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

ORAL ARGUMENT REQUESTED

RESPONDENTS' REPLY BRIEF ON APPEAL

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ABBREVIATIONS USED IN THIS BRIEF

ALJ: Administrative Law Judge Parlen L. McKenna

CFPB or Bureau: Consumer Financial Protection Bureau

CFPA: Consumer Financial Protection Act of 2010

Director: CFPB Director Richard Cordray

Dkt. 28-A: Respondent's Motion to Dismiss Notice of Charges – Attachment A

Dkt. 34: Respondent's reply Brief in Support of Motion to Dismiss

Dkt. 56: Parties' Joint Stipulations of Fact

Dkt. 87: Enforcement Counsel's Memo of Points and Authorities in Support of its Motion for Summary Disposition as to Liability

Dkt. 87-C: Exhibit B – Declaration of John Marlow (Public)

Dkt. 101: Respondents' Opposition to Enforcement Counsel's Motion for Summary Disposition

Dkt. 109: Respondents' Reply Brief in Support of Motion *In Limine* to Preclude Expert Testimony of Dr. Manoj Hastak

Dkt. 111: Order Granting In Part and Denying In Part Bureau's Motion for Summary Disposition and Denying Respondents' Motion for Summary Disposition

Dkt. 134: Enforcement Counsel's Prehearing Statement

Dkt. 172: Reporter's Official Transcript of Proceedings Hearings Volume I (Public)

Dkt. 173: Reporter's Official Transcript of Proceedings Hearings Volume II (Public)

Dkt. 174: Reporter's Official Transcript of Proceedings Hearings Volume III (Public)

Dkt. 176: ALJ's Recommended Decision

Dkt. 180: Order Denying Respondents' Motion to Stay Appeal and Remand to Hearing Officer

Dkt. 186: Enforcement Counsel's Answering Brief

EC: Enforcement Counsel

EC-EX-__: Enforcement Counsel's Exhibit __

EFTA: Electronic Fund Transfer Act

FRB: Federal Reserve Board

FTC: Federal Trade Commission

FTCA: Federal Trade Commission Act

OCC: Office of the Comptroller of the Currency

OSBC: Delaware Office of the State Bank Commissioner

Reg. E: Regulation E

Reg. Z: Regulation Z

RX-__: Respondents' Exhibit __

TILA: Truth in Lending Act

UDAAP: Unfair, Deceptive, or Abusive Acts or Practices

USCG: United States Coast Guard

The Director should find in Respondents' favor for all of the reasons stated below.

ARGUMENT

I. Integrity Advance Did Not Violate TILA

IA's loan disclosures complied with TILA and Reg. Z. The Director should reverse the ALJ's decision because the ALJ misapplied TILA and Reg. Z., improperly construed IA's loan product as a multi-payment installment loan, and conflated the TILA/Reg. Z analysis with deception doctrine. *See* Dkt. 111 at 15-24, 29-31. The "clear and conspicuous" requirement under TILA and Reg. Z mandates specific, limited disclosures reflecting "the credit terms to which the parties are legally bound *at the time of giving the disclosures.*" *See* Official Commentary to 12 C.F.R. § 1026.17(a)(1). Under TILA, disclosures must "reflect the terms of the legal *obligation*" at the time the loan disclosures were made, and, contrary to EC's contentions and the ALJ's ruling, do not require disclosure of a hypothetical, conditional future cost that would exist only if a customer exercised a renewal option multiple times. *See* 12 C.F.R. §§ 1026.17(a)(1), 1026.17(c)(1). The ALJ's conclusion that IA customers were legally obligated, on the date that the loan was consummated, to repay the loan principal, the initial finance charge, *and* all possible renewal charges is wrong and reflects an incorrect interpretation of TILA. *See* Dkt. 111 at 26-27. IA's loan disclosures correctly identified the customer's legal obligation at that time; this obligation only included repayment of the loan principal and payment of one finance charge. *See, e.g.*, EC-EX-002 at 4. IA did not violate TILA.

Further, EC strains to compare IA's loan product with a traditional 30-year mortgage that includes a "prepayment option." *See* Dkt. 186 at 2. But this comparison falls apart upon analysis and, in fact, supports IA's argument. If a consumer defaults on a traditional 30-year mortgage at the time of his first payment, that consumer is obligated to pay the principal and the interest disclosed in the TILA Box (plus any applicable late fees). If an IA customer who took out a $300

loan defaults at the time of her first payment, that consumer is only obligated to pay the $300 principal and one finance charge (typically $90 for a first-time borrower). That customer is *not* obligated to pay, as EC and the ALJ would have it, $1065. *See* Dkt. 111 at 24-25. The $1065 figure on which EC relies could have only become the total amount a consumer ultimately paid in one of many possible repayment scenarios in which a customer renewed his loan multiple times and paid off the loan through the workout plan described in the Loan Agreement. Thus, the Loan Agreement's TILA Box correctly disclosed the total legal obligation that the consumer had at the time the loan was consummated and complied with TILA and Reg. Z.

II. Respondents' Loan Agreements Were Not Deceptive

The ALJ erred in finding that IA's Loan Agreements were deceptive. In its brief supporting that decision, EC once again tries to shift the burden of proof to Respondents. *See* Dkt. 186 at 3-4. However, the burden as to the elements of a UDAAP claim lies with EC. *See* 12 C.F.R. § 1081.303(a). Among other things, the ALJ ignores the elements of deception doctrine, as they are put forward in established case law that the Bureau also has adopted. *See, e.g.,* CFPB, Supervision and Examination Manual V.2 at UDAAP 6 (Oct. 2012); *see also FTC v. Publishers Bus. Servs., Inc.*, 821 F. Supp. 2d 1205, 1223 (D. Nev. 2010)). Here, there is no evidence of what a "reasonable consumer" believed or would have likely believed about the disclosures on IA's Loan Agreements. For example, EC proffered no consumer survey, no consumer complaints as to this question, no consumer testimony, and no consumer declarations. Indeed, in order to arrive at his unfounded conclusion, the ALJ (impermissibly) deemed himself a proxy for a reasonable IA consumer. *See* Dkt. 176 at 26; Dkt. 111 at 28-29.

Given that there is no evidence of what a "reasonable consumer" believed or would have believed about IA's Loan Agreements between 2008 and 2012, EC is forced to justify the ALJ's flawed holding. To this end, EC restates the ALJ's argument that the "reasonable person

determination is properly within the fact-finder's discretion." Dkt. 186 at 3. That may be true, but a fact-finder must first have facts from which to render such a decision -- that is, facts to apply to the elements of deception doctrine. Further, EC cites two cases that only highlight the flimsy nature of the ALJ's holding in the instant case. For example, in *Floersheim v. FTC*, 411 F2d 874, 877 (9th Cir. 1969), the court held that the examiner's finding about the nature of the consumer population and what they might have believed was "amply supported by evidence in the record." In contrast, here, there is no evidence. And in *FTC v. Brown & Williamson Tobacco Corp.,* 778 F.2d 35, 40 (D.C. Cir. 1985), the court noted that as to a claim regarding tar milligram ratings, the record evidence revealed "[t]hat consumers rely on the milligram ratings promulgated pursuant to the FTC ratings system." In contrast, there is no evidence of what even one IA customer believed about the Loan Agreement's disclosures.

In addition, there is also no evidence that even one IA customer believed or would have believed that the cost of renewing the loan was material to his decision to take a loan from IA in the first instance. And the dearth of empirical evidence in the record makes it impossible to render any materiality determination. *See* RX-003 at 3 ¶ 13 (Expert Report of Dr. Nathan Novemsky) ("There are at least two lines of consumer behavior research that directly suggest that consumers may not be considering renewal at all when taking out an initial loan."). EC again tries to compensate for this lack of evidence by citing inapposite case law. But in *FTC v. Figgie Int'l, Inc.*, 994 F.2d 595, 608 (9th Cir. 1993), the court considered the question of whether the price of the products at issue was a "material fact" for the purposes of *admissibility* under the Federal Rules of Evidence, not whether or how this pricing informed consumer decision-making. And in *Steele v. Ford Motor Credit Co.*, 783 F.2d 1016, 1017, 1019-20 (11th Cir. 1986), the Circuit court held that the understatement of a loan's finance charge was a material non-

disclosure for *rescission purposes* under TILA, not for purposes of determining consumer decision-making under deception doctrine.

III. Respondents' Use Of RCCs Was Not Unfair

EC failed to prove that IA's use of RCCs violated the basic elements of any unfairness claim. First, there is no record evidence that IA's use of RCCs caused substantial consumer injury, a necessary element of any unfairness claim. In hopes of glossing over this evidentiary gap, EC references a string of its legal memoranda in support of summary disposition where the ALJ *denied* EC's motion on this issue. Dkt. 186 at 6. But this is not evidence of substantial consumer injury.

EC did not even make a prima facie case, let alone prove by a preponderance of the evidence, that IA's RCC use injured consumers.[1] EC and the ALJ incorrectly shortcut the substantial injury analysis and *assumed* that the RCCs were unauthorized and, thus, that consumers were injured. EC offered no consumer testimony, no consumer complaints, no consumer survey, and no expert analysis demonstrating that consumers were, in fact, injured.[2] EC's lack of non-speculative evidence is fatal to its claim. *See, e.g.*, *Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 972 (D.C. Cir. 1985 ("merely speculative harms" are not the type of injury that can be addressed through unfairness"); *see also*, Dkt. 176 at 37, n.3 ("While the Bureau's

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[1] Here, too, EC cites inapposite cases. *See FTC v. Amazon.com, Inc.*, Case No. 2:14-cv-01038-JCC, Dkt. 251-1 (W.D. Wash. June 13, 2016) (finding substantial injury only where the FTC supported its claim with, among other forms of evidence, many consumer complaints that children made unauthorized in-app purchases); *FTC v. Ideal Fin. Sols., Inc.*, No. 2:13-CV-00143-JAD, 2014 WL 2565688, at *1 (D. Nev. June 5, 2014) (concerning allegation that defendants had falsely billed consumers for services the consumers never purchased). Unlike these cases, EC has never alleged that consumers received loans they did not apply for, or were billed without receiving a loan at all.

[2] Indeed, EC cites the report of its expert, Dr. Manoj Hastak (whom EC did not call to testify at the hearing), who merely hypothesized that ACH Authorization in the Loan Agreement has "the potential to confuse," but did not review any consumer complaints (because there were none) or conduct a consumer survey, which, by his own admission, would have been the "best evidence" of how consumers process information. Dkt. 109 at 4.

conclusion is one logical explanation for the behavior, it is certainly not the only one."); Dkt. 111 at 23 (acknowledging that "[s]ome consumers affirmatively chose the option to extend their loan due date in return for an additional finance charge . . . . [and] got the benefit of their bargain.").

Second, EC points to nothing other than its unsupported supposition that any consumer injury allegedly caused by IA's use of RCCs was not reasonably avoidable because, in EC's own view,[3] the relevant provision of the Loan Agreement was insufficient. *See* Dkt. 186 at 7-8, n.3. But EC's (and the ALJ's) interpretations of the Loan Agreement are not evidence – and are certainly not evidence of how IA customers understood the Loan Agreement. Indeed, the ALJ recognized that EC did not provide "any credible, sworn testimony in support of its claim that consumers blocked ACH access out of sheer self-preservation." *See* Dkt. 176 at 37. But despite this acknowledged lack of evidence, the ALJ nonetheless relied on his unsupported opinion that consumers "did not believe" that they "legitimately owed" certain sums debited via RCC. *See id.* at 37-38. Here, too, the ALJ erred as a matter of law and his decision should be reversed.

EC also glosses over the fact that EC "substantially" changed its theory as to RCC injury for the first time in its post-trial briefing. *See* Dkt. 176 at 34. Throughout these proceedings, including during EC's closing argument, EC pursued a strict liability theory that does not exist – that every instance in which IA used an RCC was a *per se* unlawful act. *See* Dkt. 176 at 30. In turn, Respondents argued against EC's stated theory during the hearing, and tested that stated legal theory through cross-examination of any witnesses EC may have proffered. Dkt. 101 at 28. Now, on appeal, and well after the close of evidence, EC offers – impermissibly – a revisionist theory of liability. Dkt. 186. at 7. Here, too, the ALJ erred.

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[3] EC offered no evidence, such as customer complaints, a customer survey, or expert analysis, to support its claim that *consumers* understood the language in the Loan Agreement authorizing the use of RCCs to be "opaque, unclear, and hidden." *See* Dkt. 186 at 7, n.3.

IV. Integrity Advance Did Not Violate EFTA

EFTA and Reg. E prohibit a person from "condition[ing] the extension of credit to a consumer on such consumer's repayment by means of preauthorized electronic fund transfers." 15 U.S.C. § 1693k(1); 12 C.F.R. § 1005.10(e). The prohibition does not involve an analysis of a borrower's understanding of the authorization, as the ALJ employed, Dkt. 111 at 36, but rather the *legal obligation* of the consumer. IA's Loan Agreement did not violate this prohibition because, in authorizing ACH, consumers [a]greed that [they] could repay [their] indebtedness through other means . . . ." EC-EX-002 at 9. IA did not make loans that were required to be repaid by means of preauthorized electronic fund transfers, even initially. Indeed, the ALJ recognized that "[c]onsumers were also permitted to make payments by alternative means.' Dkt. 111 at 19. Borrowers could repay their loan "[b]y providing timely payment via cashier's check or money order . . . ." *See* EC-EX-002 at 10. IA did not violate the EFTA.

V. Mr. Carnes Cannot Be Held Individually Liable

The ALJ incorrectly concluded that Mr. Carnes is individually liable for IA's allegedly deceptive conduct. Dkt. 176 at 53. The test for individual liability considers whether: (1) an individual participated directly in the deceptive acts or had the authority to control them; and (2) the individual knew or should have known "of the misrepresentation." *See CFPB v. Gordon*, 819 F.3d 1179, 1193 (9th Cir. 2016). Both prongs of this must be met. Courts, looking to FTCA case law, have held that direct involvement in the alleged misconduct or an individual's substantive review and approval of the allegedly false representation would tend to show knowledge "of the misrepresentation." *See, e.g.*, *id.* at 1193-94. If there is no evidence that an individual was directly involved, then the case law is clear that courts must consider whether that person would have received indicia of deception or potential deception, such as a spike in

consumer complaints, chargebacks, or notices from regulators or law enforcement agencies. *See FTC v. J.K. Publ'ns, Inc.*, 99 F. Supp. 2d 1176, 1182–83, 1204–07 (C.D. Cal. 2000) (finding that the individual defendants knew disgruntled customers complained and sought chargebacks, indicating that consumers thought the corresponding credit card charges were fraudulent); *FTC v. Lanier Law, LLC*, No. 3:14-CV-786-J-34PDB, 2016 WL 3632371, at *30 (M.D. Fla. July 7, 2016) (finding that an individual defendant was aware "of consumer complaints and investigations of the Law Firm practices by state regulatory authorities").. If these types of direct or circumstantial evidence are absent from the record, then there is no individual liability for deceptive acts or practices.[4]

There is no circumstantial or direct evidence that meets the requisite knowledge standard. To gloss over this lack of evidence, EC blatantly mischaracterizes Mr. Carnes's hearing testimony: "[Mr.] Carnes . . . directly testified that he understood that [IA's] loan agreements did not accurately convey the default operation of the company's loans." Dkt. 186 at 9. EC provides no record cite because none exists. Mr. Carnes said nothing that comes even close to this; he indicated only that he was generally familiar with IA's loan process. *See* Dkt. 172 at 220:6-12.

The ALJ held, incorrectly, that Mr. Carnes is liable for the alleged "misrepresentation," which goes to the "[t]he terms and conditions of the loan agreement itself, including the mandatory TILA disclosures and the other provisions set out in the Loan Agreement and associated documents." *See* Dkt. 111 at 18. But as EC stated in its Prehearing Statement, Mr. Carnes's liability turns on whether he "was fully aware of how IA's loan product operated and

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[4] To the extent that the Director considers the incorporated-by-reference examples in EC's "previously cited" cases, Dkt. 186 at 12, Respondents respectfully request that he also consider Respondents' responses to those examples in Dkt. 170 at 4-6 & n.1. EC's description of these cases as "examples of executives who were found individually liable in circumstances analogous to those presented here" is plainly misleading.

how that did not align with the company's loan agreement disclosures." Dkt. 134 at 5. The hearing record is clear that Mr. Carnes did not draft the Loan Agreement. Mr. Carnes did not draft the Loan Agreement's disclosures. He did not substantively approve of the disclosures. *See* Dkt. 172 at 232:23-232:3. Mr. Foster, IA's former general counsel, testified, "no one at the Hayfield group of companies, including myself or Mr. Carnes, were consumer lawyers or experts in consumer law," and that "[a]ll agreements were written by outside counsel." Dkt. 173 at 26:20-27:1, 27:5-6. Mr. Carnes also testified that IA "hired outside counsel to create . . . loan documents that conformed with Delaware and federal law." *Id.* at 95:10-13. Mr. Carnes also testified that he knew that OSBC licensed IA, that such licensure was available only after OSBC examiners reviewed IA and its Loan Agreement, and that IA maintained that license through annual renewals and periodic examinations for the entirety of IA's existence. *See id.* at 80:13-81:13. Mr. Carnes knew that IA received approval to lend every year and "posted the license on [the company's] website." *Id.* at 82:7-9.[5] There is no evidence of IA receiving any warning notices from its regulator, OSBC, a low returning customer rate, or high level of consumer complaints. *See* Dkt. 101 at 17.[6] Further, Mr. Carnes testified that "complaints never rose to my level." *See* Dkt. 172 at 233:18.[7] Mr. Carnes was also aware that IA made a large majority of its

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[5] On this point, EC mischaracterizes Respondents' arguments and seems to contend that for the OSBC review and ongoing licensure of IA to be relevant, it must "absolve[] [Respondents] from liability." Dkt. 186 at 12. OSBC's actions certainly did shape the scope and contents of Mr. Carnes's knowledge regarding IA's Loan Agreement.

[6] Using the largest number of consumer complaints ever alleged by the Bureau, 127, an IA loan resulted in a complaint about the repayment amount only 0.04% of the time. *See* Dkt. 87C; RX-021 at 1 (noting that IA made 304,227 loans in total).

[7] Mr. Carnes testified at the hearing consistently with how he testified during his investigational hearing. He was not aware of the specific detail or the volume of complaints about IA's Loan Agreement because such information did not rise to his attention. *See* Dkt. 172 at 233:18-22.

loans – 66 percent – to returning customers, specifically those customers who returned to IA after having paid off an earlier IA loan. *See* RX-021; Dkt. 172 at 46:6-47:10.

Similarly, the record and the RD lack any indication that Mr. Carnes knew or should have known of misrepresentations regarding the use of RCCs. Mr. Carnes knew that IA used RCCs (but they were, and still are, lawful payment mechanisms). Dkt. 176 at 21 ¶¶ 114-16. There are no consumer complaints stemming from the use of RCCs, nor other indicators that would have led Mr. Carnes to believe that consumers might be harmed and that RCC use might have been unfair. The ALJ erred in holding that Mr. Carnes is individually liable.

VI. The CFPA, TILA And EFTA Claims Are Time-Barred

A. Count Numbers II, III, V, And VII Are Each Time-Barred Under § 5546(g)

1. The CFPA's Three Year-Statute of Limitations Applies

EC's CFPA claims are time-barred; this includes Counts II and VI, which incorporate alleged violations of TILA and EFTA, respectively, and Counts III and VII, as those counts relate to Mr. Carnes. The D.C. Circuit's decision in *PHH* regarding the application of SOLs,[8] holds that the three-year SOL applies to all claims brought in the administrative forum and district court. Indeed, the PHH Court *expressly responds to EC's arguments in this case*, stating that "the CFPB's Dodd-Frank-based argument—if accepted here— . . . [w]ould extend to all 19 of the consumer protection laws that Congress empowered the CFPB to enforce. *Cf. Integrity Advance, LLC*, 2015-CFPB-0029, Doc. No. 33, CFPB Opp. to Mtn. to Dismiss, at 12." *PHH*, 839 F.3d at 51.[9]

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[8] This is the only holding in that case for which the agency has not sought *en banc* review. *See* Resp't CFPB Pet. for Reh'rg En Banc, *PHH Corp. v. CFPB*, 839 F.3d 1 (D.C. Cir. 2016) (No. 16-46917).

[9] The ALJ also recognized that *PHH* is not limited to RESPA's SOL. Dkt. 75 at 22 ("Certainly the Director concentrated on the statute of limitations in RESPA because that was the law PHH was found to have violated, but his reasoning was not limited to RESPA; it is *broadly applicable to the Bureau's enforcement activities under § 5563*.") (emphasis added).

EC ignores the D.C. Circuit's holding. Its arguments are also inconsistent. On the one hand, EC argues that the ALJ properly applied the Director's Order in *In the Matter of PHH Corp.*, File No 2014-CFPB-0002 as binding precedent, because the ALJ held that the CFPA's three-year SOL could not apply to administrative claims brought under that statute. But EC now argues that the D.C. Circuit's decision on appeal of that *same order* "[is] narrow and has no bearing on this case." Dkt. 186 at 13-14. In short, EC argues that the Director should ignore the unchallenged holding of a D.C. Circuit case and instead continue to apply the holding from the Director's own decision, which the D.C. Circuit overturned. This position is untenable, however, since although EC contends that "time does not run against the *King*" and that "the *sovereign* is given the benefit of the doubt," Dkt. 186 at 14 (emphasis added), "[t]he rule of law constrains the governors as well as the governed," *PHH*, 839 F.3d at 48.

EC also rehashes the failed argument that the term "action" is limited to "civil actions" in federal court and so does not apply to administrative cases. Dkt. 186 at 14. The D.C. Circuit has rejected this argument, explaining that "[t]he Dodd-Frank Act itself . . . directly contradicts the CFPB's assertion about the meaning of the term 'action.' The Dodd-Frank Act repeatedly uses the term 'action' to encompass court actions *and* administrative proceedings." *PHH*, 839 F.3d at 52.

EC's position is at odds with the presumption of a "*symmetrical and coherent regulatory scheme.*" *BP Am. Prod. Co. v. Burton*, 549 U.S. 84, 99 (2006) (internal quotation omitted) (emphasis added). EC cannot, at its sole discretion, simply avoid the CFPA's SOL by bringing a case administratively, rather than in federal court. The court in *PHH* reiterated that "Congress 'does not, one might say, hide elephants in mouse holes." *Id.* (internal quotation omitted). Thus, just as the

court reasoned in *PHH*, one "would expect Congress to actually say that there is no statute of limitations for CFPB administrative actions . . . ." *See id.* The CFPA has no such language.[10]

2. EC's CFPA Claims Are Time-Barred

CFPA's three-year SOL starts running from the "date of discovery." 12 U.S.C. § 5564(g)(1). The date of discovery is "the date that a plaintiff, in the exercise of reasonable diligence, discovered or should have discovered the breach or violation." *Harris v. Koenig*, 722 F. Supp. 2d 44, 55 (D.D.C. 2010); *Gabelli v. SEC*, 133 S. Ct. 1216, 1221 (2013) (noting that traditional discovery rule SOLs begin to run "[w]hen, in the exercise of reasonable diligence, it could have been discovered"). Further, it is the discovery of the *injury*, not the other elements of a claim, which starts the clock. *Rotella v. Wood*, 528 U.S. 549, 555-56 (2000).

An SOL must start to run at an objectively-determined date in time. *See, e.g.*, *Fallini v. United States*, 56 F.3d 1378, 1380 (Fed. Cir. 1995) (the accrual of an SOL is an objective standard"). The "considerable enquiry and investigation" necessary for the EC to determine the viability of its claims cannot determine SOL timing. *Rotella*, 528 U.S. at 556.

Further underscoring the problems with its theory, EC contends that the running of the CFPA SOL can only be triggered by actions that are completely within the agency's control. *See* Dkt. 186 at 18-19 (arguing that "date of discovery" cannot occur before the Bureau issues a CID, at the earliest). EC's subjective interpretation of the SOL eviscerates the limitation's purpose. *Gabelli*, 133 S. Ct. at 1223 ("[I]t would be utterly repugnant to the genius of our laws if actions for penalties could be brought at any distance of time.") (internal quotation and citation omitted).

[10] Moreover, of course, the "traditional rule" of *quod nullum tempus occurrit regi*, "a vestigial survival of the prerogative of the Crown," *Guar. Trust Co. of N.Y. v. United States*, 304 U.S. 126, 132 (1938), has no application when, as here, Congress has applied temporal limitations to the government's ability to bring an enforcement action. *See id.* at 133.

IA's website and consumer complaints, which EC relied on to bring this action, were publicly available beginning in 2008-2009, and, thus, EC had access to this public information as early as July 21, 2011. Indeed, EC had specific knowledge of non-public complaints filed with the FTC's Consumer Sentinel Network at least by March 29, 2012. Dkt, 189, Exh. B. The Bureau accessed the complaints, and likely other information, through a formal information sharing agreement with the FTC. *See* Dkt. 189, Exh. A. Moreover, IA's filings with the OSBC identified Mr. Carnes as a principal, *see, e.g.*, RX-008 at 10, and were undoubtedly available to EC through due diligence. EC knew or had reason to know that there was alleged consumer injury caused by IA's alleged conduct and, by extension, Mr. Carnes – assuming EC's theory of Mr. Carnes's liability is viable (it is not) – at least as early as March 29, 2012 (if not well before that date).[11]

3. EC's TILA and EFTA Claims are Time-Barred

TILA and EFTA each have a 1-year statute of limitations, which time-bars Count Numbers I and V, as well. The Bureau is bound by the "one-year statute of limitations imposed by TILA's civil liability provision." *CFPB v. ITT Educ. Servs., Inc.*, No. 1:14-CV-00292-SEB, 2015 WL 1013508, at *33 (S.D. Ind. Mar. 6, 2015).[12] The identical analysis applies to EFTA in § 1693m.

The court in *ITT* draws a distinction between civil liability and administrative enforcement under TILA *with regard to the OCC and FRB*. *ITT*, 2015 WL 1013508, at *33. This distinction is, of course, not applicable to the Bureau (or EC). Among other things, the

[11] At a minimum, additional discovery is required to properly adjudicate this issue. The ALJ did not reach the question of *how* the SOL would apply, as he was bound by the Director's earlier *PHH* holding. Dkt. 176 at 29, n.2. Therefore, if the Director does not conclude that EC's CFPA claims are time-barred, which they are, Respondents should be allowed, as due process requires, to take additional discovery surrounding the "date of discovery." *See* Dkts. 179, 181.

[12] *ITT* was not "wrongly decided," as EC claims. *See* Dkt. 186 at 16 n.10. The SOLs contained in the enumerated consumer protection laws apply equally to the CFPB's civil and administrative actions. *See PHH*, 839 F. 3d at 51-54.

Bureau can prosecute all of the same causes of action and obtain all of the same remedies, regardless of whether it proceeds – via independent litigating authority – in federal district court or in its administrative forum. Thus, EC's argument that because it is proceeding under § 1607 is irrelevant. The distinction between § 1607 and § 1640 only matters in the context of the prudential regulators, which do not have federal district court litigating authority. Thus, as to the OCC, FDIC, and FRB, for example, "the two sections [§ 1607 and §1640] . . . provide separate jurisdiction for separate remedies . . . ." *Ratner v. Chem. Bank N.Y. Trust Co.*, 309 F. Supp. 983, 986 (S.D.N.Y. 1969). Under the CFPA, the Bureau's jurisdiction and available remedies in civil and administrative actions are identical, so the distinction between § 1607 and § 1640 is meaningless. *See PHH*, 839 F.3d at 54 (questioning the "nonsensical dichotomy between CFPB court actions and CFPB administrative actions" asserted by EC).[13]

VII. EC's Failure To Articulate A Damages Theory Until After The Hearing Severely Prejudiced Respondents And Is A Due Process Violation

EC inexcusably failed to present a damages theory during the hearing. Damages were one of the three "remaining issues for hearing" identified by the ALJ in his Prehearing Order. *See* Dkt. 146 at 1. Indeed, the ALJ took note of EC's "delay" in laying out a damages case, calling it "unhelpful to the court in the damages assessment." *See* Dkt. 176 at 56.

This also means that the ALJ's holding as to restitution is untethered to any actual evidence in this matter, let alone supported by substantial evidence, as it must be.

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[13] EC appears to compromise by offering 28 U.S.C. § 2462 as a potential limitation. Dkt. 186 at 16 n.9. There is no doubt that § 2462 applies and limits EC's ability to seek monetary relief. *See SEC v. Graham*, 823 F.3d 1357, 1363 (11th Cir. 2016). However, § 2462 applies *in addition to* the CFPA, TILA, or EFTA limiting provisions, not as a substitute. Highlighting this, EC has argued incorrectly that § 2462's five-year SOL does not apply to *restitution*. Dkt. 168 at 27 (arguing that "§ 2462 Does Not Bar the Monetary Relief That Enforcement Counsel Seeks" and "Section 2462 does not apply to claims for restitution-type relief and instead only applies to penalties").

EC attempts to justify its glaring omission, which in a federal district court proceeding would have resulted in the severe curtailment, if not dismissal, of its damages case. First, EC argues that there can be no prejudice because Respondents "have been on notice that Enforcement Counsel was seeking *monetary relief*." *See* Dkt. 186 at 19 (emphasis added). This misses the point. Respondents were also aware that EC had filed a lawsuit alleging violations of TILA, EFTA and UDAAP, but Respondents' awareness in that regard did not exempt EC from having to present evidence during the hearing as to those claims. Given EC's failure to put on a damages case, the imposition of any restitution in this matter would violate due process. It is uncontroverted that due process requires "evidence [be] subject to adversarial testing." *Strickland v. Washington*, 466 U.S. 668, 685 (1984). During the hearing, Respondents were not able to test, via cross-examination, any of EC's apparent damages theories because they were not presented. Respondents were similarly not able to put on a rebuttal case that responded to EC's damages case.

Furthermore, EC misrepresents the actual record in this case. It contends that "the theory and amount of restitution sought was stated explicitly" in its Motion for Summary Disposition. Dkt. 186 at 19. But this is not correct, as the word "restitution" does not even appear in that document. *See generally* Dkt. 87. It is also not enough, as EC contends, to have included a "declaration by the Bureau's data scientist summarizing IA's payment data," in its summary disposition filing. Dkt. 186 at 20. Nor is it the case that Respondents were apprised of EC's damages theory because EC provided Respondents with trial exhibits "almost two weeks before" the hearing, and those exhibits included "a summary of the data analysis that EC used to prove monetary harm." *See id.* EC's examples underscore Respondents' salient point: EC had no cognizable damages theory at any point before or during the hearing. To be sure, a chart

summarizing data is not the same thing as an analysis that ties data to alleged conduct and resulting consumer injury. Indeed, EC's data scientist admitted that he did not perform any investigation or analysis outside of the data set. *See* Dkt. 174 at 20:20-21:1. EC's continued citation to cases in which "non-economists" have analyzed customer databases also misses the point.

Each of EC's post-hearing filings from its data scientist, which still fail to support a coherent restitution theory, should be stricken from the record in this matter. Indeed, anything less is reversible error and violates due process. In *Trident Seafoods, Inc. v. NLRB*, 101 F.3d 111, 116 (D.C. Cir. 1996), the D.C. Circuit held that the petitioner's argument was deemed waived because it was not raised until the post-hearing brief and that the "the record developed with regard to that issue" was "inadequate," because there was no evidence submitted during the hearing. *Id.* at 116-17. And in that case, the petitioner was not a federal agency seeking more than $133 million in monetary relief.[14] EC is not entitled to any restitution in this matter for reason of its failure to put forward a damages case during the hearing.

VIII. Repeat Customers Must Be Excluded From The Restitution Calculation

EC bears the ultimate burden of proof. *See* 12 C.F.R. § 1081.303(a). EC has not met that burden, and, instead, attempts to shift the burden to Respondents. Moreover, contrary to EC's assertions, Respondents have presented evidence that contradicts EC's speculative claim that *all* consumers who paid amounts above that disclosed in the TILA box – including those who came back to IA multiple times for additional loans – were necessarily injured. *See* RX-020 (IA payment data illustrating that since July 21, 2011, over 26,000 customers took out 2 or more loans,

[14] As to joint and several liability, EC claims that Respondents were on notice of this claim merely because the Notice asserted claims against both Respondents. However, even EC was unable to state *during closing arguments* whether it was seeking joint and several liability when the ALJ specifically asked. *See* Dkt. 174 at 182:9-183:11.

and that nearly 1,000 customers ten or more loans); *see also* RX-021 (illustrating that, since July 21, 2011, 48% of IA customers took out two or more loans and of the 82,980 loans originated, 66% were to repeat customers). These returning customers experienced the IA loan process and opted to return – sometimes multiple times – to obtain additional loans.

EC cites inapposite cases, all of which concern false advertisements for dietary products that guarantee outcomes after long-term use. *See* Dkt. 186 at 23-24 (citing *FTC v. Wellness Support Network, Inc*., No. 10-cv-04879, 2014 WL 644749 at *2 (N.D. Cal. Feb, 19, 2014); *FTC v. Nat'l Urological Grp., Inc*., 645 F. Supp. 2d 1167, 1213 n.30 (N.D. Ga. 2008); *FTC v. Bronson Ptrs., LLC*, 674 F. Supp. 2d 373, 386 (D. Conn. 2009)). In those cases, the courts declined to exclude "reorders" from the damages calculus because users did not expect to achieve the desired outcome after only the first order. *See id.* Conversely, a returning IA customer would necessarily be aware of how the loan operated, thus their choice to return for another loan does not indicate that they were unwittingly incurring additional injury. The ALJ acknowledged as much in the Summary Disposition Order. *See* Dkt. 111 at 31 ("[c]ertainly a returning customer would be aware of the fact that they would pay more than the disclosed finance charge if they allowed the loans to renew and eventually enter auto-workout.")

Like the ALJ, however, EC conflates the determinations of liability and damages by concluding that the existence of satisfied, returning customers "does not change the fact that the loans were facially deceptive." *See* Dkt. 186 at 24 (quoting Dkt. 111 at 31). But assessing liability is not the same as assessing damages. While "[t]he existence of some satisfied customers does not constitute a defense under the FTCA," the court in *FTC v. Amy Travel Serv. Inc*., 875 F.2d 564, 572 (7th Cir. 1989) held that the lower court "correctly acknowledged the existence of satisfied

customers in computing the amount of defendants' liability." The existence of satisfied, returning customers constitutes evidence that they should be removed from the damages calculus.

IX. The ALJ Incorrectly Imposed Civil Money Penalties

The ALJ improperly imposed civil money penalties. Among other things, he clearly failed to consider all of the required mitigating factors pursuant to § 5565(c)(3). *See* Dkt. 186 at 25. Instead, EC argues that Respondents did not present evidence that would have justified a lower civil penalty. However, EC failed to meet its burden to adequately justify at the outset the amount it seeks after taking into account the mitigating factors – *as it must* under the terms of § 5565(c)(3) and its own internal guidelines. *See* 12 U.S.C. § 5565(c)(3) ("the Bureau or the court *shall* take into account the appropriateness of the penalty with respect to [listing the mitigating factors]).[15]

The ALJ recognized that IA has "virtually no financial resources," and EC presented no evidence regarding Mr. Carnes's current financial circumstances. *See* Dkt. 176 at 73. There is no evidence going to the "gravity of violations," as EC pointed only to *two unsworn* consumer complaints. *See* Dkt. 162 at 50. As to severity, EC argued that "Respondents' violations are serious, pervasive, and hurt tens of thousands of consumers." *Id.* at 51. Yet, EC cannot point to any sworn statement or testimony *from a single consumer* demonstrating such harm. Finally, EC concedes that "the record does not contain evidence of prior violations." *Id.* at 52.

Furthermore, Respondents presented extensive evidence of IA's *compliance* with Delaware law regarding short-term consumer loans, as its lending license was renewed annually, which EC acknowledged. *See* Dkt. 173 at 38:10-15 (testimony of Edward Foster); *see also* RX-008 – RX-013 (documenting IA's Delaware licensure and renewals). *See also* Dkt. 56 ¶¶ 13-15. There is

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[15] *See also* CFPB Enforcement Policies and Procedures Manual at 4-4, *available at* https://www.venable.com/files/upload/CFPB_Enforcement_Policies_and_Procedures_Manual.pdf ("Staff should also always consider all of the mitigating factors as required by the statute.").

overwhelming evidence in support of the statutorily-mandated mitigation factors; the ALJ failed to consider this evidence as he was required to do under the CFPA.

X. There Is No Legal Basis For Enjoining Respondents From "Engaging In Payday Lending Operations" For 15 Years

The ALJ's *sua sponte* injunction barring Respondents from "engaging in payday lending operations" for 15 years contravenes well-established case law. As an initial matter, injunctions are remedies appropriate to enjoin ongoing conduct or conduct that is likely to occur in the future. Respondents are not in the short-term, small dollar business now, and IA has not made a loan in nearly three years. These facts alone preclude issuance of an injunction. *See United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953) (citation omitted).

Moreover, EC's arguments in support of this remedy also fail. First, EC mischaracterizes the holding in *CFPB v. Siringoringo*, No. 14-01155, 2016 WL 102435 (C.D. Cal. Jan. 7, 2016) in stating that the court "granted injunctive relief despite the Bureau not showing each factor because the defendant's violations harmed thousands of consumers." *See* Dkt. 186 at 26. In fact, the court expressly laid out the four factors, stating that it "reviews a request for permanent injunction relief under 'well-established principles of equity'" and then proceeded to analyze each of them. *See Siringoringo*, 2016 WL 102435 at *6 (quoting *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006)). EC further states that "injunctions against individuals limiting their ability to engage in future legal violations are commonly awarded in [FTC] cases." Dkt. 186 at 26. The ALJ, however, rejected as overbroad, EC's request for an injunction prohibiting Respondents from violating any Federal consumer financial protection law. *See* Dkt. 176 at 76. There is no evidence that supports a showing of why an injunction barring Respondents from "engaging in payday lending operations" for 15 years is warranted. Nor is there any legal analysis from the ALJ – or EC – that explains how an injunction is tailored to any proven harm.

XI. The Bureau Lacked Authority Over Respondents

EC misses the salient point of Respondents' authority argument. As Respondents have previously argued, the Bureau did not have jurisdiction to enforce the CFPA as to any nonbanks, including Respondents, until it had a lawfully-appointed Director on July 16, 2013. 12 U.S.C. § 5586(a); *see* Dkt. 28-A and Dkt. 34.[16] Once authority had vested in the Bureau, Respondents were no longer engaging in the offering or provision of a consumer financial product or service, and, thus, were not covered persons – a requirement of any CFPA claim. *See* 12 U.S.C. §§ 5531, 5536. EC incorrectly argues that because the Bureau had jurisdiction over non-banks *at the time EC issued the Notice* in November 2015, and, thus, EC has authority to pursue this case. But EC cannot retroactively confer authority that the Bureau never had. Moreover, the CFPA does not contemplate a "once a covered person, always a covered person" regime. Respondents were never "covered persons" when the Bureau had authority as to nonbanks.

XII. The ALJ Was Not Appointed In Accordance With The Appointments Clause

The CFPB's ALJ is an "inferior officer" that must be appointed by the President, the "Courts of Law," of the "Heads of Departments." U.S. Const. Art. II, § 2, cl. 2. The ALJ in this matter was not so appointed. An ALJ "is 'functionally comparable' to that of a judge . . . . He may issue subpoenas, rule on proffers of evidence, regulate the course of the hearing, and make or recommend decisions. *See* [5 U.S.C.] § 556(c)." *Butz v. Economou*, 438 U.S. 478 (1978) (emphasis added). The

[16] Despite EC's protestations, it is entirely proper and, in fact, necessary for the Director to consider Respondents' arguments in support of their Motion to Dismiss. The ALJ's RD is predicated on his denial of Respondents' Motion to Dismiss (as well as his Order on the parties' cross-motions for summary disposition), and is expressly incorporated by reference into the ALJ's RD. Dkt. 176 at 9, 28-29.

defect in the ALJ's appointment "[w]as an irregularity which would invalidate a resulting order." *See United States v. L. A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 38 (1952).[17]

XIII. This Proceeding Violated Respondents' Due Process Rights

It violates Respondents' due process and equal protection rights that the Bureau can unilaterally determine whether parties, like Mr. Carnes and IA, are sued in the Bureau's administrative forum or in federal court. Indeed, it is patently unfair for the agency to "eschew the involvement of the courts and employ its own arsenal of remedies instead." *SEC v. Citigroup Global Mkts., Inc.*, 34 F. Supp. 3d 379, 381, n.8 (S.D.N.Y. 2014) (noting that such circumvention of due process represents "unchecked and unbalanced administrative power"); *Gupta v. SEC*, 796 F. Supp. 2d 503, 508 (S.D.N.Y. 2011) (noting that the SEC's "home turf" advantages eliminate rights accorded to defendants in federal court).[18]

CONCLUSION

For all of the foregoing reasons, the Director should grant Respondents' appeal and find in favor of Respondents.

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[17] Further, the Director has declined to recognize authority for which the mandate has not issued, Dkt. 180 at 2, and so should disregard EC's citation to *Raymond J. Lucia Cos. Inc. v. SEC* regarding the status of ALJs, Dkt. 186 at 28, which is currently on appeal with the mandate withheld. *See* Order, *Lucia*, 832 F.3d 277 (D.C. Cir. 2016) (No. 15-1345).

[18] Indeed, none of the cases cited by EC concern administrative adjudications where the agency sought the same type of sweeping remedies as EC seeks here, including equitable monetary relief, injunctive relief, and civil money penalties. *See Silverman v. CFTC*, 549 F.2d 28, 33 (7th Cir. 1977) (CFTC sought only a temporary industry ban and general cease and desist order precluding defendant from trading commodities without customer authorization); *McClelland v. Andrus*, 606 F.2d 1278, 1284-86 (D.C. Cir. 1979) (concerning a former employee's suit against the Park Service for wrongful discharge); *Richardson v. Perales*, 402 U.S. 389 (1971) (concerning adjudication and denial of social security disability benefits which, by their very nature, "should be understandable to the layman claimant").

Respectfully submitted,

Dated: December 12, 2016

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CERTIFICATION OF SERVICE

I hereby certify that on the 12th day of December, 2016, I caused a copy of the foregoing Respondents' Reply Brief on Appeal to be filed by electronic transmission (e-mail) with the CFPB's Office of Administrative Adjudication (CFPB_Electronic_Filings@cfpb.gov). A copy of this brief is provided by electronic mail to 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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