UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2015-CFPB-0029

In the Matter of:	**RESPONDENTS' MOTION TO DISMISS**
INTEGRITY ADVANCE, LLC and JAMES R. CARNES,	ORAL ARGUMENT REQUESTED
Respondents.	

RESPONDENTS' MOTION TO DISMISS

Pursuant to 12 C.F.R. § 1081.212 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 dismiss this action with prejudice. In support thereof, Respondents incorporate by reference the accompanying memorandum of law.

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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 Dismiss and accompanying brief 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:

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<u>RESPONDENTS' BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS</u>

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I. INTRODUCTION AND SUMMARY

Pursuant to 12 CFR § 1081.212 and Administrative Law Judge ("ALJ") Christine L. Kirby's March 13, 2020 Order, Respondents Integrity Advance, LLC and James R. Carnes ("Respondents") respectfully submit this brief in support of their Motion to Dismiss.

The Notice of Charges ("Notice") in this matter should be dismissed for multiple reasons. First, neither Integrity Advance nor Mr. Carnes was ever, nor is currently, a "covered person" within the meaning of the CFPA. Second, the Notice fails to state a claim under the Truth in Lending Act ("TILA") and its implementing regulation, Regulation Z. Third, the claims of "unfairness" and "deception" under the Consumer Financial Protection Act ("CFPA") must fail because the Consumer Financial Protection Bureau ("CFPB") did not provide fair notice of the prohibited conduct.

II. BACKGROUND

Integrity Advance was a nonbank short-term, small-dollar lender. Between May 2008 and December 2012, Integrity Advance offered short-term, small-dollar loans, which ranged in value from $100–$1000, to consumers. James R. Carnes was the CEO and president of Integrity Advance. Integrity Advance stopped offering loans to consumers over seven years ago.

The CFPA establishes the CFPB as an independent executive agency within the Federal Reserve System. *See* 12 U.S.C. § 5491 (2012). The CFPB opened its doors on July 21, 2011. This date is referred to as the "transfer date," and also the "effective date," under the CFPA. As discussed below, July 21, 2011 is called the "transfer date" because it is the date on which certain pre-existing consumer financial protection laws transferred to the CFPB from other prudential regulators. *See* 12 U.S.C. § 5582; *Designated Transfer Date*, 75 Fed. Reg. 57252 (Sept. 20, 2010). July 21, 2011 is also the "effective date" because it is the earliest date on

which certain enforcement and other statutory provisions under the CFPA could take effect, provided certain statutory strictures were met.

All of the CFPB's powers are concentrated within the hands of a single Director, who is to be appointed by the President, subject to the advice and consent of the Senate, to serve for a five-year term. On July 16, 2013, the CFPB's first-ever Director, Richard Cordray, was confirmed by the United States Senate to serve a five-year term.

On January 4, 2012, the President had appointed Mr. Cordray to serve as Director of the CFPB during a Congressional recess. In July 2014, the Supreme Court held that the recess appointments of three members of the National Labor Relations Board ("NLRB"), purportedly appointed on the same day as Mr. Cordray, were unconstitutional because the Senate was not in recess. *See NLRB v. Canning*, 573 U.S. 513, 517-21, 556-57 (2014). Based on the identical facts and reasoning, Mr. Cordray's recess appointment also was unconstitutional.

Among other things, the CFPB is authorized to enforce the consumer financial laws. To this end, the CFPA provides that the "Bureau may take an action authorized under Subtitle E [the CFPB's enforcement authority] to prevent a covered person . . . from committing or engaging in an unfair, deceptive or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service." 12 U.S.C. § 5531(a) (2012). A "covered person," in turn, is defined as "any person that engages in offering or providing a consumer financial product or service." *Id.* § 5481(6). In addition, the CFPB can bring enforcement actions against a "related person," which is defined as being, among other things, "any director or officer . . . charged with managerial responsibility for . . . [a] covered person." *Id.* § 5481(25)(C). The CFPA defines a "related person" as being a "covered person," within the meaning of the CFPA. *Id.* § 5481(25)(B). The statute also defines those products or

services that are "consumer financial products or services," and includes in that list "extending credit." *Id.* § 5481(15).

On November 18, 2015, the CFPB filed the Notice of Charges alleging that Respondents violated Section 1036 of the CFPA, 12 U.S.C § 5536 (2012).[1] In addition, the Notice alleges that Integrity Advance violated TILA, 15 U.S.C. §§ 1631, 1638 (2012), and its implementing regulation, Regulation Z, 12 C.F.R. §§ 1026.17, 1026.18 (2015), as well as the Electronic Fund Transfer Act ("EFTA"), 15 U.S.C. § 1693k (2012), and its implementing regulation, Regulation E, 12 C.F.R. § 1005.10(e) (2015).

The proceedings were initially overseen by ALJ Parlen L. McKenna, until his appointment was deemed unconstitutional following the Supreme Court's ruling in *Lucia v. SEC,* 138 S. Ct. 2044, 2055 (2018). 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

[1] On March 25, 2020, Respondents' counsel conferred with Enforcement Counsel and confirmed that the CFPB continues to agree that Counts III, IV, and VII are limited to deceptive or unfair acts and practices that occurred on or after July 21, 2011. This is consistent with their position in the prior proceeding. *See* Dkt. 33 at 14. Therefore, Respondents have not included this grounds for partial dismissal of the Charges in this Motion since Enforcement Counsel is not seeking any remedy for pre-July 21, 2011 conduct.

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 Dismiss.

III. LEGAL STANDARD

Pursuant to 12 CFR § 1081.212(b), "[a] respondent may file a motion to dismiss asserting that, even assuming the truth of the facts alleged in the notice of charges, it is entitled to dismissal as a matter of law."

A motion to dismiss should be granted if an agency cannot show that Congress has delegated authority over the defendant. *See FTC v. Compagnie De Saint-Gobain-Pont-a-Mousson*, 636 F.2d 1300, 1315 (D.C. Cir. 1980) ("The exercise of jurisdiction by any governmental body in the United States is subject to limitations reflecting principles of international and constitutional law, as well as the strictures of the particular statute governing that body's conduct."). The burden of establishing subject matter jurisdiction is on the party asserting it, here the CFPB. *See Port City Props. v. Union Pac. R.R. Co.*, 518 F.3d 1186, 1189 (10th Cir. 2008). In reviewing such a motion, "it is well established . . . that a court is not limited to the allegations in the complaint but may consider material outside of the complaint in an effort to determine whether the court has jurisdiction in the case." *Gustave-Schmidt v. Chao*, 226 F. Supp. 2d 191, 195 (D.D.C. 2002); *see also Coal. for Underground Expansion v. Mineta*,

333 F.3d 193, 198 (D.C. Cir. 2003) (holding that in disposing of a motion to dismiss, "where necessary, the court may consider the complaint supplemented by undisputed facts evidenced in the record, or the complaint supplemented by undisputed facts plus the court's resolution of disputed facts") (internal citation omitted). A motion to dismiss also should be granted if the complaint does not allege "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007).

IV. ARGUMENT

A. The CFPB does not have, and has never had, enforcement authority as to Respondents.

1. The CFPB Did Not Obtain Legal Authority To Regulate Non-Banks Until There Was a Lawfully-Appointed Director.

At the time of its creation, Congress vested the CFPB with new powers to enforce consumer financial protection laws, including the power to bring enforcement actions against nonbanks. *See* 12 U.S.C. §§ 5561-5567 (Subtitle E – Enforcement Powers). The CFPB, however, could not exercise those new powers before a Director was lawfully appointed. Rather, in the time before a Director was lawfully appointed, the CFPB could only exercise the authorities Congress transferred to the CFPB from a number of federal banking (or prudential) regulators, which was effective as of July 21, 2011. *See* 12 U.S.C. § 5586(a) ("The Secretary is authorized to perform the functions of the Bureau *under this part* until the Director of the Bureau is confirmed by the Senate in accordance with section 5491 of this title.") (emphasis added). The transferred authorities referenced in Subtitle F specifically *do not include* the authority to enforce consumer financial protection laws as to nonbanks, such as Respondents.[2]

[2] The authorities conferred in Section 5586(a) can only apply to the specific transfer authorities described in subtitle F; to read otherwise would render the phrase "under this subtitle" meaningless. *See, e.g.*, *New Process Steel, L.P. v. NLRB*, 560 U.S. 674, 680 (2010) (stating that, fundamentally, an interpretation of a statute must "[h]armonize and give meaningful effect to all

The nature of this limited authority prior to the lawful appointment of a Director is further explained in a January 10, 2011 letter jointly submitted by the Department of Treasury Inspector General and Federal Reserve Board ("Federal Reserve") Inspector General in response to a Congressional inquiry about the operations of the CFPB, as contemplated by the CFPA. This letter appears to be the only instance when any federal government entity has publicly interpreted the CFPB's authority under Section 5586(a), especially in the absence of a lawfully-appointed Director. The letter explained that in the absence of a lawfully-appointed Director, the CFPB, in pertinent part, only had the authority to:

> [P]rescribe rules, issue orders, and produce guidance related to the federal consumer financial laws that were, prior to the designated transfer date [July 21, 2011] within the authority of the Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the National Credit Union Administration [the federal banking regulators].[3]

Thus, as recognized in the OIG letter, before there was a lawfully-appointed Director, the CFPB did not have the authority to pursue enforcement actions against entities that were not previously within the jurisdiction of the federal banking regulators as described in Subtitle F of the Act.[4] *See* OIG Letter at 6-7 ("In addition to the transferred functions, the

of the provisions . . ."); *Duncan v. Walker*, 533 U.S. 167, 174 (2001) (declining to adopt a "construction of the statute, [that] would render [a term] insignificant") (internal quotation marks omitted); *Market Co. v. Hoffman*, 101 U.S. 112, 115–16 (1879) ("[A] statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be . . . insignificant" (internal quotation marks omitted)).

[3] Letter, Joint Response by the Inspectors General of the Department of the Treasury and Board of Governors of the Federal Reserve System: Request for Information Regarding the Bureau of Consumer Financial Protection, 5 (Jan. 10, 2011) [hereinafter OIG Letter], *available at* https://oig.federalreserve.gov/reports/Treasury_OIG_Posted_PDF_-_Response_CFPB.pdf

[4] These new regulatory authorities were not explicitly provided by law to federal regulators prior to the Dodd-Frank Act's enactment, in contrast with the "transferred authorities" that moved to the CFPB existing consumer financial protection powers from other federal regulators. The CFPB's transferred authorities include the power to issue rules to implement

Bureau has newly-established federal consumer financial regulatory authorities. The Secretary is not permitted to perform certain newly-established Bureau authorities if there is no confirmed Director by the designated transfer date.").

Although Respondents may have been subject to the enforcement authority of the Federal Trade Commission, those powers were not transferred to the CFPB in Subtitle F of the Act and, thus, the CFPB could not exercise that authority prior to the lawful appointment of a Director who could exercise the newly-established powers under Subtitle E of the Act. *See* 12 U.S.C. § 5581(b)(5) (stating that "[t]he Bureau shall have all powers and duties under the enumerated consumer laws to *prescribe rules, issue guidelines, or to conduct studies or issue reports mandated by such laws*, that were vested in the Federal Trade Commission on the day before the designated transfer date") (emphasis added).[5]

Moreover, at the CFPB's inception, by necessity and design, no other official could have assumed the CFPB's new consumer financial protection authority. *See* 12 U.S.C.

federal consumer financial protection laws. The transferred authorities also include supervisory, enforcement, and rulemaking powers over banks, thrifts, and credit unions holding more than $10 billion in deposits (larger depositories). 12 U.S.C. §§ 5581–5587 (2012).

[5] The prior ALJ concluded that the CFPB could exercise enforcement authority over Respondents before the lawful appointment of a Director because the definition of "consumer financial protection functions" in Subtitle F is defined as including "all authority to prescribe rules *or issue orders* or guidelines pursuant to any Federal consumer financial law . . . ." Dkt. 75 at 16-17 (citing 12 U.S.C. § 5581(a)(1)) (emphasis added). This prior ruling no longer has any effect and should be rejected here. Further, unlike other entities described in Section 5581, the provision transferring functions from the FTC does not use the term "consumer financial protection functions." *Compare* 12 U.S.C. § 5581(4) (stating that "[a]ll consumer financial protection functions of the Federal Deposit Insurance Corporation are transferred to the Bureau"), *with id.* § 5581(5) (stating that "[t]he authority of the Federal Trade Commission under an enumerated consumer law *to prescribe rules, issue guidelines, or conduct a study or issue a report mandated under such law* shall be transferred to the Bureau on the designated transfer date") (emphasis added). Thus, Subtitle F plainly contains no grant of authority to the CFPB to "issue orders" against nonbanks prior to the lawful appointment of a Director; those powers are found elsewhere.

§ 5491(b)(1); OIG Letter at 7. The Director of the CFPB exercises significant executive authority,[6] and is not directed or supervised by any other appointed executive official; he thus acts as a principal Officer of the United States. *See Edmond v. United States*, 520 U.S. 651, 663 (1997) (noting that principal officers are those whose work is not directed or supervised at some level by other appointed officers). In the absence of a lawfully-appointed Director, the CFPB would otherwise have had no "Officer[s] of the United States" appointed in accordance with the Constitution to exercise the significant authorities provided to a federal regulator for the first time by the CFPA.

Thus, in the absence of any lawfully-appointed Director, there was no other Officer who could exercise the agency's newly-created, non-transferred authorities, which include the authority to pursue enforcement actions over a nonbank, such as Integrity Advance, and its principal, Mr. Carnes.[7]

2. Under The Supreme Court's Reasoning In *Noel Canning*, The Director Was Not Lawfully-Appointed Until July 16, 2013.

President Obama purported to appoint Richard Cordray Director of the CFPB on January 4, 2012, pursuant to his authority under the Recess Appointments Clause, U.S. Const.

[6] Further to this point, the Director may only be removed by the President for "inefficiency, neglect of duty or malfeasance in office." 12 U.S.C. § 5491(c)(3) (2012). Additionally, the Director has authority to appoint and hire the employees necessary to carry out the duties of the CFPB, *id.* § 5493(a), and "to delegate to any duly authorized employee, representative, or agent any power vested in the CFPB by law," *id.* § 5492(a).

[7] Indeed, it is significant that this matter implicates the appointment and confirmation of the CFPB's first-ever director, because the CFPA further distinguishes between those instances when there is no director and, thus, no officer able to carry out the full authorities of the CFPA and all other instances involving the appointment and confirmation of a new director. To this end, the CFPA expressly contemplates a scenario in which an outgoing Director's term would be held-over until an incoming Director could be confirmed by the Senate. See 12 U.S.C. § 1011(c)(2) ("An individual may serve as Director after the expiration of the term for which appointed, until a successor has been appointed and qualified.").

art. II, § 2, cl. 3, even though the Senate was not in recess at the time.[8] Mr. Cordray's January 4, 2012 appointment under the Recess Appointments Clause was undertaken on the same day and in precisely the same manner as the President's unilateral (and unconstitutional) appointment of three members to the NLRB. *See Canning*, 573 U.S. at 517-21, 548-57.

In *Noel Canning*, the Supreme Court unanimously invalidated the NLRB recess appointments as unconstitutional. *Id.* at 557. The Court held that, because "a recess of more than 3 days but less than 10 days is presumptively too short," the "President lacked the power to make the recess appointments" to the NLRB at issue. *Id.* at 519. By direct application of the holding in *Noel Canning* to Mr. Cordray's appointment on January 4, 2012, the President "lacked the power" to unilaterally appoint Mr. Cordray as the Director of the CFPB on January 4, 2012, since the appointment occurred when the Senate was not in recess. *See id.* (stating that "[t]hree days is too short a time to bring a recess within the scope of the Clause"); *see also* David H. Carpenter & Todd Garvey, *Practical Implications of* Noel Canning *on the NLRB and CFPB*, Cong. Res. Serv., 7-5700, 1 (Apr. 1, 2013) (noting that the D.C. Circuit's decision in *Noel Canning* [subsequently upheld by the Supreme Court] casts "serious doubt" on the authority of the CFPB).

Mr. Cordray was not lawfully appointed as Director of the CFPB until he was confirmed by the Senate on July 16, 2013. *See* 159 Cong. Rec. S5704-05 (daily ed. July 16, 2013). As of that day, but not before, the CFPB was authorized to exercise the new powers to regulate nonbanks delegated by Congress in the Dodd-Frank Act. *Noel Canning*, coupled with the limitations of the authority delegated to the CFPB imposed by Section 5586(a), mean that

[8] After adjourning on December 17, 2011, the Senate agreed to hold a series of "pro forma" sessions to occur periodically until January 23, 2012. *See* 157 Cong. Rec. S883–S8784 (daily ed. Dec. 17, 2011).

before July 16, 2013, the CFPB could not have brought an enforcement action against Integrity Advance and Mr. Carnes because Respondents are nonbanks and were outside the scope of any authority that was transferred under Subtitle F of the Act.

3. The Court Should Dismiss The Notice Because Respondents Never Engaged In Conduct Within The CFPB's Jurisdiction.

As Integrity Advance ceased offering loans in December 2012—months before Mr. Cordray was lawfully appointed—neither Integrity Advance nor Mr. Carnes ever offered or provided a consumer financial product or service or otherwise engaged in any business activities over which the CFPB has jurisdiction. *See* Dkt. 1 ¶ 12. As such, they were never a "covered person" under the CFPA and the CFPB has never had authority to bring an enforcement action against them. *See* 12 U.S.C. § 5481(6); 12 U.S.C. § 5531(a).

Moreover, a "covered person," is defined in the present tense. This present tense language "strongly suggests that it [the definition] does not extend to past actions." *Sherley v. Sebelius*, 644 F.3d 388, 394–95 (D.C. Cir. 2011); *see also Carr v. United States*, 560 U.S. 438, 448 (2010) ("[T]he present tense generally does not include the past."). Nothing in the plain language of the CFPA or its legislative history suggests that the Bureau's authority over "any person that engages in offering a consumer financial product or service" should be read to mean that a "covered person" includes a person or entity that provided a consumer financial product or service in the past.

Respondents are not arguing that a company must be currently engaged in the offering or provision of a consumer financial product or service to be called a "covered person" under the CFPA. Rather, in order for the CFPB to bring a cause of action under the CFPA, an entity must have engaged in the offering or provision of a consumer financial product or service *at some point in time when the CFPB had authority as to that conduct.* That is not the case

where, as here, Integrity Advance ceased offering loans months before the CFPB had a lawfully appointed Director.

4. The CFPB's Lack Of Authority As To Respondents Cannot Be Cured.

After Director Cordray was confirmed by the Senate on July 16, 2013 and before the Supreme Court's ruling in *Noel Canning*, the CFPB published in the Federal Register a Notice of Ratification from Director Cordray on August 27, 2013. *Notice of Ratification*, 78 Fed. Reg. 53734 (Aug. 30, 2013). The Notice of Ratification stated that between January 4, 2012 and July 17, 2013, the Director had been "serving as a recess appointee," and that he believes that the "actions [he] took" during that recess appointee period "were legally authorized and entirely proper." *Id.* But, in order "[t]o avoid any possible uncertainty, however," the Director "affirm[ed] and ratif[ied] any all actions" that he "took during that period."[9] *Id.*

The Notice of Ratification, however, did not—because it cannot—create authority that never existed in the first place. *See Cook v. Tullis*, 85 U.S. 332, 338 (1873) ("[I]t is essential that the party ratifying should be able not merely to do the act ratified at the time the act was done, but also at the time the ratification was made."); *W. Nat'l Bank of N.Y. v. Armstrong*, 152 U.S. 346, 352 (1894) ("[A] ratification, to be efficacious, must be made by a party who had power to do the act in the first place."). As discussed above, the CFPB lacked legal authority over Respondents because Respondents had ceased engaging in the offering or provision of a consumer financial product or service before the Director had been lawfully appointed, and thus

[9] This sweeping, one-sentence attempt at ratification does not provide the "detached and considered judgment" required for the ratification of agency action. *See Doolin Sec. Sav. Bank, F.S.B. v. Office of Thrift Supervision*, 139 F.3d 203, 213 (D.C. Cir. 1998) (noting that, in ratifying previous enforcement action, the OTS Director "acted in the normal course of agency adjudication," "[r]ather than simply writing a letter or a memorandum adopting the Notice of Charges as his own . . . .").

were not "covered persons"—a requirement of any CFPA claim. *See* 12 U.S.C. §§ 5531, 5536. Because the CFPB did not have authority over Respondents at the time Director Cordray was lawfully appointed or at the time that Director Cordray attempted to ratify his prior actions, the Notice of Ratification did not cure the jurisdictional deficiencies present in this case. *See, e.g.*, *FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98-99 (1994) (holding that the Solicitor General could not ratify a previous filing that was made without proper authorization because he did not have the legal authority to perform the act "at the time the ratification was made"); *Franklin Sav. Ass'n v. Dir. of the Office of Thrift Supervision*, 740 F. Supp. 1535, 1539 (D. Kan. 1990) (rejecting attempt by newly-appointed Office of Thrift Supervision Director to ratify previous conduct because "since [he] had no power to appoint a conservator . . . on February 15, 1990, he lacked the power on June 1, 1990, to ratify the earlier appointment").

This case differs from other instances when courts have upheld notices of ratification that cured Appointments Clause defects. In those cases, the subsequent ratification cured Appointments Clause defects because the agency was lawfully authorized to take the action at issue *at the time of the ratification*. For example, in *FEC v. Legi-Tech, Inc.*, 75 F.3d 704 (D.C. Cir. 1996), the court upheld the FEC's subsequent review and ratification of a case, because, at the time of ratification, the agency had a lawfully appointed quorum of commissioners, which served to cure the Appointment Clause defect. Similarly, in *Doolin Security Savings Bank v. Office of Thrift Supervision*, the court held that the lawfully-appointed director of that agency "effectively ratified the Notice of Charges signed by [the unlawfully appointed director] *at a time when he could have initiated the charges himself* . . ." 139 F.3d at 214 (emphasis added). In both *Legi-Tech* and *Doolin*, the reviewing court held that the lawfully appointed agency heads could have begun each of those administrative enforcement processes

anew, because the FEC commissioners and OTS director ratifying previous agency actions had *current authority* over the respondents. In those cases—neither of which constituted instances in which the general authority of the agency was in question—ratification provided a valid cure for Appointments Clause defects. *See Legi-Tech*, 75 F.3d at 709; *Doolin*, 139 F.3d. at 213.

Conversely, here, the Constitutionally-defective appointment of the CFPB's Director is a threshold issue of authority that was not cured by Mr. Cordray's post hoc blanket ratification attempt. This is true because under Section 5586 of the CFPA and *Noel-Canning*, the CFPB did not have authority over Respondents before Mr. Cordray's lawful appointment, and at any time after he was confirmed by the Senate, as Respondents were not "covered persons." *See* Dkt. 1 ¶ 12.

Moreover, ratification is inapplicable here because that doctrine, which arises from principles of agency law, occurs when a principal approves prior actions of his or her purported agent, not when a principal purports to ratify previous actions taken when he or she did not have authority to act. *See Wilkes-Barre Hosp. Co. v. NLRB*, 857 F.3d 364, 371 (D.C. Cir. 2017) ("[R]atification occurs when a principal sanctions the prior actions of its purported agent.") (citation omitted); Restatement (Second) of Agency § 82 ("Ratification is the affirmance by a person of a prior act which did not bind him but which was done or professedly *done on his account* . . . .") (emphasis added).

In sum, because the CFPB lacks authority over Respondents and because that lack of authority cannot be cured, the ALJ should dismiss the Notice in its entirety.

B. <u>Counts I and II should be dismissed because the Notice fails to state a claim under TILA and Regulation Z.</u>

Even if the ALJ determines that the CFPB has jurisdiction over Respondents, Counts I and II of the Notice should be dismissed because the Notice fails to allege sufficient

facts to state a claim under TILA and Regulation Z. As with any type of complaint, the CFPB's Notice of Charges must contain sufficient factual allegations to produce an inference of liability strong enough to move the CFPB's claims "across the line from conceivable to plausible." *Ashcroft v. Iqbal*, 556 U.S. 662, 683 (2009). Here, with respect to Counts I and II, the Notice does not plead sufficient facts to infer "more than the mere possibility of misconduct." *Id.* at 679. For these reasons, the ALJ should dismiss Counts I and II, which allege TILA violations.

The Notice fails to state a claim under TILA because Integrity Advance's disclosure of a payment table with a single payment reflects the single-payment legal obligation between Integrity Advance and consumers; thus, it complies with TILA's strict disclosure requirements. *See* 12 C.F.R. §§ 1026.17, 1026.18. Rather than allege facts that these requirements were not met, the Notice attempts to create a new TILA disclosure standard by which a "true repayment schedule"—one which accounts for a consumer's likely extension of the contract after consummation—is required to be disclosed instead. But TILA and its implementing regulation, Regulation Z, have no such requirement. In fact, the CFPB fundamentally misconstrues TILA's disclosure rules and ignores the long-standing TILA principle that post-consummation changes to a loan do not render a disclosure at the time that the loan was made inaccurate. *Id.* § 1026.17(e); *see also Stein v. Titlemax of Ga.*, 2019 U.S. Dist. LEXIS 189993, at *17 (N.D. Ga. July 25, 2019) (recommending motion to dismiss be granted and noting that "[a]ccurate disclosures do not become TILA violations because they were rendered inaccurate by subsequent events").

TILA requires creditors to disclose specific information, as prescribed by Regulation Z, including a loan's annual percentage rate ("APR"), the finance charge, the amount financed, and a payment schedule. *See* 15 U.S.C.§§ 1631 and 1638. Regulation Z requires these

disclosures to be "clear and conspicuous," that is, that they be legible and in a reasonably understandable form, 12 C.F.R. § 1026.17(a)(1); Comment 17(a)(1)-1), and that they reflect the terms of the *legal obligation between the parties*." *Id.* § 1026.17(c)(1) (emphasis added). Read together, these provisions mandate that a required disclosure like a payment schedule reflect the terms of the underlying credit contract and be communicated in a manner that the consumer may read and understand.

Indeed, the disclosures highlighted by the CFPB track the model form from Regulation Z. The disclosure uses the appropriate format, labels, and terminology as the regulation prescribes. This Regulation Z model form, in turn, provides a safe harbor, meaning that when a company presents a TILA disclosure that tracks this model form, it is presumptively compliant with the TILA "clear and conspicuous" requirement. *See* 12 C.F.R. Part 1026, app. H (H.2). There is no question that the contract between Integrity Advance and consumers at the time of loan consummation was for a single payment loan which could be extended, at the consumer's option, beyond the maturity date. The TILA disclosures were provided on the model form and disclosed a payment schedule reflecting that agreement. This is what TILA and Regulation Z require.

The CFPB, nevertheless, attempts to allege a TILA (and Regulation Z) violation on the theory that Respondents should have assumed consumers would renew their loans after consummation and should have made a "true payment schedule" based on this assumption. This enforcement theory attempts to read into Regulation Z a requirement to predict post-consummation events and incorporate them into a payment schedule that not only does not exist, but is directly contradicted by Section 1026.17(e) of Regulation Z. That section of Regulation Z

makes clear that post-disclosure events (such as the election to renew a loan contract after consummation) do not render the initial disclosure inaccurate.

Here, any change to the loan terms necessarily resulted from a payment decision made after the loan was consummated. If consumers did not indicate that they would repay the loan under the initial terms, or if consumers elected to request a renewal, the consumer's repayment obligation changed in accordance with the terms of the contract. TILA and Regulation Z do not require, and the CFPB has not pleaded, that new after-the-fact disclosures should have been made. *See, e.g., Jasper Cnty. Sav. Bank v. Gilbert*, 328 N.W.2d 287, 290 (Iowa 1982) (concluding that TILA "does not require the lender to disclose that the dollar amount of the costs of credit will increase if the consumer makes late payments"). The CFPB has failed to state a TILA claim, and, accordingly, the ALJ should dismiss Counts I and II of the Notice.

C. <u>The UDAAP claims in Counts III, IV, and VII should be dismissed because the CFPB failed to provide fair notice.</u>

The claims in Counts III, IV, and VII alleging "unfairness" and "deception" under the CFPA should be dismissed because Respondents were not provided fair notice of the prohibited conduct. "A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *FCC v. Fox Television Stations, Inc*., 132 S. Ct. 2307, 2317 (2012). The purpose is two-fold. First, "regulated parties should know what is required of them so they may act accordingly" and, second, "precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way." *Id.*

Particularly as it relates to unfairness, courts have recognized that a prohibition against "unfair" conduct is "as vague as they come." *Beler v. Blatt, Hasenmiller, Leibsker &*

Moore, LLC, 480 F.3d 470, 474 (7th Cir. 2007). Therefore, Congress called for the CFPB to "prescribe rules . . . identifying as unlawful unfair, deceptive, or abusive acts or practices in connection with . . . a consumer financial product or service." 12 U.S.C. § 5531(b). Despite this explicit direction from Congress to provide the notice that due process requires, the CFPB has instead relied on ad hoc and retroactive enforcement actions rather than providing prospective direction through its rule-making function. This leaves entities that are subject to the CFPA to "guess at its meaning" and permits CFPB attorneys to "differ as to its application," in a manner which "violates the first essential of due process of law." *Connally v. Gen. Constr. Co.*, 269 U.S. 385, 391 (1926). It is the CFPB's burden to affirmatively provide fair notice, which "requires that a statute or agency action give [a regulated person or entity] fair warning of the conduct it prohibits or requires, and it must provide a reasonably clear standard of culpability to circumscribe the discretion of the enforcing authority and its agents." *Employer Sols. v. Office of Chief Admin.*, 833 F.3d 480, 488 (5th Cir. 2016) (internal quotations omitted).

In this case, Counts III, IV, and VII of the Notice of Charges allege "deception" and "unfairness," respectively, challenging the lawfulness of the language in the Integrity Advance loan agreement. Count VII alleges "unfairness" based on the use of remotely-created checks. These allegations were made despite the fact that the CFPB does not contest that (1) the loan agreements complied with the law in the state of Delaware in which Integrity Advance was organized, and (2) the use of remotely-created checks is legal. Under these circumstances, where Respondents complied with state law and used a method of payment that is otherwise lawful, Respondents were not given fair notice that their conduct would later be deemed by the CFPB to violate the CFPA.

Respondents acknowledge that some district courts have rejected "fair notice" challenges to the "unfairness" and "deception" provisions of the CFPA.[10] However, these courts wrongly concluded that the CFPB may regulate by either rule-making or enforcement, in its sole discretion, without regard for the significant negative impact of retrospective law-making on individual persons and entities, particularly where the CFPB seeks enormous sums in financial penalties and equitable damages. That conclusion goes against all notions of fundamental fairness and due process. As the Supreme Court has stated, "[i]t is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or else be held liable when the agency announces its interpretations for the first time in an enforcement proceeding." *Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2168 (2012).

Because Respondents were not provided with fair notice of the allegedly prohibited conduct, Counts III, IV, and VII should be dismissed..

V. CONCLUSION

For the foregoing reasons, Respondents respectfully request that their Motion be granted and the Notice of Charges be dismissed.

Respectfully submitted,

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[10] *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).

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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' Brief in Support of their Motion to Dismiss 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:

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