UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2015-CFPB-0029

In the Matter of: **INTEGRITY ADVANCE, LLC and JAMES R. CARNES,** **Respondents.**	**ENFORCEMENT COUNSEL'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF ITS MOTION FOR SUMMARY DISPOSITION AS TO LIABILITY**

ENFORCEMENT COUNSEL'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF ITS MOTION FOR SUMMARY DISPOSITION AS TO LIABILITY

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I. Introduction

For five years Respondents made loans to consumers, providing them with disclosures that told the consumers how much their loans would cost. The problem was Respondents told consumers how much their loans would cost if they were repaid in a single payment. Under the default terms of the loan agreements, Respondents automatically renewed consumers' loans repeatedly unless the consumers took affirmative steps to change the terms of their loans. Only 1% of Respondents' loans were paid off in full in a single payment. There is no genuine issue of material fact that the costs of consumers' legal obligations created by the default provisions of the loan agreements are not reflected in the loan agreements. As such, Respondents have violated the Truth in Lending Act (TILA) and the prohibition on unfair, deceptive, or abusive acts or practices (UDAAP).

In addition, Integrity Advance violated the Electronic Fund Transfer Act (EFTA) by requiring that consumers authorize electronic repayments of their loans during the application process. The undisputed facts show that as a condition of receiving a loan, Integrity Advance consumers were required to sign a document that authorized Integrity Advance to deduct payments from their bank accounts. Consumers were not able to procure a loan from Integrity Advance without granting this authorization, and that requirement is a violation of EFTA.

Finally, Respondents used a little known mechanism—remotely created checks—to continue withdrawing money after consumers blocked ACH access. The loan agreement did not clearly explain that an opaque, one sentence provision allowed Respondents to use a check drawn against consumers' accounts without their signature, knowledge, or approval. Nor did it explain that the provision would, in effect, prevent consumers from stopping Respondents' access to their accounts. The use of remotely created checks in this fashion was an unfair practice.

II. Factual Background

Integrity Advance is a Delaware limited liability company that, from at least May 2008 through December 2012, originated and serviced short term loans to consumers. SMF ¶ 1. The company offered loans ranging in value from $100 to $1000. SMF ¶ 2. From May 2008 through May 2013, Integrity Advance originated over 300,000 loans. Exh. C Hughes Decl. ¶ 3. Respondent James Carnes ('Carnes') was the President and Chief Executive Officer of Integrity Advance throughout the entire time that it offered short term, or 'payday', loans. SMF ¶ 3.

Once consumers completed the process of originating a loan with Integrity Advance, the company provided Truth in Lending Act disclosures that assumed the loan would be repaid in a single payment. SMF ¶ 19. That is, the total of payments, the finance charge, and the APR reflected calculations based on the assumption that the consumer would completely repay the loan on her next payday. *Id*. However, unless a consumer affirmatively contacted Integrity Advance to 'change the terms of their loan' Integrity Advance would automatically 'roll over' the consumer's loan by debiting a sum equal only to the finance charge. SMF ¶¶ 23, 24. This automatic renewal payment, which was the default payment arrangement under the contract, did not reduce the principal owed by the consumer. SMF ¶¶ 26, 31. Unless contacted by the consumer, Integrity Advance would roll over a loan four times. SMF ¶¶ 23, 25. After these auto-renewal payments, Integrity Advance would put a consumer into auto-workout status, during which the company would debit a finance charge plus $50 towards loan principal. SMF

¶¶ 33, 34. This auto-renewal and auto-workout process reflects the default operation of Integrity Advance's contract; it did not require an active decision, election, or further authorization by the consumer. SMF ¶¶ 26, 27, 29.

As a result, Respondents' data shows that approximately 1% of their consumers who had at least one cleared payment transaction paid exactly the amount disclosed in their loan agreement. Exh. C Hughes Decl. ¶ 7. A new Integrity Advance customer taking a $300 loan would have received a disclosure reflecting a single repayment of $390. SMF ¶ 35. Indeed, some consumers' contracts included a separate statement, just below the TILA box, explicitly stating that their payment schedule would be "one (1) payment" of $390. SMF ¶ 20. However, unless that consumer called Integrity Advance three business days before a payment due date to change the terms of the loan, she would pay much more than the amount disclosed. By the end of the default auto-renewal and auto-workout process, the consumer would have paid $1,065 instead of the $390. SMF ¶ 38.

Integrity Advance's loan agreement did not disclose to consumers the exact payment amounts that the company would be debiting from their accounts under the auto-renewal and auto-workout process. SMF ¶ 41. Integrity Advance's loan agreement never disclosed the APR, total finance charges, or total of payments that applied to consumers' loans given the default auto-renewal and auto-workout payments. SMF ¶¶ 34, 42, 43. Predictably, many Integrity Advance consumers were confused about the costs of their loans. SMF ¶¶ 45-47. Many did not understand that the auto-renewal payments did not reduce loan principal and were shocked to learn that even though they had made several payments (which in some cases equaled or exceeded the disclosed total of payments) they still owed the entire original loan balance. *Id*.

As a part of the loan application process, Integrity Advance required consumers to sign a form authorizing electronic access to their bank accounts. SMF ¶ 50. Consumers could only receive loan proceeds by way of an electronic deposit that was authorized by this ACH authorization form. SMF ¶ 52. The ACH form also provided authorization for the auto-renewal and auto-workout payments discussed above. SMF ¶¶ 53, 59, 60. Those payments occurred at regular intervals, *i.e.*, the consumer's pay day. SMF ¶ 55. There was no indication in the ACH authorization form that a consumer could obtain an Integrity Advance loan without signing the ACH authorization and authorizing recurring electronic repayments from their bank account. SMF ¶ 57. Indeed, data provided by Integrity Advance shows that over 98.5% of initial loan repayments were made via ACH. Exh. C Hughes Decl. ¶ 8.

The ACH authorization form also contained language that authorized Integrity Advance to create checks drawn on a consumer's account. SMF ¶ 61. These checks, which are known as remotely created checks, check drafts, or demand drafts, can be used to debit a consumer's account even after a consumer has withdrawn or otherwise blocked an ACH authorization. Integrity Advance's demand draft authorization was comprised of a single sentence in the loan agreement. SMF ¶ 62. This part of the authorization was not highlighted for consumers in any way and did not explain that it allowed Integrity Advance to draw checks on a consumer's account without the consumer's signature, knowledge, or further authorization. SMF ¶¶ 66-68. Integrity Advance used this provision to withdraw money from consumers' accounts after those consumers had tried to block the company's electronic account access. SMF ¶ 70.

III. Argument

A. The Bureau Has the Authority to Bring This Proceeding

The Consumer Financial Protection Bureau ('Bureau') is an independent agency of the United States that has the authority to enforce federal consumer financial law. 12 U.S.C. §§ 5511(c)(4), 5512(a), 5563, 5564. The Bureau is authorized to enforce The Truth in Lending Act ('TILA') and The Electronic Fund Transfer Act ('EFTA'). 12 U.S.C. § 5481(12), (14). The Bureau is also authorized to enforce the Consumer Financial Protection Act's ('CFPA') proscription against deceptive, unfair, and abusive acts and practices. 12 U.S.C. §§ 5531, 5536. The Bureau properly initiated this proceeding and seeks relief under the CFPA. 12 U.S.C. §§ 5563, 5565.

B. Summary Disposition Standard

A motion for summary disposition may be granted if the undisputed pleaded facts, admissions, affidavits, stipulations, documentary evidence, matters as to which official notice may be taken, and other evidentiary materials properly submitted show that: (1) there is no genuine issue as to any material fact; and (2) the moving party is entitled to a decision in its favor as a matter of law. 12 C.F.R. § 1081.212(c). Once the moving party has carried its initial burden, "its opponent must do more than simply show that there is some metaphysical doubt as to material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). That is, a party opposing summary disposition must present facts showing that there is a genuine issue for trial. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986). A factual dispute between the parties will not defeat summary disposition unless it is both genuine and material. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). A dispute is genuine if the evidence presents a sufficient disagreement to submit the matter to a reasonable factfinder. *See id*. at 251-52; *Kautz v. Met-Pro Corp*., 412 F.3d 463, 467 (3d Cir. 2005).

The instant motion seeks summary disposition as to Respondents' liability for the counts asserted in the Notice of Charges and not summary adjudication of any damages or civil penalties that might derive from any findings of liability by the Administrative Law Judge.

C. Integrity Advance and Carnes Are Covered Persons

Under the terms of the CFPA, the Bureau may take action against covered persons. 12 U.S.C. § 5481(6). Covered persons are defined to include "any person that engages in the offering or providing of a consumer financial product or service." *Id*. Consumer financial products and services include, *inter alia*, "extending credit and servicing loans." 12 U.S.C. § 5481(15)(a)(i). As seen above, Integrity Advance originated credit in the form of small dollar loans, making the company a covered person. SMF ¶¶ 1-2.[1]

Carnes is likewise a covered person due to his role as the President and Chief Executive Officer in charge of Integrity Advance's operations. Ans. ¶ 6; SMF ¶¶ 4-11. The CFPA defines a "related person" to mean, *inter alia*, "any director, officer, or employee charged with managerial responsibility" for a covered person. 12 U.S.C. § 5481(25)(C)(i). A related person "shall be deemed to mean a covered person for all purposes of any provision of Federal consumer financial law." 12 U.S.C. § 5481(25)(B). As seen above, Carnes was the Chief Executive Officer in charge of Integrity Advance, making him a related person. Therefore, Carnes is a covered person.

[1] Integrity Advance is also a covered person by virtue of directly or indirectly servicing its loans. SMF ¶ 1.

D. Integrity Advance Violated the Truth in Lending Act by Failing to Accurately Disclose the Costs of Its Loans

There is no genuine dispute regarding how Integrity Advance's loans worked. As Respondents acknowledge, they automatically rolled over their payday loans unless the consumer called three business days before payment was due to *change* the terms of the loan. Ans. ¶ 29; SMF ¶ 24. Integrity Advance admitted, "if a customer took no action, a customer was auto-renewed and the payment amount was debited...in the amount of the finance fee plus any accrued fees." SMF ¶ 24 (interrogatory response). "Respondents admit[ted] that unless a consumer contacted Integrity Advance to change the terms of the loan ... Integrity Advance renewed the consumer's loan." Ans. ¶ 29. Respondents further admitted that the renewal payments applied only to the finance charges, and after four renewal payments Respondents applied $50 to principal and the rest to finance charges. Ans. ¶ 30; SMF ¶¶ 31, 32, 33. Respondents admitted that a $300 loan to a new consumer would result in eleven payments totaling $1065 unless a consumer called to *change* the terms of the loan to repay in a single payment. Ans. ¶¶ 29, 31. Indeed, consumers authorized these future payments when they signed the ACH authorization. SMF ¶¶ 50, 53, 54. Thus, Integrity Advance's loans effectively were multi-payment installment loans, with a prepayment option, not single payment loans.

Despite this automatically renewing loan structure, Respondents admitted that they disclosed the costs of their loans as if they were single payment loans. Ans. ¶ 26 ("Respondents admit that [TILA] disclosures stated a calculation that reflected loan repayment in one payment ..."). There is no dispute about this fact. The contract does not state the total cost of the loan, or the total amount of finance charges that a consumer must pay pursuant to the auto-renewal or auto-workout provisions. SMF ¶¶

41-44. The contract does not even state the amount of the finance charge that a consumer will have to pay for each auto-renewal or auto-workout payment. SMF ¶ 43.

Given that there is no dispute about how the contracts worked or what Integrity Advance disclosed about the cost of the loans, the only remaining question is whether Integrity Advance violated TILA as a matter of law because it disclosed multi-payment, automatically renewing loans as if they were single payment loans. The clear answer is that Integrity Advance did violate TILA. This conclusion is supported by the record in this matter and a district court decision in a directly analogous case. *F.T.C. v. AMG Services, Inc.*, 29 F. Supp.3d 1338 (D. Nev. 2014).

The Truth in Lending Act (TILA) requires lenders to extend credit on terms that are transparent. *See* 15 U.S.C. § 1601(a). TILA is implemented by Regulation Z, which mandates that creditors disclose "the terms of the legal obligation between the parties." 12 C.F.R. § 1026.17(c); *id.* § 1026.17(a). This includes, *inter alia*, the loan's finance charge, annual percentage rate, due date, and series of payments scheduled to repay the total of payments. *id.* §§ 1026.17(a), 1026.18; *Beach v. Ocwen Fed. Bank*, 523 U.S. 410, 412 (1998) ("[T]he Act requires creditors to provide borrowers with clear and accurate disclosures of terms dealing with things like finance charges, annual percentage rates of interest ...."); *Chase Bank USA, N.A. v. McCoy*, 131 S.Ct. 871, 874–75 (2011) ("Congress passed TILA to promote consumers' 'informed use of credit' by requiring 'meaningful disclosure of credit terms'"); Official Staff Comments, 12 C.F.R. § 226, Supp. I, 226.9(b) cmt. 1 ("*Legal obligation*. The disclosures should reflect the credit terms to which the parties are legally bound at the time of giving the disclosures") (emphasis in original). The Administrative Law Judge can hold Integrity Advance liable for TILA violations that occurred during the company's entire history given that TILA took effect in 1969, Pub. L. No. 90-321 § 504(b) (1968), *codified a*t 15 U.S.C. § 1631 note.

Integrity Advance failed to disclose consumers' legal obligation. As seen above, Integrity Advance consumers were obligated to make a series of payments which were authorized at loan signing. SMF ¶¶ 26, 50, 53. The fact that consumers had a prepayment option does not lessen this obligation, just as the ability to prepay a 30-year mortgage does not lessen the initial obligation to make 360 monthly payments. Integrity Advance's TILA disclosures—which only included information assuming a one-time repayment—failed to inform consumers about the APR, finance charge, and total of payments given the structure of the loan agreement. Indeed, under the default terms of the contracts, an Integrity Advance consumer would pay five times the disclosed finance charge before any payments were applied to principal. SMF ¶¶ 31, 32, 38. A new Integrity Advance consumer taking a $300 loan would have made 11 separate payments totaling $1,065, not $390 as the TILA disclosure would have shown. SMF ¶¶ 35, 36, 38.

In the only case applying TILA to payday loan roll overs, a federal district court found—on very similar facts—that the defendant's conduct violated TILA and was legally deceptive, awarding summary judgment to the Federal Trade Commission. *AMG Services, Inc.*, 29 F. Supp.3d 1338. AMG Services, like Integrity Advance, provided TILA disclosures based on a single repayment schedule even though the contractual fine print required consumers to take affirmative steps to avoid numerous automatic renewals. *Id.* at 1345. There is no meaningful distinction between the facts of the *AMG* case and the facts of the instant matter.

Each of Integrity Advance's 304,227 loan agreements during its five years of operation included a false TILA disclosure. SMF ¶¶ 40, 41, Exh. C Hughes Decl. ¶ 3. The large majority of those consumers paid more than the amount listed on the TILA disclosure, and Integrity Advance should be ordered to reimburse those consumers for the amounts paid in excess of the disclosed cost. By virtue of violating TILA (Count I), Integrity Advance also violated the CFPA (Count II). 12 U.S.C. § 1036(a)(1)(A).

E. Respondents' Loan Agreements Are Deceptive

Given the undisputed facts regarding the operation of the loan agreements and Respondents' disclosures about loan costs, it is clear that Respondents' loan agreements are deceptive on their face. In fact, Enforcement Counsel's expert, Dr. Manoj Hastak, in analyzing the loan documents, found that they failed to clearly and conspicuously disclose the costs of Respondents' loans. Exh. A at 19-20. It is undisputed that Respondents disclosed a multi-payment loan as if it was a single payment loan. The Administrative Law Judge can and should conclude that the loan agreements were facially deceptive.

The Consumer Financial Protection Act allows the Bureau to take action against a covered person to prevent unfair, deceptive, or abusive acts or practices in connection with a consumer financial product or service. *See* 12 U.S.C. §§ 5531, 5536. Under analogous F.T.C. law, the Bureau must show the following elements to establish the existence of a deceptive act or practice: (a) a material (b) representation, omission, or practice (c) that is likely to mislead consumers acting reasonably under the circumstances. *See F.T.C. v. Cyberspace.Com, LLC*, 453 F.3d 1196, 1199 (9th Cir. 2006).

1. Respondents' Disclosures Regarding the Cost of their Loans Are Material Representations

The statements in the TILA disclosures—the APR, amount of the finance charge, number of finance charges, total amount owed, and total number of payments—are material representations. These terms go directly to the cost of the loans, and courts have been clear that the costs of a loan product are relevant and material to consumers. *See F.T.C. v. Figgie Int'l, Inc.*, 994 F.2d 595, 608 (9th Cir. 1993) (stating that terms relating to the price of products are material); *Steele v. Ford Motor Credit Co.*, 783 F.2d 1016, 1019-20 (11th Cir. 1986) ("[A]ny understatement of the finance charge is material because any understatement would be of some significance to a reasonable consumer.").

2. Respondents' Disclosures Were Likely to Mislead Consumers

Respondents' disclosures were likely to mislead consumers acting reasonably under the circumstances. It is well settled that proof of actual deception is not required to prove a deception claim. *See, e. g., Libbey-Owens-Ford Glass Co. v. F.T.C.*, 352 F.2d 415, 417 (6th Cir. 1965); *Stauffer Labs., Inc. v. F.T.C.*, 343 F.2d 75, 78 (9th Cir. 1965). Indeed, a practice is deceptive when it is "likely" to deceive consumers. *See F.T.C. v. Cyberspace.Com*, 453 F.3d at 1199.

Here, the loan agreements were deceptive on their face. The case law clearly shows that a court can grant summary judgment based on a facial analysis of a document. *See, e.g. id.* at 1200-01 (affirming a finding of deception on summary judgment based on a facially deceptive mailing that created the impression that a check was a refund or rebate rather than an offer of services, and finding the conclusion bolstered by evidence of actual deception). "Cases involving plainly deceptive communications ... [are] one[s] where we will grant summary judgment for the plaintiffs without requiring them to prove what is already clear." *Ruth v. Triumph Partnerships*, 577 F.3d 790, 801 (7th Cir. 2009) (reversing summary judgment for debt collector, and holding that plaintiff was not required to produce extrinsic evidence to meet burden where communications were plainly deceptive). The *AMG* court—considering a very similar agreement—held it did not need to consider the defendant's expert's testimony and held that the agreement was deceptive as a matter of law. *F.T.C. v. AMG*, 29 F.Supp.3d at 1350-1352.

Respondents stated in the TILA box the finance charge, APR, and total of payments for a single-payment loan. SMF ¶ 19. The TILA box was designed to prominently provide information about the cost of credit to consumers. *F.T.C. v. AMG*, 29 F. Supp.3d at 1349 (finding deception where "the large prominent print in the TILA Box implies that borrowers will incur one finance charge while the fine print creates a process under which multiple finance charges will be automatically incurred unless borrowers take affirmative action"). Courts have held that where the cost disclosures in the TILA box are false, as they are here, that is likely to mislead consumers acting reasonably. *Beauty Style Modernizers, Inc.*, 83 F.T.C. 1761 (1974). Moreover, it is undisputed that Integrity Advance's loan agreement never stated the full and accurate cost of the company's loans. SMF ¶¶ 42, 43. An Integrity Advance consumer could not look at her loan agreement and see the finance charge, APR, or total of payments that applied to a loan that would go through auto-renewal and auto-workout. *Id*.

Notwithstanding that proof of actual deception is not required to establish a deception claim, the record in this matter contains numerous consumer complaints demonstrating that many consumers were in fact misled about their Integrity Advance loans. *See* Exh. B Marlow Decl. ¶¶ 6, 7. Indeed, the largest category of consumer complaints submitted by consumers to the Better Business Bureau ('BBB') indicate that many consumers did not understand the costs of their loan from Integrity Advance. *Id*. Many consumers complained specifically that they thought they would only have to pay the amount Respondents disclosed in the TILA box. One consumer requested a refund of the amount above what was disclosed in the TILA box as "the truth in lending statement on their contract, page 2 clearly states in the Total of Payments section 'The amount you will have paid after you have made all payments as scheduled $650.'; I believe this is pretty clear." SMF ¶ 46 at Exh. 20 (CFOPB037335). Another stated, "[t]he amount that was [loaned] to me was 300.00 according to my papers it would cost me 390.00. As of today ... they have taken 500.00 out of my account and say [I] still owe them 400.00 more." SMF ¶ 46 at Exh. 16 (CFPB036746). One consumer complained that Integrity Advance had deducted $750 on a $500 loan and stated that he still owed an additional $650 when the TILA disclosure indicated that the cost of the $500 loan was $650. SMF ¶ 46 at Exh. 17 (CFPB036816)). Another consumer stated that Integrity Advance had taken out $1,125 on a $500 loan even though "[i]t is clearly stated in my contract that $650 is my truth in lending amount." SMF ¶ 46 at Exh. 18 (CFPB037373)). And finally, a consumer stated that if the total cost of the finance charges "was made clear in the beginning, I would have gone through the procedures to repay without being charged their finance fee." SMF ¶ 69 at Exh. 27 (CFPB037533). These complaints clearly show that consumers were deceived by Respondents' disclosures.

Respondents' violated the CFPA's prohibition on deception as to virtually all 108,789 loans serviced on or after July 21, 2011, as the loan agreements disclosed loan costs for a single payment loan and failed to disclose the costs of the default auto-renewal and auto-workout program. SMF ¶ 41 at Exh. 1 (Loan Agreement Template), Exh. 2 (Loan Agreement Template), Exh. C Hughes Decl. ¶ 4.

F. Respondents Engaged in an Unfair Act or Practice by Failing to Disclose the Costs of Their Loans

Respondents' failure to accurately disclose the costs of their loans also was legally unfair. An act or practice is unfair if it (1) is likely to cause substantial injury to consumers; (2) that injury is not reasonably avoidable by consumers; and (3) that injury is not outweighed by countervailing benefits to consumers or to competition. 12 U.S.C. § 5531(c). An analysis of these prongs shows that Respondents' loan disclosures were patently unfair.

1. Respondents' Practices Caused Substantial Injury to Consumers

Integrity Advance consumers suffered a substantial injury when the company electronically debited more money from their accounts than had been disclosed or authorized. Courts have been clear that monetary harm is considered a substantial injury. *See, e.g. Am. Fin. Servs. Ass'n v F.T.C. , 767 F.2d 957, 972-73 (D.C. Cir. 1985); F.T.C. v. Loanpointe, LLC*, No. 2:10-CV-225DAK, 2011 WL 4348304, at *5-6 (D. Utah Sept. 16, 2011) aff'd, 525 F.App'x 696 (10th Cir. 2013).

In this matter, the likelihood of substantial injury is clear. According to Respondents' own data, from May 2008 to May 2013 consumers paid a total of $133,422,838.83 more than the total amounts disclosed by Respondents. Exh. C Hughes Decl. ¶ 6a.

2. Consumers Could not Reasonably Avoid the Substantial Injury Caused by Respondents' Practices

In determining what constitutes a "reasonably avoidable" injury, courts interpreting the FTC Act have looked to whether consumers had a "free and informed choice" that would have enabled them to avoid the unfair practice. *Am. Fin. Servs. Ass'n v. F.T.C.*, 767 F.2d 957, 976 (D.C. Cir. 1985). "Consumers may act to avoid injury before it occurs if they have reason to anticipate the impending harm and the means to avoid it, or they may seek to mitigate the damage afterward if they are aware of potential avenues toward that end." *Orkin Exterminating Co.. v. F.T.C.*, 849 F.2d 1354, 1365 (11th Cir. 1988).

Respondents' customers could not reasonably avoid the injuries they suffered because Respondents did not tell them the total loan costs and in fact took affirmative steps to prevent them from learning such information. Respondents chose not to disclose total loan costs in the loan agreement. Respondents actually instructed their call representatives explicitly *not* to tell consumers the total costs of the loans during the application process. SMF ¶ 16. Furthermore, Respondents did not disclose the two week APR of their loans until after consumers completed the online application and did not provide a unified version of its contract and related documents to consumers until after they had agreed to the loan. SMF ¶¶ 15, 49. Respondents could have supplied consumers with agreements that more accurately reflected the costs of the loan, but did not do so.

Further, Respondents structured the repayment methods in the contract in a way that gave them—rather than consumers—control over the amounts collected. Respondents pulled the loan repayments directly from the consumers' accounts; consumers did not affirmatively pay the amounts owed. SMF ¶ 29 .This was an automatic process that did not require further action or authorization from the consumer.[2] *Id*. In addition, even if consumers revoked their ACH authorizations or otherwise blocked ACH withdrawals, Integrity Advance's loan agreements provided that the company could withdraw funds from their accounts through remotely created

[2] The ACH authorization in Integrity Advance's loan agreements provided that, "You further authorize us to initiate debit entries as necessary to recoup the outstanding loan balance whenever an ACH transaction is returned to us for any reason." SMF ¶ 54 at Exh. 1 (Loan Agreement Template) (CFPB000796-798); Exh. 2 (Loan Agreement Template) (CFPB000690-692).

checks, without obtaining their approval or signature at the time of the withdrawal. These provisions made it very difficult for consumers to protect their funds after they discovered that they owed much more under the agreement than they had been led to believe by the Respondents' representations. *See* discussion *infra* in Section G.

3. The Substantial Injury Caused By Respondents' Practices was not Outweighed by Benefits to Consumers or to Competition

Finally, there is no plausible argument that hiding the total cost of loans from consumers—and violating TILA in the process—provides any legitimate benefit to either consumers or competition. "[W]hen a practice produces clear adverse consequences for consumers that are not accompanied by an increase in services or benefits to consumers or by benefits to competition, the unfairness of the practice is not outweighed." *F.T.C. v. Windward Mktg., Inc.*, No. CIV. A. 1:96-CV-615F, 1997 WL 33642380, at *11 (N.D. Ga. Sept. 30, 1997) (*Cf. Orkin Exterminating Co.*, 849 F.2d at 1365); *see also F.T.C. v. J.K. Publications, Inc.*, 99 F. Supp. 2d 1176, 1201 (C.D. Cal. 2000).

Respondents' unfair practices applied to each of their 108,789 loans serviced on or after July 21, 2011. SMF ¶ 41 at Exh. 1 (Loan Agreement Template) (CFPB000640-645); Exh. 2 (Loan Agreement Template) (CFPB000684-689), Exh. C Hughes Decl. ¶ 4.

G. Respondents Unfairly Used Remotely Created Checks

Section 1031(c) of the CFPA provides that an act or practice is "unfair" if it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers" and that "substantial injury is not outweighed by countervailing benefits to consumers or to competition." 12 U.S.C. § 5531(c). Respondents' use of remotely created checks unfairly interfered with consumers' ability to contest the company's debits on consumer accounts. Through this electronic payment mechanism, which is not well-known by consumers, Respondents were able to continue taking money from consumers even after those consumers had contested the cost of their Integrity Advance loans. This caused unavoidable substantial injury to consumers which did not benefit consumers or competition.

1. Respondents Used Remotely Created Checks After Consumers Blocked ACH Withdrawals

As a part of the loan application and approval process, Integrity Advance consumers were required to sign an ACH agreement. SMF ¶ 50. The agreement contained the following opaque language: "[i]f you revoke your authorization you agree to provide us with another form of payment acceptable to us and you authorize us to prepare and submit one or more checks drawn on Your Bank Account so long as amounts are owed to us under the Loan Agreement." SMF ¶¶ 61, 62. Respondents used this language to justify initiating remotely created checks from consumers' bank accounts. SMF ¶ 70.

Remotely created checks allow an entity to withdraw funds from a consumer's account by means of a check that the consumer never completed, signed, or even saw. A remotely created check "is an oddball check that is drawn on an account but obviously wasn't torn from the account holder's checkbook and, on further inspection, doesn't even have the account holder's handwritten signature on it."[3] "[U]nlike traditional checks, the payee, and not the account holder, creates the instrument that instructs the drawee bank to make payment."[4] Due in large part to operational weaknesses that make

[3] Mercurio, Dave and Angie Spitzley, *A Guide to Remotely Created Checks*, 11 No. 8 Elec. Banking L. & Com. Rep. 1 (Oct. 2006).

[4] Cavazos-Wright, Ana R., *An Examination of Remotely Created Checks*, Federal Reserve Bank of Atlanta (2007), https://www.frbatlanta.org/media/Documents/rprf/rprf_resources/rprfwp0510.pdf?la=en.

it hard to enforce consumer protections and the fact that consumers are unfamiliar with the product, the F.T.C. has been critical of remotely created checks, even banning them in the telemarketing space.[5] Indeed, remotely created checks have been called a payment method "favored by con artists and scammers."[6]

As the record reflects, some consumers discovered that Integrity Advance rolled over their loans repeatedly such that the total cost of the loan was greater than the amount disclosed in the "Total of Payments" section of the TILA box. In response, some consumers attempted to stop Integrity Advance's ACH debits or revoke Integrity Advance's ACH authorization, *i.e.* the company's ability to electronically debit funds from the consumer's bank account. SMF ¶ 69. When consumers exercised this right, Respondents simply started creating remotely created checks and thereby continued to extract funds from consumers' accounts. SMF ¶¶ 63, 70. This practice was confirmed by Carnes's testimony, Integrity Advance's narrative responses, Respondents' data, and numerous consumer complaints. *Id*.; Exh. C Hughes Decl. ¶¶ 9, 10.

2. Respondents' Use of Remotely Created Checks Caused Substantial Injury

The use of remotely created checks resulted in substantial financial harm to Integrity Advance consumers. It is well-settled that "billing customers without permission causes injury for the purposes of asserting" an unfairness claim. *F.T.C. v. Amazon.com, Inc.*, 71 F. Supp. 3d 1158, 1164 (W.D. Wash. 2014) (*citing see e.g., F.T.C. v.*

[5] Final Telemarketing Sales Rule, 16 C.F.R. Part 310, 80 Fed. Reg. at 77,532-77,535 (Dec. 14, 2015).

[6] *F.T.C. Amends Telemarketing Rule to Ban Payment Methods Used by Scammers* Press Release, Nov. 18, 2015, https://www.ftc.gov/news-events/press-releases/2015/11/ftc-amends-telemarketing-rule-ban-payment-methods-used-scammers.

Neovi, Inc., 604 F.3d 1150, 1153 (9th Cir. 2010)); *see also, F.T.C. v. Ideal Fin. Solutions, Inc.*, 2014 WL 2565688, at *5 (D. Nev. June 5, 2014); *F.T.C. v. Inc21.com Corp.*, 745 F.Supp.2d 975, 1004 (N.D. Cal. 2010), *aff'd*, 475 F.App'x. 106 (9th Cir. 2012). Consumers who had blocked Integrity Advance's ACH access to stop the company from continuing to withdraw funds suffered financial harm when Integrity Advance used remotely created checks to take additional funds from their bank accounts. According to Respondents' own data, Integrity Advance used remotely created checks 3,545 times when the consumer had revoked or otherwise blocked ACH debits from their accounts. Exh. C Hughes Decl. ¶ 10.

That alone is sufficient to demonstrate substantial injury. However, the use of remotely created checks caused additional harm in the form of overdraft charges or insufficient funds (NSF) fees assessed to consumers. For example, one consumer complained, "Integrity Advance submitted 3 unauthorized checks to my bank ... for a total of $955. Their checks also caused an additional $210 in overdraft charges." SMF ¶ 69 at Exh. 24 (CFPB037146). *See also F.T.C. v. Direct Benefits Group, LLC*, 6:11-CV-1186-ORL-28, 2013 WL 3771322, at *2 (M.D. Fla. July 18, 2013) (finding that unexpected overdraft charges resulted in substantial injury).

3. The Injury Caused by Respondents' Use of Remotely Created Checks Was Not Reasonably Avoidable

An injury is not reasonably avoidable "[i]f consumers do not have a 'free and informed choice that would have enabled them to avoid the unfair practice[.]'" *F.T.C. v. Neovi, Inc.*, 598 F. Supp. 2d 1104, 1115 (S.D. Cal. 2008) (*quoting F.T.C. v. J.K. Publications, Inc.*, 99 F. Supp. 2d 1176, 1205 (C.D. Cal. 2000)). Here, the undisputed evidence demonstrates that consumers did not have a free and informed choice regarding the use of remotely created checks. Dr. Hastak's unrebutted conclusion is that the remotely created check provision "is neither clear nor conspicuous, is unlikely to be noticed, read, or correctly understood by borrowers" and "has the potential to confuse and misdirect borrowers rather than illuminate them." Exh. A at 26.[7] Dr. Hastak found that the provision was not prominent in any way, had a disadvantageous position, was likely easy for consumers to overlook, and was not repeated. *Id*. at 24. Indeed, the remotely created check provision is boilerplate language that appears only once in the contract.[8] SMF ¶ 62 at Exh. 1 (Loan Agreement Template) (CFPB000797); *id*. at Exh. 2 (Loan Agreement Template) (CFPB000691). Dr. Hastak also concluded that the remotely created check disclosure "fails to explain either that the company could write checks without notifying the consumer when they create such checks or that they could do so without the consumer's signature." Exh. A at 25. This lack of clarity is particularly egregious here given that the product at issue is something that would be unfamiliar to most consumers.

4. The Substantial Injury to Consumers Was Not Outweighed by Any Benefits to Consumers or Competition

There is no plausible argument that using a little known—and not well understood—product that was disclosed in a confusing and vague way and prevented consumers from stopping unauthorized charges, offered any benefit to consumers or to competition, let alone a benefit that would outweigh the substantial injury.

[7] Respondents' rebuttal expert stated that he had no opinion on whether the remotely created check disclosures were either conspicuous or clear. Exh. D (Novemsky 175:2-11).

[8] *Am. Fin. Services Ass'n v. F.T.C.*, 767 F.2d 957, 976-78 (D.C. Cir. 1985) (The presence of boilerplate language in standardized credit contracts prevented consumers from reasonably avoiding injury arising from inclusion of security interests and wage assignments in credit contracts.).

Data provided by Respondents indicates that they unfairly initiated 3,545 remotely created checks after consumers revoked or blocked ACH access. Exh. C Hughes Decl. ¶ 10. This resulted in $839,879.50 being debited from consumers' accounts. *Id.* at ¶ 11.

H. Carnes Engaged in the Deceptive and Unfair Acts and Practices

Carnes is liable for the deceptive and unfair acts described herein because he engaged in those practices as the Chief Executive Officer, owner, and ultimate decision maker at Integrity Advance. SMF ¶¶ 3, 10. An individual is liable for the unfair, deceptive or abusive acts of a corporation if the individual: (1) had authority to control the corporate defendants or participated directly in the wrongful acts or practices and (2) had some knowledge of the acts or practices. *See F.T.C. v. Tax Club, Inc.*, 994 F. Supp. 2d 461, 471 (S.D.N.Y. 2014) (*quoting F.T.C. v. Five-Star Auto Club*, 97 F.Supp.2d 502, 535 (S.D.N.Y. 2000)). Authority to control the company can be inferred from active involvement in business affairs and the making of corporate policy, including assuming the duties of a corporate officer. *Id*. at 471 (*quoting F.T.C. v. Med. Billers Network, Inc.*, 542 F.Supp.2d 283, 320 (S.D.N.Y. 2008)). "An individual's assumption of the role of president and her authority to sign documents on behalf of the corporation demonstrate that she had the requisite control over the corporation to be held liable under the F.T.C. Act." *Id*. at 471 (*quoting Five-Star Auto Club*, 97 F.Supp.2d at 538). Individuals also engage in the act or practice in question when they have authority and should have known about the unfair or deceptive practices. *See F.T.C. v. Stefanchik*, 559 F.3d 924, 931 (9th Cir. 2009); *F.T.C. v. Cyberspace.Com*, 453 F.3d at 1202; *F.T.C. v. LeanSpa, LLC*, 920 F.Supp.2d 270, 277-78 (D. Conn. 2013); *F.T.C. v. Millennium Telecard, Inc.*, 2011 WL 2745963 (D. N.J. July 12, 2011).

The undisputed facts in this matter show that Carnes meets the legal standard for engaging in the practices described above. Carnes was the founder of Integrity Advance and the CEO of the company during its entire existence. SMF ¶ 3. He had ultimate say over company policies and procedures. SMF ¶ 10. Carnes testified that he was involved in the daily management of the company when it was setting up its loan product and policies and procedures, and stated that over time the "product never changed." SMF ¶ 11. Indeed, the record reflects that over the course of the years that Integrity Advance operated, the loan agreement changed very little. SMF ¶ 13. Additionally, Carnes testified that he understood that consumers complained about not understanding the loan product and about the fact that roll over payments were not applied to loan principal. SMF ¶ 47. Carnes also understood that most Integrity Advance consumers would make higher repayments than what the company disclosed. SMF ¶ 48.

The record also makes clear that Carnes was actively involved in running Integrity Advance. He testified that he was responsible for hiring all of the company's employees and directly or indirectly supervised everyone. SMF ¶¶ 4, 5. Carnes worked in Integrity Advance's Kansas City area office on a daily basis with other company employees and met with the company's chief operating officer "a few times a week." SMF ¶¶ 6-9. Additionally, Carnes was the signatory on the contract with the vendor that provided debt collection services to Integrity Advance. SMF ¶ 12.

Given these undisputed facts, there can be little doubt that Carnes had knowledge of Integrity Advance's deceptive and unfair practices and had the authority to stop or change them. Since he did not, under the CFPA his liability is equal to that of his company.

I. Integrity Advance Violated EFTA by Requiring Electronic Repayment

Because the undisputed facts demonstrate that, as a part of its loan application process, Integrity Advance required consumers to sign an agreement that authorized electronic fund transfers to repay their loans, Integrity Advance unlawfully conditioned offers of credit on electronic repayments in violation of the Electronic Fund Transfer Act, 15 U.S.C. §§ 1693 *et seq*., and Regulation E, 12 C.F.R. § 1005 *et seq*.

Regulation E prohibits requiring consumers to agree to repay a loan via pre-authorized electronic fund transfers in order to receive credit. 12 C.F.R. § 1005.10(e). To establish a violation, Enforcement Counsel must show that (1) Integrity Advance's loans were a form of credit; (2) consumers' repayments were preauthorized electronic fund transfers; and (3) Integrity Advance conditioned the extension of credit on the authorization of such electronic fund transfers. The Administrative Law Judge can hold Integrity Advance liable for EFTA violations that occurred during the company's entire history given that EFTA took effect in 1979, Pub. L. No. 95-630 § 2101 (1978).

1. Integrity Advance's Loans Are Credit

There is no dispute that Integrity Advance's loans qualify as credit under Regulation E. Regulation E defines credit as the right "to defer payment of a debt." 12 C.F.R. § 1005.2(f). Integrity Advance's loan agreements allowed consumers to defer repaying the amounts loaned: pursuant to the default auto-renewal and auto-workout provision, consumers could repay the debt over a series of payments made on successive pay dates. SMF ¶¶ 25, 30, 32, 33. Even electing to change the terms of the agreement to pay in full on the first payment date is still deferring payment of the debt. Thus, there is no plausible argument that the loans were not credit.

2. The Payments Authorized by Integrity Advance's Loan Agreement Were Preauthorized Electronic Fund Transfers

Regulation E defines preauthorized electronic fund transfers as transfers "authorized in advance to recur at substantially regular intervals." 12 C.F.R. § 1005.2(k). The commentary further explains that transfers are preauthorized where a series of payments takes place at regular intervals "without further action by the consumer." Official Staff Commentary on Regulation E, F.R.R.S. 6-416.3, 2006 WL 3946633, at *1 (2006). "The statute applies where electronic fund transfers are preauthorized by the consumer, whether or not the preauthorized transfers actually do (or must) occur." *Baldukas v. B & R Check Holders, Inc.*, No. 12-CV-01330-CMA-BNB, 2012 WL 7681733, at *3 (D. Colo. Oct. 1, 2012) report and recommendation adopted *sub nom. Baldukas v. B & R Check Holders*, 12-CV-01330-CMA-BNB, 2013 WL 950847 (D. Colo. Mar. 8, 2013).

Integrity Advance's ACH form authorized the withdrawal of all payments by electronic fund transfer, expressly including the payments required by the default auto-renewal and auto-workout provisions. SMF ¶ 53. Once the consumer signed the loan documents and accepted the loan, they had authorized Integrity Advance to debit the entire series of default auto-renewal and auto-workout payments from their accounts, and Integrity Advance deducted these payments from the consumers' accounts every consumer payday (typically every two weeks) without any further action or authorization from the consumer. *Id.*

Courts have held that payday loan roll overs are considered preauthorized for purposes of Regulation E. For example, in *Johnson v. Tele-Cash, Inc.*, the court rejected the argument that a "single payment" payday loan transaction did not fall within the scope of EFTA. 82 F. Supp. 2d 264, 277-78 (D. Del. 1999), *rev'd in part on other grounds*, 225 F.3d 366 (3d Cir. 2000) (compelling arbitration of EFTA claims). Tele-Cash denied that their loans involved preauthorized electronic fund transfers because they were not authorized to make transfers that would "recur at substantially regular intervals," but rather were only authorized to "effect a debit entry [of] one payment." *Id*. Tele-Cash argued that, to renew a payday loan, a consumer had to enter into a new loan agreement (with a new one-time debit authorization). The court rejected these arguments and agreed with the plaintiff that, because his loan was very likely to roll over, it was "possible, and even likely" to result in recurring debits. *Id*. The court also found that the defendant's "literal interpretation" of the term preauthorized electronic fund transfer would undermine the consumer protection objectives that underlie EFTA and Regulation E. *Id*. The fact of preauthorization is even stronger here where the regularly recurring payments happened by default.

3. Integrity Advance Required Electronic Repayment for Its Loans

There is no dispute that Integrity Advance conditioned its loans on consumers agreeing to repay the loans via ACH. The undisputed facts in this case make clear that consumers had to sign the ACH authorization in order to get a loan. Ans. ¶¶ 39-40. Indeed, failing to tell consumers that they do not have to authorize ACH access and failing to provide an alternative to such authorization qualifies as conditioning an offer of credit on authorization for electronic fund transfers (EFTs). *See F.T.C. v. Payday Financial LLC*, No. 11-3017, slip op. at 14-17, (D. S.D. Sep. 30, 2013). In *Payday Financial*, the company did not tell consumers in the contract that they were not required to agree to electronic repayments and the company failed to provide a means for consumers to obtain a loan without initially agreeing to EFTs. *Id*. The court held that conditioning credit on an electronic repayment clause was a violation of EFTA and Regulation E.

Similarly, in this matter, the contracts offered by Integrity Advance contained no provision stating consumers could obtain the loan without ACH authorization, nor did the contract provide alternatives to electronic payments. There was no way for an Integrity Advance consumer to complete the online application process without signing the ACH authorization. SMF ¶ 51. Respondents admitted that consumers had to sign the ACH authorization form to get the loans, stating that "[c]onsumers could only receive loan proceeds by way of an electronic deposit which was authorized by the ACH authorization form." Ans. ¶ 40. Importantly, the form authorized *both* the deposit *and* the withdrawals for payments via ACH. SMF ¶¶ 52, 53. Furthermore, according to Respondents' own data, 98.5% of initial loan repayments were made via electronic means. Exh. C Hughes Decl. ¶ 8.

Even if a consumer could revoke an ACH authorization after signing the contract, it is still unlawful to require a consumer to agree to preauthorized electronic fund transfers to receive credit. Courts have ruled that a cancellation right does not cure an initial credit extension conditioned on electronic repayments. *See F.T.C. v. Payday Fin. LLC*, 2013 WL 5442387 at *8-9 (D.S.D. Sept. 30, 2013); *O'Donovan v. CashCall, Inc.*, No. C 08–03174 MEJ, 2009 WL 1833990 (N.D. Cal. June 24, 2009).

Integrity Advance required electronic access, and thereby violated EFTA, for each of its 304,227 loans originated during the company's lending operations. *See* SMF ¶ 50 at Exh. 1 (Loan Agreement Template) (CFPB000796-798); Exh. 2 (Loan Agreement Template) (CFPB000690-692); *see also* Exh. C Hughes Decl. ¶ 3. By virtue of violating

EFTA (Count V) Integrity Advance also violated the CFPA (Count VI). 12 U.S.C. § 1036(a)(1)(A).

IV. Conclusion

There are no genuine facts in dispute here. Respondents originated over 300,000 loans and each of the accompanying loan agreements contained violations of law that are evident from the four corners of the document. The loan agreements failed to convey consumers' legal obligations and misled them about the costs of the loans. Collectively, consumers paid over $133 million dollars more than what the loan agreements indicated the loans would cost. The undisputed evidence also establishes that Integrity Advance wrongfully required electronic repayment of their loans. Finally, thousands of consumers took the extreme step of revoking their ACH authorization but discovered that Respondents could by-pass their directions to their bank and access their funds. None of these facts are in dispute. Most are explicitly admitted by Respondents. The loan agreements on their face were deceptive, unfair, and violated TILA and EFTA. Enforcement Counsel accordingly respectfully requests that the Administrative Law Judge grant its Motion for Summary Disposition in its entirety.

Respectfully submitted,

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