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' POST-HEARING BRIEF**

<u>RESPONDENTS' POST-HEARING BRIEF</u>

Integrity Advance, LLC and James R. Carnes (together, "Respondents"), pursuant to 12 C.F.R. § 1081.305, and the Court's Order Scheduling Post-Hearing Submissions, Dkt. 149, submit the following post-hearing brief.

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Regulations

Other Authorities

I. INTRODUCTION

Enforcement Counsel has failed to provide substantial evidence in support of its claims as required by the Administrative Procedure Act ("APA"), 5 U.S.C. § 556(d) ("A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence."), as well as to survive judicial review under the APA, 5, U.S.C. § 706. This standard requires Enforcement Counsel to show, by a preponderance of the evidence, that it is entitled to relief on any of its claims. Enforcement Counsel has failed to meet its burden of proof. 12 C.F.R. § 1081.303(c); *Steadman v. SEC*, 450 U.S. 91, 103 (1981) (applying the preponderance of the evidence standard to adjudicatory proceedings subject to the APA); *Dir., Office of Workers' Comp. Programs, Dep't of Labor v. Greenwich Collieries*, 512 U.S. 267, 277 (1994) (same).

Enforcement Counsel has failed to make a *prima facie* case, let alone prove by a preponderance of the evidence, that Respondent James Carnes is independently liable for deceptive conduct. There is neither testimony nor documents in the record that establish that Mr. Carnes had the requisite level of authority or knowledge as to Integrity Advance's loan agreement disclosures. Enforcement Counsel also has failed to show that Respondents engaged in unfair practices through Integrity Advance's use of remotely created checks ("RCCs" or "demand drafts"). Indeed, Enforcement Counsel's case-in-chief did nothing but establish the fact that RCCs were used in limited instances, and that Enforcement Counsel has a preference – albeit one that is not supported by any actual case law or regulations – that the use of RCCs not be allowed. But Enforcement Counsel never proffers any evidence that meets each of the three prongs of an unfairness inquiry under the Consumer Financial Protection Act ("CFPA").

Finally, Enforcement Counsel has failed entirely to make any case that monetary (or injunctive relief) is appropriate in this case. Enforcement Counsel presented no damages case. Instead, it proffered a data scientist who testified about the compilations of consumer numbers he assembled at the request of Enforcement Counsel; he did little more than add together the total numbers of Integrity Advance customers who took out loans during the relevant time period, under a number of different circumstances. In fact, Enforcement Counsel has still not enunciated a damages theory for this case. It has failed altogether to show that even one consumer was injured as a result of the alleged conduct. Enforcement Counsel, thus, has failed to show any causal link between its requests for monetary relief and the conduct it has alleged (and also failed to prove). Enforcement Counsel has failed to meet any part of its burden of proof as to Mr. Carnes's liability for deceptive acts or practices, Respondents' liability for unfair acts or practices regarding the use of RCCs, and as to Enforcement Counsel's apparent (and convoluted) requests for monetary relief in this action. The Court should find entirely for Respondents on all of these issues. [1]

II. ARGUMENT

A. There Is No Evidence That Mr. Carnes Engaged In Deceptive Acts Or Practices

1. Enforcement Counsel Has Not And Cannot Meet The Legal Standard Necessary To Show That Mr. Carnes Engaged In Deceptive Acts Or Practices

Enforcement Counsel has failed to prove its deception claims as to Mr. Carnes. In order to establish that Mr. Carnes is liable for allegedly deceptive conduct, Enforcement Counsel had

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[1] Respondents renew their motion for a directed ruling, made at the close of Enforcement Counsel's case-in-chief. Hr'g Tr. III-49:19 – III-54:10. Enforcement Counsel has failed to make a *prima facie* case as to Mr. Carnes's personal liability for the claims at issue or that Integrity Advance's use of RCC's was unfair.

the burden to prove that: (1) Mr. Carnes participated directly in deceptive acts or had the authority to control those acts, and (2) Mr. Carnes had knowledge of the misrepresentations, was recklessly indifferent to the truth or falsity of the misrepresentation, or was aware of a high probability of fraud along with an intentional avoidance of the truth. *See CFPB v. Gordon*, 819 F.3d 1179, 1193 (9th Cir. 2016). These two elements are necessary and conjunctive, and do not represent two different "paths" to individual liability as Enforcement Counsel incorrectly argued at closing. *See* Hr'g Tr. III-184:17-21. Enforcement Counsel presented no evidence at trial that could possibly show Mr. Carnes's liability, let alone evidence sufficient to meet each prong of this standard by a preponderance of the evidence. [2]

Enforcement Counsel has acknowledged that *Gordon* is instructive in establishing the standard for establishing individual liability under the CFPA. There, the Ninth Circuit affirmed a finding of individual liability for an attorney alleged to have engaged in deceptive mortgage relief schemes. But in that case, the Bureau put on evidence in district court that included: (1) testimony from a services consultant, who had been hired to perform marketing and advertising services, that the defendant "reviewed the scripts and any marketing material used by the operation, and [the defendant] edited and modified those items"; (2) a business plan for the loan modification venture that stated that the defendant himself would "assure that all advertising is

[2] Enforcement Counsel cited myriad different cases for showing individual liability as to allegedly deceptive conduct. Nevertheless, Enforcement Counsel has failed to meet the burdens for showing individual liability that are enunciated in any of these cases. For example, Enforcement Counsel cited *Gordon*, for its proposed standard for individual liability in its opening statements. Hr'g Tr. I-10:13-21. Enforcement Counsel's closing statement cited *FTC v. Freecom Commc'ns, Inc.*, 401 F.3d 1192 (10th Cir. 2005) and *FTC v. Commerce Planet* for the "main paths to holding an individual liable." *Id.* at III-184:17-21. And Enforcement Counsel cited *FTC v. Five-Star Auto Club, Inc.*, 97 F. Supp. 2d 502, 539 (S.D.N.Y. 2000) in its pre-hearing briefing. *Id.* at III-185:13-16.

legal"; (3) testimony from an office manager at the defendant's law firm that the defendant reviewed all of the marketing materials, that the defendant approved the use of the scripts read by sales representatives, and that the office manager had forwarded marketing materials to the defendant for his review; and (4) an e-mail from the defendant that states: "Mainly, as it pertains to how existing clients will be pitched, representations made to the public in marketing our services . . . my word is the law. Period." *Gordon*, 819 F.3d at 1193. Here, of course, as noted below, the Court heard no evidence establishing Mr. Carnes's involvement in the creation, drafting or revision of any loan agreement, which Enforcement Counsel asserted would prove that he engaged in deceptive acts or practices. *See, e.g.*, Enforcement Counsel's Pretrial Statement at 5.

Furthermore, in *Gordon*, the Ninth Circuit also looked to case law interpreting the Federal Trade Commission ("FTC") Act, especially as to what an individual defendant knew or should have known about allegedly deceptive conduct. *Gordon*, 819 F.3d at 1202 n.8. Here, too, FTC case law is clear that the requisite level of knowledge for individual liability is substantial and specific, as "the Commission must prove that the individual defendant knew that [the company] or one or more of its agents engaged in dishonest or fraudulent conduct and had actual control or authority to control such conduct and that such conduct caused actual deception and consumer injury." *FTC v. Int'l Diamond Corp.*, No. C-82-0878 WAI (JSB), 1983 WL 1911, at *1 (N.D. Cal. Nov. 8, 1983).

Numerous FTC cases establish such a standard for showing liability as to an individual defendant. For example, in *FTC v. Freecom Communications, Inc.*, the Tenth Circuit held that "to hold an individual personally liable for consumer redress, the FTC must show a heightened standard of awareness beyond the authority to control." 401 F.3d 1192, 1207 (10th Cir. 2005).

There, the court affirmed the trial court's finding of liability based on evidence presented by the FTC showing that the individual defendant knew that the company's marketing efforts were deceptive. That evidence included employee testimony that the defendant "attended and participated in a meeting where the topic of discussion was 'speakers . . . taking license about things that they were representing about the products'"; testimony from a corporate officer that he had discussed with the defendant the officer's "belief that 'speakers were not consistent with the actual product being delivered'"; and evidence that the defendant "held a meeting at his house discuss issues of integrity and honesty," which officers described as an "ongoing issue." *Id.* at 1207. Indeed, as discussed below, there is no such evidence in this record; nor could there be, in light of Mr. Carnes's uncontroverted role at Integrity Advance.

In another example, in *FTC v. Five-Star Auto Club, Inc.*, the court held that an automobile leasing company operated out of the founder and sole owner's home was an illegal pyramid scheme. 97 F. Supp. 2d 502 (S.D.N.Y. 2000). Here, too, the court found the president/owner individually liable because he had "received almost a dozen cease and desist orders and inquiries of various kinds regarding [the company's] operations as a pyramid scheme," showing more than sufficient knowledge of the misrepresentations and deceptive claims made by the company. *Id.* at 537. The court also held the vice president of the company, the owner's wife, liable due to her role in the illegal scheme and her apparent knowledge of the violations. This knowledge was evidenced by her having prepared filings and responses to state regulators, and her having provided "lengthy substantive responses about [the company's] business in reply to inquiries directed to [the company]" by state Attorneys General. *Id.* at 538.[3]

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[3] Enforcement Counsel, in closing arguments, did not provide all the facts surrounding the court's holding in *Five Star Auto Club* and, thus, greatly overstates the scope of individual

Indeed, the court found that the defendant "serve[d] as a "front woman" in responding to law enforcement inquiries." *Id.* at 538. Mr. Carnes had no such role and never engaged with any regulatory agencies on behalf of Integrity Advance; indeed, he expressly testified, as noted below, that he hired attorneys with consumer finance regulatory expertise to engage on the Company's behalf. *Id.* at II-95:10-13.

In yet another case with inapposite facts, a court found in *FTC v. Commerce Planet, Inc.*, that the defendant company and its principal engaged in deceptive and unfair website marketing when the defendant offered a free "Online Auction Starter Kit" as a way to enroll customers in the defendant's paid subscription service. 878 F. Supp. 2d 1048 (C.D. Cal. 2012). There the FTC presented evidence establishing the principal's liability. To this end, the principal "testified that he had seen, reviewed, commented on, and approved various versions" of the website pages at issue. And the principal was found to have (1) received "weekly reports of the call logs in customer service that contained the cancellation rates and refund amounts"; (2) been aware of credit card chargebacks that indicated that consumers were unhappy with their acceptance of the free kit; (3) "had ample notice of consumer complaints", including complaints specific to the fee kit; and (4) to have "rejected the company's experiments in placing clearer disclosures and sending post-transaction e-mails because [the changes] hurt conversion rates." Moreover, a witness also testified that "one of the primary suggested changes brought up during the weekly

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liability under the FTC Act. Enforcement Counsel stated only that "the owner's wife was liable", Hr'g Tr. III-185:19, eliding the fact that the owner's wife also acted as vice president of the company and "was found to have requisite knowledge because of her preparation of filings and responses to state regulators." *Id*. II-185:23-25. By contrast, Mr. Carnes, who had only cursory knowledge of the disclosures in Integrity Advance's loan agreement, no expertise with which to evaluate the disclosures, and no indications that the disclosures might have been inaccurate, lacked any such "requisite knowledge."

meetings was to enlarge the font of the disclosure," and that the individual defendant rejected this idea. *Id.* 878 F. Supp. 2d at 1082. Indeed, as these cases make clear, both the FTC Act and *Gordon* require facts and evidence vastly different from that presented in this case as to Mr. Carnes in order to find a principal individually liable for a company's deceptive or unfair practices.

2. There Is No Evidence To Support A Finding Of Individual Liability As To Mr. Carnes

Enforcement Counsel presented no evidence that Mr. Carnes engaged in deceptive acts or practices. Mr. Carnes testified that he did not write, edit, or revise Integrity Advance's loan agreement template or any version of the agreement. Hr'g Tr. II-75:11-25, II-76:1-13; *see also id.* at I-228:25 – I-229:6. He also testified that he never conferred about the contents of the loan disclosures. *See id.* In fact, Mr. Carnes testified that the Company "hired outside counsel to create . . . loan documents that conformed with Delaware and federal law." *Id.* at II-95:10-13. Indeed, Mr. Carnes, as he and his former general counsel testified, deferred to the consumer financial regulation experts for the drafting and revisions of loan agreement language. *See, e.g.*, *id.* at I-30:11-16, I-47:15-17[4]; *id.* at II-26:20-25, II-27:1 (Mr. Foster testified that "no one at the Hayfield group of companies, including myself or Mr. Carnes, were consumer lawyers or experts in consumer law"). The evidence repeatedly shows that Mr. Carnes played no role in any drafting of or revisions made to Integrity Advance's loan agreement. *See, e.g.*, *id.* II-26:20-23 ("[n]o one at the Hayfield group of companies . . . were consumer layers or experts in consumer law."); *id.* II-27:5-6 ("[a]ll agreements were written by outside counsel.").

[4] Timothy Allen Madsen, the former Vice President of Marketing for Integrity Advance, testified that he and Mr. Carnes discussed primarily lead purchasing and performance of leads through to actual loans. Hr'g Tr. I-30:11-16, I-47:15-17, I-50:3-19. Mr. Madsen testified that he never discussed any aspect of the loan agreement with Mr. Carnes. *See id*. at I-67:12-23.

Similarly, Mr. Carnes did not review, edit, revise, or discuss call center scripts. *Id.* at II-74:13-25, II-75:1-9. In fact, Mr. Carnes testified that he never saw any call center scripts. *Id.* at II-75:10. This stands in stark contrast to the facts in *Gordon*, where the principal had written, edited, and modified the materials found to be deceptive, including scripts, and where the principal asserted that he was the final arbiter of their contents. *See Gordon*, 819 F.3d at 1193.

Similarly, Mr. Carnes would not have been alerted to any violations or deception through Integrity Advance's high returning customer rate – which remained high well after the Company was established. *See* Hr'g Tr. I-46:6 – I-47:10. Since July 21, 2011, 66% of Integrity Advance's loans were made to returning customers, and a total of 26,129 customers (48% of Integrity Advance customers since July 21, 2011) chose to take out two or more loans. *See* RX-021. Over the course of Integrity Advances five years of lending, a third of its customers were repeat borrowers. *Id.*[5] If anything, this evidence would have reasonably led someone in Mr. Carnes' position to understand that consumers were satisfied with Integrity Advance's products – not that there was an issue with consumer understanding of the loan agreements.

Similarly, Mr. Carnes neither knew nor had reason to know that any aspect of the loan agreement could be alleged to be deceptive, given Integrity Advance's high returning customer rate, which increased with each passing year. Since July 21, 2011, a total of 26,129 customers (48% of Integrity Advance customers since July 21, 2011) chose to take out two or more loans with Integrity Advance. *See* RX-021. Over the course of Integrity Advance's five years of lending, a third of its customers were repeat borrowers. *Id.*[6] The evidence shows that Integrity

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[5] Since July 21, 2011, more than 6,527 customers chose to take out *five or more* loans and 926 customers chose to take out *ten or more loans*. *See* RX-020

[6] Since July 21, 2011, more than 6,527 customers chose to take out *five or more* loans and 926 customers chose to take out *ten or more loans*. *See* RX-020

Advance personnel, including Mr. Carnes had access to and reviewed information regarding the number of repeat customers through an Integrity Advance dashboard. *See* Hr'g Tr. I-46:6 – I-47:10. There is no evidence showing or even tending to show that Mr. Carnes knew, should have known, or recklessly avoided knowing about any alleged deception stemming from Integrity Advance's loan agreement disclosures; the evidence shows the exact opposite to be the case.

In fact, the information that was available to Mr. Carnes indicated that the loan agreement complied with applicable laws and accorded with industry practices. As Mr. Foster testified, "the company's outside counsel reviewed the agreement of Integrity Advance on a regular basis as did the Delaware Banking Commission through its annual licensing process and the exams it received all reviewed the agreement." *Id.* at II-38:10-15; *see also* RX-008 – RX-013 (documenting Integrity Advance's Delaware licensure and renewal). Integrity Advance did, in fact, comply, as evidenced by the fact that its lending license was renewed during each year that it made loans to consumers. Among other things, Delaware law, starting in 2002, has allowed for any short-term consumer loan to be rolled-over no more than four times. *See* Hr'g Tr. III-135:1-11, III-138:3-10. As Elizabeth Quinn Miller, Senior Investigator for the Delaware Office of the State Bank Commissioner explained, the lending licensure process involves a review of the applicant's loan agreement – including the TILA box. Hr'g Tr. III-127:1-19. She also indicated that during the years that Integrity Advance had a lending license with the state of Delaware, she personally looked at lenders' loan agreements before those lenders were allowed to obtain a license. *Id.* at III-119:11-13. She also testified that lenders' loan agreements were likely reviewed on a regular basis during the State's supervisory examination process. *Id.* at III-132:19-20.

Mr. Carnes testified that he had a high level understanding that Delaware granted Integrity Advance a lending license, and renewed the license annually upon the Company's application. *Id.* at II-80:13-25, II-81:1-13. He also testified that he knew that Integrity Advance received approval to lend every year and "posted the license on [the company's] website." *Id.* at II-82:7-9. The evidence is clear that Mr. Carnes understood that Integrity Advance's lending license was renewed on an annual basis, because the Company complied with all relevant lending laws.

Accordingly, there is no basis for a holding that Mr. Carnes was individually and personally liable for any violations of the CFPA found by the Court. The evidence supports no other findings than that Mr. Carnes was the CEO of the Integrity Advance, which was only one of his multiple other business ventures and involved only part of his time, *see, e.g.*, *id.* at II-63:3-8, II-65:2-7, was involved in the Company's business relationships with lead generators and other vendors, and addressed other issues that rose to his attention from time-to-time. *See id.* at I-30:11-16; *id.* at I-216:2-9; *id.* at I-178:4-11. And although there is evidence that Mr. Carnes was an engaged CEO, his time commitments to Integrity Advance, especially during the relevant years at issue – namely 2011 and 2012 when the Company made loans that post-dated July 21, 2011 – did not amount to more than 10% of the total time he committed to professional endeavors. *See id*. at II-69:7-II-70:19. Indeed, he testified that he was routinely engaged in other business endeavors, in addition to Integrity Advance. *See id*. at II-64:23-65:9.

The dearth of evidence presented by Enforcement Counsel at trial suggests that its entire case hinges only on the fact that Mr. Carnes is a "related person" because he was the CEO of Integrity Advance. But as the case law makes clear, this, of course, does not establish any finding of liability as to Mr. Carnes. Naming Mr. Carnes as a "related person" merely confers upon the Bureau subject matter jurisdiction under the CFPA.[7] A showing that the Company engaged in deceptive or unfair conduct does not establish liability as to Mr. Carnes.[8] Enforcement Counsel must still establish that any "related person" is liable for the alleged conduct at issue. To this point, the D.C. Circuit in *Grant Thornton, LLP v. Office of Comptroller*, applying the Federal Deposit Insurance Act as to "institution associated parties ("IAPs")[9] makes clear, the CFPB's burden to show individual liability of Mr. Carnes is twofold. He must be shown to: (1) "fit within the statutory definition" of "related person" and (2) to have "commi[ted] the acts actually triggering punishment." 514 F.3d 1328, 1331–1332 (D.C. Cir. 2008). Mr. Carnes was not sufficiently involved with the allegedly deceptive conduct to be held personally liable for any allegedly deceptive conduct. Accordingly, the Court should find in Mr. Carnes's favor as to Count III of the Bureau's Notice of Charges.

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[7] The CFPA provides that 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).

[8] It is similarly insufficient for Enforcement Counsel to rely on supposition and inference – including Enforcement Counsel's assertion that the Court should draw an undefined "adverse inference" from the assertion of attorney-client privilege by Integrity Advance's former general counsel. *See* Hr'g Tr. III-187:1-7. Enforcement Counsel's request is improper and should be rejected because, under well-settled law, an adverse inference may not be drawn from the assertion of privilege. *Doe ex rel. Rudy-Glanzer v. Glanzer*, 232 F.3d 1258, 1265 (9th Cir. 2000); *see also Knorr-Bremse Sys. Fuer Nutzfahrzeuge GMBH v. Dana Corp.*, 383 F.3d 1337, 1344 (Fed. Cir. 2004) ("no adverse inference shall arise from invocation of the attorney-client and/or work product privilege"); *Parker v. Prudential Ins. Co.*, 900 F.2d 772, 775 (4th Cir. 1990) (no negative inference permitted from assertion of attorney-client privilege); *In re Tudor Assocs. Ltd. III.*, 20 F.3d 115, 120 (4th Cir. 1994) ("A negative inference should not be drawn from the proper invocation of the attorney-client privilege."); *Sand Hill Advisors, LLC v. Sand Hill Advisors LLC*, Case No. C 08-5016 SBA MEJ, 2010 WL 3702372, at *5 (N.D. Cal. June 1, 2010) (refusing to draw adverse inference from invocation of privilege).

[9] The CFPA's definition of "related person" is nearly identical to the definition of "institution-affiliated person" ("IAP") under the Federal Deposit Insurance Act ("FDIA"). *Compare* 12 U.S.C. § 5481(25)(C)(i), with 12 U.S.C. § 1813(u)(1). The FDIA enables the banking agencies to bring claims against IAPs for allegedly unfair or deceptive conduct arising under section 5 of the FTC Act.

B. The CFPB Has Failed To Demonstrate That Integrity Advance's Use Of Remotely-Created Checks Was Unfair, And That Mr. Carnes Engaged In Unfair Acts Or Practices With Regard To The Use Of RCCs

Respondents did not engage in any unfair acts or practices as to the use of RCCs. To the contrary, Integrity Advance used RCCs in a lawful (and very limited) manner. In order to prove conduct is unfair under the CFPA, Enforcement Counsel must establish that the act or practice: (1) caused substantial injury to consumers, which is not reasonably avoidable by consumers; and (2) substantial injury is not outweighed by countervailing benefits to consumers or competition. *See* 12 U.S.C. § 5531(c). Here, there is no evidence that Respondents engaged in unfair acts or practices as to the use of RCCs.

RCCs are legal and were legal during all relevant times Integrity Advance operated, as Enforcement Counsel's witness Mr. Joseph Baressi repeatedly testified.[10] Hr'g Tr. II-181:17-18; II-183:7-11; II-188:5 – II-189:10. It is undisputed that a demand draft is a legitimate payment mechanism governed by the Uniform Commercial Code ("UCC"), U.C.C. § 3-104(f), and Regulation CC.[11] Despite these undisputed facts, Enforcement Counsel seeks to impose a strict-liability standard and a finding that every instance in which Integrity Advance used an RCC after a consumer had withdrawn authorization for ACH debits constituted an unfair practice.[12] Hr'g

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[10] Respondents have moved to strike Mr. Baressi's testimony and maintain that his testimony is (a) improper lay-opinion testimony, and (b) unduly prejudicial. *See* Dkt. 153, Resp'ts' Motion to Strike Testimony of Joseph Baressi (Jul. 29, 2016).

[11] Regulation CC defines "remotely created check" as "[a] check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn." 12 C.F.R. § 229.2(f).

[12] To date, the CFPB has not identified a single case in which a Court has imposed a standard akin to strict liability for the use of demand drafts. Indeed, all of the cases cited by the CFPB throughout this proceeding involve wholly inapposite circumstances in which the customers *had no relationship at all* with the parties making the alleged demand drafts. *See, e.g.*, *FTC v. Ideal Fin. Sols., Inc.*, No. 2:13-CV-00143-JAD, 2014 WL 2565688, at *1 (D. Nev. June 5, 2014)

Tr. I-205:8-11 ("[a]s to remotely created checks Your Honor it is our position, Your Honor, that everything that was taken via remotely created checks was unfair and should be recouped."). Enforcement Counsel seeks to do so without any evidence that Integrity Advance's use of RCCs caused substantial injury to consumers that was not reasonably avoidable and not outweighed by any benefits to consumers or competition, and, thus, unfair.

Rather, Enforcement Counsel asks the Court to adopt the following flawed reasoning: (1) the mere use of remotely created checks is fraudulent and abusive (even though RCCs are legal); (2) some indeterminate fraction of customers in the less than one percent of loans that involved remotely created checks *may* have placed a stop payment on certain ACH debits (although, there is no evidence in the record establishing why customers did so or what communications Integrity Advance had with those customers after doing so); (3) Integrity Advance subsequently used an RCC to withdraw funds from some small number of customers, and, (4) therefore Integrity Advance acted unfairly and is liable for $265,000 in "damages" and over $2.8 million in civil money penalties .[13] Enforcement Counsel's reasoning has no basis in law or logic and, most critically, lacks any evidence connecting Integrity Advance's use of RCCs with consumer injury.

("The FTC claims that Defendants *set up shell companies, established merchant accounts with third-party payment processors, and billed consumers using these merchant accounts, with charges upwards of $30* . . . . when those customers called the phone number listed on the debit transaction, they were falsely told they had purchased financial counseling services.") (internal citations omitted) (emphasis added); *FTC v. Inc21.com Corp.*, 745 F. Supp. 2d 975, 982 (N.D. Cal. 2010), *aff'd*, 475 F. App'x 106 (9th Cir. 2012) ("The record also demonstrates that individual [defendants] knew that most of *their 'customers' were unaware that they were customers*.") (emphasis added). Here, by contrast, there is no evidence that any Integrity Advance customers were unaware that they were customers.

[13] Although it has not specified which theory of injury it is pursuing, Enforcement Counsel in its closing argument at the hearing stated that it is seeking more than $265,000 in "damages," and over $2.8 million in civil money penalties relating, presumably, to the use of RCCs. *See* Hr'g Tr. III-181:1-5, III-183:20 – III-184:5.

"[M]erely speculative harms" are not the type of injury that can be addressed through "unfairness." *See, e.g.*, *Am. Fin. Servs. Ass'n v. F.T.C.*, 767 F.2d 957, 972 (D.C. Cir. 1985). The Court should find in favor of Respondents as to Count VII.

1. There Is No Evidence Of Any Consumer Injury Linked To Integrity Advance's Use of RCCs

To prove that certain RCCs are unfair, Enforcement Counsel must first prove that Integrity Advance's specific use of RCCs caused substantial injury to consumers. There is no evidence to support this first necessary element of any unfairness claim. At trial, Enforcement Counsel did not introduce any evidence from any consumer showing that the consumer was injured by Integrity Advance's use of RCCs. Enforcement Counsel did not even introduce a single customer complaint concerning RCCs. Indeed, throughout this entire case, Enforcement Counsel has not pointed to even a *single* consumer complaint proving that the use of RCCs caused substantial injury.[14] *See* Dkt. 88E, Ex. 24 at 48. Nor for that matter did Enforcement Counsel introduce a consumer survey or any expert testimony on how Integrity Advance's use of RCCs caused consumer injury.

In fact, Enforcement Counsel has not presented *any* evidence at trial purporting to link Integrity Advance's use of RCCs to consumer injury. Instead, Enforcement Counsel relied only on (a) an improper lay-opinion witness, Mr. Baressi,[15] who *works as a lawyer for the CFPB* to testify *generally* about how RCCs work, and (b) a flawed numerical analysis presented by a

[14] Notably, that single consumer complaint predates July 21, 2011 and thus cannot form the basis for liability. *See, e.g.* Dkt. 94, CFPB Opp. to Mot. to Stay at 7 (Enforcement Counsel acknowledging that its UDAAP claims do not reach conduct that allegedly occurred before July 21, 2011).

[15] At the time of this filing, Mr. Baressi's testimony is subject to Respondent's motion to strike.

CFPB data scientist. Neither of these witnesses offered testimony that show any consumer injury, let alone substantial injury, stemming from the use of RCCs.

First, Mr. Baressi did not, and, in fact, could not, testify about how Integrity Advance used remotely created checks. *See, e.g.*, Hr'g Tr. II-167:5:19. Mr. Baressi explained that he has no knowledge about how RCCs are used in the context of payday lending, except he noted that RCCs have not been banned regarding short-term loans. *Id.* at II-183:9-11. Mr. Baressi's testimony is in fact wholly irrelevant to the question of whether Integrity Advance's use of RCCs was unfair. Indeed, Respondents' objections were sustained when Enforcement Counsel attempted to argue around the elements of unfairness in response to these objections.[16] *Id.* at II-181:17-182:1; II-192:20-193:21.

Second, the CFPB's numerical analysis presented by Mr. Hughes served only to establish the undisputed fact that that Integrity Advance used remotely created checks to withdraw certain amounts from a small percentage of Integrity Advance customer's accounts. *See* EC-EX-097 at 4-5; EC-EX-100. Mr. Hughes testified that he (a) conducted no investigation outside of the data set, (b) did not talk to any consumers, (c) did not know what communications Integrity Advance may have had with a consumer who was allegedly injured by the use of an RCC, and (d) did know why a customer may have placed a stop payment or withdrawn authorization for ACH debits. Hr'g Tr. III-20:10 – III-21:9. Furthermore, Mr. Hughes testified that although he included in his analysis instances in which a "NACHA code" for "stop payment" preceded an RCC, Mr. Hughes did not know why the customer may have stopped a payment and testified that

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[16] During the course of Mr. Baressi's testimony, it became clear that Enforcement Counsel was attempting to cast a patina of fraud around Integrity Advance's business, implicitly arguing that remotely created checks are prone to fraud and abuse and Integrity Advance should be held liable for using them.

it was possible that the customer wanted merely to renege on his obligation to repay. *Id.* III-22:17 – III-23:20. In other words, Enforcement Counsel has nothing more than an unsupported assumption that *all* uses of RCCs where an Integrity Advance customer had purportedly stopped ACH debits caused substantial consumer harm.

Enforcement Counsel failed to present any evidence to show how that this could constitute "substantial injury" to consumers.

Enforcement Counsel has failed to meet its burden of showing that consumers suffered substantial injury from Integrity Advance's use or RCCs. On that basis alone, the Court should find for Respondents on Count VII.

2. To The Extent There Was Any Injury, It Was Reasonably Avoidable By Customers

It is undisputed that Integrity Advance customers signed an ACH authorization that expressly acknowledged the possibility that Integrity Advance could use demand drafts to satisfy unpaid balances. Mr. Carnes also gave uncontroverted testimony that Integrity Advance rarely used RCCs and did so only after numerous attempts to contact a customer to set up alternative payment arrangements. Hr'g Tr. II-84:6 – II-85:11 (testifying that RCCs were used in "under one percent" of loans and were only used after "numerous calls and e-mails refused to contact with us and to set up alternative payment arrangements"). Mr. Carnes's testimony was corroborated by Mr. Hughes's own analysis, which indicates RCCs were only used in less than one percent of all loans during the post-July 21, 2011 period. *See* EC-EX-097 at 1, 5.[17]

[17] Moreover, Enforcement Counsel's presentation of a host of irrelevant data concerning its RCC claim is a red herring. Specifically, page 4 of EC-EX-097 contains data pertaining to alleged pre-July 21, 2011 conduct, including a bolded box at the bottom of the page featuring a wholly irrelevant figure, which has no bearing on the damages actually sought. As described for the first

Furthermore, the ACH authorization was a completely different section of the loan agreement, and the demand draft paragraph was located at the bottom of the first page of that authorization. *See, e.g.*, EC-EX-001. At trial, Enforcement Counsel completely disregarded the fact that the ACH authorization was presented separately to consumers, instead misleadingly presenting the authorization as an embedded portion of a larger document. *See* Hr'g Tr. I-13:7 – I-14:10 (ignoring the fact that EC-EX-063 is a *compilation* of several forms presented *separately online* to customers). Customers could reasonably avoid the use of RCCs, and there is no evidence in the record that supports a contrary finding.

3. The Evidence Does Not Demonstrate That Mr. Carnes Engaged In Unfair Acts Or Practices With Regard To Remotely-Created Checks

As discussed above, Enforcement Counsel bears the burden of proving that Mr. Carnes is individually liable for alleged unfair conduct. The record evidence shows that Mr. Carnes's knowledge of RCCs was limited to the fact that they were used in some rare instances, when all other attempts to contact a customer had failed, to collect unpaid balances. *Id.* at II-84:6 – II-85:12; I-235:8 – I-236:11. However, he was not personally involved in setting Integrity Advance's policies regarding the use of RCCs or the decision to issue specific RCCs. *Id.* at II-98:3-14, II-98:23 – II-99:3. This on-the-ground determination was made by call center personnel. *Id.* at II-32:17-22. Nor was Mr. Carnes involved in drafting, reviewing, or revising any RCC-related disclosures that were made to consumers. *See id.* at I-231:23-25, II-95:11-16. At most, the evidence shows that Mr. Carnes was the CEO of Integrity Advance and was involved with entirely unrelated aspects of the business. *See id.* at I-67:1 – I-68:7. Enforcement

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time during Enforcement Counsel's closing argument at trial, Enforcement Counsel is seeking a substantially smaller figure confined to post-July 21, 2011 conduct.

Counsel has failed to show that Respondents engaged in unfair acts or practices regarding the use of RCCs.

C. The Court Should Not Award Any Monetary Or Injunctive Relief In This Matter, As Enforcement Counsel Has Failed To Prove That Such Relief Is Warranted

1. Awarding Any Monetary Relief In This Matter Would Violate Respondents' Due Process Rights

Under the rules governing this proceeding, "Enforcement counsel shall have the burden of proof of the ultimate issue(s) of the Bureau's claims at the hearing." *See* 12 C.F.R. § 1081.303(a). In advance of the trial in this matter, the ALJ articulated three issues that remained for the hearing, one of which was "Damages and recoupment." *See* Dkt. 146, Prehearing Order Concerning the Status of Remaining Issues and All Exhibits at 1. In support of its damages case, Enforcement Counsel proffered only a data scientist to testify about the chart, which listed different categories of Integrity Advance customers, which he compiled from the Integrity Advance database that Respondents produced. This data specialist is not an economist. He did not – indeed, could not – connect the numbers of Integrity Advance customers enumerated on at spreadsheet with any theory of injury. This data specialist did not – indeed, could not – define, let alone explain and defend, why certain assumptions about consumer injury would or would not apply in light of the evidence in the record. In fact, the data specialist did little more than discuss the basic computation that he and his team of other data specialists did at the request of Enforcement Counsel. Such an analysis is patently inadequate to establish a basis for awarding any monetary relief. It does not meet Enforcement Counsel's burden of proof in this matter.

It is also inadequate to articulate a damages analysis after trial through post-trial briefing. This deprives Respondents of their due process rights to test, through cross-examination, the underlying assumptions, analyses and damages theory that should have been part of Enforcement Counsel's case-in-chief. Respondents should have the opportunity to test any damages theory with arguments and evidence. Indeed, "[a] post-hearing brief is not the place for new theories. This is not arbitrary, but rather essential for a fair hearing process." *See United States v. Schiff*, 538 F. Supp. 2d 818, 841 (D.N.J. 2008)). Due process requires that evidence be "subject to adversarial testing" and "presented to an impartial tribunal for resolution of issues defined in advance of the proceeding." *Strickland v. Washington*, 466 U.S. 668, 685 (1984). Similarly, a defendant may not be convicted based on a charge or legal theory "that was neither subject to adversarial testing, nor defined in advance of the proceeding." *White v. Beard*, No. CV 13-7921 RGK (MRW), 2014 U.S. Dist. LEXIS 129716, at *7 (C.D. Cal. July 24, 2014) (quoting *Sheppard v. Rees*, 909 F.2d 1234, 1237 (9th Cir. 1989)). Respondents' due process rights are implicated by Enforcement Counsel's failure to present any damages case during trial. Enforcement Counsel's omission is especially egregious because the Court expressly apprised the parties, in advance of trial, that "damages and recoupment" was one of the outstanding issues remaining for disposition.

The lack of evidence here was further highlighted by Enforcement Counsel's failure to even put forward a damages number (or numbers) until its closing argument, and only after a request from this Court to do so. *See* Hr'g Tr. III-179:11-14. Even then, Enforcement Counsel did not articulate the actual type of "damages and recoupment" it is seeking nor the theory through which it is actually seeking these amounts under 12 U.S.C. § 5565. Under Section 5565(a)(2), relief may include, among other things, restitution, disgorgement or compensation for unjust enrichment.

Thus, Respondents are effectively left to guess – *at the post-trial briefing stage* – the basis for Enforcement Counsel's claims, including its theory of damages and consumer harm. Respondents' ability to mount a defense is severely prejudiced, if not rendered entirely impossible by Enforcement Counsel's failure to comply with even the most basic of requirements for bringing a case in this Court. Indeed, courts have denied any monetary relief when parties have failed to inform defendants about their damages theory before trial. *See, e.g.*, *Apple, Inc. v. Samsung Elecs. Co.*, No. 11-CV-01846-LHK, 2013 U.S. Dist. LEXIS 162863, at *21-22 (N.D. Cal. Nov. 12, 2013) (stating that a new damages theory "on the literal eve of trial" would be grossly prejudicial). Here, Respondents still have little-to-no idea on which damages theory Enforcement Counsel is seeking to proceed and asking the Court to grant relief; this is true after trial. The Court should deny Enforcement Counsel's request for monetary relief.

2. Enforcement Counsel Has Failed To Show Any Causal Link Between The Alleged Conduct And Its Request For Monetary Relief

Enforcement Counsel had the burden of proving that allegedly unlawful conduct caused quantifiable consumer harm. Following a three-year investigation and a three-day trial, Enforcement Counsel has failed to provide any evidence to support its theory that the Integrity Advance loan agreement disclosures or Integrity Advance's use of RCCs caused injury to even one consumer. And the Court admonished Enforcement Counsel – repeatedly, in fact – that it would not be "fair to Respondents if this matter, recoupment or penalty is to be handled in globo." *Id*. at I-17:7-11.

Enforcement Counsel offered no evidence that could link up a dollar number with actual consumer harm. Enforcement Counsel did not offer the testimony of even a *single* consumer. Similarly, Enforcement Counsel never offered a consumer survey – at any stage of this litigation – which might have suggested *the possibility* of consumer injury. Enforcement Counsel elicited no testimony about consumer injury, including consumer complaints. Indeed, Enforcement Counsel failed entirely to show any causal link between alleged conduct and the monetary relief that it apparently seeks from Respondents. *See id.* at III-181:1-5 (seeking *in globo* relief of "the total amount paid by consumers after the transfer date . . . $265,420.50). Indeed, the first (and only) time Enforcement Counsel even discussed consumer injury was during a hypothetical presumption Enforcement Counsel made during closing argument rebuttal, during the last five minutes of trial, as a seeming after-thought. *See* Hr'g Tr. III-203:16-20 ("I think if you ask any of the consumers whose funds were taken in amounts higher than the amounts that they expected whether they were harmed, they would uniformly say yes.").

a. Enforcement Counsel Did Not Even Approximate Consumer Harm

Nevertheless, Enforcement Counsel seeks every dollar paid to Integrity Advance above that disclosed in the TILA box, both since the company's inception and since July 21, 2011, in amounts of $133,422, 838.83 and $38,795,583.12 respectively. Enforcement Counsel, however, did not even remotely approximate consumer harm caused by Respondents' alleged conduct. Indeed, it is axiomatic that courts "should base [their] calculations [of monetary damages] on the injury *to consumers*, not on the net revenues received by defendants." *FTC v. Publishers Bus. Servs., Inc.*, 540 F. App'x 555, 558 (9th Cir. 2013) (emphasis added). To this end, in proving equitable monetary relief arising from alleged deceptive or unfair conduct, Enforcement Counsel, like the FTC in similar situations must "first 'show that its calculations reasonably approximated' the amount of the defendant's *unjust gains*, after which 'the burden shifts to the defendants to show that those figures were inaccurate.'" *FTC v. Verity Int'l, Ltd.*, 443 F.3d 48, 67 (2d Cir. 2006) (quoting *FTC v. Febre*, 128 F.3d 530, 535 (7th Cir. 1997)) (emphasis added). For example, in *Verity* defendants operated a website that charged for its services by identifying the telephone line used to connect the user's computer with its modem, and billing that telephone line subscriber without a mechanism to ensure the telephone subscriber actually authorized the charge. *Id.* at 52. The court found that the FTC's claim for damages, which included the total amount paid by consumers, was not a "reasonable approximation of defendants-appellants' unjust gains" because it did not account for consumers who "actually used or authorized others to use the services at issue." *Id.* at 69. The Second Circuit explained that "[a]lthough the district court recognized that restitution is based on unjust payments, not just overall payments, it never explained its basis for concluding that the overall sum collected through the billing system reasonably approximated the amount of unjustly obtained funds." *Id.* Accordingly, "because the district court did not first assess the reasonableness of the FTC's approximation of unjust gain, the district court was premature in shifting the burden of proof to the defendants-appellants . . . ." *Id.*[18]

Furthermore, within this framework, courts have acknowledged that while the defendants' gross receipts "is a proper *baseline* in calculating the amount of sanctions necessary to compensate injured consumers. *A baseline is only the beginning, however*. To accurately calculate *actual loss*, the defendants must be allowed to put forth evidence showing that certain amounts should offset the sanctions assessed against them." *FTC v. Kuykendall*, 371 F.3d 745, 766 (10th Cir. 2004) (emphasis added). Indeed, the *Kuykendall* court expressly highlighted circumstances in which such offsets to this baseline would be appropriate. For example, "the defendants might be able to show that some customers received full refunds of their payments or than others were wholly satisfied with their purchases and thus suffered no damages." *Id.*

[18] The court noted that "[i]f the law were otherwise, the FTC would be relieved at the first stage from submitting a reasonable approximation of unjust gain and could recover any amount it chose to submit, however unreasonable, that fit within the presumption against the wrongdoer." *Id.*

Similarly, the Ninth Circuit in *Publishers* vacated the lower court's damages calculation because it was based on net revenues received by defendants rather than the injury to the consumers. 540 F. App'x at 558. In particular, the district court erred by failing to consider customers who renewed subscriptions because "a customer who renewed subscriptions necessarily knew the actual terms of the transaction at the time of the renewal," and thus was not misled or injured by the defendant's conduct. *See id.*

b. Any Equitable Monetary Relief Must Reflect Actual Consumer Loss, Which Is Evidence That Is Not In The Record

Any equitable monetary relief in this case must reflect *only* actual loss – *e.g.*, *actual injury* – to Integrity Advance's customers. Enforcement Counsel's calculations, proffered only through its data specialist, fail to do so for several reasons.

First, Enforcement Counsel's calculations erroneously begins from the position that *every single customer* that paid more than the "Total of Payments" in the TILA box was injured. This assumes, without justification, that every single customer rolled over his or her loan and paid more than the TILA box did so because the customer was deceived by Integrity Advance's disclosures. Enforcement Counsel's theory does not account in any way for consumers who understood the disclosures and affirmatively *chose* to rollover their loans. As this Court has already recognized, this is a false premise, because "[s]ome consumers affirmatively chose the option to extend their loan due date in return for an additional finance charge. In such cases, the consumers got the benefit of their bargain . . . ." and thus cannot be found to have been injured by Integrity Advance's conduct. *See* Dkt. 111, July 1, 2016 Order at 23. Moreover, Enforcement Counsel's theory rests on the unfounded assumption that not a single customer chose to rollover his or her loan. Enforcement Counsel offered no customer survey, expert opinion, or other evidence to support such an assumption, and such an assumption defies logic in light of the tens of thousands of repeat customers. Without such evidence, there is no basis to conclude that each and every person who paid more than the amount disclosed in the TILA box was injured by the alleged deceptive act or practice. Instead, Enforcement Counsel's claim of injury and request for monetary relief is purely speculative.

Second, despite this Court's repeated admonition that damages should not be assessed "*in globo*,"[19] Enforcement Counsel's relief calculations improperly include payments made by returning customers. Hr'g Tr. III-179:15-20, III-180:9-14. An Integrity Advance customer who completed the process of taking out one loan – and paid it off in its entirety, including amounts above the "Total of Payments" in some instances – before taking out another loan was undoubtedly informed of and understood how the loan operated, and thus, payments made towards second or higher loans do not reflect consumer injury. *See Publishers Bus. Servs.*, 540 F. App'x at 558. This is strongly supported by the data. Indeed, since July 21, 2011, a total of 26,129 customers – or 48 percent of all Integrity Advance customers – chose to take out two or more loans. *See* RX-021. During the same period, more than 6,500 customers chose to take out five or more loans and nearly 1,000 customers chose to take out ten or more loans. *See* RX-020. Similarly, of the 82,980 loans originated on or after July 21, 2011, 66 percent of those loans were loans to repeat customers. *See* RX-021. This evidence belies any notion that *all* consumers were deceived or that the loan agreements were unfair. Enforcement Counsel offers no explanation of how or why a repeat customer who indisputably experienced the effects of the alleged deceptive/unfair conduct was harmed when that customer then returned to Integrity Advance to

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[19] *See* Hr'g Tr. I-17:9-11 ("I don't think it's fair to Respondents if [in] this matter, recoupment or the penalty is to be handled *in globo*"); *see also id*. at I-204:24-25 ("[T]his is not going to be a global assessment that everything that was taken in is recoupable.")

get a second, third and even tenth loan – nor could Enforcement Counsel do so in light of the record evidence. Accordingly, this means that, at a minimum, the amounts paid above the amount disclosed in the TILA box by customers for their second or greater loans must be excluded from any relief calculation. Indeed, the evidence of the high number of return customers undermines even the theory that repeat customers were deceived into taking out their first loan. Accordingly, an additional reasonable reduction in Enforcement Counsel's calculations would be to deduct *all* amounts paid by customers above the total of payments who took out more than one loan. To hold otherwise is to award relief based on an unsupported and demonstrably erroneous assumption about the extent of consumer injury.

Thus, using Enforcement Counsel's own calculations,[20] when all amounts paid above the amount disclosed in the TILA box by repeat customers for their second or greater loans are excluded from the claim for Count I of $133,422,838.83, the claims are reduced to $69,628,680.01. *See* EC-EX-102. When the same category of payments are excluded from the claim for Counts II and III of $38,795,584.12, the claims are reduced to $12,250,544.28. *See id*.

When the amounts paid by customers above the total of payments who took out more than one loan are excluded from Enforcement Counsel's damages calculation for Count I, the damages award is reduced from $133,422,838.38 to $39,918,716.78. *See id*. When the same

[20] These calculations represent adjustments to Mr. Hughes's calculations. Respondents do not agree that Mr. Hughes's calculations reflect a reasonable starting point for assessing any amount of injury or equitable monetary relief. Among other reasons previously identified, Mr. Hughes's analysis ignores instances in which a customer's underpayment on one loan offsets overpayments on other loans the same consumer took out. *See* Dkt. 155 at 3. In other words, while some repeat customers paid more than the Total of Payments on one loan, then paid less than the Total of Payments on another loan – yielding a net payment of zero – Mr. Hughes's calculation only accounts for the overpayment and does not reflect injuries to consumers as a whole. *Id*. at n.3.

category of payments are excluded from the claim for Counts II and III of $38,795,584.12, the damages are reduced to $8,999,964.45. *See id*. The record, however, does not support awarding any monetary relief, as Enforcement Counsel has failed to connect consumer injury with alleged conduct. The discrepancy between Enforcement Counsel's $133,422,838.38 number and the more – although still unsupported – plausible number of $8,999,964.45 highlights this failure.

3. Enforcement Counsel's Damages Claims Amount To A Triple Recovery

Enforcement Counsel's damages claims should be rejected, as it seems to be seeking to recover the same damages *three times* by, seeking multiple claims of recovery from the *same pool of payments by consumers* for the *same alleged practices*. *See Medina v. District of Columbia*, 643 F.3d 323, 326 (D.C. Cir. 2006) (holding that "a party 'cannot recover the same damages twice, even though the recovery is based on two different theories'") (quoting *Atkinson v. Anadarko Bank & Trust Co*., 808 F.2d 438, 441 (5th Cir. 1987), *cert. denied*, 483 U.S. 1032 (1987)).

For example, Enforcement Counsel first seeks $133,422,838.83 for Count One – which represents "the amounts paid above the total of payment amount that was disclosed in the TILA box for the entire period that Integrity Advance was in business." *See* Hr'g Tr. III-179:17-22. Second, Enforcement Counsel seeks $38,795,584.12 for Count Two, which represents the total payments made by Integrity Advance consumers above the total of payment amount disclosed in the TILA box on loans originated on or after July 21, 2011. *See id.* at III-179:24-180:1; *see also* EC-EX-097 at 3. This necessarily overlaps with the relief sought for Count One. Finally, Enforcement Counsel seeks the same amount, $38,795,584.12, for Count Three, which, again, represents the "amount paid over . . . the amount that was disclosed in the total of payments box post transfer date." *Id.* at III-180:9-14. In addition to repeatedly dipping into the same pool of money, Enforcement Counsel also readily acknowledges that Counts One through Three are all a part of *the same practice*. *See id.* at III-183:23 ("Counts One through Three, is one practice.") There is no basis for such triple recovery under the law.

4. Enforcement Counsel May Not Retroactively Enforce The CFPA Regarding Conduct Prior To July 21, 2011

Enforcement Counsel cannot obtain relief as to conduct that pre-dates the CFPA, the statute that authorizes the agency's existence. Enforcement Counsel has stated that it is only seeking monetary relief under the provisions of the CFPA. Hr'g Tr. III-180:17-25.[21] However, Enforcement Counsel stated at closing that it seeks monetary relief under Count I, which concerns allegations arising from TILA violations, "for the entire period that Integrity Advance was in business." *Id.* at III-179:17-20. The time period impermissibly covers May 2008 to December 2012. *See* Dkt. 1, Notice of Charges ¶ 12.

In seeking equitable monetary relief under the CFPA for conduct that occurred prior to the enactment of that statute, Enforcement Counsel relies – incorrectly – on the FTC's authority. Enforcement Counsel seemingly ignores the fact that the FTC's remedial authority *does not include the power to order equitable monetary relief in that agency's administrative forum*. *See Heater v. FTC*, 503 F.2d 321, 326–27 (9th Cir. 1974). The FTC's administrative adjudicatory authority is limited to pursuing cease-and-desist orders. To seek consumer redress, as Enforcement Counsel is doing here, the FTC must file an action in district court, pursuant to Section 19b of the FTC Act, alleging consumer injury caused by the conduct that was at issue in the administrative proceeding. 15 U.S.C. § 57b. The FTC must demonstrate that the conduct

[21] *See also* Dkt. 134, Enforcement Counsel's Prehearing Statement at 8; Dkt. 99, Enforcement Counsel's Opp'n to Respondents' Mot. for Sum. Disp. at 32 ("Enforcement Counsel has sought relief under 12 U.S.C. § 5565, not any provisions of TILA or EFTA").

was such as "a reasonable man would have known under the circumstances was dishonest or fraudulent." *Id.* § 57b(a)(2).

The limitations placed on the FTC directly affect the legal consequences of Respondents' conduct. As the Ninth Circuit stated in *Heater*, "to reconcile the [FTC's] broad power with the need for a specific notice to an individual who must conform his behavior to the terms of the [FTC] Act, Congress limited the consequences of violation of the Act to a cease and desist order." 503 F.2d at 324. Thus, while Enforcement Counsel contends that its authority to seek such relief is predicated on the FTC's authority, such authority was *expressly denied* to the FTC by Congress.

Nevertheless, Enforcement Counsel has cited Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), as the analogue it seeks to use to extend the Bureau's authority. The cases under Section 13(b), however, are uniform in describing any equitable monetary relief available under that provision as a specific and exclusive extension of the district courts' broad equitable powers. *See, e.g.*, *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1112 (9th Cir. 1982) (holding that all the inherent equitable powers of the *District Court* are available for the proper and complete exercise of that Jurisdiction") (emphasis added).[22] Indeed, the Ninth Circuit has noted that the CFPA provides the Bureau with different authority than is ascribed to the FTC under Section 13(b).

[22] A similar analysis applies to equitable remedies sought by the SEC. *See SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1103-04 (2d Cir. 1972) ("[o]nce the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy" even where not "specifically authorize[d]" by statute.); *id.* ("[i]t is for the federal courts to adjust their remedies so as to grant the necessary relief where federally secured rights are invaded.")

See Gordon, 819 F.3d at 1197 n.9.[23] Thus, the Bureau cannot use the FTC as an analogue by which to apply the CFPA retroactively.

The CFPA provides the Bureau with the authority to pursue monetary relief its administrative forum, but only as to conduct the occurred after the statute was enacted. Thus, Enforcement Counsel has not only argued that it should be allowed to reach back to conduct prior to the CFPB's existence, but also that it should be allowed to retroactively apply FTC authority that was never granted to the FTC by Congress. Under Enforcement Counsel's argument, the Bureau should be allowed to step into the shoes of the FTC *and* an Article III court without the attendant procedural protections. There can be no doubt that the assertion of such sweeping authority "[c]reates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past" and is, thus, impermissibly retroactive. *Landgraf v. USI Film Prods.*, 511 U.S. 244, 269 (1994) (internal quotation marks omitted).

5. No Civil Money Penalties Are Appropriate Here

No evidence supports the application of civil money penalties ("CMPs") in this matter. Enforcement Counsel seeks, without describing any basis or underlying rationale, the *maximum* CMP amount for violations of the CFPA[24] – tripled across three different "practices." For each

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[23] The FTC itself notes the differences between administrative adjudication and civil actions in federal court. The Commission states that "administrative adjudication offers certain advantages over direct judicial enforcement" but notes that civil action under Section 13(b) "is preferable to the adjudicatory process because, in such a suit, the court may award both prohibitory and monetary equitable relief in one step." FTC, What We Do: Enforcement Authority (July 2008), https://www.ftc.gov/about-ftc/what-we-do/enforcement-authority. Cherry-picking the elements of the FTC's authority preferred by the Bureau and applying such authority retroactively clearly violates the retroactivity principles in *Landgraf*.

[24] The different "tiers" of CMPs relate only to a finding of scienter required to support such penalties. Enforcement Counsel seeks the maximum CMP amount in the first tier. 12 U.S.C. § 5565(c)(2)(A) ("For any violation of a law, rule, or final order or condition imposed in writing

"practice," Enforcement Counsel seeks $2,881,610, for a total of $8,644,830 in penalties. At the hearing, Enforcement Counsel articulated no basis for pursuing the maximum CMP amount in this case. Indeed, Enforcement Counsel never apprised Respondents of this – or any – or any CMP number until closing argument.

In fact, in light of the statutory mitigating factor the Court must take into account, there is no basis for imposing any CMPs here, let alone the maximum amount Enforcement Counsel seeks here. The statutory mitigating factors of 12 U.S.C. § 5565(c)(3) include:

> (A) the size of financial resources and good faith of the person charged;
>
> (B) the gravity of the violation or failure to pay;
>
> (C) the severity of the risks to or losses of the consumer, which may take into account the number of products or services sold or provided;
>
> (D) the history of previous violations; and
>
> (E) such other matters as justice may require.

12 U.S.C. § 5565(c)(3). Application of these mitigating factors shows that civil money penalties are not warranted here, and, in the alternative, any penalty imposed against either Respondent should be of minimal amount. Enforcement Counsel has proffered no evidence disputing this. Integrity Advance offered an industry-standard loan product that has now, *post hoc*, been deemed non-compliant and "facially deceptive." The Company operated in good faith and took all the steps expected of an institution in a highly regulated industry. The evidence presented at the trial showed that Integrity Advance was properly licensed by the Delaware State Bank Commissioner and operating within the bounds of Delaware law. Hr'g Tr. III-138:18-144:14. The Company used outside compliance counsel to prepare its loan documents and sought and

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by the Bureau, a civil penalty *may not exceed* $5,000 for each day during which such violation or failure to pay continues.") (emphasis added).

received the appropriate licensure. *Id*. at I-226:20-227:9; II-26:13-27:6. Enforcement Counsel has presented no evidence to suggest that Respondents knew or should have known that the loan product might not comply with the law. Far from a deluge of consumer complaints, the hearing record contains only four. *See* EC-EX-075 at CFPB037172-73; CFPB037606-07; CFPB037660-62; CFPB037825-27. Furthermore, Enforcement Counsel introduced no witnesses to authenticate or otherwise testify to the contents of these complaints. Respondents had no reason to suspect that Integrity Advance's loan agreements might later be found to violate TILA or mislead consumers, *see supra* Section II.A.2, and the key case cited by Enforcement Counsel (pertaining to Counts I through III), *FTC v. AMG Serv., Inc.*, was published on May 28, 2014,[25] nearly a year and half after Integrity Advance ceased offering loans. Finally, Integrity Advance began winding down after the sale of HIP to EZCORP in December 2012; the Company was in the process of winding down when it received the Civil Investigative Demand from the Bureau on January 7, 2013; and it does not exist as a going concern today. The Company and Mr. Carnes lack the financial resources to pay the CMPs sought by Enforcement Counsel.[26]

6. There Is No Basis For Injunctive Relief

In its closing arguments, Enforcement Counsel made passing reference to its intent to seek "injunctive relief."[27] However, Enforcement Counsel again failed to articulate: (1) what

[25] 29 F. Supp. 3d 1338 (D. Nev. 2014).

[26] During the hearing, Enforcement Counsel declined to answer the Court's questions regarding the liability of Mr. Carnes under Enforcement Counsel's request for CMPs, instead holding, again, their arguments for post-hearing briefing. *See* Hearing Transcript III-183:11–14. Enforcement Counsel did acknowledge that Mr. Carnes "[i]s not responsible for all of the damages on all of the counts." *Id.* at III-182:20–23.

[27] In its closing arguments, Enforcement Counsel stated "[p]lus we would be seeking injunctive relief, which we will layout [*sic*] in much greater detail in our post trial briefing." *See* Hr'g Tr. III-184:3-4.

relief it would seek; (2) why such relief was justified; and (3) the legal standard under which it expects this Court to evaluate its propriety. Furthermore, Enforcement Counsel has made no reference to the scope and breadth of the injunctive restriction(s) it seeks (whatever they may be) nor to which of the Respondents it seeks to apply them. Respondents are, again, left to guess about the scope of injunctive relief Enforcement Counsel seeks.

Integrity Advance, of course, ceased operations in 2013. And the Supreme Court has explained that "[t]he purpose of an injunction is to prevent *future* violations," which could not even apply to the Company. *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953) (citation omitted, emphasis added). Moreover, "the moving party must satisfy the court that relief is needed. The necessary determination is that there exists some cognizable danger of recurrent violation, something more than the mere possibility which serves to keep the case alive." *Id.* And to date, Enforcement Counsel has not shown that there is any possibility that Mr. Carnes will, or is likely to, engage in any conduct in the future that violates the CFPA, TILA, or EFTA.

Finally, Enforcement Counsel's intent to brief an argument for injunctive relief for the first time in its post-hearing brief also greatly prejudices Respondents and deprives Mr. Carnes of his due process rights, which are, as noted above, embedded in the right to test any damages or other theory of relief at trial in advance of there being any finding of liability and imposition of punishment. Respondents will have no chance to examine any witnesses and evidence that Enforcement Counsel may assert in support of its request for injunctive relief. Here, too, the Court must deny any request for injunctive relief. [28]

[28] In addition to the arguments above, the Court should not award any monetary or injunctive relief in this matter for the following reasons: (1) The CFPA's three-year statute of limitations bars any claims against Mr. Carnes. 12 U.S.C. § 5564(g). Since Enforcement Counsel can achieve identical remedies in federal court or its own administrative forum, *id.* § 5565(a), the

7. Even If The Court Applies The CFPA Retroactively, § 2462 Limits The Relief Enforcement Counsel May Seek

Even if Court deems the application of Count I prior to July 21, 2011 valid, under 28 U.S.C. § 2462, the CFPB may not seek "any civil fine, penalty, or forfeiture" against Respondents related to conduct prior to November 18, 2010. Any monetary requested by Enforcement Counsel would fall within the five-year limitations period of § 2462. *See SEC v. Graham*, 823 F.3d 1375 (11th Cir. 2016). Enforcement Counsel's claims "accrued" as to the conduct alleged against Respondents when the conduct occurred (*i.e.*, when the loans were made). *See 3M Co. (Minn. Mining & Mfg.) v. Browner*, 17 F.3d 1453, 1460-63 (D.C. Cir. 1994); *see also United States v. Lindsay*, 346 U.S. 568, 568 (1954) (stating that general rule that a cause of action "accrues when it comes into existence"). Thus, under any theory, Enforcement

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same protections and limitations should also apply. (2) The TILA and EFTA one-year statutes of limitations bar the claims under these statutes as to Integrity Advance, and Enforcement Counsel is not pursuing these claims as to Mr. Carnes. In *CFPB v. ITT Educ. Servs., Inc.*, No. 1:14-cv-00292-SEB-TAB, 2015 WL 1013508, *33 (S.D. Ind. Mar. 6, 2015), the district court held that the one-years statute of limitations under TILA applied to the Enforcement Counsel's claims. This principle, and a similar limiting provision under EFTA, apply to Enforcement Counsel's claims here. Enforcement Counsel cannot select the protections that will apply to Respondents simply by choosing which forum through which to seek relief. (3) The Bureau's administrative forum and its rules of procedure violate the due process and equal protection clauses of the Constitution. The use of an administrative law judge who is not appointed by the Executive branch violates the appointments clause of the Constitution. (4) The newly-created consumer financial protection powers of the CFPA – which include taking enforcement actions against nonbanks for violations of the CFPA – had not vested in the agency prior to confirmation of its first Director in July 2013. Specifically, Respondents were no longer engaged in the offering or provision of any consumer financial service or product by that time. Accordingly, Respondents never offered or provided a consumer financial product or service at a time when the Bureau had CFPA jurisdiction as to nonbanks. Enforcement Counsel seeks to retroactively apply its CFPA authority to Respondents, who never offered consumer financial products or services at a time when the CFPA reached that conduct. (5) Fundamental principles of retroactivity, which Enforcement Counsel has already acknowledged apply in this matter, preclude the application of any monetary relief – civil money penalties or equitable relief – for conduct that predates July 21, 2011, including conduct that allegedly violated TILA and EFTA.

Counsel cannot obtain monetary damages or penalties as to conduct that predates November 18, 2010, which is five years before the Notice of Charges was filed.

D. The Court Should Reconsider Its Grant Of Summary Disposition That Integrity Advance's Loan Agreement Was "Facially Deceptive" And Violated TILA

In light of evidence that was presented at trial, Respondents respectfully request that the Court reconsider its grant of summary disposition as to the question of whether Integrity Advance engaged in deceptive acts or practices and whether the Company violated the Truth in Lending Act (TILA). While there is no rule in the Bureau's Rules of Practice governing motions for reconsideration of an ALJ's decision on summary disposition, the closest analogue is a motion for reconsideration under Rule 60 of the Federal Rule of Civil Procedure. Rule 60 provides that reconsideration is appropriate when justice so requires and/or when new evidence mandates reconsideration.[29] Here, the evidence presented at trial warrants reconsideration of the Court's grant of summary disposition for a few reasons.

First, the new testimony presented during trial contradicts the Court's conclusion on summary disposition as to violations of TILA. For example, the Court concluded that the "TILA

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[29] In pertinent part, Rule 60 states:

> On motion and just terms, the court may relieve a party or its legal representative from a final judgment, order, or proceeding for the following reasons:
> …
> (2) newly discovered evidence that, with reasonable diligence, could not have been discovered in time to move for a new trial under Rule 59(b);
> … [or]
> (6) any other reason that justifies relief.

Fed. R. Civ. P. 60(b).

disclosures should have included all finance charges for the life of the loan, and the APR and total of payments should have been calculated accordingly." Dkt. 111 at 26-7. However, the undisputed evidence that was presented at trial established that the State of Delaware approved of the precise type of renewal (or rollover) loans that Integrity Advance offered. *See* Hr'g Tr. III-134:19 – 135:14, III-138:6-15. Indeed, Quinn Miller specifically testified that during the time that Integrity Advance operated and had a lending license issued by her office, the State of Delaware had (and still has) a provision in its banking law that allowed a short-term lender to roll-over a loan four times. *Id; see also id.* at III-146:22 – 147:14. Investigators on Ms. Miller's staff also ran calculations to confirm the accuracy of the numbers in the TILA boxes. *Id.* at III-150:1 – 153:11. She also testified that she personally reviewed each loan agreement to ensure that the TILA box was accurate and correctly placed.[30] *Id.* at III-126:18 - 127:20. To this end, although Ms. Miller did not testify about the nature of supervisory examinations, she also noted that entities with lending licenses in the State of Delaware – including during the years that the Company operated – are examined for compliance with the consumer finance laws. *See id.* at III-128:19 – 132:9.

In other words, the Company's loan agreement included a TILA box that was reviewed for accuracy by Ms. Miller and others on her staff as a condition for obtaining a lending license and reviewed by examiners as a condition for maintaining the license. The State Bank Commissioner's reviews of the TILA box were conducted against a well-recognized statutory backdrop that the Company's rollover or loan renewal mechanism

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[30] The TILA Box itself is limited to the exact wording described by Regulation Z and the Model Forms. *See* 12 C.F.R. § 1026, App. H-2. The law is clear that any additional information about the loan must have been contained in the body of the loan agreement, and not within the TILA box, notwithstanding Enforcement Counsel's misapprehension of TILA and Regulation Z.

was expressly contemplated by the State of Delaware's lending laws. The Company's loan agreement complied with the State of Delaware, which was its only regulator during the time it made loans to consumers. Thus, the Court's conclusions on summary disposition do not square with the facts presented at trial.

Second, Enforcement Counsel still has not – even after three days of trial – shown what even one "reasonable consumer" understood about the terms and operation of the loan agreement. An act or practice is only "deceptive" if (1) "there is a representation, omission, or practice that," (2) "is likely to mislead consumers acting reasonably under the circumstances," and (3) "the representation, omission, or practice is material." *See CFPB v. Frederick J. Hanna & Assocs., P.C.*, 114 F. Supp. 3d 1342, 1370 (N.D. Ga. 2015), *mot. to cert. appeal denied sub nom. CFPB v. Frederick J. Hanna & Assocs., P.C.*, No. 1:14-CV-2211-AT, 2015 WL 10551424 (N.D. Ga. Nov. 16, 2015) (citing *FTC v. Tashman*, 318 F.3d 1273, 1277 (11th Cir. 2003). The Court in its order on summary disposition reasoned, in large part, that consumers, acting reasonably, were likely to be deceived by virtue of the fact that the information disclosed in the TILA box was "likely to mislead consumers into believing they were not obligated to pay the loan in a single lump sum." Dkt. 111 at 28. However, as discussed above, the evidence presented at trial supports a contrary conclusion, namely that the State of Delaware reviewed the accuracy of the TILA box disclosures and examined Integrity Advance for compliance on an annual basis. Thus, it does not follow that consumers were likely to have been deceived by lawful TILA disclosures, and these disclosures were found to be lawful by the Company's only regulator examining these disclosures when the Company made loans.

The new evidence presented at trial necessitates holding that Integrity Advance did not engage in deceptive conduct and that it also did not violate the Truth in Lending Act. The Court should reconsider its summary disposition that Integrity Advance engaged in deceptive acts or practices and that it violated TILA.

III. CONCLUSION

For all of the foregoing reasons, the Court should recommend that Respondents are entitled to judgment in their favor on the Bureau's Notice of Charges.

Respectfully submitted,

Dated: August 29, 2016

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CERTIFICATION OF SERVICE

I hereby certify that on the 29th day of August, 2016, I caused a copy of the foregoing Post-Hearing Brief to be filed by electronic transmission (e-mail) with the U.S. Coast Guard Hearing Docket Clerk (aljdocketcenter@uscg.mil), Heather L. MacClintock (Heather.L.MacClintock@uscg.mil), and Administrative Law Judge Parlen L. McKenna (cindy.j.melendres@uscg.mil), and served by electronic mail on the following parties who have consented to electronic service:

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