UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2015-CFPB-0029

In the Matter of: **INTEGRITY ADVANCE, INC. and JAMES R. CARNES,** **Respondents.**	**RESPONDENTS' BRIEF IN OPPOSITION TO ENFORCEMENT COUNSEL'S MOTION FOR SUMMARY DISPOSITION**

RESPONDENTS' BRIEF IN OPPOSITION TO ENFORCEMENT COUNSEL'S MOTION FOR SUMMARY DISPOSITION

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I. INTRODUCTION AND SUMMARY

Contrary to the claims of the Consumer Financial Protection Bureau ("CFPB"), the undisputed facts of this case do not show that Respondents Integrity Advance, LLC and James R. Carnes ("Respondents") violated the law or operated their business in a deceptive or unfair manner. This is not a case of false or misleading promises. This is not a case of hiding important information from or confusing the consumer. And, this is not a case of fraud. Instead of identifying undisputed facts, the CFPB relies on unsupported speculation, disputed facts, and incorrect legal conclusions – none of which demonstrate that it is entitled to relief.

First, the CFPB has not established that the fee disclosures in the Loan Agreement violated the Truth in Lending Act ("TILA"), nor that they were deceptive or unfair under the Consumer Financial Protection Act ("CFPA"). The Loan Agreement disclosed the parties' legal obligations at the time of the loan – a single payment loan, due on a specific date, that may be renewed for additional fees. There is no requirement that loan disclosures predict post-consummation actions. The CFPB put on no evidence from actual consumers, and ignored the evidence that a high rate of satisfied, repeat customers took out successive loans under the same terms. In fact, the CFPB incorrectly claimed that 99% of loans cost consumers more than the amount disclosed in the Loan Agreement. That assertion is flatly contradicted by its own witness's mathematical analysis, which showed that 31% of loans were repaid in the amount disclosed in the "Total of Payments" or less. Further, the CFPB's reliance on the court's analysis in *AMG* is unavailing as Integrity Advance's Loan Agreement and practices differed in important ways from those at issue in *AMG*. *See FTC v. AMG Servs., Inc.*, 29 F. Supp. 3d 1338 (D. Nev. 2014), *aff'd sub nom. FTC v. AMG Capital Mgmt., LLC*, 910 F.3d 417 (9th Cir. 2018).

Second, the CFPB has not established that the use of remotely created checks ("RCCs") was unfair or that it caused unavoidable injury. Integrity Advance provided its customers with multiple payment options to repay their loans. RCCs, which are a legitimate and lawful payment mechanism, were used sparingly. The CFPB relies on opinion testimony from its expert Dr. Hastak to attempt to show that Integrity Advance's use of RCCs were unfair and caused injury, but that opinion was disputed by Respondents' expert witness and cannot provide the basis for summary disposition.

Third, the CFPB has not established that Integrity Advance violated the Electronic Funds Transfer Act ("EFTA") because the extension of credit was not conditioned on pre-authorization of EFTs. The Loan Agreement expressly provided for multiple payment options, and the CFPB's own evidence shows that consumers were able to receive loans without authorizing or making electronic payments.

Fourth, the CFPB has not established that Mr. Carnes can be held personally liable, as they base their allegations on disputed facts. For example, the CFPB incorrectly alleges that Mr. Carnes supervised everyone who provided services to Integrity Advance and exercised control over all business decisions. The evidence demonstrates that both allegations are wrong. Additionally, the CFPB has not established the type of fraud or misrepresentation that would be required to hold Mr. Carnes individually liable for corporate acts.

Finally, the CFPB's motion to impose its requested remedies as a matter of law should be denied. If there ultimately is a finding of liability, then the ALJ should consider all of the evidence – disputed or undisputed – in crafting appropriate remedies. Indeed, restitution is not appropriate in cases, such as this one, where the CFPB has not established fraud or that consumers did not receive the benefit of their bargain. Further, were restitution to be ordered, the CFPB has failed to present facts to determine an appropriate restitution amount. Injunctive relief also is not appropriate because the CFPB failed to even argue the applicable law – let alone establish by undisputed facts – that it is entitled to such relief. Civil money penalties also should not be awarded, particularly in the maximum amount as requested by the CFPB, given the mitigating factors in Respondents' favor such as their good faith and lack of financial resources.

For all of these reasons, and based on Respondents' Motion for Summary Disposition, the ALJ should deny the CFPB's Motion, grant Respondents' Motion for Summary Disposition, or, in the alternative, hold a hearing so that disputed issues of fact (including credibility determinations) may be resolved.

II. ARGUMENT

A. Integrity Advance accurately disclosed the cost of its loans and thus fully complied with TILA and Regulation Z.

The CFPB contends that Integrity Advance violated TILA because the Loan Agreement "disclosed the costs of [its] loans as if they were single-payment loans" when they "were, in fact, multi-payment installment loans, with a prepayment option." Dkt. 276 at 8. This argument rests on a misreading of the plain terms of the Loan Agreement and attempts to create a heightened standard of disclosure not found in TILA or Regulation Z.

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 reflect the terms of the underlying credit contract and be communicated in a manner that the consumer may read and understand.

As set forth in Respondents' Motion for Summary Disposition, *see* Dkt. 272 at 21-24, that is precisely what Integrity Advance's Loan Agreement did. As required by TILA and Regulation Z, the Loan Agreement accurately disclosed, at the time the loans were made, that the consumer had a legal obligation to pay the loan in full on the Payment Due Date or to set up an alternative payment option, including electing to renew the loan, by contacting Integrity Advance. Dkt. 273 ("Resp'ts' Facts") ¶¶ 12-13. Only when a consumer failed to contact Integrity Advance and otherwise failed to pay his or her loan in full on the Payment Due Date would the loan be automatically renewed. *Id.* ¶ 21 ("If you fail to contact us to confirm your Payment Option at least three (3) business days prior to any Payment Due Date, or otherwise fail to pay the loan in full on any Pay Date, Lender may automatically renew your loan . . . ."). The Loan Agreement clearly and conspicuously disclosed this legal obligation in the TILA Box and in various places throughout the Loan Agreement. *Id.* ¶ 22 (consumers "[p]romise[d] to pay [Integrity Advance] the Total of Payments . . . on the Payment Due Date . . . ." and, contingent on the consumers' choices, "[a]ll other amounts owed to us under the Loan Agreement"); *id.* ¶ 13 ("You must select your payment option at least three (3) business days prior to your Payment Due Date by contacting us at (800) 505-6073."). These disclosures were sufficient to comply with TILA and Regulation Z and, in fact, are presumptively compliant because they follow Regulation Z's model form. *See* Dkt. 272 at 22 (discussing legal safe harbor in Regulation Z).

Despite this, the CFPB seeks to hold Integrity Advance liable for a TILA violation because it claims that Integrity Advance failed to disclose that "customers were ***obligated*** to make a series of payments that were authorized at loan signing." Dkt. 276 at 9 (emphasis added). The CFPB, however, mischaracterizes the nature of the legal obligation at the time of loan consummation.[1] At loan signing, customers were not obligated to renew their loans and thereby make a "series of payments." *Id*. Rather, they were obligated to pay off their loans in full on the Payment Due Date or choose to renew their loans. Resp'ts' Facts ¶¶ 12-13. That obligation was disclosed in the Loan Agreement.

In essence, the CFPB's argument seeks to add into Regulation Z a requirement that a loan agreement must include a disclosure that predicts post-consummation events and incorporate that prediction into any TILA disclosure. But such a reading of Regulation Z is contradicted by the regulation's plain language. Section 1026.17(e) of Regulation Z makes clear that post-disclosure events (such as the renewal of a loan contract after consummation) do not render the initial disclosure inaccurate. *See* 12 C.F.R. § 1026.17(e); *see also Stein v. Titlemax of Ga.*, 2019 U.S. Dist. LEXIS 189993, at *17 (N.D. Ga. July 25, 2019) (noting that "[a]ccurate disclosures do not become TILA violations because they were rendered inaccurate by subsequent events"). Put simply, TILA and Regulation Z do not require new after-the-fact disclosures to be 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").[2]

[1] The CFPB also takes language in Respondents' Answer out of context when it repeatedly asserts that a consumer was required to contact Integrity Advance to "change the terms of the loan." Dkt. 276 at 8 (citing Dkt. 21 ¶ 29). However, as noted earlier in this litigation, Respondents' use of the phrase "change the terms of the loan" was in error and Respondents previously sought, and were denied, the opportunity to amend their Answer to clarify that statement to make their Answer internally consistent. *See* Dkt. 98 (Order denying Respondents' motion for leave to file an amended answer but noting "I have not deemed the language in the Answer as a binding judicial admission"). The ALJ should reject the CFPB's attempt to cherry pick language in Respondents' Answer to suggest that Respondents admitted that the Loan Agreement was misleading. At best, there is a disputed issue as to a material fact that must be resolved at a hearing. To the extent the ALJ is inclined to rely on the purported admissions in Paragraphs 29 and 30 of Respondents' Answer, Respondents renew their Motion to Amend their Answer (Dkt. 83) for the reasons stated here and in the previously-filed Motion.

[2] Requiring a lender to disclose all potential scenarios at the time of loan consummation would hardly be workable in light of the myriad ways that a consumer's obligation could subsequently change, including because: (a) the consumer cancelled the loan; (b) the consumer chose to prepay the loan before the Payment Due Date; (c) the consumer paid the loan in full on their Payment Due Date; (d) the consumer chose to renew the loan; (e) the consumer did not choose a payment option or repay the loan in full as required by the agreement, allowing the loan

The CFPB's reliance on *FTC v. AMG Servs., Inc.*, 29 F. Supp. 3d 1338 (D. Nev. 2014), *aff'd sub nom. FTC v. AMG Capital Mgmt., LLC*, 910 F.3d 417 (9th Cir. 2018), is misplaced. In *AMG*, the court granted summary judgment in favor of the Federal Trade Commission ("FTC"), finding that a payday lender violated the Federal Trade Commission Act and TILA as a matter of law. However, the loan agreement at issue in *AMG* differs in at least four critical respects from the Loan Agreement at issue here.

First, in *AMG*, the court found that the format of the loan agreement "create[d] uncertainty" and "visually prioritize[ed] one half" of the agreement, while "hiding important information—including the provision that makes 'renewal' automatic . . . ." In contrast, here, the Loan Agreement placed the Payment Options, Auto-Renewal, and Auto-Workout sections directly below the TILA Box, demarcated by bold, all-caps headers, and formatted for ease of comprehension by separating these sections into individual paragraphs. *See* Dkt. 274A (Ex. 1 to Zack Decl.) at 2.

Second, in *AMG*, the court found consumers could agree to the loan by clicking four boxes, without needing to read the terms and conditions. Such terms and conditions were provided through hyperlinks that could easily be overlooked by consumers. *AMG*, 29 F. Supp. 3d at 1358 ("[D]efendant's webpage facilitates borrowers not reading Defendants' terms and conditions."). In contrast, the Integrity Advance Loan Agreement required that consumers read through the entire agreement and electronically sign (rather than simply click) in six to eight

to renew automatically (one to four times, creating four repayment scenarios); (f) the consumer's debt was deemed paid in full through a separate agreement with Integrity Advance; (g) the consumer's obligation was negated through bankruptcy proceedings; or (h) any other subsequent occurrence. Such a requirement also would be inconsistent with TILA's intent to balance the need for complete disclosures against the need to avoid "information overload." *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 568 (1980) (internal quotation marks and alterations omitted); *see also* Testimony of Governor Edward M. Gramlich, Regulation Z (Truth in Lending Act), Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, May 17, 2005, *available at* http://www.federalreserve.gov/BoardDocs/Testimony/2005/20050517/default.htm (recognizing that combating "information overload" was a key concern of the Federal Reserve Board when it comprehensively reviewed Regulation Z's implementation of TILA in 2005).

places. Resp'ts' Facts ¶ 6. Moreover, as noted above, the key terms of Integrity Advance's Loan Agreement were set forth in the body of the document, right below the TILA Box, demarcated by bold, all-caps headers, rather than being hidden behind hyperlinks or buried elsewhere in the document. *See* Dkt. 274A (Ex. 1 to Zack Decl.) at 2.

Third, in *AMG*, the court found that the loan note never informed consumers that they would be automatically enrolled in the "renewal" plan. *AMG*, 29 F. Supp. 3d at 1377 ("Neither the TILA box nor the fine print state that borrowers are automatically enrolled in the 'renewal' plan. In fact, the word 'automatic' never appears in the loan note."). In contrast, Integrity Advance's Loan Agreement demarcated the "Auto-Renewal" and Auto-Workout" provisions in bold, all caps font, clearly stating that if a consumer "fail[ed] to contact [Integrity Advance] to confirm [his or her] Payment Option at least three (3) business days prior to any Payment Due Date, or otherwise fail[ed] to pay the loan in full on any Pay Date, [Integrity Advance] may automatically renew [the] loan . . . ." Resp'ts' Facts ¶ 21.

Finally, in *AMG*, consumers could only decline the renewal of the loan "through [a] confusing email-and-hyperlink procedure." *AMG*, 29 F. Supp. 3d at 1361. The *AMG* court found that the lender controlled the consumer's ability to decline the renewal, since it controlled when the email containing the hyperlink was sent. *Id*. In contrast, Integrity Advance's Loan Agreement made clear how customers were to select their payment option, which customers could do simply by calling Integrity Advance at the provided telephone number. Resp'ts' Facts ¶ 13. Additionally, Integrity Advance worked with an experienced third party call center, which called and emailed customers to provide information and answer questions, such as those regarding loan renewal. *Id.* ¶¶ 7-9.

Moreover, additional factual differences between this case and *AMG* further illustrate why summary disposition in favor of the CFPB is not appropriate. In *AMG*, the court highlighted the thousands of consumer complaints that had been lodged against the lender–a staggering ***8,500 complaints***—as well as evidence that approximately 80% of borrowers interviewed by the FTC "complained that Defendants had withdrawn more from their accounts than the loan cost." *AMG*, 29 F. Supp. 3d at 1346, 1362. In contrast, in this case, the CFPB has relied on a handful of consumer complaints[3] and has not adduced evidence from a single consumer who was misled by Integrity Advance's Loan Agreement. *See* Dkt. 277 ("EC Facts") ¶¶ 70-71, 93-94; Resp'ts' Facts ¶ 73. In *AMG*, the FTC presented evidence from the defendant company's own employees "that the loan terms [we]re confusing and should be changed" and that employees knew that customers were confused. *AMG*, 29 F. Supp. 3d at 1362. In contrast, the CFPB has not presented any such evidence here, nor could it, because Integrity Advance had policies to ensure that customers understood their loan terms. Resp'ts' Facts ¶¶ 7-9. Finally, in *AMG*, the court found that the lender trained its employees to mislead consumers. *AMG*, 29 F. Supp. 3d at 1362. In contrast, Integrity Advance used an experienced third party call center to ensure that customers were fully informed, as evidenced by the phone calls and emails sent to customers to answer questions about the loan and its terms, both at the start and throughout the life of the loan. Resp'ts' Facts ¶¶ 7-9. Although the CFPB seeks to challenge this by asserting that "Respondents actually instructed their call representatives explicitly *not* to tell consumers the total costs of the loans during the application process," Dkt. 276 at 14,[4] its argument only

[3] The CFPB seeks to characterize the handful of complaints it has identified as "numerous consumer complaints demonstrating that many consumers were in fact misled about their Integrity Advance loans." Dkt. 276 at 12. A complaint rate of approximately 0.04% can hardly be deemed persuasive, particularly when compared to the astronomical number of consumer complaints in the *AMG* case. *See* Dkt. 101 at 10 n.4.

[4] This assertion by the CFPB is misleading as it attempts to draw negative inferences from the following portion of the call center manual: "It is our policy not to disclose cost information until you apply for a loan. We

underscores the genuine issues of material fact that preclude granting summary disposition in the CFPB's favor. The CFPB has not, and cannot, carry its burden of proving that Integrity Advance violated TILA or Regulation Z.

B. <u>The Loan Agreements were not deceptive.</u>

The CFPB argues that Respondents violated the CFPA as to all loans issued on or after July 21, 2011 because the Loan Agreements were "deceptive on their face." Dkt. 276 at 10-13.[5] The CFPB relies primarily on the Loan Agreements and, secondarily, on the expert testimony of Dr. Manoj Hastak. For the reasons stated in Respondents' Motion for Summary Disposition, *see* Dkt. 272 at 8-14, the ALJ should find that the Loan Agreements were ***not*** deceptive as a matter of law. In the alternative, the ALJ should deny the CFPB's Motion for Summary Disposition because it has failed to establish that a reasonable consumer was likely to be misled by the Loan Agreement and that any alleged deception related to a material fact.

1. <u>Reasonable consumers were not likely to be misled by the Loan Agreement.</u>

To show that the Loan Agreement was deceptive, the CFPB must prove that reasonable consumers were likely to misunderstand the nature, operation, and/or terms of the loan for which they applied and to which they agreed. Moreover, the CFPB must show that a "*reasonable*" consumer would be misled, not merely that the "least sophisticated consumer" would be misled. *See CFPB v. Weltman, Weinberg & Reis Co.,* 2018 U.S. Dist. LEXIS 124630,

provide that information in the loan packet. Should you decide you do not wish to take the loan; you are under no obligation to do so." EC Facts ¶ 63 (relying on EC-EX-078 at 13 (procedures manual)). There are good reasons that lenders do not freely disclose loan costs to non-applicants, particularly in isolation from the rest of the loan terms. However, as the manual states, Integrity Advance provided the cost information during the loan process and loan applicants were not obligated to take out a loan simply because they applied. *Id.*

[5] The CFPB's almost singular reliance on the Loan Agreement contradicts its prior argument in briefing on the statute of limitations issue that the CFPB could not have discovered the alleged violations more than three years prior to the filing of the Notice of Charges. As Respondents noted previously and as preserved here, because the CFPB's claim arises solely from the Loan Agreement, the CFPA's three-year statute of limitations began to run when the CFPB knew or should have known of the alleged violations. *See* Dkt. 239 at 16.

at *6 n.1 (N.D. Ohio July 25, 2018) (noting that the "reasonable person" standard of the CFPA is more stringent than the "least sophisticated consumer" standard used for violations of the Fair Debt Collection Practices Act). The CFPB has not done so, and cannot do so, here.

As discussed above, the Loan Agreement clearly and conspicuously set forth a consumer's legal obligation at the time the loan was made, i.e. a consumer was obligated to pay off the loan in full on the Payment Due Date or, alternatively, to renew the loan. Resp'ts' Facts ¶¶ 12-13. The CFPB has not presented any evidence to show that a reasonable consumer was likely to have misunderstood these terms. The CFPB did not conduct any consumer surveys, nor did it present testimony from a single consumer. *Id.* ¶¶ 24, 73. Further, the CFPB's *own expert witness*, Dr. Manoj Hastak, testified at a deposition that he "didn't talk to any customers, and [he] didn't rely on complaints either." *Id.* ¶ 24. The CFPB instead relies on unsupported speculation and a handful of consumer complaints. But even its own expert discounted reliance on consumer complaints. *Id.* (Dr. Hastak testifying that "the complaints are not representatives of the customers of Integrity Advance, and so they're just a small sampling of individuals who had a problem with Integrity Advance . . ." and were, thus, not "representative in any way" of a "typical consumer"); *see also, e.g.*, *Bennett v. Nationstar Mortg,* LLC, No. CV 15-00165-KD- C, 2015 WL 5294321, at *12 (S.D. Ala. Sept. 8, 2015) (analyzing RESPA's statutory damages requirements and noting that "[s]imply, 'complaints' do not equate to 'noncompliance . . . .'").

Instead, the very mechanics of the Loan Agreement ensured that consumers were required to visually scan through the document before agreeing to its terms. Resp'ts' Facts ¶ 6. A reasonable consumer would have necessarily seen the bolded and/or all-caps terms including the "Special Notice" that highlighted the nature of a payday loan, reducing the possibility that a reasonable consumer would be misled. *See Karakus v. Wells Fargo Bank, N.A.*, 941 F. Supp. 2d

318, 342 (E.D.N.Y. 2013), *adhered to on denial of recon.*, No. 09-CV-4739, 2013 WL 3187055 (E.D.N.Y. June 20, 2013) ("A reasonable consumer is responsible for reading and familiarizing herself with the terms of an agreement she freely enters into. . .").

Moreover, the CFPB's reliance on the *AMG* decision again misses the mark. As discussed above, there are extensive and fundamental differences between the facts of *AMG* and the facts present here. *See supra* Section II.A. Whereas the *AMG* court found that the loan agreement at issue in that case was written, designed, and formatted to be misleading to consumers, the Loan Agreement here utilized short paragraphs, bolded important terms, bolded and all-caps headers, and up to eight signature points to ensure that consumers could review the Loan Agreement efficiently and effectively. *See* Resp'ts' Facts ¶¶ 12-13, 15-21. And, whereas the loan agreement at issue in *AMG* was complicated (*e.g.*, requiring a "convoluted email-and-hyperlink procedure" to "decline" the renewal of the loan), the Loan Agreement here provided a telephone number for customers to select their payment option. *See id.* ¶ 13.

Aside from the CFPB's failure to meet its burden of showing deception as a matter of law, it also ignores at least three key undisputed facts that show that a reasonable consumer would ***not*** have been misled. First, and perhaps most probative, is the undisputed fact that Integrity Advance had a high rate of repeat customers. Indeed, since July 21, 2011, a total of ***26,129*** customers (***48%*** of Integrity Advance customers since July 21, 2011) chose to take out two or more loans. Resp'ts' Facts ¶ 50. And, of the 82,980 loans originated on or after July 21, 2011, ***66%*** of those loans were loans to repeat customers. *Id.* ¶¶ 51-52. Importantly, in order to take out a second loan, a customer was required to fully repay his or her first loan. *Id.* ¶ 48. Therefore, approximately half of Integrity Advance's customers (representing two-thirds of loans) were repeat customers who repaid their initial loans under the Loan Agreement terms, and then chose to take out additional loans under the same terms. Especially in light of the small number of customer complaints, *see id.* ¶ 47, the high rate of repeat customers shows that a ***reasonable*** consumer understood the Loan Agreement.[6]

Second, the undisputed fact that Respondents retained outside counsel to draft the Loan Agreement shows that Respondents intended the loan documents to comply with the law. As explained by former Integrity Advance general counsel Edward Foster, neither he nor Mr. Carnes were "experts in consumer law. So the strategy of the company was to always have highly compensated, highly acknowledged and reputable consumer law counsel, outside counsel, to provide the counsel and guidance on those matters." *Id.* ¶ 40. Mr. Carnes explained that the purpose of hiring legal counsel was to ensure the loan documents conformed with the law. *Id.*

Finally, Respondents provided the Loan Agreement, along with all other requested information, to Delaware regulators during the licensing and renewal process, expecting that it would be reviewed. *Id.* ¶¶ 27, 29, 33, 38. After the Loan Agreement was submitted and reviewed, the Delaware regulator approved Integrity Advance to extend credit and then annually renewed that approval. *Id.* ¶¶ 36, 38. This logically assured Respondents that the Loan Agreement was legally compliant. Respondents transparently provided the Loan Agreement to regulatory authorities and thus did not intend the Loan Agreement to deceive or mislead consumers.

[6] Additionally, the CFPB overstates the evidence from its own data witness, Mr. Hughes, regarding the incident rate of loans repaid above the "Total of Payments." In the introduction to its brief, the CFPB argues that: "only 1% of Integrity Advance's loans were paid off in full in a single payment; the other 99% of loans cost consumers more than the amount disclosed by Integrity Advance." Dkt. 276 at 1; *see also id.* at 4 (repeating statistic and citing Dkt. 87D (Hughes Decl.) ¶ 7). However, the cited paragraph in Mr. Hughes' declaration actually stated: "Respondents' dataset shows that renewed loans (with at least one cleared payment transaction) that paid exactly the amount disclosed in the loan agreement represent only 0.99% of all loans." Dkt. 87D (Hughes Decl.) ¶ 7 (emphasis added). Hughes concluded in this same declaration that: "69% of all loans (including those in which there were no rollovers) paid more than the amount that the company would have disclosed as the total of payments' in the TILA box." *Id.* ¶ 6 (emphasis added). Therefore, 31%, not 1%, of loans were repaid in the amount of the "Total of Payments" disclosure or less. *Id.*

The ALJ should find that the CFPB has failed to show that a reasonable consumer would have been misled by the Loan Agreement as a matter of law.

2. The CFPB has failed to show that the representations at issue relate to a material fact.

The Loan Agreement disclosed all material facts about the loan to customers. Nevertheless, in contravention of well-established law, the CFPB posits that the future "total cost" of a loan, albeit unknown at the time the loan was made, was a material fact that Integrity Advance should have disclosed in its Loan Agreement. In addition to the impossibility of disclosing unknown "total costs," the CFPB's arguments do not support summary disposition.

The CFPB has not established (and cannot establish) that consumers considered the possibility of loan renewals to be "material" to their decision making at the time they entered into the Loan Agreement. For example, the CFPB presented no customer testimony and conducted no survey of what customers might have considered material. Resp'ts' Facts ¶ 24, 73. And, as discussed above, Integrity Advance had a high rate of repeat customers, which shows that the rollover provision was not material to a reasonable consumer's decision to obtain a loan. *See id.* ¶¶ 48-52. The materiality requirement cannot be met here.

The CFPB also cannot establish materiality through reliance on Dr. Hastak's testimony. Dr. Hastak assumed, based on his own "experience and understanding of the kinds of things that consumers typically focus on" that the cost of renewing the loan would be "an important factor" to Integrity Advance consumers, *see* Dkt. 102C (Dr. Hastak Dep. Tr.) at 97:10-17; 99:7-17, without conducting any empirical evaluation to test this assumption. *Id*. at 99:22-100:8; 209:8-16; 208:11-13. Respondents' expert witness, Dr. Novemsky, rebutted Dr. Hastak's conclusion on this issue because Dr. Hastak's report "provides no empirical support for the idea that consumers find [renewal cost disclosures] relevant in the first instance when taking out a loan." Dkt. 274A (Ex. 12; Novemsky Report) at 783, ¶ 13. Further, Dr. Novemsky stated that "renewal costs are neither immediate nor certain" meaning that consumers might not view the renewal costs as material. *See id.* at 787, ¶ 24. As Dr. Novemsky explained, consumer decision making is just as easily driven by immediate costs and benefits, rather than later-in-time issues. *Id.* at 787, ¶¶ 22–24. Dr. Novemsky also cited a study finding that fast and simple access to credit was more important to consumers than the cost of the credit. *Id.* at 784, ¶ 15 (citing E.C. Lawrence & G. Elliehausen, *A comparative analysis of payday loan customers*, Contemporary Econ. Pol'y, 26(2), 299–316) (2008)). At best, these are disputed issues requiring a hearing.

The CFPB cites inapposite case law to support the assertion that "the costs of a loan product are relevant and material to consumers." Dkt. 276 at 11. In *FTC v. Figgie Int'l, Inc.*, the court analyzed then-Federal Rule of Evidence 803(24), which addressed materiality as a question of admissibility, finding that the price of the products at issue was a "material fact." 994 F.2d 595, 608 (9th Cir. 1993). And, in *Steele v. Ford Motor Credit Co.*, the court held that the understatement of a loan's finance charge, based on the lender miscalculating the amount of interest owed by the borrower, was a material non-disclosure *under TILA*. 783 F.2d 1016, 1017, 1019–20 (11th Cir. 1986). "Material disclosure" is a defined term under TILA and Regulation Z. 12 C.F.R. § 1026.23(a)(3)(ii). Neither "material facts" under the evidentiary rules, nor "material disclosures" under TILA are relevant here. The only salient question is what would be material to a reasonable consumer at the time he or she took out a loan from Integrity Advance.

Accordingly, the CFPB cannot meet its burden of showing that the Loan Agreement terms were deceptive. The ALJ should deny the request for summary disposition as to Count III.

C. **Respondents did not engage in any unfair acts or practices nor did they cause substantial injury.**

The CFPB has failed to show that Respondents engaged in unfair acts or practices relating to its Loan Agreement application process or that the Loan Agreement disclosures caused, or were likely to cause, any consumer injury, let alone the type of "substantial injury" required to prove an unfairness claim under the CFPA. Because the unfairness claim is predicated on Integrity Advance's allegedly "deceptive" conduct relating to the disclosure of the costs of its loans, *see* Dkt. 1 ¶ 72, the claim must fail for the same reasons discussed above in Section II.B. Moreover, the CFPB's theory that every single customer who paid more than the "total of payments" presented in the TILA box was deceived is based on nothing but speculation. *See* Resp'ts' Facts ¶¶ 24, 73. But "[m]erely speculative harms" do not suffice to support an unfairness claim. *See Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 972 (D.C. Cir. 1985) (noting that the FTC, in the exercise of its unfairness authority, "is not concerned with trivial or merely speculative harms"); *see also Anderson v. Hannaford Bros. Co.*, 659 F.3d 151, 160 (1st Cir. 2011) (using FTC Act principles to conclude that "[t]he substantial injury requirement is designed to weed out 'trivial or merely speculative harms" (internal quotation and citation omitted)). The CFPB's theory also fails to account for the high rate of repeat customers, which shows that customers got what they bargained for and certainly did not suffer "substantial injury." *See* Resp'ts' Facts ¶¶ 48-52.

Even if the CFPB had shown consumer injury, which it has not, it has failed to show that any such injury was not reasonably avoidable. The Loan Agreement was designed to direct consumers to closely read its terms, and in fact required that a customer sign or initial the document up to eight separate times before receiving a loan. *Id.* ¶ 6. The Loan Agreements set forth multiple ways in which a consumer could have reasonably avoided the alleged harm, such as by repaying the loan on time or by exercising the right to rescind the loan. *Id.* ¶ 13, 19. These characteristics, coupled with the bolded fonts and other elements that alerted consumers to the loan's terms, make any alleged injury "certainly avoidable." *See Davis v. HSBC Bank Nevada, N.A.*, 691 F.3d 1152, 1169 (9th Cir. 2012) (consumers were instructed to read and consent to the terms and conditions of the loans "before completing the application, [which] meant that [they] could have aborted [their] application[s] upon reading the terms and conditions," and therefore were "provided 'the means to avoid' the alleged harm"); *see also* Dkt. 272 at 18 (collecting cases). And, repeat customers could have reasonably avoided the alleged harm by not taking out another loan under the same terms and conditions. Resp'ts' Facts ¶¶ 48-52.

Further, the CFPB incorrectly asserts that "Respondents actually instructed their call representatives explicitly not to tell consumers the total costs of the loans during the application process." Dkt. 276 at 14. As explained *supra* in Footnote 4, the CFPB misconstrues the meaning of the call center manual's instructions regarding what should be said to potential loan applicants. When consumers submitted a loan application, the costs of that loan were not determined until eligibility was verified and the loan was underwritten. For example, if a customer had an outstanding loan with Integrity Advance, the pending loan application would not be approved (and thus cost is irrelevant). If the customer was a returning customer, the cost of the loan would be less than for a new applicant. *See* Dkt. 274A (Ex 2; Carnes Dep. Tr.) at 16, 162:9-24. Thus, the customer had to submit his or her loan application before the costs could be accurately disclosed. Loan applicants were not obligated to accept the loan.

Finally, the CFPB fails to address conflicting evidence regarding another requirement of its unfairness claim – the benefits to consumers of Integrity Advance's loan product. The availability of the loans (and the possibility of renewing those loans) provided substantial consumer benefits, as it increased consumer options. *See FTC v. J.K. Publ'ns, Inc.*, 99 F. Supp. 2d 1176, 1201 (C.D. Cal. 2000) (noting that "an increase in services or benefits to consumers or by benefits to competition" can outweigh adverse consequences to consumers) (citation omitted). As the CFPB has acknowledged, "some consumers provided favorable responses about the speed at which these loans are given, the availability of these loans for some consumers who may not qualify for other credit products, and consumers' ability to use these loans as a way to avoid overdrawing a deposit account or paying a bill late." Resp'ts' Facts ¶ 23.

The ALJ should deny summary disposition on the unfairness claim in Count IV.

D. Integrity Advance's limited use of remotely created checks was not unfair.

Integrity Advance used RCCs in less than one percent of all loans during the post-July 21, 2011 period. Resp'ts' Facts ¶ 58. The decision to use RCCs was made by Integrity Advance's third party call center on a case-by-case basis, and RCCs were used sparingly when efforts to collect amounts owed to Integrity Advance failed. *Id.* ¶¶ 60-61; *id.* ¶ 62. Consumers could stop the RCC process after it had been initiated by informing the Company of an alternative payment method. *Id.* ¶ 67. Integrity Advance clearly and conspicuously set out the terms for the use of RCCs in the Loan Agreement. *See id.* ¶¶ 63-66, 70-72. Although the ALJ should find that summary disposition is warranted in favor of ***Respondents*** based on the undisputed material facts, *see* Dkt. 272 at 20-21, the CFPB has not shown that it is entitled to summary disposition.

First, as the CFPB's own witness, Joseph Baressi, acknowledged, RCCs are, and have been, a lawful payment mechanism. Resp'ts' Facts ¶¶ 56-57.[7] The ALJ should reject the

[7] Reliance by the CFPB on Mr. Baressi's testimony is subject to Respondents' Motion to Strike. *See* Dkt. 153, Resp'ts' Mot. to Strike Test. of Joseph Baressi (Aug. 5, 2016).

CFPB's attempt to treat Integrity Advance's limited use of RCCs as *per se* unlawful.[8] Second, the cases cited by the CFPB are inapposite because those cases involve circumstances in which consumers ***did not authorize*** the use of demand drafts or RCCs. Indeed, those customers had no apparent relationship – contractual or otherwise – with the parties making the alleged demand draft debits. *See, e.g.*, *FTC v. Inc21.com Corp.*, 745 F. Supp. 2d 975, 982 (N.D. Cal. 2010), *aff'd*, 475 F. App'x 106 (9th Cir. 2012) ("The record also demonstrates that individual defendants Roy and John Lin knew that most of their 'customers' were unaware that they were customers. . . most (if not all) of their customers had been fraudulently acquired and were being billed without authorization."). Here, by contrast, Integrity Advance's customers explicitly agreed to the provision authorizing use of RCCs.

Finally, the CFPB is wrong that the use of RCCs caused injury that was not "reasonably avoidable." The Loan Agreement expressly provided an alternative to RCCs; customers could and did, in fact, "provide [Integrity Advance] with another form of payment," including, but not limited to, a cashier's check or money order. *See* Resp'ts' Facts ¶¶ 63-66. Consumers could even stop the RCC process if it had been initiated by informing the Company of an alternative payment method. *Id.* ¶ 67.

The CFPB's arguments to the contrary are unavailing. To begin, the CFPB incorrectly states that Dr. Hastak offered an unrebutted conclusion that the RCC provision was "unlikely to be 'correctly understood' and 'ha[d] the potential to confuse and misdirect borrowers rather than illuminate them.'" Dkt. 276 at 18. In rebutting Dr. Hastak's Report, Respondents' expert, Dr. Novemsky, expressly stated that "there is no data provided about how

[8] The CFPB's citation to an FTC Rule promulgated in December 14, 2015 that banned the use of RCCs in the telemarketing field is a red herring. *See* Dkt. 276 at 16. That Rule would not apply to Integrity Advance if it was still operational as Integrity Advance never engaged in telemarketing sales, and the Rule certainly would not apply retroactively.

many consumers read [the RCC authorization provision,] and there is no empirical analysis provided about what consumers underst[oo]d" from that authorization. *See* Dkt. 274A (Ex.12; Novemsky Report) at 795-796, ¶ 49. In fact, Dr. Novemsky repeatedly testified that in order to opine on how consumers would interpret the RCC authorization provision, he would need to review empirical data, such as a consumer survey, which the CFPB chose not to undertake. *See* Dkt. 87E (Dr. Novemsky Dep. Tr.) at 174:5-175:11. Instead, the CFPB identifies only one potentially relevant consumer complaint that post-dates July 21, 2011. *See* Dkt. 276 at 16-17 (citing Dkt. 88E, Ex. 30 to EC Facts at 69-72). But, as the CFPB's own expert acknowledged, consumer complaints do not equate to violations of the law, particularly a single potentially relevant complaint as opposed to the thousands identified in *AMG*. *See* Resp'ts' Facts ¶ 24.[9]

For these reasons, the CFPB is not entitled to summary disposition on Count VII.

E. <u>Integrity Advance did not violate EFTA.</u>

EFTA provides that "[n]o person may condition the extension of credit to a consumer on such consumer's *repayment* by means of preauthorized electronic fund transfers." 15 U.S.C. § 1693k(a)(1) (emphasis added). The Official Interpretation to Regulation E further states that "[c]reditors may not *require repayment of loans* by electronic means on a preauthorized, recurring basis." 12 C.F.R. § 1005, Supp. I, 1005.10(e)(1) (emphasis added).

In its argument, the CFPB again misreads the plain language of the Loan Agreement. Contrary to its assertion that "the contract [did not] provide alternatives to electronic payments," Dkt. 276 at 25, the Loan Agreement did just that. *See* Resp'ts' Facts ¶ 66 (noting that Integrity Advance customers could pay by personal check, debit card, credit card, Paypal account, Western Union, or MoneyGram). Moreover, the Loan Agreement's ACH

[9] In addition, this complaint, as well as any other complaint that the CFPB seeks to rely on (most of which are roughly eight years old), constitute inadmissible hearsay.

authorization plainly stated that "[y]ou may repay your indebtedness through other means, including by providing timely payment via cashiers check or money order directed to: Integrity Advance, 300 Creek View Road, Suite 102, Newark DE 19711." *Id.* ¶ 63. Indeed, the CFPB itself alleges that 95% of consumers that obtained loans with Integrity Advance signed the ACH authorization, meaning that 5% of consumers received loans without signing the authorization. Dkt. 1 ¶ 41. Additionally, the CFPB introduced evidence from its own employee, Robert Hughes, that 98.5% of initial loan repayments were made by electronic means. Dkt. 87D at 3, ¶ 8. If some percentage of loan recipients *did not* provide Integrity Advance with electronic access to their bank accounts or repay the loan via electronic means, then—by definition—it was not a condition for a loan.

In contrast to Integrity Advance's Loan Agreement, the loan agreement in *FTC v. PayDay Financial LLC*, a case cited by the CFPB (Dkt. 276 at 24), provided that "any loan payment by a consumer '***shall*** be made by us [meaning the defendant lender] effecting one or more ACH debit entries to your Account at the Bank.'" 989 F. Supp. 2d 799, 812 (D.S.D. 2013) (alteration in original) (emphasis added). That distinction is important. EFTA "protect[s] consumers' ability to choose their payment method," *see Kemply v. Cashcall, Inc.*, No. 08-CV-03174-MEJ, 2016 WL 1055251, at *7 (N.D. Cal. Mar. 16, 2016), rather than forcing consumers to repay loans through electronic transfers. Unlike in *PayDay Financial*, Integrity Advance's Loan Agreement gave consumers that choice. *See* Resp'ts' Facts ¶¶ 63-66.

The CFPB's reliance on *Johnson v. Tele-Cash, Inc.*, 82 F. Supp. 2d 264, 277-78 (D. Del. 1999), *rev'd in part on other grounds*, 225 F.3d 366 (3d Cir. 2000), is similarly unavailing. The issue here is not whether "payday loan rollovers are considered preauthorized for purposes of Regulation E," Dkt. 276 at 23, but rather whether Integrity Advance ***required*** consumers to pay back their loans via electronic transfers as a precondition to getting a loan. Integrity Advance did not do so and, thus, did not violate EFTA. The ALJ should deny the CFPB's request for summary disposition as to Count V.

F. <u>James Carnes is not individually liable.</u>

Mr. Carnes has been individually charged with deception and unfairness regarding the fee disclosures in the Loan Agreement (Counts III and IV) and unfairness regarding the use of RCCs (Count VII). The ALJ should deny the CFPB's Motion, and grant Respondents' Motion, for summary disposition as to Mr. Carnes' liability.

As an initial matter, Respondents agree with the CFPB regarding the heightened standard by which an individual, such as Mr. Carnes, may be held liable for alleged corporate acts of either deception or unfairness under the CFPA. *See* Dkt. 276 at 19; *see also CFPB v. Gordon*, 819 F.3d 1179, 1193 (9th Cir. 2016). An individual may only be held liable where:

> (1) he participated directly in the deceptive acts or had the authority to control them; and (2) he had knowledge of the misrepresentations, was recklessly indifferent to the truth or falsity of the misrepresentation, or was aware of a high probability of fraud along with an intentional avoidance of the truth.

Id.

1. <u>The CFPB has not established Mr. Carnes' participation or control over the Loan Agreement terms or use of RCCs</u>

Mr. Carnes was the CEO of Hayfield Investment Partners ("HIP"), which was the parent company of Integrity Advance and approximately thirty other entities, and the *de facto* CEO of Integrity Advance. Resp'ts' Facts ¶¶ 90-92. Based on that role, Mr. Carnes had ultimate authority over Integrity Advance. *Id.* ¶ 101. However, that is not enough to hold Mr. Carnes individually liable. *See Gordon*, 819 F.3d at 1193; *see also FTC v. Freecom Commc'ns*, *Inc.*, 401 F.3d 1192, 1207 (10th Cir. 2005) (analyzing individual liability under the FTC Act and finding "the FTC must show a heightened standard of awareness beyond the authority to control"); *see also CFPB v. Mortgage Law Group, LLP*, 196 F. Supp. 3d 920, 946-947 (W.D. Wis. July 20, 2016), *modified by* 2016 U.S. Dist. LEXIS 192781 (W.D. Wis. Nov. 23, 2016) (granting summary judgment in favor of individual defendant as to allegedly deceptive marketing communications, despite the fact that he was the majority partner with final decision-making authority over the company and actively participated in the company's operations).

In its brief, the CFPB has attempted to show that Mr. Carnes exercised day-to-day management of Integrity Advance, but the "facts" relied upon by the CFPB are disputed. For example, the CFPB claims that "Carnes supervised all individuals who provided services to Integrity Advance." Dkt. 276 at 20 (citing EC Facts ¶¶ 15, 22, 28). That is not the case. The individuals called by the CFPB as witnesses (Edward Foster, Bruce Andonian, Timothy Madsen) testified that they were employed by HIP. Resp'ts' Facts ¶¶ 74, 80, 87, 92. Mr. Carnes led HIP, but there were multiple layers in the chain of command as individuals reported up through management, eventually to Mr. Foster and finally to Mr. Carnes. *See* Dkt. EC Facts ¶ 15 (based on underlying sources at EC-EX-065; EC-EX-068 at 32:4-14; EC-EX-069 at 21:23-22:1-5). It is not accurate to say that Mr. Carnes "supervised" all of these individuals. Additionally, Integrity Advance outsourced certain key functions to experienced third parties. For example, Integrity Advance contracted with a third party call center to administer the loans on a day to day basis, including handling consumer complaints. Resp'ts' Facts ¶¶ 43-45. The employees of the call center did not report to Mr. Carnes, as they were employed by a separate company with its own management. *Id.*; Dkt. 88C (Ex. 3; Carnes Dep. Tr.) at 12:14-13:15. Further, Mr. Carnes did not directly consult with, let alone supervise, the outside counsel that were retained to create Integrity Advance's Loan Agreement. Resp'ts' Facts ¶¶ 41, 99.

The CFPB also asserts that Mr. Carnes "participated in Integrity Advance's day-to-business" and "was an active and engaged manager who exercised control over all business decisions." Dkt. 276 at 20, 22. But the degree of Mr. Carnes' participation is disputed. For example, Mr. Carnes testified that, for the time period at issue, July 21, 2011 to December 2012, he spent only a small minority of his time on Integrity Advance – less than 15%. Resp'ts' Facts ¶¶ 95-96. Finally, the CFPB has not established, as it must, that Mr. Carnes' participation or control extended to the specific terms of the Loan Agreement. Indeed, in its brief, the CFPB asserted merely that "Carnes exercised control over Integrity Advance." Dkt. 276 at 19. The CFPB did not address Mr. Carnes' involvement in the Loan Agreement itself, nor include the Loan Agreement in its list of Mr. Carnes' purported oversight activities. *See id.* at 20. Similarly, the CFPB did not address Mr. Carnes' involvement in or control over the use of RCCs. *Id.* Instead, the facts show that Mr. Carnes did not draft, edit, or substantively review the Loan Agreement, which was created by experienced outside counsel. Resp'ts' Facts ¶¶ 39-41, 97-101. Further, the facts show that the decision regarding the use of RCCs, which were rarely used, was made by the third party call center. *Id.* ¶¶ 60-62.

2. <u>The CFPB has not established the requisite level of knowledge</u>

The CFPB must also establish the second prong of the *Gordon* standard – that Mr. Carnes had the requisite level of knowledge regarding the purportedly deceptive or unfair terms in the Loan Agreement and the purportedly unfair use of RCCs. *See Gordon*, 819 F.3d at 1193. The CFPB must do more than show that Mr. Carnes had knowledge of Integrity Advance's business; it must show that he knew, was recklessly indifferent to, or intentionally avoided knowing that the terms of Loan Agreement were "deceptive" or "unfair" and the use of RCCs was "unfair." *See Mortgage Law Group, LLP*, 196 F. Supp. 3d at 946-947 (granting summary judgment in favor of individual defendant where "there is no evidence that [Defendant] knew or should have known about the content of the [allegedly violative materials]."); *cf. Gordon*, 819 F.3d at 1193 (citing evidence that the individual defendant reviewed, edited, and modified the deceptive materials and was responsible for "assur[ing] that all advertising is legal").

Here, the undisputed facts show that Mr. Carnes was not involved with the Loan Agreement template, and neither drafted nor substantively reviewed it. Resp'ts' Facts ¶¶ 97-99. Integrity Advance retained experienced outside counsel to create the Loan Agreement and ensure that the Loan Agreement complied with the law. *Id.* ¶¶ 40-41. It is further evident that Mr. Carnes understood the Loan Agreement to be lawful, and neither deceptive nor unfair, because he and Integrity Advance provided this Loan Agreement to Delaware regulators. *Id.* ¶¶ 34-38. The Delaware regulators then licensed and annually renewed the license of Integrity Advance to extend credit using the Loan Agreement, which further bolstered Mr. Carnes' understanding that the Loan Agreement was lawful. *Id.* Additionally, an experienced third party call center managed the day to day administration of the Loan Agreement, including the rare decision to use RCCs (which occurred in less than 1% of loans). *Id.* ¶¶ 43-44, 58-62. The CFPB has not shown that Mr. Carnes knew, nor had any reason to know, that their use was unfair.

Accordingly, the CFPB has not shown that Mr. Carnes knew, was recklessly indifferent, or intentionally avoided knowing that the fee disclosures in the Loan Agreement were deceptive or unfair or that the use of RCCs was unfair.

3. The CFPB has not established that the Loan Agreement or use of RCCs amounted to misrepresentation, falsity or fraud

Under the *Gordon* standard, the CFPB also must show that Mr. Carnes had the requisite level of knowledge regarding actual "misrepresentations," "falsity," or "fraud" in the fee disclosures in the Loan Agreement or the use of RCCs. *See Gordon*, 819 F.3d at 1193 (requiring a showing that an individual defendant "had knowledge of the *misrepresentations,* was recklessly indifferent to the truth or *falsity* of the misrepresentation, or was aware of a high probability of *fraud* along with an intentional avoidance of the truth") (emphasis added). Without this showing, individual liability cannot be imposed upon Mr. Carnes.

The CFPB has not presented any facts establishing this type of misrepresentation, falsity, or fraud. The Loan Agreement disclosed the terms of the loan – including the fees for a single payment loan and the option for renewal with additional fees. Resp'ts' Facts ¶¶ 11-22. That information was accurate. At most, the CFPB relies on disputed expert opinion evidence that the fee disclosures and RCC disclosures were not "clear and conspicuous;" however, its expert did not find that the disclosures were false. *Id.* ¶¶ 24-25.[10] Most compelling on this issue, as discussed elsewhere in this brief, are the undisputed facts that show that Mr. Carnes, in good faith, relied upon the work of experienced counsel and transparently provided the Loan Agreement to Delaware regulators. The CFPB has not shown and cannot show that Mr. Carnes had the requisite knowledge of misrepresentations, falsity or fraud, and, therefore, summary disposition must be denied as to Mr. Carnes.

G. <u>Remedies</u>

The CFPB seeks imposition of restitution, injunctive relief, and civil money penalties based on purportedly undisputed facts as a matter of law. Dkt. 276 at 25. However, both restitution and injunctive relief are equitable remedies subject to discretion. *See CFPB v. CashCall, Inc.*, 2018 U.S. Dist. LEXIS 9057, at *35 (C.D. Cal. Jan. 19, 2018) ("[A] Court is not required to award restitution merely because a defendant violates the CFPA."); *see also CFPB v. Siringoringo*, No. 14-01155, 2016 US Dist. LEXIS 4272, at *14 (C.D. Cal 2016) ("[T]he Court reviews a request for permanent injunctive relief under well-established principles of equity.")

[10] This opinion is disputed as Respondents' expert opined that the CFPB's expert used a faulty methodology in reaching his conclusions. Resp'ts' Facts ¶ 26.

(internal quotations omitted). Similarly, the award of civil money penalties requires the evaluation of statutory mitigating factors. *See* 12 U.S.C. § 5565(c)(3). Therefore, given the nature of the requested relief, the ALJ should consider all of the evidence, including facts about which the parties dispute, to ensure that any relief granted is appropriate.[11] *See* 12 U.S.C. § 5565(a) (the ALJ has "jurisdiction to grant *any appropriate* legal or equitable relief") (emphasis added). The CFPB's Motion for Summary Disposition as to remedies should be denied.

1. Restitution should not be granted

a. Restitution is an equitable remedy subject to judicial discretion

The CFPB asserts that it is seeking legal restitution and thus must merely show "legal violations" and "harm to consumers," after which the ALJ is required to award restitution as a matter of law. Dkt. 276 at 25-26. That is legally incorrect.[12] Restitution in CFPA matters is an equitable remedy, subject to the discretion of the ALJ. *See CFPB v. Nationwide Biweekly Admin., Inc.*, No. 15-cv-02106-RS, 2017 U.S. Dist. LEXIS 145923, at *31 (N.D. Cal. Sep. 8, 2017) (denying an award of restitution and finding that "restitution is an equitable remedy, to be applied with as much fairness as feasible"); *see also* 12 U.S.C. § 5565(a) ("The court (or the Bureau, as the case may be) in an action or adjudication proceeding brought under Federal consumer financial law, shall have jurisdiction to grant *any appropriate* legal or equitable relief" which "*may include* . . . restitution.") (emphasis added).

[11] There are certain remedies that are not available to the CFPB as a matter of law, as shown by Respondents in their brief in support of their Motion for Summary Disposition, and the ALJ may grant summary disposition in favor of Respondents as to those remedies. *See, e.g.*, *SEC v. Fisher*, 2012 U.S. Dist. LEXIS 122144, at *40 (N.D. Ill. Aug. 28, 2012) (granting defendant's motion for summary judgment as to the equitable remedies of injunction and director/officer bar). However, if the ALJ seeks to impose any restitution, injunctive relief, or penalties on Respondents, she should consider all facts – including those in dispute – before she orders a remedy.

[12] In addition to being legally incorrect, the CFPB should also be judicially estopped from raising this argument in contradiction to its prior position, which it raises now for the first time to avoid the results of recent district court cases regarding the appropriateness of restitution in CFPA matters. *See New Hampshire v. Maine*, 532 U.S. 742, 749 (2001) (judicial estoppel "generally prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument to prevail in another phase").

The cases cited by the CFPB make clear that restitution in this matter is an equitable rather than a legal remedy, and therefore subject to discretion. For example, in *FTC v. Commerce Planet, Inc.* 815 F.3d 593, 602 (9th Cir. 2016), the court found restitution was an "equitable" rather than "legal" remedy, "even if imposed as a merely personal liability upon the defendant." The CFPB's citation to *Curtis v. Loether* is equally unhelpful to its position. 415 U.S. 189 (1974). There, the Supreme Court found that certain claims for actual and punitive damages, which are inapposite here, triggered the Seventh Amendment right to a jury trial, in contrast to claims for "an equitable remedy, a form of restitution." *Id.* at 197; *see also FTC v. Stefanchik*, 559 F.3d 924, 931 (9th Cir. 2009) (reviewing the lower court's restitution award as a "grant of equitable monetary relief for an abuse of discretion."). Further, many of the key "facts" on which the CFPB relies to show the alleged "legal violations" and "harm to consumers" are in dispute, as shown throughout this brief. Therefore, summary disposition cannot be awarded in favor of the CFPB to award restitution.

b. <u>The CFPB has not established that restitution is appropriate</u>

Instead of being an automatic award, "the CFPB bears the burden of proving that restitution is an appropriate remedy and that the amount of restitution it seeks represents a defendant's unjust gains." *CashCall, Inc.*, 2018 U.S. Dist. LEXIS 9057, at *35. Restitution is not appropriate unless the CFPB establishes that "Defendants intended to defraud consumers or that consumers did not receive the benefit of their bargain." *Id.* at *36-37; *see also Nationwide Biweekly Admin., Inc.,* 2017 U.S. Dist. LEXIS 145923, at *28-29 (finding that restitution was not an appropriate remedy where the CFPB failed to show "that defendants engaged in the type of fraud commonly connoted by the well-worn phrase 'snake oil salesmen'" or that "the [interest minimizer program] never provides a benefit to consumers, or that no fully-informed consumer would ever elect to pay to participate in the program").

The CFPB has not presented undisputed facts, nor even alleged, that Respondents intended to defraud consumers.[13] Instead, the undisputed facts show that Respondents intended to act lawfully, taking the reasonable and prudent steps that would be expected. For example, they worked with a third party call center that was experienced in administering loans. Resp'ts' Facts ¶¶ 43-44. They retained experienced counsel to create the Loan Agreement. *Id.* ¶¶ 40-41. They provided copies of the Loan Agreement to Delaware regulators for review. *Id.* ¶¶ 35-38. After which, the Delaware regulators licensed and annually renewed the license for Integrity Advance to extend credit. *Id.* ¶¶ 27-29. Additionally, there was a high rate of repeat business, which reasonably indicated to Respondents that customers were satisfied with the product. *Id.* ¶¶ 50-52. The undisputed facts support a finding that Respondents did not intend to defraud consumers, and the CFPB has not met its burden to show otherwise.

Similarly, the CFPB has not shown and cannot show that consumers did not receive the benefit of their bargain, or that the Integrity Advance loan "never provides a benefit to consumers, or that no fully-informed consumer would ever elect to pay to participate in the program." *Nationwide Biweekly Admin., Inc.,* 2017 U.S. Dist. LEXIS 145923, at *29. Indeed, two-thirds of Integrity Advance's loans went to repeat customers. Resp'ts' Facts ¶ 52. Therefore, the CFPB cannot show that consumers did not receive the benefit of the bargain or that "no fully-informed consumer would ever elect" to take out a loan with Integrity Advance.

c. <u>The CFPB has not established a restitution amount that reasonably approximates any unjust gains</u>

Even if the CFPB was able to meet its burden to show that restitution is

[13] This also is evident in the fact that the CFPB seeks civil money penalties as a first tier penalty, in which it need not prove Respondents' scienter. *See* 12 U.S.C. § 5565(2)(A) (first tier penalty for "any violation"); *cf.* 12 U.S.C. § 5565(2)(B) and (C) (second tier penalty for one who "recklessly engages in a violation"; third tier penalty for one who "knowingly violates").

appropriate based on undisputed material facts, which it cannot, the CFPB also must show that the amount it seeks "reasonably approximates the defendant's unjust gains." *Gordon*, 819 F.3d at 1195. The CFPB must establish Respondents' "*unjust* gains" not merely their "overall gains." *See FTC v. Verity Int'l, Ltd.*, 443 F.3d 48, 67 (2d Cir. 2006).[14] The burden then shifts to Respondents to show that this amount overstates any "unjust gains." *Gordon*, 819 F.3d at 1195. The CFPB has not shown that it can meet its burden.

In its brief, the CFPB calculates the restitution figure based on the total amount that all of Integrity Advance's customers paid above the amount identified in the "Total of Payments" box on the Loan Agreement, as calculated by its data witness Robert Hughes. Dkt. 276 at 27. Using this method, the CFPB calculates restitution as: $132,580,041.06 for Count I; $38,453,341.62, for Counts II, III, and IV (as subsets of one another and Count I); and $115,024.50 for Count VII (as a subset of Counts I, II, III, and IV). *Id.* at 28-30. However, the CFPB has not matched these figures to actual harm to consumers and has not established that these figures approximate "unjust gains."

The CFPB acknowledges that it must prove that consumers were harmed by Respondents' purportedly violative acts in the amount that it seeks. *See* Dkt. 276 at 26; *see also* Dkt. 1 at 14 (seeking "[r]estitution in an amount to be determined at trial to compensate borrowers who were the victims of Respondents' practices"). But the CFPB has not presented testimony from even a single consumer who was harmed by the Loan Agreement. Instead, the

[14] The CFPB also may approximate "unjust gains" by calculating the "net revenues" tied to consumer harm. *See CashCall*, 2018 U.S. Dist. LEXIS 9057, at *44. However, the CFPB has not attempted to calculate this amount. For example, they have not taken into account Respondents' business expenses. *Id.* at 44 (finding that the CFPB did not meet its burden of establishing a reasonable approximation of "net revenues" where its witness "admitted on cross-examination that he did not believe the CFPB's proposed restitution amount was netted to account for expenses.") As the ALJ has denied Respondents the opportunity to present additional evidence regarding expenses, the record is silent on this issue. Therefore, the CFPB cannot establish Respondents' "net revenues" based on the existing record.

CFPB makes a blanket statement that "where Respondents charged consumers more than was disclosed on Integrity Advance's loan agreements, it is reasonable to calculate consumer loss as the amount paid by consumers in excess of the total payments disclosed by Respondents." Dkt. 276 at 27. But Respondents dispute this assertion. As discussed elsewhere in this brief, the Loan Agreement *did* disclose consumers' legal obligations, and the third party call center explained its terms to consumers. Additionally, return customers already knew the terms of the Loan Agreement so they could not have been harmed by the Loan Agreement's disclosures. Finally, the CFPB has not shown that consumers were harmed by the use of RCCs, which were disclosed in the Loan Agreement and used sparingly.

If the ALJ were to find Respondents liable and restitution were to be granted, any repeat customers should be excluded from the restitution calculation, as they could not have been harmed by the disclosures in the Loan Agreement. *See FTC v. Publrs. Bus. Servs.*, 540 Fed. App'x 555, 558 (9th Cir. 2013) (in determining restitution, courts may consider that "a customer who renewed subscriptions necessarily knew the actual terms of the transaction at the time of renewal"); *see also FTC v. Kuykendall*, 371 F.3d 745, 766 (10th Cir. 2004) (defendants may offset restitution calculation by showing that customers "were wholly satisfied with their purchases and thus suffered no damages"). Using the CFPB's calculation method, but excluding repeat customers, results in a restitution amount of $8,999,964.45 for conduct since July 21, 2011, which is approximately 5% of the amount that the CFPB is seeking. *See* EC-EX-102 (CFPB's analysis of First Time and One-Time Loans; attached as Ex. 1 hereto).[15] Although there is still no evidence that one-time loan recipients were harmed by the Loan Agreement, this

[15] For all loans, not limited by time period, this amount is $39,918,716.68. EC-EX-102.

calculation at least excludes those customers for whom there is affirmative evidence that they were satisfied with the loan terms and chose to take out additional loans under the same terms.

d. The CFPB cannot recover for conduct prior to July 21, 2011

The CFPB is seeking restitution and other remedies pursuant to its enforcement authority established in the Dodd-Frank Act. *See* Dkt. 1 at 14 ("Wherefore, as permitted by 12 U.S.C. § 5565 et seq., the Bureau requests an Order granting . . .Restitution"). This authority is expressly limited to conduct occurring on or after the effective date of the CFPA, on July 21, 2011. *See* 12 U.S.C. § 5561 ("[t]his subtitle shall take effect on the designated transfer date" which was July 21, 2011); *see also Hughes Aircraft Co. v. U.S. ex rel. Schumer*, 520 U.S. 939, 946 (1997) (applying the principle that "the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place") (internal citation omitted).

The CFPB has acknowledged this restriction, in part, by agreeing that it is not seeking restitution for its CFPA claims (Counts II, III, IV, and VII) for conduct prior to July 21, 2011. Dkt. 276 at 28-29. However, without any explanation of its purported authority to do so, the CFPB does seek restitution for its TILA claim (Count I) for conduct dating back to 2008, years before the agency or its enabling statute existed. The CFPB's attempt to impose retroactive liability violates due process provisions within the Constitution that "protect[] the interests in fair notice and repose that may be compromised by retroactive legislation." *Landgraf v. USI Film Prods*., 511 U.S. 244, 266 (1994). As the Supreme Court explained, "[a] statement that a statute will become effective on a certain date does not even arguably suggest that it has any application to conduct that occurred at an earlier date." *Id.* at 257.

The CFPB does not provide a justification for its purported authority in its brief. But, the CFPB has previously argued that it may rely upon the FTC's authority to regulate TILA established under the FTC Act, pre-dating the CFPA. *See* Dkt. 162 at 38. However, the FTC has *never* had authority to obtain equitable monetary relief in administrative hearings. *See Heater v. FTC*, 503 F.2d 321, 326–27 (9th Cir. 1974) (finding that the FTC is statutorily limited to the remedy of prospective injunctive relief in its administrative setting). Therefore, there is no such authority for the CFPB to rely on to seek monetary relief in an administrative proceeding for conduct that pre-dates the CFPA. Further, the CFPB cannot exercise authority under the FTC Act because the FTC Act was expressly excluded from the definition of "federal consumer financial law," which the CFPB has authority to enforce. *See* 12 U.S.C. § 5481(14). Therefore, the CFPB cannot rely on the FTC Act as justification to seek relief, and any restitution awarded under the TILA claim must be limited to conduct after July 21, 2011.

2. Injunctive relief should not be granted

The CFPB also seeks certain forms of injunctive relief as a matter of law. However, before the ALJ grants *any* remedy, which includes injunctive relief, she should consider all of the evidence – including facts that are in dispute.

For injunctive relief sought under the CFPA, "the Court reviews a request for permanent injunctive relief under 'well-established principles of equity.'" *Siringoringo*, 2016 US Dist. LEXIS 4272, at *14 (quoting *eBay, Inc. v. MercExchange, LLC*, 547 U.S. 388, 391 (2006)). Therefore, the CFPB must demonstrate "(1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction." *Id.* at *14-15.

In its Motion for Summary Disposition, the CFPB does not address even one of these factors to show that it is entitled to injunctive relief. Dkt. 276 at 30. Further, the CFPB does not attempt to root its request in any evidence or factual support (much less undisputed facts). *Id.* The CFPB merely asserts without citing to any facts that there is "potential" harm based on "any efforts to collect outstanding consumer debt" or the "furnishing of derogatory information to consumer reporting agencies." *Id.* This is mere speculation and is not sufficient to meet the CFPB's burden to demonstrate irreparable harm or to justify injunctive relief. *See, e.g., S.J.W. v. Lee's Summit R-7 Sch. Dist.*, 696 F.3d 771, 779 (8th Cir. 2012) ("Speculative harm does not support a preliminary injunction."). The CFPB cites to no evidence that these "potential" events are occurring, and there is no basis to grant injunctive relief in this regard.

Even further removed from any factual support, the CFPB seeks to enjoin Respondents from "committing any future violations of Federal consumer financial laws." Dkt. 276 at 30. However, Integrity Advance stopped offering loans nearly eight years ago, in December 2012, and its assets were sold to another company. Resp'ts' Facts ¶¶ 3, 4. Further, there have been no loan payment transactions since July 2013. Dkt. 276 at 3; EC Facts ¶ 2. The CFPB has not alleged that Respondents have committed any additional violations since that time, and the CFPB offers no basis to conclude (much less establish as a matter of law by undisputed facts) that either Mr. Carnes or Integrity Advance will commit "any future violations." Instead, Respondents are legally prohibited from violating consumer financial laws, just like anyone else, without the need for a permanent injunction. The CFPB cannot demonstrate that injunctive relief is warranted, and its Motion should be denied.

3. Civil Money Penalties should not be granted

In addition to seeking permanent injunctive relief and over $100 million in restitution, the CFPB seeks triple civil money penalties ("CMPs") (for three "practices") in the maximum amount of the First Tier, as a matter of law. Dkt. 276 at 30-31. Again, the CFPB's Motion should be denied because it cannot establish that CMPs, particularly in the amount requested, are appropriate as a matter of law based on undisputed facts.

The CFPB requests the maximum penalty available to it, under the First Tier CMPs. *Id.*; *see* 12 U.S.C. § 5565(c)(2)(A) ("For any violation of law . . . a civil penalty *may not exceed* $5,000 for each day during which such violation . . . continues.") (emphasis added). However, under the CFPA, the ALJ *must* consider statutory mitigating factors:

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

12 U.S.C. § 5565(c)(3). Because many of these mitigating factors are present in this case, the CFPB cannot establish that the maximum penalty is appropriate based on undisputed facts.

In its brief, the CFPB purports to address these factors. Dkt. 276 at 32-24. However, in addressing the first factor, the CFPB concedes that Integrity Advance does not have financial resources. *Id*. at 32. Regarding Mr. Carnes, the brief cites to financial information from nearly a decade ago (2010-2012) and does not present any current information. *Id*. Indeed, especially given the exorbitant restitution award that the CFPB seeks, neither Integrity Advance nor Mr. Carnes would have *any* financial resources with which to pay CMPs. Further, the CFPB ignores the second part of the first factor – discussing "financial resources" but omitting "good faith of the person charged." *Id.* at 32-33; 12 U.S.C. § 5565(c)(3)(A). The facts show that Respondents acted in good faith, for the reasons discussed throughout this brief, and the CFPB cannot establish otherwise. In light of Respondents' good faith and lack financial resources, the ALJ should not award CMPs or should significantly reduce the amount. Additionally, the lack of any history of violations of federal consumer laws, or any new violations in the years since Respondents ceased operating, show that CMPs are not warranted or should be greatly mitigated.

In addition to requesting the maximum penalty three times over, the CFPB requests this penalty for every day from July 21, 2011, the effective date of the CFPA, until July 9, 2013. Dkt. 276 at 31. Though the CFPB does not explain why it believes this is the relevant time period, it appears to rely on the last transaction date of July 9, 2013 as the ending point. EC Facts ¶ 3. However, the parties agree that Integrity Advance ceased offering loans in December 2012, Resp'ts' Facts ¶ 4; EC Facts ¶ 3, and Respondents could not have committed any violations after they ceased offering loans.

The CFPB has alleged that the violations occurred within the disclosures in the Loan Agreement itself. This is apparent in its Notice of Charges and throughout its brief in support of its Motion for Summary Disposition. Therefore, the allegedly violative acts would have occurred *at the time the loans were offered,* so December 2012 is the outer limit of the possible timeframe.[16] Nor can this time period be extended because of any alleged continuing harm as a result of the disclosures in the Loan Agreement. As the Supreme Court has acknowledged, the continuing effect of a past violation does not create a new violation. *See Ledbetter v. Goodyear Tire & Rubber Co*., 550 U.S. 618, 625 (2007), *overturned on other grounds by* Pub. L. 111-2, 123 Stat 5 (Jan. 29, 2009) (finding that the ongoing impact of past acts of discrimination did not create a new violation). The CFPB's motion for the imposition of CMPs should be denied.

III. <u>CONCLUSION</u>

For the foregoing reasons, the ALJ should deny the CFPB's Motion for Summary Disposition in its entirety.

[16] To the degree that the CFPB asserts that each use of RCCs is a violation (Count VII), it has not identified the days or number of days on which RCCs were used. Therefore, the CFPB has not established the amount of CMPs applicable to Count VII, and that request for CMPs as to Count VII should be denied.

Dated: June 4, 2020

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 4th day of June 2020, I caused a copy of the foregoing Respondents' Brief in Opposition to Enforcement Counsel's Motion for Summary Disposition 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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