UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2015-CFPB-0029

In the Matter of:	)	**RESPONDENTS' CONSOLIDATED REPLY BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS, MOTION TO AMEND, AND SUPPLEMENTAL BRIEF IN SUPPORT OF MOTION TO OPEN RECORD FOR A NEW HEARING**
INTEGRITY ADVANCE, INC. and JAMES R. CARNES,	)	
Respondents.	)	

RESPONDENTS' CONSOLIDATED REPLY BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS, MOTION TO AMEND, AND SUPPLEMENTAL BRIEF IN SUPPORT OF MOTION TO OPEN RECORD FOR A NEW HEARING

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

Respondents Integrity Advance, LLC and James R. Carnes ("Respondents") respectfully submit this consolidated Reply Brief in support of their Motion to Amend (Dkt. 259), Motion to Dismiss (Dkt. 260), and Supplemental Brief in Support of their Motion to Open Record for a New Hearing (Dkt. 261).

I. The CFPB does not have enforcement authority over Respondents.

As noted in Respondents' Opening Brief, at the time the Consumer Financial Protection Bureau ("CFPB") was created, it could only exercise the powers Congress transferred to the CFPB from a number of federal banking (or prudential) regulators. Dkt. 260 at 5. The CFPB could not exercise its newly-acquired powers, including the power to bring enforcement actions against nonbanks, until a Director was lawfully appointed. *Id.* Here, a Director was not lawfully appointed until July 16, 2013, well after Integrity Advance ceased offering loans in December 2012. *See* Dkt. 1 ¶ 12. Thus, it is beyond dispute that Respondents never offered any loans to consumers at any point in time when the CFPB had authority as to that conduct.

Despite this, Enforcement Counsel contends that the CFPB may bring an enforcement action against Respondents based on that past conduct because the CFPB had authority to enforce the law against nonbanks on the date that the Notice of Charges was filed. Dkt. 264 at 5. Enforcement Counsel is wrong. The question is not whether the CFPB had authority over nonbanks as of the date that the Notice of Charges was filed, but rather whether Respondents were ever a "covered person" under the Consumer Financial Protection Act ("CFPA"). They were not. *See* Dkt. 260 at 10-11. There is nothing in the CFPA that suggests that the CFPB'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***, and Enforcement Counsel has not

pointed to anything to the contrary in its Opposition. The ALJ should grant Respondents' Motion to Dismiss and dismiss the Notice of Charges.

II. Respondents should not be denied the opportunity to present defenses based on advice of counsel and lack of fair notice in the new hearing ordered by the Director.

In the event that the ALJ does not grant Respondents' Motion to Dismiss, the ALJ should allow Respondents to amend their Answer to add affirmative defenses based on good faith reliance on advice of counsel and lack of fair notice. In asking the ALJ to deny Respondents' Motion to Amend, Enforcement Counsel ignores the "liberal standard of permitting amendments of pleadings" embodied in the CFPB's Rules of Practice for Adjudication Proceedings. 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"). Rather, Enforcement Counsel again selectively quotes the Rules in an attempt to support its argument that the ALJ should sacrifice fairness for speed. *See* Dkt. 264 at 18 (partially quoting Federal Register, which states in full: "In drafting the Final Rule, the Bureau endeavored to create an adjudicatory process that provides for the expeditious resolution of claims ***while ensuring that parties who appear before the Bureau receive a fair hearing***.") (emphasis added) (citing 77 Fed. Reg. 39058, 39059 (June 29, 2012)).

But while Enforcement Counsel complains that Respondents are seeking to add defenses "at [a] late date," Dkt. 264 at 15, Enforcement Counsel notably does not argue that it will be prejudiced at all, much less unduly so, by allowing the amendments. The concession is noteworthy. As noted previously, courts addressing motions to amend have "recognized a 'policy in favor of hearing cases on their merits,'" and have noted that courts should only deny leave to amend in certain situations, such as where there will be "undue prejudice to the

opposing party by virtue of allowance of the amendment." Dkt. 259 at 4 (citing *Bronner v. Duggan*, 324 F.R.D. 285, 290 (D.D.C. 2018)); *see also* 12 C.F.R. § 1081.202(b) (allowing ALJ to admit evidence at a hearing not included in a party's answer where that evidence "is likely to assist in adjudicating the merits of the action" and the other party is not prejudiced). There is no prejudice here in allowing the amendments—*see* Dkt. 259 at 5-7, 9—and Enforcement Counsel has not even argued to the contrary. *See, e.g.*, *Hopkins v. Women's Div.*, 284 F. Supp. 2d 15, 25 (D.D.C. 2003) ("It is well understood in this Circuit that when a plaintiff files an opposition to a dispositive motion and addresses only certain arguments raised by the defendant, a court may treat those arguments that the plaintiff failed to address as conceded.").

Enforcement Counsel also does not identify, because it cannot, any cases predating *CashCall* that recognized the viability of an advice of counsel defense in a CFPA matter. Instead, Enforcement Counsel seeks to punish Respondents for a decision made by prior counsel based on the state of the law at the time. Because the law has since changed, and because the Director has ordered a "new hearing," the ALJ should grant Respondents leave to amend their Answer. In any event, even if the ALJ does not permit Respondents to amend their Answer, Respondents should be permitted to raise the issue of good faith reliance on advice of counsel as it relates to the determination of appropriate remedies. Enforcement Counsel has not raised any serious argument to the contrary, and the ALJ should not deny Respondents the ability to raise all available defenses in a case in which Respondents face a potential restitution order in the magnitude of hundreds of millions of dollars.

III. Respondents are entitled to a new hearing not merely a de novo review of the record.

Consistent with the Supreme Court's ruling in *Lucia v. SEC*, Respondents are entitled to a "new hearing before a properly appointed official." *Lucia v. SEC*, 138 S. Ct. 2044,

2055 (2018) (internal citations omitted). Enforcement Counsel's attempt to establish a standard by which Respondents must show "good cause" in order to be afforded this new hearing is unavailing. *See* Dkt. 263 at 2-3.

In making its argument, Enforcement Counsel relies on two opinions from administrative hearings conducted by the United States Department of Agriculture ("USDA"). *See* Dkt. 263 at 2-3 (citing *Philip Trimble*, HPA Docket No. 15-0097, 2019 WL 2345419, at *2 (U.S.D.A. Feb. 19, 2019); *Stearns Zoological Rescue & Rehab Ctr., Inc.*, AWA Docket No. 15-0146, 2020 WL 836672, at *4-5 (U.S.D.A. Feb. 7, 2020)). However, the USDA's proceedings are governed by the orders of the USDA's Judicial Officer,[1] who ruled (albeit incorrectly) that a de novo record review can be sufficient for USDA proceedings. *Philip Trimble*, 2019 WL 2345419, at *2.[2] In so ruling, the USDA Judicial Officer conceded that the de novo review process "is not specifically contemplated by the Rules of Practice." *Philip Trimble*, 2019 WL 2345419, at *2. This concession highlights the difference between the Judicial Officer's order and that of the CFPB Director, who explicitly ordered that this new hearing be conducted "in accordance with the Bureau's Rules of Practice for Adjudication Proceedings [the "CFPB Rules"]." *See* Dkt. 216 at 2. In fact, in one of the cases cited by Enforcement Counsel, the USDA ALJ goes so far as to hold that all of the prior ALJ's decisions and rulings would stand, with the exception of the final Decision and Order. *Stearns Zoological*, 2019 WL 2345419, at *2

[1] The USDA's Judicial Officer is appointed by the Secretary of Agriculture and is the final deciding officer for USDA adjudicatory proceedings. *See* 7 U.S.C. §§ 450c-450g (summarized at https://oalj.oha.usda.gov/office-judicial-officer).

[2] This decision was due, in large part, to the fact that the Secretary of the USDA had already ratified the appointments of the USDA ALJs in 2017, long before the *Lucia* decision. *Philip Trimble*, HPA Docket No. 15-0097, Judicial Officer's Order Granting Respondent's Petition for Appeal to Judicial Officer for a New Hearing (Nov. 29, 2018), *affirmed in relevant part and superseded by* 2019 WL 2345419, available at https://oalj.oha.usda.gov/sites/default/files/15-0097%20-%20JO%20Order_Redacted.pdf.

("[N]o rulings aside from those that were contained in the now vacated Decision and Order are overturned."). That is in stark contrast to the CFPB Director's order, as recognized by this ALJ, that the ALJ is to "give no weight to, nor presume the correctness of, any prior opinions, orders, or rulings issued by" the prior ALJ. Dkt. 217 at 1. The USDA proceedings post-*Lucia* are not analogous to the CFPB proceedings and should not be relied upon as persuasive authority.

Instead, the CFPB Director's orders are consistent with those made by the Securities and Exchange Commission ("SEC"). Just like the CFPB Director, the SEC ruled that all post-*Lucia* proceedings are new hearings to be conducted pursuant to the SEC's Rules. *See In re: Pending Administrative Proceedings*, Release Nos. 33-10536, et al., Commission Opinion, at 2 (Aug. 22, 2018) (The SEC's "Rules of Practices. . . shall govern all pending proceedings.").[3] Consistent with the SEC's order, the SEC's Chief ALJ issued an order assigning new ALJs to preside over all new hearings except "where the parties waived their right to a new hearing and requested that the Commission decide their petitions for review on the present record." *In re: Pending Administrative Proceedings*, File Nos. 3-15006, et al., Chief Administrative Law Judge's Order Assigning Proceedings Post *Lucia v. SEC* (Sep. 12, 2018).[4] Subsequently, the SEC ALJs have conducted post-*Lucia* proceedings, as ordered, consistent with SEC procedural rules including expert reports, live testimony, dispositive motions, etc. *See, e.g., In re: Anton & Chia, LLP, et al.*, File No. 3-18292, Order (Mar. 15, 2019) (ordering procedural schedule).[5] Similar to the SEC, CFPB hearings also must be conducted in accordance with agency rules, as ordered by the CFPB Director.

[3] Available at: https://www.sec.gov/litigation/opinions/2018/33-10536.pdf.

[4] Available at: https://www.sec.gov/alj/aljorders/2018/ap-5955.pdf.

[5] Available at: https://www.sec.gov/alj/aljorders/2019/ap-6499.pdf.

Enforcement Counsel also relies on the D.C. Circuit Court's 2015 decision in *Intercollegiate* for the principle that a de novo record review is appropriate after an Appointments Clause violation, absent a showing of the need to supplement the record. *See* Dkt. 263 at 3 (citing *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 126 (D.C. Cir. 2015)). That reliance is misplaced. The *Intercollegiate* court contrasted a "new hearing" with a "de novo review of the record," recognizing that the two procedures are distinct from one another but finding that a new hearing was not required under the existing law at the time. *Id.* at 119-120. The *Intercollegiate* court disagreed with the appellant's proposition that "the only way to remedy the exercise of judicial authority by invalidly appointed judges is for the new judges to 'conduct a new *hearing*, not merely a *de novo* review of the record." *Intercollegiate* at 119 (emphasis in original). The court further distinguished past case law by finding that "[n]othing in that sentence [in the Supreme Court's opinion in *Ryder v. United States*, 515 U.S. 177 (1995)] suggests that a new hearing would have been required if the reviewing court had possessed de novo authority." *Id.* at 120. The court then found that a de novo record review, rather than a new hearing, was a sufficient remedy for an Appointments Clause violation. *Id.* However, the Supreme Court has since effectively overruled that decision, holding that a new hearing by a new ALJ is in fact the required remedy. *Lucia*, 138 S. Ct. at 2055. Neither the parties nor the ALJ need to guess at what constitutes a "new hearing" in the current circumstances as the CFPB Rules clearly outline the procedures for a hearing in a CFPB administrative proceeding. 12 C.F.R. §§ 1081.300 - 1081.306.

Even if Respondents were required to show "good cause" why it is necessary to supplement the record, which they are not, Respondents have done so. First, the resolution of this matter relies upon witness credibility determinations, in particular regarding the personal

liability of Respondent James Carnes. *See Intercollegiate*, 796 F.3d at 126 (upholding the denial of a new evidentiary hearing where the appellant "fail[ed]. . . to point to . . . any portion of the Final Determination that turned on witness credibility"). The prior ALJ denied Enforcement Counsel's motion for summary disposition as to Mr. Carnes' liability, recognizing that the written record did not contain sufficient evidence on this point and that live testimony was needed. Dkt. 111 at 11-12. Then, after the hearing, the prior ALJ explicitly relied on witness credibility determinations to find Mr. Carnes liable, which was necessary given the evidence on the record that, if determined to be credible, disproved Mr. Carnes' liability. *See* Dkt. 176 at 54 ("I have thoroughly considered Mr. Carnes' testimony about his role at Integrity Advance and do not find it fully credible. . ."). The ALJ explained that he assessed witness demeanor in making these credibility determinations. *Id.* at 12-13.

In its response, Enforcement Counsel expresses concern that Respondents seek a "procedural advantage" by calling witnesses whose memories may have faded, without explaining how that would create an advantage for Respondents. Dkt. 263 at 3. However, even at the first proceeding, witnesses testified about conduct that had occurred more than four years beforehand (and in some instances, such as the initial creation of the loan agreement, as many as eight years before), as they were required to do given that the CFPB waited years after the conduct had ended to file charges. That cannot be a reason to now deny Respondents the opportunity to have a fair hearing in which the fact-finder hears and sees the witness testimony for herself.

Additionally, there is relevant evidence not on the current record.[6] In particular, the record is incomplete on the issue of restitution, given developments in the law since the first proceeding. *See CFPB v. CashCall, Inc. et al*, CV 15-07522-JFW, 2018 U.S. Dist. LEXIS 9057 (C.D. Cal. Jan. 19, 2018) (finding that good faith advice of counsel is relevant to determining whether to award restitution). In response, Enforcement Counsel first argues that Respondents must be held to strategic decisions made in the first proceeding, apparently regardless of any changes in the law or other extenuating circumstances, while the CFPB is permitted to change strategy and even revive a claim it previously moved to withdraw with prejudice. Dkt. 263 at 3 n.2; Dkt. 264 at 17, n.11. Enforcement Counsel in effect argues that its prior strategic decision was made based on circumstances while Respondents' strategic decision was "on their own volition" and "their decision alone." Dkt. 263 at 1, 9. That is a false distinction. Strategic decisions are always made based on the circumstances at the time, and Enforcement Counsel was not forced to make its prior strategic decision to withdraw Count IV. Instead, the decision was made "on [its] own volition." There is no meaningful reason to allow Enforcement Counsel to change its strategic decisions (particularly as it relates to withdrawing a claim with prejudice) and limit Respondents to decisions made in the first proceeding, especially where new court decisions make relevant additional issues.

In an effort to avoid the impact of these new court decisions, Enforcement Counsel declares, for the first time, that they are seeking restitution as "legal" rather than "equitable" relief. Dkt. 263 at 9-10; *cf.* Dkt. 162 at 29 ("Enforcement Counsel hereby requests

[6] This includes evidence that was not introduced in the first proceeding because the ALJ determined certain issues on summary disposition (particularly as it relates to Counts I, II, III, V, and VI as to Integrity Advance). Dkt. 111. Enforcement Counsel concedes that certain claims "were not addressed in the prior hearing," and suggests that the ALJ can wait to determine the scope of the new hearing after summary disposition motions. Dkt. 263 at 8, note 7. Enforcement Counsel thus appears to accept that supplemental evidence is necessary where the record is deficient.

the following monetary restitution."). On this basis, Enforcement Counsel asserts that the award of restitution is not discretionary. *Id.* However, no court has ever analyzed restitution under the CFPA in this manner. Instead, the court in *CashCall* held, after a lengthy and detailed analysis, that restitution in CFPA enforcement actions is not appropriate where the CFPB does not establish fraudulent intent. *CashCall*, 2018 U.S. Dist. LEXIS 9057, at *39-41; *see also CFPB v. Nationwide Biweekly Admin., Inc.*, No. 15-cv-02106-RS, 2017 U.S. Dist. LEXIS 145923 (N.D. Cal. Sep. 8, 2017) (finding that the CFPB had not met its burden to show restitution was an appropriate remedy). Further, the *CashCall* court found that reliance on the advice of counsel is relevant to that inquiry. *CashCall*, 2018 U.S. Dist. LEXIS 9057, at *40. While Enforcement Counsel would like to avoid dealing with the decision in *CashCall*, summarily rejecting it as "incorrectly decided" and confident that it will be overturned by the Ninth Circuit, that decision has not been vacated and is persuasive authority that is directly applicable to the circumstances here. Respondents should be afforded the opportunity to present evidence of their good faith reliance on counsel.

Finally, Enforcement Counsel argues that expenses are not relevant to the restitution calculation. Dkt. 263 at 12-14. However, Enforcement Counsel cites to a series of cases that all pre-date the court's decision in *CashCall*. In *CashCall*, the court considered expenses to be relevant to the inquiry. *CashCall*, 2018 U.S. Dist. LEXIS 9057, at *43. Based on the new law, Respondents should be permitted to present evidence on this point.

* * *

For the foregoing reasons, and for the reasons stated in Respondents' Opening Briefs (Dkt. 259; Dkt. 260; Dkt. 261), the ALJ should dismiss this action or, in the alternative, grant Respondents' Motion to Amend and Motion to Open Record for a New Hearing.

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: April 15, 2020

CERTIFICATE OF SERVICE

I hereby certify that on the 15th day of April 2020, I caused a copy of the foregoing Respondents' Consolidated Reply Brief in Support of their Motion to Dismiss, Motion to Amend, and Supplemental Brief in Support of Motion to Open Record for a New Hearing 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.
Deborah.Morris@cfpb.gov

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