all, because Mr. Cain's original Citibank agreement contained an arbitration provision with a class action ban. Reversing opinions from two lower courts that had sided with Midland, the Maryland court of appeals held that by bringing the collection action against Mr. Cain in court when the agreement would

have allowed for arbitration instead, Midland waived its right to arbitration not just in the 2009 action but in the related class action that Mr. Cain brought four years later, because without the earlier collection action, the 2013 class action would not exist. The court also held as a matter of first impression, and consistent with opinions from the Seventh and D.C. Circuits, that Mr. Cain did not have to prove that Midland's actions prejudiced him in order to prevail on his waiver claim. Cartwright-Baron Staff Attorney Karla Gilbride of Public Justice briefed and argued this case before the Maryland Court of Appeals.

Degidio v. Crazy Horse Saloon and Restaurant, Inc., 880 F.3d 135 (4th Cir. 2018)

Plaintiff Alexis Degidio claimed that she and other entertainers who performed at the defendant's club were misclassified as independent contractors and denied minimum wages under the FLSA and South Carolina law. Defendant answered the complaint in October 2013 and participated in discovery for over a year, also filing a summary judgment motion that argued the dancers were properly classified as a matter of law before arguing for the first time in opposition to Plaintiff's class certification motion in early 2015 that entertainers who had signed arbitration agreements were barred from participating in any class or collective action and had to bring their claims in arbitration. Defendant had obtained signatures on these arbitration agreements beginning in November 2014, when the case was already pending. After summary judgment was granted in Defendant's favor on some of the state law claims, the employer filed two more motions for summary judgment, sought merits discovery from FLSA opt-ins, and moved to certify questions to the South Carolina Supreme Court. Judge Wilkinson, writing for a unanimous Fourth Circuit panel, concluded that this three-year pattern of merits-oriented litigation activity was inconsistent with Defendant's right to enforce any arbitration agreement and had prejudiced the plaintiffs by requiring them to litigate issues that they might have to argue again in arbitration. Rather than treating arbitration as an efficient substitute to litigation, the Fourth Circuit noted, Defendant had tried to use it as an "insurance policy in an attempt to give itself a second opportunity to evade liability." Moreover, Defendant did not inform the court of its intention to bind potential class members to arbitrate so that the court could supervise these communications but rather presented the agreements "in a furtive manner" with either the employer's CFO or counsel present, in a setting "ripe for duress." And the agreements were misleading in that they suggested the entertainers could only retain

their tips and flexible work schedules if they continued to be classified as independent contractors, and that they could only retain that classification if they signed the arbitration agreement. The Fourth Circuit commended the "admirable care and patience" of the district court and its decision to deny enforcement to Defendant's "sham agreements."

Fed. Nat'l Mortg. Ass'n v. Prowant, 209 F. Supp.3d 1295 (N.D. Ga. 2016)

The district court held that Fannie Mae waived its right to arbitration and breached its arbitration agreement when it sought a declaratory judgment in court to prevent an arbitrator from deciding whether to allow FLSA collective action procedures in an ongoing arbitration. Employees filed a demand for arbitration against Fannie Mae under the FLSA, alleging overtime violations and seeking to represent similarly situated employees. The arbitration agreement required an employee to arbitrate claims before bringing suit in court and stipulated that the "arbitrator will resolve all disputes over the interpretation and applicability of the Policy, and over the arbitrability of all matters presented under it." On the eve of the arbitrator's hearing on whether the plaintiffs could proceed as a class or collective action, Fannie Mae filed a declaratory judgment action in a federal district court seeking a declaration that class arbitration was unavailable under the agreement, and an injunction preventing class arbitration. Thereafter, the employees filed counterclaims alleging that Fannie Mae waived its right to arbitration and breached the arbitration provision of the contract by seeking the declaratory action in court. The district court agreed with the employees, finding that Fannie Mae's acts were inconsistent with its right to arbitrate, and that Fannie Mae's actions prejudiced the employees. Fannie Mae argued that the purpose of the declaratory judgment action was to continue to arbitrate within the scope of the agreement. The court described this argument as "nonsense," since Fannie Mae filed a federal court action to strip the arbitrator of his decision-making powers under the arbitration agreement and enjoin any class arbitration, steps inconsistent with its right to arbitrate. The court further found that the employees were prejudiced by a "substantial delay" of two years and "significant litigation expenses" in a case that could have been decided much sooner by the arbitrator. Finally, the court held that Fannie Mae breached the arbitration agreement by filing a federal court action, allowing the employees to rescind the agreement. Accordingly, the court ordered that the case proceed in federal court and not in arbitration. In a subsequent order issued on May 31, 2017 and published at 255 F. Supp.3d 1291,, the district court extended its

waiver finding to apply to nine opt-ins who joined the FLSA action after the original order, whose claims Fannie Mae also attempted to compel into arbitration.

Roach v. BM Motoring, LLC, 155 A.3d 985 (N.J. 2017)

The New Jersey Supreme Court denied a motion to dismiss for lack of jurisdiction and to compel arbitration in a suit brought by two plaintiffs against a car dealership because it found the dealership had materially breached the arbitration agreement. The plaintiffs had initially filed arbitration demands with the American Arbitration Association (AAA) pursuant to the Dispute Resolution Agreements they each had signed when they purchased cars from the dealership. Upon receiving the complaints, the AAA advised the dealership that it was required to pay the applicable filing fees and an arbitrator compensation deposit. The dealership refused and did not respond, and the AAA dismissed the arbitration claims for non-payment. When the plaintiffs brought suit in New Jersey state court, the dealership filed a motion to dismiss for lack of jurisdiction based on the terms of the Dispute Resolution Agreement and moved to compel arbitration. The plaintiffs argued that the dealership's non-payment and failure to respond to the AAA constituted a material breach of the DRA. The dealership argued that the agreement did not designate the AAA as the proper forum and instead only provided for arbitration by a retired judge or retired attorney who would follow AAA rules, and thus it was not obligated to comply with the AAA's demands. The New Jersey Supreme Court found that the filing of the claim with the AAA was not inconsistent with the Dispute Resolution Agreement, and that a plaintiff's choice of forum is entitled to preferential consideration. The court also held that the failure to pay arbitration fees constituted a material breach because it resulted in the dismissal of the arbitration claim and deprived the other party of the benefit of the dispute resolution agreement. The court held that the dealership, because of its material breach, was barred from later compelling arbitration, and remanded the case to the trial court for further proceedings.

Sprunk v. Prisma LLC, 14 Cal. App.5th 785 (2017)

A restaurant that employed exotic dancers was found to have waived its right to compel arbitration against absent class members in a wage and hour case after it moved to compel arbitration against the named plaintiff but then withdrew that motion and did not renew it for over four years. The defendant claimed that it withdrew the motion because

it was concerned about the possibility that it would be forced to engage in class arbitration. But the defendant did not renew its motion to compel arbitration until more than a year after the California Supreme Court resolved the enforceability of class action waivers in *Iskanian v. CLS Transportation Los Angeles LLC*, 59 Cal.4th 348 (2014) and not until the trial court had granted the plaintiff's motion to certify a class. This timing caused the trial and appellate courts to conclude that Prisma was not motivated by a genuine uncertainty about the law but rather was trying to gain a tactical advantage by defeating the motion for class certification first while holding the arbitration option in reserve. "An attempt to gain a strategic advantage through litigation in court before seeking to compel arbitration is a paradigm of conduct that is inconsistent with the right to arbitrate" and supported a finding of waiver. The court also held that the time and expense incurred by the plaintiff in briefing the class certification motion, which might not have been necessary if the defendant had moved for arbitration promptly, constituted the prejudice needed for a waiver finding under California law.

NOTES

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Lusnak v. Bank of America, N.A.,
883 F.3d 1185 (9th Cir. Mar. 2, 2018)

Submitted by:
Karla Gilbride

Public Justice

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883 F.3d 1185
United States Court of Appeals, Ninth Circuit.

Donald M. LUSNAK, on behalf of himself and all others similarly situated, Plaintiff–Appellant,
v.
BANK OF AMERICA, N.A., Defendant–Appellee.

No. 14-56755
|
Argued and Submitted November 7, 2016, Pasadena, California
|
Filed March 2, 2018

Synopsis
Background: Mortgagor brought putative class action against mortgagee bank, asserting claims for breach of contract and violation of California's Unfair Competition Law (UCL) stemming from bank's failure to pay interest on funds in mortgagor's escrow account. The United States District Court for the Central District of California, George H. King. C.J., 2014 WL 677913, granted bank's motion to dismiss. Mortgagor appealed.

Holdings: The Court of Appeals, Nguyen, Circuit Judge, held that:

[1] Office of the Comptroller of the Currency (OCC) regulation interpreting National Banking Act's (NBA) preemption standard was entitled to little deference;

[2] California's escrow interest law was not preempted by the NBA;

[3] mortgagor could not state UCL claim based on bank's purported violation of federal escrow requirements;

[4] mortgagor stated UCL claim based on bank's purported violation of California's escrow interest law; and

[5] mortgagor stated breach of contract claim.

Reversed and remanded.

West Headnotes (12)

[1] **Federal Courts**
Pleading

Court of Appeals reviews de novo a district court's dismissal for failure to state a claim. Fed. R. Civ. P. 12(b)(6).

Cases that cite this headnote

[2] **States**
Congressional intent

The purpose of Congress is the ultimate touchstone in every pre-emption case.

Cases that cite this headnote

[3] **States**
State police power

Courts start with the assumption that the State's historic police powers are not preempted by federal law unless that was the clear and manifest purpose of Congress.

Cases that cite this headnote

[4] **Antitrust and Trade Regulation**
Preemption
States
Trade Regulation; Monopolies

Where courts are confronted with potential federal preemption of state consumer protection laws, a field traditionally regulated by the states, compelling evidence of an intention to preempt is required.

Cases that cite this headnote

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A statute should be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.

Cases that cite this headnote

[5] **Administrative Law and Procedure**
Deference to agency in general
States
Federal administrative regulations

The weight to be accorded an agency's explanation of a state law's impact on a federal scheme depends on its thoroughness, consistency, and persuasiveness.

Cases that cite this headnote

[6] **Administrative Law and Procedure**
Trade or business
Deposits and Escrows
Operation and Effect of Delivery in Escrow
Finance, Banking, and Credit
Deposits and accounts

Office of the Comptroller of the Currency (OCC) regulation interpreting the National Banking Act's (NBA) preemption standard was entitled to little, if any, deference in determining whether NBA preempted California's escrow interest law; regulation purported to adopt Supreme Court's articulation of applicable preemption standards in prior cases but did so inaccurately, and Congress, in enacting the Dodd–Frank Wall Street Reform and Consumer Protection Act, underscored that consumer financial law was preempted only if it prevented or significantly interfered with the exercise by the national bank of its powers and made clear that only *Skidmore* deference applied to the OCC's preemption determinations. 12 U.S.C.A. § 25b(b)(1)(B); 12 C.F.R. § 34.4(a); Cal. Civ. Code § 2954.8(a).

Cases that cite this headnote

[7] **Statutes**
Superfluousness

[8] **Federal Civil Procedure**
Affirmative Defenses, Raising by Motion to Dismiss

Ordinarily, affirmative defenses such as preemption may not be raised on a motion to dismiss except when the defense raises no disputed issues of fact.

2 Cases that cite this headnote

[9] **Deposits and Escrows**
Operation and Effect of Delivery in Escrow
Finance, Banking, and Credit
Deposits and accounts
States
Banking and financial or credit transactions

California's escrow interest law did not prevent or significantly interfere with mortgagee bank's exercise of its national bank powers, and thus the National Bank Act (NBA), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, did not preempt the escrow law; Dodd-Frank language requiring banks to pay interest on escrow account balances if prescribed by "applicable State law" expressed Congress's view that such laws would not necessarily prevent or significantly interfere with a national bank's operations, and given that not every state had escrow interest laws, "applicable" referred to any relevant or appropriate state laws requiring creditors to pay interest on escrow account funds. 12 U.S.C.A. § 25b(b)(1)(B); Truth in Lending Act § 129D, 15 U.S.C.A. § 1639d(g)(3); Cal. Civ. Code § 2954.8(a).

2 Cases that cite this headnote

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[10] **Antitrust and Trade Regulation**
Finance and banking in general; lending
Mortgages and Deeds of Trust
Retroactive or Prospective Operation

Federal law mandating that creditors establish escrow accounts in connection with certain mortgages and providing requirements for such accounts did not apply to mortgagor's escrow account, and thus mortgagor could not state claim against mortgagee bank under California's Unfair Competition Law (UCL) based on bank's failure to pay escrow interest in alleged violation of the law; Congress's use of prospective language indicated that the law's requirements applied to accounts established pursuant to the law after it took effect in 2013, and mortgagor's escrow account was not a federally mandated account "subject to" the law's interest requirements because it was established before the law took effect. Truth in Lending Act § 129D, 15 U.S.C.A. § 1639d; Cal. Bus. & Prof. Code § 17200.

1 Cases that cite this headnote

[11] **Antitrust and Trade Regulation**
Finance and banking in general; lending
Mortgages and Deeds of Trust
Federal preemption
States
Banking and financial or credit transactions

Mortgagor stated claim against mortgagee bank under California's Unfair Competition Law (UCL) based on bank's failure to pay interest on mortgagor's escrow account as required under California law; California's escrow interest law had never been preempted by federal law, meaning that bank's obligation to pay interest on any funds in mortgagor's escrow account was triggered when it assumed control over the account. Cal. Civ. Code § 2954.8(a); Cal. Bus. & Prof. Code § 17200.

Cases that cite this headnote

[12] **Deposits and Escrows**
Conditions or contingencies

Mortgagor stated breached of contract claim against mortgagee bank under California law based on bank's failure to pay interest on mortgagor's escrow account, where mortgage documents required bank to pay escrow interest if "Applicable Law requires interest to be paid on the Funds," and defined "Applicable Law" as "all controlling applicable federal, state and local statutes, regulations, ordinances and administrative rules and orders, as well as all applicable final, non-appealable judicial opinions."

1 Cases that cite this headnote

***1187** Appeal from the United States District Court for the Central District of California, George H. King, District Judge, Presiding, D.C. No. 2:14-cv-01855-GHK-AJW

Attorneys and Law Firms

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Before: Marsha S. Berzon, Morgan Christen, and Jacqueline H. Nguyen, Circuit Judges.

OPINION

NGUYEN, Circuit Judge:

***1188** Congress significantly altered the regulation of financial institutions with the enactment of the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank"). This sweeping piece of legislation was a response to the worst financial crisis since the Great Depression, in which millions of Americans lost their homes. This appeal requires us to determine whether in light of Dodd–Frank, the National Bank Act ("NBA") preempts California's state escrow interest law, California Civil Code § 2954.8(a).

California's escrow interest law, enacted in 1976, requires financial institutions to pay borrowers at least two percent annual interest on the funds held in the borrowers' escrow accounts. This type of account is often set up in conjunction with a mortgage, either as a condition set by the lender or at the request of the borrower. Its purpose is to ensure payment of obligations such as property taxes and insurance. These accounts often carry a significant positive balance.

Plaintiff Donald Lusnak, on behalf of a putative class, filed suit against Bank of America, which does not pay borrowers any interest on the positive balance in their accounts. The district court dismissed the suit on the ground that the NBA preempted California Civil Code § 2954.8(a).

We reverse. Although Dodd–Frank significantly altered the regulatory framework governing financial institutions, with respect to NBA preemption, it merely codified the existing standard established in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 116 S.Ct. 1103, 134 L.Ed.2d 237 (1996). Applying that standard here, we hold that the NBA does not preempt California Civil Code § 2954.8(a), and Lusnak may proceed with his California Unfair Competition Law ("UCL") and breach of contract claims against Bank of America.

I. Background

A. The National Bank Act

"In 1864, Congress enacted the NBA, establishing the system of national banking still in place today." *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 10, 127 S.Ct. 1559, 167 L.Ed.2d 389 (2007) (citations omitted). The NBA provides for the formation of national banks and grants them several enumerated powers as well as " 'all such incidental powers as shall be necessary to carry on the business of banking.' " *Id.* at 11, 127 S.Ct. 1559 (quoting 12 U.S.C. § 24(Seventh)). Congress established the Office of the Comptroller of the Currency ("OCC") to charter, regulate, and supervise these national banks. National Bank Act, 38 Cong. Ch. 106, § 1, 13 Stat. 99, 99–100 (1864)[1]; *About the OCC*, Office of the Comptroller of the Currency, https://www.occ.treas.gov/about/what-we-do/mission/indexabout.html (last visited Jan. 25, 2018) ("The OCC charters, regulates, and supervises all national banks ....").

The NBA also ushered in a "dual banking system," wherein banks could be chartered either by the OCC or by a State ***1189** authority and be subject to different legal requirements and oversight from different regulatory bodies. *See First Nat'l Bank of Fairbanks v. Camp*, 465 F.2d 586, 592 (D.C. Cir. 1972); Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 Stan. L. Rev. 1 (1977). Since the NBA's enactment, the Supreme Court has often ruled on the scope of State authority to regulate national banks. *See Watters*, 550 U.S. at 11–13, 127 S.Ct. 1559. Congress has also enacted legislation "[t]o prevent inconsistent or intrusive state regulation from impairing the national system." *See id.* at 11, 127 S.Ct. 1559.

B. Dodd–Frank

In 2010, Congress enacted Dodd–Frank in response to a "financial crisis that nearly crippled the U.S. economy."[2] S. Rep. No. 111-176, at 2 (2010); *see also id.* at 15 ("It has become clear that a major cause of the most calamitous worldwide recession since the Great Depression was the simple failure of federal regulators to stop abusive lending, particularly unsustainable home mortgage lending." (quoting *The Creation of a Consumer Financial Protection Agency to Be the Cornerstone of America's New Economic Foundation: Hearing Before S. Comm. On Banking, Hous., and Urban Affairs*, 111th Cong. 82 (2009) (Statement of Travis Plunkett, Legislative Director, Consumer Federation of America))). Dodd–Frank brought about a "sea change" in the law, affecting nearly every corner of the nation's financial markets. *See, e.g.*, *Loan Syndications & Trading Ass'n v. S.E.C.*, 818 F.3d 716, 718 (D.C. Cir. 2016); Damian

Paletta & Aaron Lucchetti, *Law Remakes U.S. Financial Landscape*, Wall St. J., July 16, 2010, at A1 ("Congress approved a rewrite of rules touching every corner of finance ...."). One of Congress's main goals in this sweeping legislation was to prevent another mortgage crisis, which resulted in "unprecedented levels of defaults and home foreclosures." *See, e.g.*, H.R. Rep. No. 111-94, at 48 (2009).

Titles X and XIV of Dodd–Frank, at issue in this case, aim to prevent, and mitigate the effects of, another mortgage crisis. In a section of Title X called "Preservation of State Law," Congress addressed the framework of NBA preemption determinations. These provisions were designed to address "an environment where abusive mortgage lending could flourish without State controls." S. Rep. No. 111-176, at 17. Congress aimed to undo broad preemption determinations, which it believed planted the seeds "for long-term trouble in the national banking system." *Id.* at 17. In a section of Title XIV called "Escrow and Impound Accounts Relating to Certain Consumer Credit Transactions," Congress established a series of measures to help borrowers understand their mortgage obligations. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1461, 124 Stat. 1376, 2178–81 (2010) (codified at 15 U.S.C. § 1639d). These provisions were designed to correct abusive and deceptive lending practices that contributed to the mortgage crisis, specifically with regard to the administration of escrow accounts for property taxes and insurance. H.R. Rep. No. 111-94, at 53–56.

C. Factual Background

In July 2008, Lusnak purchased a home in Palmdale, California with a mortgage from Countrywide Financial. Soon thereafter, Bank of America purchased Countrywide Financial and assumed control over ***1190** Lusnak's mortgage. In March 2009, Lusnak refinanced his mortgage, and in January 2011, he and Bank of America agreed to modify certain terms. The 2009 agreement and 2011 modification contain the relevant terms governing Lusnak's mortgage. The agreements provide that Lusnak's mortgage "shall be governed by federal law and the law of the jurisdiction in which the Property is located." The parties agree that the terms of Lusnak's mortgage require Bank of America to pay interest on escrow funds if required by federal law or state law that is not preempted.

As a condition for obtaining a mortgage, Lusnak was required to open a mortgage escrow account into which he pays $250 per month. Lusnak alleges that Bank of America is able to enrich itself by earning returns on funds in his account. Bank of America acknowledges that it does not comply with state escrow interest laws and that Wells Fargo—its chief competitor and the largest mortgage banker in America—does. But it contends that no federal or "applicable" state law requires it to pay interest on Lusnak's escrow account funds.

D. Procedural History

On March 12, 2014, Lusnak filed this lawsuit on behalf of himself and a proposed class of similarly situated Bank of America customers. Pursuant to the "unlawful" prong of California's UCL, Lusnak alleged that Bank of America violated both state law, Cal. Civ. Code § 2954.8(a), and federal law, 15 U.S.C. § 1639d(g)(3), by failing to pay interest on his escrow account funds. Lusnak also brings a breach of contract claim, alleging that Bank of America's failure to pay interest violated his mortgage agreement. Bank of America promptly moved to dismiss on the ground that California Civil Code § 2954.8(a) is preempted by the NBA.

The district court granted the motion to dismiss. *Lusnak v. Bank of Am., N.A.*, No. CV 14-1855-GHK (AJWx), 2014 WL 6779131 (C.D. Cal. Oct. 29, 2014). It first acknowledged that Dodd–Frank clarified and amended the NBA preemption framework. *Id.* at *3–5. The district court then concluded that California's escrow interest law "prevents or significantly interferes with" banking powers and therefore is preempted by the NBA. *Id.* at *7–8. In so concluding, the district court determined that section 1639d(g)(3) of Dodd–Frank did not impact the preemption analysis. *Id.* at *8–9. This appeal followed.

II. Jurisdiction and Standard of Review

[1]We have jurisdiction under 28 U.S.C. § 1291. This court reviews de novo a district court's dismissal for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6). *Aguayo v. U.S. Bank*, 653 F.3d 912, 917 (9th Cir. 2011). "Questions of statutory interpretation are

reviewed de novo ... as are questions of preemption." *Lopez v. Wash. Mut. Bank*, 302 F.3d 900, 903 (9th Cir. 2002) (citations omitted).

III. Discussion

The central question here is whether the NBA preempts California Civil Code § 2954.8(a). Section 2954.8(a) requires "[e]very financial institution" to pay "at least 2 percent simple interest per annum" on escrow account funds.[3] The portion of ***1191** Dodd–Frank to which the parties draw this court's attention, section 1639d(g)(3), which amends the Truth in Lending Act ("TILA"), states:

> (3) Applicability of payment of interest
>
> If prescribed by applicable State or Federal law, each creditor shall pay interest to the consumer on the amount held in any impound, trust, or escrow account that is subject to this section in the manner as prescribed by that applicable State or Federal law.

15 U.S.C. § 1639d(g)(3). According to Lusnak, this section's plain language—requiring creditors to pay interest on escrow fund accounts like his if "prescribed by applicable" state law—made clear that Congress perceived no conflict between state laws like California Civil Code § 2954.8(a) and the powers of national banks. Therefore, Congress clearly did not intend for these state laws to be preempted by the NBA. Bank of America counters that such state laws are preempted because they prevent or significantly interfere with the exercise of its banking powers, and a preempted law cannot be an "applicable" law under section 1639d(g)(3). We begin by examining the relevant preemption framework.

A. Preemption Framework

1. *Guiding Principles of Preemption*

[2] [3]Our analysis is governed by "the two cornerstones of ... preemption jurisprudence." *Wyeth v. Levine*, 555 U.S. 555, 565, 129 S.Ct. 1187, 173 L.Ed.2d 51 (2009). "First, 'the purpose of Congress is the ultimate touchstone in every pre-emption case.' " *Id.* (quoting *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485, 116 S.Ct. 2240, 135 L.Ed.2d 700 (1996)). "[W]hen Congress has made its intent known through explicit statutory language, the courts' task is an easy one." *English v. Gen. Elec. Co.*, 496 U.S. 72, 79, 110 S.Ct. 2270, 110 L.Ed.2d 65 (1990). Second, we start with the assumption that the State's historic police powers are not preempted "unless that was the clear and manifest purpose of Congress." *Wyeth*, 555 U.S. at 565, 129 S.Ct. 1187 (quoting *Medtronic*, 518 U.S. at 485, 116 S.Ct. 2240).

[4]In the context of the NBA, Dodd–Frank provides that state laws are preempted if they "prevent[ ] or significantly interfere[ ] with the exercise by the national bank of its powers." 12 U.S.C. § 25b(b)(1)(B). Applying this standard, there is no presumption against preemption. *See Bank of Am. v. City & Cty. of San Francisco*, 309 F.3d 551, 558 (9th Cir. 2002). This does not, however, absolve a national bank of the burden of proving its preemption defense. *See Dilts v. Penske Logistics, LLC*, 769 F.3d 637, 649 (9th Cir. 2014) ("Defendants ... bear the burden of proof in establishing the affirmative defense of preemption."). Where, as here, we are confronted with state consumer protection laws, "a field traditionally regulated by the states, compelling evidence of an intention to preempt is required." *Aguayo*, 653 F.3d at 917 (quoting *Gen. Motors Corp. v. Abrams*, 897 F.2d 34, 41–42 (2d Cir. 1990)). Accordingly, because this case involves state regulation of consumer credit, Bank of America must affirmatively demonstrate that Congress intended to preclude states from enforcing their escrow interest laws.

2. *Dodd–Frank's Amendments to the NBA Preemption Framework*

Dodd–Frank addressed the preemptive effect of the NBA in several ways. First, it emphasized that the legal standard for ***1192** preemption set forth in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 116 S.Ct. 1103, 134 L.Ed.2d 237 (1996), applies to questions of whether state consumer financial laws are preempted by the NBA. 12 U.S.C. § 25b(b)(1)(B). Second, it required the OCC to follow specific procedures in making any preemption determination. *See id.* §§ 25b(b)(1)(B) (requiring the OCC to make any preemption determination on a "case-by-case basis"); 25b(b)(3)(B) (requiring the OCC to consult the Bureau of Consumer Financial Protection when making a preemption determination). And third, it clarified that the OCC's preemption determinations are entitled only to *Skidmore*

deference. 12 U.S.C. § 25b(b)(5)(A); *see Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944) (explaining that an agency's views are "entitled to respect" only to the extent that they have the "power to persuade"). Of these, only the second amendment was an actual change in the law. The first and third amendments merely codified existing law as set forth by the Supreme Court.

Before Dodd–Frank, the Supreme Court held in *Barnett Bank* that states are not "deprive[d] ... of the power to regulate national banks, where ... doing so does not *prevent or significantly interfere* with the national bank's exercise of its powers." 517 U.S. at 33, 116 S.Ct. 1103 (emphasis added). This is because "normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted." *Id.*

Following *Barnett Bank*, the OCC issued in 2004 its interpretation of the NBA preemption standard: "Except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized real estate lending powers do not apply to national banks." 12 C.F.R. § 34.4(a) (effective Jan. 13, 2004). The OCC framed its interpretation as merely reflecting *Barnett Bank* and earlier obstacle preemption case law. *See* Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1910 (Jan. 13, 2004) ("The OCC intends this phrase as the distillation of the various preemption constructs articulated by the Supreme Court, as recognized in Hines and Barnett, and not as a replacement construct that is in any way inconsistent with those standards."). But its formulation raised concern and confusion over the scope of NBA preemption.[4]

[5] [6]We never addressed whether the OCC's interpretation was inconsistent with *Barnett Bank*, or whether the regulation was owed deference while it was in effect. The Supreme Court, however, has indicated that regulations of this kind should receive, at most, *Skidmore* deference—and even then, only as to a conflict analysis, and not as to the legal conclusion on preemption. In *Wyeth v. Levine*, the Supreme Court noted that when Congress has not ***1193** authorized an agency to preempt state law directly, the Court "ha[s] not deferred to an agency's *conclusion* that state law is preempted." 555 U.S. at 576, 129 S.Ct. 1187. Rather, it "ha[s] attended to an agency's explanation of how state law affects the regulatory scheme" based on the agency's "unique understanding of the statutes [it] administer[s] and [its] attendant ability to make informed determinations about how state requirements may pose an 'obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Id.* at 576–77, 129 S.Ct. 1187 (citations omitted). And the weight to be accorded an agency's explanation of a state law's impact on a federal scheme "depends on its thoroughness, consistency, and persuasiveness." *Id.* at 577, 129 S.Ct. 1187; *see Skidmore*, 323 U.S. at 140, 65 S.Ct. 161.

We conclude that under *Skidmore*, the OCC's regulation would have been entitled to little, if any, deference in light of *Barnett Bank*, even before the enactment of Dodd–Frank. This regulation was the OCC's articulation of its legal analysis; the OCC simply purported to adopt the Supreme Court's articulation of the applicable preemption standards in prior cases, but did so inaccurately. *See* 69 Fed Reg. at 1910 ("We have adopted in this final rule a statement of preemption principles that is consistent with the various formulations noted [in Supreme Court precedent] ... ; that is, that state laws do not apply to national banks if they impermissibly contain a bank's exercise of a federally authorized power."). The OCC did not conduct its own review of specific potential conflicts on the ground. *See id.* It follows that the OCC's 2004 preemption regulation had no effect on the preemption standard prior to Dodd–Frank, which was governed by *Barnett Bank*.

[7]In Dodd–Frank, Congress underscored that *Barnett Bank* continues to provide the preemption standard; that is, state consumer financial law is preempted *only if* it "prevents or significantly interferes with the exercise by the national bank of its powers," 12 U.S.C. § 25b(b)(1)(B). Congress also made clear that only *Skidmore* deference applies to preemption determinations made by the OCC.[5] *See id.* § 25b(b)(5)(A). The OCC has recognized as much. *See, e.g.*, 76 Fed. Reg. at 43557 (conceding that section 25b(b)(1)(B) "may have been intended to change the OCC's approach by shifting the basis of preemption back to the [*Barnett Bank*] decision itself"). Therefore, to the extent that the OCC has largely reaffirmed its previous preemption conclusions without further analysis under the *Barnett Bank* standard, *see* 76 Fed. Reg. at 43556, we give it no greater deference than before Dodd–Frank's enactment, as the standard applied at that time did not conform to *Barnett Bank*. That is, the OCC's conclusions ***1194** are entitled to little, if any, deference.

The one substantive change in the law that Dodd–Frank enacted was to require the OCC to follow certain procedures in making preemption determinations. Dodd–Frank mandates that all of the OCC's future preemption determinations be made "on a case-by-case basis, in accordance with applicable law." 12 U.S.C. §

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25b(b)(1)(B). Under the "case-by-case basis" requirement, the OCC must individually evaluate state consumer laws *and* consult with the Bureau of Consumer Financial Protection before making any preemption determinations. 12 U.S.C. § 25b(b)(3). In addition, the OCC may not deem preempted a provision of a state consumer financial law "unless substantial evidence, made on the record of the proceeding, supports the specific finding regarding the preemption of such provision in accordance with [*Barnett Bank*]." 12 U.S.C. § 25b(c). Finally, the OCC must review its preemption determinations at least once every five years. 12 U.S.C. § 25b(d). These changes have no bearing here where the preemption determination is made by this court and not the OCC.

We now turn to the question of whether the NBA preempts California's escrow interest law.

B. The NBA Does Not Preempt California's Escrow Interest Law

[8]Under both *Barnett Bank* and Dodd–Frank, we must determine whether California Civil Code § 2954.8(a) "prevents or significantly interferes" with Bank of America's exercise of its national bank powers.[6] As Congress provided in Dodd–Frank, the operative question is whether section 2954.8(a) *prevents* Bank of America from exercising its national bank powers or *significantly interferes* with Bank of America's ability to do so. *See* 12 U.S.C. § 25b(b)(1)(B). Minor interference with federal objectives is not enough. *Watters*, 550 U.S. at 11, 127 S.Ct. 1559 ("[F]ederal control shields national banking from *unduly* burdensome and duplicative state regulation." (emphasis added)); *id.* at 12, 127 S.Ct. 1559 ("[W]hen state prescriptions *significantly* impair the exercise of authority, enumerated or incidental under the NBA, the State's regulations must give way." (emphasis added)).

[9]Applying that standard here, we hold that California Civil Code § 2954.8(a) is not preempted because it does not prevent or significantly interfere with Bank of America's exercise of its powers. Again, section 1639d(g)(3) of Dodd–Frank states, "If prescribed by applicable State or Federal law, each creditor shall pay interest to the consumer on the amount held in any ... escrow account that is subject to this section in the manner as prescribed by that applicable State or Federal law." 15 U.S.C. § 1639d(g)(3). This language requiring banks to pay interest on escrow account balances "[i]f prescribed by applicable State [ ] law" expresses Congress's view that such laws would not necessarily ***1195** prevent or significantly interfere with a national bank's operations.

Dodd–Frank does not define the term "applicable." But the Supreme Court recently explained:

> "Applicable" means "capable of being applied: having relevance" or "fit, suitable, or right to be applied: appropriate." Webster's Third New International Dictionary 105 (2002). See also New Oxford American Dictionary 74 (2d ed. 2005) ("relevant or appropriate"); 1 Oxford English Dictionary 575 (2d ed. 1989) ("[c]apable of being applied" or "[f]it or suitable for its purpose, appropriate"). So an expense amount is "applicable" within the plain meaning of the statute when it is appropriate, relevant, suitable, or fit.

Ransom v. FIA Card Servs., N.A., 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011); *see also Applicable*, Collins English Dictionary 97 (12th ed. 2014) ("being appropriate or relevant"); *Applicable*, Oxford Dictionaries (Oxford University Press), https://premium.oxforddictionaries.com/definition/american_english/applicable (last visited Jan. 25, 2018) ("[r]elevant or appropriate"). Accordingly, "applicable" law in the context of section 1639d(g)(3) would appear to include any relevant or appropriate state laws that require creditors to pay interest on escrow account funds.

The inclusion of this term makes sense because not every state has escrow interest laws. In a regulation implementing Dodd–Frank's amendments to the TILA, the Consumer Financial Protection Bureau explained that:

> [T]he creditor may be able to gain returns on the money that the consumers keep in their escrow account. Depending on the State, the creditor might not be required to pay interest on the money in the escrow account. The amount that the consumer is required to have in the consumer's escrow account is generally limited to two months' worth of property taxes and home insurance. However, some States require a fixed interest rate to be paid on escrow accounts, resulting

> in an additional cost to the creditors.

Escrow Requirements Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 4726, 4747 (Jan. 22, 2013). Lusnak notes that only thirteen states appear to have escrow interest laws similar to California's. Through its requirement that creditors pay interest "in the manner as prescribed by" the relevant state law, Congress demonstrated an awareness of, and intent to address, the differences among state escrow interest laws. 15 U.S.C. § 1639d(g)(3). "[W]e may reasonably presume that Congress was aware of [existing law when it legislated]," *Do Sung Uhm v. Humana, Inc.*, 620 F.3d 1134, 1155 (9th Cir. 2010), and that it used the term "applicable" to refer to state escrow interest laws where they exist.[7]

Although we need not resort to legislative history, we note that it, too, confirms our interpretation of section 1639d(g)(3). A House Report discusses how mortgage servicing, and specifically escrow accounts, contributed to the subprime mortgage crisis. H.R. Rep. No. 111-94, at 53–56. The Report notes that mortgage servicers are typically "large corporations" who "may ... earn income from the float from escrow ***1196** accounts they maintain for borrowers to cover the required payments for property insurance on the loan." *Id.* at 55. The Report's section-by-section analysis of Dodd–Frank then explains Congress's purpose behind section 1639d(g)(3), stating:

> Servicers must administer such accounts in accordance with the Real Estate Settlement Procedures Act (RESPA), [Flood Disaster Protection Act], and, if applicable, the law of the State where the real property securing the transaction is located, *including* making interest payments on the escrow account if required under such laws.

Id. at 91 (emphasis added). This passage shows Congress's view that creditors, including large corporate banks like Bank of America, can comply with state escrow interest laws without any significant interference with their banking powers.

No legal authority supports Bank of America's position that California Civil Code § 2954.8(a) prevents or significantly interferes with the exercise of its powers. Bank of America falls back on the OCC's pre-Dodd–Frank preemption rule, 12 C.F.R. § 34.4(a) (2004), but as we explained, Congress has since clarified that *Barnett Bank*'s preemption standard applies. Bank of America's reliance on the OCC's post-Dodd–Frank revision of section 34.4(a) also fails. Reading section 34.4(a) in isolation, Bank of America argues that state escrow interest laws necessarily prevent or significantly impair its real estate lending authority. However, the OCC's amendments specifically altered the language of section 34.4(b) to clarify that state laws "that [are] made applicable by Federal law" (which would include Dodd–Frank's TILA amendments) "are not inconsistent with the real estate lending powers of national banks ... to the extent consistent with [*Barnett Bank*]." 12 C.F.R. § 34.4(b)(9) (2011).

All of Bank of America's cited cases are inapposite. *Flagg v. Yonkers Savings & Loan Association* concerned the Office of Thrift Supervision's ("OTS") authority to regulate federal savings associations, and the Second Circuit's holding in that case was based on the OTS's field preemption over the regulation of such associations. 396 F.3d 178, 182 (2d Cir. 2005). Unlike the OTS, the OCC does not enjoy field preemption over the regulation of national banks.[8] *Aguayo*, 653 F.3d at 921–22 ("[W]hile the OTS and the OCC regulations are similar in many ways ... the OCC has explicitly avoided full field preemption in its rulemaking and has not been granted full field preemption by Congress."). *First Federal Savings and Loan Association of Boston v. Greenwald* also fails to support Bank of America's position. 591 F.2d 417 (1st Cir. 1979). *Greenwald* concerned a direct conflict between a state regulation requiring payment of interest on certain escrow accounts and a federal regulation expressly stating that no such obligation was to be imposed on federal savings associations "apart from the duties imposed by this paragraph" or "as provided by contract." *Id.* at 425. Here, there is no federal regulation that directly conflicts with section 2954.8(a).[9]

***1197** In sum, no legal authority establishes that state escrow interest laws prevent or significantly interfere with the exercise of national bank powers, and Congress itself, in enacting Dodd–Frank, has indicated that they do not. Accordingly, we hold that the NBA does not preempt California Civil Code § 2954.8(a).

C. Lusnak's Claims For Relief

We turn now to Lusnak's two claims for relief. Using the UCL as a procedural vehicle, Lusnak alleges that Bank of America violated both state law, Cal. Civ. Code § 2954.8(a), and federal law, 15 U.S.C. § 1639d(g)(3), by failing to pay interest on his escrow account funds. *See Levitt v. Yelp! Inc.*, 765 F.3d 1123, 1130 (9th Cir. 2014) ("In prohibiting 'any unlawful' business practice, the UCL 'borrows violations of other laws and treats them as unlawful practices that the unfair competition law makes independently actionable.' "). Lusnak also brings a state-law breach of contract claim, alleging that Bank of America's failure to pay interest violated his mortgage agreement.

[10]Bank of America—failing to distinguish between Lusnak's state and federal theories—argues that his UCL claim cannot proceed because his escrow account was created before section 1639d's effective date of January 21, 2013. 124 Stat. at 2136. We agree that Lusnak cannot rely on section 1639d in prosecuting his UCL claim. Section 1639d mandates that creditors establish escrow accounts in connection with certain mortgages. *See* 15 U.S.C. § 1639d(a)–(b). Specifically, section 1639d(a) states that "a creditor, in connection with the consummation of a consumer credit transaction secured by a first lien on the principal dwelling of the consumer ... *shall establish, before the consummation of such transaction*, an escrow or impound account ... *as provided in, and in accordance with, this section*." 15 U.S.C. § 1639d(a) (emphasis added). The use of prospective language, specifically "shall establish, before the consummation of such transaction," indicates that Congress intended the detailed requirements in section 1639d to apply to accounts established pursuant to that section after it took effect in 2013.

Moreover, section 1639d(g)(3) requires creditors to pay interest under "applicable" state law on funds in federally mandated escrow accounts that are "subject to this section." 15 U.S.C. § 1639d(g)(3). Lusnak's escrow account was not a federally mandated account "subject to" section 1639d at the time it was created because it was established before that section took effect in 2013. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208, 109 S.Ct. 468, 102 L.Ed.2d 493 (1988) ("[C]ongressional enactments ... will not be construed to have retroactive effect unless their language requires this result.").

[11]However, these conclusions do not preclude Lusnak from obtaining relief under the UCL. Because California Civil Code § 2954.8(a) is not preempted, Bank of America was required to follow that law, and Lusnak may proceed on his UCL claim on the theory that Bank of America violated the UCL by failing to comply with section 2954.8(a). The parties argue over when exactly Bank of America's obligation to comply with section 2954.8(a) might have begun. Given that the *Barnett Bank* standard applied both pre- and post-Dodd Frank, the preemption analysis is the same in both time periods. Therefore, because section 2954.8(a) was not preempted when Bank of America assumed control over Lusnak's pre-existing escrow account, Bank of America's obligation to pay interest on any funds in Lusnak's escrow account was triggered from that point forward.

[12]Lusnak may also proceed on his breach of contract claim. Lusnak's mortgage ***1198** documents require Bank of America to pay escrow interest if "Applicable Law requires interest to be paid on the Funds." The mortgage defines "Applicable Law" as "all controlling applicable federal, state and local statutes, regulations, ordinances and administrative rules and orders (that have the effect of law) as well as all applicable final, non-appealable judicial opinions." Accordingly, on the allegations in the complaint, a jury could find that the "Applicable Law" provision of the contract also requires that Bank of America pay interest on funds in Lusnak's escrow account.

IV. Conclusion

For the reasons set forth above, we **REVERSE** and **REMAND** the case for further proceedings consistent with this Opinion.

All Citations

883 F.3d 1185, 18 Cal. Daily Op. Serv. 2171, 2018 Daily Journal D.A.R. 1987

Footnotes

1 The Act was renamed "the national-bank act" in 1874. An Act Fixing the Amount of United States Notes, 43d Cong. Ch. 343, § 1, 18 Stat. 123, 123 (1874).

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2 The crisis resulted in 9.3 million lost homes, 8.8 million lost jobs, and $19.2 trillion in lost household wealth. *See* U.S. Dep't of the Treasury, The Financial Crisis Response in Charts 3 (2012); Laura Kusisto, *Many Who Lost Homes to Foreclosure in Last Decade Won't Return*, Wall St. J., Apr. 20, 2015, at A2.

3 In full, California Civil Code § 2954.8(a) states:

> Every financial institution that makes loans upon the security of real property containing only a one- to four-family residence and located in this state or purchases obligations secured by such property and that receives money in advance for payment of taxes and assessments on the property, for insurance, or for other purposes relating to the property, shall pay interest on the amount so held to the borrower. The interest on such amounts shall be at the rate of at least 2 percent simple interest per annum. Such interest shall be credited to the borrower's account annually or upon termination of such account, whichever is earlier.

4 The OCC's preemption rule reads more broadly than *Barnett Bank*'s "prevent or significantly interfere" standard in two respects. First, the OCC omitted the intensifier "significantly" and used the terms "impair" and "condition" rather than "interfere." Second, it insisted that banks be able to "fully" exercise their NBA powers. *See* Staff of H. Comm. on Fin. Servs., 108th Cong., Views and Estimates of the Committee on Financial Services on Matters to be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005 15–16 (Comm. Print 2004) ("[The OCC's 2004] rules may represent an unprecedented expansion of Federal preemption authority ...."); Jared Elosta, *Dynamic Federalism and Consumer Financial Protection: How the Dodd–Frank Act Changes the Preemption Debate*, 89 N.C. L. Rev. 1273, 1280 (2011) ("[T]here is reason to believe that the OCC went beyond clarifying Barnett Bank and in fact made it much easier for the OCC to preempt state laws than the Barnett Bank standard would allow.").

5 That these provisions were among those that had a future effective date, *see* 124 Stat. at 2018, makes no difference to our analysis. If we were to apply the "previous" NBA preemption standard and level of deference to OCC preemption determinations, we would apply, as explained above, the *Barnett Bank* standard and *Skidmore* deference required by the Dodd–Frank amendments.
Of course, a statute should be "so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." *TRW Inc. v. Andrews*, 534 U.S. 19, 31, 122 S.Ct. 441, 151 L.Ed.2d 339 (2001) (quoting *Duncan v. Walker*, 533 U.S. 167, 174, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001)). But no such superfluity exists here where the effective date provision applies to the whole subtitle, which imposes other requirements upon the OCC, and not just the provisions clarifying the preemption and agency deference standards. 124 Stat. at 2018. In fact, the OCC appears to have interpreted the effective date in just such a manner. *See* 76 Fed. Reg. at 43557.

6 Ordinarily, affirmative defenses such as preemption may not be raised on a motion to dismiss except when the defense raises no disputed issues of fact. *Scott v. Kuhlmann*, 746 F.2d 1377, 1378 (9th Cir. 1984) (per curiam); *see also Rose v. Chase Bank USA, N.A.*, 513 F.3d 1032, 1038 n.4 (9th Cir. 2008) (declining to remand for further discovery because "no amount of discovery would change the central holding that Congress intended for the NBA to preempt [this] state restriction[ ] on national banks ...."). Such is the case here. Bank of America's arguments are purely legal and do not depend on resolution of any factual disputes over the effect of California law on the bank's business. Indeed, Bank of America confirms that "[n]o discovery is necessary ... because this is a legal inquiry, not a factual one."

7 In so construing the term "applicable," we do not suggest that a state escrow interest law can *never* be preempted by the NBA. For example, a state law setting punitively high rates banks must pay on escrow balances may prevent or significantly interfere with a bank's ability to engage in the business of banking. We simply recognize that Congress's reference to "applicable State ... law" in section 1639d(g)(3) reflects a determination that state escrow interest laws do not necessarily prevent or significantly interfere with a national bank's business.

8 Nor does the OCC enjoy field preemption over the regulation of federal savings associations. 12 U.S.C. § 1465(b).

9 Bank of America's district court authorities are nonbinding and unpersuasive. *See Hayes v. Wells Fargo Bank, N.A.*, No. 13cv1707 L( ), 2014 WL 3014906 (S.D. Cal. Jul. 3, 2014); *Wis. League of Fin. Insts., Ltd. v. Galecki*, 707 F.Supp. 401 (W.D. Wis. 1989). As in *Flagg*, the court in *Hayes* based its holding on the OTS's field preemption over the regulation of federal savings associations. 2014 WL 3014906, at *5. And *Galecki* concerned the regulatory authority of the Federal Home Loan Bank Board, which was "*preemptive of any state law purporting to address the subject of the operations of a Federal [savings] association.*" 707 F.Supp. at 404 (quoting 12 C.F.R. § 545.2).

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Elizabeth L. McKeen and Benjamin D. Brooks, Standing Decisions Following *Spokeo, Inc. v. Robins*, 136 S.Ct. 1540 (2016)

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In *Spokeo, Inc. v. Robins*,[2] the Supreme Court clarified that mere violation of a statutory right is not, in itself, sufficient to satisfy the "concrete injury" standard for Article III standing. Many practitioners expected *Spokeo* to impact courts' standing analysis in FCRA and other litigation in potentially significant ways. But *Spokeo*'s impact appears to have been more marginal. Many courts have ostensibly applied *Spokeo*'s guidance, with results that appear largely indistinguishable from the pre-*Spokeo* jurisprudence.

I. THE *SPOKEO* DECISION

In *Spokeo*, the defendant operated a web site that allowed users, including prospective employers, to search for information about individuals by name, e-mail address, or phone number. In response to an inquiry, Spokeo provided information such as the individual's address, phone number, marital status, age, occupation, hobbies, finances, shopping habits, and musical preferences.

The plaintiff discovered that Spokeo had generated a profile relating to him containing inaccurate information. In particular, it inaccurately stated that plaintiff was married, in his 50s, employed, relatively affluent, had children, and held a graduate degree. He filed suit, asserting claims that Spokeo willfully violated the Fair Credit Reporting Act's ("FCRA")[3] requirements that consumer reporting agencies ("CRAs") must: (1) follow reasonable procedures to ensure maximum possible accuracy of information in consumer reports, (2) notify providers and users of consumer information of the CRA's FCRA responsibilities, (3) limit the circumstances under which CRAs provide consumer reports for employment purposes, and (4) post toll-free numbers for consumers to request their consumer reports.[4]

The district court dismissed the complaint for failure to plead an injury in fact sufficient to confer standing, but the Ninth Circuit reversed, holding that because plaintiff alleged that "Spokeo violated *his* statutory rights," and because "his personal interests in the handling of his credit information are individualized," plaintiff satisfied Article III's injury-in-fact requirement.[5]

2. 136 S.Ct. 1540 (2016).
3. 15 U.S.C. §§ 1681 *et. seq.*
4. *Id.* at 1545 (citing 15 U.S.C. §§ 1681e(b), 1681e(d), 1681b(b)(1), 1681j(a), and 1681n(a)).
5. *Id.* at 1546 (emphasis in original) (internal quotation marks omitted).

The Supreme Court held that the Ninth Circuit's standing analysis was incomplete.[6] To establish injury-in-fact, the Court held that the harm must be both particularized and concrete, and the Ninth Circuit's analysis only addressed whether plaintiff's alleged injury was particularized.[7] The Court did not take issue with the Ninth Circuit's analysis regarding particularity, but remanded the case with instructions to address whether plaintiff alleged a concrete harm, and it provided instruction regarding how to determine whether a harm is concrete.[8]

With respect to statutory violations, *Spokeo* distinguishes concrete harms, which it defined as *de facto* harms that "actually exist"—even if they are intangible, difficult to prove or quantify, or were previously inadequate in law—from mere procedural statutory violations divorced from some concrete interest affected by the violation.[9] Further, to determine whether an intangible harm is concrete, *Spokeo* explains that courts should consider both congressional judgment and whether the alleged intangible harm has a "close relationship" to traditional common law injuries.[10] Accordingly, after *Spokeo*, a violation of a statutory right does not automatically satisfy the injury-in-fact requirement, even if the statute purports to authorize private vindication of the right.[11]

Practitioners expected *Spokeo* to significantly impact standing determinations in litigation asserting bare statutory violations, and particularly in the context of FCRA litigation. However, as the numerous standing decisions standing since *Spokeo* demonstrate, *Spokeo* left ample room for courts to maintain their pre-*Spokeo* standing tests.

II. *SPOKEO'S* APPLICATION IN SUBSEQUENT STANDING DECISIONS

Since *Spokeo*, standing to pursue FCRA claims has become a frequently litigated topic. Indeed, before *Spokeo*, federal appellate courts addressed consumers' standing to pursue FCRA claims in only five instances. In contrast, in the approximately two and a half years since *Spokeo*, federal appellate courts have issued 20 decisions addressing plaintiffs' standing to

6. *Id.* at 1548.
7. *Id.*
8. *Id.* at 1549–50.
9. *Id.* at 1548–50.
10. *Id.* at 1549.
11. *Id*.

pursue FCRA claims.[12] Nevertheless, and despite the fact that appellate courts frequently grapple with the standing requirements *Spokeo* articulated, the courts have essentially continued to apply their pre-*Spokeo* analyses. In particular, the courts point to *Spokeo*'s affirmation of congressional authority to elevate previously inadequate harms, characterize procedural statutory requirements as bearing on the statutory scheme's fundamental purposes (such as to reduce incidence of identity theft or to protect consumer privacy), and loosely analogize to common law torts.

For example, on remand in *Spokeo* itself, the Ninth Circuit held that the plaintiff had suffered a concrete injury and accordingly held that the plaintiff had standing to pursue his claims.[13] It explained that plaintiff's interest in accurate reporting of his consumer information was concrete, and that the nature of the information at issue (plaintiff's age, marital status, educational background, and employment history) might be important to prospective employers or others that would make use of the Spokeo's profile.[14] Further, it held that a violation of the procedural requirement at issue—to adopt reasonable procedures to ensure the maximum possible accuracy of information in consumer reports—presents a real risk of harm to the plaintiff's concrete interest in accurate reporting.[15] The court further reasoned that the inaccuracies at issue did not appear to be mere technical violations.[16]

Under the Ninth Circuit's rule, it did not matter that the plaintiff had not alleged that his Spokeo profile was provided to anyone other than plaintiff, that any prospective employer had viewed his profile, or that there was an impending risk that a prospective employer might do so.[17]

Other circuits have responded similarly. For example, the Third Circuit held in *Long v. Southeast Pennsylvania Transportation Authority* that *Spokeo* did not require it to change its standing analysis.[18] In *Long*, the

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12. *Meyers v. Oneida Tribe of Indians of Wisconsin*, 836 F.3d 818 (7th Cir. 2016), had opportunity to address plaintiffs' standing to pursue their FCRA claims under *Spokeo*, which had been decided after briefing and argument had concluded in *Meyers*, but instead resolved the case on a separate threshold basis.
13. *Robins v. Spokeo*, 867 F.3d 1108, 1118 (9th Cir. 2017) ("*Spokeo II*").
14. *Id.* at 1117.
15. *See id.* at 1113–14.
16. *Id.* at 1117.
17. *See Spokeo*, 136 S.Ct. at 1546 (noting that "someone ([plaintiff's] complaint does not specify who) made a Spokeo search request for information about plaintiff," and "[b]y some means not detailed in [plaintiff's] complaint, he became aware of the contents of that profile"); *see also Spokeo II*, 867 F.3d at 1110–11.
18. 903 F.3d 312, 324 (3d Cir. 2018), *reh'g denied* (Oct. 5, 2018).

plaintiffs had applied for employment, and they provided criminal history disclosures in connection with their applications and authorized the defendant to conduct background checks.[19] The defendant denied plaintiffs' applications based on their criminal histories, but did not provide copies of plaintiffs' background checks to them before denying the applications as the FCRA requires.[20] The defendant had a categorical ban on hiring anyone for the positions for which plaintiffs applied where the applicant had a prior drug conviction, and plaintiffs did not allege that anything in their background checks was inaccurate.[21] The district court dismissed the complaint, holding that the defendant's FCRA violation "did not cause the type of harm to Plaintiffs, or present any material risk of harm, that would give rise to a de facto injury."[22]

The Third Circuit reversed, holding that an employer's procedural FCRA violation of failing to provide a copy of a consumer report to the applicant before taking adverse action based on the report is itself a concrete injury, even if the applicant could not have taken any action to prevent the adverse action.[23] In the *Long* court's view, the requirement to provide a copy of the consumer report to the applicant before taking adverse action not only protects consumers' interest in accurate consumer reporting, but also protects consumers' interest in the fair use of their information.[24] The court explained that the provision allows the plaintiff to ensure the information is accurate, but also gives the applicant the opportunity to explain why negative information is immaterial.[25] Finally, the court deemed the use of the applicant's personal information without the applicant's ability to see or respond to it to be sufficiently analogous to traditional common law torts relating to interference with individuals' ability to control their personal information.[26]

Similarly, in *Robertson v. Allied Solutions, LLC*, the plaintiff alleged that the defendant revoked a job offer based on information contained in her consumer report without providing the consumer report to plaintiff in advance.[27] The district court dismissed the claim for lack of jurisdiction

19. *Id.* at 317.
20. *Id.*; *see also* 15 U.S.C. § 1681b(b)(3)(i).
21. *Id.*
22. *Id.* (internal quotation marks omitted).
23. *Id.*; *see also* 15 U.S.C. § 1681b(b)(3)(A)(i).
24. *Id.* at 318–19.
25. *Id.* at 324.
26. *Id.*
27. 902 F.3d 690, 693 (7th Cir. 2018).

because plaintiff had not alleged facts connecting the defendant's failure to provide the consumer report to plaintiff with the defendant's offer revocation, and noted that plaintiff did not allege that information was inaccurate, or that plaintiff could have favorably explained the information.[28] Like *Long*, the *Robertson* court reversed, explaining that the disclosure requirement at issue protects consumers' substantive interest in reviewing the reason for any adverse decision and responding to the information, even if the information is accurate.[29] The court thus held that "what matters is that [plaintiff] was denied information that could have helped her craft a response to [defendant's] concerns."[30]

Indeed, there are only a few discrete categories of claims since *Spokeo* in which federal appellate courts have held the plaintiff lacked standing to pursue FCRA claims: claims based on (1) requirements to truncate or omit credit card information on receipts;[31] (2) requirements to provide post-hoc notice of consumer report information on which adverse employment action was based;[32] (3) authorization and permissible purpose requirements

28. *Id.* at 694.
29. *Id*. at 696.
30. *Id*. at 697.
31. *See Bassett v. ABM Parking Servs., Inc.*, 883 F.3d 776, 780–82 (9th Cir. 2018) (holding that the requirement was designed to curb identity theft, that Congress had determined that credit card expiration dates did not materially contribute to identity theft, and noting that plaintiff did not allege that there was second receipt, that the receipt was lost or stolen, or that plaintiff had been a victim of identity theft). *See also Daniel v. Nat'l Park Serv.*, 891 F.3d 762, 768 (9th Cir. 2018) (similar); *Crupar-Weinmann v. Paris Baguette Am., Inc.*, 861 F.3d 76 (2d Cir. 2017) (similar); *Meyers v. Nicolet Restaurant of De Pere, LLC*, 843 F.3d 724 (7th Cir. 2016) (similar); *Noble v. Nevada Checker Cab Corp.*, 726 F. App'x 582 (9th Cir. 2018) (holding alleged violation of requirement to truncate credit card numbers on retail receipts did not confer standing where the defendant had included the first and last four digits of the consumer's credit card number because the first digit only identifies the brand of the card, and the FCRA does not prohibit printing the name of the card issuer on a receipt).
32. *Rivera v. Allstate Ins. Co.*, 907 F.3d 1031, 1046 (7th Cir. 2018) (holding that FCRA's requirement to provide notice of information in a consumer report after taking adverse action against an employee based on the information was insufficient to confer standing because the requirement performed only a post-hoc notice function, and did not allow the consumer to meaningfully respond to the information or avert the adverse action).

where all conduct was within the scope of the plaintiff's consent;[33] and (4) requirements to provide a clear and conspicuous pre-employment background check disclosure in a standalone document.[34]

For example, in *Bassett v. ABM Parking Services, Inc.*, the plaintiff had used his credit card at defendant's parking garage and received a receipt containing his credit card's full expiration date, in violation of the FCRA, as amended by the Fair and Accurate Credit Transactions Act ("FACTA").[35] The plaintiff alleged a statutory violation and potential for exposure to injury. In particular, the plaintiff did not allege that another copy of his receipt existed, that he was the victim of identity theft, or that anyone besides his lawyers had seen the receipt.[36] The court held that the FACTA violation at issue was insufficient to confer standing. It explained that the provision could be characterized as providing the following "rights": (1) "the right to be free from identity theft," (2) "the right to be free from disclosure to others of [plaintiff's] full credit card information," and (3) "the right to be free from receiving a receipt showing his credit card expiration date."[37] It held that only the last purported "right" had been violated, and that to the extent the provision created a substantive right, it was to prevent disclosure of a consumer's private financial information to

33. *Auer v. Trans Union, LLC*, 902 F.3d 873, 880 (8th Cir. 2018) (holding that the plaintiff did not suffer a concrete injury in connection with defendants' alleged violations of FCRA requirements to have a permissible purpose to pull a consumer report and to obtain certifications from the prospective user of the consumer report because all of the alleged conduct was within the scope of consent that plaintiff provided to the defendants).
34. *Grosheck v. Time Warner Cable, Inc.*, 865 F.3d 884, 889 (7th Cir. 2017), *cert. denied*, 138 S. Ct. 740 (2018) (holding that the defendant's failure to provide a background check disclosure in a standalone document did not cause a concrete harm because plaintiff did not allege that he failed to understand the disclosure, and did not allege that he would have acted differently had the defendant provided a compliant disclosure); *see also Robertson v. Allied Sols., LLC*, 902 F.3d 690, 694 (7th Cir. 2018) (holding plaintiff lacked standing to pursue claim that defendant violated provision requiring clear and conspicuous FCRA disclosure because plaintiff would not have acted differently had defendant provided a compliant disclosure). *See also Owner-Operator Independent Driver's Association, Inc. v. United States Department of Transportation*, 879 F.3d 339, 347 (D.C. Cir. 2018), which involved a separate statute that incorporated the FCRA's requirements by reference. *Owner-Operator* held that the Department of Transportation's mere inclusion of inaccurate information about drivers in its database, without subsequent dissemination of the information to a third party, did not create standing. *Id.*
35. 883 F.3d at 777; *see also* Pub. L. No. 108-159, 117 Stat. 1952.
36. *Id.* at 793.
37. *Id*. at 792 (internal quotation marks omitted).

identity thieves.[38] Moreover, the court noted a prior congressional determination that disclosure of a credit card's expiration date does not appreciably increase the risk of identity theft, and that common law privacy and wrongful disclosure torts were inapposite because they required the defendant to inappropriately access the plaintiff's information or disseminate it to third parties.[39]

Similarly, the Ninth Circuit held in *Noble v. Nevada Checker Cab Corp.* that the unlawful inclusion of a credit card's first digit on a receipt was not a concrete injury.[40] The court explained that the first digit only identifies the credit card brand, and that the FCRA does not prohibit including the name of the card issuer on a receipt. Thus, because the failure to truncate the first digit of a credit card number does not appreciably increase the risk of identity theft, this procedural violation does not cause a concrete injury sufficient to create standing.[41]

Further, in *Grosheck v. Time Warner Cable, Inc.*, the defendant provided a job application form that impermissibly combined a disclosure that the defendant would obtain a consumer report relating to the applicant, an authorization, and a liability waiver on the same form.[42] Plaintiff filed suit based on these violations, alleging that he suffered informational and privacy injuries.[43]

The Seventh Circuit held that plaintiff lacked standing because he did not allege that defendant failed to provide the required disclosure, or facts demonstrating that the additional information caused him to misunderstand the disclosure or the consent he provided, and he did not allege he would have withheld consent if defendant had provided a compliant disclosure.[44] First, it held that plaintiff had not suffered any informational injury because plaintiff had not failed to obtain any information.[45] Further, the court held that the plaintiff did not suffer any privacy injury because he signed the disclosure and authorization form.[46] Thus, the defendant's procedural violation of failing to include the disclosure on a standalone form was insufficient in itself to cause a concrete injury.

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38. *Id*.
39. *Id*. at 781–82.
40. 726 F. App'x 582 (9th Cir. 2018).
41. *Id*.
42. 865 F.3d 884, 886 (7th Cir. 2017).
43. *Id*.
44. *Id*. at 887.
45. *Id*. at 887–88.
46. *Id.* at 888–89.

Nevertheless, other courts addressing these types of claims have come to conclusions that would appear to be less consistent with what practitioners had anticipated in the wake of *Spokeo*. For example, in *Muransky v. Godiva Chocolatier, Inc.*, the plaintiff alleged that the defendant provided him with his credit card number's first six digits and the last four digits, in violation of FACTA's truncation requirement.[47] Like *Bassett*, the plaintiff in *Muransky* alleged only the statutory violation, which purportedly exposed plaintiff to a heightened risk of identity theft.[48] There was no allegation that anyone other than plaintiff received or viewed the receipt, nor was there any allegation that the plaintiff suffered identity theft, or was in imminent danger of identity theft.[49] And like *Noble*, the court recognized that the improperly-included digits merely identified the card issuer.[50]

But unlike *Basset* and *Noble*, the *Muransky* court held that the mere failure to truncate a credit card number on a receipt, without more, causes a concrete injury.[51] The court held that the resulting harm from the violation was "concrete in the sense that it involve[d] a clear *de facto* injury, *i.e.*, the unlawful disclosure of legally protected information."[52] The court based its decision on its assessment that "congress conceived of the harm as happening when the merchant provides *a customer* with an untruncated receipt," as opposed to disclosing the information to a third party.[53] In support, the court analogized the violation to common law breach of confidence and breach of implied bailment torts, and noted that plaintiff had been subject to the additional burdens to safely keep or dispose of the receipt, which was also a sufficient injury in fact.[54]

Similarly, unlike in *Groshek*'s holding that an employer's procedural failure to provide a disclosure that it may procure an applicant's consumer report in a standalone document is not itself a concrete injury, the Ninth Circuit has held that such a procedural failure may cause a sufficiently concrete harm to confer standing. In *Syed v. M-I, LLC*, the plaintiff allegedly discovered that his employer had provided him a non-compliant disclosure and authorization form that included a liability waiver in the same

47. 905 F.3d 1200, 1204–05 (11th Cir. 2018).
48. *Id*.
49. *Id.*
50. *See id.* at 1212.
51. *Id.* at 1210 ("We . . . conclude printing more than five digits of a credit card number in willful violation of FACTA causes the person whose account number is disclosed to suffer a concrete injury.").
52. *Id.* at 1210 (internal marks omitted).
53. *Id*. at 1210 (emphasis added).
54. *Id*. at 1211.

document.[55] Plaintiff had signed the authorization/waiver document, and pursuant to the agreement, the defendant had procured plaintiff's consumer report.[56] The court held that the plaintiff's allegation that the defendant had procured his consumer report pursuant to the noncompliant disclosure form was "sufficient to infer that [plaintiff] was deprived of the right to information and the right to privacy guaranteed by [the FCRA] because it indicates that [plaintiff] was not aware that he was signing a waiver authorizing the credit check when [plaintiff] signed it."[57] Drawing inferences in favor of the plaintiff, the Ninth Circuit held it could infer that the plaintiff had been confused by the disclosure, and that he would not have consented to a background check if the defendant had provided a compliant disclosure.[58]

As these and other standing decisions since *Spokeo* demonstrate, the concrete injury analysis *Spokeo* articulated has not materially changed the landscape of standing outcomes in cases asserting claims for bare statutory violations.

III. CONCLUSION

Contrary to practitioners' expectation that *Spokeo* would significantly impact courts' application of standing principles in litigation asserting claims for bare statutory violations, *Spokeo*'s impact has been marginal. Notwithstanding that standing issues are litigated in such cases more frequently, courts have with limited exception continued to apply their pre-*Spokeo* standing tests, and reach the same results.

55. 853 F.3d 492, 496 (9th Cir. 2017), *cert. denied*, 138 S. Ct. 447 (2017).
56. *Id*. at 496–97.
57. *Id.* at 499.
58. *Id.*

NOTES

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Truth as a Double-Edged Sword: Deception, Moral Paradox, and the Ethics of Advocacy, 14 J. Legal Prof. 89 (1989)

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Truth as a Double-Edged Sword: Deception, Moral Paradox, and the Ethics of Advocacy

*Linda E. Fisher**

> In speaking of lies, we come inevitably to the subject of truth. There is nothing simple or easy about this idea. There is no "the truth," "a truth"—truth is not one thing, or even a system. It is an increasing complexity. . . . Lies are usually attempts to make everything simpler—for the liar—than it really is, or ought to be.
>
> Adrienne Rich[1]

> "Telling the truth" . . . is not solely a matter of moral character; it is also a matter of correct appreciation of real situations and of serious reflection upon them. The more complex the actual situations of [one's] life, the more responsible and the more difficult will be [the] task of "telling the truth" . . . . [T]he simple fact is that the ethical cannot be detached from reality, and consequently continual progress in learning to appreciate reality is a necessary ingredient in ethical action.
>
> Dietrich Bonhoeffer[2]

> A lawyer shall not engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.[3]

INTRODUCTION

Lawyers wield the power of language and affect the lives of clients in complex and difficult situations. Rather than taking full responsibility for the power of our language to shape and characterize reality, we lawyers tend to adopt, unthinking, a role that obscures the complexity

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1. A. RICH, ON LIES, SECRETS AND SILENCE 187-88 (1979).

2. D. BONHOEFFER, ETHICS 364-65 (1949).

3. MODEL CODE OF PROFESSIONAL RESPONSIBILITY [hereinafter MODEL CODE] DR 1-102(A)(4) (1980). The corollary in the Model Rules of Professional Conduct states, "It is professional misconduct for a lawyer to engage in conduct involving dishonesty, fraud, deceit or misrepresentation." MODEL RULES OF PROFESSIONAL CONDUCT [hereinafter MODEL RULES] Rule 8.4(c) (1983).

of our professional duties. We find ourselves engaging in deceptive conduct that we would consider unacceptable in other contexts, without fully understanding or grappling with the discrepancy. When, if ever, is deception or deceptive ambiguity justified? Often, we suppress the resulting unease and qualms of conscience and consequently find ourselves burning out, experiencing a debilitating psychic tension.

By confronting some of the conflicts I and other lawyers have experienced in litigation, I will attempt to construct a moral theory to explain the ethics and paradoxes of litigation regarding dishonesty, focusing particularly on deception. I discuss dishonesty on two levels: first I am concerned with the personal dishonesty and self-deception of lawyers who fail to confront truthfully the moral ambiguities and complexities of legal practice. Second, I address this issue in the context of certain deceptive lawyer behavior in the courtroom, with clients, or vis-a-vis adversaries.

In constructing this ethical model, I will first introduce some of the paradoxes of litigation that generate much of its complexity. Next, I will discuss certain ethical conflicts that the paradoxes generate and attorney responses to them. After setting forth the requirements of the Model Rules of Professional Conduct and the Model Code of Professional Responsibility (professional codes) regarding zealous representation and dishonesty, I will outline my conception of the general relationship between the professional codes, lawyers' role-morality and ordinary morality, and the paradoxes. The interrelationships between these norms help explain the ethical dilemmas associated with the paradoxes of litigation. Finally, I will examine a situation I commonly encountered in practice that potentially involves deception and lying[4] – coaching witnesses in preparation for deposition or trial. I will analyze this situation using the expanding concentric circles of perspectives of the professional codes, role-morality and general morality.

I conclude that while we lawyers should remain subject to the counsel of ordinary morality in performing our legal tasks, nevertheless the unique nature and demands of the legal world often require a different application of moral standards than does private life. Although I endorse the professional codes, I also urge that we follow certain additional and stricter guidelines. We can remain moral persons operating in the legal world by seeking a pragmatic justice and truth that recognizes

4. Lying may be understood broadly as the use of any statement designed to deceive or mislead the listener. *See, e.g.*, S. BOK, LYING 13 (1978): ("I shall define as a lie any intentionally deceptive message which is stated." *Id.*)

reality and does not rationalize essential dishonesty.

THE PARADOXES OF LITIGATION

The conflicts mentioned above result partially from failure to fully understand the ethical dilemmas created by the paradoxes of litigation.[5] The three paradoxes I enumerate here comprise the tensions between duty to the client and to the court, between the real and the ideal, and between determinacy and indeterminacy.

The first paradox arises out of the constant tension between the attorney's duty to her client and to the court. Passionate commitment to the client often opposes the detached perspective of a universal duty to the entire legal system. This tension can also be conceptualized as a conflict between the political and moral aspects of litigation. Advocates espouse multiple and particular points of view, urging that their clients' perspectives prevail, while officers of the court work for justice and ultimate reconciliation of opposing views.

Unfortunately, however, courts themselves often operate politically, to ensure that judges' preferred policies are implemented or that the system operates efficiently, by disposing of cases and maintaining continuity. Advocates may further complicate the paradox by operating morally and seeking just resolutions to aid all parties. Finally, advocates or judges often convince themselves, whether truthfully or not, that they are the only moral actors in the litigation, in combat with actors who respond only to political pressures.

The second paradox arises from the tension between the real and the ideal. Although this tension is present in some fashion in all human activity where the theoretical must give way to the practical, it takes on a unique form in litigation.[6] Even though, on the one hand, the legal

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5. Regarding the relevance of the notion of paradox in the law, *see generally* B. CARDOZO, THE PARADOXES OF LEGAL SCIENCE 4 (1927):

> The reconciliation of the irreconcilable, the merger of antitheses, the synthesis of opposites, these are the great problems of the law . . . . We fancy ourselves to be dealing with some ultramodern controversy, the product of the clash of interests in an industrial society. The problem is laid bare, and at its core are the ancient mysteries crying out for understanding—rest and motion, the one and the many, the self and the not-self, freedom and necessity, reality and appearance, the absolute and the relative . . .

6. *See* White, *The Ethics of Argument: Plato's Gorgias and the Modern Lawyer*, 50 U. CHI. L. REV. 849, 889 (1983), which creates a fictional dialogue between Socrates and Euphemes, a defender of legal practice. Euphemes explains:

> The function of the law is to maintain a language that keeps alive [the]

ideal is to treat all parties fairly, the competitive reality of the adversary system nevertheless requires that each meet, if not outdo, the other in rhetorical tactics.[7] On the other hand, the system also holds an ideal of seeking justice and truth, while treating all parties fairly.

Under one view of the moral response to this tension, neither we nor our clients would ever sacrifice the whole truth for effectiveness. Under another view, effective advocacy is part of the ideal, allowing certain omissions, although essential dishonesty or compromise of the truth is not countenanced. Both views are distinct from the reality of legal practice, where lawyers regularly compromise the truth, without restriction, for the sake of expediency.

Furthermore, because disposition of a lawsuit requires placing the case into one of a discrete set of predetermined legal categories, the legal system encourages simplification and less than fully accurate characterization. Required to present a believable narrative, the litigator also must search for the most plausible explanation of events. The ideal of truthseeking often falls victim to this process.[8] Values enshrined in the Constitution and rules of evidence, such as privacy, further usurp the full truth at times.[9] The professional codes generally reflect a laissez-faire approach to the realities of practice, but also assert the ideal of justice at points, and maintain this tension.

The third paradox arises from the tension between determinacy and indeterminacy, or objectivity and relativity, as to both law and fact, inherent in our legal system. Law is largely indeterminate. While in an absolute, logical sense, it may be almost completely indeterminate,[10] sufficient standards of interpretation and value nevetheless exist to render a fair number of legal determinations, at least in the "easy" cases, rational and relatively objective. Regardless, indeterminacy allows many other legal decisions to be made politically.

> tension between fact and ideal, expediency and justice, self and other; this tension is in fact essential to the practice of talking about what justice requires . . . .[W]hen I say that the lawyer makes the "best case" that can be made in the circumstances, does that mean the case that is most persuasive or most just? . . .[T]he answer to that question is always, or almost always, unclear.

Id.

7. *See* Burns, *A Lawyer's Truth: Notes for a Moral Philosophy of Litigation Practice*, 3 J. OF LAW AND RELIGION 229, 236, 253-255 (1985).

8. *See Id.* at 257-59, 261-62.

9. *See* M. FRANKEL, PARTISAN JUSTICE 12 (1978).

10. *See generally* Tushnet, *Post-Realist Legal Scholarship*, 1980 WIS. L. REV. 1383 (1980).

Lawyers will make different arguments and pursue cases differently in a system perceived as indeterminate than in a system perceived as fixed. It can be very difficult to discern a frivolous argument or locate justice in a system containing characteristics of both poles. Thus, a lawyer may perceive as legitimate a legal argument that a judge considers frivolous.

For instance, suppose an appellate court ruled in a brief order that plaintiffs could not obtain damages for violations of their pure due process rights absent additional loss. Certain language in the opinion suggests that pure violations of other constitutional rights would be similarly noncompensable. A lawyer then argues to a district court that first amendment violations should be compensable because the law considers free speech rights particularly fragile and in need of special protection.

When I was in a similar situation, the judge became angry, treating our argument as frivolous. However, although one view of the law would support the court's perception, I believe our argument was legitimate under another view. No single correct view of the law existed in this situation, and I felt obligated to make the argument on behalf of my client. I also believe justice supported our position, although the appellate opinion easily could be read to foreclose the damages we requested.

Likewise, factual decisionmaking is often indeterminate. Perception and judgment are so dependent on the preconception and bias of the observer that even simple events are not susceptible to easy characterization.[11] The knower is part of the known and much knowledge is constructed.[12] This does not mean that no objective reality exists, but the difficulties of perceiving it make it easier for lawyers to distort sincere perceptions to conveniently support predetermined ends. Even our most unbiased attempts at knowledge are partial. Like the blind men and the elephant, we must be careful not to expand our limited perspectives to fill the universe. But lawyers are retained to lobby for the client's perspective only, tempting advocates to discard any vision of the whole. Ultimately, justice must be based on such a vision, though it must not abandon simultaneous concern for the individual.[13]

The partial moral relativity of our culture exacerbates the indeterminacy of both law and fact. Individuals do not necessarily evaluate

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11. *See* FRANKEL, *supra* note 9, at 74.

12. *See* M. BELENKY, ET AL., WOMEN'S WAYS OF KNOWING 137 (1986).

13. *See* Burns, *supra* note 7, at 252.

behavior or render legal judgments of behavior as would others. Without culturally agreed-upon values, uniformity of evaluation is impossible. An advocate cannot automatically refer to a value she believes is ultimate and objective, and expect that that reference potentially enlighten the listener. When it lacks a common standard, moral argument becomes incoherent because only an appeal to that which is shared can be rational.[14] Furthermore, if the advocate or her listener does not believe in any objective standards of morality, true moral argument is impossible. She can only persuade by appealing to the listener's subjective preferences.[15]

I do not believe, however, that our culture has become primarily morally relativistic. While traditional beliefs do not hold the authority they once did, Americans do share certain general notions of justice and truth, right and wrong. Lawyers can appeal to these core notions in their arguments, but beyond the most basic beliefs, much disagreement exists. At this second level, a lawyer can appeal to incommensurate beliefs and values only by invoking the holder's preferences, rather than a commonly-held standard. Then, a lawyer is pressured to manipulate her audience without reference to her own truth.[16] It can be extremely difficult to discern when one has reached that point, as well as the nature of one's ethical obligations under such conditions.

ETHICAL CONFLICT, THE PARADOXES, AND DISHONESTY IN LITIGATION

The paradoxes generate ethical dilemmas because the values related to each pole often conflict in concrete situations, creating competing perceptions and responsibilities. Failure to understand and resolve these paradoxes is related to conflicts and unease in two ways. First, the resulting discomfort causes many lawyers to abdicate responsibility in difficult situations involving conflicting values. Rather than resolving the conflict, or discerning the appropriate values of both poles of the paradox, we follow one pole or the other. We deny the existence of a conflict by declaring to ourselves and our clients that the legal system permits only one course of action.[17] We thus obviate care-

14. *See* Perry, *Moral Knowledge, Moral Reasoning, Moral Relativism: A "Naturalist" Perspective*, 20 GA. L. REV. 995, 1067-68 (1986) ("[T]here can be productive moral discourse if there are relevant shared beliefs . . . . [T]here cannot be productive moral discourse in the absence of relevant shared beliefs.)" *See also* Stick, *Can Nihilism Be Pragmatic?*, 100 HARV. L. REV. 332, 355-56 (1986).

15. *See generally* A. MACINTYRE, AFTER VIRTUE 19; 23-24 (1984).

16. *See id.*; *see also* Burns, *supra* note 7, at 262.

17. *See* Chemerinsky, *Protecting Lawyers From Their Profession: Redefining the*

fully analyzing our actions or the legal reality in which we operate, or examining our consciences. Consequently, our response is essentially flat, rather than nuanced, as real situations demand.

For example, with respect to the first paradox, which holds in tension duties to clients and the court, we often fail adequately to analyze situations in which an attorney is aware of adverse legal authority unknown to her opponent. Assuring ourselves we need not do the other side's work and betray our client, we follow the custom of legal culture and do not reveal to the court that the law is not unequivocally in our favor.[18] We see only duty to our client. On the other hand, a lawyer could also disclose adverse authority without taking the time to realize the authority actually is distinguishable and should not control. Thus efforts to please the court can undermine zealous advocacy by providing an excuse for failing to creatively examine or imagine alternative approaches.

Instead of responding inadequately, lawyers should reflect upon considerations favoring each possible response, and choose the most ethically sound approach to that particular situation. For example, if opposing authority is on all fours with the lawyer's own case, justice could not be done without disclosing the authority. On the other hand, disclosure of authority that is arguably noncontrolling might unnecessarily complicate or derail litigation of a highly meritorious claim.

Second, the failure to resolve the paradoxes generates the lawyer's inadequate response, which merely suppresses and thus perpetuates the conflict. Abdicating responsibility, we may not come to terms with conflict. Instead, it can catch up to us and we end up burning out.[19]

Lawyer's Role, 5 J. OF LEGAL PROF. 31, 32-34 (1980), *reprinted in* G. HAZARD & D. RHODE, THE LEGAL PROFESSION: RESPONSIBILITY AND REGULATION 179-80 (1988).

18. Although the MODEL CODE and MODEL RULES require disclosure of adverse controlling authority to the court, *see* MODEL CODE D.R. 7-106(B)(1);MODEL RULES Rule 3.3 (a)(3), in practice this requirement tends to be observed in the breach. In addition, one may often escape responsibility for this breach by constructing an argument, sincere or insincere, that a particular decision is distinguishable and thus not controlling. *See, e.g.*, Wojan v. General Motors Corp., 851 F.2d 969, 976 (7th Cir. 1988) (failure to disclose adverse precedent to court did not warrant imposition of Rule 11 sanctions). *Cf.* Golden Eagle Dist. Co. v. Burroughs Corp., 801 F.2d 1531, 1541-42 (9th Cir. 1986) (discussing conflict between duty to disclose and zealous representation in context of sanctions proceeding under Fed. R. Civ. P. 11). *But see* Borowski v. DePuy, Inc., 850 F.2d 297, 304-05 (7th Cir. 1988) (Rule 11 sanctions warranted for, *inter alia*, pretending that potentially dispositive adverse authority did not exist).

19. *See* Zimmerman, *Professional Standards Versus Personal Ethics: The Lawyer's*

Entropy seems to operate in law, as elsewhere, causing the creative energy that these paradoxes hold in tension to collapse. Deceit and misrepresentation seem the all too common by-products of litigation's tendency to reach the lowest common denominator. The first two paradoxes often resolve themselves by settling into their first poles: the duty to clients (or self-interest embodied in clients) subsumes all others and the reality of legal culture overshadows all other ethical considerations. After all, the values in that pole are rewarded much more heavily than those in the other pole. Clients pay lawyers, or at least promise to pay under a contingent agreement, and thus winning becomes critical.

Sometimes, however, entropy leads to the opposite pole. Self-interest can appear in the guise of duty to the court. When a lawyer does not expect a case to be remunerative, perhaps because it is risky, the client is unattractive, or the injuries not terribly severe, she can convince herself that it should be settled quickly, to avoid wasting the court's time, even if justice cannot obtain by means of early settlement. In this system, idealistic young lawyers tend to become disillusioned and then cynical. That certainly happened to me to some degree.

Although the professional codes prohibit lying, a large gray area exists between an outright lie and a negligent misstatement or an overly biased interpretation. The third paradox thus comes into play. Facts are often unclear and elusive, law is often indeterminate, and we have plenty of room to manipulate both away from justice and truth. In some instances, it is not even apparent what justice and truth demand. In addition, the more indeterminate and political the legal process appears to be, the less likely lawyers will value factual accuracy.[20]

In some instances, however, the facts, law and demands of justice are clearer than we would like them to be, but we pretend they are not. Moreover, lawyers probably fail or refuse to recognize many of their lies. In the rush of law practice I believe we often rationalize that because clients are impatiently waiting for us to handle their cases we do not have time to meditate on the morality of winning.

As Adrienne Rich said in the quote that begins this article, truth is complex, while lies often are simplifications. Simplifications easily can slide from condensed versions of the accurate to deceptions omitting or distorting critical facts or law, bypassing justice itself. Advocates must take sides and persuade the court of the merit of the client's case, and

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Dilemma, 1989 UTAH L. REV. 1, 4.

20. *See* H. ARENDT, TRUTH AND POLITICS, IN BETWEEN PAST AND FUTURE 231-39 (2d ed. 1968) (discussing denigration of factual truth in political situations).

inevitably all presentations of cases selectively condense reality, reflecting the point of view of the interpreter. But at some point, interpretation can become deception.

At times I may have helped my clients gain larger settlements or judgments by twisting and distorting. At other times, I may have settled cases too quickly and easily, out of a desire to accommodate the court, representing to clients that their cases were not as meritorious as they might have been under another legitimate view of the law. I remain uncomfortable with these tactics, partly because I did not know where to draw the line in different contexts. When is interpretation transmuted into deception? Is potentially deceptive ambiguity that falls short of outright fraud and misrepresentation ever justifiable?

Perhaps an understanding of the ethics of advocacy requires an ability to shift perspectives, to see both sides of the paradoxes as simultaneously true, though each is an incomplete representation. Lawyers' ethics may be a bit like quantum mechanics in that respect: light can behave both like a wave and a particle, and lawyers must operate both like realists and idealists, simultaneously subject to clients, the demands and practices of our legal system, and all others. A mature moral judgment that can operate with creative tension is necessary. In that manner, one is more likely to avoid the dishonesty of oversimplification that Adrienne Rich refers to.

It is still possible, however, that the implicit rules of practice may require or allow more potentially deceptive conduct than is acceptable in our personal lives. The combination of responsibility for clients, the one-sided nature of our presentations to courts on their behalf, and the need to come to a legal conclusion that fits within existing categories press towards simplification. But our response to these factors must not be an oversimplification. If we must modify personal standards of private conduct in certain public contexts, we should still remain true to our integrity and to the situation. That adds another dimension of responsibility to our task: we must achieve complete truthfulness with ourselves about the reality we face, as the Dietrich Bonhoeffer quote recognizes.

THE PROFESSIONAL CODES ON DISHONESTY

The professional codes form an ethical floor for professional conduct. They prescribe the minimum legally acceptable behavior,[21] but

21. The Preliminary Statement to the Model Code of Professional Responsibility declares: "The Disciplinary Rules state the minimum level of conduct below which no

encourage ethical conduct above and beyond the minimum.[22]

The major premise of the professional codes is that attorneys must zealously represent clients within the bounds of the law, and clients have the authority to decide on objectives of the representation.[23] If the client's desired goals are not fraudulent, attorneys generally do not have the authority to refuse to pursue the chosen goals as long as the representation continues.[24] Their only recourse is either to withdraw from representation[25] or to consult with the client in an attempt to reach an agreement modifying the client's goals.[26] Attorneys do have

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lawyer can fall without being subject to disciplinary action."

22. For instance, the Preamble to the Model Code states: "Each lawyer must find within his own conscience the touchstone against which to test the extent to which his conduct should rise above minimum standards." The Preamble to the Model Rules states: "Many of a lawyer's professional responsibilities are prescribed in the Rules of Professional Conduct . . . However, a lawyer is also guided by personal conscience . . . [Thus the Model] Rules do not . . . exhaust the moral and ethical considerations that should inform a lawyer, for no worthwhile human activity can be completely defined by legal rules. The Rules simply provide a framework for the ethical practice of law."

23. *See* MODEL CODE Canon 7 ("A lawyer should represent a client zealously within the bounds of the law.") *See also* MODEL CODE D.R. 7-101(A)(1); MODEL CODE EC 7-1, 7-7, 7-8; Rule 1.2(a) of the Model Rules states that "A lawyer shall abide by a client's decisions concerning the objectives of representation . . . and shall consult with the client as to the means by which they are to be pursued," *id.*, and Rule 1.3 proclaims that "A lawyer shall act with reasonable diligence . . . in representing a client."

24. *See, e.g.*, MODEL CODE D.R. 7-101(A)(1) ("A lawyer shall not intentionally fail to seek the lawful objectives of his client through reasonably available means permitted by law and the Disciplinary Rules"). *See also* MODEL CODE E.C. 7-2—7-6 (doubts resolved in favor of client). *Cf.* MODEL RULES Rule 1.2 Comment 1 ("The client has ultimate authority to determine the purposes to be served by legal representation . . . . At the same time, a lawyer is not required to pursue objectives or employ means simply because a client may wish that the lawyer do so."). *But cf.* MODEL CODE D.R. 7-101(B)(1) ("A lawyer may, where permissible, exercise his professional judgment to waive or fail to assert a right or position of his client."); D.R. 7-101(B)(2) (A lawyer may "refuse to aid or participate in conduct that he believes to be unlawful, even though there is some support for an argument that the conduct is legal."); MODEL RULES Rule 1.2(a) (A lawyer shall abide by a client's decisions concerning the objectives of representation . . .").

25. MODEL RULES Rule 1.16(b)(3) states: "[A] lawyer may withdraw from representing a client if . . . a client insists upon pursuing an objective that the lawyer considers repugnant or imprudent." *Cf.* MODEL CODE D.R. 2-110(C)(1)(d) (lawyer may withdraw where it is "unreasonably difficult for the lawyer to carry out his employment effectively"); D.R. 2-110(C)(1)(e) (in matter not pending before tribunal, withdrawal permissible if client "insists . . . that the lawyer engage in conduct that is contrary to the judgment and advice of the lawyer but not prohibited under the Disciplinary Rules"); D.R. 2-110(C)(6) ("tribunal will find the existence of other good cause for withdrawal")

26. *See* MODEL RULES Rule 1.2(c) ("A lawyer may limit the objectives of the repre-

discretion, however, to determine tactics and means by which to achieve a client's chosen objectives.[27]

These rules do not endorse winning at all costs. They enshrine loyal service to clients as the ultimate value, but temper zeal with certain limited duties to the court and other parties. Unfortunately, these rules provide little guidance in resolving these oftentimes conflicting values.

I have no problem with these general priorities. Although I recall some uneasiness with these propositions when they were first presented to me in law school, litigation experience changes one's perspective. As a student, I was a little uncomfortable with the notions of partisanship and zealous representation. They seemed to require abdicating personal moral judgment in favor of the client's, but I no longer think that represents the full dynamics of the real situation. In practice, I did not abdicate, but rather made a personal moral decision to generally pursue the client's objectives rather than substituting my own. In most cases, anything less would have been both paternalistic and dishonest, because when practicing law, one holds oneself out as a zealous and loyal advocate.[28] Moreover, the professional codes commendably prohibit less than fully zealous advocacy, reminding us where our primary loyalty belongs.

Certain qualms of conscience are most appropriately heeded when choosing clients, rather than after undertaking representation. If an attorney has a fundamental disagreement with a client's goals, she should not represent that person in the first place.[29] Finally, when the

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sentation if the client consents after consultation."). *Cf.* MODEL CODE D.R. 7-101(B)(1) (A lawyer may "waive or fail to assert a right or position of his client" only "where permissible."). *See also* MODEL CODE E.C. 7-7 (withdrawal allowed "only in areas of legal representation not substantially prejudicing the rights of a client,"); E.C. 7-8 (Withdrawal allowed "only with the client's consent,"); E.C. 7-9 (attorney should "ask his client for permission to forego . . . action" if "it seems to him to be unjust").

27. *See, e.g.*, MODEL RULES Rule 1.2, Comment 1.

28. I had fewer problems in this area than many people because I represented plaintiffs in civil rights actions and usually believed in the justice of their claims. Of course, if the legal culture and the professional understanding of zealous advocacy changed, lawyers and clients would develop a different understanding of "loyalty." If duty to the court became more prominent, the standard for loyalty would become correspondingly lower. Nevertheless, although the definition of this concept is not written in stone, current usage requires a very high degree of loyalty and zeal.

29. However, this assertion disregards the "last lawyer in town" problem. *See infra* text accompanying note 67. I believe, therefore, that the assertion more properly applies to civil litigation rather than criminal, where one's duties are somewhat different.

client's goals seriously conflict with the lawyer's personal morality, the attorney may either withdraw from representation or attempt to persuade her client to drop these goals.[30]

In addition, attorneys may always discuss with the client modifying the goals of litigation. After all, attorneys have discretion to choose tactics and means – a privilege frequently abused. The professional codes prohibit this attorney abuse, though, and theoretically do not allow attorneys to hide behind the excuse of zealousness.

Still, the ideal of zealous representation can cause numerous problems. It often tends to overwhelm all countervailing considerations, even the basic demands of justice. It can allow attorneys to rationalize unethical conduct and make the possibility of withdrawing from representation seem unreasonable.[31]

With respect to dishonesty, the professional codes are somewhat ambiguous.[32] Clearly, they prohibit outright lying[33] but exactly how far does zealous representation allow one to go in stretching the apparent truth, particularly when the attorney should resolve doubts in the client's favor? The prohibitions against "dishonesty, fraud, deceit, or misrepresentation" are not too helpful in this regard, as those terms are not well-defined.[34] Perhaps it is better not to confine these terms to detailed definitions which could be narrowly construed and provide an excuse for morally questionable behavior. On the other hand, their very ambiguity provides another convenient excuse to ignore them or construe them as inapplicable.

The professional codes further prohibit knowing failure to disclose

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30. *See supra* notes 23-27 and accompanying text. Attorneys arguably should choose this alternative more often instead of assuming that all clients simply want more money. *See generally* Pepper, *The Lawyer's Amoral Ethical Role: A Defense, A Problem, and Some Possibilities*, 1986 AM. B. FOUND. RES. J. 613, 630-32 (1986).

31. *See generally* MODEL RULES Rule 1.2 comment.

32. Particularly in conjunction with accepted role morality for lawyers, see *infra* text accompanying notes 40-56, zealous advocacy tends to imply that lawyers should not make personal moral judgments of clients' behavior and withdraw from cases. It may also leave no room for lawyers to refuse initial representation of clients based on personal moral qualms.

33. *See, e.g.*, Note, *Professional Conduct and the Preparation of Witnesses for Trial: Defining the Acceptable Limitations of "Coaching,"* 1 GEO. J. OF LEGAL ETHICS 389, 395-98 (1988).

34. *See* MODEL CODE D.R. 7-102(A)(5) ("In his representation of a client, a lawyer shall not . . . knowingly make a false statement of law or fact); MODEL RULES Rule 3.3(a)(1) ("A lawyer shall not knowingly make a false statement of material fact or law to a tribunal."). *See also* Rule 4.1(a) (no false statements to third parties). "Knowingly" denotes "actual knowledge of the fact in question . . . ." MODEL RULES Preamble.

certain information.[35] Misleading omissions easily can rise to the level of affirmative deception when surrounding circumstances imply that all relevant information has been or should be revealed. The professional codes also prohibit assisting a client in fraudulent or perjurious conduct[36] or in presenting false evidence.[37] Finally, frivolous claims are impermissible.[38]

Countering duty to the client with limited duties to the court and other parties, the professional codes reflect, but do not resolve, the tension between clients and others that form the first paradox of litigation practice. They are too ambiguous and vague in many ways to provide clear guidance or a bright-line rule for every situation. However, they set a general floor for lawyer conduct that is above many of the everyday realities of practice. When asked, any practicing attorney can instantly come up with numerous instances of deceptive and unethical conduct on the part of adversaries even though we tend to be less forthcoming about our own behavior. Most such conduct is overlooked and unpunished, which leads into the second paradox, the tension between the reality and the ideal of treating everyone fairly in the search for justice.

We need the restraint of categorical rules to inhibit overzealous behavior. Without them, attorneys would tend to surge beyond the limits of what we know in our more objective moments to be acceptable. The rules help resolve the tension between the real and ideal worlds. For instance, attorneys must make their most difficult decisions

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35. "Fraud" denotes "conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information." MODEL RULES Preamble. Moreover, a "false representation of law constitutes dishonesty toward the tribunal." MODEL RULES Rule 3.3. Finally, "[a] misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentations can also occur by failure to act." MODEL RULES Rule 4.1.

36. The Model Code prohibits nondisclosure of information when an attorney "is required by law to reveal" the information. MODEL CODE D.R. 7-102(A)(3). MODEL RULES Rule 3.3(a)(2) prohibits knowing failure "to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client. *Id.*"

37. MODEL CODE D.R. 7-102(A)(4) (" Attorney should not . . . knowingly use perjured testimony or false evidence"); D.R. 7-102(A)(7) ("counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent"); D.R.7-102(B) (lawyer must call upon client to rectify fraud that lawyer discovers; if not rectified, lawyer must reveal fraud if unprivileged). MODEL RULES Rule 1.2(d) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . ."); MODEL RULES Rule 3.4(b) ("A lawyer shall not falsify evidence, [or] counsel or assist a witness to testify falsely . . . .").

38. *See* MODEL CODE D.R. 7-102(A)(4), 7-102(A)(6); MODEL RULES Rule 3.3(a)(4), 3.3(c).

when opponents are playing hardball, deploying every known obstructionist and prejudicial tactic. How far should one go in fighting back? Does their unfairness justify treating litigation as war? What if your client has a just and valid claim, but your adversary intends to highlight an extremely prejudicial aspect of your case? Even here, the professional codes provide a floor for conduct. Attorneys can explain to clients that their hands are tied when it comes to engaging in the truly egregious behavior the professional codes prohibit. That the professional codes themselves are somewhat indeterminate does not undermine their core concepts. There is sufficient agreement on the meaning of these terms within legal culture to impose restraints on behavior.

The third paradox concerns the tension between law and facts as indeterminate instead of objective and ascertainable. In practice, this tension means that often we really do not know what occurred in a given situation or what the applicable law is. On the other hand, we cannot say that the law is merely what the judge says it is. Justice remains a guiding principle; some black-letter law can be applied clearly to unambiguous or stipulated facts. The professional codes indicate or imply that doubts regarding law and facts should be resolved in the client's favor.[39] But whether one has reasonable doubts in a particular situation, such as whether a claim is frivolous, will depend on whether one is honestly and accurately finding the just balance between indeterminacy and objectivity. Of course, reasonable people can differ on the location of that balance in most instances, once again throwing the answer to an ethical question into doubt. The professional codes give no sure guidance on how to answer that question.

ROLE MORALITY AND THE STANDARD CONCEPTION

By and large, the professional codes seem to reflect the "standard conception" of an attorney's role.[40] This conception has two major tenets: first, that attorneys must represent clients zealously – the principle of partisanship; and second, that attorneys are not morally accountable for actions taken during representation – the principle of nonaccountability.[41] The principle of partisanship, as explained above, is

39. *See* MODEL RULES Rule 3.1 ("A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis for doing so that is not frivolous . . . ."); MODEL CODE D.R. 7-102(A)(2) ("[A] lawyer shall not knowingly advance a claim or defense that is unwarranted under existing law . . . .").

40. *See, e.g.*, MODEL CODE E.C. 7-2 - 7-6; MODEL RULES Rule 3.1 Comment.

41. *See* D. LUBAN, LAWYERS AND JUSTICE 393 (1988); Postema, *Moral Responsibility in*

foundational in the professional codes, and appropriately so. Moreover, because clients are ultimately responsible for goals of representation, and because attorneys must defer to them, the professional codes also render attorneys unaccountable for legal, nonfrivolous goals, though not for tactics and means. The typically open-ended nature of the professional codes also leaves room for personal moral accountability in the interstices between the rules and in areas beyond the minimum.

In contrast, the standard conception omits personal moral accountability. Treating litigation as combat is the norm most operative in legal culture today.[42] Its sole justification lies in the good attorneys can accomplish acting pursuant to role. Thus, actions premised on the standard conception easily can deviate from even the minimal standards of the professional codes. Withdrawal from representation based on personal moral qualms would be nonsensical under the standard conception. Even initial refusal of representation for moral reasons could be unjustified.

The standard conception of an attorney's role is premised on the notion that the role of attorney/advocate is a social good in itself justifying certain deviations from ordinary morality.[43] In other words, zealous representation of clients is so important to us as a society that we are willing to overlook certain of its byproducts, such as conduct that would be unfair in another context. For instance, under this conception lawyers assert and strenuously argue for only those points that maxi-

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Professional Ethics, 55 N.Y.U. L. REV. 63-64, 73-83 (1980), *reprinted in* G. HAZARD & D. RHODE, THE LEGAL PROFESSION: RESPONSIBILITY AND REGULATION 181, 182-83 (1988). *Cf.* Postema at 73-74 ("[T]he proper range of the lawyer's concern – the boundaries of the lawyer's 'moral universe' – is defined by two parameters: the law and the client's interests and objectives. These factors are the exclusive points of reference for professional deliberation and practical judgment").

42. *See, e.g.*, M. DOMBROFF, DOMBROFF ON UNFAIR TACTICS (1984 & Supp. 1989) ("[The] terms prejudice or unfair are not necessarily bad. From your perspective everything which you offer into evidence should be perceived as unfair and prejudicial in favor of your case by your opponent. By the same token, everything which your adversary introduces in support of his or her case should be considered as unfair and prejudicial by you. The difficulty which you confront is discerning where the fine line of propriety and admissibility is . . . and when you step over it. Until you or your opponent do so, the techniques and tactics discussed in [this book] are fair game. The key to success is making it your game.")

43. *See* C. WOLFRAM, MODERN LEGAL ETHICS, 10.3.2, at 581 (1986). *See generally* Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relationship*, 85 YALE L.J. 1060-62, 1065-72, 1067-89 (1976), *reprinted in* G. HAZARD & D. RHODE, THE LEGAL PROFESSION: RESPONSIBILITY AND REGULATION 250, 260 (1988).

mize client goals and interests, disregarding other considerations and interests of other parties.[44]

The ultimate justification for the standard conception of lawyers' role-morality must lie in the adversary system itself.[45] Partisanship and nonaccountability, considered the machinery of the adversary system, can only produce a social good if the results the system generates are a good. We lawyers tend to take this as an article of faith, professed as a quid pro quo for obtaining a license to practice. The professional codes also recognize the principle.[46] But does the system produce enough justice or truth to merit this faith?

Many have argued persuasively that it does not.[47] No empirical

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44. While nothing explicitly requires lawyers to behave in this manner, the competitive nature of legal practice makes it an implicit requirement.

45. David Luban defines the adversary system as consisting of: 1) an impartial tribunal of defined jurisdiction; 2) formal procedural rules; 3) The parties' responsibility to present their own cases and to challenge their opponents'. LUBAN, *supra* note 41, at 56-57. Wolfram includes the following features:

> 1) The parties initiate and control the definition of the issues and the presentation of evidence . . . .
> 2) The presentations of the parties' cases are representational . . . .
> 3) The exploration of issues and presentation of evidence is party-centered and contentious from beginning to end . . . .
> 4) Judge and jury are both neutral and passive . . . .
> 5) The proceedings are governed by procedural rules . . . .
> 6) Finally, law and procedures formulate remedial endings to the litigation that are largely either-or in nature . . . and that must be based only on the issues and evidence that the parties have presented.

C. WOLFRAM, *supra* note 43, at 46.

46. Model Code E.C. 7-19 provides:

> [A]n adversary presentation counters the natural human tendency to judge too swiftly in terms of the familiar that which is not yet fully known; the advocate, by his zealous preparation and presentation of facts and law, enables the tribunal to come to the hearing with an open and neutral mind and to render impartial judgments. The duty of a lawyer to his client and his duty to the legal system are the same: to represent his client zealously within the bounds of the law.

47. Luban, for example, sets forth six potential justifications for the adversary system: 1) It is the best way of arriving at truth; 2) It is the best way to defend clients' legal rights; 3) Its checks and balances guard against excess; 4) The lawyer-client relationship is intrinsically good; 5) It honors human dignity by giving everyone a voice; 6) It is so woven into our social fabric that it should not be disrupted. LUBAN, *supra* note 41, at 67. He defeats each justification in turn and finally argues that the adversary system should be retained only for pragmatic reasons – we have not yet devised anything demonstrably better. *See generally* M. FRANKEL, PARTISAN JUSTICE (1978). Judge Frankel criticizes numerous features of the current American adversary system, and argues for reforms that

evidence has demonstrated that it obtains better results than another type of system.[48] It assumes relative equality of opposing counsel. Therefore, it disproportionately favors the wealthy, who can afford superior legal representation.[49] In addition, it is a formalistic justification because it assumes without proof that feeding disputes into its machinery and procedures will produce just results by rational application of law to fact.[50] Because we are all realists now, we know that this is not necessarily the case.

Ultimately, there is no proof that the adversary system is the best conceivable, or that it justifies the lawyer's amoral role as expressed in the standard conception. I find the notion of litigation as a marketplace of ideas appealing, but this justification is undermined when misrepresentation distorts the search for justice or truth. Nonetheless, no one has produced a better alternative to the adversary system, and it is the system now in place, so any pragmatic approach to legal ethics must begin with it.[51]

However, this system does not provide a strong enough justification to support the full standard conception. A problem arises because the nonaccountability principle seemingly justifies practically any conduct.[52] It tends toward hyperzeal, rather than exemplary ethical conduct, and extends outward from goals to cover means and tactics as well. The lawyer persuades herself that because she is not accountable for clients' goals, she is equally unaccountable for means and tactics that she chooses to achieve those ends. The standard conception allows one to rationalize and blur the distinction between means and ends that the professional codes set forth.

In addition, the nonaccountability principle could exculpate a lawyer who adopted certain frivolous or harassing client goals (though probably not illegal ones). When one must be zealous, is morally unaccountable, and is otherwise self-interested in winning, ethical constraints become increasingly irrelevant. The trend is toward the lowest com-

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include, *inter alia*, a duty to reveal truthful inculpatory evidence to the court. *See also infra* notes 48-50 and accompanying text.

48. Rhode, *Ethical Perspectives on Legal Practice*, 37 STAN. L. REV. 589, 595-626, 643-647 (1985), *reprinted in* G. HAZARD AND D. RHODE, THE LEGAL PROFESSION: RESPONSIBILITY AND REGULATION 170-179 (1988).

49. *Id.* at 597.

50. *Id.* at 595.

51. *See* V. Held, *The Division of Moral Labor and the Role of the Lawyer*, in THE GOOD LAWYER 60, 61 (D. Luban ed. 1984).

52. It would not justify, however, lack of zealous representation.

mon denominator. Thus, the standard conception of role-morality easily descends below the floor established by the professional codes, absent enforcement.[53] The trend toward the lowest common denominator is exacerbated by the law's indeterminacy. Even in a nonpartisan context, it is extremely difficult, if not impossible, to achieve a neutral and objective view of the facts of a case and the law applicable to it. First the legal realists, and later the deconstructionists, demonstrated this indeterminacy. Lawyers are trained to capitalize on indeterminacy, exploiting it to construct a version of the facts and law favorable to their clients, or sometimes themselves. In addition, the widespread influence of legal positivism has provided a justification for separating values and morality from law.[54]

Finally, as explained above,[55] moral indeterminacy, or the perception of it, can provide a further excuse to the irresponsible or unscrupulous. Instead of respecting an audience and diligently searching for an appeal to common values, the zealous advocate often becomes the consummate rhetorician whose compelling articulation of preferred positions sweeps away less manipulative modes of communication.[56] In extreme situations, the same rhetorical skills can be turned even against clients.

Thus, a role morality that includes full nonaccountability acts as an

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53. For example, the attorneys in the Law Department of the City of Chicago tend to see their role solely as limiting the City's financial liability. To that end, the Corporation Counsel recently required counsel for a prevailing civil rights plaintiff to choose between waiving the right to statutory attorney's fees or facing an appeal of the ruling on the merits in the client's favor. *See* Jeff D. v. Evans, 475 U.S. 717 (1986) The Supreme Court allowed a fee waiver in exchange for a pre-trial settlement. Where a party has already won on the merits, by contrast, compelling the choice is considerably more unfair and undermines the purpose of fee-shifting statutes. *See id.* at 740, n.32.

54. *See* Pepper, *supra* note 30, at 624-25. Professor Pepper adds that, in addition to legal realism and positivism, process jurisprudence has taught lawyers to focus on "client goals and private structuring . . . . These three views of 'the law' are mutually reinforcing rather than conflicting." *Id.* at 625. Combined with the lawyer's traditional amoral role, "there is no moral input or constraint in the present model of the lawyer-client relationship." *Id.* at 626.

55. *See supra* notes 5-16 and accompanying text.

56. *See* Burns, *supra* note 7, at 253-55; White, *supra* note 6, at 869-70, describing Plato's view of rhetoric in the Gorgias: "The goal of rhetoric . . . is the power to persuade others, to reduce them to one's will . . . [R]hetoric naturally treats others as means to an end . . . Rhetoric persuades another not by refuting but by flattering him, by appealing to what pleases, rather than to what is best for him. If successful, it injures him. And it injures the persuader as well, for the flatterer, in the nature of things, becomes like the object of his flattery."

opposing force to the limiting principles in the professional codes, failing to distinguish between means and ends. It eliminates the paradoxes: first, it pulls only for the client (or for one's own financial interests); second, it acknowledges only the reality of winning at all costs; and third, it exploits indeterminacy by eliminating objectivity or any ultimate criterion of justice. In short, nonaccountability cannot admit justice or truth. It remains insulated from them, opening the door to all types of dishonesty. The standard conception oversimplifies reality and allows no growing understanding of the multi-layered complexity of legal representation.

Therefore, the standard conception and its complete nonaccountability are not justifiable. They do not produce, on balance, a social good. They must be tempered by considerations of ordinary morality and enforced disciplinary codes. Only then will nonaccountability be suffficiently constrained and a positive role-morality develop.

General Morality and the Attorney Role

An appropriate morality for attorneys should not be a completely separate system, insulated from all outside scrutiny. Rather, it should be considered a special instance of general morality.[57] The actor in the lawyer role remains ultimately accountable for her actions. Deference to role does not provide an automatic justification, although role requirements may mandate responses that differ from the ordinary in particular circumstances. The special context in which lawyers operate may impose special duties at those times. In some circumstances, however, considerations of general morality will outweigh role obligations. Under this conception, role requirements and general morality remain in tension.[58] One will then synthesize the two by exercising personal judgment to apply general principles to particular situations. Different persons may synthesize the tensions differently, precluding one "right" answer in some situations.

The standard conception, or indeed any role morality or indeed any role-morality divorced from general moral standards, is reductionist: because of its insulation from scrutiny and lack of responsibility for justice-seeking,

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57. *See* LUBAN, *supra* note 41, at 125: "[T]he appeal to a role in moral justification is simply a shorthand method of appealing to the moral reasons incorporated in the role. And these may be—*must* be—balanced against the moral reasons for breaking the role expressed in common morality."

58. *Id.*

> Role morality . . . establishes a monolithic point of view. Its vice lies in its virtue—in the fact that the moral agent is no longer responsible for the whole of morality. The complexity of the moral world is thereby reduced and made manageable. But this is done by parcelling out responses to given situations in such a way that no single role is sensitive to all situations or has available to it a full range of responses.[59]

A more appropriate hybrid role morality would be shot through with references to the general morality that applies to all of life. It would not mandate rigid responses to situations. This appropriate norm for lawyers to follow beyond the ambiguous minimum of the professional codes necessarily includes a large component of personal discretion,[60] although it is also constrained by certain general principles.

Although the professional codes form the foundation for discretionary decisionmaking, categorical rules cannot account for all moral situations we encounter in practice. The uniqueness of many situations calling for moral judgment requires a flexible approach ranging far beyond the generalities expressed in the professional codes. Only personal judgment can remain attuned to all the nuances of different situations and the reciprocal significance of both poles of the paradoxes. Guidance from many sources can inform that personal judgment, and keep us accountable for all our decisions. Thus, general moral principles justify this approach, although reference should also be made to values of the legal system itself.[61]

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59. *Id.* at 127.

60. *See, e.g.*, Simon, *Ethical Discretion in Lawyering*, 101 HARV. L. REV. 1083 (1988). Professor Simon endorses a discretionary approach to ethical decisionmaking, not to supplement categorical rules, but to replace them. He first posits a "professional duty of reflective judgment," and then sets forth criteria to guide that judgment. While I agree that seeking justice is the ultimate standard we ought to use, *see id.* at 1090, rather than legal permissibility, I disagree that personal discretion can substitute for all categorical rules. It leaves too much room for rationalization of self-interest without external checks on behavior. Simon admits that his approach "takes for granted that lawyers are substantially motivated to act ethically." *Id.* at 1144. My approach does not have to assume that. Leaving the ethical codes in place, endorsing effective enforcement of them, and adding several additional, straightforward guidelines, *see infra* text accompanying notes 74-83, I instead argue for a personal choice to follow higher standards. I do not rely on an assumption that the majority of lawyers will follow this approach, although clearly legal practice would be much improved if they did.

61. *See id.* at 1113-19. For a "natural law lawyer," legal and moral obligations often converge, for "[s]uch a lawyer believes that a legal system must meet certain normative preconditions to be entitled to respect and compliance." *Id.* at 1115.

A. *The Analogy to Personal Relationships and Women's Moral Reasoning*

For example, one can integrate guidance from personal relationships, from the professional codes, and from purely legal values to help determine when and whether to refuse to represent a client or to withdraw from representation when dishonesty is involved. To a limited extent, the lawyer-client relationship is analogous to close personal relationships, such as between parents and children or close friends. They all involve dependence and reliance. Close relationships justify our loyalty and advocacy on behalf of the best interests of the one we are protecting and caring for.

However, these relationships do not allow us to use dishonest means and tactics to advance the other's interests.[62] Neither should the attorney-client relationship permit dishonest means to reach benign ends.[63] The professional codes do not permit it, since attorneys are responsible for means, but the standard conception could permit it and thus slip below the threshhold of the other standards.

Similarly, close personal relationships do not justify automatic deference to the other's goals. In dependent relationships, we may even help the person who relies on us to set her goals. It is never the case that we should automatically adopt the goals of the other. We would not consider such a relationship healthy, or morally correct, whether it was between friends or relatives.

We always reserve a certain amount of skepticism for the goals of a friend or relative, because we are ultimately morally accountable ourselves for actions taken on behalf of others. We can strenuously urge our close friends to adopt different goals, as a lawyer can explain to a client that a particular goal is against the client's (or her own) self-interest, but in the end, the friend will disassociate herself from an undesirable end,[64] whereas lawyers generally do not. But should they?

I believe that lawyers also ought not to represent clients whose goals are morally repugnant, though still arguably nonfrivolous. The

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62. Certain exceptions to the prohibition of dishonesty exist. Deception can be justified in instances where it does not injure the parties involved or society as a whole. Requiring absolute honesty and precluding deception in all circumstances can betray individuals' trust in their community. *See* Note, *Deception and Lawyers: Away from a Dogmatic Principle and Toward a Moral Understanding of Deception*, 64 NOTRE DAME L. REV. 722, 743-44 (1989).

63. *But cf.* Fried, *supra* note 43, at 254-55, 259-60.

64. *But see* D'Amato & Eberle, *Three Models of Legal Ethics*, 27 ST. LOUIS U. L.J. 761, 766 (1983) ("[W]hen morality is at stake, a friend is just a coconspirator").

professional codes appear to allow such refusal.[65] But because the standard conception of role-morality is impervious to moral accountability, refusal to represent a client under these conditions is necessarily inconsistent with it.

The situation differs somewhat once representation has begun, because the duty of loyalty has been invoked. Nonetheless, if an attorney initially accepts a case and then discovers that a goal of the client appears dishonest or immoral to her, she ought to withdraw from representation, even though this is a more drastic step than initially refusing representation. Indeed, one would (or should) do the same in a personal relationship. The professional codes appear to allow this, at least in certain situations,[66] but it would be incoherent to the standard conception. Lack of moral accountability, combined with zealous representation, would endorse continuing representation.

Factors unique to lawyering further support an attorney's right to withdraw when confronted with an immoral client goal. Lawyers adopt, or should adopt, a set of principles related to the attorney function itself regarding such basic values as the right to legal representation. These are not just role values but moral values as well. Ideally, we internalize these positive values and they become part of our personal ethical beliefs. Therefore, it is not a consequence of the approach I outline here that criminal defendants who appear to be guilty will go unrepresented. Many lawyers have private ethical beliefs that endorse the presumption of innocence and the right to due process. In addition, if we were the "last lawyer in town," many of us would represent someone we otherwise would find repugnant, again because we believe in the principle of the right to representation.[67]

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65. *See* MODEL CODE E.C. 2-26 ("A lawyer is under no obligation to act as advisor or advocate for every person who may wish to become his client"). MODEL RULES Rule 6.2 comment ("A lawyer ordinarily is not obliged to accept a client whose character or cause the lawyer regards as repugnant").

66. *See supra* note 25. An attorney seeking to withdraw based on personal moral misgivings probably could not be fully candid with the court about the reasons for withdrawal. Ordinarily, this should pose no problem, for the attorney could invoke the confidentiality privilege to prohibit disclosure. When my cocounsel and I did this, the court accepted the privilege and inquired no further. If, however, the court chose to inquire further, the attorney might have to reconsider withdrawing if disclosure would unduly prejudice the client. Attorneys would also have to consider client prejudice if they sought to withdraw shortly before trial, when it is difficult to substitute counsel without harming trial preparations.

67. I believe these considerations would apply similarly, though perhaps with somewhat less force, to civil litigation and representation of indigents. In any event, the

This does not entirely solve the dilemma of what ought to be done when the last lawyer in town does not believe strongly enough in representation to overcome his repugnance. I think, however, that the importance of lawyers heeding their own integrity and ethical systems outweighs the possible negative consequences of this approach. Once we let go of our principles and internal moral gyroscope, we are in danger of sliding down a slippery slope. I know of far too many instances in which friends and acquaintances of mine have represented clients whose goals they find completely repugnant. Sometimes they justify their conduct by saying that "someone has to represent this client," while knowing full well that they are far from being the last lawyer in town. In fact, the real reason for their representation probably is financial. Indeed, hundreds of other lawyers would line up to represent this client if my friends declined initially or withdrew after discovering the immoral goal.

Analogizing client relationships to personal relationships is, I believe, a particularly attractive approach for many women. Women's moral reasoning tends to focus more on maintaining relationships and on the concrete contexts in which relationships occur than does the more abstract and rule-bound moral reasoning frequently characteristic of men. Rather than showing concern for preserving networks of relationship, male moral reasoning often limits individual self-assertion to the point at which rights of others are violated.[68] Emphasizing care and responsibility for actual persons, women who engage in this type of moral reasoning would focus on loyalty to, and even love for, individual clients as a primary responsibility. Our clients are people for whom we feel a great deal of responsibility, and with whom we develop a type of personal, as well as professional, relationship.

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primary reason lawyers refuse to do pro bono work is not that they find clients' goals morally repulsive, or that they do not believe that the underrepresented have a right to representation, but that the cases generally are unremunerative, and often difficult and time-consuming.

68. *See* C. GILLIGAN, IN A DIFFERENT VOICE (1982). The two voices Professor Gilligan describes are not mutually exclusive. Most real people have characteristics of both the "male" and "female" types of moral reasoning, though on the whole women seem to display the caring mode more often than men. Further, use of the terms "male" and "female" is not meant to imply that differences are innate. In all likelihood, many, or most, are socially conditioned. *See also* Gilligan, et al., *Feminist Discourse, Moral Values, and the Law—A Conversation*, 34 BUFF. L. REV. 11, 47, 59 (1985); Baier, *What Do Women Want in a Moral Theory?*, 19 NOUS 53, 57 (1985) (positing a women's moral theory based on the concept of appropriate trust, which incorporates elements of both love and obligation, reason and feeling).

Secondarily, however, concern for maintaining relationships of care and responsibility carries over, albeit to a more limited extent, to other persons and parties involved in the litigation. We thus have certain responsibilities to our opponents, to the court, and to the public. Each must be treated with fairness and respect, which raises conflicts between felt responsibilities to everyone involved. Our paramount responsibility and highest level of care are to our clients, but subsidiary responsibilities create competing demands.[69] Our task is that of any litigator; we must learn to balance responsibilities in an appropriate manner that is sensitive to context. To accomplish this task, we must become increasingly conscious of the true moral nature of litigation and legal representation,[70] balancing both the male and female forms of

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69. Professor Gilligan maintains that women often find themselves torn between various responsibilities. When the opposition is between self (conceived of as selfish) and others, denial of self is generally the result. Women's moral growth occurs when women realize that the ethic of self-sacrifice is not all-encompassing, but rather one consideration in developing an appropriate sense of responsibility. The morally mature woman takes into account the rights of all involved, including herself. *See* GILLIGAN, *supra* note 68, at 149. Thus, she will incorporate elements of typically male reasoning into her own style of moral reasoning. When the conflict is between various others, the concept of the rights of each, as well as responsibility, can also help determine an appropriate response. In other words, we should integrate the best elements of both types of moral reasoning. As one observer put it:

> [Morally mature] women resist premature generalization about what they would do or what should be done, particularly about matters of right and wrong. They insist on a respectful consideration of the particulars of everyone's needs and frailties . . . They do not want to neglect the "practicalities of everyday life"for the sake of abstract justice or for the illusory search for "some kind of end all, be all, cure all."

Belenky, et al., *supra* note 12, at 149.

70. This conceptualization of the litigator's moral task is practically identical to that described elsewhere in the paper. Love, care, and ensuing responsibility are emphasized here, whereas in other sections, I also include more general notions of duty and reconciliation of abstract conflicting rights and duties. Each describes essentially the same notion from a different perspective, incorporating elements of both the male and female modes that Gilligan describes:

> This is what I mean by two voices, two ways of speaking. One voice speaks about equality, reciprocity, fairness, rights; one voice speaks about connection, not hurting, care, and response. My point is that these voices are in tension with each other. In my work I have attempted to ask, "What does it mean to include both voices in defining the domain of morality, of humanity and so forth?" . . . The inclusion of two voices in moral discourse, in thinking about conflicts, and in making choices, transforms the discourse. It is no longer either simply about justice or simply about caring; rather, it is about bringing them together to transform the domain.

moral reasoning.

Attaining that insight requires understanding that the analogy to truthfulness in purely personal relationships is only useful to a point. Many features of legal representation and litigation are distinct from ordinary life, as mentioned earlier in the paper.[71] Pulling us away from utter, absolute truthfulness, these factors include, first, expectations grounded in legal culture that inform the relationship between lawyer and client. Clients expect lawyers to conform to the norms of legal practice, although dialogue and a sort of informed consent could modify this in individual cases. Additionally, notwithstanding legal culture, our basic duty of loyalty and responsibility to clients can pull us away from complete candor and truthfulness. We must be responsive to clients' needs as well as those of the system.

Second, the competitive nature of litigation in an adversary system exerts a strong downward pull on attempts to act morally. The main goal of participating in the system is to win, and matching or outdoing one's opponent is the common means of winning.

Third, the facts of any case must be modified or stretched to fit within existing legal categories that determine the prevailing party. Some damage will be done to the whole truth in order to create a cognizable case. Lawyers function in part as translators, describing ordinary situations in a language comprehensible to the system.

Fourth, indeterminacy and relativity, coupled with zealous advocacy, push us towards rhetorical manipulation and away from factual truth. In fact, to the extent that litigation is political, it can be directly hostile to truth.[72] Fortunately, however, our hybrid legal system also contains a truth-seeking component which can neutralize some of its political aspects. Caught up in the tension of the third paradox, lawyers must deal existentially with the intricacies of each situation. To avoid oversimplifying reality, we must simultaneously stand outside legal culture and operate within it.

Therefore, a great need exists for lawyers who are constantly growing in moral sensitivity and discernment. It takes considerable moral maturity to mediate the antagonism between politics and morality in litigation, while remaining sensitive to the individuals involved. Achieving an appropriate balance between fidelity to clients and care for the entire situation is extremely difficult. The problem is that legal

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Gilligan, et al., *Feminist Discourse*, *supra* note 68, at 44-45 (1985).

71. *See supra* text accompanying notes 6-9.

72. *See* ARENDT, *supra* note 20, at 249, 259.

practice pulls us towards less sensitivity, tending to the cynicism and conformity to the ordinary norms of legal culture.

The only answer to this dilemma is to take time periodically to reflect honestly on our behavior. The task is to keep before us the ideal, which incorporates a conception of absolute justice, truth, and mercy, but apply it to our ever-growing comprehension of the real and its limitations. The notion of compassionate vision can help bridge the gap between real and ideal. The attempt to view real individuals with love can clear away the illusion and self-interest that motivate and underlie so much of our behavior and perceptions. Paradoxically, the resulting closer connection to the real paradox also brings us closer to the ideal.[73] A pragmatic justice and truth would result, adapted to legal culture and litigation and the parties, but without nonessential compromises of ideals.[74]

B. Guidelines For Decisionmaking

Of course, it is much easier to describe the general process of ethical decisionmaking than it is to solve concrete problems, just as it is simpler to describe the paradoxes than to synthesize their poles. But certain guidelines or principles can help us determine how to act appropriately in the gray areas beyond or in the gaps of the professional codes. They can help increase our awareness of the problems and restrain rationalization.[75]

First, loyalty to clients remains critically important. This loyalty is best expressed by acting responsibly towards and caring for our clients. Additionally, care also creates a concern for providing them real help, instead of concentrating on one's own moral purity. Winning a case does make a difference to clients and can achieve at least a partial justice. Our vigorous representation can compel the system to pay attention to an individual who otherwise would be neglected. Thus, while the adversary system itself does not fully justify zealousness, the need to help this particular individual attain a measure of justice does. None-

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73. *See* I. MURDOCH, THE SOVEREIGNTY OF GOOD 73 (1970).

74. *See* White, *supra* note 6, at 889: "[T]o be the 'most just' argument it must be a workable one; to be workable, it must be just, at least in the sense that it must maintain the possibility, essential to the existence of self and community, of appealing to ideals that limit the will."

75. I am limiting their application to civil litigation. Factors applying to criminal cases, such as the defendant's potential loss of liberty, would require modifications of this approach. Because my own experience is primarily in civil rights litigation, I am more qualified to speak to the civil area here.

theless, loyalty does not substitute for or usurp all other relevant factors. For instance, zealousness does not automatically justify incomplete representations of fact that are subject to misrepresentation.[76] Whether such statements are justified in a particular context will depend further on the likelihood of misrepresentation, as well as the consequences of it.

Suppose a lawyer asks a court for an extension of time, explaining that she has just entered an appearance in the case, and the court grants the extension. What the lawyer said was truthful, but she omitted to explain that she was already quite familiar with the case because she had been working for some time on another case arising out of the same transaction. While the lawyer may well have needed the extension in order to do a good job on the client's case, she should not have implied to the court that she was unfamiliar with the litigation. Merely stating that she had just filed her appearance implies just that and undermines the ability of the court to perform its functions.[77]

Second, lawyers must carefully and, to the extent possible, dispassionately analyze the legal merits of claims asserted on behalf of clients. If we do not sincerely believe an argument is viable, we ought not to make it, rather than advocating everything that could aid the client and that a court could conceivably consider nonfrivolous.[78]

Third, if our client's claim appears to be just, we ought to aggressively promote it even if precedent does not appear to be in our favor, as long as we can assert what we believe is a meritorious argument. That argument can be based on natural law or policy, as long as it is

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76. The ethical codes only prohibit omissions when an attorney is legally required to reveal information or when disclosure is necessary to avoid assisting a client fraud. *See supra* note 35. MODEL RULES Rule 3.3, comment 2, declares that: "There are circumstances where failure to make a disclosure is the equivalent of an affirmative representation," but it does not specify further what those are.

77. Professor Simon also urges that lawyers consider the legal merit of claims before acting. *See* Simon, *supra* note 60, at 1096-1113. However, rather than accepting the need for client loyalty, he suggests lawyers seek the most appropriate legal resolution of a case, taking into account all parties' rights. For instance, he argues that an attorney should inform opposing counsel of a recently-enacted statute that would aid the opponent's client and of which counsel appears ignorant. *Id.* at 1098-99. Such an approach requires an attorney in effect to represent all parties and could seriously undermine the faithful representation for which clients hire lawyers in the first place. It is also inconsistent with the adversary system.

78. *Cf.* MODEL RULES Rule 3.3, comment 3 ("A lawyer is not required to make a disinterested exposition of the law, but must recognize the existence of pertinent legal authorities . . . . The underlying concept is that legal argument is a discussion seeking to determine the legal premises properly applicable to the case").

not frivolous. Legal arguments should be well-researched and well-thought out. When presenting legal arguments not squarely covered by existing precedent, however, lawyers should be careful not to present the case as if current precedent controlled without an extension or modification of existing law. It is highly misleading to cite cases for propositions they do not cover.[79]

Fourth, we should not state as fact something we believe is false,[80] nor should we state as fact something we have not adequately investigated.[81] Unless asked specifically, we have no duty to disclose facts that adversaries have every opportunity to discover, such as a witness' drinking problem, but if a fact is solely within our client's custody, and reasonable inquiry is made, we should not omit facts whose absence is sure to be misleading. In contrast, if omission of a fact could be, but is

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79. *Cf.* MODEL RULES Rule 3.3 (a)(1): "A lawyer shall not knowingly make a false statement of material fact to a tribunal" *Id.*; Rule 3.3 (c): "A lawyer may refuse to offer evidence that the lawyer reasonably believes is false."

80. The definition of "adequate" varies with the stage of the litigation, increasing as the litigation progresses. At the complaint stage, much less investigation is required than before trial. Matters asserted "on information and belief" can be adequate if the relevant information is not within the client's custody or readily obtainable. *See generally* FED. R. CIV. P. 8; 11. Further, the requirement of adequacy hinges upon whether or not the statement is intended to reflect the lawyer's own knowledge, although statements made substantially by clients, such as complaints, should not be considered wholly outside of the realm of the lawyer's knowledge. *See* FED. R. CIV. P. 11: "Every pleading . . . and other paper shall be signed by at least one attorney . . . The signature . . . constitutes a certificate by him . . . that to the best of his knowledge, information and belief formed after reasonable inquiry it is well-grounded in fact . . . " *Cf.* MODEL RULES Rule 3.3, comment 2:

> An advocate is responsible for pleadings and other documents prepared for litigation, but is usually not required to have personal knowledge of matters asserted therein, for litigation documents ordinarily present assertions by the client . . . and not assertions by the lawyer . . . . However, an assertion purporting to be on the lawyer's own knowledge, as in an affidavit by the lawyer or in a statement in open court, may properly be made only when the lawyer knows the assertion is true or believes it to be true on the basis of a reasonably diligent inquiry.

Courts are split on the question whether attorneys must investigate plaintiffs' allegations before filing suit. *Compare*, for example, Nelson v. Miller, 227 Kan. 271, 607 P.2d 438, 448-450 (1980) (To avoid malpractice, attorney has duty to reasonably investigate truthfulness of facts alleged in client's complaint; however, absent privity, attorney not liable to client's adversary for acts of professional negligence.) *with* Friedman v. Dozorc, 412 Mich. 1, 312 N.W. 2d 585, 591-593; 605-606 (1981) (Attorney may presume truthfulness of client's assertions absent some level of scienter on part of attorney to contrary).

81. *Cf.* DOMBROFF, *supra* note 42, at 3-4 (Aggressiveness is proper trial conduct).

not necessarily misleading, an opponent probably has a duty to inquire further.

The fifth guideline concerns attorney behavior when an opponent is playing hardball. We should also be able to do so when the opponent's behavior goes beyond normal conduct but is less than improper or deceptive. For example, an opponent may be less cooperative than usual, requiring us to go into court on each motion filed. Our failure to respond in kind often is interpreted as a sign of weakness and a basis for escalation. We can hurt our clients if we fail to act aggressively in return.[82]

A problem can arise here, though, when our personal moral standards are stricter than what is normally considered improper, either in legal culture or as defined by the professional codes. This can create disadvantages for clients in general because, even in non-hardball situations, a failure to act aggressively can harm a client's interests. But it is even more likely that a client will be harmed in hardball situations, where an opponent has shown his willingness to press hard for every advantage. Therefore, in such cases, we need to consider more seriously our duty to the client. That may require an exception to our ordinary standards. The exception would remain a moral one, however; its justification would lie in the need for loyalty in a unique situation. And it would not override the other ethical limitations discussed here.

Finally, if an opponent is acting in an officially-recognized improper manner, such as highlighting an extremely prejudicial aspect of a case to a jury or harassing a witness in a deposition, we can alert the court, obviating a retaliatory response on our part.[83] An opponent's unfair-

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82. The problem would be more complex if an opponent was emphasizing an aspect of the case that appealed to the prejudices of the court. The only recourse in that event is appeal.

83. Politically-based distinctions may be tempting, but I do not believe they are rationally supportable. For instance, one could attempt to argue that the poor and disadvantaged are entitled to more aggressive representation than others, but the argument could only hold if that aggressive representation took place entirely within the realm of generally-acceptable conduct, above the minimum. The guidelines I set forth herein address the minimum, or floor, for conduct, and thus are not amenable to alteration in special circumstances.

One could construct a sliding scale of minimally-acceptable litigation conduct whereby the floor of acceptability correlates to the relative merits of the case or client. William Simon engages in a similar sort of analysis, *see supra* note 60 at 1100-1101, but I do not find it particularly convincing, because he leaves too much room for lawyer rationalization. We need certain objective standards to provide guidance in difficult situations where the temptations to indulge self-interest and the win-at-all-cost mentality

ness does not justify an equivalent response on our part. The ends justify the means only in extremely limited circumstances. Allowing an adversary to determine our standards here would impugn and devalue our moral integrity.

Sixth, these criteria of conduct should apply uniformly. Lawyers for certain clients are not more entitled to fight dirty than others. Making rational distinctions between various types of clients is not possible when the issue is justifying minimally acceptable litigation tactics.[84]

Finally, lawyers must always be careful that their motives for litigating are not only financial, but that the client's legal rights and interests remain primary. Although the professional codes also would frown on such pecuniary motivations,[85] this guideline bears mention here because it affects the actual practice of law more than any other single criterion. Lawyers tend to accept borderline nonmeritorious cases based on likely remuneration, rather than a client's right to representation. While we all should have an unimpeded right to make a reasonable living, that right does not support rationalizing pure self-interest.

Although not exhaustive, the approach I have outlined here suggests guidelines that can help increase our awareness of ethical dilemmas, while restraining behavior falling below a minimally acceptable floor. Rather than oversimplifying dilemmas, it respects the paradoxes of litigation. First, it endorses zealous representation, but tempers it with responsibilities to other parties and the court. Connected with their personal integrity and not rationalizing it away or ignoring it, lawyers can find an appropriate balance above the ambiguous minimum the professional codes set.

Second, this approach maintains the tension between the real world of legal culture and the fairness ideal. Using our own judgment, we can find our way as we experience dilemmas that call upon us to exercise personal moral responsibility.

Third, the approach maintains the tension between indeterminacy

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are great.

Simon's argument is stronger when he ties the initial decision to represent someone to the merits of the case or need for representation of the client. That decision does not threaten to justify otherwise morally reprehensible conduct, at least not to the extent that a decision regarding deceptive litigation tactics does. *See id.* at 1092-93.

Interestingly, in practice many lawyers seem to follow implicitly a similar analysis in deciding how much time and energy to devote to a case. We may find ourselves paying more attention to a relatively more meritorious case.

84. *See, e.g.*, MODEL RULES Rule 6.1, MODEL CODE E.C. 2-24, 2-25.

85. *See supra* text accompanying notes 71-72.

and objectivity in law. It does not exploit indeterminacy for immoral ends, but rather softens it with a sensitivity to seeking justice. On the other hand, it does not blindly assume that the law is determinate, but looks behind the surface for justice. The ideal of justice maintains the proper relationship between the poles.

Thus, lawyers using this approach could avoid following the deceptive oversimplification and would honestly confront the complexity of legal representation. Whether they attain those goals or not will depend largely on their moral character. Looking back at my own experience, I can see that although I succeeded sometimes, other times I did not.

PREPARING WITNESSES FOR TRIAL OR DEPOSITION

The last section of this paper will apply some of the concepts developed in the previous sections to a specific problem I experienced as a litigator that raised ethical dilemmas—coaching witnesses. While preparing witnesses, I sometimes felt uncomfortable with the standard techniques of "coaching" or preparing witnesses. I was uncertain about employing zealous representation in these situations, even though I conducted myself in accordance with the techniques I had learned both in law school and at my firm.

These techniques include telling witnesses what the law requires (or seems to require) in order to prevail. Sometimes, one begins an interview in this fashion before eliciting the witness' own narrative account of the incident. Leading questions asked at strategic points also imply that a certain answer is desirable. To develop internally consistent testimony, one also reminds witnesses of what they said at previous interviews or depositions, as well as telling them what other witnesses had said.

Do these techniques induce deception? They can, but do not necessarily. Personal discomfort can derive from personal standards unadapted to litigation as well as from legal standards uninformed by morality.

First, the factors distinguishing litigation from ordinary life situations[86] compel lawyers to prepare witnesses to testify. Clients hire lawyers to promote a perspective on the facts that is as favorable to them as possible. Loyalty to our clients predisposes us to that point of view, which does not mean that we circumvent the objective truth when we endorse a certain version of facts. If that version is itself a sincere at-

86. *See* ARENDT, *supra* note 20, at 261-62.

tempt to be faithful to reality, it can suffice. All interpretations are selective and told according to the point of view of the narrator. One who tells "the truth" always tells a story,[87] and thus we are under no obligation to tell the complete, objective truth.

Indeed, that sort of truth probably is impossible to reconstruct *post hoc*. Memory does not involve recollecting an indelible impression. Rather than a fixed substance, it is a creative process very much dependent on the subjective biases and interests of the observer. One perceives what one wants to and has been taught to perceive and remembers similarly.[88]

The second factor, the competitive nature of litigation, buttresses the necessity of preparation. We are derelict in our duty if we fail to prepare our witnesses as thoroughly as opponents will prepare theirs. My opponents in the police misconduct cases I litigated often were police officers trained as professional witnesses.[89] The adversary system also ensures that at least two versions of the facts[90] will be presented, further lessening any need for us to present the whole.

Moreover, preparation can aid the search for truth, as the prepared witness' version of facts may be more accurate; it is likely more detailed than an unprepared witness' account.[91] Many of my unsophisticated and uneducated clients were not naturally articulate about a particularly traumatic incident in their lives.[92] The client's or witness' initial, unprepared version is not necessarily more true. It may have been distorted by the client's mistaken notion of his interest.[93] No omniscient

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87. *See* M. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM 64-67 (1975).

88. Chicago police officers have been known to engage in extremely deceptive tactics in order to win cases and cover up for each other. One particularly egregous example is Jones v. City of Chicago, 856 F.2d 985 (7th Cir. 1988), in which supervisory officers suppressed clearly exculpatory reports on a murder defendant, deceived an investigator that the prosecution had been abandoned, signed a deceitful report for the prosecutor, and approved clearly unconstitutional actions by subordinate officers taking part in the investigation. Others involved in the scheme also suppressed exculpatory evidence. *Id.* at 992. The suppressed reports were contained in a "street file," following a longstanding Department custom, which was not revealed to either the prosecution or defense. *Id.* at 995.

89. Often, there are as many versions of the facts as witnesses. Witnesses easily subvert our attempts at consistency.

90. *See* FREEDMAN, *supra* note 87, at 68.

91. *See* RICH, *supra* note 1, at 67: "[L]anguage is power and . . ., as Simone Weil says, those who suffer from injustice most are the least able to articulate their suffering . . . ."

92. FREEDMAN, *supra* note 88, at 74.

93. *See* BURNS, *supra* note 7, at 257-58; Plato, Phaedrus 272d: "Even actual facts

observer determines the answer.

The third factor concerns the system's inability to process facts not contained within its preexisting categories. Testimony must be clipped and pruned to fit into legal categories. Cases are not cognizable unless they are articulated according to this scheme. We must translate witnesses' initial accounts into terms that could allow our client to prevail.

Thus, the need for preparation is evident. It should also be evident that some damage to the whole truth is probably inevitable. We must be careful, however, not to engage in unnecessary trampling on facts, mutating them with deception. Faithfulness to the witnesses' perception of reality remains the touchstone.

Retaining witnesses' intended meanings can be difficult to achieve, as many temptations to cross the line of acceptability exist. The desire to win at any cost fuels the temptations. The need for plausibility enhances this potential. Sometimes the most plausible story is not the most accurate.[94] Any need to downplay prejudicial, albeit irrelevant, aspects of a case, and the need for consistency among witnesses further increase the temptation to deceive a factfinder. Finally, one is tempted not to forgo any client advantage that the standard techniques may promote.

I hesitated to impose my own values on clients, and thus limited preparation techniques. Any foregone advantage could hurt clients, not me, and I usually believed that my clients' claims were just. Moreover, because my clients generally were unsophisticated and uneducated people, it would have been difficult to have a moral dialogue with them about the ethics of our tactics. They tended to expect their lawyers to be aggressive, invulnerable, and omniscient. That made it especially problematic for a young woman like myself to show equivocation or lack of firmness. Clients also tended to defer to us on questions of the propriety of various tactics. Nonetheless, we would come to know each other as the litigation developed and I often would acquire a sense of the clients' personal principles.

In the midst of these complexities, I often did not know where to draw the line when preparing witnesses. The situations were ambiguous, and I tended to err on the side of more interference rather than less.

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ought sometimes not be stated, if they don't tally with probability: they should be replaced by what is probable . . . ." One should also note, however, Phaedrus 273d: "[T]he multitude get their notion of probability as the result of a likeness to truth, and . . . these likenesses can always be best discovered by one who knows the truth." *Id.*

94. *See* Note, *supra* note 31, at 400, 401-03.

The paradoxes reveal the complexity of the situation. I had to zealously represent my clients, while not crossing the line into deception, balancing the poles of the first paradox. Under the second paradox, I had to balance the reality of legal culture against the ideal of fairness to everyone, remembering the context in which I operated. Litigation is not just a personal encounter, but a situation where clients are expected to receive assistance in developing their cases to promote their interests. And opponents generally will follow the standard conception, observing only the conventions of legal culture.

The third paradox, though, particularly complicates the picture. Factual indeterminacy renders facts and reality highly malleable. The human inability to be truly objective exacerbates one's tenuous grasp of factual reality. Moral indeterminacy creates further difficulties. It is difficult to know which aspects of our own morality are universal and generalizable to others.

The professional codes, a sort of bottom-line universal morality for lawyers, provide some guidance in this area, but not much. A lawyer cannot promote an illegal or fraudulent client goal, but my clients usually did not intend to tell a false story. Preparing testimony involved means and tactics, the lawyer's province, more than ends. A lawyer cannot be involved in deceit or misrepresentation, but this general prohibition seems merely to restate the problem, which is deciding exactly when zealous advocacy becomes deceitful. The prohibition against creating false evidence is more specific, but the question remains at what point the witness' story becomes false, bearing in mind that doubts should be resolved in the client's favor.

Notwithstanding these ambiguities, lawyers should at the very least be prohibited from telling witnesses outright that they must state a certain version of the facts, or from endorsing a known lie by a witness. That clearly would promote perjury. Beyond that, the professional codes do not in themselves resolve the question because of the ambiguity of their terms.

The standard conception of role morality would place no further proscriptions on a lawyer's conduct. General morality, however, can be of further assistance. Personal moral judgment and intuition can tell us not only that deception and lying are wrong, but more precisely, where and when deception occurs. Judgment fleshes out the professional codes and gives interpretive guidance.

The fourth criterion from the previous section also provides some guidance. Adding to the professional codes' prohibition against creating false testimony, it specifies that lawyers should not state as fact some-

thing believed to be false or inadequately investigated. Further, they should not omit stating facts within their sole custody after inquiry. Lawyers also should not counsel or assist witnesses to do these things.

Certain uses of the standard techniques could transgress these boundaries. Strongly suggesting or clearly implying that a witness should change his intended meaning to fit a preordained version of the facts would violate this criterion. It probably would violate the professional codes as well.[95] Surely unmistakeable implications have no greater moral weight than explicit directives. Furthermore, even if the lawyer's preferred preordained version of the facts is not necessarily false, its truthfulness has insufficient support unless investigation has revealed witnesses who can spontaneously begin articulating this version as their own. Their testimony may need quite a bit of refinement, but it must be essentially their own.

Therefore, telling witnesses what the law requires is unethical when it is done in a manner that directs the witness's testimony.[96] In general, it is probably better to inform the witness about the law after eliciting his own version of the facts. There is nothing instrinsically wrong, however, about discussing the legal requirements in the case. On the contrary, unless done to coerce certain testimony, it generally is a good idea.

Leading questions clearly implying that a witness should modify his original intended meaning and create a new version of the facts also would be unethical. On the other hand, suggesting rephrasings faithful to the original meaning would be acceptable,[97] as would reminding witnesses of facts they know but forgot to relate. One can accomplish that by reminding witnesses of what they said previously, or otherwise refreshing their memories. Relating what other witnesses have said also can refresh memory. It is acceptable as long as the lawyer's message is not that the witness' own version must be consistent with that of other witnesses.

Whether a lawyer's implications are coercive will depend on their tone and the context in which they occur. We must learn to recognize the line of deception when it looms and to avoid creating testimony. Applied to my own practice, in general I think I should have spent more time thinking about each situation, rather than evading my unease. Because each case was unique and complex, involving very different facts

95. FRANKEL, *supra* note 9, at 15.

96. *See* Note, *supra* note 31, at 399-401.

97. *See supra* notes 64-66 and accompanying text.

and personalities, each merited careful and individual consideration. Certain clients and witnesses were more susceptible to influence than others. Some were more able to comprehend what the law required than others.

Second, despite the difficulties, I should have tried to dialogue more with my clients about tactics and means, rather than just assuming they wanted only to win as much money as possible, unless I saw signs to the contrary. It would not have been easy in some cases to do so, but in many instances it would have been worth an attempt.

Third, I should have been less fearful about imposing my moral standards on others. I share those standards for the most part with the larger society, and the professional ideal as expressed in the professional codes does not conflict with them. In addition, automatic deference to client standards can be counterproductive. Throughout this paper, I have urged that we listen to our own inner voice and heed our own integrity. That integrity requires following our own standards. Failure to do so can lead to the conflicts I have enumerated. If the issue concerns means and tactics, that is the lawyer's province in any event. If it concerns a client goal, we probably will not be able to provide effective representation if we have serious moral disagreements with the goal.

For myself and other women litigators, the conflict may be seen as one between responsibility to self and others.[98] The most mature response to this conflict balances everyone's rights as the situation demands, rather than abdicating responsibility to ourselves in favor of the client. Ironically, adhering to our own truth may bring us closer to an appropriate balance of responsibilities to everyone involved in the case than would a too-easy adoption of a client's standards. For responsibility to ourselves entails responsibility for others. We must wrestle carefully with the questions. Doing so can enable us to confront reality in all its dimensions, and not opt for the easy way out, the simple and not fully honest answer that fails to respect the paradoxes.

CONCLUSION

In this article I have explored some of the complexities involved in analyzing the issue of deception in litigation. Adopting a highly contextualized approach, I conclude that while categorical rules governing attorney conduct are of some assistance in ethical decisionmaking, only personal judgment can provide adequate guidance in unique and par-

98. *See supra* notes 64-66 and accompanying text.

ticular situations. Reality is too complex to be adequately embraced by general formulations. We lawyers must walk a fine line between upholding truth while seeking justice, and remaining faithful to our clients. Continually growing in our knowledge of reality, we must live in response to both values.

I have also set forth certain guidelines I suggest can increase our awareness and help us make informed choices about ethical conflicts, while constraining unacceptable behavior. We must refine and balance these guidelines, and other relevant principles, as we apply our practical judgment to particular cases. We can create a pragmatic truth as we live and work in the context of the legal system if we are willing to devote sufficient attention to the problem.

NOTES

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Table. Public CFPB Enforcement Cases Including Claims Against Attorneys and Law Firms, 2012–2018

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Consumer Federation of America
University of Utah

Table. Public CFPB enforcement cases including claims against attorneys and law firms, 2012-2018.

	primary product or service	alleged violations	deceptive practices alleged
Gordon Law Firm	foreclosure relief	CFPA 1031 & 1036; Reg. O	yes
Mission Settlement Agency	debt relief or debt settlement services	CFPA 1031 & 1036; Telemrktg Sales Rule	yes
Borders & Borders	real estate settlement	RESPA	no
Frederick J. Hanna & Associates	debt collection	CFPA 1031 & 1036; FDCPA	yes
Siringoringo Law Firm	foreclosure relief	CFPA 1031 & 1036; Regulation O	yes
Residential Litigation Group	foreclosure relief	CFPA 1031 & 1036; Reg. O	yes
Macey, Aleman, & Searns	foreclosure relief	CFPA 1031 & 1036; Reg. O	yes
World Law Group	debt relief or debt settlement services	CFPA 1031 & 1036; Telemrktg Sales Rule	yes
Pressler & Pressler	debt collection	CFPA 1031 & 1036; FDCPA	yes
Access Funding, LLC	structured settlement financing	CFPA 1031 & 1036	yes
Works & Lentz, Inc.	debt collection	FDCPA; FCRA	yes
Vincent Howard, Lawrence W. Williamson, et al.	debt relief or debt settlement services	Telemrktg Sales Rule	yes
Weltman, Weinberg & Reis Co., L.P.A.	debt collection	FDCPA; CFPA 1031 & 1036	yes
Park View Law, Inc. (f.k.a. Prime Law Experts, Inc.), and Arthur Barens	credit repair	Telemrktg Sales Rule; CFPA 1031 & 1036	yes
Transworld Systems, Inc.	debt collection	CFPA 1031 & 1036	yes

Source: Analysis of CFPB enforcement cases 2012-2018.

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