**UNITED STATES OF AMERICA**
**Before the**
**CONSUMER FINANCIAL PROTECTION BUREAU**

**ADMINISTRATIVE PROCEEDING**
**File No. 2015-CFPB-0029**

| | | |
|---|---|---|
| **In the Matter of:** | ) | **RESPONDENTS' MOTION TO AMEND ANSWER** |
| **INTEGRITY ADVANCE, LLC and JAMES R. CARNES,** | ) | ORAL ARGUMENT REQUESTED |
| **Respondents.** | ) | |

**RESPONDENTS' MOTION TO AMEND ANSWER**

Pursuant to 12 C.F.R. § 1081.202(a) and Administrative Law Judge ("ALJ") Christine L. Kirby's March 13, 2020 Order, Respondents Integrity Advance, LLC and James R. Carnes ("Respondents") respectfully request that the ALJ grant Respondents leave to amend their Answer to include affirmative defenses based on their good faith reliance on advice of counsel and the CFPB's lack of fair notice as to the prohibited conduct underlying its CFPA claims for "unfairness" and "deception." In support thereof, Respondents incorporate by reference the accompanying memorandum of law and Exhibit A thereto.

Counsel for Respondents certify pursuant to 12 C.F.R. § 1081.205(f) that they have conferred with Enforcement Counsel in a good faith effort to resolve the issues raised by this Motion and have not been able to resolve this matter by agreement.

Respectfully submitted,

/s/ Richard J. Zack
Richard J. Zack, Esq.
zackr@pepperlaw.com
215.981.4726

Michael A. Schwartz, Esq.
215.981.4494
schwarma@pepperlaw.com

Christen M. Tuttle, Esq.
tuttlec@pepperlaw.com
215.981.4285

Saverio S. Romeo, Esq.
romeos@pepperlaw.com
215.981.4440

PEPPER HAMILTON LLP
3000 Two Logan Square
Eighteenth & Arch Streets
Philadelphia, PA 19103-2799

*Counsel for Respondents Integrity Advance LLC and James R. Carnes*

Dated: March 26, 2020

**CERTIFICATE OF SERVICE**

I hereby certify that on the 26th day of March 2020, I caused a copy of the foregoing Respondents' Motion to Amend Answer to be filed by electronic transmission (email) with the Office of Administrative Adjudication (CFPB_electronic_filings@cfpb.gov), and served by email on opposing counsel at the following addresses:

Stephen Jacques, Esq.
Stephen.Jacques@cfpb.gov

Benjamin Clark, Esq.
Benjamin.Clark@cfpb.gov

Alusheyi Wheeler, Esq.
Alusheyi.Wheeler@cfpb.gov

Deborah Morris, Esq.
Debora.Morris@cfpb.gov

/s/ Saverio S. Romeo
Saverio S. Romeo, Esq.

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**RESPONDENTS' BRIEF IN SUPPORT OF THEIR MOTION TO AMEND ANSWER**

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## I. INTRODUCTION AND SUMMARY

Pursuant to 12 C.F.R. § 1081.202(a) and Administrative Law Judge ("ALJ") Christine L. Kirby's March 13, 2020 Order, Respondents Integrity Advance, LLC and James R. Carnes ("Respondents") respectfully file this brief in support of their Motion to Amend Answer. Respondents seek to add two affirmative defenses to their Answer.[1]

First, Respondents seek to add an advice of counsel/good faith defense. While at the original hearing, which now has been vacated based on the improperly appointed ALJ, Respondents asserted privilege as to the advice they received from counsel, a more recent District Court decision held that the good faith reliance on advice of counsel can have a significant impact on the financial penalties and restitution that can be imposed in CFPB enforcement matters. As explained in detail below, it is in the interest of justice to allow Respondents to now assert such a defense. Any potential prejudice to Enforcement Counsel can be mitigated by allowing reasonable discovery on this defense.

The second defense that Respondents seek to add is a purely legal constitutional challenge regarding fair notice relating to the CFPA claims for "unfairness" and "deception." Enforcement counsel will not be prejudiced since it previously has responded to similar challenges in other cases, and it is in the interest of justice to allow Respondent to raise constitutional challenges to a statute under which companies and individuals face significant penalties for practices which the government may believe are unfair or deceptive but which others may reasonably believe are proper and lawful business arrangements in accordance with state law, such as the loans at issue in this case.

[1] Respondents have attached a draft Amended Answer as Exhibit A hereto. The only substantive changes are the addition of two new paragraphs (¶¶ 9 and 10) under the "Affirmative Defenses" heading on Pages 14-15.

## II. BACKGROUND

On May 29, 2019, Director Kathleen L. Kraninger remanded this matter to ALJ Kirby for a "new hearing and recommended decision in accordance with the Bureau's Rules of Practice for Adjudication Proceedings." Dkt. 216 at 2, 9. In part due to significant legal developments in the time since the prior proceedings occurred, Respondents filed a Motion to Open Record for a New Hearing in which Respondents argued, inter alia, that further discovery was needed on the statute of limitations issue. *See* Dkt. 229A at 7-8. By Order dated October 28, 2019, the ALJ denied further discovery and ordered briefing on the merits of the threshold statute of limitations issue. Dkt. 238. Following briefing and oral argument on the statute of limitations issue, the ALJ denied Respondents' Motion to Dismiss/and or for Summary Disposition on Grounds Limited to October 28, 2019 Order, and directed that the parties file a Joint Proposed Schedule for further proceedings by February 6, 2020. Dkt. 249. The parties conferred but were unable to agree, so each party offered its own proposed schedule. Dkt. 250.

By Order dated February 7, 2020, the ALJ directed that the parties brief the issues of whether the CFPB is unconstitutional because it violates separation of powers principles and whether further proceedings should be stayed pending the outcome of *Seila Law*. Dkt. 251. After briefing, the ALJ denied Respondents' Motion to Dismiss on separation of powers grounds and Motion to Stay Proceedings by Order dated March 13, 2020. The ALJ further directed Respondents to file, as relevant here, their Motion to Amend Answer.

## III. LEGAL STANDARD

Pursuant to the CFPB's Rules of Practice for Adjudication Proceedings, a party may amend or supplement its Answer "with the opposing party's written consent or leave of the hearing officer." 12 C.F.R. § 1081.202(a). This Rule "reflect[s] a liberal standard of permitting amendments of pleadings, but implements an appropriate limit for amendments that are unduly

prejudicial." Rules of Practice for Adjudication Proceedings, 77 Fed. Reg. 39058-01, 39069 (June 29, 2012); *accord* Fed. R. Civ. P. 15(a)(2) (when leave of court is required for a party to amend its pleading, "[t]he court should freely give leave when justice so requires"). Courts addressing motions to amend have "recognized a 'policy in favor of hearing cases on their merits,' which weighs in favor of permitting amendments." *Bronner v. Duggan*, 324 F.R.D. 285, 290 (D.D.C. 2018) (citation omitted). Courts should only deny leave to amend in "cases involving 'undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, [and] futility of amendment.'" *Id.* (citation omitted).

## IV. ARGUMENT

### A. The ALJ should allow Respondents to amend their Answer to include an advice of counsel/good faith defense.

In January 2018, a District Court held that the good faith reliance on advice of counsel is "relevant to the determination of whether restitution is an appropriate remedy" in a CFPB enforcement matter. *CFPB v. CashCall, Inc., et al.*, 2018 U.S. Dist. LEXIS 9057, at *40-41 (C.D. Cal. Jan. 19, 2018). The court held that restitution is not appropriate in CFPB enforcement actions where the CFPB does not show by a preponderance of the evidence that the defendant acted with the intent to defraud. *Id.* at *42 ("[T]he Court cannot conclude that Defendants acted in bad faith, resorted to trickery or deception, or have been guilty of fraud in connection with the origination of the loans that are issue in this case. As a result, the Court finds that the CFPB did not carry its burden of proving that restitution is appropriate in this case."). In finding that the CFPB did not meet its burden in that case, the court cited to evidence that the defendants had relied on the advice of their counsel (the same outside counsel who advised Respondents in this case), reasonably and in good faith. *Id.* at *39-41.

The court's reasoning in *CashCall* is directly relevant to the instant matter, in which Respondents relied on the advice of their counsel in conducting their business, and the CFPB has sought restitution against Integrity Advance in the amount of $132,580,041 and against Integrity Advance and Mr. Carnes, jointly and severally, in the amount of $38,453,341. Dkt. 162 at 29. Given the stakes at issue, and the recent development of the law, it is in the interest of justice to permit this amendment.

Although the *CashCall* decision is of obvious importance to Respondents and to the fair adjudication of this matter, it was not decided until January 2018, long after Respondents filed their Answer in December 2015, the prior hearing was conducted in July 2016, and the prior ALJ rendered his decision in September 2016. *See CashCall*, 2018 U.S. Dist. LEXIS 9057 (C.D. Cal. Jan. 19, 2018); *see also* Dkt. 21; Dkt. 150-152; Dkt. 176. Indeed, soon after this matter was remanded for a new hearing by CFPB Director Kathleen L. Kraninger, Respondents notified Enforcement Counsel and the ALJ that it may seek to amend their Answer to assert defenses based on advice of counsel/good faith. Dkt. 228 at 2; Dkt. 229A at 12 (both filed on August 14, 2019). Respondents specifically cited to the *CashCall* case as the basis for the amendment. Dkt. 228 at note 1; Dkt. 229A at 12.

Now, since the ALJ denied the statute of limitations and constitutional separation of powers motions, Respondents submit this brief to show why good cause exists to grant Respondents leave to amend their Answer to include an advice of counsel/good faith defense. While counsel recognizes that such a defense was not raised at the first hearing and that Respondents' then-counsel raised objections to preserve attorney-client privilege, the *CashCall* case made it clear that the defense, which Respondents believe applies here, could have a significant impact on any potential penalty and restitution award. Under the current

circumstances, in which the proceeding is not merely a continuation of the prior proceeding but instead "remanded. . . for a new hearing and recommended decision in accordance with Part 1081 of the Bureau's Rules" in which the ALJ must "give no weight to, nor presume the correctness of any prior opinions, orders, or rulings" of the prior ALJ, *see* Dkt. 216 at 9, Respondents have not "unduly delayed" seeking to add an advice of counsel/good faith defense to their Answer. *See Haddix v. Teachers Ins. Co.*, No. 2: 18-CV-662-ECM, 2019 U.S. Dist. LEXIS 122922, at *3 (M.D. Ala. July 24, 2019) (granting motion to amend to add advice of counsel defense where party did not "undu[ly] delay" in making the request).

Even if Respondents had not provided prompt notice to Enforcement Counsel, which they did, but instead waited until the hearing to assert this issue, the Rules direct that the ALJ should still permit Respondents to raise the issue where it "is likely to assist in adjudicating the merits of the action" and the other party is not prejudiced. *See* 12 C.F.R. §1081.202(b). In those circumstances, to prevent potential prejudice, the ALJ "may grant a continuance to enable the objecting party to meet such evidence." *Id.* Given the current stage of the proceedings, which are not in the midst or on the eve of a hearing, the CFPB will not be "unduly prejudiced" by allowing Respondents to raise an advice of counsel/good faith defense. *See Bronner*, 324 F.R.D. at 290-91.

Respondents do not seek to use advice of counsel as a sword and a shield. Rather, as noted previously, Respondents do not object to Enforcement Counsel seeking reasonable discovery on the advice of counsel/good faith defense. Though the parties may engage in some additional discovery should Enforcement Counsel choose to do so, that is not the type of undue prejudice that justifies denial of a motion to amend. *See id.* at 291 (noting that "[i]nconvenience or additional cost to a [party] is not necessarily *undue* prejudice," and that "an amendment is not

automatically deemed prejudicial if it causes the non-movant to expend additional resources") (citations omitted) (emphasis in original); *id.* ("If the court 'were to employ a policy of denying [parties] leave to amend in every situation where an amended [pleading] may result in additional discovery or expense, then this court would fail to abide by the legal standard of granting leave 'freely . . . when justice so requires.'"') (citation omitted). In line with that policy, courts have allowed parties to amend pleadings even where doing so would result in discovery into the advice of counsel defense. *See, e.g.*, *Haddix*, 2019 U.S. Dist. LEXIS 122922, at *6 (granting motion to amend to add advice of counsel defense and noting that "the court must conclude that whether [defendant] ultimately can prove the affirmative defense asserted is an issue to be determined after factual development in this case, and not in the context of a motion to amend the answer").

Enforcement Counsel also cannot show that Respondents are seeking to make the amendment in bad faith. *See Bronner*, 324 F.R.D. 285, 292 (D.D.C. 2018) (noting that "[p]reventing a party from amending her [pleading] on the basis of bad faith generally requires an affirmative showing by the nonmoving party" and that "conjectural guess-work" as to a party's motive is not sufficient to support denial of a motion to amend). This is not a situation in which Respondents are seeking to amend their answer "on the eve of trial" or in response to "an already-pending motion . . . ." *Id.* Rather, Respondents are seeking to add a significant defense in light of a development in the law that occurred well after they filed their Answer and well after the improperly-appointed ALJ rendered a decision in the prior proceeding. Moreover, as the Director has explicitly ordered a "new hearing," Respondents should not be prohibited from advancing all available defenses, especially a defense that could substantially limit any financial penalty/restitution which Enforcement Counsel is seeking in this case. *See id.* at 290 ("Courts

have . . . recognized a 'policy in favor of hearing cases on their merits,' which weighs in favor of permitting amendments.") (citation omitted).

Finally, while Respondents are seeking to amend their Answer in an abundance of caution, Respondents should be permitted to raise the advice of counsel/good faith issue even in the absence of an amended Answer. As it relates to restitution, Respondents are not raising advice of counsel/good faith as an affirmative defense to liability but instead as relevant to the appropriateness of a specific remedy. *See, e.g., CashCall*, 2018 U.S. Dist. LEXIS 9057, at *40-41 (advice of counsel relevant to determination of restitution); *Reyes v. Collins & 74th, Inc.*, No. 16-24362-CIV, 2017 U.S. Dist. LEXIS 101982, at *13 (S.D. Fla. June 30, 2017) (noting that defendant may use advice of counsel to "avoid liquidated damages" under the Fair Labor Standards Act) (citation and internal quotation marks omitted). Under the CFPB's Rules, Respondents are not even required to respond to the CFPB's sought-after remedies, much less assert affirmative defenses as to the remedies. *See* 12 C.F.R. §1081.201 ("A respondent is not required to respond to the portion of a notice of charges that constitutes the prayer for relief or proposed order.") Further, as the court found in *CashCall*, it is the CFPB's burden to show that Respondents acted with the requisite bad intent (which advice of counsel and good faith would negate) to justify restitution. *CashCall*, 2018 U.S. Dist. LEXIS 9057, at *42. As such, the assertion of advice of counsel/good faith is not an affirmative defense but merely demonstrates that the CFPB has not met its burden to show restitution is appropriate. *See Mathew Enter. v. Chrysler Group LLC,* 738 Fed. Appx. 569, 570 (9th Cir. 2018) ("A defense which demonstrates that plaintiff has not met its burden of proof is not an affirmative defense.") (internal citation omitted). Additionally, to the degree that the advice of counsel/good faith issue relates to liability, Respondents already have raised the affirmative defense of "good faith" in their Answer

as it relates to the Truth in Lending Act and Electronic Funds Transfer Act claims. *See* Dkt. at 15, ¶¶ 5 and 6; *see also Howard v. SEC*, 376 F.3d 1136, 1148 (D.C. Cir. 2004) (noting that the "reliance [on advice of counsel] defense … is not really a defense at all but simply some evidence tending to support a defense based on due care or good faith") (citation omitted).

However, in light of the development in the law, and in an abundance of caution, Respondents are seeking to amend their Answer to include good faith reliance on the advice of counsel as an affirmative defense to the Notice of Charges. The ALJ should find good cause to allow Respondents to amend their Answer to assert an advice of counsel defense.

**B. The ALJ should allow Respondents to amend their Answer to add a lack of fair notice defense.**

Respondents also are seeking to amend their Answer to assert a defense that the CFPB did not provide fair notice of the prohibited conduct underlying the CFPA claims for "unfairness" and "deception." As a result, Respondents were denied a reasonable opportunity to understand what was prohibited at the time of their alleged conduct through December 2012. *See* Dkt. 1 at ¶ 12. Given the "liberal standard of permitting amendments of pleadings," the ALJ should grant the request. *See* Rules of Practice for Adjudication Proceedings, 77 Fed. Reg. 39058-01, 39069 (June 29, 2012). Importantly, the CFPB is not prejudiced by the assertion of this defense, as it has ample time to respond and has in fact responded to this defense in other matters. *See CFPB v. Ocwen Fin. Corp.*, 2019 U.S. Dist. LEXIS 152336 (S.D. Fla. Sept. 5, 2019); *CFPB v. Navient Corp.*, 2017 U.S. Dist. LEXIS 123825 (M.D. Pa. Aug. 4, 2017); *CFPB v. Think Fin., LLC*, 2018 U.S. Dist. LEXIS 130898 (D. Mont. Aug. 3, 2018); *CFPB v. D & D Mktg.*, 2016 U.S. Dist. LEXIS 194709 (C.D. Cal. Nov. 17, 2016). Particularly given the unusual circumstances of the current proceedings, which were remanded for a "new hearing" with no reliance on the rulings of the prior ALJ, the interests of justice mitigate in favor of granting the

motion to amend. The ALJ should allow Respondents to raise this issue where it "is likely to assist in adjudicating the merits of the action" and the other party is not prejudiced. *See* 12 C.F.R. §1081.202(b).

## V. CONCLUSION

For the foregoing reasons, Respondents respectfully request that the ALJ grant their Motion to Amend Answer.

Respectfully submitted,

/s/ Richard J. Zack
Richard J. Zack, Esq.
zackr@pepperlaw.com
215.981.4726

Michael A. Schwartz, Esq.
215.981.4494
schwarma@pepperlaw.com

Christen M. Tuttle, Esq.
tuttlec@pepperlaw.com
215.981.4285

Saverio S. Romeo, Esq.
romeos@pepperlaw.com
215.981.4440

PEPPER HAMILTON LLP
3000 Two Logan Square
Eighteenth & Arch Streets
Philadelphia, PA 19103-2799

*Counsel for Respondents Integrity Advance LLC and James R. Carnes*

Dated: March 26, 2020

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Stephen Jacques, Esq.
Stephen.Jacques@cfpb.gov

Benjamin Clark, Esq.
Benjamin.Clark@cfpb.gov

Alusheyi Wheeler, Esq.
Alusheyi.Wheeler@cfpb.gov

Deborah Morris, Esq.
Deborah.Morris@cfpb.gov

/s/ Saverio S. Romeo
Saverio S. Romeo, Esq.