Modern Consumer Law

Katherine M. Porter

Part Four. The Deal Goes Awry: Enforcement

Assignment 21. Creditor Remedies

Consumer law is concerned with regulating how businesses attract consumers to deals (Part 2 of this book) and the substantive laws regulating those deals (Part 3). Most of the time, consumers and businesses engage in positive ways. Consumers get goods or services that they desire, and in return, businesses get money from consumers. When deals go awry, however, both parties look to law for remedies. Part 4 of this book considers how businesses and consumers can enforce consumer rights.

A central theme is that enforcement is perhaps the most vexing issue in consumer protection (yes, even worse than designing effective disclosures or writing clear regulations). The disparities between businesses and consumers that prompt the law to protect consumers and to impose duties on businesses are equally present in the enforcement context. Businesses have more resources to spend to learn about the law and have more experience in enforcement. But without enforcement, consumer protections are of little value to people.

It matters dramatically to the design of the remedies whether the business or consumer is more likely to be the party that files the lawsuit. Businesses and consumers have different perspectives on the availability of self-help remedies, the standard for class actions, statutory damages, and attorneys' fees for prevailing parties. These are key issues in designing an enforcement scheme.

This first enforcement Assignment focuses on consumer credit. In this context, businesses file the vast majority of lawsuits or initiate other legal remedies. They do so to collect unpaid debts. Just as consumer credit transactions are an enormous part of the body of substantive consumer law, the rules governing the enforcement for debt collection are among the most widely used laws in America. The Federal Reserve estimates that 14 percent of consumers were contacted by a third-party (not the original creditor) debt collector in 2010. Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit* (Feb. 2012), http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q42011.pdf. This is double the rate from a decade before. The foreclosure crisis also has sharpened awareness of the policy consequences of debt collection law. With the system facing new pressures, both creditors and debtors are pushing to revisit collection remedies, which are some of the oldest consumer laws on the books. Our study starts with creditors' remedies, in part because most debtors' rights are framed as protective from abuse of these remedies.

As a preliminary note, remember that there must be a default before the creditor can validly take collection action. The loan agreement will typically define default but a creditor may wait until the default is "serious" in its estimation before it begins formal legal collection. Missing even one payment, however, is likely to bring about at least a collection letter. One key provision related to defaults is an acceleration clause. This language allows the creditor to make the entire amount of the debt due and owing upon a default. Without this language, the creditor would have to sue each month (or other repayment date) to get the next payment from the consumer. Acceleration clauses are efficient for creditors and the courts but they also magnify the consequences of a missed payment for a consumer. In many instances, focused as they are on getting paid and keeping accounts in good status, creditors will allow a debtor to cure the default by making any missed payments, reinstating the prior loan payment schedule and de-accelerating the balance due.

A. Collecting Unsecured Debts

Debts come in two basic flavors: unsecured and secured. Secured debts are those for which the creditor has the right to look to specific property to be paid in the event of a default. Mortgages, auto loans, and tax liens are examples of secured debts. Unsecured debts are those for which the creditor does not have collateral or a remedy in specific property. Medical debts, credit card debts, and student loans are examples of unsecured debts. By dollar volume, secured debts are large on consumers' balance sheets. By number, unsecured debts predominate.

Unsecured and secured debts usually are collected using different techniques. Secured creditors, however, have the best of both worlds. They can use their special remedies—trying to be paid from the property associated with the debt—or they can use the remedies of unsecured creditors. The law also provides mechanisms that allow unsecured debt to be transformed into secured debts, if the creditor is willing to take the required legal steps.

The unsecured framework is common to both types of creditors and is more likely to be familiar to you from your study of civil procedure than the specialized rules for secured debts. We start there.

1. Lawsuits

When a consumer defaults on an unsecured debt, the creditor does not have any property that is specifically pledged or linked to that debt. Instead, the creditor must begin by obtaining a judgment. (Usually, of course, the creditor will try non-legal mechanism such as phone calls, letters, or hiring a debt collection agency first. The issues raised by these practices are the subject of Assignment 22.)

A judgment is the outcome of litigation. A debt collection lawsuit follows the usual rules of civil procedure. A complaint is filed, and the consumer has the opportunity to answer. There may be discovery, settlement, summary judgment motions, and the like. Ultimately, a trial will be held if needed. For debt collection, however, trials are extraordinarily rare. In fact, it appears that most lawsuits involve no response from consumers at all. Creditors simply obtain default judgments and proceed directly to collecting the judgment. The reality of debt collection lawsuits strays far from the ideals of fact-finding and weighty adjudication on the merits.

One major factor in such lawsuits is the procedural rules of the court hearing the case. Some states permit debt collections to proceed in small claims courts. The small claims process has fewer rules and requirements for plaintiffs to bring cases but it also means that defendants have fewer protections and opportunities to contest the dispute. Originally small claims courts were designed to aid non-lawyers in resolving minor disputes between each other. Today their primary users are collection agencies. Small claims court is a boon for creditors because the debt collectors nearly always hire lawyers to represent them as plaintiffs. The lawyers enjoy the speedy and streamlined process as they pursue consumers who may have less judicial involvement, time, or hurdles to contest the dispute. A Boston Globe investigation concluded that in Massachusetts, "The 'people's court' has become the collectors' court.…Debtors often feel intimidated in this arena, and with reason. The system is tilted against them." Beth Healy, *Dignity Faces a Steamroller*, THE BOSTON GLOBE, (July 31, 2006), http://www.boston.com/news/special/spotlight_debt/part2/page1.html.

Another procedural issue for collection cases is the evidentiary burden needed to file a complaint and obtain a default judgment. Debts are often many years old at the time of a lawsuit. The debts may have been sold by the original creditor at the time of origination or assigned to a debt collector upon default. Either way, the creditor may have only limited documentation to support the alleged debt. Because debtors frequently do not appear, the result is that creditors can file and win a judgment with only bare factual assertions. In jurisdictions that do require affidavits in support of complaints or motions for summary judgment, some consumer advocates believe that the affiants frequently lack a basis for knowing the stated facts or that such affidavits are mass-produced without the requisite knowledge.

Obtaining a judgment is frequently easy for a business and a frightening experience for a consumer. In addition to problems learning of the lawsuit or showing up to defend it, consumers often believe wrongly that they must immediately and voluntarily pay a judgment. The judgment does have immediate consequences for the consumer's credit report, where it will appear for seven years as adverse information (see Assignment 7).

2. Execution and Garnishment

A judgment is, in the most concrete sense, merely a piece of paper. It does not itself magically transform into paper currency that can be used to repay the creditor's debt. The process for using a judgment to locate and levy on debtors' property is generally called "execution." The creditor, now referred to as the judgment creditor, issues a writ of execution to a public officer. A writ is a document directing someone to do something, in this case, to go out and levy on the judgment debtor's property. When that levy occurs, a lien on the property at issue is created in favor of the judgment creditor. The creditor can then initiate further processes to have that property sold and the proceeds applied toward paying the judgment. The two-step judgment and execution process, if successful, essentially turns unsecured creditors into secured creditors, able to look to specific property for payment. While levy seems straightforward, this classic case illustrates the importance of getting it right. With a deadbeat debtor, there are often other creditors attempting to get paid from the same property.

Credit Bureau of Broken Bow, Inc. v. Moninger

284 N.W.2d (Neb. 1979)

BRODKEY, Justice.

This is an appeal from an order of the District Court for Custer County which affirmed a judgment entered by the county court of Custer County awarding the proceeds from a sheriff's sale of a 1975 Ford pickup truck.…The Credit Bureau of Broken Bow, Inc. (hereinafter referred to as Bureau) obtained a default judgment against John Moninger (hereinafter referred to as Moninger) in the amount of $1,518.27 on October 20, 1977. No appeal was taken from this judgment.…On June 27, 1978, at the request of the Bureau, a writ of execution was issued on its judgment in the amount of $1,338.50, the balance remaining due on the judgment.

The deputy county sheriff who received the writ examined the motor vehicle title records on July 7, 1978, to determine if a lien existed as of that date on the pickup owned by Moninger. Finding no encumbrance of record, the deputy sheriff proceeded to Moninger's place of employment to levy on the vehicle. The deputy sheriff found Moninger, served him with a copy of the writ, and informed Moninger that he was executing on the pickup. Moninger testified he informed the officer that there was money borrowed from the Bank against the pickup, and that the Bank had title to the vehicle. Following this conversation, the officer proceeded to the vehicle, "grabbed ahold of the pickup," and stated: "I execute on the pickup for the County of Custer." The officer did not take possession of the vehicle at that time, nor did he ask for the keys to the vehicle.

On July 10, 1978, after being informed of the events which occurred on the 7th, the [State] Bank and Moninger executed a security agreement on the vehicle which was then filed. Notation of the security interest was made on the title to the pickup truck that same day. The vehicle was seized by deputy sheriffs on July 13, 1978, and sold at sheriff's sale on August 14, 1978, for $2,050.

The sheriff filed a motion in the county court for a determination of the division of the proceeds from the sheriff's sale. The Bank joined the action by application for the proceeds of the sheriff's sale, basing its claim on its alleged status as a secured creditor. Prior to a hearing on these matters, a stipulation was entered into by all parties whereby this dispute was limited to the distribution of the proceeds of the sheriff's sale, the pickup having previously been sold.

...

The Bureau first assigns as error the ruling of the trial court which found the Bank's security interest in the vehicle to be superior to the execution lien of the

Bureau. Specifically, the Bureau contends that the actions of the deputy sheriff on July 7, 1978, amounted to a valid levy which bound the vehicle for the satisfaction of the Bureau's judgment against Moninger. §25-1504, R.R.S. 1943. On that date, the Bank held only an unperfected security interest in the vehicle. The Bureau contends that since the levy of execution made the Bureau a lien creditor, and since the lien creditor has an interest superior to that of an unperfected secured party, the trial court was in error in ruling that the Bank had a superior interest in the proceeds.

In effect, the Bureau is relying on section 9-301, U.C.C. [ED. NOTE—now §9-317.], which relates to the relative priorities as between unperfected security interests and lien creditors. "[A]n unperfected security interest is subordinate to the rights of…a person who becomes a lien creditor without knowledge of the security interest and before it is perfected." §9-301(1)(b), U.C.C. The correctness of the Bureau's position turns on two issues: (1) Whether the Bureau was in fact a lien creditor on July 7, 1978; and (2) whether the Bureau was a lien creditor without knowledge of the Bank's alleged security interest prior to the perfection of such interest by the Bank.

From an examination of the record, we conclude that the Bureau was a lien creditor on July 7, 1978. Section 9-301, U.C.C., defines a lien creditor as "a creditor who has acquired a lien on the property involved by attachment, levy or the like.…" A lien on personal property is acquired in this state at the time it is "seized in execution." §25-1504, R.R.S. 1943. Therefore, the Bureau became a lien creditor within the meaning of section 9-301, U.C.C., when the sheriff levied on the vehicle.

The rule by which to test the validity of a levy has been earlier set out by this court. "'A manual interference with chattels is not essential to a valid levy thereon. It is sufficient if the property is present and subject for the time being to the control of the officer holding the writ, and that he in express terms asserts his dominion over it by virtue of such writ.'" Battle Creek Valley Bank v. First Nat. Bank of Madison, 62 Neb. 825, 88 N.W. 145 (1909). We believe a review of the record makes it clear that a valid levy did occur before the Bank had perfected its security interest in the chattel.

The deputy sheriff expressly asserted his dominion over the vehicle by virtue of the writ. He likewise exerted control over the vehicle as against all others at the time of levy. At that time the deputy sheriff informed Moninger that he was sorry that he had to execute on the vehicle but that it was his job. He further stated that he hoped Moninger would straighten the problem out with the Bureau. It should be noted that the officer's report, as well as the return on the writ, clearly indicated that the officer "executed" on the vehicle on July 7, 1978. On the basis of this evidence, we conclude that a valid levy took place at that time.

The Bank would have us hold that the pickup should have been physically seized to make the levy valid. We do not believe that failure to take physical possession in this case goes to the validity of the levy. The deputy sheriff did all that was required by the laws of this state with regard to levying under a writ of execution. Whether or not the officer took physical possession after he levied relates to the ability of the officer to produce the property levied on, and to his possible civil liability for failure to do so, not to the validity of the levy. It is, of course, possible that the failure of a levying officer to protect and preserve the property levied upon might give rise to an action between the officer, or his bonding company, and the judgment creditor. In this connection see 33 C.J.S., Executions, §97, p. 245. We therefore reject the

Bank's contention and conclude that the Bureau was a lien creditor on July 7, 1978, by virtue of the deputy sheriff's levy on the writ of execution.

...

Reversed and remanded.

Garnishment is a variation on execution in which the creditor asks a third party to the dispute to pay over money or property in which the debtor has an interest. A writ of garnishment is issued to the third party, most typically an employer or a bank. This party, now a "garnishee," must answer the writ by answering a set of questions about its relationship with the debtors' property. The writ then commands the garnishee to pay the money or turn over the property to the garnishor—the judgment creditor. Procedures exist to give notice of the garnishment to the judgment debtor and to permit the garnishor or judgment debtor to raise defenses. Those defenses usually do not include attacking the underlying validity of the judgment, meaning that even default judgments obtained with minimal procedure, put consumers at the risk of lost wages. The debtor protections against execution and garnishment are the subject of the next assignment. For now, remember that they give creditors tremendous leverage in dunning, even without resort to the actual remedies.

B. Collecting Secured Debts

Creditors have a number of remedies to deploy when payment is not forthcoming. One major factor is the amount of the debt; it simply is not cost effective to garnish someone for a very small amount, for example. Less comfortably, collection tactics also probably vary based on the collector's assessment of the debtor's class status and education level, in some part because these correlate with the likelihood of the consumer complaining to a regulator or exercising their rights. The biggest distinction in debt collection, however, is that between secured creditors and unsecured creditors. Being a secured creditor is so fabulous that law students endure entire courses on how to create and enforce security interests. *See generally* Robert Lawless, Lynn LoPucki & Elizabeth Warren, SECURED CREDIT: A SYSTEMS APPROACH (7th ed. 2011).

For personal property security interests, Article 9 of the Uniform Commercial Code gives the applicable rules, including for collection. For real property mortgages, the rules come from non-uniform state law. In fact, foreclosure is one of the most varied areas of consumer law.

1. Repossession

As with unsecured creditors, a default that gives rise to remedies is defined in the loan contract. With consumer contracts, the triggering event for a collection effort is nearly always failure to make one or more payments. Another possibility, however, is the consumer's failure to protect the collateral, such as by letting its insurance lapse or misusing it in a way that could diminish its value.

Secured creditors rely on their collateral to improve the chances that they are repaid. If the debtor defaults on the debt, the secured creditor may repossess the collateral. Taking possession of the debtor's property tends to have a "focusing effect" for the consumer on the need to comply with payment obligations, especially if that car was how the consumer planned to get to work tomorrow. Because secured creditors will look to the collateral to be repaid, they try to keep track of it. In the case of auto loans to high-risk consumers, the dealer may even get the consumer to agree to the installation of a GPS device. Barring that, some dealers install mechanisms so that they can lock the car's ignition remotely.

Tradesfolk specializing in repossession are a colorful lot called "repo men." The task is part demographer and part psychological profiler, trying to anticipate what kind of person and attitude might greet the repo man at work. Repo men describe guns on the front seat as a warning to stay away, dogs chained to the bumpers, vehicles parked in the neighbor's garage. Just as for used cars, there are repossession agents for other types of collateral. And the bigger they are, the harder they fall.

> It was snowing hard when the bank called Nick Popovich. They needed to grab a Gulfstream in South Carolina now. Not tomorrow. Tonight.
>
> All commercial and private planes were grounded, but Nick Popovich wasn't one to turn down a job. So he waited for the storm to clear long enough to charter a Hawker jet from Chicago into South Carolina. There was just one detail: No one had told Popovich about the heavily armed white supremacist militia that would be guarding the aircraft when he arrived.
>
> But then again, no one had told the militia about Popovich, a brawny and intimidating man who has been jailed and shot at and has faced down more angry men than a prison warden. When Popovich and two of his colleagues arrived that evening at a South Carolina airfield, they were met by a bunch of nasty-looking thugs with cocked shotguns. "They had someone in the parking lot with binoculars," Popovich says, recalling the incident. "When we went to grab the plane, one of them came out with his weapon drawn and tells us we better get out of there." Undeterred, Popovich continued toward the plane until he felt a gun resting on his temple.
>
> "You move another inch and I'll blow your fucking head off," the gravel-and-nicotine voice told Popovich.
>
> "Well, you better go ahead and shoot, 'cause I'm grabbing that plane."
>
> A shot was discharged in the air.
>
> The gravel-and-nicotine voice again. "I'm not kidding."
>
> "Then do it already."
>
> Popovich's first rule of firearms is pretty simple: The man who tells you he's going to shoot you will not shoot you. So without so much as looking back, he got on the plane and flew it right to Chicago. "My job is to grab that plane," Popovich says. "And if you haven't paid for it, then it's mine. And I don't like to lose."
>
> Nick Popovich is a repo man, but not the kind that spirits away Hyundais from suburban driveways. Popovich is a super repo man, one of a handful of

> specialists who get the call when a bank wants back its Gulfstream II jet from, say, a small army of neo-Nazi freaks.

Marc Weingarten, *The Learjet Repo Man*, SALON.COM (Jun. 6, 2009), http://www.salon.com/2009/06/06/lear_jet_repo_man.

The foregoing excerpt demonstrates why secured status of a creditor is so important. If you are behind on your Visa bill, and Visa sends some guy to take your car to "square things up," that's called theft. But if you get behind on your auto loan and some guy takes your car, that's called repossession. It is the ultimate creditor self-help remedy and is almost entirely outside the judicial process. Given this extra-judicial nature and high-friction environment, U.C.C. §9-609 codifies the common law rule that prohibits a repossessor from committing a "breach of the peace." The case law is all over the place on what constitutes a breach of the peace, and the fact patterns are, shall we say, memorable. Generally, the standard is permissive; a repossession agent cannot use fists, weapons, or otherwise threaten violence. Telling lies or entering someone's driveway is fair game. A threat by the *debtor* to breach the peace (for example, by pulling a gun when she sees the tow truck) means the creditor has a duty to back off, even though the debtor is the party stirring up trouble.

Repossession is a rough and tumble world. If the secured creditor cannot stomach such brusquerie, it can invoke the formal legal process by using its secured status to seek a writ of replevin or sequestration, which ends with the sheriff taking the property. Keep in mind that repossession is about "possession." In the context of real property, the process to get possession is called eviction. That means legally dispossessing whomever is living there, be he an owner or tenant or squatter or great-uncle Gerald. Repossession is not about ownership. To get title to the property, the creditor will have to take additional steps.

2. Foreclosure

Foreclosure is the name given to extinguishing a security interest and allowing the creditor to look to the collateral for recovery. While the term is used most frequently with regard to real property, there are analogous procedures for personal property in Article 9 of the Uniform Commercial Code. The legal concept is the same; the debtor no longer owns the property and the creditor can recover from the property's value. The biggest difference is the degree of formality required to foreclose. Under Article 9, creditors can sell collateral in a private sale as long as all aspects of the sale (advertising, bidding, etc.) are "commercially reasonable." U.C.C. §9-610.

The process is quick and driven by creditor preference. In the context of cars, for example, the lender could sell the car to a wholesaler in cash after allowing only a short period to elapse. The law does require notice to the consumer of the disposition, U.C.C. §9-614, and provides special protections to consumers if the creditor proposes to retain the collateral in satisfaction of the debt. U.C.C. §9-620. The logic is that without a sale to determine the value of the collateral, a creditor could pronounce the collateral to be nearly or entirely worthless and then sue the consumer on the debt to get a judgment. The effect, if the collateral had value, would be to boost the creditor's recovery beyond the amount of the debt. While this is a theoretical concern, the bigger problem for most creditors is that the collateral—even if sold to maximize value—does not repay the debt. Bankers call this a "loss severity." The managing director of a bank calls it "somebody-around-here's problem" and will want to recover as near as possible to the balance owed.

A "deficiency" lawsuit is the tool for attempting to recover the difference between what the collateral brought at sale and the amount owed. For residential real property, about half of all states ban the collection of a deficiency after foreclosure. This is a debtor protection, but the flip side—the ability to go after consumers long after the lender has taken possession and sold the house—is a powerful creditor's remedy. The laws on what a creditor must do to collect a deficiency depend on the type of foreclosure process that the creditor used and the state's public policy. Generally, permitting deficiency judgments should ease credit access and lower credit costs. *See, e.g.*, Jihad Dagher & Yanfan Sun, *Borrower Protection and the Supply of Credit: Evidence from Foreclosure Laws* (2014) (finding that anti-deficiency statutes result in higher rejection rates for jumbo mortgage loans). Both effects can be seen as particularly important with regard to homeownership. The contrary policy point, however, is that the goal is sustainable homeownership, not temporary homeownership followed by a foreclosure, and that barring deficiency judgments promotes sound underwriting because it limits creditors to the collateral for payment.

Foreclosure of real property can be either judicial or non-judicial. All states have a judicial foreclosure process; about half of all states permit non-judicial foreclosure as an alternative. If it is an option, a creditor will prefer non-judicial foreclosure because as a general matter, it is faster, cheaper, and presents less risk of legal challenge. Even in non-judicial foreclosure states, the sale process is much more circumscribed by law than with personal property under the U.C.C. Homes are high stakes collateral—for consumers and creditors—and the remedies reflect those consequences. As a result of the foreclosure spike in 2008-2015, the law imposes more duties on creditors before foreclosing than in the past.

The term "judicial foreclosure" suggests the involvement of a judge but judicial activity is limited or infrequent. As in other situations when creditors go to court, vigorous defense by the borrower is rare. Judicial foreclosure does, however, require significant steps by other public actors. To begin, a complaint must be filed that pleads the elements of the foreclosure statute. These typically include that there is a valid mortgage between the parties, that the borrower is in default under the terms of the mortgage, and that any required pre-suit notifications were given. A case number and judge are assigned, and the complaint must be served on the borrower. At that point, many cases will end with a summary judgment motion being granted in favor of the lender. If not, the court will adjudicate the dispute. If it concludes the lender has the legal right to foreclose, the court will issue a judgment that determines the amount owed. If this amount is not paid by the deadline established in the judgment, a sheriff or other public offer will sell the property. In some states, there is post-sale judicial review that confirms the sale but in others, the sale is the final step. If a deficiency judgment is permitted, the order confirming the sale will set that amount and create a judgment that the mortgage company can use to pursue the debtor. Some studies have found most reductions in access to credit in judicial foreclosure states compared to nonjudicial foreclosure states, which is often pinned to higher costs in adhering to the judicial process. *See, e.g.*, Karen Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. OF ECON. & STAT. 177 (2006) (estimating that loan sizes are 3 percent to 7 percent smaller in judicial foreclosure states).

Nonjudicial foreclosure is conducted by private non-state actors. The original mortgage (or deed of trust, which is a similar document commonly used in nonjudicial foreclosure states) will contain a "power of sale" clause that permits the lender to take steps to sell the property if the borrower defaults. To satisfy due process, all nonjudicial statutes require at least some notice and procedure. Personal service of process, a matter of course in judicial foreclosure, is only required in five states. Instead service is by mail, sometimes registered or certified, and also through public notice, such as a newspaper advertisement or posting in a public place (such as the county recorder's office). After notice and an elapsed waiting period, the house may be sold. These are often private auctions, conducted by "trustees" named under the deed of trust. If a homeowner wants to raise a defense to the foreclosure, he or she must file a court action requesting an injunction to halt the sale.

Great finality is given to foreclosure sales, whether judicial or nonjudicial. The goal is to maximize the sale price by minimizing any concerns of the purchaser about the sale being upset. In all states, borrowers have the right to "redeem" the property by paying the entire balance owed after the sale. In some states this is an equitable right, while it others it is a statutory right. If the latter, the borrower may only have to pay the sale price and the costs of the sale to the purchaser. (If the bank had a deficiency judgment, however, redemption does not eliminate that debt; it transfers ownership of the house back to the borrower.)

To minimize the financial and social harms of foreclosure, the law provides several protections to borrowers. Although these are technically "debtor's rights," they are covered here as precedents to the creditor being able to foreclose. Half of the states give borrowers the ability to cure the default, by paying any amounts due, before sale. Even when not an official right, lenders are often delighted to get a chunk of money and avoid the losses that come from a sale that will frequently bring less than the amount due on the mortgage.

Federal and some states' laws impose procedural obligations on actors initiating foreclosure to advise borrowers of possible foreclosure alternatives. As with student loans, collecting payments and addressing defaults is performed by a servicer, who is not usually the original lender. The mortgage servicer bought the right to service the note in return for payment for services rendered. It is the servicer (not the owner of the note that is often a securitized trust or other passive entity) that will be communicating with the borrower. Servicers have no duty to provide any specific loss mitigation options. 12 C.F.R. §1014.41(a). The focus is on communication and procedural protections. The timing for the creditors' obligations is highly structured, based off a series of key dates. Confusingly, the key dates are measured from different events, including delinquency (but that is not explicitly defined in the regulation).

The most important rules, described in more detail in Assignment 15, require good faith efforts to reach the borrower, providing information about loss mitigation options, and delaying foreclosure to evalute a complete application for loss mitigation options.

You may be wondering why these loss mitigations are coming up in an Assignment about creditor remedies; they certainly seem like debtor protections. The foreclosure, however, cannot be filed until 120 days have elapsed to allow for the loss mitigation process. Additionally, the foreclosure cannot begin if a borrower has submitted a complete application. 12 C.F.R. §1024.41(f)(2)(i). This prohibits "dual tracking," so named because of prior practices in which servicers would file a foreclosure (track 1) while the borrower was pursuing a loan modification (track 2). These are substantial curbs on the contractual rights to foreclose and create a major federal overlay on state foreclosure procedure. Before the CFPB's rules, it was possible to foreclose in some states in as little as 37 days. (Can you see now where the 37-day period for evaluating a loss mitigation application derived from? It's still a terrible number from the standpoint of consumer comprehension.)

C. Protection from Debtor Suit

On some levels, creditors are like everybody else—they would like to avoid being sued. A highly technical law, the "holder in due course" rule, gives them a major leg-up in this regard. This rule only applies when a debt is sold to a party that did not originate the debt, but because such assignment is extremely common in consumer financial markets, creditors who meet certain requirements enjoy protection from claims by debtors that arise under state or federal consumer protection laws.

1. Holder in Due Course Doctrine

The holder in due course rule limits the liability of assignees or purchasers of credit instruments. In the consumer context, this means that if an originating lender sells a note to a third party, the borrower cannot assert most claims against the third party. The rule, and its qualifying elements, is found in U.C.C. §3-305. It limits the liability of a "holder in due course" to a borrower defense based on four grounds:

> (i) infancy of the obligor to the extent it is a defense to a simple contract,
> (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor,
> (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or
> (iv) discharge of the obligor in insolvency proceedings.

These are very limited grounds. Either the factual scenarios are relatively uncommon, such as infancy or duress, or the standard for proving the defense is very hard, such as fraud.

To take advantage of this rule, however, one must qualify as a "holder in due course" of an "instrument." This implicates three definitions in the Uniform Commercial Code. First, one must be a holder. This requires the successful completion of the process of "negotiation," which itself is a defined term. U.C.C. §3-201. There is an important caveat here, which is that the so-called "shelter rule" may protect a transferee who acquired instruments from holders in due course, even if the transferee is not a holder in due course. The key point is to check that a party actually is a holder; it is not enough to wish or assume statuses such as assignees or purchasers nearly always are. (Part of the reason they get away with that, however, is that legal aid and consumer lawyers do not know enough hard-core commercial law to challenge the application of the holder in due course rule. This stuff is tough but it is powerful.)

Second, creditors must have acquired their status "in due course." Uniform Commercial Code §3-302 sets out the requirements for such transactions. The two key provisions are that the "the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity" and that the holder "took the instrument for value, in good faith, without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, and without other specified problems." The thrust of this rule is that assignees are holders in due course if they lacked knowledge of certain problems.

The third definitional requirement of using the holder in due course doctrine is that the document at issue must be an "instrument." This too is a defined term. U.C.C. §3-104. While most parties intend promissory notes to be negotiable instruments, there are technical requirements for negotiability. If the note at issue is not an instrument, the holder in due course rule does not shield the noteholder (the creditor) from liability. Indeed, some law professor has even tried to assert that the Fannie Mae Uniform Note is not a negotiable instrument. Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 971-72 (1997) (suggesting that borrower's right to prepay may impair negotiability).

2. FTC Preservation Rule

The holder in due course rule applies generally. For consumer transactions, the FTC has passed a rule that reverses the Uniform Commercial Code. The "Preservation of consumers' claims and defenses" rule makes it an unfair or deceptive practice under the FTC Act for any assignee or seller to take or receive a consumer credit contract without a specified "Notice" or to accept the proceeds of any purchase money loan if its contract does not contain the "Notice." 16 C.F.R. §433.2. The "Notice" reads:

> Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder.

The notice is, as you may be figuring out, actually reversing the substantive rights of the parties. By reversing the Holder in Due Course doctrine, it "preserves" consumers' claims or defenses against an originator of a loan and allows them to be applied to the assignee or purchaser. For added good measure, the FTC rule also eliminates contractual waivers of a consumer's right to assert a defense against an assignee.

Given the FTC Rule that lets consumers assert claims against the assignees and buyers of consumer credit contracts, why did you endure the torture of learning the holder in due course doctrine? The answer lies in the scope of the FTC Rule. It applies only to consumer contracts that are connected to the sale of goods or services. It does not apply to straight loans for money. So, for example, it does apply to a loan to purchase a used car, but it does not apply to a credit card debt. Also, the FTC Preservation rule does not apply to non-goods—otherwise, commonly known as real property. Because mortgages are nearly always assigned through the securitization process, the application of the holder in due course rule leaves consumers with nobody to sue for most claims relating to the origination of their mortgage loans. If you wondered why the foreclosure crisis was not a feast for consumer lawyers, you have your answer. The company holding the mortgage note enjoyed the protection of the holder in due course and the consumer could not assert claims against the holder except for infancy, duress, and fraud—all of which were inapplicable or impossible to prove.

Deutsche Bank National Trust Co. v. Carmichael (In re Carmichael)

443 B.R. 699 (Bankr. E.D. Pa. 2011)

RASLAVICH, Chief U.S. Bankruptcy Judge.

INTRODUCTION

Before the Court is Plaintiff Deutsche Bank's Motion for Summary Judgment. It is opposed by the Defendants who are the debtors in this bankruptcy case. Briefs were submitted. The Court next took the motion under advisement. For the reasons which follow, the Motion for Summary Judgment will be granted.

PROCEDURAL BACKGROUND

This matter began in state court where Deutsche filed a Complaint in Mortgage Foreclosure. A default judgment was entered and then opened. Debtors filed an Answer and New Matter to which Plaintiffs filed a reply. The New Matter consists of an affirmative defense which makes up the thrust of their opposition.

...

The Court turns first to what is required for a movant to be entitled to summary judgment in mortgage foreclosure. Entry of summary judgment is appropriate in a mortgage foreclosure action where mortgagors "admit that the mortgage is in default, that they have failed to pay interest on the obligation, and that the recorded mortgage is in the specified amount." Cunningham v. McWilliams, 714 A.2d 1054, 1057 (Pa. Super. 1998).

...

DEBTORS' AFFIRMATIVE DEFENSE IN CONTEXT

Defendants contend that at the loan's inception, AMC induced them to sign the mortgage note with fraudulent representations. Although Deutsche was not the original lender who made the loan, Debtors go on, they may raise their fraud claim against Deutsche's foreclosure complaint.

Were it framed as a counterclaim, such a claim would not be allowed in this context. A defendant in a mortgage foreclosure action can only raise counterclaims which arise from the same transaction or occurrence from which the plaintiff's action arose. See Pa. R.C.P. 1148. That rule, however, governs only counterclaims in mortgage foreclosure action and does not apply to new matter. See First Wisconsin Trust Co. v. Strausser, 653 A.2d 688, 692-693 (Pa. Super. 1995).

DEUTSCHE'S RESPONSE

Deutsche does not dispute the Defendant's claim of fraud with regard to certain representations that the original lender, Ameriquest, may have made. Deutsche's position is that it was not aware of such claims when it purchased the loan from Ameriquest. As a result, Deutsche maintains that it is a holder in due course immune from the Debtors' fraud claims.

THE FTC HOLDER RULE

As a threshold matter, the Defendants assert that Deutsche is precluded from raising defenses under applicable federal regulations. They refer here to the FTC Holder Rule:

> In connection with any sale or lease of goods or services to consumers, in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for a seller, directly or indirectly, to:
> a. Take or receive a consumer credit contract which fails to contain the following provision in at least ten points, bold face, type:
> NOTICE
> ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS

> HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.
> or,
> b. Accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:
> [same as above].

16 C.F.R. §433.2 (2005). However, the FTC Holder Rule, by its terms, does not apply to mortgage loans for the purchase of real estate, as in this case. See 41 F.R. 20024 (Friday, May 14, 1976) (excluding purchases of real estate from affected transaction); see also In re Woodsbey, 375 B.R. 145, 149-150 (Bankr. W.D. Pa. 2007) citing Kaliner v. MERS (In re Reagoso), 2007 Bankr. LEXIS 2004, 2007 WL 1655376 at *6 (Bankr. E.D. Pa., June 6, 2007) citing Johnson v. Long Beach Mortg. Loan Trust 2001-4, 451 F. Supp. 2d 16, 55 (D.D.C. 2006). Therefore, Defendants may not rely on that rule in attempting to assert set-offs or recoupment as against Deutsche Bank for the claims they have against the original lender. It will be state law which determines what defenses the Defendants may raise as to Deutsche's foreclosure rights.

HOLDER IN DUE COURSE UNDER PENNSYLVANIA LAW

Pennsylvania law does recognize that a holder of commercial paper may raise a defense of good faith. Deutsche asserts innocence as to any claims of fraud which the Debtor would have against the original lender, here, AMC. As a holder in due course, Deutsche declares, it is not vicariously liable for its predecessor's torts. A determination of whether Deutsche has established such status follows.

MORTGAGE LOAN AS NEGOTIABLE INSTRUMENT

The threshold requirement for holder in due course (HDC) status is that the party asserting that defense be a holder of a negotiable instrument. Thus, the first element for the present analysis is whether what Deutsche holds is a negotiable instrument. A negotiable instrument is defined as [ ] an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

> (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
>
> (2) is payable on demand or at a definite time; and
>
> (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain:
>
> > (i) an undertaking or power to give, maintain or protect collateral to secure payment;
> >
> > (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral; or

(iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

13 Pa. C.S. §3104(a). Defendants say that a mortgage cannot be a negotiable instrument. Defendants' Brief, 7. However, it is not a mortgage which Deutsche holds, but a promissory note. The mortgage serves to secure that note. Under Pennsylvania law, a promissory note accompanied by a mortgage may be a negotiable instrument. Mellon Bank, N.A. v. Ternisky, 999 F.2d 791, 796 (4th Cir. 1993) (applying Pennsylvania law to hold that mortgagee was holder in due course).

IS DEUTSCHE A HOLDER IN DUE COURSE

Having determined that the note is a negotiable instrument, the Court turns to whether the record demonstrates that Deutsche acquired the note in good faith (i.e., in due course). The circumstances which indicate innocence are as follows:

(1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) the holder took the instrument:

(i) for value;

(ii) in good faith;

(iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series;

(iv) without notice that the instrument contains an unauthorized signature or has been altered;

(v) without notice of any claim to the instrument described in section 3306 (relating to claims to an instrument); and

(vi) without notice that any party has a defense or claim in recoupment described in section 3305(a) (relating to defenses and claims in recoupment).

13 Pa. C.S. §3302(a).

There is no allegation of forgery or alteration (subsection (a)(1)). Likewise, the PSA demonstrates that Deutsche took the loan for value and in good faith (subsection (a)(2)(i), (ii)). Defendants contend that Deutsche's innocence is in question when considering ¶2(iii) above. By the time of the assignment, they explain, the loan was already nine months in default. Defendants' Brief in Opposition to Summary Judgment, 3. Deutsche contests that premise arguing that the assignment occurred at least two years earlier. What does the record show?

DEBTORS' DEFAULTS/DEUTSCHE'S KNOWLEDGE

In April 2005, the mortgage loan in question was made by Ameriquest Mortgage Company (AMC) to the Defendants. This much is admitted. See Answer to Foreclosure Complaint, ¶3. To demonstrate when Deutsche obtained the loan, Deutsche offers the Affidavit of Ronaldo R. Reyes, V.P. According to Mr. Reyes, AMC, Ameriquest Mortgage Services (AMS), and Deutsche entered into a Pooling and Services Agreement (PSA) on June 1, 2005. Pursuant to the PSA, AMC sold the Debtors' loan to AMS which immediately conveyed the loan to Deutsche. Along with the loan, the PSA provided that AMS would also deliver to Deutsche "an original Assignment assigned in blank" as well as any "original recorded intervening assignment or complete chain of assignment from the original to the person assigning the mortgage to Deutsche." PSA, §2.01(iii), (iv). Although the Assignment from AMC to Deutsche would not be recorded until 3 months after Deutsche filed this foreclosure complaint, the PSA had already conveyed the Debtors' mortgage loan from AMC to AMS and then on to Deutsche 2 1/2 years earlier. For that reason, the Court finds that Deutsche took the loan well before it ever went into default. Accordingly, the Court finds Deutsche to have been a holder in due course.

DEFENSES TO HDC STATUS

Yet even a holder in due course is susceptible to certain prescribed defenses of an obligor/borrower. Section 3305 provides, in pertinent part:

> (b) Right of holder in due course to enforce obligation.—The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1), but is not subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3) against a person other than the holder.

13 P.S. §3305(b) (emphasis added). The defenses stated in subsection (a)(1) are:

> (1) a defense of the obligor based on:
>
> (i) infancy of the obligor to the extent it is a defense to a simple contract;
>
> (ii) duress, lack of legal capacity or illegality of the transaction which, under other law, nullifies the obligation of the obligor;
>
> (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms; or
>
> (iv) discharge of the obligor in insolvency proceedings;

13 Pa.C.S. §3305(a)(1). Which of those defenses, if any, might apply?

As it turns out, none. There is no claim of infancy, duress or other lack of legal capacity. Neither is there raised a discharge of the obligation. That leaves the fraud defense in subparagraph (iii). This provision does not include fraud in all its forms: it draws a distinction between certain types of fraud-based defenses. Subsection (a)(1)(iii) thus preserves as against the HDC on the claim of fraud that is alleged to have occurred in the execution of the instrument, i.e, fraud in factum. Therefore, it precludes other frauds such as a fraudulent inducement to enter into the transaction. See In re Balko, 348 B.R. 684, 698 n. 18 (Bankr. W.D. Pa. 2006) (explaining that fraud in the inducement is not a real defense to a holder in due course); Exchange Intern. Leasing Corp. v. Consolidated Bus. Forms Co., Inc., 462 F. Supp. 626, 628 (W.D. Pa. 1978) ("Under Pennsylvania only fraud in the factum as opposed to fraud in the inducement, is a defense to a holder in due course"); Catasauqua Nat. Bank v. Miller, 60 Pa. Super. 220, 1915 WL 4398 at *3 (Pa. Super.) ("The great fabric of commercial business in this country rests largely upon the proposition, long recognized and everywhere accepted, that a negotiable note is 'a courier without luggage,' and that innocent holders for value, who take such paper in due course of business, are not to be bound or affected by any secret equities between the maker of such paper and the payee named."); Ternisky, supra, 999 F.2d at 796 (applying Pennsylvania law to hold that where bank held mortgage in due course purchaser could not raise defense of fraud in the inducement). As it turns out, the fraud claim which the Defendants would impute to Deutsche consists of a claim of fraudulent inducement. They maintain that they were fraudulently persuaded to refinance their mortgage loan based on representations that if it would be beneficial for them to refinance, then they would later be permitted to refinance notwithstanding the existence of a prepayment penalty in the note. Simply put, these claims may not be raised as to Deutsche, but they are in no way barred as to AMC, the original lender.

UTPCPL

In addition to the fraud in the inducement claim, Defendants raise the affirmative defense of state consumer protection law, the Unfair Trade Practices and Consumer Protection Law. The UTPCPL protects consumer against unfair or deceptive practices to the text of the note and is thus akin to the fraud in the inducement claims discussed, supra. Indeed, the Defendants' claim even used the predicate "induced" to explain how they were allegedly lured into the mortgage with AMC in the first place. Accordingly, they would likewise be subject to the holder in due course defense. See also In re Reagoso, supra 2007 Bankr. LEXIS 2004, [WL] at *6 citing State Street Bank & Trust Co. v. Strawser, 908 F. Supp. 249, 252 (M.D. Pa. 1995)

BREACH OF CONTRACT

Additionally, Defendants construe the same facts which support their fraud in the inducement claims as a breach of contract They are referring here to certain alleged promises made by an AMC representative with regard to the note's prepayment penalty. Defendants maintain that AMC assured them that in the event that they needed to refinance the note, then such prepayment penalty would be waived. In other words, the original parties to the loan contract (i.e, AMC and the Defendants) orally modified one of its terms and that AMC breached that oral argument. Defendants argue that such breach should be enforced against Deutsche. Is such a claim likewise barred against an HDC?

It is. To repeat, §3305(b) specifically provides that "[t]he right of a holder in due to enforce the obligation of a party to pay the instrument is…not subject to the defenses of the obligor stated in subsection (a)(2)…" 13 Pa. C.S. §3305(b). The defenses of subsection (a)(2) are:

> a defense of the obligor stated in another section of this division of the note or a defense that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract

13 Pa. C.S. §3305(a)(2). The Comment to subsection (a)(2) explains:

> Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 and

> those based on common law contract principles. Article 3 defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3-105(b)); failure to countersign a traveler's check (Section 3-106(c)); modification of the obligation by a separate agreement (Section 3-117); payment that violates a restrictive indorsement (Section 3-206(f)); instruments issued without consideration or for which promised performance has not been given (Section 3-303(b)), and breach of warranty when a draft is accepted (Section 3-417(b)).

Milton v. Wilshire Credit Corporation (In re Milton), 2005 Bankr. LEXIS 3318, 2005 WL 6508305 at **10-11 (Bankr. E.D. Pa., July 26, 2005) quoting 13 Pa. C.S. §3305 Uniform Commercial Code-Comment 1990. The subsection renders the HDC immune from breach of contract claims. Any promise or agreement by AMC to waive the prepayment penalty which it later would not honor is just such a claim. As such, it may not be raised as a defense to Deutsche's enforcement of the note. In sum, none of the causes of action raised in Defendants' New Matter are viable as to Deutsche.

SUMMARY

Based on the evidence offered by Deutsche and the lack of any contrary evidence from Defendants, Deutsche is entitled to a judgment in mortgage foreclosure. Nothing in the Court's ruling, however, constitutes an adjudication on the merits of Defendants' fraud claim against Ameriquest Mortgage Company.

An appropriate Order follows.

A few other laws help mitigate this harsh effect but they are not widely applicable. If a consumer attempts to rescind a mortgage loan under the Truth in Lending Act (a remedy covered in in Assignment 14), the assignee must cooperate in the rescission process. *See* 15 U.S.C. §1641(c). Assignees of home loans that are covered by the Home Ownership and Equity Protection Act (HOEPA) are "subject to all claims and defenses with respect to that mortgage that the consumer could assert against the creditor." 15 U.S.C. §1641(d)(1). This liability applies whether or not the required notice about assignee liability for HOEPA loans appeared in the note and regardless of whether the current owner is a holder in due course. Similarly, some state predatory lending laws also make assignees liable under their provisions for origination-related claims.

Problem Set 21

21.1. Diane Jacobsen went to District Court last week over a $438 utility bill. She had missed her prior court dates and has never denied to anyone that she owes the money. When she appeared in court, Judge Bill Smith told her to hand over the jewelry that she was wearing to pay the money that day or go to jail. Reluctantly, she surrendered her grandmothers' pearls and spent one month scraping up the money from family and friends to pay the debt. In the Legal

Aid office about her pending separation from her husband, she relayed this story to your family law colleague, who was outraged. The family law lawyer correctly states that debtors' prisons were outlawed centuries ago. She asks you how Judge Smith can get away with his behavior. What do you tell her?

21.2. Lynn LoPucki is the long-suffering assistant to the County Sheriff in Black Hawk County, Iowa. A newly elected sheriff has just arrived for his first day of work and has announced that he will be out all morning "testing out the speed potential" of the sheriff's car to "make sure it is adequate to serve his crime-fighting goals." Lynn rolls his eyes, and hands him the legal document delivered earlier that day. Then Lynn goes back to playing games on his computer. A few minutes later the sheriff is still scratching his head and distracting Lynn. Lynn already opened the envelope before giving it to him (hey, the only perk of the job is the right to be nosy) and knows that it contains a "Writ of Execution" form with all the blanks complete. The total owing is $462 and the judgment debtor's address is only about five blocks from the sheriff's office. If he decides to take pity on the sheriff, what should Lynn advise the sheriff to do? *See* Iowa Code and Iowa Rules of Civil Procedure.

21.3. Bruno Holtry is one of your company's best repossession agents. He's quick at his work, which limits the potential for violent responses from debtors. Bruno just called you to report on his last job of the night. He says that he was headed to the employer of Isabel Fury to repossess her 2000 Honda Accord when she passed him headed home from work. He followed her. She stopped the car in front of a modest ranch house and went to the door. He verified that the address was not her home based on your records but figured since it was a few blocks away that he would repo the car and let her walk home. The job was easy, he reported, because Isabel left the keys in the car and the windows rolled down. He heard her yelling and chasing after him when he was a half-block away, but he knew better than to stop and invite trouble.

At this point, you are wondering why the call when Bruno says that he better call you back "because a helicopter's landing out back." You are nonplussed but can't put the pieces together. Waiting for Bruno to call you back, you flip on the office TV. Across the bottom of the screen is an "Amber Alert" for a missing two-year old, Jermaine Fury. When the telephone rings back, it is a police detective, who explains that when Bruno took the car, Jermaine was asleep in his car seat. Apparently, Bruno did not notice him, but Isabel called 911 to report a stolen child. After launching an intense missing child protocol, the police called Bruno and had him check the car. When the police and Isabel arrived on the scene, Bruno was giving the toddler his first root beer. Is your company in legal trouble based on the day's events? Is Bruno? Is Isabel? Is Jermaine? *See* U.C.C. §9-609.

21.4. You are the Deputy Assistant to the General Counsel for the Consumer Financial Protection Bureau. Your boss has been tasked with a major project on examining whether the FTC's Preservation Rule is appropriate in its scope. The project is just starting, and because of your place in the organization's hierarchy, you have been assigned the "background" section of the report. Specifically, you are supposed to explain the justification for the FTC Preservation Rule. What problems is it thought to be correcting? How does it help improve the marketplace for consumer goods and financial services?

Assignment 22. Debtor Rights

Creditors usually "win" debt collection actions, in the sense that they obtain judgments or are able to take their collateral. But their recovery is often curbed by laws that protect debtors. One type of law gives debtors the right to sue and recover from debt collectors who engage in abusive processes. This is the subject of Assignment 23. The other set of laws, examined below, permit debtors to shield property either temporarily or permanently from creditors or even to avoid liability entirely for some debts.

A. FTC Credit Practices Rule

A specialized set of rules for consumer collections that aims to protect debtors is contained in the FTC Credit Practices Rule. 16 C.F.R. §§444.1-444.5. Passed in 1985 under the authority of the Unfair and Deceptive Practices Act, it prohibits a practice known as "pyramiding" late charges and prohibits practices that may mislead cosigners for consumer debts. Lenders or retail sellers are required to give cosigners a separate document, "Notice to Cosigner," that explains that cosigners may be liable for the full amount of the debt and that the creditor can collect from the cosigner without first attempting to collect from the borrower. 16 C.F.R. §444.3(c). If this notice is provided, the creditor is shielded from liability for misrepresenting the nature or extent of cosigner liability, an act prohibited by 16 C.F.R. §444.3(a)(1).

The Credit Practices Rule also prohibits lenders or retail installment sellers from including certain provisions in contracts that essentially allow the creditor to short-circuit the normal collection process. For example, some consumer credit contracts specified that the debtor—by signing the contract—was giving up her right to be notified of a court hearing and agreeing to allow an attorney to confess a judgment in favor of the creditor. These provisions were called "confessions of judgment" or "cognovits." While they remain legal in some states and are used in commercial lending, the FTC Rule makes it an unfair act or practice to include such clauses in consumer contracts. Similarly, consumer contracts may not contain an "assignment of wages" that is an irrevocable agreement to allow a creditor to take a debtor's wages upon default. The effect of such an assignment was to permit wage garnishment without the normal legal steps of filing a garnishment action, permitting an answer, etc.

These rules were established decades ago, unlike so many areas of consumer credit in which the landscape has changed in the wake of Dodd-Frank. But just because a legal rule is old does not mean that it gets followed —even with the "help" of counsel.

F.T.C. v. Loanpointe

2011 U.S. Dist. LEXIS 104982, 2011 WL 4348304 (D. Utah Sept. 15, 2011)

KIMBALL, District Judge.

This matter is before the court on Plaintiff Federal Trade Commission's Motion for Summary Judgment against Defendants LoanPointe, LLC, Eastbrook, LLC, and Joe S. Strom (collectively, "Defendants").…

BACKGROUND

Plaintiff Federal Trade Commission ("FTC") enforces federal statutes prohibiting unfair or deceptive acts or practices in or affecting commerce, specifically debt collection and credit practices. Defendant Eastbrook, LLC is no longer an operating entity because its books were merged into Defendant LoanPointe, LLC. LoanPointe is a Utah limited liability company doing business as GetECash through its internet website www.GetECash.com. Defendant Joe S. Strom is a manager, officer, principal, and registered agent of both Eastbrook and LoanPointe.

Since at least September 2008, Defendants have used their website to offer short-term, small dollar, unsecured, high-interest rate extensions of credit, commonly referred to as payday loans. The principal of the loans is usually less than $1,000 and the term of the loan is meant to extend only to the next payday. Consumers obtain the loans by completing an online application on Defendants' website. Before receiving the loan, consumers must agree to the Terms of the Application, the Privacy Policy, the Authorization Agreement, and the Loan Note and Disclosure. Consumers indicate their agreement by checking a box, as an electronic signature, next to links to each of those documents.

The version of the Loan Note and Disclosure at issue in this case, which consumers had to accept before receiving a loan, included a clause that read, "NOTICE: I agree to have my wages garnished to pay any delinquent amount on this loan." The clause was written in the fine print and it was in bold and underlined.

Strom knew that the loan agreements contained the wage assignment clause. However, he believed that his companies could lawfully use the wage assignment clause and garnish the wages of borrowers under its authority. Strom had sought and received advice from an attorney before authorizing the loan documents. When the FTC notified Strom that certain documents were not legal, Strom withdrew his approval from those documents.

Using the wage assignment clause as authority, Defendants garnished the wages of consumers who were in default on their loans. Although 80% of the consumers that Defendants attempted to garnish wages from refused to allow the garnishment, the wage assignment clause was used to recover approximately 16% of all loan repayments from approximately 10% of all borrowers.

In order to garnish a consumer's pay from a consumer's employer, Defendants would send a garnishment package to the employer that included the following documents: 1) a "Letter to Employer & Important Notice to Employer"; 2) a "Wage Garnishment" document; 3) a "Wage Garnishment Worksheet"; and 4) an "Employer Certification." These document titles match exactly the document titles that the Treasury Department's Financial Management Service ("FMS") includes in the wage garnishment package that it sends to employers when federal agencies seek to garnish wages.

In addition to the other documents in the wage garnishment package, Defendants would also send copies of the consumer's loan application to the consumer's employer, which included the loan amount. Although Strom's declaration states that "all collection efforts, including the wage assignments…sent to employers" were from GetECash, Defendants sent their garnishment package using a fax coversheet from LoanPointe, a LoanPointe fax tagline, and the words "LoanPointe Garnishment Manager" as the signature.

In addition to sending a garnishment package with document titles identical to those sent by the FMS, Defendants' "Letter to Employer" also included wording similar to the wording included in the FMS's "Letter to Employer." The FMS's letter states the following:

> One of your employees has been identified as owing a delinquent nontax debt to the United States. The Debt Collection Improvement Act of 1996 (DCIA) permits Federal agencies to garnish the pay of individuals who owe such debt without first obtaining a court order. Enclosed is a Wage Garnishment Order directing you to withhold a portion of the employee's pay each period and to forward those amounts to us. We have previously notified the employee that this action was going to take place and have provided the employee with the opportunity to dispute the debt.

Defendants' letter states the following:

> One of your employees has been identified as owing a delinquent debt to GetECash. The Debt Collection Improvement Act of 1996 (DCIA) permits agencies to garnish the pay of individuals who owe such debt without first obtaining a court order. Enclosed is a Wage Garnishment Assignment directing you to withhold a portion of the employee's pay each period and to forward those amounts to GetECash. We have previously notified the employee that this action was going to take place and have provided the employee with the opportunity to dispute the debt.

After being informed by the Treasury Department that the portion of Defendants' letter referring to the DCIA was inaccurate and unacceptable to the government, Defendants discontinued the use of the challenged documents. Specifically, Defendants removed the language referring to the DCIA and asked the Treasury agent if she had any other concerns with the letter. When Defendants did not get a response, they assumed that the remaining information in the letter was proper.

Prior to undertaking any garnishment of wages, Defendants assert that they attempted to contact the consumers several times by telephone, voice mail, and email. According to Defendants, these communications would inform consumers that their continued failure and refusal to repay loans would result in garnishment of their wages. Despite these communications, the FTC references two consumers who were unaware of the Defendants' ability to garnish their wages until Defendants' made contact with their employers, and it references another consumer who was unaware of Defendants' ability to garnish wages after reviewing the loan application. The FTC also references comments from several consumers suggesting that Defendants' contact with consumers' employers exposed them to embarrassment and risk of adverse action, such as job loss.

Using the loan application with the wage assignment clause, Defendants have made at least 7,121 payday loans to consumers from which they have collected a total of $3,013,044. Of that total, $976,107.54 represents principal that consumers repaid to Defendants. Defendants used wage garnishment to collect $468,020.91 of the total amount.

On March 15, 2010, the FTC filed a Complaint against Defendants claiming that Defendants' practices violated Section 5 of the Federal Trade Commission Act ("FTC Act"), the Fair Debt Collection Practices Act ("FDCPA"), and the FTC's Trade Regulation Rule Concerning Credit Practices ("Credit Practices Rule"). As relief for these violations, the FTC sought a preliminary injunction during the pendency of the action, a permanent injunction to prevent future violations, and any other relief the court finds necessary such as rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of illgotten monies. The parties agreed to the entry of a preliminary injunction in April 2010.

DISCUSSION

…

I. Violations of the FTC Act

The FTC argues that Defendants violated the FTC Act by engaging in the following unfair or deceptive practices: misrepresenting to consumers' employers that they were authorized to garnish wages under the DCIA without a court order; misrepresenting to consumers' employers that they had notified consumers and given consumers an opportunity to dispute the debt prior to sending the garnishment request; and communicating with and disclosing the existence and amount of consumers' loans to consumers' employers without consumers' knowledge or consent.

…

A. Deceptive Practices

The FTC argues that Defendants were deceptive by making explicitly false claims that the DCIA authorized non-federal entities to garnish wages without a court order and that Defendants provided consumers with an opportunity to dispute their debts before seeking wage garnishment. In addition, the FTC claims that Defendants engaged in unfairness through disclosing consumers' debts to third parties, including their employers.

It is undisputed that Defendants made representations that they had authority under the DCIA and that they had notified consumers and given consumers a chance to dispute the debt. Defendants concede that they did not have authority under the DCIA to garnish wages. In addition, although Defendants argue that they notified consumers prior to contacting consumers' employers to garnish wages, Defendants do not argue that they gave consumers an opportunity to dispute the debt before attempting to garnish wages. Therefore, both statements were false and potentially misleading. Accordingly, the only disputes are whether the representations were likely to mislead consumers and whether they were material.

Defendants argue that the representations were not likely to mislead consumers because they were sent to the consumers' employers. Therefore, the crucial question in this analysis is whether sending misleading information to the consumers' employers qualifies as a deceptive act for purposes of the FTC Act.

Both individuals and businesses can be consumers for purposes of Section 5 liability. See, e.g., FTC v. Inc21.com Corp., 745 F. Supp. 2d 975, 982 (N.D. Cal. 2010). The employers in this case are the consumers to whom Defendants' deceptive garnishment letters were directed. Defendants sent the employers letters that looked identical to a garnishment request from the government. The letter also alleged that Defendants had the right to garnish under the DCIA. While Defendants' business is extending credit and loans and they would be expected to know the applicable law applying to such business, the consumers' employers would be in various fields unrelated to the credit and loan business. Thus, the consumers' employers could be, and likely were, misled by Defendants' letter into believing that Defendants had the right to garnish. Moreover, Defendants' represented to the consumers' employers that they had given the employee a right to dispute the debt. The consumers' employers would not be in a position to know whether that was factually correct. Even if the employer questioned its employee regarding the factual representation, it would not be able to verify which version of the facts was accurate. Defendants' factual misrepresentation, therefore, could, and likely did, mislead reasonable employers into believing that Defendants had given the employees an opportunity to dispute the debt. Therefore, the second prong of the test for whether an act or practice is deceptive is met because Defendants conduct was likely to mislead an individual or an entity in a way that affects commerce.

Under the third element, Defendants' practices will be considered deceptive if they are material. To be material, a misrepresentation would have to be "likely to affect a consumer's choice of or conduct regarding a product." In re Thompson Medical Co., 104 F.T.C. 648, 788 (1984), aff'd, 791 F.2d 189, 253 U.S. App. D.C. 18 (D.C. Cir. 1986).…

Here, Defendants expressly stated that they had authority under the DCIA and that they had given consumers an opportunity to dispute their debt. Defendants' claims made the employers more likely to garnish the wages of their employees. The claims indicated to the employers that Defendants had the right to garnish and that they had complied with any prerequisites that may be necessary for such garnishment. The evidence demonstrates that approximately twenty percent of the employers that received the documents with those representations actually garnished wages. Because the misrepresentations affected employers' conduct, the representations were material and violated Section 5 of the FTC Act.

B. Unfair Practices

In addition to alleging that Defendants participated in two deceptive acts or practices under the FTC Act, the FTC also argues that Defendants participated in an unfair act or practice by disclosing consumers' debts to their employers without prior approval from the consumers. To qualify as an unfair practice under the Act, the practice need only cause, or be likely to cause, substantial injury to consumers which is not reasonably avoidable by consumers and not outweighed by countervailing interests to consumers or competition. Disclosing consumers' debts to their employers is likely to cause substantial injury to consumers.

Other courts have recognized that wage assignment clauses and wage garnishment procedures cause substantial harm to consumers. For example, the Circuit Court for the District of Columbia has noted that the FTC "found wage assignments particularly harmful to consumers because they can be invoked without the due process safeguards of a hearing and opportunity to present defenses." Am. Fin. Servs. Assoc. v. FTC, 767 F.2d 957, 974 (D.C. Cir. 1985). The following specific injuries to consumers were mentioned in the rulemaking record for the unfair practices provision:

> Employers are hostile to wage assignments due to added administrative costs and burdens and the fear that the employee's job motivation and performance will suffer as a result of the reduction in wages. Moreover, employers tend to view the consumer's failure to repay the debt as a sign of irresponsibility. As a consequence many lose their jobs after wage assignments are filed. Even if the consumer retains the job, promotions, raises, and job assignments may be adversely affected.
>
> …Loss of a substantial portion of wages tends to cause further disruption of family finances and may even put at risk the wage earner's ability to provide necessities for the family.…The invocation of a wage assignment or just simply the threat of invocation may lead a debtor to enter into costly refinancing, to improvidently default on other obligations, or to forego valid defenses.…

Id. at 974-75. The FTC summarized the injuries to consumers as "severe, substantial disruption of employment, the pressure that results from threats to file wage assignments, and the disruption of family finances." Id. at 975. Based on these findings and conclusions by the FTC, the court concluded that "[t]he harms to consumers resulting from the use of…wage assignments identified by the Commission on the basis of the rulemaking record are neither trivial or speculative nor based merely on notions of subjective distress or offenses to taste," and that the "risk of substantial economic and monetary harm to the consumer" is significant. Id. at 975. Therefore, the court concludes that Defendants' practice of disclosing debts and the amount of the debts to consumers' employers qualifies as an unfair practice under the FTC Act.

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III. Violations of the Credit Practices Rule

The FTC further argues that Defendants violated the Credit Practices Rule by including an improper wage assignment clause in their credit contracts. The Credit Practices Rule generally prohibits the use of wage assignment clauses, but it allows such clauses to be included if the wage assignment: (i) is, by its terms, revocable at the will of the debtor; (ii) is a payroll deduction plan or preauthorized payment plan, commencing at the time of the transaction, in which the consumer authorizes a series of wage deductions as a method of making each payment; or (iii) applies only to wages or other earnings already earned at the time of the assignment. 16 C.F.R. §444.2(a)(3).

Defendants' wage assignment clause in its loan application does not meet any of the requirements of the Credit Practices Rule. Even though several consumers refused to allow Defendants to garnish their wages upon request, the wage assignment clause was still not revocable by its terms. Because Defendants' clause was not revocable by its terms, Defendants violated the Credit Practices Rule.

Defendants incorrectly attempt to require the FTC to make an additional showing that the violation is a deceptive or unfair practice. In promulgating the Credit Practices Rule, however, the FTC already found that improper wage assignment clauses are unfair and cause substantial harm to consumers. See Am. Fin. Servs. Ass'n v. FTC, 767 F.2d 957, 974-74 (D.C. Cir. 1985). Therefore, the court concludes that summary judgment is appropriate on the issue of whether Defendants violated the Credit Practices Rule.

Defendants dispute the appropriate remedy for a violation of the Credit Practices Rule. Defendants attempt to assert an affirmative defense to their violation of the Credit Practices Rule because they did not know that their wage assignment clause was illegal. However, good faith is not a defense to liability under the FTC Act, in part because the FTC need not prove intent. See, e.g., FTC v. Cyberspace.com, LLC, 453 F.3d 1196, 1202 (9th Cir. 2006). In addition, reliance on others, including counsel, is no defense to FTC Act liability. Cyberspace.com, 453 F.3d at 1202; Amy Travel, 875 F.2d at 575.

Good faith, however, may be relevant in determining the scope of injunctive relief because permanent injunctions are only appropriate if "there exists some cognizable danger of recurrent violation." United States v. W.T. Grant Co., 345 U.S. 629, 633 (1953). Whether there is a danger of a recurrent violation is determined by looking at two factors: 1) the deliberateness and seriousness of the present violation and 2) the violator's past record with respect to unfair advertising practices, Sears, Roebuck and Co. v. FTC, 676 F.2d 385, 392 (9th Cir. 1982). Good faith on the part of a defendant could be relevant to the first factor. Hang-Ups Art. Enters., 1995 U.S. Dist. LEXIS 21444 at *10-11.

Defendants' ignorance of the Credit Practices Rule does nothing to negate the need for permanent injunction in this case because not knowing that the clause was illegal does not lessen the deliberateness or seriousness of the conduct, see Jerman v. Carlisle, McNellie, Rini, Kramer, & Ulrich LPA, 130 S. Ct. 1605, 1612 (2010), and because Defendants should have been diligent in understanding the law relating to their chosen line of business. Therefore, Defendants' good faith defense reinforces, instead of excuses, the need for permanent injunctive relief to ensure that consumers are not harmed in the future.

...

CONCLUSION

Based on the above reasoning, Plaintiff Federal Trade Commission's Motion for Summary Judgment is granted as discussed above and the FTC shall submit a Judgment in accordance with the court's decision within ten days of the date of this Memorandum Decision and Order.

The FTC Credit Practices Rule also limits creditors' rights to take debtors' property. As background for understanding these rules, recall the general idea of a security interest from the prior assignment. If the debtor offers up property as collateral as part of a transaction, secured creditors can repossess or foreclose on that property upon the debtor's default. The right to take the collateral is contractual. The nature of that relationship means that the law generally assumes that debtors knowingly and voluntarily are giving the creditor a property interest in the collateral, including the right to possess and sell the collateral if a default occurs. The FTC Credit Practices Rule accepts this process but distinguishes it from efforts by creditors to use contractual language to require a debtor to "waive" their rights to protect "exempt", non-collateral property from being seized subject to a writ of execution. 16 C.F.R. §444.2(a)(2). The exemption laws, discussed more below, give debtors a right to keep certain delineated property from being taken to satisfy a judgment. It is not subject to levy or sale by a sheriff. A debtor can offer such property as collateral for a security interest but the rules for the creation and enforcement of a security interest, set out for personal property in Uniform Commercial Code, Article 9, must be followed. The logic of the rule seems to be that debtors will understand the consequences of offering up property as collateral ("If I don't pay, the creditor can take it away") but that debtors will not sufficiently value the protection of the property exemptions at the time of contracting to be able to sensibly decide whether they wish to waive them.

A student who has taken a class on secured credit may see a potential loophole in this scheme. Article 9 of the Uniform Commercial Code allows creditors to take security interests in "all the debtor's property." Because the FTC Credit Practices Rule excludes security interests taken at the time of the consumer loan, why can't a creditor not effectively achieve an executory waiver of the exemption laws by taking as collateral everything that a debtor owns, including property that would be protected by the exemption laws? The reason is the second limitation on collateral in the FTC Credit Practices Rule: lenders or retail installment sellers who take a nonpossessory security interest, other than a purchase money security interest, in household goods are engaging in an unfair act or practice. 16 C.F.R. §444.2(a)(4). Household goods are defined to include items such as clothing, furniture, and "personal effects" (including wedding rings). 16 C.F.R. §444.1(i). These items are frequently of very low resale value but are needed by debtors to maintain a safe and adequate standard of living for themselves and their dependents.

The baby crib is the classic tearjerker example used to illustrate the harm the rule is trying to prevent. A cash-strapped new mother, who desperately needs a loan to make ends meet, cannot offer their babies' cribs as collateral. Without such a security interest, the creditor is prohibited from repossessing the crib upon default, leaving the baby sleeping somewhere unsafe as a result (or perhaps just as direly, the mother doing something desperate to pay the creditor to avoid losing the crib). The purchase money exception to the household goods rule means that items such as a crib can be collateral when a consumer is buying them in a transaction. This facilitates extensions of credit for purchasing household goods, giving families the ability to borrow to obtain basic living items such as furniture.

B. Exemptions

1. Property Exemptions

Every state has one or more laws that specify certain property as exempt from seizure for collection. When a creditor obtains a judgment and the sheriff goes out to levy, this property cannot be taken. Exemptions protect debtors from being left destitute after creditor collection. While this is obviously consumer protection in that sense, exemption laws also provide a societal benefit. If debtors are left with nothing—no clothes, no furniture, no tools of their trade—they will need support from society or the government to live. Alternatively, such debtors could be left to suffer but that creates its own strain on community norms about fairness and justice.

Exemptions are creatures of statutes. State legislatures have very different views on the appropriate scope of exemptions. Nowhere is this more pronounced than in the context of homestead exemptions, protections for debtors' places of residence. A handful of states allow debtors to protect a homestead (often limited to a certain number of acres in size) regardless of its value; another handful of states provide no homestead exemption at all. Most states take an intermediate approach, but even there, the variance is large.

Personal property exemptions nearly always include items such as clothing and basic household goods but beyond that have little consistency in their reach. Some statutes clearly reveal their origins in the days of yore, protecting things like a church pew and an ox. Other states amend their statutes regularly, updating them to clarify that things like personal computers are household goods. Of crucial importance to debtors is whether the state provides any protection for cash, whether on hand or in a bank account. These funds are crucial to the debtor being able to buy food, pay bills, and the like.

While debtors enjoy the protection of exemptions by operation of law, they usually need to assert them at the time of levy or at the latest before judicial sale to satisfy the writ of execution. The exemption statutes result in many writs of execution being returned unfulfilled (sometimes noted by the Latin phrase *nulla bona*). The sheriff surveyed the debtor's property but found no non-exempt property. In effect, the exemption laws sharply limit the practical benefits of obtaining a judgment for debtors with few assets. In place of using such legal process, creditors may use informal collection procedures such as dunning, or if the debtor is employed, use wage garnishment procedures instead.

2. Wage Exemptions

In an analog to the property exemption laws, most states put limits on the amount of a debtor's paycheck that can be garnished. At one extreme is Texas, whose state constitution prohibits garnishment entirely. At the other extreme are states with no garnishment protections, but in those states the debtor has a back-stop: federal garnishment limits. The Consumer Credit Protection Act sets out two alternate tests that limit the amount that may be garnished. This law does not apply to support orders (for children or spouses) or to tax collection efforts. 15 U.S.C. §1673. If the debtor's state of residence has a more protective rule, either in amount or scope, the debtor gets to shield that amount. The federal statute creates a floor, bringing some uniformity to a disparate system and preventing the complete garnishment of wages that left debtors with no money to support themselves. A few states, such as Texas, prohibit wage garnishment entirely. Tex. Const. Art. 16, §28.

Exemptions and protection from garnishment may seem merciful to downtrodden debtors. That is certainly their intent. But in application, the outcomes can be excruciatingly difficult to accept. The statutes typically apply to all creditors with very few exceptions, as this case illustrates.

J.M. v. Hobbs

797 N.W.2d 227 (Neb. 2011)

GERRARD, Justice.

Nebraska law provides that a court may order any property of a judgment debtor, not exempted by law, in the hands of either the debtor or any other person or corporation, or due to the debtor, to be applied toward the satisfaction of the judgment. But the Nebraska State Patrol Retirement Act (the Act) provides, as relevant, that annuities or benefits "which any person shall be entitled to receive under" the Act are not subject to garnishment, attachment, levy, or any other process of law. The question presented in this case is whether a plaintiff who wins a civil judgment against a former state trooper can obtain an order in aid of execution against the trooper's State Patrol retirement benefits.

BACKGROUND

The plaintiff in this case, J.M., is the guardian and conservator for his minor child, C.M. In 1999, when C.M. was 7 years old, her mother married the defendant, Billy L. Hobbs. C.M. lived with her mother and Hobbs. Hobbs sexually assaulted C.M. while she was between 12 and 14 years old. In 2006, Hobbs was convicted of first degree sexual assault of a child and sentenced to 25 to 30 years' imprisonment. And J.M. sued Hobbs on C.M.'s behalf and won a judgment of $325,000.

J.M. filed a motion for an order in aid of execution, alleging that Hobbs was a judgment creditor and, although incarcerated, was receiving a retirement pension from the State Patrol. J.M. requested that Hobbs be asked to pay all nonexempt property and funds that came into his hands on a recurring basis toward satisfaction of the judgment. J.M. also moved for the appointment of a receiver to take control of Hobbs' assets in the event that Hobbs did not comply. Hobbs objected, alleging that his State Patrol retirement benefits were exempt from execution and that the order sought by J.M. would effectively subject his retirement benefits to process of law in violation of §81-2032. The district court agreed and denied J.M.'s motion.

J.M. appealed, and we granted his petition to bypass the Nebraska Court of Appeals.

...

ANALYSIS

As noted above, §25-1572 provides that in aid of execution of a judgment, a court "may order any property of the judgment debtor, not exempt by law, in the hands of either himself or any other person or corporation, or due to the judgment debtor, to be applied towards the satisfaction of the judgment." The question in this case is whether Hobbs' State Patrol retirement funds are "exempt by law." J.M. argues that the applicable statute here is Neb. Rev. Stat. §25-1563.01 (Reissue 2008), which provides as relevant that "an interest held under a stock bonus, pension, profit-sharing, or similar plan or contract payable on account of illness, disability, death, age, or length of service" is generally exempt from process "[t]o the extent reasonably necessary for the support of the debtor and any dependent of the debtor." J.M. argues that because Hobbs is imprisoned, he does not need his retirement funds for support, so they are available to satisfy C.M.'s judgment.

But Hobbs relies on §81-2032, which provides:

> All annuities or benefits which any person shall be entitled to receive under [the Act] shall not be subject to garnishment, attachment, levy, the operation of bankruptcy or insolvency laws, or any other process of law whatsoever and shall not be assignable except to the extent that such annuities or benefits are subject to a qualified domestic relations order under the Spousal Pension Rights Act.

Hobbs contends that this provision creates a legal exemption from execution for the funds he receives under the Act. We agree with the district court that §81-2032 precludes J.M. from obtaining the relief requested in this proceeding.

J.M. attempts to draw a distinction between the funds that Hobbs "shall be entitled to receive," as specified by §81-2032, and the funds that Hobbs already has received and which are in his possession. J.M. contends that the words "annuities" and "benefits" in §81-2032 refer to a right to payment, not to the payment or proceeds themselves. So, J.M. claims, §81-2032 is actually intended not to protect the money received by a beneficiary of the Act, but simply to protect the Nebraska State Patrol Retirement System from having to deal with the administrative burdens of execution and garnishment. But J.M.'s argument is inconsistent with the language of the Act and the weight of authority applying similar anti-attachment provisions.

To begin with, we have often said that absent a statutory indication to the contrary, words in a statute will be given their ordinary meaning. The words "annuity" and "benefit" are often used to refer, respectively, to "[a] fixed sum of money payable periodically" and "a cash payment or service provided for under an annuity, pension plan, or insurance policy." And those ordinary meanings for "annuity" and "benefit" are clearly how the terms are used in the Act. For example, the Act describes the authority of the Public Employees Retirement Board to "require repayment of benefits paid" or "offset future benefit payments" in the event of "an overpayment of a benefit," and to compensate a beneficiary in the event of "an underpayment of a benefit." And the Act explains how an officer who has reached retirement age or is disabled is entitled to receive "a monthly annuity" for the remainder of his or her life or disability. There is simply no merit to J.M.'s argument that "annuities" and "benefits" in §81-2032 refer to something other than payments of money.

Nor are we persuaded that §81-2032 no longer applies when the money is paid to the beneficiary. The language of §81-2032 mirrors that of anti-attachment provisions that generally have been held to protect benefits such as those provided under the Act from being used by judgment creditors to satisfy private obligations. J.M. argues that the statutes at issue in those cases are distinguishable, because they contained express language that more clearly applies to, for instance, money "'either before or after receipt by the beneficiary.'" But this distinction has been consistently rejected by courts discussing statutes, such as §81-2032, that do not contain such language. The language of §81-2032 is still clearly intended to protect benefits under the Act from legal process.

As Chief Justice Cardozo explained, when addressing whether payments "'due'" were limited to compensation owing and unpaid, "'due,' like words generally…, has a color and a content that can vary with the setting. Compensation due under an act may be a payment presently owing, or one to become due in the future, or one already made, but made because due, i. e., required or commanded." And the 10th Circuit, in addressing a provision of the Civil Service Retirement Act that exempted only "money mentioned by this subchapter," concluded that although the statutory language was "not as precisely drafted" as the provision of the Social Security Act that the U.S. Supreme Court had previously addressed, "the broad language of [the statute] offers no hint that its protections are any narrower than those afforded to Social Security payments or that Congress intended to treat future payments any differently than payments already received." Accordingly, the 10th Circuit concluded that the same protection extended to payments that had already been received.

The same is true here. Although we recognize that the result may often seem inequitable, courts have held that anti-attachment provisions are to be given effect even where a creditor is attempting to collect restitution for a criminal act, or a tort judgment. As the Kansas Supreme Court said, in a case involving strikingly similar facts:

> If we were free to decide the case on public policy or equitable consideration, there could be no strong reason asserted for not permitting the attachment. The language of the relevant federal statutes and the United States Supreme Court decision make it clear that we do not have the luxury of deciding the case on the basis of what is the "right" or desirable result. Plaintiff herein is a judgment creditor.…We find no legal basis for holding the funds are not exempt due to some implied exception.

And as the U.S. Supreme Court has more generally explained, it is not appropriate for a court to approve any generalized equitable exception to an antigarnishment provision, even for criminal misconduct, despite a "natural distaste for the result."

> [An antigarnishment provision] reflects a considered congressional policy choice, a decision to safeguard a stream of income for pensioners (and their dependents, who may be, and perhaps usually are, blameless), even if that decision prevents others

> from securing relief for the wrongs done them. If exceptions to this policy are to be made, it is for Congress to undertake that task.
>
> As a general matter, courts should be loath to announce equitable exceptions to legislative requirements or prohibitions that are unqualified by the statutory text. The creation of such exceptions, in our view, would be especially problematic in the context of an antigarnishment provision. Such a provision acts, by definition, to hinder the collection of a lawful debt. A restriction on garnishment therefore can be defended only on the view that the effectuation of certain broad social policies sometimes takes precedence over the desire to do equity between particular parties. It makes little sense to adopt such a policy and then to refuse enforcement whenever enforcement appears inequitable. A court attempting to carve out an exception that would not swallow the rule would be forced to determine whether application of the rule in particular circumstances would be "especially" inequitable. The impracticability of defining such a standard reinforces our conclusion that the identification of any exception should be left to Congress.

Guidry v. Sheet Metal Workers Pension Fund, 493 U.S. 365, 376-77 (1990) (superseded by statute in U.S. v. Irving, 452 F.3d 110 (2d Cir. 2006)). We agree with the Court's reasoning, and we likewise find that if an exception to §81-2032 is to be created for circumstances such as these, it is a matter for the Legislature to undertake. But as it stands, §81-2032 clearly provides greater protection to benefits under the Act than does the general pension exemption set forth in §25-1563.01. And it is well established that where general and special provisions of statutes are in conflict, the general law yields to the special, without regard to priority of dates in enacting the same. The district court was correct in relying upon this principle to conclude that Hobbs' retirement benefits, even in his possession, are exempted from execution by §81-2032.…

For the sake of completeness, we note that Hobbs could, obviously, voluntarily pay his retirement funds toward C.M.'s judgment if he chose to do so and that his willingness (or unwillingness) to do so could be seen as relevant to many of the factors that the Board of Parole is instructed to take into account when making a determination regarding a committed offender's release on parole. We also note that although this opinion addresses the general applicability of §81-2032, we make no comment on the extent to which the exempt status of Hobbs' retirement funds might be affected by any transformation in their character, such as through spending or investment. And, as suggested above, nothing in this opinion should be construed to comment on whether the Legislature, if it chose to do so, could amend the scope of §81-2032.

CONCLUSION

The district court correctly concluded that §81-2032 foreclosed the relief J.M. sought in this proceeding. The court's judgment is affirmed.

The law on whether exempt funds that are then deposited in bank accounts remain exempt mostly favors debtors, often based on either a close statutory reading or legislative intent to sweep broadly. Debtors may lose their rights in exempt funds if the money becomes commingled and cannot be traced or in some instances, if funds are accumulated beyond the amount needed for daily care and maintenance. *See In re Schoonover*, 331 F3d 575 (7th Cir. 2003) (holding that Illinois exemption does not protect "hoards of cash" of over $75,000 because it was meant to protect "minimum monthly income of beneficiaries").

C. Consumer Bankruptcy

Perhaps the ultimate debtor remedy is bankruptcy. Consumers generally file either chapter 7 bankruptcy or chapter 13 bankruptcy. Chapter 7 is liquidation bankruptcy. A bankruptcy trustee takes any non-exempt property of the debtor and sells it for the benefit of the debtor's creditors. Any unpaid debt is discharged. The entire process usually takes about four months. Chapter 13 is repayment bankruptcy. The debtor can retain all property, regardless of exemptions, but must pay any disposable income (income less certain permissible expenses) to a trustee for a period of three to five years. The trustee collects this income and distributes it to the debtor's creditors. In chapter 13, the debtor can even retain property subject to security interests and can catch up on missed payments over time, although to keep the property the debtor must remain current on the ongoing obligations. If the debtor makes all plan payments, he or she will emerge with their property intact and have any remaining amounts owed to unsecured creditors discharged.

In either chapter, the debtor gets immediate relief from bankruptcy in the form of the automatic stay. Upon the filing of a bankruptcy petition, the law prohibits most collection actions. 11 U.S.C. §362(a). This includes most evictions, shut off of utilities, repossession, and the like. The automatic stay continues until the end of the bankruptcy case. Creditors may seek relief from the stay by asking the bankruptcy court to permit it to take actions prohibited by the stay. If a debtor continues to miss mortgage payments during bankruptcy, for example, the court will frequently lift the stay to allow the mortgage servicer to foreclose.

The definition of the debtor's property in bankruptcy, termed "property of the estate," is very broad. The reason, in part, is to give full effect to the automatic stay. This often comes as a surprise to secured creditors, for whom every repossessed car is a potential trove for recovery of unpaid debt.

Mitchell v. BankIllinois (In re Mitchell)

316 B.R. 891 (Bankr. S.D. Tex. 2003)

ROSENTHAL, District Judge.

Appellant BankIllinois financed debtor/appellee Georgina Mitchell's purchase of an automobile in 2000. On March 12, 2002, BankIllinois repossessed Mitchell's vehicle for failure to make payments. Later that same day, Mitchell filed for bankruptcy protection under Chapter 13 of the Bankruptcy Code. Mitchell demanded that BankIllinois return her vehicle, but BankIllinois refused. Mitchell filed a Complaint for Turnover and for Damages in the bankruptcy court. The court found that the vehicle was property of the bankruptcy estate under 11 U.S.C. §542(a) and that BankIllinois had violated the automatic stay imposed under 11 U.S.C. §362(a)(3) by failing to return the vehicle in response to Mitchell's demand. The court awarded Mitchell $8,520.97 in actual damages and attorney fees under 11 U.S.C. §362(h). BankIllinois appeals this judgment, arguing that an automobile repossessed prepetition is not property of the estate and that BankIllinois was entitled to hold the vehicle until Mitchell demonstrated that its interest in the vehicle was adequately protected. BankIllinois contends that although Mitchell provided proof of insurance for the automobile, this did not show adequate protection of BankIllinois's interests.

After careful consideration of the parties' submissions and the record on appeal, with the applicable law, this court affirms the bankruptcy court's ruling. The reasons are set out in detail below.

I. BACKGROUND

Mitchell purchased a 1997 Chevrolet Monte Carlo (the "vehicle") on December 5, 2000. BankIllinois financed Mitchell's purchase. BankIllinois repossessed the vehicle on March 12, 2002, after Mitchell failed to make payments. Later that day, Mitchell filed a Chapter 13 bankruptcy petition. Mitchell notified BankIllinois by facsimile of the bankruptcy filing and demanded that BankIllinois return the vehicle. Mitchell included proof of her insurance on the vehicle in this facsimile.

The next day, counsel for BankIllinois replied to Mitchell's facsimile. In the reply, counsel stated that its bankruptcy attorney, John Maloney, was away until March 18, but the office would instruct BankIllinois to protect the vehicle until Maloney's return. BankIllinois's counsel also requested a copy of Mitchell's Chapter 13 plan.

On March 18, Maloney responded by letter. Maloney acknowledged receiving Mitchell's proof of insurance. Maloney contended that Mitchell only retained a right of redemption because the repossession occurred prepetition. Maloney stated that BankIllinois wanted to discuss "what arrangements can be made…that would allow your client to reinstate the loan," and to have "some serious Code Section 362 discussions." Maloney repeated BankIllinois's request for a copy of Mitchell's Chapter 13 plan, but made no reference to a need for additional proof of adequate protection.

In a facsimile sent to BankIllinois's counsel on March 19, Mitchell repeated her demand that BankIllinois return her automobile. Mitchell also stated that she had lost time at work and was renting a car in order to travel to work. Mitchell stated that she would file an adversary action for turnover of the automobile if BankIllinois did not return the vehicle.

On March 21, Mitchell filed a Complaint for Turnover and Damages in the bankruptcy court. On March 27, BankIllinois filed a motion for relief from the automatic stay of 11 U.S.C. §362 and for adequate protection. BankIllinois requested that this motion be considered on an emergency basis, but withdrew that request at the hearing on Mitchell's complaint

The bankruptcy court held an evidentiary hearing on Mitchell's motion for turnover on March 28, 2002. In that hearing, BankIllinois took the position that the vehicle was not property of Mitchell's bankruptcy estate and Mitchell had no possessory right in the car because it was repossessed prepetition. The bankruptcy court disagreed. Relying primarily on United States v. Whiting Pools, 462 U.S. 198 (1983), the bankruptcy court held that the vehicle was property of the estate and subject to turnover despite the fact that it was seized prepetition. The court found that under Texas law, ownership of collateral remains with the debtor until sale. Because of this, BankIllinois did not own the repossessed vehicle and the vehicle became property of the estate once Mitchell filed her Chapter 13 bankruptcy petition.

The court ordered BankIllinois to return the vehicle to Mitchell. The court stated that although BankIllinois was entitled to request adequate protection of its interest in the vehicle, BankIllinois did not request adequate protection in its initial correspondence with Mitchell, and only raised the issue of adequate protection six days after Mitchell filed her turnover action. The court concluded that "BankIllinois used possession of the vehicle to coerce [Chapter 13] plan treatment to its liking." The court found that BankIllinois willfully violated section 362(a)(3) and ordered it to pay $8,520.97 actual damages and attorney fees under section 362(h). The court did not award sanctions or punitive damages.

...

III. ANALYSIS

BankIllinois argues that the bankruptcy court erred in concluding that the vehicle was property of the estate. BankIllinois also contends that even if the vehicle was property of the estate, BankIllinois did not violate the automatic stay by refusing to return the vehicle on demand because its interest in the vehicle was not adequately protected.…

A. The Issue of Whether the Vehicle Was Property of the Estate

BankIllinois contends that the vehicle was not property of the estate because it was repossessed before Mitchell filed her Chapter 13 bankruptcy petition. Mitchell responds that under Texas law, she retained ownership of the vehicle after it was repossessed, so that the vehicle became property of the bankruptcy estate once she filed her Chapter 13 petition.

Under 11 U.S.C. §541(a)(1), a bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." Section 542(a) requires that an entity in possession of property "that the trustee may use, sell, or lease under section 363" must deliver that property to the trustee. The Supreme Court in *Whiting Pools*, 462 U.S. 198, held that if a secured creditor repossesses the debtor's property prepetition, that property may be included in the estate. "[Section] 542(a) grants to the estate a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of the proceedings." 462 U.S. at 207. *Whiting Pools* involved a Chapter 11 proceeding, and the Court reserved the question whether section 542(a) has the same effect in Chapter 13 proceedings. 462 U.S. at 208 n. 17. However, many courts have applied *Whiting Pools* to Chapter 13 cases. See In re Robinson, 285 B.R. 732, 735 (W.D. Okla. 2002); In re Sharon, 234 B.R. 676, 681-82 (6th Cir. BAP 1999); In re Spears, 223 B.R. 159, 163 (N.D. Ill. 1998); In re Richardson, 135 B.R. 256, 257 (E.D. Tex. 1992); In re Attinello, 38 B.R. 609, 610-11 (E.D. Pa. 1984).

The *Whiting Pools* Court stated that section 542(a) may not apply if the seizure of the property transferred ownership. Ownership under section 541 is determined under state law. Butner v. United States, 440 U.S. 48, 55 (1979); In re Thomas, 883 F.2d 991, 995 (11th Cir. 1989); In re Robinson, 285 B.R. at 735. Once the debtor's state law property rights are determined, federal bankruptcy law applies to establish the extent to which those rights are property of the estate. Butner, 440 U.S. at 55; In re Thomas, 883 F.2d at 995; In re Robinson, 285 B.R. at 735. This court must decide whether BankIllinois's repossession of the vehicle gave it ownership of the vehicle, or whether Mitchell retained ownership after BankIllinois took possession. This is a question of Texas law.

Under Tex. Bus. & Com. Code §9.609, a secured party may take possession of collateral after default without judicial process if it proceeds without a breach of the peace. After repossession, a secured party may sell, lease, license, or otherwise dispose of the collateral, so long as it provides the debtor notification before disposition. Tex. Bus. & Com. Code §§9.610-9.612. Under Tex. Bus. & Com. Code §9.617(a), "a secured party's disposition of collateral after default (1) transfers to the transferee for value all of the debtor's rights in the collateral." A secured party can accept the collateral in satisfaction of the debtor's obligation only with the debtor's consent. Tex. Bus. & Com. Code §§9.620(a). The secured party receives "all of a debtor's rights in the collateral" only after it accepts the collateral in satisfaction of the obligation. Tex. Bus. & Com. Code §9.622(a)(2).

Third parties purchasing repossessed collateral from the secured creditor generally require that the certificate of title reflect their ownership. Under Tex. Bus. & Com. Code §§9.619(b), title can be transferred from the debtor to the third-party purchaser after the secured creditor disposing of the property prepares a "transfer statement." The transfer statement must state: (1) that the debtor has defaulted on an obligation secured by specific collateral; (2) that the secured party has exercised its post-default remedies with respect to the collateral; (3) that, through the secured creditor's exercise of the right to dispose of the collateral, a transferee has acquired the rights of the debtor in the collateral; and (4) the name and mailing addresses of the secured party, the debtor, and the transferee. Tex. Bus. & Com. Code §9.619(a).

Section 9.619(b) provides:

> A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certificate-of-title system covering the collateral.

The "transferee" is the third party purchasing the collateral from the secured party that repossessed it.

Under sections 9.617 and 9.619(b), a third party purchasing the collateral from the secured creditor is entitled to "all of the rights of the debtor" in the collateral. The third-party purchaser obtains more than the right to redeem; it obtains ownership of the collateral. The secured creditor's rights are limited to enforcement of its security interest through disposing of the collateral. All of the debtor's rights in the collateral are transferred to the third-party purchaser when the sale is consummated. The secured party obtains the debtor's rights in the collateral by accepting the collateral in satisfaction of the debtor's obligation or purchasing the collateral. Tex. Bus. & Com. Code §§9.610(c), 9.622(a)(2). In *Comerica Acceptance Corp. v. Dallas Central Appraisal Dist.*, 52 S.W.3d 495, 497 (Tex. App.—Dallas 2001, writ denied), the court interpreted the meaning of the term "owner" under the Texas Tax Code, stating as follows:

> Interpreting "owner" to include a secured party in possession of property for purposes of selling it to recover on a debt does not comport with these rules of statutory construction. Simply stated, a lienholder is not an "owner" of the property within the common meaning of that term. Typically the lienholder does not enjoy any of the common benefits of ownership. A lienholder ordinarily has no legal right to share in any accretions to the collateral's value, or a legal obligation to bear any risk of lost value. A lienholder ordinarily has no right to possession or use of the property; what rights it has to use and possession are only in the context of its right to take possession of the collateral upon default and sell it pursuant to the security agreement.

See also In re Clelland, 268 B.R. 539, 540 (E.D. Ark. 2001) (finding that under Texas law debtor retained ownership of an automobile despite having lost possessory rights); In re Richardson, 135 B.R. 256, 257 (E.D. Tex. 1992) ("It is beyond dispute that Debtor's automobile, while lawfully repossessed prior to the filing of Debtor's bankruptcy petition, continues to be the property of the estate.").

A debtor's rights in repossessed collateral include the right to notification before the disposition of the collateral, Tex. Bus. & Com. Code §9.611; the right to any surplus from the disposition of the collateral, Tex. Bus. & Com. Code §9.615(d)(1); and the right to redeem the collateral, Tex. Bus. & Com. Code §9.623. These rights are transferred to a third-party purchaser on sale of the collateral. In *Whiting Pools,* 674 F.2d 144, 149-150 and n.8 (2d Cir. 1982), aff'd, 462 U.S. 198, (1983), the Court held that the debtor's similar rights in property repossessed prepetition made that property belong to the bankruptcy estate. Under *Whiting Pools*, the property rights Mitchell held in the vehicle under Texas law made it property of the estate. "While there are explicit limitations on the reach of §542(a), none requires that the debtor hold a possessory interest in the property at the commencement of the reorganization proceedings." In re Pluta, 200 B.R. 740, 743 (D. Mass. 1996) (citing Whiting Pools, 462 U.S. at 205-06). The estate had a possessory right in the vehicle under section 542(a).

BankIllinois cites two recent cases, *In re Kalter*, 292 F.3d 1350 (11th Cir. 2002) and *In re Lewis*, 137 F.3d 1280 (11th Cir. 1998), in support of its argument that the estate had no possessory right to the vehicle because it was seized prepetition. Subsequent cases criticize both these cases. See In re Robinson, 285 B.R. at 738 n.6; In re Sanders, 291 B.R. 97, 101 (E.D. Mich. 2003). Moreover, both decisions are distinguishable from the present case.

The *In re Lewis* court looked in part to the Alabama common law of conversion in determining that an automobile seized prepetition is not the property of the estate. Because Mitchell's property rights are based on Texas law, *In re Lewis* is inapposite.

In re Kalter stated that the term "debtor," as defined in the Florida UCC, included the owner of the collateral, even if that party was not liable for payment of the secured obligation. The *In re Kalter* court reasoned that the term "debtor" could refer to either the debtor or the creditor in possession of the collateral. 292 F.3d at 1354. The *In re Kalter* court found the language of the Florida UCC insufficient to establish ownership of vehicles repossessed prepetition, and relied on the Florida Certificate of Title statute to determine ownership. The Texas UCC, by contrast, provides sufficient guidance to determine ownership in this case. The Texas UCC defines "debtor" as "a person having an interest, other than a security interest or other lien, in the collateral." Tex. Bus. & Com. Code §9.102(a)(28). A "secured party" is "a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding." Tex. Bus. & Com. Code §9.102(a)(73). The sections of the Texas UCC regarding disposition of collateral seized after default make it clear that the party seizing the collateral is a secured party and that the defaulting party is the debtor. See Tex. Bus. & Com. Code §9.609-9.624. Because of this, the analysis of the Florida UCC in *In re Kalter* is inapposite. The terms of the Texas UCC are sufficient to determine that Mitchell's vehicle became property of the bankruptcy estate after she filed her bankruptcy petition; this court need not rely on Texas title statutes to determine ownership of the vehicle.

Following *Whiting Pools* and the majority of courts that have considered this question, this court finds that Mitchell's vehicle was property of the bankruptcy estate, despite the fact that BankIllinois seized it prepetition.

B. Whether BankIllinois Violated the Automatic Stay

BankIllinois contends that it did not violate the section 362 automatic stay by refusing to return the vehicle upon demand. BankIllinois argues that the proof of insurance Mitchell provided was not adequate protection of its interest in the vehicle.

Under section 362(a)(3), the filing of a bankruptcy petition acts as a stay of "any act…to exercise control over property of the estate." The courts disagree as to whether a creditor violates the automatic stay by refusing to turn over an automobile repossessed before the debtor filed a bankruptcy petition. The majority of courts have held that creditors retaining an automobile repossessed prepetition, after the debtor demands return and tenders adequate protection, violate the section 362(a)(3) automatic stay. See In re Sharon, 234 B.R. 676, 681-682 (6th Cir. BAP 1999); Carr v. Sec. Sav. & Loan Ass'n., 130 B.R. 434 (D.N.J. 1991); GMAC v. Ryan, 183 B.R. 288 (M.D. Fla. 1995); In re Knaus, 889 F.2d 773, 774-75 (8th Cir. 1989) ("the duty [to turnover property repossessed before the filing of a bankruptcy petition] arises upon the filing of a bankruptcy petition. The failure to fulfill this duty, regardless of whether the original seizure was lawful, constitutes a prohibited attempt to exercise control over the property of the estate' in violation of the automatic stay."). A creditor rejecting the debtor's tender of protection as inadequate may not retain the property, but must turn over the property to the debtor and turn to the bankruptcy court for relief. Id.

There is an emerging minority view that a creditor need not turn over collateral seized prepetition until adequate protection has been provided. See In re Spears, 223 B.R. 159, 166-67 (N.D. Ill. 1998); In re Fitch, 217 B.R. 286, 291 (S.D. Cal.

1998); In re Young, 193 B.R. 620 (D.D.C. 1996) (rejecting *In re Knaus* and finding that creditor that seized collateral before bankruptcy petition filed was entitled to demand adequate protection before turning over collateral); In re Richardson, 135 B.R. 256 (finding that the automatic stay is designed to preserve the status quo at the time of bankruptcy petition's filing and that refusal to return automobile seized before petition filed is consistent with maintaining the status quo and not a violation of the automatic stay). These cases hold that the creditor is entitled to retain possession of the collateral until the adequate protection question has been resolved. In re Spears, 223 B.R. at 166. The creditor may hold the collateral until the bankruptcy court determines that the debtor or bankruptcy trustee has met its burden of proving adequate protection under 11 U.S.C. §363(o)(1). See In re Young, 193 B.R. at 625.

The record shows that Mitchell provided BankIllinois proof of insurance on the vehicle in her initial March 12, 2002 letter demanding that BankIllinois return the vehicle. BankIllinois refused to return the vehicle after Mitchell demanded its return and provided proof of insurance. "Adequate protection" is meant only to assure that a secured creditor does not suffer a decline in the value of its interest in the estate's property, rather than to compensate the creditor for the bankruptcy-imposed delay in enforcing its rights in that property. In re Addison Properties, Ltd. P'ship., 185 B.R. 766, 769 (N.D. Ill. 1995). Courts consider proof of insurance adequate protection for a creditor's interest in a debtor's automobile. See In re Fitch, 217 B.R. at 291 ("Demanding proof of insurance is a valid request for assurance [that prepetition position will be protected]."); Carr, 130 B.R. at 436 (creditor obligated to turn over automobile after filing of bankruptcy petition and verification of insurance); In re Matthews, 118 B.R. 398 (D.S.C. 1989) (ordering turn over of automobile upon debtor's providing proof of insurance). Mitchell's vehicle was insured, protecting BankIllinois's interest.

The record shows that BankIllinois waited a substantial amount of time before asserting its right to adequate protection. Mitchell demanded that BankIllinois turn over the vehicle on March 12, 2002 and provided proof of insurance. Mitchell repeated her demand on March 19, 2002. (Debtor's Ex. 8.) Mitchell filed her Complaint for Turnover and Damages on March 21, 2002. BankIllinois waited until March 27, 2002, more than two weeks after Mitchell demanded the vehicle's return and provided proof of insurance, to move for relief from the section 362 automatic stay and to assert its right to adequate protection.

A creditor has immediate access to the courts to obtain assurance adequate protection of the collateral under 11 U.S.C. §362(e)-(f). Under section 362(e), the court may condition or prohibit the debtor's use of collateral as necessary to provide adequate protection of the creditor's interest. In re Zaber, 223 B.R. 102, 104 (N.D. Tex. 1998). A creditor can seek such relief on an emergency basis under section 362(f), if the creditor's rights are threatened with irreparable harm. "The creditor with a secured interest in property included in the estate must look to [section 362(e)] for protection, rather than the nonbankruptcy remedy of possession." Whiting Pools, 462 U.S. at 204. "While the creditor may suggest terms of adequate protection, it may not unilaterally condition the return of the property on its own determination of adequate protection.…Any prerequisite to turnover is determined by the bankruptcy court, not by the creditor." In re Sharon, 234 B.R. at 686 (quoting In re Colortran, Inc., 210 B.R. 823, 827-28 (9th Cir. 1997), reversed in part on other grounds, 165 F.3d 35 (9th Cir. 1998)); see also In re Jackson, 251 B.R. 597, 600-01 (D. Utah 2000).

If BankIllinois considered the proof of insurance inadequate to protect its interest in the vehicle, it could have filed a motion under section 362(e), on an emergency basis if necessary under section 362(f). Instead, BankIllinois waited until after Mitchell twice demanded the return of the vehicle and filed her turnover complaint. It is true that BankIllinois offered to have “some serious Code Section 362 discussions” before Mitchell filed her turnover complaint. BankIllinois contends that these discussions would encompass the question of adequate protection. Once Mitchell provided proof of insurance on the automobile, however, BankIllinois could not retain the automobile based on its unilateral determination that the insurance was not adequate protection. The record and applicable law support the bankruptcy court’s determination that BankIllinois’s refusal to return the vehicle violated the section 362 automatic stay.

C. Damages

The bankruptcy court awarded Mitchell $8,520.97 in actual damages, declining to award punitive damages under section 362(h). BankIllinois challenges the actual damages award as unreasonable.

Section 362(h) provides that “an individual injured by any willful violation of a stay provided by [section 362] shall recover actual damages, including costs and attorneys’ fees, and, in appropriate circumstances, may recover punitive damages.” A willful violation of the automatic stay occurs when the creditor acts deliberately with knowledge of the bankruptcy petition. In re Sharon, 234 B.R. at 687. A belief that withholding possession would not violate a stay does not preclude a finding of willful violation of section 362(h). In re Sharon, 234 B.R., at 687-88; In re San Angelo Pro Hockey Club, Inc., 292 B.R. 118, 125 (N.D. Tex. 2003).

Mitchell informed BankIllinois of her bankruptcy petition and provided proof of insurance on March 12, 2002. BankIllinois independently verified that the bankruptcy petition had been filed. BankIllinois continued to withhold possession of the vehicle deliberately and with knowledge of the bankruptcy petition. Even BankIllinois’s asserted belief that it was entitled to retain possession of the automobile until Mitchell provided adequate protection for the bank’s interest does not remove the willful nature of its actions. BankIllinois had ample opportunity to raise the adequate protection issue in the bankruptcy court before taking the actions that violated the automatic stay. In re Diviney, 225 B.R. at 774. Instead, BankIllinois waited for more than two weeks before raising the question of inadequate protection in the bankruptcy court, in response to Mitchell’s turnover motion. BankIllinois willfully violated the section 362 stay and is liable for Mitchell’s actual damages under section 362(h).

BankIllinois contends that Mitchell’s legal fees are unreasonable. BankIllinois notes that Mitchell’s initial complaint incorrectly alleged that the vehicle was repossessed after the bankruptcy petition was filed and the automatic stay went into effect. BankIllinois contends that Mitchell’s counsel did not cooperate with its efforts to settle the case, delaying a resolution and increasing the attorney fees both parties incurred.

The bankruptcy court’s award of attorney’s fees is reviewed for abuse of discretion, as are determinations regarding rates and hours.…

The bankruptcy court noted the fact that much of the litigation in the adversary proceeding related to the issue of whether BankIllinois was liable for repossessing the vehicle postpetition, which resulted from the inaccurate allegation in Mitchell's complaint. The bankruptcy court also reviewed Mitchell's counsel's billing records as a whole and determined that some of the fees were charged for work unrelated to this case. The bankruptcy court reduced Mitchell's attorney fee recovery by $2,000 to account for these expenditures.

...

BankIllinois argues that Mitchell rejected its offers to negotiate a settlement, prolonging the action and unnecessarily increasing the attorney fees incurred. BankIllinois contends that "the bargaining leverage was all on the debtor's side" because BankIllinois, an out-of-town bank, was forced to defend a suit over a car with a value of only $7,650.

The record reveals that the bank's conduct contributed to the delays. Mitchell waited over a week before receiving a response to her demand. Mitchell made a second demand that BankIllinois return her car, threatening to begin a turnover proceeding, before BankIllinois responded to her request. BankIllinois's contention that Mitchell held "all the bargaining leverage" is inconsistent with the fact that BankIllinois retained possession of the vehicle even after Mitchell provided proof of insurance. The record shows that Mitchell lost wages and incurred rental car charges during the period BankIllinois refused to return the car. BankIllinois's decisions to retain the vehicle after demand and to delay any challenge to the adequacy of the insurance as protection for its interest violated the section 362 automatic stay. These decisions delayed the resolution of the action and caused Mitchell to bring this adversary action.

The fact that Mitchell's actual damages and attorney fees are roughly equal to the value of the vehicle does not make the award unreasonable. BankIllinois's failure to return the vehicle required Mitchell to file the turnover action. Disproportion alone does not make an award of attorney fees excessive. See Northwinds Abatement, Inc. v. Employers Ins. of Wausau, 258 F.3d 345, 354-55 (5th Cir. 2001) (award of attorney fees that was three times the size of trebled damages award not unreasonable solely on that ground). Mitchell prevailed on all her claims. An award of attorney fees roughly equal to the damages she suffered is not so disproportionate as to make the attorney fee award excessive.…

IV. CONCLUSION

The bankruptcy court's ruling is affirmed. Mitchell is entitled to receive $8,520.97 in actual damages, plus attorney fees and costs incurred in defending this appeal. Mitchell must submit documentation of the fees incurred in defending this appeal within ten days from the date this Memorandum and Order are filed.

As the bankruptcy case progresses, debtors enjoy the other benefits of bankruptcy: retention of property and a discharge of all or most of their debts. There are specific exemptions that either replace or supplement the state exemptions for bankruptcy debtors. 11 U.S.C. §522. Discharge in bankruptcy is a permanent injunction against taking any action to collect debts. Certain debts, such as domestic support obligations (known as spousal or child support outside the bankruptcy context), are not dischargeable. Other debts, such as taxes and student loans, are dischargeable only if certain conditions are satisfied. 11 U.S.C. §§523, 727. Note that the discharge does *not* prohibit the enforcement of a security interest or mortgage (a major difference between it and the automatic stay). If a debtor wants to retain collateral after the bankruptcy ends, she will need to be current on payments and otherwise not in default.

In chapter 7 bankruptcy, discharge usually occurs about four to six months after filing the case. In chapter 13 bankruptcy, discharge usually requires completion of the three to five year repayment plan. Nearly all debtors qualify for a discharge, with two notable exceptions. *Pro se* debtors often get tripped up by the paperwork requirements of bankruptcy and have cases dismissed for noncompliance. Repeat filers also are limited in how often they may receive a discharge, with at least four years and often as many as eight years, needing to elapse to renew eligibility. That said, only about 30-40 percent of those who file chapter 13 complete the promised repayment and receive a discharge. In chapter 7, the discharge rate is above 95 percent.

Problem Set 22

22.1. Household Helpers has store-front operations in low-income areas. It sells new and used household items and provides financing for purchases that exceed $100 in total. It also cashes paychecks and provides short-term emergency loans to its customers. Do the following transactions by Household Helpers violate the FTC Credit Practices Rule? 16 C.F.R. §§444.1-444.5.

a. Jacob Abiola would like to buy a washer/dryer set from Household Helpers. It has agreed to lend him 80 percent of the $1,000 purchase price. The contract requires that Jacob have the loan payments of $45 deducted from each of his paychecks. It also states that Jacob gives Household Helpers a security interest in the washer and dryer. State law specifies that such property is exempt.

b. Solomon Willig purchased a new Blu-Ray DVD player and video gaming system from Household Helpers. He borrowed $200 at the time of the transaction, offering the DVD player and gaming system as collateral. He made all the payments as they came due and paid off the loan in six months, at a total cost of $250. He would now like to buy a used personal computer from Household Helpers. It is willing to lend him $400 for the computer purchase, provided that Solomon gives Household Helpers a security interest in the Blu-Ray DVD player and video gaming system.

c. On January 3, Abby Hoffman borrowed $400 from Household Helpers to pay her overdue heating bill. The interest rate was eye-popping but Household Helpers required no collateral, which was a relief to Abby, who didn't want to put any of her property at risk. The loan payments began two weeks later. Abby made the first payment of $75 in full and on time on January 17. She paid her second $75 payment, due one week later on January 24, two days late, on January 26. Household Helpers sent her a letter stating that she owed them a $20 late fee and to send them $95 by February 9. Abby only had $75, however, but she mailed in that amount on time by February 9. Household Helpers applied $20 of the $75 payment to the late fee, leaving her short on making the regular payment of $75. It then assessed her account another $20 late fee for failing to pay the $95 by February 9.

22.2. Dean Peters is employed as a free-lance graphic designer by an advertising agency and his expected calendar year earnings are $52,000. Finance Co. recently obtained a $10,000 judgment against Dean Peters. If Peters' weekly "disposable earnings" are $800, how long will it take Finance Co. to satisfy its judgment by garnishing his wages? Can you take any additional steps to collect the judgment if (a) Peters deposits his earnings in a checking account at First Bank and (b) the checking account currently has a balance of $12,000? Assume that only federal law is applicable. See 15 U.S.C. §§1672 and 1673.

22.3. Masu Haque has come to see you about her serious debt problems. She makes about $28,000 a year as a teacher's aide in a preschool but was out of work last year for three months after a back injury. Her current wages are reduced by $100 per week because a credit card company obtained a garnishment order. She owes about $13,700 in unsecured debt, including medical bills, an unsecured loan from her credit union, and store credit cards. She also owes $7,500 on her car loan and another $400 to an auto repair garage. Her ex-husband is owed $400 in overdue alimony; while Masu has limited money, he is unemployed and desperately needs her to pay him so he has some funds. Masu is worn down with the collection calls and worries that her chiropractor is going to refuse to see her for ongoing treatment unless she pays him off. She is twelve days behind on her rent, and she fears her landlord will act quickly to evict her. She hastens to add that even if she stays in her apartment, she is just waiting for the lights to go out, as she is three months behind on her electrical bill. She wants to know if she files chapter 7 bankruptcy whether that will solve her immediate problems with paying her bills. What do you tell her? See 11 U.S.C. §362(a) and (b).

Assignment 23. Debt Collection Abuses

Debt collection is a fairly common experience. In 2014, the Urban Institute found that 35 percent of Americans have at least one debt in collection. While some of these creditors have given up, debt collectors are a part of many Americans' lives. Estimates are that about one in seven households has contact with a debt collector in a year. In part, the incidence of debt collection reflects default rates, but it is also shaped by greater use of technology such as remote call centers and consumer information databases. It is easier and cheaper to email someone than chase a debtor physically across the West to Texas, a refuge in America's early years for debtors. *See* Bruce Mann, *Republic of Debtors: Bankruptcy in the Age of American Independence* (2002).

Many Americans find their interactions with debt collectors to be unsatisfying, to understate the situation. In each of the last several years, the most complained about industry to the Federal Trade Commission was debt collection. In 2014, debt collection was the subject of more than one-third of complaints to the Consumer Financial Protection Bureau. *Consumer Response Annual* Report (2014), http://files.consumerfinance.gov/f/201503_cfpb_consumer-response-annual-report-2014.pdf.

The federal statute, the Fair Debt Collection Practices Act (FDCPA), is the foundational law. It is fairly well settled, in part because for a number of years there was little public enforcement. Between 2005 and 2010, the FTC brought an average of just two actions per year against collectors. Jessica Silver-Greenberg, *Consumers Cry Foul Over Debt Collectors*, WALL ST. J. C1 (Dec. 15, 2011). That seems poised to change. In late 2015, the state attorneys general, the CFPB, and the FTC announced a collaborative initiative to enforce the laws applicable to debt collectors. Yuka Hayashi, *Regulators Ramp-up Debt Collection Crackdown*, WALL ST. J. (Nov. 4, 2015). Late 2015 saw over 30 enforcement actions, multiples of prior years. Some companies were shut down, while others faced multi-million dollar fines. Debt collection law is entering a regulatory renaissance, much to the chagrin of the industry and cheers from consumers.

A. Prohibited Acts

The basic approach of the FDCPA is to ban certain kinds of practices, and then provide a non-exclusive list of specific acts that fit into those categories. The trio of prohibited practices are those that are "harassment or abuse," §1692(d), "false or misleading representations," §1692e, and "unfair practices," §1692(f). Although the case below is an oldie, the tactics of debt collectors have changed little in subsequent decades. The kinds of tactics that motivate debtors to pay have remained unchanged. This case provides a detailed description of the pattern of conduct often involved in the collection process.

Bingham v. Collection Bureau, Inc.

505 F. Supp. 864 (D.N.D. 1981)

VAN SICKLE, District Judge.

This is an action by consumers, Michael and Peggy Bingham, against two related collection agencies, Collection Bureau, Inc. (CBInc), and Collection Bureau of North Dakota, Ltd. (CBLtd) for violations of the Fair Debt Collection Practices Act, 15 U.S.C. §1692 et seq.

Plaintiffs allege that the defendant CBInc violated the act in the following particulars:

a. Failure to give the written notice required by 15 U.S.C. §1692g.
b. The making of an unconscionable interest claim in violation of 15 U.S.C. §1692f(1).
c. Harassment by annoying telephone calls in violation of 15 U.S.C. §1692d(5).
d. Extortion by threat of imprisonment in violation of 15 U.S.C. §1692e(4).
e. Harassment by false threats of intent to take legal action in violation of 15 U.S.C. §1692e(5).
f. Slanderous representations that debtors were committing a crime in violation of 15 U.S.C. §1692e(7).
g. Falsely threatening nonjudicial attachment and garnishment in violation of 15 U.S.C. §1692f(6).
h. False and deceptive means to collect a debt by using two corporations with deceptively similar names in violation of 15 U.S.C. §1692e(10).…

The defendants generally deny all allegations of wrongdoing…and allege conscientious efforts to obey the spirit and language of 15 U.S.C. §1692, et seq. (Fair Debt Collection Practices Act), while still performing their economic obligation of liquidating bad debts.

FACTS

…

Michael and Peggy Bingham are a young married couple who must rely on the unskilled labor market for their livelihood. They have two children, Rebecca, born in 1977, and Robert, born in 1978. Peggy Bingham, who claims substantial damages to her personality by virtue of the conduct of the collectors, is 22 years old, obese, doll like, described by a psychologist witness as unsophisticated, immature, with limited ability to act without a leader, having an inadequate dependent personality. In 1977 they were living in Brinsmade, North Dakota. Rebecca was born in Mercy Hospital, Devils Lake. The Binghams had made several payments on current services but the 1977 bill and several subsequent accounts had been written off by the creditor hospital, and set over for collection.

March 23, 1979, Mercy Hospital sent to CBLtd a list of accounts for collection. The accounts, due by the Binghams, as transferred showed a balance of $958.65 due, included no loading for interest, and were computed from the hospital records by the hospital finance officer, Mr. Lindell.…Both parties have agreed that the first notice of a five notice system was sent and received sometime between March 23, 1979 and April 24, 1979.

First was the “Urgent” notice.

April 24, 1979 the “Past Due” notice was sent.

April 24, 1979 the “Please Take Notice” notice was sent.

(Why they were sent out the same day was never satisfactorily explained except for the suggestion this occurred during the changeover from manual to computer record keeping.)

May 5, 1979 the “Avoid Further Action” notice was sent.

May 14, 1979 the “Notice of Further Action” notice was sent.

These five notices had in common:

a. They showed CBLtd as mailer.
b. They directed payment to Mercy Hospital.
c. They showed the balance due as $958.65.

CBLtd sent these notices out for a fee of $4.95. They were sent with an understanding between the hospital and the collector that upon completion of the five notice series, the hospital, if it assigned the account for more aggressive collection, would assign it only to CBInc. CBInc took such assignment on a fee schedule which was computed at one-third for collection prior to authorization to sue, and 50% if the creditor did in fact authorize suit.

The five notices elicited no response from either plaintiff. Mr. Bingham explained that:

“I had heard from other guys it was hard to talk to the management at Devils Lake so I didn’t try.”

Mrs. Bingham asserted that she had no recollection of receiving the first notice. She received the second and third cards at the same time. And from the language of the fourth card she perceived a threat to put her in jail. She interpreted the fifth notice as a threat to bring a civil action to collect, carrying it to judgment if necessary. The first payment made in 1979 was made on June 1, 1979. It was received by the hospital and credited to a more recent account which had not been written off as a bad debt and set over for collection.

At the conclusion of the five notice program, CBLtd, then…[went] forward with the next collection stage, that is, the telephone collector stage.

This stage called for skip tracing the debtor to determine whether telephone contacts were possible, and to gather information which would assist in a recommendation to sue or not to sue out the account, while exerting telephonic pressure to effect collection. This stage and the litigation stage were both handled under the name of CBInc.…Vickie Eichbaum, a skip tracer, traced the Binghams to Maddock, North Dakota. Michael Bingham answered the call to the Maddock number.

In keeping with well established policy the skip tracer, immediately upon learning that she was talking to the debtor, transferred the call to Jerry Huseby whose telephone alias was “Mr. Mattson.” The call should normally have gone to Clyde Hardesty whose telephone alias was “Mr. Hager,” because Mr. Hardesty was handling the debtors’ names from A to F.

Mrs. Bingham testified precisely and consistently as to the time, circumstance, and language of each telephone call. In fact, on cross examination she was unable to discuss the calls except in the order of her recital, thus communicating the suggestion of rote, rather than recollection testimony. Mrs. Bingham testified:

That all calls except the call-back of June 19, made at 10:30 to 11:00 P.M., were made at 10:30 to 11:00 A.M., and she knew this because they all came while she was preparing potatoes for lunch. That the caller always gave his name (alias), the name of his employer (CBInc.), and the name of the account (Mercy Hospital).

She testified to a total of 14 calls as follows:

1. June 11, 1979, Monday. First call, a woman may have asked her to hold. Then Mr. Mattson stated he was calling for Mr. Hager. Stated it was about the hospital bill, amount $958.65, inquired about deposits, land, stock, inheritance, jewelry, “do you have a wedding ring?” Told her unless she paid her bills she could go to jail. Asked to have her husband call back.
2. June 18, 1979, Monday. Mr. Hager called. Inquired where Michael worked, she told him but told him not to call the place of work. How much he made. She told him $120.00 a week. Asked for one whole check. She said she could not. Asked for $70.00 from each check. She offered $10.00 per week. He stated that was not enough.
3. June 19, 1979, Tuesday. Mr. Hager called. Said $10.00 was not enough. Said she shouldn’t have children if she couldn’t afford them. She told him that she, a Catholic, couldn’t break her marriage vows.
4. June 20, 1979, Wednesday. Mr. Hager called. Wanted them to borrow the money.
5. June 21, 1979, Thursday. Mr. Hager called. Wanted to be paid right now.
6. June 25, 1979, Monday. Mr. Hager called. Told her to borrow from her parents. Unless paid he would garnish their wages and would have papers served on them.
7. June 26, 1979, Tuesday. Mr. Hager called. Urged them to borrow. Threatened garnishment.
8. June 27, 1979, Wednesday. Mr. Hager called. Said pay by July or else we will serve papers and garnish.
9. June 28, 1979, Thursday. Mr. Hager called and asked if she had the money. She said no.
10. June 29, 1979, Friday. Mr. Hager called.
11. June 29, 1979, Friday. Mr. Hager called in the evening.

12 & 13. July 6, 1979, Friday (long 4th of July weekend). Mr. Hager called. Michael Bingham answered. Hung up. Hager called back in a few minutes. Peggy’s mother answered. Told Hager she was paying the phone bill and he was not to call on her phone again.

14. July 11, 1979, Wednesday. Mr. Hager called. She told him “anything further, call my lawyer.”

Jerry Huseby (Mattson) testified that he spoke to Peggy on June 11. That despite the policy to record all debtor contacts, he did not record on either the account card, or the computer, this call. He denied he has ever threatened any debtor, including Peggy, with “going to jail.” He denied any reference to a wedding ring.…Clyde Hardesty (Hager) stated that he was on vacation June 2 through 18, 1979. That he knew he was subject to telephone monitoring; that he called at the most on any account every other day. That he realized the danger of a claim of harassment, and as a business man he knew that given the work load of a collector, in excess of 100 calls a day, even an account this size could not be worked more often than every second or third day. He recalled two contacts on the 28th of June, and two contacts on the 11th of July. One was the call-back when he talked to Peggy’s mother and one was a late call as authorized by Peggy. He did not always record no-answer calls. He denied using profanity. He denied calling to harass.…

He denied making any call on June 19, 1979. He claimed he never has and never would have told a woman she should not have children unless she could afford them. He denies he called on June 20, 1979. He would tell a debtor that legal action to enforce a claim was a possibility and such an action could result in judgment and garnishment in aid of execution. He does ask if a young debtor can get help from parents. He did not and would not tell a debtor that it was illegal to refuse to pay a debt and he or she could go to jail.

On July 2, 1979 he recommended an assignment of the Bingham account and when it was returned to him, in the usual manner referred the claim to the legal department for suit. Return of the assignment began the third stage, reduction of the claim to judgment. In the course of this stage, Binghams received a notice of referral for action.…

The following payments were made in the course of the collection efforts:

June 20, 1979, $10.00 paid to hospital; June 26, 1979, $10.00 paid to hospital; July 03, 1979, $10.00 paid to hospital; July 19, 1979, $10.00 paid to hospital; July 25, 1979, $10.00 paid to hospital.

This extended recital of the facts is made because of the numerous issues raised as to the application of a statute that has heretofore received little judicial interpretation.

GENERAL PRINCIPLES

In 1977 a new title was added to the Consumer Credit Protection Act. It was the Fair Debt Collection Practices Act, 15 U.S.C. §1692, which is in the tradition of “social legislation” so dear to the heart of William O. Douglas. His attitudes have been reflected in the approach and policies of the Federal Trade Commission since the days when he headed it in the early 1930’s.

It was in keeping with this tradition that the statute was drafted for administration by the Federal Trade Commission. It is clearly addressed to protecting the weak and unsophistical debtor from abusive, dishonest and sharp collection practices. The initial paragraph of the statute reads:

> 15 U.S.C. §1692(a). "There is abundant evidence of the use of abusive, deceptive and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy."

...

However the framers of the statute recognized that the vast majority of the collectors are ethical persons and a purpose of the act was not to impose unnecessary restrictions on ethical debt collectors. U.S. Code Cong. & Admin. News, 1977, Vol. 2, pp. 1695, 1696.

The drafters recognized that:

> "Unlike creditors, who generally are restrained by the desire to protect their good will when collecting past due accounts, independent collectors are likely to have no future contact with the consumer and often are unconcerned with the consumer's opinion of them." U.S. Code Cong. & Admin. News, supra, p. 1696.

But, nevertheless, the abrasive persuasive collector is the adverse side of the coin of the unctuous persuasive credit extender, and the statute must be considered with that fact in mind.

...

FINDINGS AND CONCLUSIONS

...

Before evaluating the lawfulness of the telephone contact program, a few general observations are in order:

The telephone collectors who testified had certain characteristics in common. They were all young, competent verbalizers, with resonate voices and an authoritative manner of speech. They had better than average intelligence and had a touch of arrogance and of ruthlessness.

Telephone contacts as distinguished from personal contacts, while more efficient in terms of number of contacts made, and increased gross collections, are less efficient in terms of excellence of each contact, and extent to which an accurate evaluation of the debtor's situation, capacity, state of mind, etc., can be made.

Statements made and language used in a telephone contact can be and often are more oppressive than the same communication made in a face to face situation.

Plaintiffs claimed a total of fourteen calls. Defendant stated that the policy, subject to judgment decisions of the collector, was to average not more than one call every other day. "Hager" also claimed that aside from the opening call taken by "Mattson" he was on vacation and unable to make that many calls. "Mattson" took the call of June 11. "Hager" was absent until June 18. "Hager" stated he must have been absent until June 24 because he bought gas in North Sioux City, South Dakota, on June 22, and in Fargo on June 23. But the calls were logged on June 21 and June 25. "Hager" could easily have driven to North Sioux City, South Dakota, on the week end of June 21, leaving after work on Thursday. The Binghams made their first remittance generated by the collection effort on June 20. This payment was more likely caused by calls on June 18 and June 19, than the week old call of June 11. And while all telephone contacts are supposed to be logged, admittedly the call records on the computer printouts are not accurate.

Finally, fourteen calls between June 18 and July 11 is about one call every other day. So I conclude that it is more likely so than not so that the schedule of calls reported by Peggy is accurate.

Plaintiffs claim harassment was evidenced by the number of calls and the time of day of the calls. 15 U.S.C. §1692d(5) describes the violation of:

> "Causing a telephone to ring or engaging any person in telephone conversation repeatedly or continuously with intent to annoy, abuse, or harass any person at the called number."

The calls came in a pattern of four days of calls, then four days of no calls. The calls produced results in terms of payments, and neither Peggy nor Michael told the caller to stop calling until July 11, when he did stop.

So I find no harassment in the number of calls.

As to the time of day of the calls, 15 U.S.C. §1692c(a)(1) provides that generally a debt collector may not communicate with the debtor:

> "at any unusual time or place or a time or place known or which should be known to be inconvenient to the consumer. In the absence of knowledge of circumstances to the contrary, a debt collector shall assume that the convenient time for communicating with a consumer is after 8 o'clock antimeridian and before 9 o'clock post-meridian, local time at the consumer's location."

I interpret this statute to apply to telephonic communications.

The June 29 evening call was at the suggestion of Peggy. It was not harassment. It was not at an unreasonable time.

The July 6 call was terminated when Michael hung up after both parties were identified to each other. The recall came immediately. That was harassment.

As to the contents of the calls: My conclusion that the calls were made does not include a finding as to the contents of the calls.

As to the call of June 11, and the reference to the wedding ring. Inquiry as to the assets of the debtor is a necessary step for a collector to take. Inquiry as to jewelry, including rings, is not surprising in light of the current news coverage of the liquidation of jewelry because of the inflationary price of gold. I conclude that an inquiry as to assets including jewelry, for example, wedding rings, was made. But the inquiry was not interpreted as the inquirer intended. This is an example of the risk of telephonic communications with the less sophisticated. The applicable statute to this situation is the general prohibition against harassment, 15 U.S.C. §1692d.

I conclude that a telephonic inquiry by the collector about personal jewelry, which includes references to highly personal items like wedding rings, does have a natural consequence to harass, and therefore find it was harassment.

As to the threat of "going to jail." Peggy first claimed the threat was embodied in Form No. 4, then she found it again in the call of June 11. I conclude that her testimony as to this threat is not reliable.

As to the call of June 19, and the claimed statement by “Hager” that Peggy should not have children if she could not afford them. This call was one covered by Peggy’s testimony from notes. This remark is not the kind which would have been pulled out of thin air by the witness. Her claimed response that she protested she could not violate her marriage vows shows she may be coloring the original remark by her recollection of the response. I conclude that some remark to that sense was made. I also conclude that any remark of that tenor in a telephonic collection contact is egregious and that the remark was harassment.

As to the claim of repeated threats of garnishment not in aid of execution. Peggy admitted she kept no notes of what was said after the first few calls, and her recollections ran together. Cross examination of the collectors demonstrated that they were sensitive to the risk of oppression by inaccurate and repeated threats of judgment, garnishment, attachment, etc., all of which can only follow a decision to sue, a successful suit, and proper procedures in aid of execution of a judgment.

But a discussion of the ramifications of suit does have its place in collection dialogues. I conclude that the plaintiffs have failed to establish that they suffered harassment and abuse because of improper discussions by the collector, of the possibility, and foreseeable consequences of civil action to collect.

...

B. Scope of FDCPA

Although the FDCPA could sweep in a large number of practices, its reach is sharply limited because it does not apply to all entities. The FDCPA only applies to “debt collectors,” defined as “any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another.” 15 U.S.C. §1692a(6). The key exclusion is also made explicit. A debt collector is not “any officer or employee of a creditor, while in the name of the creditor, collecting debts for such creditor.” The FDPCA only applies to third-party debt collectors, not those working on behalf of themselves. The effect is to prohibit certain behavior by certain people, not to prohibit the behavior regardless of the actor.

There are several explanations for the limited scope of the FDCPA. At the time of its enactment, the worst abuses may have been committed by third-party debt collectors. Without evidence of problematic actions by creditors, perhaps Congress simply wrote a narrow statute. The counterpoint is that if creditors were already following the law, then what is the harm in extending its reach to apply to them? And any suggestion that creditors and debt collectors use different debt collection practices begs the question why creditors might be more restrained. One answer is reputation. Debt collectors may benefit from being known as ruthless or tough. Who would you pay first, "Brass Knuckles Collection" or "Fluffy Kitten Collection"? If a consumer is scared or upset, that just makes for easier work the next time the debt collector calls them. Original creditors, on the other hand, deal primarily with consumers as purchasers of goods or as borrowers who do repay their obligations. These customers might go elsewhere if a store's or business's reputation was unsavory. Another explanation is that debt collectors might be difficult to sue because they have few assets and simply close down if sued and reopen as new legal entities. This may well be true but it suggests a different enforcement mechanism for debt collectors, not different substantive liability. The most cynical explanation is that debt collectors do not have the lobbying power of original creditors, which include large retailers who sell on installment credit, and so Congress "solved" the problem of debt collection by imposing restrictions only on a small segment of those engaged in collection.

But not all those who fancy themselves as having political clout escaped the FDCPA's scope. You, dear future lawyer, need to read on.

Dickman v. Kimball, Tirey & St. John, LLP

982 F. Supp. 2d 1157 (S.D. Cal. 2013)

MILLER, District Judge.

ORDER DENYING DEFENDANT's MOTION TO DISMISS

On August 27, 2013, Plaintiff filed a complaint alleging Defendant violated the Federal Fair Debt Collection Practices Act ("FDCPA").…

BACKGROUND

On June 15, 2012, Plaintiff entered into a residential lease agreement for property located in Escondido, California ("the Escondido Property"). Plaintiff signed the lease on June 27, 2012, for a one-year term starting on July 1, 2012, and ending on June 30, 2013; however, Plaintiff alleges the lease contains a typographical error stating that it terminated on June 30, 2012. Plaintiff entered into the lease agreement with ENL Investments, LLC and Ed Forrester. Ed Forrester is the owner of ENL Investments, LLC, and he was Plaintiff's point of contact regarding the lease agreement. Plaintiff began residing at the Escondido Property on July 1, 2012.

The lease agreement required Plaintiff to make monthly rental payments of $1,900.00 by electronic deposit into ENL Investments, LLC's bank account. Plaintiff alleges that it was her regular practice to timely make these deposits at the beginning of each month. Plaintiff's payments were processed online by her bank and cleared her account on the next business day.

Unbeknownst to Plaintiff, a notice of default and notice of trustee's sale had been recorded against the property prior to the date that she signed the lease agreement and took possession of the property. On July 5, 2012, Mr. Forrester filed for bankruptcy relief under Chapter 7 of the bankruptcy code. As a result, a pending foreclosure sale on the Escondido Property was rescheduled for August 23, 2012. Mr. Forrester filed papers with the bankruptcy court claiming to be an owner of the Escondido Property pursuant to an unrecorded quit claim deed prepared prior to the date that he filed for bankruptcy relief. Plaintiff alleges she was unaware of the scheduled foreclosure sale of the Escondido Property.

On August 23, 2012, U.S. Financial, LP ("U.S. Financial") bought the Escondido Property at the trustee's sale without Plaintiff's knowledge. A trustee's deed was delivered to the County recorder's office for recording on August 31, 2012. As a result of the standard procedures used by the San Diego County Recorder's Office, the transfer deed did not become visible in the public record until two business days later on September 5, 2012. Plaintiff received no notice of the recorded deed prior to its public filing.

During the foreclosure process, Plaintiff initiated the electronic funds transfer on Saturday, September 1, 2012, to pay rent to ENL Investments, LLC for the month of September. As the payment was made on a three-day weekend, the payment did not clear Plaintiff's bank account until September 4, 2012. Plaintiff alleges that she did not have actual or constructive notice of the transfer of the Escondido Property to U.S. Financial at the time she made the September rent payment.

On about September 9, 2013, Don Rady, the owner of U.S. Financial, left a business card for Plaintiff at the Escondido Property. The back side of the business card had a handwritten note stating that "we are the new owners of this house, please call us." This card was the first actual notice Plaintiff received that ownership of the Escondido Property had changed hands. On September 13, 2012, Defendant, acting as legal counsel for U.S. Financial, drafted, signed, and directed that a three-day Notice to Pay Rent or Quit ("Notice") be served on Plaintiff. Plaintiff received service of the Notice on September 13, 2012.

The Notice demanded payment of $1,900.00 for September rent "WITHIN THREE DAYS" or legal proceedings would be instituted to recover possession of the subject premises, court costs, attorney's fees, and statutory damages up to $600.00. The Notice further informed Plaintiff that if she failed to pay the requested $1,900.00 within three days, the owner of the subject premises would elect to declare Plaintiff's rental agreement for the Escondido Property forfeit. This suggested to Plaintiff that her rental agreement was still in effect.

At the same time that Defendant served the Notice on Plaintiff, Defendant also sent a letter to Plaintiff stating: "If we receive a judgment against you, the Sheriff will remove you from the premises. Our client could also garnish your wages, levy on your bank accounts, and/or attach your non-exempt personal property for judicial sale in order to collect all monies due." This letter further stated: "This debt will be assumed to be valid unless you notify us within 30 days of receipt of this letter that you dispute all or part of the debt. If you notify us in writing within this same 30-day period, we will send you verification of this debt. Upon written request within the thirty-day period, we will provide you with the name and address of the original creditor, if different from the current creditor."

On about September 17, 2012, after expiration of the three-day Notice, U.S. Financial sent a letter acknowledging that Plaintiff had paid the rent to the prior owner, and claiming that Plaintiff "failed to acknowledge [U.S. Financial] as the owner of the Property, [Plaintiff] completely disregarded the tenant questionnaire and [Plaintiff] improperly paid rent to the prior owner of the Property.” However, Plaintiff had received no notice regarding where to send rent to the new owner until she received the September 13, 2012 three-day Notice to pay or quit.

Despite knowing that Plaintiff had already paid rent to the prior landlord, Plaintiff alleges that Defendant filed an unlawful detainer action against Plaintiff on October 3, 2012. The complaint claimed that Plaintiff owed rent in the amount of $1,900.00 for the month of September 2012 and referenced the three-day Notice to pay rent or quit that Defendant served on Plaintiff. On November 20, 2012, after a civil trial, the court dismissed Defendant’s unlawful detainer action against Plaintiff because the required 60- and 90-day notice under California and Federal law had not been given and because the elements of an unlawful detainer had not been met.

Based upon these factual allegations, Plaintiff alleges Defendant violated the FDCPA. According to the complaint, Defendant’s violations of the FDCPA include, but are not limited to the following:

a. 15 U.S.C. §1692e(2)(A) by making a false representation of the character, amount, or legal status of the alleged debt;
b. 15 U.S.C. §1692e(5) by threatening to take an action that cannot legally be taken or that is not intended to be taken;
c. 15 U.S.C. §1692e(10) by making use of a false representation or deceptive means to collect or attempt to collect a debt;
d. 15 U.S.C. §1692f(1) by attempting to collect an amount not permitted by law;
e. 15 U.S.C. §1692f generally by using an unfair or unconscionable means of collecting a debt in contravention of federal and state laws protecting tenants at foreclosure.

As a proximate result of the alleged FDCPA violations, Plaintiff seeks actual damages pursuant to 15 U.S.C. §1692k(a)(1), statutory damages in an amount up to $1,000.00 pursuant to 15 U.S.C. §1692k(a)(2)(A), and reasonable attorney’s fees and costs pursuant to 15 U.S.C. §1692k(a)(3). For actual damages, Plaintiff claims emotional distress in the amount of at least $15,000.00.

...

DISCUSSION

The sole cause of action raised by Plaintiff’s complaint is Defendant’s alleged violation of the FDCPA. The FDCPA was passed to prevent abusive debt collection practices, including the use of “false, deceptive, or misleading representation or means in connection with the collection of any debt.” 15 U.S.C. §1692e. Under the FDCPA, debt collectors are prohibited from engaging in certain inappropriate communications with consumers, harassing or abusing consumers, or engaging in other unfair practices, such as collecting fees not specified in the agreement creating the debt. See 15 U.S.C. §§1692c, 1692d, and 1692f. The FDCPA defines debt collectors as those who collect or attempt to collect a debt owed to another entity, although the definition carves out several exceptions to the definition. See 15

U.S.C. §1692a. However, the Supreme Court in *Heintz v. Jenkins* held that the FDCPA "applies to attorneys who regularly engage in consumer-debt-collection activity, even when that activity consists of litigation." Heintz v. Jenkins, 514 U.S. 291, 299 (1995).

California Litigation Privilege in California Civil Code Section 47(b)

First, Defendant argues that its actions are protected by the litigation privilege. Specifically, Defendant argues the litigation privilege set forth in California Civil Code Section 47(b) protects any publication or broadcast made in any judicial proceeding. Defendant argues the alleged violations of the FDCPA in the complaint, i.e. filing and litigating a lawsuit as well as serving a three-day Notice and sending a letter regarding said litigation, are all actions properly protected from attack by the litigation privilege.

In response, Plaintiff contends the United States Supreme Court ruled in *Heintz v. Jenkins* that the FDCPA covered litigation activities. 514 U.S. 291, 295 (1995). As a result, Plaintiff argues it has been nationally recognized since 1995 that the litigation privilege does not apply to claims under the FDCPA. Indeed, the California district court in *Oei v. North Star Capital Acquisitions, LLC* indicated that "[i]t is well settled that the Supremacy Clause of the United States Constitution grants Congress the power to preempt state and local laws…As a result, it is equally well settled that California's litigation privilege does not apply to federal causes of action, including FDCPA claims." Oei v. North Star Capital Acquisitions, LLC, 486 F. Supp. 2d 1089, 1098 (C.D. Cal. 2006).…

Having reviewed the cases relied upon by the parties, the court finds the California litigation privilege does not bar Plaintiff's FDCPA claim. See Holmes v. Electronic Document Processing, Inc., 966 F. Supp. 2d 925, (N.D. Cal. Aug. 15, 2013) (noting it is well established that the California litigation privilege does not apply to FDCPA claims); see also Heintz, 514 U.S. at 298 (concluding the FDCPA "applies to attorneys who 'regularly' engage in consumer-debt-collection activity, even when that activity consists of litigation"). Notably, Defendants have not cited any legal authority for the proposition that the litigation activities alleged by Plaintiff are privileged from liability under the FDCPA. Accordingly, Defendant's motion to dismiss Plaintiff's FDCPA claim on the basis of the California litigation privilege is denied.

...

Underlying Litigation as a Debt Collection

Defendant argues the unlawful detainer action was not a debt collection under the FDCPA. As alleged in the complaint, Defendant served Plaintiff with a three-day Notice to pay rent or quit the Escondido Property and subsequently filed an unlawful detainer action. Defendant contends both of these actions primarily seek possession of the property rather than debt collection. Defendant contends a debt collector's actions to evidence a debt rather than collect a debt are not actionable, i.e. a trustee's deed upon sale evidences a sale, rather than collection of a debt, and therefore is not subject to the FDCPA.[1] For these reasons, Defendant contends it is not liable for the conduct alleged within the complaint, and the motion to dismiss should be granted accordingly.

Plaintiff contends Defendant's actions constitute debt collection as defined by the FDCPA. The FDCPA applies to debt collection of consumer debts with "debt" broadly defined as follows:

> any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.

15 USC §1692a(5). As support for her argument, Plaintiff relies upon decisions from other courts that have found that rent owed pursuant to a lease is an obligation within the scope of the FDCPA's definition of "debt." See Romea v. Heiberger & Assocs., 163 F.3d 111, 114-15 (2d Cir. 1998); Leasure v. Willmark Communities, Inc., 2011 U.S. Dist. LEXIS 60986, 2011 WL 2267598, at *2 (S.D. Cal. June 7, 2011) (finding persuasive the Second Circuit's holding in *Romea* that, in light of the language of the FDCPA, there was no reason why residential rent incurred by a consumer should not constitute a debt). Here, Plaintiff alleges Defendant's actions were designed to coerce Plaintiff into paying rent for September, which she had already paid to the prior landlord and did not owe to the new owner, and threatened Plaintiff with removal from her home in doing so. Plaintiff contends these actions constitute debt collection, and they are therefore covered by the FDCPA.

...

Having found back rent constitutes a debt under the FDCPA, the Second Circuit then concluded that delivery of a three-day rent demand notice, as required by New York law as condition precedent to summary eviction proceeding, was a "communication" to collect a debt, within the meaning of the FDCPA, and the attorneys were acting as "debt collectors" for FDCPA purposes. Romea at 116-18.

Once again, Defendant has not provided the court with any authority suggesting that its alleged conduct does not constitute debt collection under the FDCPA. Under the circumstances, the court finds the analysis in *Romea* provides a reasonable basis for finding Plaintiff has sufficiently alleged Defendant engaged in debt collection under the FDCPA. Accordingly, Defendant's motion to dismiss Plaintiff's FDCPA claim for failing to allege debt collection activities covered by the statute is denied.

...

CONCLUSION

Based on the foregoing, Defendant's motion to dismiss is denied. Defendant is ordered to file its answer within 20 days of the filing of this order.

C. State Debt Collection Laws

All but seven states have laws that deal with abuses in debt collection. The state debt collection statutes, in an analogy to UDAP, should not be thought of as "mini" FDCPAs because they often have broader reach and greater remedies. Specifically, they frequently apply to creditors, not just to third-party debt collectors, and they often have statutes of limitation that are longer than the one-year period in the FDCPA. The statutes sometimes go beyond prohibiting acts and practices to take preventative approaches such as requiring the licensing or bonding of debt collectors.

The statutes are part of a cumulative approach used by plaintiffs whereby a violation of federal law triggers a violation of a particular state law, which may also trigger a violation of a more general state UDAP law. This case illustrates that approach, and also provides a look at some of the threshold legal issues presented in an FDCPA case.

Finley v. Dynamic Recovery Solutions LLC

2015 WL 3750140 (N.D. Cal. June 15, 2015)

HENDERSON, U.S. District Judge

BACKGROUND

In June of 2001, banks and debt collectors started contacting Plaintiff Nancy Finley ("Plaintiff") regarding a debt she owed of approximately $18,000. California's four-year statute of limitations for Plaintiff's debt appears to have run sometime in 2004 or 2005. Nonetheless, debt collection agencies continued to contact Plaintiff, off and on, for almost ten years after the statute of limitations expired.

On January 15, 2010, Defendant Accelerated Financial Solutions ("Accelerated") purchased Plaintiff's debt. Also, sometime in April of 2010, Plaintiff received a letter from Defendant Consumer Recovery Associates ("Consumer"), requesting repayment of the debt. Plaintiff's counsel sent a letter to Consumer on April 29, 2010, notifying Consumer that Plaintiff was represented by counsel and making other demands.

Sometime between January 27 and February 4, 2014, Accelerated opened an account with Defendant Dynamic Recovery Solutions ("Dynamic") for the purposes of collecting Plaintiff's debt. On May 7, 2014, Dynamic sent a debt collection letter to Plaintiff, requesting payment of $39,969.99. The collection letter offered to "settle [Plaintiff's] account" under various payment plan arrangements.

Plaintiff also alleges that Dynamic called her approximately nine times between March 8, 2014, and June 7, 2014.

Plaintiff brought suit in August of 2014 against Defendants Accelerated, Dynamic, and Consumer, alleging violations of the federal Fair Debt Collection Practices Act, the California Rosenthal Act,…and the California Unfair Competition Law. Defendants Accelerated and Dynamic now move for summary judgment on all of Plaintiff's claims against them.

...

I. Plaintiff's Fair Debt Collection Practices Act Claims

a. Both Defendants Are Debt Collectors and Are Subject to the Act

The federal Fair Debt Collection Practices Act, Title 15, United States Code, section 1692 et seq., prohibits debt collectors from taking certain actions in the course of collecting a debt. The statute distinguishes between "debt collectors," to whom these prohibitions apply, and "creditors," to whom they do not; "these two categories—debt collectors and creditors—are mutually exclusive." Schlosser v. Fairbanks Capital Corp., 323 F.3d 534, 536 (7th Cir. 2003).

A "debt collector" is defined as "any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another." 15 U.S.C. §1692a(6). A "creditor," on the other hand, is defined as "any person…to whom a debt is owed, but such term does not include any person to the extent that he receives an assignment or transfer of a debt in default solely for the purpose of facilitating collection of such debt for another." 15 U.S.C. §1692a(4).

Because of the latter clause in the "creditor" definition, courts around the country have found that businesses are debt collectors, and subject to the requirements of the Fair Debt Collection Practices Act, where they purchased a debt that was already in default for the purpose of debt collection. E.g., Ruth v. Triumph Partnerships, 577 F.3d 790, 796-97 (7th Cir. 2009) ("Where, as here, the party seeking to collect a debt did not originate it but instead acquired it from another party, we have held that the party's status under the FDCPA turns on whether the debt was in default at the time it was acquired."); see also Guerrero v. RJM Acquisitions LLC, 499 F.3d 926, 931 (9th Cir. 2007) (explaining that a party that purchases a debt can still be subject to the Act).

Courts in this district have relied on *Ruth* and *Guerrero,* and looked to whether a debt was in default at the time of its purchase to determine whether the purchaser is a creditor or a debt collector. E.g., McQueen v. Am. Exp. Centurion Bank, 2012 WL 5301075, at *2-3 (N.D. Cal. Oct. 25, 2012).

Here, it is clear that Defendant Dynamic is a debt collector within the meaning of the Fair Debt Collection Practices Act. The collection letter that Dynamic sent to Plaintiff stated "This is an attempt to collect a debt by a debt collector.…" Dynamic does not argue otherwise.

Accelerated is also a debt collector covered by the statute, under the reasoning of *Ruth*, *McQueen*, and *Suellen*. Accelerated purchased Plaintiff's debt while it was in default: Plaintiff started receiving collection letters as early as 2001, and Accelerated purchased the debt on January 15, 2010. Accelerated is therefore subject to the requirements of the Fair Debt Collection Practices Act, discussed below.

b. Plaintiff Shall Conduct More Discovery to Determine Whether Defendants Knew Plaintiff Was Represented

Among other requirements and prohibitions, the Fair Debt Collection Practices Act prohibits a debt collector from communicating directly with a consumer "if the debt collector knows the consumer is represented by an attorney.…" 15 U.S.C. §1692c(a)(2).

Courts considering allegations that a debt collector communicated directly with a represented consumer under section 1692c require that the consumer show the debt collector had "actual knowledge" that the consumer was represented. Randolph v. IMBS, Inc., 368 F.3d 726, 729 (7th Cir. 2004); Offril v. J.C. Penny Co., Inc., No. C 08–5050 PJH, 2009 WL 69344, at *3 (N.D. Cal. Jan. 9, 2009). This is because, unlike the other provisions of the Act, section 1692c makes it a violation to communicate directly to a consumer "if the debt collector *knows* the consumer is represented by an attorney." 15 U.S.C. §1692c(2).

The Act also has an affirmative "bona fide error" defense, whereby a debt collector will not be held liable if it shows "by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." 15 U.S.C. §1692k(c). Some courts, considering allegations under other provisions of the Fair Debt Collection Practices Act, have held that it is a "strict liability offense," subject to the affirmative bona fide error defense described above. E.g., Reichert v. National Credit Sys., Inc., 531 F.3d 1002, 1005 (9th Cir. 2008) (considering alleged violation of section 1692f); Clark v. Capital Credit & Collection Servs., Inc., 460 F.3d 1162, 1176 (9th Cir. 2006) (considering alleged violation of section 1692e). However, the Court is not aware of any case holding that the "actual knowledge" requirement of section 1692c is also subject to the reasonable procedures required in the bona fide error defense.

Here, the evidence suggests that neither Defendant had actual knowledge that Plaintiff was represented by an attorney when Dynamic sent its letter and called her. Accelerated's CEO testified in a declaration that the company "did not know Plaintiff was represented by counsel when it sent the account to Dynamic.…" Dynamic's CFO similarly testified that the company "did not have notice of any prior letters from Plaintiff and/or her counsel prior to sending its letter," and it "did not know Plaintiff was represented by counsel in connection with the subject debt."

However, Plaintiff submitted evidence that Plaintiff told another Defendant, Consumer, that she was represented and was disputing the debt, and that Consumer subsequently placed a "cease and desist" label on her account to stop collection. Ex. B to King Decl. Plaintiff is already conducting discovery on the question of what information Consumer communicated to Accelerated in the process of attempting to collect Plaintiff's debt. May 7, 2015 Order at 2.

Plaintiff shall be allowed to conduct additional discovery regarding what, if anything, Consumer told Accelerated and/or Dynamic regarding Plaintiff being represented by an attorney.…

c. Defendants May Have Made Misleading Statements Regarding the Debt

The Fair Debt Collection Practices Act also prohibits debt collectors from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt," including "the false representation of…the character, amount, or legal status of any debt;" "the threat to take any action that cannot legally be taken;" and "[c]ommunicating…to any person credit information which is known or which should be known to be false, including the failure to communicate that a disputed debt is disputed." 15 U.S.C. §1692e & (2)(A), (5), (8).

"Whether conduct violates §1692e requires an objective analysis that takes into account whether the least sophisticated debtor would likely be misled by a communication." Gonzales v. Arrow Fin. Servs., LLC, 660 F.3d 1055, 1061 (9th Cir. 2011) (alteration and quotation omitted). "The 'least sophisticated debtor' standard is lower than simply examining whether particular language would deceive or mislead a reasonable debtor." *Id.* (quotation omitted).

Federal courts disagree about whether a debt collector can be liable under the Fair Debt Collection Practices Act for sending a collection letter to a consumer for an unenforceable debt, such as where the statute of limitations has expired. Alborzian v. JPMorgan Chase Bank, N. Am., 235 Cal. App. 4th 29, 36–37 (Cal. Ct. App. 2015) (collecting cases). In the Sixth and Seventh Circuits, a debt collector may be liable if the collection letter would mislead the least sophisticated debtor about the enforceability of the debt. Buchanan v. Northland Group, Inc., 776 F.3d 393, 399 (6th Cir. 2015); McMahon v. LVNV Funding, LLC, 744 F.3d 1010, 1020 (7th Cir. 2014) ("The proposition that a debt collector violates the FDCPA when it misleads an unsophisticated consumer to believe a time-barred debt is legally enforceable, regardless of whether litigation is threatened, is straightforward under the statute."). In the Third and Eighth Circuits, however, such a collection letter is only actionable if it is accompanied by a threat of litigation. Huertas v. Galaxy Asset Mgmt., 641 F.3d 28, 32–33 (3d Cir. 2011); Freyermuth v. Credit Bureau Servs., Inc., 248 F.3d 767, 771 (8th Cir. 2001) ("[I]n the absence of a threat of litigation or actual litigation, no violation of the FDCPA has occurred when a debt collector attempts to collect on a potentially time-barred debt that is otherwise valid.").

The Ninth Circuit has not yet determined whether a threat of litigation is required for such a debt collection letter to be actionable. Two cases in this district, both decided prior to the Seventh Circuit decision of *McMahon*, have followed the approach of the Eighth Circuit and required a threat of litigation in a debt collection letter. Abels v. JBC Legal Grp., P.C., 428 F. Supp. 2d 1023, 1027 (N.D. Cal. 2005); Perretta v. Capital Acquisitions & Mgmt. Co., No. C–02–05561 RMW, 2003 WL 21383757, at *4 (N.D. Cal. May 5, 2003). In *Perretta,* Judge Whyte applied the "least sophisticated debtor" standard to the potential threat of litigation, and found that a letter threatening "further steps would be taken" could be threatening to the least sophisticated debtor. 2003 WL 21383757, at *4.

Here, Defendants have neither shown the absence of dispute as to any material fact, nor that they are entitled to judgment as a matter of law. It should be noted, first, that Defendants only raised arguments under this section in their replies. Second, it is undisputed that Dynamic did not tell Plaintiff that the statute of limitations had expired on her debt when it communicated with her. Third, Dynamic's letter to Plaintiff offered to "settle her account." *Id.* It is plausible that the least sophisticated consumer could view an offer to settle as a veiled threat of litigation, or, at the least, as a misrepresentation that a debt is still enforceable. McMahon, 744 F.3d at 1020.

Moreover, Defendants did not discuss Plaintiff's claim that they failed to communicate the legal status of her debt *to each other* whatsoever in their briefing. Yet, under section 1692e(8), quoted above, there is a possible cause of action if any Defendant failed to communicate to another that Plaintiff was disputing the status of her debt. Because this cause of action potentially exists, and Defendants did not argue the issue at all, they are not entitled to summary judgment on this claim.

Accordingly, Defendants' motions for summary judgment on Plaintiff's claims under section 1692e of the Fair Debt Collection Practices Act are DENIED.

II. Plaintiff's Rosenthal Act Claims

Plaintiff also brought claims under California's Rosenthal Fair Debt Collection Practices Act, California Civil Code §1788 et seq. The Rosenthal Act explicitly incorporates the federal Fair Debt Collection Practices Act by reference, except for its definitions section. Cal. Civ. Code §1788.17; Alborzian, 235 Cal. App. 4th at 36. Defendants are entitled to summary judgment on the Rosenthal Act claims only to the extent that they are entitled to summary judgment on the federal claims. See Diaz v. Kubler Corp., 785 F.3d 1326 (9th Cir. May 12, 2015) ("The Rosenthal Act mimics or incorporates by reference the FDCPA's requirements.…The parties do not dispute that the Rosenthal Act claims at issue in this appeal rise or fall with the FDCPA claims.").

Just as Defendants have not shown that they did not violate sections 1692c and 1692e of the federal statute, they also have not shown that they did not violate the Rosenthal Act. Defendants' motions for summary judgment on Plaintiff's Rosenthal Act claims are denied.

...

IV. Plaintiff's Unfair Competition Law Claim

Plaintiff also brings a claim under California's Unfair Competition Law ("UCL"), Business and Professions Code §17200 et seq. "The UCL borrows violations of other laws and treats them as unlawful practices that the unfair competition law makes independently actionable. Further, the UCL creates three varieties of unfair competition—acts or practices which are unlawful, or unfair, or fraudulent." Wilson v. Hewlett-Packard Co., 668 F.3d 1136, 1140 (9th Cir. 2012) (quotation omitted). Individuals suing under the UCL cannot recover damages; rather, they are limited to restitution and injunctive relief. Korea Supply Co. v. Lockheed Martin Corp., 29 Cal. 4th 1134, 1150 (Cal. 2003).

Defendants argue that Plaintiff's UCL claims must fail to the extent that they are based on any of the statutory claims discussed above. However, as discussed above, Defendants have not shown that they are entitled to summary judgment on Plaintiff's Fair Debt Collection Practices Act and Rosenthal Act claims. As a result, Plaintiff may still maintain claims under the "unlawful" prong of the UCL.

Moreover, Defendants made no argument regarding the "unfair" and "fraudulent" prongs of the UCL. They therefore have not shown that they are entitled to summary judgment on these separate causes of action under the UCL, and Defendants motions regarding Plaintiff's UCL claims are denied.

CONCLUSION

For the reasons set forth above, the Court grants in party and denies in part Defendants' motions for summary judgment. Defendants' motions regarding Plaintiff's Fair Debt Buying Practices Act claims are granted. Their motions regarding Plaintiff's Fair Debt Collection Practices Act section 1692e claims, and related Rosenthal Act and UCL claims, are denied. The Court reserves judgment on Defendant's motions regarding Plaintiff's section 1692c claims until Plaintiff has conducted additional discovery.

IT IS SO ORDERED.

D. Debt Buyers

While a consumer continues to be bound to pay a debt, the lender may exit the deal. The originator may sell the debt to another entity. Sometimes this is part of a "high finance" deal such as a securitization of debt and other times it is a "spoiled fruit" deal whereby the company just wants to get difficult to collect accounts off its books.

Consumer debts are normally transferred in bulk pursuant to a purchase and sale agreement. Portfolios are made up of debts that share common attributes such as the type of credit issued, the elapsed time since the consumer accounts went into default, and the number of third party debt collection firms with which creditors placed the accounts prior the creditors offering them for sale. The price of the debt is negotiated and reflects not only the amounts owed, but also the credit risk of the portfolio. Upon consummation of the sale, the debt buyer has the right to receive the consumer's payments on the debts and inherits other rights, including standing to sue to collect the debt, if defaulted under the terms of the loan. The consumer is not a party to the purchase and sale debt contract and typically will not receive any notice that a sale has occurred. Delinquent debts are more likely to be sold, and the older and less collectible the debt is, the more brisk the market of companies willing to try to recover by dunning, having paid only pennies per dollar owed.

As part of the sale, debt buyers are given some information about the consumer debtor and the nature of the debt. Often, particularly in some industries such as credit card or medical debt, the information received is inaccurate or incomplete. Debt sellers are under no obligation to release additional information to either debt buyers or consumers once the debt has been sold.

When debt buyers file suits for judgment in state courts, most consumers do not respond. Estimates are that as many as 90 percent of debt collections from debt buyers are achieved through defaults in the court system. Legal requirements for default are easy to meet because the lawsuit is usually filed as an “account stated” or “open account.” Bare information identifying the debtor and the amount due is generally all that is contained in the complaint. Those minimal requirements facilitate debt buying because they lower the amount of information that must be retained and transferred between creditors. But for consumers, the complaints are often a source of confusion and frustration. Consumers cannot figure out how they came to owe a particular company, which they never borrowed from.

Debt buying is not for the faint of heart. Jake Halpern’s book, *Bad Paper* (2014), is a highly readable look at the dealings of debt buyers with consumers and with each other.

> One of Brandon’s first jobs in collections was at a law firm in Boston that had two divisions, one composed of collectors stationed at phone banks and the other manned by lawyers who sued debtors in court. Brandon was appalled by how the office worked. “There was a lot of crooked stuff going on,” he told me. “I noticed it right away and I put a stop to it.”…
>
> It wasn’t long before Brandon’s abilities as a collector, combined with his efforts to clean up the office, caught the attention of one of the firm’s owners, a well-regarded lawyer named Jeff Schreiber. On their first encounter, Brandon introduced himself…by explaining that he was a former armed robber who did “ten years in the can.” Jeff was not impressed. “He made me cringe when he told me about going to prison [and that] he’s a convicted felon,” Jeff told me. “I thought, *Oh great, this is what I have on my payroll*.” And yet that didn’t stop Jeff from soon promoting Brandon to become a manager.…
>
> In addition to collecting on debt, Brandon began buying and selling it as well. He talked to everyone, did his research, and found opportunities that no one else could—like a portfolio of paper that no one had touched for five years, other than an incompetent call center based in Brazil. “I am a bottom feeder,” Brandon told me. “I specialize in finding paper that everyone else thinks is worthless.” As far as Brandon was concerned, the older and more beaten-up that debt *appeared* to be, the better. People falsely assumed that it was very difficult to collect on old debt, but it all depended on the history of the portfolio—who exactly had tried to collect on it, how long they had been trying, and how successful they had been. Brandon’s specialty became finding old debt that paid. “I buy old crap,” Brandon told me. “I’m the King of Crap.”

Id. at 41-42, 44-45.

Just as debt collectors were singled out in the 1970s by the FDCPA from creditors collecting their own debts, debt buyers are being identified as a major reason for the complaints about debt collection. About a dozen states have passed legislation to impose additional duties on debt buyers. California's law, the Fair Debt Buying Practices Act, intervenes to limit when a debt buyer may make any written statement to a consumer or when a default judgment may enter in favor of a debt buyer. Cal. Civ. Code §§1788.50-1788.64 (2013). Under the statute, a debt buyer means a person who regularly purchased consumer debt that has been charged off, defined as being removed from the creditor's books as an asset and treated as a loss or expense. Debt buyers must provide key pieces of information about a debt, including the amount, nature, and reason for all post-charge-off interest and fees, the dates of default and last payments, and the identity of the charge-off creditor and all entities that purchased the debt after charge-off. The law also prohibits a debt buyer from filing suit or initiating an arbitration if the statute of limitations for the debt has expired. Cal. Civ. Code §1788.56. This transforms the common law rule that a statute of limitations is an affirmative defense that must be pled when answering a complaint.

As evidence of the political and normative complexities of regulating debt collection, note that a few states have gone the opposite direction. In the last few years, Arizona, Tennessee, and Arkansas have all made it easier to obtain a default judgment on a debt collection suit.

E. Debt Settlement or Consolidation

Consumers often are eager for a way out of the sweat box of dunning or collection. Companies are all too willing to promise to handle a consumer's debts—for a fee. While there are non-profit credit counseling agencies that receive funding from major philanthropic organizations, many companies promise to consolidate or settle debts without delivering on their promises. In a typical set-up, the consumer is asked to give permission for the company to pull a credit report and required to provide all mailings from creditors. The company then contacts the creditors and asks if they will agree to a reduced payment, either in lump sum or over time. The consumer meanwhile is depositing money each week or month in an account with the company. The idea is that the consumer's savings will be doled out to the creditors, eliminating debt entirely for less than half of what is owed.

There is nothing wrong with this arrangement in and of itself. Indeed, it is trying to solve the very real problem of each creditor wanting all the debtor's scare money for itself and the debtor being overwhelmed by the collective dunning effort. The problem is with the fees.

The FTC's Telemarketing Sales Practice Rule prohibits charging upfront fees for debt settlement. 16 C.F.R. §310. The CFPB has joint authority to enforce this rule. Often, the situation is pretty straightforward as a legal matter. The company took a fee and then did nothing. In addition to violating the FTC Telemarketing Sales Practice Rule, this is clearly an unfair and deceptive practice. Indeed, it comes close to conversion or theft. The trickier situation is when the debt settlement company does perform services, but at a very steep price, such as several hundred dollars to eliminate only a few thousand dollars of debt.

Problem Set 23

23.1. Teddy Moore loves his neighborhood bar. Built in the 1940s, it features an old-fashioned atmosphere, complete with record jukebox and photos of patrons hanging everywhere, all shot by bar owner, Pauline Jones, an amateur portrait photographer. The bar also has antiquated payment policies. Patrons can either pay cash or run up a monthly tab: no credit or debit cards are accepted. For over a year, Teddy has enjoyed good times that worked out to about a $75 tab. He has always paid it up when reminded, but this month simply doesn't have the cash. He explained his situation to Pauline, but she turned hostile on Teddy snatching back the draft that she had just poured him. Teddy has ventured in the bar one time since but was shocked to discover that the portrait that Pauline had taken of him now featured a big hot pink post-it note with the word "deadbeat" written on it over his face. Teddy fled the bar before Pauline or anyone else saw him, but several of his friends have since kidded him about the situation. He wants to know if Pauline's actions have violated the federal FDCPA or the California Rosenthal Fair Debt Collection Act. *See* 15 U.S.C. §§1692a; 1692c; 1692d; Cal. Civ. Code §§1788.2; 1788.12.

23.2. To finance his undergraduate studies at Humongous University, Alan Parker obtained a $15,000 student loan from Students First Bank. Parker discontinued his studies at Humongous University in 2013 and has been living with his parents ever since. On December 25, 2015, Parker received a telephone call from Martha Raven, an account manager employed by the Business Collection Bureau. Raven told Parker that Business Collection Bureau had been engaged to collect the loan extended by the Students First Bank. She had begun to outline various repayment plan possibilities when Parker interrupted her to say that he had no intention of repaying a single cent of his student loan and that he would appreciate it if she would refrain from calling him again about the matter. On February 1, 2016, Raven again called Parker at his parents' home. Parker responded to her proposal of an extended repayment plan by reiterating his unwillingness to repay any part of his student loan. Has Raven violated any provisions of the Fair Debt Collection Practices Act? *See* 15 U.S.C. §§1692c; 1692g.

23.3. Julia King is the billings manager for a pediatric practice group, Lil' Health Hugs, that serves a low- to moderate-income community. The sign above the reception desk states that "payment is due at time of service" but as a matter of practice, very little money is collected. Most patients are harried, dealing with sick kids, and are not sure how much of the visit will be covered by insurance. The Lil' Health Hugs' doctors grew frustrated with the 90-120 day delay in payment by most patients and told Julia to speed up collection.

Julia has hired an "early action" firm, Wickets & Wappers LLP, to contact patients as soon as the pediatrics practice has submitted its claim to insurance, usually one week after the patient visit. The firm is run by two local lawyers. They supervise a large staff that calls patients and reviews the explanation of insurance benefits over the phone, and asks for a payment of the amount of patient responsibility. If the money is not paid, Wickets & Wappers LLP then sends a letter, "on behalf of Lil' Health Hugs," stating that payment of the patient responsibility amount of $X is due immediately." Two follow-up phone calls are made, a week apart. If 75 days from the patient visit and 70 days from submission to insurance, the patient responsibility amount is not paid, Wickets & Wappers returns the debt to Lil' Health Hugs. At that point, Julia sells the debts to a debt buyer that specializes in filing small claims actions to recover.

You provide general legal advice on matters such as employment, insurance liability, and partnership law to Lil' Health Hugs. Julia has asked you to "take a quick look" at the new debt collection scheme and make sure it checks out, including whether Wickets & Wappers are bar members in good standing. Having validated the latter, is Lil' Health Hugs in violation of the FDCPA? 15 U.S.C. §1692a(6).

23.4. As deputy chief of staff for the state's attorney general, you got to a lot of community meetings on her behalf. Per instructions, you take notes, nod to show that you are listening, and exuberantly thank people for their thoughts and comments. You recently went to the Consumer Coalition meeting, which consists of practicing attorneys from several legal aid organizations and a couple of not-for-profits that do policy work. When you arrived ready to listen, you were met with a visual assault. The entire room was decorated with gigantic posters that reproduced debt collection letters that clients of the organizations had received. Big red arrows labeled areas of the letters that threatened to file lawsuits, "Shame on You," or "Bad Bad."

The meeting went downhill immediately, with the advocates pressing on a very specific issue: Will the attorney general sue debt collectors who send dunning letters when the applicable statute of limitations for the debt has expired? You stuck to your small guns, repeating over and over again, "I'll look into that and get back to you." Having escaped back to the office, what is your conclusion on the legality of the practice? You need to brief the mayor and the head of Consumer Affairs and provide a legal analysis and a range of options for their consideration. So far, you have figured out that in your state any violation of the federal Fair Debt Collection Practices Act is a *per se* violation of the state unfair and deceptive acts and practices law. *See* 15 U.S.C. §1692e.

Consider a business that is sued for an unfair practice and offers two settlement options: 1) payment of $10,000 to the aggrieved party plus that party's attorneys' fees and litigation costs, or 2) a settlement that promises to stop the unfair practice and provides an education campaign to improve consumers' abilities to protect themselves in similar situations that might arise. A private litigant is powerfully motivated to take the money and recover costs. A public litigant may prefer to end the unfair practice; it remedies the problem going forward even if it provides no restitution to the aggrieved party.

The barriers to private litigation are substantial. The legal process may be too complex or expensive for private parties to use or a law may not give any remedy to private parties. Because private parties file suit to vindicate their own rights and obtain relief for personal wrongs, they may lack a broad perspective on the issue or a desire to reshape the marketplace. Attorneys general are insulated from restrictions on class actions that let them pursue aggregate litigation when private litigants cannot. Myriam Gilles & Gary Friedman, *After Class: Aggregation Litigation in the Wake of AT&T Mobility v. Concepcion*, 79 UNIV. OF CHI. L. REV. 623 (2012). For these reasons, public enforcement is a cornerstone of consumer protection activity. It occurs at the federal, state, and even local levels, with these agencies having overlapping authority that sometimes raises preemption issues or policy tensions about the best actor to enforce a law.

Notwithstanding its power, public enforcement can be curbed. Agencies face resource constraints from taxpayer funding and competing priorities. Political pressure may influence elected officials to forsake or abandon enforcement. The private interests of regulated groups may drive policy decisions to the point where agencies are "captured" and no longer acting in the public interest. Last, but not least, public enforcement may not identify or focus on the issues that are salient to consumers in the real world. Rights may be vindicated in a way that does not provide redress to harmed consumers, such as when agencies obtain an injunction to change future conduct but no restitution damages. Public aggregate litigation may not be bound by sufficient procedures to ensure due process or adequate representation of potential private claimants. Margaret H. Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, 126 HARV. L. REV. 486 (2012).

A. Federal Actors: CFPB and FTC

The Dodd-Frank Act greatly reduced the number of federal actors with enforcement responsibilities for consumer law. Instead of responsibility for even a single given law scattered among several regulators, the Consumer Financial Protection Bureau (CFPB) and the Federal Trade Commission (FTC) are now the only major players at the federal level. Their authority is divided in two ways: the laws for which they are responsible and the market actors over whom they have jurisdiction.

The CFPB enforces "federal consumer law," a term defined to include the consumer protection aspects of seventeen different statutes.[1] The CFPB also has the power to take enforcement action against unfair, deceptive, and abusive acts and practices. 12 US.C. §5531. The FTC has enforcement powers under the Unfair and Deceptive Practices Act, 15 U.S.C. §45.

On some basic level, the CFPB has authority over financial services companies as to federal consumer law. Technically, it much more complicated. There are several relevant definitional terms. 12 U.S.C. §5481. The CFPB has authority over "covered persons" and "service providers" who offer or provide a "consumer financial product or service." The latter term incorporates a complex definition of "financial product or service. 12 U.S.C. §5481(15). Additionally, the CFPB can reach "related persons," who include, *inter alia*, directors, officers, employees, shareholders who have managerial responsibility or materially participate in the conduct of covered persons.

Consumer Financial Protection Bureau v. ITT Educational Services, Inc.

__ 123 F. Supp. 3d __, 2015 WL 1013508 (S.D. Ind. Mar. 6, 2015)

BARKER, District Judge.

...

FACTUAL AND PROCEDURAL BACKGROUND

Plaintiff Consumer Financial Protection Bureau ("the Bureau"), a United States federal agency, has brought this suit against Defendant, alleging violations of provisions of the Consumer Financial Protection Act ("CFPA"), 12 U.S.C. §§5531(a), 5536(a), 5564(a), & 5565, the Truth in Lending Act ("TILA"), 15 U.S.C. §§1601 et seq., and regulations thereunder. Because this cause is before us on a motion to dismiss, we consider the facts as presented by the Bureau's Complaint.

Defendant ITT Educational Services, Inc. ("ITT") is a publicly-traded, for-profit company offering post-secondary courses and degrees to students at more than 100 locations nationwide. Many of ITT's students and prospective students have limited financial means, and ITT therefore derives much of its revenue from federal aid, including loans, secured by the students. Some 80% of ITT's revenue, in fact, comes from aid granted under Title IV of the Higher Education Act of 1965, 20 U.S.C. §§1070 et seq. ("Title IV Aid"). However, a large number of students are still unable to afford full tuition to enroll at ITT even with federal assistance. To enable students to close this "tuition gap," ITT extended to many of them short-term, no-interest loans called "Temporary Credit." The Temporary Credit packages were offered to students at the beginning of an academic year, and payment was due nine months later, at the close of the school year.

ITT's Aggressive Tactics

The Bureau alleges that ITT employed the Temporary Credit loans as an "entry point" for "pushing" students into taking out private loans when the Temporary Credit came due and students were again unable fully to afford tuition for coming school terms. According to the Bureau, ITT misled students about the balance of costs and benefits associated with ITT enrollment—thus guiding them into an unmanageable financial predicament—in a number of ways.

In the first place, ITT represented to students through oral representations and advertisements that its programs greatly advanced an enrollee's career prospects and job placement rates; the Bureau alleges that these representations were exaggerated and were based on incomplete information. The Bureau utilized "mystery shoppers"—young men or women presenting themselves as prospective students—who reported that ITT staff made exaggerated claims about student success, such as that graduates with associates' degrees "usually make six figures." In contrast to these claims, ITT's annual disclosures in 2012 indicated that "reported annualized salaries initially following graduation averaged approximately $32,061 for the Employable Graduates in 2011."

The Bureau alleges that ITT also misleadingly represented to prospective students that its "national accreditation" placed it on par with other major educational institutions. In fact, while a "national" accreditation sounds authoritative, most non-profit colleges and universities are "regionally" accredited; such institutions accept transfer credits from for-profit schools like ITT only on a case-by-case basis. According to the Bureau, ITT not only created an inaccurate overall impression in this respect, but also misled some prospective students in a more specific way: one recruiter claimed that ITT had the same accreditation as "all other schools"; another falsely claimed that "ITT Tech is accredited by the Department of Defense."

Having given prospective students an inflated notion of the standing of the school and the career benefits derived from the degrees it bestowed, the Bureau alleges that ITT's recruiting staff engaged in heavy-handed methods to convince students to enroll. These methods included frequent phone calls and in-person multimedia presentations that mystery shoppers described as overwhelming in nature. Prospective students were encouraged to take an admission test that, in fact, was "virtually impossible to fail," but was used to give them the impression that the school had rigorous admissions standards and that their passing the test augured well for their prospects. Despite the volubility of the overall sales pitch, the Bureau maintains that ITT recruiters were instructed to be vague and evasive on the question of costs; they responded to applicants' questions by stating, "I cannot tell you what your exact cost will be," or by asking, "Do you want a discount education, or a valuable one that will give you a return in the future?"

Once students agreed to enroll, the Bureau alleges that ITT then switched gears, hurrying them through the enrollment and financial aid processes—so quickly that "many consumers did not know or did not understand what they signed up for." Specifically, ITT required enrollees to sign an Enrollment Agreement before they could receive any information about their financial aid options or meet with financial aid staff. Mystery shoppers reported being rushed through e-signatures of documents, including authorizations to request transcripts and credit check approvals without understanding the nature of the forms they were signing.…

Once students had completed an academic term at ITT, the time came for them to "repackage" their financial aid and loans for the next year. The Bureau alleges that ITT's financial aid staff employed aggressive tactics in seeking to repackage students, including tracking them down on campus, barring or pulling them from class, and enlisting the aid of other ITT staff such as professors. An ITT executive conceded that the school also used the threat of withholding course materials and transcripts as "leverage" to ensure that students would repackage. At both the initial and repackaging stages, ITT staff encouraged students to rely on school representatives in seeing them through the process, including the use of forms that automatically populated and required only the students' signatures at the conclusion of the process. An executive stated that ITT was "essentially holding [the students'] hands"; one mystery shopper stated that a financial aid coordinator told him that he would "get more free money that I don't have to pay back if I let them take care of my paperwork."

THE "PRIVATE LOANS"

The Bureau's claims against ITT focus on its assertion that, having knowingly cajoled and guided students into a financial predicament in which they were already heavily invested in an ITT degree yet lacked the financial resources to complete it—with the Temporary Credit expiring and financial aid insufficient to fully cover the "tuition gap"—ITT then persuaded continuing students to take out financially irresponsible "private loans" from third-party lenders. In the Bureau's words:

> ITT Financial Aid staff coerced students into taking out loans that they did not want, did not understand, or did not even realize they were getting.…ITT sought to have its students pay for the tuition gap with ostensible third-party loans because outside sources of payment could be booked as income to the company, improving its free cash flow and the appearance of its financial statements, and because outside sources of revenue helped ITT meet a requirement by the Department of Education that at least 10% of its revenue be derived from sources outside Title IV loans and grants.

One of the sources of the students' predicament was ITT's alleged failure to adequately disclose the nature of the nine-month Temporary Credit to new students. Students who received the Temporary Credit signed a "Cost Summary Payment

Addendum" (CSPA), which stated that the loan was to last for the length of an academic year and carry no interest. According to the Bureau, however, the CSPA's references to "new temporary credit" and "renewal of carryforward temporary credit" could mislead students into believing that renewal of the no-interest loan for future academic years was available. Some students believed that the Temporary Credit would be available until they graduated and a mystery shopper reported that she had been led to believe that future years' costs would be "covered under a new temporary credit and that I would owe no money out of pocket." One director of finance at an ITT location instructed staff to describe the Temporary Credit as "funding" rather than as a loan that would have to be repaid. ITT was aware that many or most students lacked the ability to repay the Temporary Credit, and it characterized them as "doubtful accounts" on its balance sheets.

The Bureau alleges that, beginning in 2008, ITT constructed [a] "private loan" program as a vehicle for students to discharge the Temporary Credit: continuing students would use the cash they received from the new loans to pay off their debt to ITT and thus remove the "doubtful accounts" from ITT's balance sheets.…The Complaint asserts that ITT was heavily involved in the creation of the SCUC program: developing its underwriting criteria, providing a credit facility, paying the credit union membership fees in the lead credit union on behalf of the students taking out the SCUC loans, and providing the SCUC loan originators with a stop-loss guarantee that it would make them whole for losses if defaults on the loans exceeded 35%. ITT was the "sole intermediary" between SCUC and its students; funds were disbursed through ITT to the student, and could be used only to pay ITT for tuition and not for any other purpose. Additionally, eligibility criteria for the loans were tailored such that, if students had received Temporary Credit, they were automatically eligible for an ITT private loan.

The loans granted under the SCUC program carried a 10-year term. For students with credit scores below 600, the interest rate after April 2011 was 13% plus prime—or 16.25%—in addition to a 10% origination fee. Nearly half of the students taking SCUC loans fell into this low-credit-score cohort. These rates are drastically higher than those available under federal Stafford loans, whose rates since 2009 have ranged from 3.4% for subsidized borrowers to 6.8% for unsubsidized borrowers. Despite their exacting terms, some 79% of the SCUC loans issued went to continuing ITT students who had previously received Temporary Credit in their first year at ITT. As of May 2011, ITT's consultant for loan default analysis projected a gross default rate of 61.3% for the existing SCUC loans.

Crucially, the Bureau alleges that these "private" loans, though nominally originated by third-party lenders, were the brainchild of ITT and that ITT consciously steered economically distressed students, faced with indebtedness upon the expiration of the Temporary Credit, into the SCUC loans. ITT executives, in quarterly earnings calls with investors and analysts, stated that the ITT private loan program was a vehicle for taking the Temporary Credit off of ITT's balance sheets.…

According to the Bureau, many students did not migrate from the Temporary Credit to the "private loans" with eyes fully open: some accepted the new loans in reliance upon ITT's acting in their interests, while others did not realize they had incurred a new type of debt because of the "rushed and automated manner" in which ITT financial staff processed the students' paperwork.

For those students who had Temporary Credit debt at the close of their first year at ITT but who did not take out "private loans," ITT offered them an incentive to pay off the debt in a lump sum upon graduation—in the form of a 25% discount. For those students who were unable to pay off the Temporary Credit debt in a lump sum, ITT offered a "temporary credit installment plan" involving monthly payments that ranged, depending on the total amount owed, from six months to more than six years. According to the Bureau, the paperwork students were given upon enrolling in the installment plan did not disclose this forgone 25% discount as constituting a "finance charge."

...

DISCUSSION

This suit arises primarily under the Consumer Financial Protection Act (CFPA), the Bureau's organic statute. Congress enacted the CFPA as Title X of the "Dodd–Frank Act" of 2010, with the stated purpose of "ensuring that the federal consumer financial laws are enforced consistently so that consumers may access markets for financial products, and so that these markets are fair, transparent, and competitive." 12 U.S.C. §5511(a). Counts One through Three of the Complaint allege that ITT engaged in "unfair" and "abusive" acts or practices, in violation of the CFPA's operative provisions, 12 U.S.C. §§5531(c)(1), 5531(d)(2)(B) & 5531(d)(2)(C). The Bureau further alleges in Count Four that ITT's nondisclosure of a finance charge violated the Truth in Lending Act (TILA), 15 U.S.C. §§1601 et seq., and its implementing Regulation Z, 12 C.F.R. §1026.17.

ITT seeks dismissal on three broad grounds. First, it contends that the Bureau lacks standing to bring this suit because it is an unconstitutional entity and the CFPA's prohibitions violate the due process clause. Second, ITT urges that the complaint fails to state a claim because ITT is not a covered entity subject to its provisions. Lastly, ITT argues that all four counts fail on their merits. We address these bases of ITT's motion in turn.

I. Constitutionality of the CFPA

A. Removal Power and the "Take Care" Clause

ITT argues that the CFPA violates the constitutional separation of powers by unduly restricting the President's authority to remove the Bureau's Director if he "loses confidence in the intelligence, ability, judgment, or loyalty" of that officer. Because the Bureau is an unconstitutional entity and thus lacks standing, ITT urges that the suit must be dismissed in its entirety for the absence of a judiciable case or controversy. To explain ITT's misreading of the constitutional protections afforded the President's power to remove officials like the Director of the Bureau, it is necessary to review the evolution of the doctrine.

...

ITT first argues that, because "the limitations on removal here are far more restrictive than a 'good cause' provision," the CFPA runs afoul of

Free Enterprise Fund's dictum that "the President cannot 'take care that the Laws be faithfully executed' if he cannot oversee the faithfulness of the officers who execute them." Free Enter. Fund, 561 U.S. at 484. In fact, however, the CFPA specifies precisely the same grounds for removal as the archetypal "for cause" provision approved by the Court in *Humphrey's Executor*: the President may remove the Bureau's director only for "inefficiency, neglect of duty, or malfeasance in office." 12 U.S.C. §5491(c)(3). Compare with 15 U.S.C. §41 ("Any Commissioner may be removed by the President for inefficiency, neglect of duty, or malfeasance in office.").

ITT's notion that the degree of insulation from executive oversight afforded the Bureau's Director is explicitly proscribed by precedent therefore lacks merit. The Director is responsible directly to the President, without the additional layer of screening the Court found problematic in the structure of the Public Company Accounting Oversight Board. Cf. Free Enterprise Fund, 561 U.S. at 507 (distinguishing circumstances where "the President has…authority to initiate a Board member's removal for cause"). The CFPA's structure is thus unconstitutional only if the authority wielded by the Bureau exceeds the bounds recognized by *Humphrey's Executor* and *Morrison*.

Here, there is no doubt that the Bureau partakes of some of the quasi-legislative and quasi-judicial functions that characterize an independent regulatory agency. It is invested with the authority to engage in rulemaking to further implement Congress's enactments on the subject of consumer financial protection, and its regulatory powers include administrative adjudication. 12 U.S.C. §§5511, 5562–5565. Cf. Humphrey's Executor, 295 U.S. at 628 (noting that the FTC "is an administrative body created by Congress to carry into effect legislative policies embodied in the statute"); Buckley v. Valeo, 424 U.S. 1, 140-141 (1976) (noting that the "administrative" functions performed by the Federal Election Commission are "of kinds usually performed by independent regulatory agencies"). The Bureau also undoubtedly wields paradigmatic "executive" powers—notably the authority to bring suit on behalf of the United States—but we find no basis for concluding that the Director's powers are so great that the inability to remove him or her at whim fatally undermines the President's constitutional prerogatives.

While it is true that the Bureau does not operate only for a fixed time like a Department of Justice independent counsel, cf. Morrison, 487 U.S. at 672 ("[T]he office of the independent counsel is 'temporary' in the sense that an independent counsel is appointed essentially to accomplish a single task…"), its enforcement powers are constrained within the subject-matter of its organic statute. ITT objects specifically to CFPA's grant of litigating authority, arguing that the Bureau has "broad jurisdiction and significant power over numerous industries," and that "without meaningful Presidential control over the Director, the Director could initiate suits advancing his—and not the President's—views on the proper construction of federal laws." But courts have long and consistently upheld the endowment of regulatory agencies with law enforcement powers against constitutional challenge. See Bowsher v. Synar, 478 U.S. 714 (1986) (implicitly affirming the proposition that "officers of the United States" other than the President and Attorney General, such as FTC commissioners, may engage in the enforcement of federal law). This is true of the Securities and Exchange Commission, whose commissioners are subject to removal only for cause and which enjoys broad enforcement powers over publicly traded companies.

See SEC v. Blinder, Robinson, & Co., Inc., 855 F.2d 677, 682 (10th Cir. 1988) (upholding the SEC's constitutionality).…

We therefore reject ITT's argument that the Supreme Court's established removal power jurisprudence forecloses the for-cause removal protections of the Bureau's Director.

3. ITT's Alternate Grounds of Unconstitutionality

In its reply brief, ITT shifts gears. Rather than contending that the Bureau runs afoul of any particular precedent, it asserts that no federal entity has heretofore "combine[d] the Bureau's panoply of problematic features"—including the length of the Director's tenure, 12 U.S.C. §5491(c)(3); for-cause removal of the Director, id. at §5491(c)(3); the fact that the Bureau's authority is concentrated in a single director rather than a multi-member commission, id. at §5491(b)(1); its "unconstitutionally appointed" Deputy Director, id. at §5491(b)(5); its "immunity from the congressional appropriations process," id. at §5497(a)(2)(C); and its "unprecedented restrictions on judicial review," id. at §§5512(b)(4)(B), 5513(a), 5513(c)(3)(B)(ii), & 5513(c)(8); among other ostensibly problematic features.

There are at least two problems with ITT's "mosaic" theory of the Bureau's unconstitutionality. First, ITT never offers a convincing basis for the conclusion that many of these features of the CFPA contribute, even in a piecemeal sense, to the Bureau's unconstitutionality. Second, its generalized assault on the "unprecedented" nature of the Bureau proceeds from the mistaken premise that that which is not specifically approved by precedent is forbidden.

ITT notes, for instance, that the CFPA empowers the Director to delegate any or all of his powers to any "duly authorized employee, representative, or agent." 12 U.S.C. §5492(b).…We have difficulty extracting from this language any notion that the Constitution is offended by allowing a presidential appointee to delegate some of her own authority to her subordinates; such delegation is a commonplace and unavoidable feature of any large institution. See, e.g., 21 U.S.C. §871(a) (permitting the Attorney General to "delegate any of his functions [under the Controlled Substances Act] to any officer or employee of the Department of Justice").…

Turning to the Bureau's funding, ITT complains that the "Director may unilaterally claim up to 12% of the Federal Reserve's budget…without Congress's approval." 12 U.S.C. §5497(a). According to ITT, this "immunity from the Congressional appropriations process" further contributes to the Bureau's unconstitutionality. ITT overstates the degree of the Bureau's insulation from congressional control; more to the point, it neglects to explain how the Bureau's source of funding implicates constitutional concerns. The CFPA does indeed restrict the House and Senate Appropriations Committees from reviewing the Bureau's primary funding source, see 12 U.S.C. §5497(a)(2)(C), but it does not strip Congress as a whole of its power to modify appropriations as it sees fit. As the Bureau has pointed out, the Constitution does not prohibit Congress from enacting funding structures for agencies that differ from the procedures prescribed by the ordinary appropriations process.…ITT's conclusory assertion that the CFPA's funding structure violates the Origination Clause, U.S. Const. Art. I, §7, cl. 1, is therefore without merit.

Lastly, ITT argues, in a footnote, that the "CFPA…limits judicial oversight in ways that are relevant to separation of powers analysis." ITT cites three statutory provisions in support of this point. Two of them, 12 U.S.C. §5513(a) and 12 U.S.C. §5513(c)(3)(B)(ii), have nothing to do with judicial review. The third cited provision does concern judicial review, stating that "the deference that a court affords the Bureau with respect to a determination by the Bureau regarding the meaning of interpretation of any provision of a Federal consumer law shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law." 12 U.S.C. §5512(b)(4)(B). This merely prescribes that the Bureau's constructions of organic law in its subject area are to be given deference, in accordance with the well-established principles first enunciated in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). ITT has not succeeded in identifying anything remotely problematic about the CFPA's provision for judicial review of the Bureau's decisions.

Regardless of the groundlessness of its individualized objections to the Bureau's statutory features, ITT's argument in reply proceeds from a flawed premise. The CFPA is undoubtedly new—and its combination of features thus, in some sense, "unprecedented." Its constitutionality has not yet been subject to authoritative review by the Supreme Court or by any of the Courts of Appeals.…

Apart from two law review articles and an opinion piece in the *Wall Street Journa*l, ITT cites no authority for its theory that the Bureau's amalgamated features render it unconstitutional. Rather, it appears to argue that, because precedent does not explicitly sanction the Bureau's structure and range of powers—which ITT asserts constitute "a gross departure from longstanding practice"—the CFPA exceeds constitutional bounds. This inverts the premise from which we must start in exercising judicial review over Congress: the presumption of constitutionality. Morrison, 529 U.S. at 607.…ITT thus bears a considerable burden in arguing that, though none of the CFPA's features is itself expressly unconstitutional, the statute as a whole nonetheless runs afoul of the separation of powers.…As we have already noted, we believe that the structure and powers of the Bureau are sufficiently analogous to those of the FTC, SEC, and other regulatory agencies that the question of the constitutionality of the CFPA's removal provision is settled.…

II. Whether ITT Is a "Covered Entity"

ITT argues that Counts One, Two, and Three of the Complaint fail to state a claim because ITT is not a covered entity subject to suit under the CFPA. We conclude that, taking the Bureau's factual allegations as true, the pleadings place ITT within the statute's purview.

The operative provisions under which the Bureau has sued ITT apply only to a "covered person" or "service provider." 12 U.S.C. §5536(a)(1). The Act defines a "covered person," in turn, as "any person that engages in offering or providing a consumer financial product or service." 12 U.S.C. §5481(6)(A). A "product or service," as the phrase implies, is more than simply the direct extension of a loan to a consumer: it may include "brokering" or servicing loans, 12 U.S.C. §5481(15)(A)(i), as well as "providing financial advisory services…to consumers on individual financial matters." Id. at §5481(15)(A)(viii). The CFPA defines a "service provider," on the other hand, as one who "provides a material service to a covered person in connection with" the covered person's offering of a "consumer financial product." Id. at §5481(26)(A). Such material service may include participating in "designing, operating, or maintaining the consumer financial product or service," or processing "transactions relating to the consumer financial product or service." Id.

...

The Bureau has, however, sufficiently stated a claim that ITT engaged in conduct qualifying as the provision of "financial advisory services." The Act specifies that such advisory services include, without limitation, "providing credit counseling to any consumer" and "providing services to assist a consumer with debt management or debt settlement, modifying the terms of any extension of credit, or avoiding foreclosure." 12 U.S.C. §5481(15)(A)(viii). The Complaint includes allegations that ITT advised students on how to manage their debt to the school after having taken out Temporary Credit; this advice often channeled the students into the private loan programs. According to the Bureau, ITT completed nearly every step in the process of acquiring CUSO loans on the students' behalf, including filling out the requisite forms (save signatures) and forwarding them to the lending credit union. At a minimum, we conclude that such conduct, if proven, would fall within the realm of "credit counseling" and "assist[ing] a consumer with debt management."

...

ITT offers another, related argument against interpreting the CFPA's "financial advisory services" to include its interactions with its students. "Congress," it reminds us, does not "hide elephants in mouseholes." Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 468 (2001). Including an educational institution like ITT within the ambit of entities liable under the statute for providing financial advisory services is such a significant step, ITT insists, that Congress could hardly have taken it without more explicitly saying so. In *American Bar Association v. F.T.C.*, 430 F.3d 457 (D.C. Cir. 2005), which ITT cites in support of its argument, the D.C. Circuit rejected the FTC's attempt to regulate a law firm as a "financial institution." There, the FTC had supported its expansive reading by pointing to the statute's broad definition of a financial institution as "any institution the business of which is engaging in financial activities," and by noting the same lengthy list of permissible non-banking activities for "financial institutions" that we have already discussed above. 430 F.3d at 467. The court ruled that the statutory framework governing financial institutions, including Congress's definition of the term, contained insufficient ambiguity to warrant deference to the agency's attempt to cram a "rather large elephant in a rather obscure mousehole." Id. at 469.

While we do not question the wisdom of the D.C. Circuit's decision in *American Bar Association*, we find it distinguishable. The Consumer Financial Protection Act is aptly named: Congress stated that its purpose is to ensure "that markets for consumer financial products and services are fair, transparent, and competitive." 12 U.S.C. §5511. As we have already discussed, the statute does not restrict its regulatory reach to "financial institutions." See 12 U.S.C. §§5536, 5481. In the absence of any indication that holding educational institutions —or law firms, for that matter—liable for unfairness to consumers is contrary to the statute's goals, we see no reason to circumscribe what Congress has spoken broadly. While it may be an unacceptably dramatic conceptual leap to label a law firm as a "financial institution," it is hardly a leap at all to say that a school offers "financial advisory services" to its students—particularly on the facts alleged here.

ITT also qualifies as a "service provider" under the CFPA. As we have previously noted, the statute extends its reach to any entity that "provides a material service to a covered person in connection with" the covered person's offering of a "consumer financial product." A "material service" may include participating in the "designing, operating, or maintaining" of the consumer financial product or service in question. See 12 U.S.C. §5481(26)(A)(i).

ITT does not dispute that the third-party originators of the SCUC "private loans" were "covered persons" based on the Bureau's allegations. See 12 U.S.C. §§5481(5), 5481(6).…The Complaint alleges that ITT used Temporary Credit as a tool to pre-qualify students for the private loans, that ITT developed the loans' underwriting criteria, that it paid the credit union membership fees in the lead credit union on behalf of the students who took out the loans, and that it provided a stop-loss guarantee to the programs' lenders—covering any losses from defaults exceeding 35% of participating students. These allegations are more than "unsupported generalities"—as ITT calls them—and they suffice to meet the Bureau's burden at this stage of the litigation. Cf. Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009).

…

IV. Count Four: Violation of the Truth in Lending Act

"Regulation Z," promulgated by the Federal Reserve Board in implementation of the Truth in Lending Act, 15 U.S.C. §1601 et seq., requires the disclosure of certain "finance charges," as defined by the Act, in writing before the consummation of the transaction giving rise to the charges. 12 C.F.R. §§1026.17, 18(d). See also 15 U.S.C. §1605(a) (defining "finance charge"). The Bureau alleges that the discount ITT offered students who paid off their Temporary Credit balances in a lump sum constituted a finance charge, and that ITT's failure to disclose the charge violated TILA and Regulation Z. We do not reach the merits of the claim, because we agree with ITT that Count Four is barred by the applicable statute of limitations.

ITT contends that this claim is governed by the section of TILA governing "civil liability," which provides that "any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation." 15 U.S.C. §1640(e). Because the Complaint was filed on February 26, 2014—well more than one year after the conduct described in the allegations occurred—ITT asserts that this action lies outside the limitations period.

The Bureau counters that its claim in Count Four is governed not by TILA's civil liability provision, but by 15 U.S.C. §1607, the section of the statute which grants the Bureau—together with several other federal agencies—power to "enforce[e] compliance with any requirement imposed" by the Act. 15 U.S.C. §1607(a)(6). Enforcement actions brought under 15 U.S.C. §1607 are not subject to the one-year statute of limitations imposed by Section 1640. See Fed. Reserve Bd. Consumer Compliance Handbook, Regulation Z, at 57. See also Household Credit Servs., Inc. v. Pfennig, 541 U.S. 232, 238 (2004) (noting that the Federal Reserve Board and its staff have been designated by Congress as the primary source for interpretation and application of TILA).

We disagree with the Bureau's interpretation of the distinction between the two statutory provisions. First, we see no persuasive evidence that 15 U.S.C. §1640 governs only private civil actions. The provision itself does not exclude actions in which a government agency is the plaintiff, and in fact it explicitly recognizes the possibility of intervention by federal agencies in civil suits initiated by private parties. 15 U.S.C. §1640(e)(1). Second, agency interpretations support the conclusion that the agency enforcement powers contemplated by Section 1607 are administrative in nature, and are separate from any authorization to file civil suits.…[T]he Federal Reserve's interpretive manual for Regulation Z states that "regulatory administrative enforcement actions…are not subject to the one-year statute of limitations." Fed. Reserve Board Consumer Compliance Handbook, Regulation Z at 57 (Nov. 2013).…

Here, Congress demonstrated its "concern that a creditor not face limitless liability in terms of time" by setting a one-year statute of limitations for the filing of civil suits under TILA. Consol. Bank, N.A., Hialeah, Fla. v. U.S. Dep't of Treasury, Office of Comptroller of Currency, 118 F.3d 1461, 1467 (11th Cir. 1997). When the government chooses to enforce the Act by filing a civil suit rather than resorting to the administrative actions under its power, we see no reason why the same congressional concerns should not apply—indeed, they may apply with still greater force.…[W]e decline to read an exception for agency plaintiffs into the one-year statute of limitations imposed by TILA's civil liability provision. We therefore dismiss Count Four as time-barred.…

The FTC regulates a much broader swath of businesses, including those selling non-financial products and services. Remember, for example, that the FTC brought an action against Kraft for false advertising of its cheese slices. The FTC also has authority over auto-dealers, carved out from the reach of the CFPB. An example may help illustrate the division of labor, and potential overlap, between the CFPB and the FTC. If a company advertises and sells identity-theft monitoring, they are within the purview of the FTC because they are engaged in interstate commerce. The CFPB would not have jurisdiction because the identity theft company is not selling a consumer financial product or service. If the identity theft monitoring company also offered credit report error correction, however, then it would be a "covered person" or a "service provider" subject to the CFPB's enforcement process. Many mobile payments companies, which think of themselves as Silicon Valley tech startups, were surprised to learn that the CFPB had jurisdiction over them under laws such as the Electronic Funds Transfer Act. Because these companies are not financial institutions, they were not subject to examination and supervision by prudential regulators such as the Federal Reserve, FDIC, or state banking authorities. The FTC and the CFPB are required to coordinate enforcement, including providing notice before action is taken. 12 U.S.C. §5514(c)(3).

The CFPB has authority to use a wide variety of public enforcement tools. It may seek any appropriate legal or equitable relief, including:

(A) rescission or reformation of contracts;
(B) refund of moneys or return of real property;
(C) restitution;
(D) disgorgement or compensation for unjust enrichment;

(E) payment of damages or other monetary relief;

(F) public notification regarding the violation, including the costs of notification;

(G) limits on the activities or functions of the person; and

(H) civil money penalties, as set forth more fully in subsection (c).

12 U.S.C. §5565(a)(2). The CFPB cannot, however, pursue exemplary or punitive damages. 12 U.S.C. §5565(a)(3). The civil penalties for violating a law, rule, or final order or condition imposed in writing by the CFPB may not exceed $5,000 for each day during which such violation or failure to pay continues but can go as high as $25,000 for reckless acts and, $1,000,000 for knowing acts. The CFPB can file suit in federal court but it also has the authority to set up an administrative tribunal and to bring cases before its own administrative law judge.

In its first years, the CFPB has brought dozens of actions, including against some of the largest players in the financial service industry. It also has sued smaller companies such as debt settlement organization or debt collectors. While it initially relied on unfair or deceptive authority, the CFPB now alleges abusive conduct in its complaints. It has focused heavily on fines and restitution in its complaints, giving companies a fresh taste of what Senator Magnuson (yes, the namesake of the Magnuson-Moss Warranty Act) called the "Robin Hood method: a combination penalty-restitution—taking the profits away from the swindlers and returning them to the cheated consumers." Warren Magnuson, *The Dark Side of the Marketplace* 71-72 (1968).

Because it is a Commission, the FTC requires consensus before it can take an enforcement action. The FTC is required to consider the public interest in deciding whether to challenge a practice as unfair or deceptive. 15 U.S.C. §45(5)(b); see also 15 U.S.C. §45(n) (allowing the FTC to consider "established public policies as evidence," but not as its primary basis for a determination) that a practice is unfair. The FTC can issue cease and desist orders, which if violated, can allow it to file a civil suit to recover penalties of $10,000 per violation. 15 U.S.C. §45(m)(1).

For decades, there has been a vigorous debate about whether regulators are engaged in over- or under-enforcement of consumer law. One study created a "Shadow FTC" of those with prior employment experience at the FTC or as commissioners and asked it to evaluate cases brought under the state consumer protection acts by either states attorneys general or private litigants. The Shadow FTC believed that only 22 percent of the case scenarios described illegal practices, although litigation was brought in all the case scenarios. This suggests that the FTC may hold itself to a very high standard in deciding to bring an enforcement action as compared to states attorneys general or private litigants. Henry N. Butler & Joshua D. Wright, *Are State Consumer Protection Acts Really Little-FTC Acts?* 63 FLA. L. REV. 163 (2011). The critiques of the study were fierce, however, noting that there was little transparency in the methodology. *See, e.g.,* Dee Pridgen, *Wrecking Ball Disguised as Law Reform: ALEC's Model Act on Private Enforcement of Consumer Protection Statutes,* 39 N.Y.U. REV. OF LAW & SOC. CHANGE 279, 292-293 (2015). States also may be more responsive to local or regional concerns and be more nimble; the FTC's national focus and commission structure may hamper it.

Both the CFPB and the FTC share enforcement authority over their rules with state attorneys general. The CAN-SPAM Act, which sets rules for email that advertises or promotes commercial products or services is illustrative of overlapping enforcement authority. It provides that compliance shall be enforced by a laundry list of regulators, including the Office of the Comptroller of the Currency for national banks, the Federal Reserve for member banks (other than national banks), the FDIC for banks insured by it (other than banks that are members of the Federal Reserve System), the Securities and Exchange Commission with respect to any broker or dealer, state insurance authorities, the Secretary of Transportation for air carriers, and the Federal Communication Commission for anyone under its authority. 15 U.S.C. §7706(b). It also authorizes an attorney general, or an official or agency of a state, that has “reason to believe that an interest of the residents of that State has been or is threatened or adversely affected” by a violation to bring a civil action on behalf of residents of the state in U.S. district court. 15 U.S.C. §7706(f). The benefit of this kind of approach is that there are many “cops on the beat” with regard to the law. One drawback, however, is that the agencies may defer to each other or fail to communicate. Another problem is that it is difficult for any agency to develop expertise in a law—and produce coherent policy—when authority is scattered.

B. State Attorneys General

The roots of the office of state attorney general run deep in American jurisprudence. All thirteen American colonies had an attorney general and today all fifty states have an office of state attorney general. Although each state has its own constitution and statutes, laws and traditions bring remarkable similarity to the roles of state attorneys general. Unlike private and other government lawyers, who work in areas of narrow jurisdiction subject to ethical rules that defer decision making to clients, state attorneys general have significant discretion in their advice and litigation decisions. They possess extraordinarily broad jurisdiction. Precisely because of their broad legal powers, state attorneys general operate within shifting budgetary, political, and ethical parameters. Within those parameters, state attorneys general have considerable autonomy to choose which issues to pursue in the name of the public’s interest.

The doctrine of “parens patriae” underlies much of the jurisdiction and culture of state attorneys general. This doctrine originated in English common law to permit the king to protect and act for minors or incompetents—those who could not protect themselves. Attorneys general have the duty to represent all the citizens of a state and not just the interests of a client. But “[i]t is a short step from the state’s assertion of its own damages to assertion of claims on behalf of its citizens for damages arising from the same torts.” Jack Ratliff, *Parens Patriae: An Overview*, 74 TULANE L. REV. 1847 (2000). Parens patriae is often specifically alleged in consumer protection litigation, and in a broad sense it describes the “fix it” culture that pervades attorneys general practice.

Most state UDAP statutes give the attorney general broad remedial authority to protect the public against deceptive or unfair conduct. An attorney general may seek injunctive relief, which can be useful even if the defendant has gone out of business or changed its business because it serves as a warning to other entities with similar business models. In most states, the attorney general also can seek civil penalties and the recovery of the costs of its investigation. Increasingly, attorneys general seek restitution for injured consumers, rather than the more traditional public relief discussed above.

The largest consumer protection action by state attorneys general is the $25 billion national mortgage settlement, which was signed in February 2012 by 49 state attorneys general and the five largest mortgage servicers. The relief included hundreds of specific practices to be reformed or adopted, promises to provide loan modifications to homeowners facing foreclosure that equaled billions of dollars, and cash payments of civil fines to each state. The settlement was controversial for its size, for its imposition of an "independent" monitor (paid for by the settling banks, however), and for its implementation. This headline reveals one critique. Shaila Dewan, *Needy States Use Housing Aid Cash to Plug Budget*, N.Y. TIMES (May 15, 2012) (noting that only half of states devoted all their funds to housing programs and that some states sent millions straight to their general funds). The settlement also raised the issue of the degree to which it is appropriate to use litigation to prospectively change conduct. "While there are no neat dividing lines dictating or allocating permissible regulatory and enforcement powers between government branches," regulating prospectively through large monetary settlements may "circumvent traditional law making through the legislature and often fail to satisfy basic due process concerns such as notice, participation, and adequate representation." Elizabeth Chamblee Burch, *Revisiting the Government as Plaintiff*, 5 J. OF TORT L. 227, 228 (2014).

In obtaining such broad relief, attorneys general may deliver "corrective justice" to harmed consumers. While that may sound like a nice thing, scholars have noted that the theory of corrective justice is "inherently retrospective, intrapersonal and incremental." Adam Zimmerman, *The Corrective Justice State*, 5 J. OF TORT L. 189 (2014). Public law, by contrast, is supposed to promote the public interest in a prospective, general, and comprehensive way. As attorneys general have pursued broader remedies, some have complained that these suits lack procedural protections. *See, e.g.,* Margaret Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, 126 Harv. L. Rev. 486 (2012).

West Virginia v. CVS Pharmacy, Inc.

646 F.3d 169 (4th Cir. 2011)

NIEMEYER, Circuit Judge.

The State of West Virginia, by its Attorney General, commenced this action in state court against CVS Pharmacy, Inc., and five other pharmacies (collectively, the "Pharmacies"), alleging that the Pharmacies sold generic drugs to West Virginia consumers without passing along to the consumers the cost savings of generic drugs over brand name equivalents, in violation of West Virginia Code §30-5-12b(g), regulating the practice of pharmacy, and the West Virginia Consumer Credit Protection Act, prohibiting “unfair or deceptive acts or practices in the conduct of any trade or commerce,” West Virginia Code §46A-6-104, and “excess charges,” id. §46A-7-111. The State, claiming to act in its “sovereign and quasi-sovereign capacity,” seeks injunctive relief, restitution and disgorgement of “overcharges,” recovery on behalf of the consumers of “excess charges,” civil penalties, interest, costs, and attorneys’ fees.

The Pharmacies removed the action from state court to the district court under the Class Action Fairness Act of 2005 (“CAFA”), Pub. L. No. 109-2, 119 Stat. 4 (2005), arguing that the action is a “disguised class action” and therefore was subject to removal under CAFA.

On the State’s motion, the district court ordered that the action be remanded to state court, holding that the action was not a “class action” under CAFA, but rather a “classic parens patriae action” intended to vindicate the State’s quasi-sovereign interests and the individual interests of its citizens.

...

Attorney General Darrell McGraw commenced this action in the Circuit Court of Boone County, West Virginia, naming as defendants CVS Pharmacy, Inc., Kmart Holding Corporation, the Kroger Company, Wal-Mart Stores Inc., Walgreen Co., and Target Stores, Inc., and alleging that in filling drug prescriptions, these Pharmacies overcharged West Virginia citizens, in violation of two laws, West Virginia Code §30-5-12b (the “Pharmacy Act”) and West Virginia Code §§46A-6-104 and 46A-7-111 (the West Virginia Consumer Credit Protection Act or “WVCCPA”), and thereby obtained unjust profits.

The Pharmacy Act requires pharmacists to fill prescriptions with generic drugs, when appropriate, and to pass on to the consumer the savings in the cost of the generic drugs. Thus, when a pharmacy acquires a brand name drug at $30 and a generic equivalent at $10, the pharmacy must pass on at least the $20 difference to the consumer. See W. Va. Code §30-5-12b(g). But it must also pass on any other savings, such as the savings represented by the difference in the retail prices. See id. The Attorney General contends that violations of the Pharmacy Act also constitute violations of the WVCCPA, which prohibits “unfair or deceptive” trade practices and the collection of “excess charges.” See W. Va. Code §§46A-6-104, 46A-7-111.

As authorized by these Acts, the West Virginia Attorney General is, in this action, seeking a temporary and permanent injunction against further violations of the Acts; “[e]quitable relief, including but not limited to restitution and disgorgement of monies obtained as a result of the overcharges”; repayment of the “excess charges” to affected consumers; civil penalties of up to $5,000 for each willful violation of the WVCCPA; pre-judgment and post-judgment interest; and costs including legal fees. The State alleges that it is pursuing these remedies “in its sovereign and quasi-sovereign capacity.”

The Pharmacies removed the action to federal court, relying on several distinct grounds for doing so, including CAFA. To justify removal under CAFA, the Pharmacies asserted that because the “complaint [was] a disguised class action” designed “to recover funds on behalf of those consumers who have allegedly paid overcharges,” it was a removable class action. In particular, they pointed to Count III, which is dedicated to the remedy of collecting, on behalf of consumers, excess charges under West Virginia Code §46A-7-111(1). That section provides that if "an excess charge has been made, the court shall order the [defendant] to refund to the consumer the amount of the excess charge." Id. Noting the large number of consumers in West Virginia and prescriptions filled for them, the Pharmacies argued that Count III met CAFA's numerosity and amount-in-controversy requirements. Because the Pharmacies are not West Virginia citizens, they also argued that minimal diversity was satisfied. Finally, because the Attorney General was seeking refunds on behalf of each affected West Virginia purchaser of generic drugs, the Pharmacies contended that the action was a representational proceeding, qualifying as a "class action" under CAFA.

The district court granted the State's motion to remand, rejecting each of the various grounds relied on for removal. With respect to the CAFA ground, which is the only issue on appeal, the court concluded that this action was "a classic parens patriae action that is neither a class action nor a mass action contemplated by CAFA." West Virginia ex rel. McGraw v. CVS Pharmacy, Inc., 748 F. Supp. 2d 580 (S.D. W. Va. Sept. 21, 2010). In concluding that this action was a parens patriae action, the district court noted that the WVCCPA authorized the Attorney General to act "as an administrator of the law," independently of individual consumer complaints. Id. at *36-37 (quoting Manchin v. Browning, 296 S.E.2d 909, 919 (W. Va. 1982)); see also id. at *42 (observing that the Attorney General is charged with "a freestanding consumer-protection duty"). The district court also noted that the State's action was "imbued with a 'disgorgement' purpose," "separate and apart from the interests of particular consumers in obtaining recompense." Id. at *38-39. In this sense, the court explained, "the Attorney General's paramount goal [was] to extract from the alleged wrongdoers every penny associated with the excess charges, along with civil penalties flowing to the State alone," thereby "warning… future violators that they [would] not long profit from consumer fraud." Id. at *39-40.…

In arguing that the district court erred in concluding that this action was not removable as a class action under CAFA, the Pharmacies acknowledge that the Attorney General did not purport to bring his action as a class action but rather relied on his authority under the Pharmacy Act and the WVCCPA. But the Pharmacies argue:

> It is well-settled that "in determining whether there is jurisdiction, federal courts look to the substance of the action and not only at the labels that the parties may attach."
>
> …
>
> Thus, the AG may not plead around federal jurisdiction merely by labeling his claims as brought in the state's sovereign or quasi-sovereign capacity.
>
> …
>
> Instead, this Court must consider whether, in substance, the Amended Complaint satisfies CAFA's requirements for a "class action." That analysis makes clear this case is properly removed as a CAFA class action, and that the district court erred by remanding it.

(Quoting Louisiana ex rel. Caldwell v. Allstate Ins. Co., 536 F.3d 418, 424 (5th Cir. 2008)). After asserting that the requirements for minimal diversity, the jurisdictional amount, and numerosity were in fact satisfied, the Pharmacies assert, as they must, that the state statutes on which the Attorney General relied were "similar" to

Federal Rule of Civil Procedure 23. They explain that the statutes are “similar” because, in particular, the WVCCPA allows the Attorney General “to represent in a single action thousands of consumers who all suffer a similar injury—excess charges.” “That similarity alone,” they argue, is enough to satisfy federal removal jurisdiction.

To determine whether the Pharmacies’ position is sustainable requires a straightforward statutory analysis of CAFA.

CAFA authorizes the removal of any civil action which is a class action in which (1) “the matter in controversy exceeds the sum or value of $5,000,000, exclusive of interest and costs,” 28 U.S.C. §1332(d)(2); (2) “any member of a class of plaintiffs is a citizen of a State different from any defendant,” id. §1332(d)(2)(A); and (3) there are 100 or more plaintiff class members, id. §1332(d)(5)(B). And it defines “class action” to mean “any civil action filed under rule 23 of the Federal Rules of Civil Procedure or similar State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action.” Id. §1332(d)(1)(B).

Inasmuch as West Virginia’s action was commenced in state court, it was obviously not commenced under Federal Rule of Civil Procedure 23. Thus, it would be removable only if it were filed under a “*similar* State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action.” 28 U.S.C. §1332(d)(1)(B) (emphasis added).

A state statute or rule is “similar” to Federal Rule of Civil Procedure 23 if it closely resembles Rule 23 or is like Rule 23 in substance or in essentials. See Merriam-Webster’s Collegiate Dictionary, 1161 (11th ed. 2007). Moreover, as CAFA requires, the state statute or rule must resemble or be like Rule 23 by “authorizing an action to be brought by 1 or more representative persons *as a class action*.” 28 U.S.C. §1332(d)(1)(B) (emphasis added). While the statutory definition is, to some degree, circular, Congress undoubtedly intended to define “class action” in terms of its similarity and close resemblance to Rule 23.

At its essence, Rule 23 provides that “one or more members of a class may sue or be sued as representative parties on behalf of all members only if” the criteria for numerosity, commonality, typicality, and adequacy of representation are satisfied. Fed. R. Civ. P. 23(a) (emphasis added). Without this representative nature of the plaintiffs’ action and the action’s satisfaction of the four criteria stated in Rule 23(a), the action is not a class action. It is not fortuitous that CAFA parroted Rule 23 language when it required that a “similar” state statute or rule “authoriz[e] an action to be brought by 1 or more representative persons as a class action.” 28 U.S.C. §1332(d)(1)(B). Thus, while a “similar” state statute or rule need not contain all of the other conditions and administrative aspects of Rule 23, it must, at a minimum, provide a procedure by which a member of a class whose claim is typical of all members of the class can bring an action not only on his own behalf but also on behalf of all others in the class, such that it would not be unfair to bind all class members to the judgment entered for or against the representative party. West Virginia Civil Rule of Procedure 23 would satisfy the “similarity” requirement, but it was not invoked here.

Instead, the Attorney General filed a statutorily authorized action on the State’s behalf, asserting claims arising exclusively under state consumer protection statutes. Count I alleges that the Pharmacies violated state law regulating the practice of pharmacy in West Virginia, particularly West Virginia Code, §30-5-12b(g).

Counts II and III allege that the Pharmacies violated portions of the WVCCPA, a wide ranging statute designed "to protect consumers from unfair, illegal, and deceptive acts or practices," as prescribed in West Virginia Code, §46A-6-101 et seq. West Virginia ex rel. McGraw v. Scott Runyan Pontiac-Buick, Inc., 194 W. Va. 770 (W. Va. 1995). For its enforcement the WVCCPA grants the Attorney General "broad powers to supervise, investigate and prosecute violations." Id. at 525 (quoting Harless v. First National Bank, 162 W. Va. 116 (W. Va. 1978)). Although the Attorney General may "[r]eceive and act on complaints," the WVCCPA also empowers him to "commence proceedings on his own initiative." W. Va. Code §46A-7-102(1)(a).

Section 46A-7-111, on which Count III is based, authorizes the Attorney General to pursue refunds on behalf of consumers affected by "excess charges" and to seek civil penalties where the excess charges were repeatedly and willfully collected by a defendant. W. Va. Code §46A-7-111(1)-(2). Here, the Attorney General has exercised both of these powers, as this action seeks repayment to consumers under §46A-7-111(1) and penalties inuring to the State of "up to $5,000 for each repeated and willful violation" under §46A-7-111(2).

These West Virginia statutes, on which the Attorney General relies for his claims, contain virtually none of the essential requirements for a Rule 23 class action. To begin with, the Attorney General is not designated as a member of the class whose claim would be typical of the claims of class members. Rather, he is authorized to file suit independently of any consumer complaints, as a parens patriae, that is, as the legal representative of the State to vindicate the State's sovereign and quasi-sovereign interests, as well as the individual interests of the State's citizens. Indeed, the fact that the Attorney General is acting to obtain disgorgement of ill-gotten gains, "separate and apart from the interests of particular consumers in obtaining recompense," CVS Pharmacy, Inc., 748 F. Supp. 2d 580, validates this action as a parens patriae action. See In re Edmond, 934 F.2d 1304, 1310 (4th Cir. 1991).

Moreover, neither the Pharmacy Act nor the WVCCPA contains any numerosity, commonality, or typicality requirements, all of which are essential to a class action.

Finally, these Acts authorize the Attorney General to proceed without providing notice to overcharged consumers, which would also be essential in a Rule 23 class action seeking monetary damages. See Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 812 (1985).

The Pharmacies argue that the suit is nonetheless a "disguised class action" because Count III is a representative action in which the Attorney General acts on behalf of the citizens, each of whom allegedly suffered a common injury. See Louisiana ex rel. Caldwell v. Allstate Ins. Co., 536 F.3d 418 (5th Cir. 2008). But that type of representation is not the type that would make the State's action a class action. A class action is an action filed by an individual as a member of a class and whose claim is typical of the class members' claims. Thus, for a representative suit to be a class action, the representative party "must be part of the class and 'possess the same interest and suffer the same injury' as the class members." Gen. Tel. Co. v. Falcon, 457 U.S. 147, 156 (1982). The Attorney General's claim on behalf of the State, however, does not require the State to be a member of the class, to suffer the same injury as class members, or to have a claim typical of each class member's claim. Rather, in representing the citizens, the State acts more in the capacity of trustee representing beneficiaries or a lawyer representing clients, neither of which is the type of representation essential to the representational aspect of a class action.

Indeed, the West Virginia Attorney General's role here is more analogous to the role of the EEOC or other regulator when it brings an action on behalf of a large group of employees or a segment of the public. Yet, the Supreme Court has concluded that such a regulator's action is not a class action of the kind defined in Rule 23. For example, in *General Telephone Co. v. EEOC*, 446 U.S. 318, 334 (1980), the Supreme Court held that a sex-discrimination suit brought by the EEOC under Title VII was "not properly characterized as a 'class action' subject to the procedural requirements of Rule 23." The Court reached that conclusion despite the fact that the suit sought back pay and other relief on behalf of all of the employer's adversely affected employees in California, Idaho, Montana, and Oregon. Id. at 321, 324. Likewise, in *Edmond*, we held that a bankruptcy claim brought by the Maryland Attorney General's Office "on behalf of itself and all [affected Maryland] consumers" did not need to comply with Rule 23, even though one of the claim's primary purposes was to provide individual citizens with refunds pursuant Maryland's Consumer Protection Act. See 934 F.2d at 1306; see also id. at 1310-13.

Much like the statutes at issue in *General Telephone* and *Edmond*, the WVCCPA authorizes the Attorney General to bring enforcement actions against violators and, in so doing, to pursue relief on behalf of aggrieved individuals. See Scott Runyan, 461 S.E.2d at 523-24. Yet that type of representation by the State is no more characteristic of the representational nature of a class action than were the claims in *General Telephone* and *Edmond*. Neither the State nor the Attorney General is a member of the class purportedly represented, and neither suffered the same injury as the citizens in that class.

The Pharmacies nonetheless argue that CAFA's legislative history supports their position.…Moreover, while some floor statements cited by the Pharmacies are favorable to their arguments, others cited by the Attorney General, from the same Senator and the same page of the Congressional Record, point in the opposite direction. Compare 151 Cong. Rec. S1163 (daily ed. Feb. 9, 2005) (statement of Sen. Charles Grassley that a subsequently defeated amendment intended to exempt suits brought by state attorneys general would have "create[d] a very serious loophole"), with id. (statement of Sen. Charles Grassley that "the amendment [was] not necessary" because "cases brought by State attorneys general will not be affected by this bill"). This legislative history is hardly probative.

In sum, we conclude that because the action before us was not brought under Federal Rule of Civil Procedure 23 or a "similar State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action," 28 U.S.C. §1332(d)(1)(B), the district court did not err in remanding this case to the Circuit Court for Boone County.

The West Virginia Attorney General initially filed this action in a West Virginia state court to enforce, on behalf of West Virginia and its citizens, state consumer protection laws applicable only in West Virginia. Were we now to mandate that the State was not entitled to pursue its action in its own courts, we would risk trampling on the sovereign dignity of the State and inappropriately transforming what is essentially a West Virginia matter into a federal case. The Pharmacies nonetheless rationalize such a transformation on the basis that the Attorney General somehow mispleaded his case, disguising what would otherwise be a CAFA class action.

The Pharmacies' approach, however, would have to ignore the Attorney General's stated basis for his action of seeking to vindicate West Virginia's interests in how pharmacies may charge West Virginia consumers in filling prescriptions. If we accept the Attorney General's good faith in pleading his claims—and we are given no reason not to—the Pharmacies have no basis, real or postured, to assert that this is an "interstate case of national importance," the defining federal interest animating CAFA's removal provisions. See CAFA, Pub. L. No. 109-2 §2(b)(2).…In this case, where West Virginia has raised no federal question and where all persons on whose behalf West Virginia has filed this action are West Virginia citizens, the "claim of sovereign protection from removal [arises] in its most powerful form." In re Katrina Canal Litig. Breaches, 524 F.3d 700, 706 (5th Cir. 2008).…

We conclude, in the circumstances presented here, that CAFA does not clearly demand that West Virginia's action, which is essentially a parens patriae type of action for enforcement of its own laws on behalf of itself and its citizens, be removed to federal court, even though the Pharmacies are citizens of States different from West Virginia. The Pharmacies are summoned to West Virginia courts only because they do business in West Virginia and, while there, allegedly violated its laws.…

Accordingly, the district court's order remanding this matter to the Circuit Court for Boone County is affirmed.

GILMAN, Senior Circuit Judge, dissenting:

The majority has concluded that the Class Action Fairness Act (CAFA) does not provide federal jurisdiction over the West Virginia Attorney General's lawsuit because this case is a parens patriae action and not a "class action" as defined by CAFA. For the reasons set forth below, I respectfully disagree.

The primary difficulty in this case, as I see it, is that CAFA does not actually define a class action. As the majority notes, CAFA's definition of a class action is essentially circular: "the term 'class action' means any civil action filed under rule 23 of the Federal Rules of Civil Procedure or similar State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action." 28 U.S.C. §1332(d)(1)(B). And CAFA gives no guidance as to what type of state statute or rule of judicial procedure should be considered "similar" for purposes of conferring federal jurisdiction.

In my view, the essence of a class action is set forth in the first sentence of the term's definition in Black's Law Dictionary: "A lawsuit in which the court authorizes a single person or a small group of people to represent the interests of a larger group.…" Black's Law Dictionary 284 (9th ed. 2009). I believe that the present suit brought by the Attorney General squarely fits within that authoritative definition of a class action.

...

The Attorney General brings this suit in what he alleges is West Virginia's parens patriae capacity. "In order to maintain such an action, the State must articulate an interest apart from the interests of particular private parties," also known as a "quasi-sovereign interest." Alfred L. Snapp & Son, Inc. v. Puerto Rico ex rel. Barez, 458 U.S. 592, 607 (1982). The Supreme Court has stated that there are two general categories of quasi-sovereign interests: (1) a state's interest in the physical and economic well-being of its citizens in general, and (2) a state's interest in "not being discriminatorily denied its rightful status within the federal system." Id.

[E]xamples of successful parens patriae actions include cases where a state has sought to enjoin a public nuisance or ensure the economic well-being of its citizenry generally. See, e.g., Missouri v. Illinois, 180 U.S. 208, 248 (1901) (holding that Missouri could pursue an injunction to prevent the defendants from discharging sewage in such a way that polluted the Mississippi River in Missouri); Pennsylvania v. West Virginia, 262 U.S. 553, 592 (1923) (recognizing Pennsylvania and Ohio as the proper parties to represent the interests of their citizens in maintaining access to natural gas produced in West Virginia).…

Here, the Attorney General asserts that the defendants (the Pharmacies) violated West Virginia's Pharmacy Act and the WVCCPA, and he seeks damages payable directly to the allegedly aggrieved West Virginia purchasers of generic drugs under WVCCPA §46A-7-111(1), civil penalties under WVCCPA §46A-7-111(2), injunctive relief, and other appropriate remedies. Utilizing a claim-by-claim framework, I believe that the primary thrust of this case is the excess-charges claim (Count III) for which the Attorney General seeks reimbursement payable directly to the affected consumers under WVCCPA §46A-7-111(1).

I reach this conclusion for two reasons: (1) the WVCCPA provides that a ruling that the consumers have been overcharged will result in those overcharges being remitted directly to the consumers, and (2) injunctive relief and any civil penalties are discretionary with the court and require more stringent proof on the part of the Attorney General. Compare West Va. Code §46A-7-111(2) (requiring proof of repeated and willful violations of the WVCCPA before civil penalties may be awarded) with West Va. Code §46A-7-111(1) (allowing the Attorney General to bring an action against a creditor for charging consumers in excess of what the law permits, regardless of the creditor's state of mind).

The West Virginia Attorney General here does not have a quasi-sovereign interest in the refunds that the Pharmacies will be required to pay directly to the affected consumers if they are found to have violated the WVCCPA. Admittedly, the Attorney General is also seeking civil penalties and injunctive relief, these being the type of claims clearly within the state's parens patriae authority. But for the reasons stated above, I do not believe that these claims are the primary focus of this case, and are instead subsidiary claims that will be considered by the trial court only if the primary claim of reimbursement to the allegedly overcharged consumers is successful.

I believe that my analysis is strengthened by the fact that some of the same private attorneys representing the Attorney General here are simultaneously representing individuals who have filed essentially identical claims against the same defendants in Michigan and Minnesota. No one questions that those cases are class actions; in fact, they were filed as class actions. See Graphic Comms. Local 1B Health & Welfare Fund "A" v. CVS Caremark Corp., 725 F. Supp. 2d 849 (D. Minn. 2010). If one were to close one's eyes as to who the named plaintiff is in the three lawsuits, there is no way to detect a material difference between the Attorney General's request for repayment to overcharged consumers under WVCCPA §46A-7-111(1) in the present case and the same claims that are pending in Michigan and Minnesota.

CAFA's legislative history, which is admittedly limited, also supports my conclusion that this case is simply not a parens patriae action. During the debate in the U.S. Senate over CAFA, Senator Pryor proposed an amendment that would have exempted all class actions filed by state attorneys general from removal under

CAFA. See 151 Cong. Rec. S1157 (daily ed. Feb. 9, 2005). Both Senators Grassley (a cosponsor of CAFA) and Hatch (the former chair of the Senate Judiciary Committee) opposed the Pryor Amendment because, among other things, the Amendment risked "creating a situation where State attorneys general can be used as pawns so that crafty class action lawyers can avoid the jurisdictional provisions of [CAFA]" by "simply includ[ing] in their complaint a State attorney general's name as a purported class member." Id. at 1163-64.

The concern that Senators Grassley and Hatch expressed in opposing the ultimately defeated Pryor Amendment is exactly what has come to fruition here. I believe that the West Virginia Attorney General has been "used as a pawn" so that the private class-action lawyers can remain in state court and avoid the impact of CAFA, despite the fact that the real parties in interest are the allegedly aggrieved West Virginia consumers and not the state.

Having concluded that the affected West Virginia consumers are the real parties in interest, I find that this action should be removable under CAFA because the essential requirements of a class action are met given the factual circumstances of this case.…

[T]he allegedly overcharged consumer, like any putative class member considering whether to join a class action, has the ultimate say as to whether to be bound by the Attorney General's lawsuit. WVCCPA §46A-7-111(1) provides in pertinent part that

> [i]f a consumer brings an action against a creditor to recover an excess charge or civil penalty, an action by the attorney general to recover for the same excess charge shall be stayed while the consumer's action is pending and shall be dismissed if the consumer's action is dismissed with prejudice or results in a final judgment granting or denying the consumer's claim.

The Attorney General's power over a particular generic-drug purchaser's claim is thus ultimately controlled by the consumer. I therefore believe that WVCCPA §46A-7-111 is sufficiently similar to Rule 23 of the Federal Rules of Civil Procedure to meet CAFA's requirements for class actions. And because this is (1) a civil action (2) in which the amount in controversy exceeds the sum or value of $5,000,000 and (3) involves a plaintiff class exceeding 100 persons whose West Virginia citizenship is different from any defendant, none of whom are considered citizens of West Virginia, I would hold that CAFA's jurisdictional requirements are met. See 28 U.S.C. §1332(d).…

In sum, there is a saying that if something looks like a duck, walks like a duck, and quacks like a duck, it is probably a duck. To my mind this case "quacks" much more like a CAFA class action than a parens patriae case. I would therefore reverse the judgment of the district court and allow this case to proceed in federal court.

Consumer protection scholars have generally lined up opposite the civil procedure folks to make the case for wide-ranging public enforcement. One key point that they raise is that public suits do not foreclose private actions. This was true of the national mortgage settlement, although consumers had limited success in individual actions and virtually no success (at least yet) in class actions, despite the talents of some of the nation's best class action attorneys at work. Another defense of public enforcement is to note that it has substantial efficiency benefits. It is cheaper and quicker. As one scholar quipped, "Why pay for a 'private attorney general' when there is a public attorney general who works for free?" Jack Ratliff, *Parens Patriae: An Overview*, 74 TULANE L. REV. 1847, 1849 (2000). Others have noted that the calculation of public compensation is often based on restitution and recovery of illegal gain, rather than damages and loss. Given that, there should be less concern about the reduced procedural protections for consumers as compared to a private class action. *See* Prentiss Cox, *Public Enforcement Compensation and Private Rights*, __ MINN. L. REV. __ (2015).

An empirical study of actions by state attorneys general concluded that there was a "measured use" of enforcement powers and "robust cooperation between federal and state authorities" when there was express statutory authority for the states to litigate (as opposed to solely relying on parens patriae). Amy Widman & Prentiss Cox, *State Attorneys General's Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws*, 33 CARDOZO L. REV. 53 (2011). And perhaps given Dodd-Frank's explicit adjustment of consumer law in favor of more limited federal preemption and authorization of state enforcement, these concerns will abate.

Because every state's unfair and deceptive statute includes a private enforcement mechanism, the state attorneys general are partners in enforcement with the private bar. By contrast, in the federal regime, the FTC or the CFPB have exclusive enforcement responsibility. While a private litigant may file suit under a specific statute, such as the Truth in Lending Act, individual or class actions cannot allege a violation of the federal unfair or deceptive (or abusive) statutes.

More than half of the state attorneys general have the authority to interpret state consumer protection statutes by way of rulemaking. The requirements for rulemaking generally follow the dictates of each state's administrative procedures act. Some state statutes provide that the attorney general's regulations have the force of law. In other states a violation of a regulation is prima facie evidence of a violation of the consumer protection statute.

Problem Set 24

24.1. Last year, the Rose State Attorney General filed suit against Active Arbitration (AA), a private dispute resolution company that operated nationwide. AA's headquarters were about 2,000 miles from Rose State and AA had no employees or operation in Rose State, except for when a consumer demanded an in person hearing after losing an arbitration based on paper filings. The Attorney General alleged that AA misled consumers with representations of neutral arbitration practices when in fact AA had financial ties to the credit card companies whose contracts required arbitration with AA. Just three days after filing suit, AA agreed to a consent judgment to stop arbitrating such complaints entirely. The attorney general crowed to you, his political advisor for his reelection campaign this fall, about this success, sending you multiple copies of the press releases on the suit. He suggests that you nickname him the

“Big Dog” and bragged that he singlehandedly stopped credit card arbitrations on a national basis.

You have recently caught wind that the opposing candidate for the attorney general’s job has a different take on the AA litigation. He is developing a series of attack ads, asserting that the attorney general needs to avoid pursuing and creating national remedies because it is a waste of the taxpayers of Roses’ dollars and that it reflects a sense of knowing what is best for everyone rather than doing the job at hand. Are these criticisms valid? In the upcoming debate, what arguments do you expect the opponent to flush out in support of his positions? How will you advise the incumbent attorney general to respond?

24.2. You work in the government services division of a major consulting firm, having left behind the world of law after a few years as an associate. The attorney general for the state of Union has hired your firm to evaluate its consumer complaint process. She believes the legislature might dramatically reduce funding for the attorney general due to budget constraints, and she has wondered if closing the consumer complaint division would be an effective cost-cutting measure. She provides you with the following information about Union’s process. Consumers can submit complaints either by calling a 1-800 hotline or filing a complaint online. After making the initial complaint, the consumer has to mail in copies of any relevant documents that support a complaint, such as loan disclosures, leases, etc. After receiving the complaint, the Consumer Protection Division writes to the business to initiate a mediation with the business. If the business declines to respond, the Consumer Protection Division provides the consumer with a packet of information on how to file a dispute in small claims court.

Last year, the Division received 4,000 complaints. In 3,000 instances, the business did not respond to the mediation request. In 1,000 cases, the dispute was mediated to the satisfaction of the parties. Among the 4,000 complaints, the attorney general initiated an investigation in three cases and filed a lawsuit in two of those cases. One lawsuit resulted in injunctive relief; the other resulted in injunctive relief and a $500,000 restitution award. The attorney general filed 15 consumer protection lawsuits in total for the year; the other practices or businesses at issue in the other 13 actions were identified through the attorney general’s staff conducting investigations at its own behest.

As part of your analysis, identify the purpose of a consumer complaint program. Who does it serve? Is it consistent with the public enforcement duties of an attorney general and the parens patriae theory? What problems or value do you see to the approach used by this attorney general and what suggestions might you make for improvement?

24.3. Henrietta just got a call from her law school classmate, Alberto, asking if she would represent him as he is being “sued by the CFPB.” Henrietta, who specializes in professional misconduct cases, was surprised. First, she’s never heard of the CFPB and has no idea why Alberto would call her when he well knows that she mostly represents attorneys in bar discipline cases. Second, she is surprised because Alberto was an upstanding person in law school and she knows he has built a successful firm that represents financial start-up companies.

Alberto says that he is so distraught that he cannot even read the complaint with any care but that he’ll email it to Henrietta. Alberto says that as far as he can calm himself to scan the complaint, it seems to allege that he engaged in “unlawful conduct” in breach of his professional duties as a lawyer. He explains that his firm has filed more than a dozen cases last year challenging the constitutionality of the CFPB. While those claims have all been dismissed, he believes his strategy has slowed down litigation and helped clients negotiate settlements with the CFPB. On what basis could the CFPB have jurisdiction over Alberto? What might Henrietta argue in trying to have the complaint dismissed? *See* 12 U.S.C. §5481(25); 12 U.S.C. §5531; Fed. R. Civ. P. 11.

In addition to public enforcement, most consumer law statutes allow individuals to bring claims, in addition to providing for public enforcement. To some extent, public and private enforcement can substitute for each other, but not wholly so. Public enforcement may be too slow, may not address the consumer's particular issue, or simply may not occur at all because government does not wish to take up the consumer's situation. Private enforcement has different purposes, including primarily redress for the individual consumer.

Even when consumers can file a lawsuit, however, they often do not. Most statutes are infrequently used, and may produce only modest success for consumers. Underenforcement via private lawsuit is perhaps the most vexing problem in consumer law. Its causes are multiple. Most importantly, law is not free. Consumer remedies are often difficult to use, and consumer lawyers are hard to identify and afford. Some statutes provide for no remedy other than restitution, which may be insufficient to justify filing suit, while others provide for only actual damages, which can be difficult to quantify or prove. Some laws try to remedy these problems with statutory or punitive damages or to permit class actions. These mechanisms appear to be only partially successful and work better for some kinds of wrongs than others.

Underenforcement raises both practical and theoretical concerns. For lawyers, inadequate remedies can make practice unprofitable or risky. For consumers, it can cause disillusionment with the legal system, larded on top of the actual harms suffered by the businesses' wrongdoing. For advocates, underenforcement makes it difficult to know whether the costs of obtaining new substantive protections are worthwhile, given the risk of non- or under-enforcement of those rights. How just is a system of consumer law that cannot produce a remedy for the aggrieved consumers? Different ideas of justice, such as deterrence or restorative justice, translate into different approaches to enforcement. Private remedies, as much as the substantive rights themselves, raise normative questions about the purpose and utility of consumer law.

A. Litigation Remedies

Little attention was given to remedies in much of this book. The focus was on the law itself and whether a legal violation occurred in particular circumstances—not on what an aggrieved party could (or would likely) do about it. Often in law school, the issue of remedies is ignored entirely. Many new lawyers dutifully explain a large body of legal rules to their clients, only to face pointed questions about just what the client can do or get.

One reason to cover remedies as a collective topic (rather than law by law) is that many consumer statutes share the same private enforcement scheme. The best example of this is the repetitive enforcement pattern in many subparts of the umbrella Consumer Credit Protection Act, which includes TILA, ECOA, FDCPA, FCRA, etc. While there are variations that justify examining each liability provision with care in practice, at a general level these laws offer three kinds of remedies to consumers: actual damages, statutory damages of a limited amount, and an award of attorneys' fees and costs of the action, if the consumer is successful. These remedies are discussed in order in this Assignment. The remaining sections consider some of the most contested issues in private enforcement: litigation costs and class actions.

As a reminder, a few of the exceptional remedies that apply to particularized products have previously been discussed. The most important of these are rescission for foreclosure, statutory discharge for student loans, and lawsuits under Magnuson-Moss for breach of U.C.C. warranties.

1. Actual Damages

When a statute provides any remedy, it usually permits "actual damages." This functions as kind of a minimum remedy. Indeed, if a consumer did not suffer any harm, the statute would likely not provide a private right of action at all. That said, it is extraordinarily difficult to establish actual damages for many consumer law protections. Several statutes illustrate the point.

The Truth in Lending Act makes a creditor who fails to comply with any requirement "liable to such person in an amount equal to the sum of…any actual damage sustained by such person as a result of the failure." 15 U.S.C. §1640(a). But what is the actual harm to a consumer who did not receive an appropriate disclosure? In most instances, consumers cannot show any monetary harm. The rate and other terms of the loan were not affected by the legal violation. Consumers could argue that they were harmed because they relied on the inaccurate disclosure and failed to shop for cheaper products. But remember that the Truth in Lending Act punishes both overdisclosure and underdisclosure of the finance charge, the APR, and the amount financed. And most consumers cannot show that they read, much less understood, the Truth in Lending Act disclosure at the time of the transaction or that they did shop or would have shopped for a better loan. Frequently, the violations raised are "technical," in the sense that the law was not followed but that fact did not change the outcome of the transaction. The consumer would have borrowed the money at the same rate from the same lender with or without an accurate disclosure. Courts are hard pressed to find actual damages in such situations.

To take another example, the Fair Debt Collection Practices Act also provides for actual damages. 15 U.S.C. §1692k. Consider a creditor who calls before 9:00 A.M., violating §1692c(a)(1), or who uses obscene or profane language, violating §1692d(2). These acts are annoying and may offend a consumer's sensibilities. They are also patently illegal. But is there an actual harm to being called a name or being awoken by the telephone? If so, what is the appropriate measure of monetary damages?

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40 F. Supp. 2d 1323 (M.D. Ala. 1998)

DE MENT, District Judge.

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FACTUAL BACKGROUND

On October 7, 1995, Plaintiff purchased a 1990 Nissan automobile from Dyas Nissan, Inc. The vehicle was financed with Defendant Nissan. Plaintiff entered into a Retail Installment Contract ("Contract") with Nissan whereby Plaintiff agreed to pay monthly installments. When Plaintiff signed the contract with Nissan, she understood that there would be a late charge if payments were not paid in a timely manner. Plaintiff also understood that the car would be repossessed if payments were not made. Plaintiff did not understand that the car could be sold upon repossession.

Over the course of the ensuing year, Plaintiff made payments to Nissan, but she was delinquent in making some of these payments. Throughout the year, Nissan employees called Plaintiff to inquire about delinquent payments.

On or about October 10 or 11, 1996, an employee from Nissan, ("Ed") called Plaintiff regarding her delinquent payment. Plaintiff and Ed reached an agreement whereby Plaintiff would pay Nissan one hundred thirty-two dollars ($132.00). Plaintiff and Ed did not discuss repossession of the car or whether the account would be considered current. Plaintiff sent a check for $132.00 to the Nissan employee on October 12, 1996.

On or about October 23, 1996, the vehicle was repossessed by Joiner's Recovery Service ("Joiner's"). Joiner's was hired by Defendant Nissan to repossess the vehicle. At the time of the repossession, Plaintiff did not know the identity of the men who came to repossess the vehicle. One of the men informed Plaintiff that he was acting for Nissan. Plaintiff was approximately one month behind in payment to Nissan. The men repossessed the vehicle from the parking lot of Plaintiff's place of employment. Plaintiff was employed by Trinity United Methodist Church in Opelika, Alabama, as the office manager. The repossession occurred while Plaintiff was at work, and Plaintiff was left with no means of transportation.

At the time of the repossession, Plaintiff by telephone spoke with a Nissan employee and explained to the employee the arrangement she had made with the Nissan employee Ed on October 10, 1997. The Nissan employee denied that there was any such arrangement. The Nissan employee told Plaintiff that "there was nothing that [Plaintiff] could do, just hand over the keys, and the account was now closed, it was over."

When the car was repossessed, Plaintiff had personal property in the car. Plaintiff attempted to retrieve her personal property at the time of repossession, but she was unable to recover all of it. Among the items remaining in the vehicle were tapes, personal papers, toys, movies, a children's coat, and a blanket. While Plaintiff retrieved the personal property she was able to, the Joiner's employee hooked up the car to be towed. The Joiner's employee informed Plaintiff that she could retrieve the remainder of her personal belongings upon paying $45.00 to Joiner's.

The repossession upset and embarrassed Plaintiff. While the vehicle was repossessed, members of the church walked by and watched. Plaintiff cried to one of the associate pastors as the vehicle was taken away.

Plaintiff did not know where the Joiner's employee worked or where he was taking the car. The Joiner's employee told Plaintiff he would contact her with information regarding where she could retrieve her personal belongings. The man never contacted Plaintiff.

On the morning of October 24, 1996, Plaintiff called and spoke with the Nissan employee Ed. She asked Ed why the vehicle had been repossessed subsequent to their agreement. Ed told Plaintiff he could not speak with her, and he informed her that she would have to pay $6,700.00. Plaintiff's understanding was that upon repossession of the vehicle, the account was satisfied.

Subsequent to the repossession, Plaintiff claims she received neither proper notice of her right to redeem the vehicle nor proper notice of the disposal of the vehicle. Thus, Plaintiff never knew where the vehicle was held or from where she could redeem it.

Unbeknownst to Plaintiff, Defendant Nissan sold the vehicle and received $3,200.00 from the sale. Plaintiff asserts that the sale occurred only two days after the repossession. Defendant Nissan claimed it was still owed a remainder of $3,824.68. Defendant Nissan contacted Defendant Nationwide Credit, Inc. ("Nationwide") and hired them to collect Plaintiff's account.

Plaintiff received three collection letters from Defendant Nationwide, dated March 4, 1997, March 27, 1997, and April 24, 1997. Each letter contained the address P.O. Box 740639, Atlanta, GA XXXXX-XXXX, near the bottom of the letter, and the second letter designated Pamela Rushforth as the contact person.

On March 7, 1997, a Nationwide employee called Plaintiff at Plaintiff's place of employment and identified herself as Pamela Rushforth, saying that she was from Nationwide Credit and that Plaintiff owed a debt to Nissan. Plaintiff explained that she did not believe she owed Nissan anything because the vehicle had been repossessed. Ms. Rushforth informed Plaintiff that the car had been sold and that Plaintiff still owed approximately thirty-seven hundred dollars. Plaintiff said she knew nothing about the car being sold. Further, Plaintiff informed Ms. Rushforth that she would be unable to pay that debt.

Ms. Rushforth called Plaintiff a second time on March 14, 1997. Ms. Rushforth demanded that Plaintiff send seven hundred and fifty dollars ($750.00) overnight through the mail. When Plaintiff said that she did not have the money, Ms. Rushforth said that Plaintiff could postdate the check to the end of the month. Plaintiff refused to send a postdated check, and Ms. Rushforth said that if Plaintiff did not pay, legal action would be taken. Ms. Rushforth used a rude tone of voice.

On March 17, 1997, Ms. Rushforth called Plaintiff at Plaintiff's place of employment numerous times and was rude to the receptionist when informed that Plaintiff was not available. Ms. Rushforth left messages that "Pam" called. Ms. Rushforth asked to speak to someone who could verify Plaintiff's employment, and the financial secretary spoke with her. Ms. Rushforth inquired about Plaintiff's length of employment and salary. The financial secretary refused to answer these questions. Ms. Rushforth also called Plaintiff's home numerous times that day and left messages that "Pam" called.

On March 17, 1997, Plaintiff sent Nationwide a letter in which she requested that Nationwide not call her at work and also informed Nationwide that she did not owe

Nissan any money because of the repossession. In the letter Plaintiff also requested that all future contact be restricted to the mail. Nationwide continued to call Plaintiff, her parents, and her employer.

On March 19, 1997, another Nationwide employee called Plaintiff at work several times and was told Plaintiff could not speak with him. On March 21, 1997, a third Nationwide employee called Plaintiff at work, and Plaintiff told her not to call her at work.

During the last week of March, Ms. Rushforth called Plaintiff at home and spoke with Plaintiff's mother. Plaintiff's mother told her not to call again. Ms. Rushforth yelled at Plaintiff's mother. Nationwide employees continued to call Plaintiff throughout April and May of 1997.

Plaintiff filed her complaint on September 5, 1997, in the Circuit Court of Lee County, Alabama, claiming that Defendant Nissan converted her personal property during the repossession; Defendant Nissan violated [Alabama's enactment of U.C.C. §9-501]; and Defendants Nissan and Nationwide violated the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. §1692, et seq. Defendants Nissan and Nationwide removed the action to this court on October 8, 1997. Defendants Nissan and Nationwide separately moved for summary judgment on July 31, 1998 and September 29, 1998, respectively.

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IV. DEFENDANT NATIONWIDE'S LIABILITY FOR MENTAL ANGUISH DAMAGES PURSUANT TO THE FDCPA IS NOT LIMITED TO $1000

Defendant Nationwide moves the court for summary judgment on the issue of damages. The FDCPA provides in pertinent part:

> [A]ny debt collector who fails to comply with any provision of this subchapter with respect to any person is liable to such person in an amount equal to the sum of (1) any actual damage sustained by such person as a result of such failure; (2)(A) in the case of any action by an individual, such additional damages as the court may allow, but not exceeding $1,000.

15 U.S.C. §1692k. Defendant Nationwide asserts that Plaintiff does not claim any actual damages and, therefore, Plaintiff's potential recovery from Defendant Nationwide should be limited to a maximum of $1,000.00.

Although Plaintiff does not claim any physical injury or out-of-pocket loss caused by Defendant Nationwide's alleged violations of the FDCPA, Plaintiff claims that she "suffered mental anguish and has been upset and has been treated rudely." The court notes that the issue of whether mental anguish constitutes actual damages pursuant to the FDCPA is a matter of first impression in this Circuit. Thus, the court looks to other jurisdictions for guidance.

In *Carrigan v. Central Adjustment Bureau, Inc.*, the District Court for the Northern District of Georgia determined that damages for mental anguish constitute actual damages within the purview of 15 U.S.C. §1692k(a)(1). 502 F. Supp. 468 (N.D. Ga. 1980). In making this determination, the court decided that "[s]ince the particular section of the Act which has been violated is designed to stop harassment of debtors through repeated contact by the creditor, the Court holds that Plaintiff's entitlement to damages here should turn on whether or not he would be entitled to collect damages, were this a cause of action for the intentional infliction of mental distress.” Id. at 470. Georgia law permits recovery of damages for mental suffering and emotional anguish “where there is intentional infliction of mental distress, without a showing of contemporaneous physical harm.” Id. Thus, the court determined such damages to be recoverable as actual damages pursuant to 15 U.S.C. §1692k(a)(1). Id.

The District Court of Delaware employed different reasoning to reach the same conclusion. In *Smith v. Law Offices of Mitchell N. Kay*, the court found to be proper a jury instruction stating that “[a]ctual damages not only include any out of pocket expenses, but also damages for personal humiliation, embarrassment, mental anguish or emotional distress.” 124 B.R. 182, 185 (D. Del. 1991). Rather than compare the FDCPA with a state law claim, the court reached this conclusion by comparing the FDCPA with the Fair Credit Reporting Act (“FCRA”):

> Under the FCRA, a statutory scheme very similar to the FDCPA, a plaintiff who proves a violation of the act is entitled to actual damages for emotional distress arising from the violation, without first having to prove a right of action under state law. This Court similarly holds that, when a violation of the FDCPA has been established, actual damages for emotional distress can be proved independently of state law requirements.

Id. at 188.

In the instant case, the court finds that damages for mental anguish are recoverable pursuant to 15 U.S.C. §1692k(a)(1). First, the court agrees with the *Smith* court’s analysis analogizing the FDCPA to the FCRA. Further, under the methodology employed by the *Carrigan* court, damages for mental anguish are recoverable under 15 U.S.C. §1692k(a)(1) because Alabama law provides that such damages are recoverable pursuant to a cause of action for intentional infliction of mental distress. See Continental Cas. Ins. Co. v. McDonald, 567 So. 2d 1208, 1211 (Ala. 1990).

The court also notes that under Alabama law, the common law claim of invasion of privacy provides for recovery of unlimited mental anguish damages. See, e.g., Norris v. Moskin Stores, Inc., 272 Ala. 174, 177 (1961) (holding that a debtor has a cause of action sounding in invasion of privacy “for injurious conduct on the part of the creditor which exceeds the bounds of reasonableness”). As damages for mental anguish could be unlimited pursuant to an invasion of privacy claim, the court finds that damages for mental anguish should also be potentially unlimited pursuant to the FDCPA.

Finally, the court finds that common sense dictates finding that mental anguish damages falls within the purview of 15 U.S.C. §1692k(a)(1). Absent such a finding, a debtor suffering mental anguish without pecuniary or physical damages would be limited to recovering a maximum amount of $1,000 pursuant to the FDCPA. The court finds this to be an entirely unsatisfactory result as the harassment suffered by a debtor at the hands of a debt collector could well cause more than $1,000 in mental anguish damages. Just as Alabama law permits unlimited recovery for mental anguish damages in claims brought for intentional infliction of emotional distress and invasion of privacy, the court interprets the term “actual damages” in 15 U.S.C. §1692k(a)(1) as encompassing mental anguish damages and thus allowing unlimited recovery in this context. The court therefore finds that summary judgment is due to be denied on this point.

McGrady was lenient in allowing the plaintiff to go forward and try to prove mental anguish. You may have noticed that it cited “common sense” as its authority and wondered if other courts found more august authority. Indeed, there are opinions to the contrary. In *Branco v. Credit Collection*, 2011 U.S. Dist. LEXIS 94077, 2011 WL 3684503 (E.D. Ca. Aug. 23, 2011), the court noted a split of authority and were persuaded that the better approach was to require a plaintiff asserting intentional infliction of emotional distress as part of an actual damages claim to satisfy the requirements of state tort law for emotional distress. *See also Burns v. Anderson*, 2008 U.S. Dist. LEXIS 123632, 2008 WL 8834614 (D. Colo. Aug. 15, 2008).

A remedy for small actual damages is used in some state unfair and deceptive practices statutes. A plaintiff who proves a violation can receive double or treble actual damages as relief. *See, e.g.,* Mass. Genl. Laws §93A. This is a type of hybrid between actual damages and statutory damages.

2. Statutory Damages

Statutory damages can be analogized to criminal or civil fines, whereby a legislatively-determined range of damages is added to the statute. “Statutory damages are explicitly a bonus for the plaintiff, designed to encourage private enforcement…,” *Williams v. Countrywide Home Loans, Inc.*, 504 F. Supp. 2d 176, 186 & n.3 (S.D. Tex. 2007). A more meaningful threat of enforcement, in turn, is designed to deter future misconduct. While statutory damages may seem like a boon to plaintiffs who in retrospect suffered little or no actual damages, their function might actually be to shape the behavior of defendants prospectively. In class actions, statutory damages can be costly for defendants.

Most liability provisions in the Consumer Credit Protection Act provide statutory damages of not less than $100 and not more than $1,000. *See, e.g.,* 15 U.S.C. §1693(m) (Electronic Funds Transfer Act). Some statutes, such as the FDCPA, do not have the $100 minimum, 15 U.S.C. §1692k, but have only a maximum. In some cases, that has led to statutory damages awards of $1, surely a disincentive to bringing suit. *Lester E. Cox Med. Ctr., Springfield, Mo. v. Huntsman*, 408 F.3d 989 (8th Cir. 2005).

Other statutes, presumably where the stakes are perceived to be higher, allow higher damages. For closed-end, mortgage credit violations, TILA allows quadruple the normal amount (minimum $400 and maximum of $4,000). 15 U.S.C. §1640(a)(2)(A)(iv). For open-end, non-mortgage consumer credit, TILA provides a minimum of $500 and a maximum of $5,000. 15 U.S.C. §1640(a)(2)(A)(iii). Notice that there are two remaining categories of cases: i) closed-end, non-mortgage credit (e.g., car loan), and ii) open-end mortgage credit (e.g., home equity loan). The statute is not well-drafted, having been the subject of several amendments and a Supreme Court case that resulted in five opinions on how to interpret its language, *Koons Buick Pontiac GMC v. Nigh*, 543 U.S. 50 (2004). It appears that the initial clause that liability shall be “twice the amount of any finance charge in connection with the transaction” 15 U.S.C. §1640(a)(2)(A)(i), is then capped for the two categories above at a minimum of $200 and a maximum of $2,000, despite there being language in clause (ii) that seems to concern only consumer leases. 15 U.S.C.

§1640(a)(2)(A)(ii). Even if the finance charge is less than the minimum, or there is no finance charge in the transaction, the consumer recovers the statutory minimum if there is a violation. *See Brown v. CitiMortgage*, 817 F. Supp. 2d 1328 (S.D. Ala. 2011).

3. Other Relief

In addition to actual and statutory damages, a few statutes offer other penalties. Depending on your client, the best and worst of these are punitive damages. Some statutes are generous. For example, an entity that violates the Credit Repair Organizations Act, 15 U.S.C. §1679 et seq., may be liable for punitive damages in "such additional amount as the court may allow." 15 U.S.C. §1679g. This puts the limit at due process. *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996). Other statutes are much more restrained with regard to punitive damages. Civil liability for punitive damages for ECOA is capped at $10,000 in an individual lawsuit, and the lesser of $500,000 or 1 percent of the net worth of the creditor in a class action. 15 U.S.C. §1691e. And many statutes do not permit punitive damages at all.

Usury is an example of a consumer law statute that can result in criminal liability. There are others. Something as seemingly banal as the Electronic Funds Transfer Act can result in a year of imprisonment—but only if the violation was knowing and willful. 15 U.S.C. §1693n.

B. Litigation Barriers

Stronger enforcement is not merely about higher damages. It is also about expanding access to remedies for consumers, particularly disadvantaged ones. That goal, in turn, implicates the roles of lawyers and other intermediaries. A seminal study of private enforcement of consumer law illustrates the difficulties. In the wake of the widely heralded consumer victory of the passage of the Magnuson-Moss Warranty Act, most lawyers "knew next to nothing" about the law, and "many had never heard of it." Stewart Macaulay, *Lawyers and Consumer Protection Laws*, 14 LAW & SOCIETY REVIEW 115, 118 (1979). He concluded that without better understanding of the practice of consumer law, "reformers are likely to go on creating individual rights which have little chance of being vindicated, and, as a result, they may fail to achieve their ends repeatedly." *Id.* at 161.

Some would argue that is exactly what has happened in most areas of consumer law, and that the barriers to private litigation have grown more acute in the last two decades. Individual lawsuits are relatively rare when compared to the number of complaints or reported violations. The CFPB found that consumers filed only 1,200 federal lawsuits, on average, each year in six markets, including credit cards, payday loans, and checking accounts. Only two cases in the CFPB's sample went to trial. CFPB Press Release, *Study Finds that Arbitration Agreements Limit Relief for Consumers* (March 10, 2015). The proffered solutions range from the simplification of the law, *see, e.g.*, Melissa B. Jacoby, *Making Debtor Remedies More Effective*, http://ssrn.com/abstract=1550964, to encouraging "low bono" law practice that charges clients reduced fees to reflect the financial constraints of most consumers, *see, e.g.*, Luz Herrera, *Encouraging the Development of "Low Bono" Law Practices*, 14 U. MD. L.J. RACE RELIG. GENDER & CLASS 1 (2014).

Some types of litigation have blossomed in recent years, particularly state UDAP class actions. Businesses have raised concerns about excessive litigation and the costs of compliance, including the deterrence of valuable economic activity. Defense lawyers argue that UDAP statutes are being commandeered by plaintiffs' lawyers "who seek to circumvent traditional, rational requirements of the common law." Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 U. KAN. L. REV. 1,3 (2005). Because UDAP laws are statutes, it is not clear why common law requirements would be a valid concern, but nonetheless critics argue that elements such as reasonable reliance, willful or knowing intent, or injury in fact should be required for a plaintiff to bring a case. Consumer advocates have complained that the intent is to cripple consumer protection under the guise of reform. Dee Pridgen, *Wrecking Ball Disguised as Law Refom: ALEC's Model Act on Private Enforcement of Consumer Protection Statutes*, 39 N.Y.U. REV. OF LAW & SOC. CHANGE 279 (2015).

Nearly all states' consumer fraud statutes permit plaintiffs to recover attorneys' fees. Most federal consumer laws, such as the Truth in Lending Act, also do so. But these litigation incentives have run headlong into courts' unwillingness to apply such rules generously. *See* Margaret H. Lemos, *Special Incentives to Sue*, 95 MINN. L. REV. 782 (2011) (arguing that judges adopt procedural rules that counteract the effects of fee shifts). Sometimes the problems are compounded by the statutes themselves, which may leave attorneys' fees entirely in the discretion of the court. The more protective statutes require an award of "reasonable" attorneys' fees to prevailing plaintiffs, but even that term has raised consternation from courts. While the Supreme Court has affirmed that a fee award is not excessive merely because it exceeds the amount of damages, *Riverside v. Rivera*, 477 U.S. 561 (1986) (civil rights act case), courts consider several factors in determining the amount of attorney's fees to award a plaintiff's lawyer.

Sheffer v. Experian Information Solutions, Inc.

290 F. Supp. 2d 538 (E.D. Pa. 2003)

SCHILLER, District Judge.

This case reveals the potential problems that accompany the generally salutary effects of fee-shifting statutes. While fee-shifting provisions are intended to facilitate the pursuit of claims that vindicate both individual rights and the larger public interest, they can be misused when they become a mechanism for obtaining large attorney's fee awards in cases with de minimis returns for the client and society in general. Furthermore, the prospect of a fee award can skew attorneys' incentives when confronted with settlement offers that would more than compensate their clients, but that fall short of the large fees already incurred. These concerns are most prevalent in cases such as this, where recovery of private damages, rather than the vindication of constitutional rights, is the primary purpose. While it is Congress' duty to re-shape fee-shifting provisions to alleviate these concerns, it is this Court's duty to determine a reasonable fee in light of the de minimis victory achieved in this case. See Hensley v. Eckerhart, 461 U.S. 424, 436 (1983) (holding that "the most critical factor" in the analysis of a reasonable fee is "the degree of success obtained").

I. BACKGROUND

After a jury trial before this Court in the above-captioned matter, judgment was entered against Defendant Sears & Roebuck, Inc. ("Sears") in favor of Plaintiff's claims under the Fair Credit Reporting Act ("FCRA"). The jury awarded Plaintiff Richard Sheffer $1,000.00 in actual damages, but declined to award punitive damages. Now before the Court is Plaintiff's motion for attorneys' fees and costs pursuant to the fee-shifting provision of the FCRA, 15 U.S.C. §1681o(a)(2), and Federal Rules of Civil Procedure 54(d)(1) and 54(d)(2)(B). For the reasons that follow, I grant in part and deny in part Plaintiff's motion for attorneys' fees.

II. DISCUSSION

Plaintiff seeks an award of $126,543.33 in fees and $14,010.75 in costs, representing the work of the following three firms: Francis & Mailman, P.C., Thomas Lyons & Associates, P.A., and the Consumer Justice Center, P.A. Defendant Sears contests $54,024.47 of Plaintiff's fee request and $8,495.21 of Plaintiff's cost request. Defendant also broadly challenges the reasonableness of Plaintiff's attorneys' hourly rates and requests an overall two-thirds reduction due to Plaintiff's limited success.

The FCRA provides explicit statutory authority to award costs and counsel fees to a prevailing party "in the case of any successful action to enforce any liability under this section." 15 U.S.C. §1681o(a)(2) (2003). Plaintiff, as the prevailing party in this litigation, bears the burden of demonstrating that the fee request is reasonable. See Rode v. Dellarciprete, 892 F.2d 1177, 1183 (3d Cir. 1990). Courts assess the reasonableness of a claimed fee using the "lodestar" formula, which entails multiplying the number of hours reasonably expended by the appropriate hourly rate. See Hensley, 461 U.S. at 433; Maldonado v. Houstoun, 256 F.3d 181, 184 (3d Cir. 2001). Although the lodestar is presumed to yield a reasonable fee, a district court has considerable discretion to adjust the lodestar upward or downward after the opposing party objects to the fee request. See Rode, 892 F.2d at 1183 (citing Bell v. United Princeton Props., 884 F.2d 713, 721 (3d Cir. 1989)).

A. Plaintiff's Request for Attorneys' Fees

1. Reasonableness of the Hourly Rate

A court determines a reasonable hourly rate by assessing the prevailing party's attorneys' experience and skill compared to the market rates in the relevant community for lawyers of reasonably comparable skill, experience, and reputation. See Maldonado, 256 F.3d at 184.…

The Third Circuit has held that the attorney's fee schedule composed by Community Legal Services ("CLS") is "a fair reflection of market rates in Philadelphia." Maldonado, 256 F.3d at 187. Defendant contests the hourly rates of four of Plaintiff's attorneys because they exceed the prevailing market rates as set by the CLS schedule. The CLS schedule suggests that attorneys with six to ten years of experience should charge hourly rates between $190.00 and $240.00.…Given their relative experience, the guidelines set in the CLS fee schedule and the rates approved in comparable cases in this district, I find that Mr. Mailman, Mr. Francis and Mr. Lyons Jr. should reasonably receive $235.00 per hour. The $235.00 hourly figure is near the top of the guideline range and represents a slight increase above the hourly rates approved for these attorneys in the two recent cases cited above. I find that Mr. Soumalis should receive $160.00 per hour based on his experience and skill and because he performed the tasks of a junior associate in this litigation. Adjusted accordingly, Plaintiff's fee petition totals $106,569.38. This figure is the starting point for the further reductions enumerated below.

2. Reasonableness of Hours Expended

A prevailing party may request fees for work that is "useful and the type ordinarily necessary to secure the final result obtained." Commonwealth of Pennsylvania v. Del. Valley Citizens' Council, 478 U.S. 546, 560-61 (1986). The fee petition must be sufficiently specific to allow the court to determine if the hours claimed are unreasonable for the work performed. See Washington, 89 F.3d at 1037. A court has "the affirmative function" to "review the time charged, decide whether the hours set out were reasonably expended for each of the particular purposes described and then exclude those that are 'excessive, redundant, or otherwise unnecessary.'" Maldonado, 256 F.3d at 184. A court, however, cannot generally reduce hours *sua sponte*, rather, objections must be specific for a court to reduce the amount of fees requested. See United States v. Eleven Vehicles, 200 F.3d 203, 211-12 (3d Cir. 2000).…

Defendant Sears contests the reasonableness of Plaintiff's counsel's specific time entries on numerous grounds. To facilitate the Court's evaluation of each contested time entry, Defendants have submitted a chart that groups Plaintiff's contemporaneous time entries into various categories and includes a column detailing Sears' specific dispute with each entry. Although mindful of the Supreme Court's admonition that "this process should not result in a second major litigation," this Court has endeavored to address each of Defendant's numerous disputes. Hensley, 461 U.S. at 437.

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b. Overstaffing and Excessive Fees

Defendants contend that Plaintiff's attorneys' hours should be reduced due to three instances of purported overstaffing. First, Defendant asserts that it was unnecessary for both Mr. Mailman and Mr. Francis to accrue hours responding to Sears' motion to dismiss and that the total hours expended on this task were excessive. Sears' motion to dismiss argued that Sears could not be sued under the FCRA as a furnisher of information, an issue that had not previously been addressed in the Third Circuit. Although other circuits had addressed the issue, it required considerable research by Plaintiff. In light of the nature and complexity of the arguments raised in Sears' motion to dismiss, I find that these hours were neither excessive nor duplicative. See Rodriguez-Hernandez v. Miranda-Velez, 132 F.3d 848, 860 (1st Cir. 1998) ("Time spent by two attorneys on the same general task is not, however, per se duplicative…preparation often requires collaboration and rehearsal.").

Second, Defendants claim that it was unreasonable for both Mr. Francis and Mr. Soumalis to attend the deposition of Equifax's representative, Alicia Fluellen, which they assert could have been handled by Mr. Soumalis alone. Since Mr. Francis and Mr. Soumalis's combined hours represent an unnecessary duplication of responsibilities, the Court will disallow the fees associated with Mr. Soumalis' mere attendance at the deposition. Finally, Defendants contest as duplicative time entries of Mr. Francis and Mr. Soumalis that refer to, *inter alia,* preparation of the proposed points for charge and verdict form, among other things. The Court finds that these hours reflect a reasonable time expenditure for the tasks described and a permissible degree of collaboration between the senior attorney working on this case and the junior associate.

In addition, Defendants contest four entries solely on the ground that the time expended was excessive in light of the work performed. After review of the entries, I disagree and find that these entries also reflect a reasonable time expenditure for the tasks described.

c. Trial Preparation and Attendance

Defendants ask the Court to decline to award fees related to trial preparation by Mr. Mailman and Mr. Lyons, Jr. because they did not attend trial and it is unclear from their time entries what type of trial preparation they performed.…

This Court acknowledges that reasonable trial preparation entails collaboration and rehearsal among attorneys. Rodriguez-Hernandez, 132 F.3d at 860. However, hours attributed to trial preparation and collaboration by Mr. Lyons, Jr. and Mr. Mailman are excessive and duplicative, especially given the fact that neither appeared at trial and the two highly experienced attorneys who served as lead trial counsel had ample access to each other for collaboration. Furthermore, many of the entries, tersely describing the activity as "trial prep," are not sufficiently specific to allow the Court to determine if the hours claimed are reasonable for the work performed. See Rode, 892 F.2d at 1190 (citing Pawlak v. Greenawalt, 713 F.2d 972, 978 (3d Cir. 1983)). This Court finds that the trial preparation hours billed by Mr. Lyons, Mr. Francis and Mr. Soumalis, together totaling 117.36 hours, were more than sufficient preparation for a trial that did not even last a full three days. Therefore, the 6.1 hours billed by Mr. Mailman and the 18 hours billed by

Mr. Lyons, Jr.—only four hours shy of the total trial preparation billed by lead counsel Mr. Francis—will be deducted.

Furthermore, Defendants object to expenses related to Mr. Soumalis's trial attendance. Plaintiff's counsel's table was amply staffed by Mr. Lyons and Mr. Francis. Mr. Soumalis was not the trial attorney; he did not participate in the examination of any witnesses and did not sit at counsel's table. Rather, Mr. Soumalis served as an actor, reading the deposition testimony of two third-party witnesses who did not attend trial. Therefore, Sears should not be charged for Mr. Soumalis's trial attendance and Mr. Soumalis's acting skills should be compensated at $50.00 per hour, rather than his associate rate of $160.00 per hour.

...

e. Allocation of Responsibilities Among Partners and Junior Associates

Sears objects to several of Plaintiff's fees on the ground that certain tasks could have been accomplished more cost effectively by a junior associate. Although a court must exclude hours that reflect "the wasteful use of highly skilled and highly priced talent for matters *easily* delegable to non-professionals or less experienced associates," delegation is neither always possible in a small firm nor always desirable. Ursic v. Bethlehem Mines, 719 F.2d 670, 677 (3d Cir. 1983) (emphasis added). First, a duty to delegate presupposes that the attorneys charging maximum rates readily have junior associates and supporting paralegals at their disposal. See Poston v. Fox, 577 F. Supp. 915, 919-20 (D.N.J. 1984) (finding that it is not always possible to delegate in small office). Although Plaintiff was represented by attorneys from three different law firms, attorneys in small firms often have limited access to junior associates. Given the number of junior attorneys available to work on this litigation, this Court does not find Plaintiff's attorneys' non-delegation of responsibilities unreasonable. Furthermore, it is reasonable for lead trial counsel to desire to expend his or her own time on some activities that, although within the competency of less highly paid associates, are better performed by the lead counsel to ensure the smooth functioning at trial. Thus, Mr. Francis's assistance in preparing the trial binder and other trial preparations are reasonable given his position as trial counsel. Regardless, these alleged instances of non-delegation are not frequent enough to mandate reducing the number of hours that will be computed in the lodestar. See Poston, 577 F. Supp. at 920.

f. Clerical Work

Defendant objects to the clerical nature of certain tasks performed by paralegals Sue Wolsfeld, Patti Sullivan, and Dania Richardson, all of which were billed at a $95.00 hourly rate. Clerical tasks should not be billed at senior associate or paralegal rates. See Missouri v. Jenkins, 491 U.S. 274, 285-88 (1989) (holding that "purely clerical or secretarial tasks should not be billed at a paralegal rate, regardless of who performs them"). Plaintiffs offer no explanation for why Sears should pay these fees and do not suggest that they constitute paralegal work. Since the costs of clerical work, such as filing and copying, are ordinarily considered to be part of an attorney's rate as office overhead, they will not be compensated.

g. Tasks Described Without Required Specificity

Defendant contests Mr. Goolsby's August 28, 2003 entry for "research" as insufficiently specific. See Washington, 89 F.3d at 1037 (stating that fee petition must be sufficiently specific to allow court to determine if hours claimed are unreasonable for work performed). In response, Plaintiffs supplement Mr. Goolsby's entry, claiming that the ten hours were spent researching the fee petition. The Court finds that this is a reasonable amount of time and that the Plaintiff is entitled to recover for time spent preparing a fee application. See Hernandez v. Kalinowski, 146 F.3d 196, 199 (3d Cir. 1998) ("[C]ourts consistently have interpreted fee shifting statutes…to provide for reasonable fees…related to the preparation and litigation of motions for attorney's fees.").

...

[ED. NOTE—The court also reduced fees in response to defendant's objection for overbilling for deposition work and adjusted fees based on apportionment of the work billed to Sears, one of four defendants in the initial case.]

The reductions in attorneys' fees enumerated above reduce the lodestar amount to $78,749.97.

B. REDUCTION FOR LACK OF SUCCESS

After determining the lodestar, a court's duty in determining a reasonable fee award is not completed. The Supreme Court has cautioned that if "a plaintiff has achieved only partial or limited success, the product of hours reasonably expended on the litigation as a whole times a reasonable hourly rate may be an excessive amount." Hensley, 461 U.S. at 436. In measuring the level of success a plaintiff has achieved, the district court may consider the amount of damages awarded compared to the amount of damages requested. Farrar v. Hobby, 506 U.S. 103, 114 (1992) (quoting Riverside v. Rivera, 477 U.S. 561 (1986) (Powell, J., concurring in judgment) ("Where recovery of private damages is the purpose of…civil rights litigation, a district court, in fixing fees, is obligated to give primary consideration to the amount of damages awarded as compared to the amount sought.")); see also, Hensley, 461 U.S. at 436 (stating that "the most critical factor" in determining reasonableness of fee award "is the degree of success obtained"). It should be noted that this assessment is distinct from a proportionality analysis between the amount of damages awarded and the amount of counsel fees requested, which is an impermissible basis upon which to reduce a fee award. See Washington, 89 F.3d at 1042 ("[T]he reason why the damage amount is relevant is not because of some ratio that the court ought to maintain between damages and counsel fees. Rather, the reason has to do with the settled principle…that counsel fees should only be awarded to the extent that the litigant was successful.").

In making a downward adjustment for partial success, "the district court may attempt to identify specific hours that should be eliminated, or it may simply reduce the award to account for the limited success." Hensley, 461 U.S. at 436–37. The Supreme Court has rejected "a mathematical approach comparing the total number of issues in the case with those actually prevailed upon." Id. at 435 n. 11. Courts in this circuit have taken a wide array of approaches to the reduction of attorneys' fees for lack of success. See, e.g., Washington, 89 F.3d at 1043 (finding that reduction of attorney's fees by fifty percent was appropriate where plaintiff requested more than $750,000.00 in damages and the jury awarded "nominal victory of $25,000.00"); Hall v. Am. Honda Motor Co., Civ. A. No. 96-8103, 1997 WL 732458, at *4, 1997 U.S. Dist. LEXIS 18544, at *11 (E.D. Pa. Nov.24, 1997) (reducing award by ten percent where plaintiff sought damages in excess of $50,000.00 and received final judgment of $4,000.00); Hilferty v. Chevrolet Motor Div. of Gen. Motors Corp., Civ. A. No. 95-5324, 1996 WL 287276, at *6-7, 1996 U.S. Dist. LEXIS 7388, at *24-25 (E.D. Pa. May 30, 1996) (reducing fee award by approximately two-thirds where plaintiff recovered only eight percent of damages sought.)

In the instant case, Plaintiff sought $300,000.00 in damages, comprised of a $50,000.00 claim for actual damages, arising out of purported credit denials and emotional distress, and $250,000.00 for statutory and punitive damages. Despite Plaintiff's request, the jury awarded the nominal amount of $1,000.00. Although this Court cannot be certain of the basis for the $1,000.00 award, the only testimony at trial specifically assigning a monetary value to any of Mr. Sheffer's purported damages consisted of testimony regarding a $1,000.00 retainer that Mr. Sheffer paid to Mr. Lyons' law firm. Thus, it appears that the award, rather than indicating the jury's valuation of Mr. Sheffer's compensatory damages, was in fact designed to reimburse Mr. Sheffer for his out-of-pocket expenses associated with this lawsuit. Furthermore, the $1,000.00 judgment Mr. Sheffer derived from this lawsuit is significantly less than the $30,000.00 amount Sears' offered in settlement. It would be inappropriate and unreasonable to award Plaintiff for such a modest result by granting the fees Plaintiff seeks. See Farrar, 506 U.S. at 115 (stating that fee shifting statutes were never intended to "produce windfalls to attorneys") (quoting Riverside v. Rivera, 477 U.S. 561, 580). Given Plaintiff's limited success in this lawsuit, this Court finds that $25,000.00 is reasonable compensation.

...

III. CONCLUSION

In sum, the revised hourly rate reduced Plaintiff's lodestar to $106,569.38 and the subsequent reductions detailed in Part II.A.2 resulted in an adjusted lodestar amount of $78,749.97. This amount was further reduced to $25,000.00 to account for the de minimis level of success achieved by Plaintiff's attorneys. Therefore, I conclude that Plaintiff, as the prevailing party, is entitled to attorneys' fees in the amount of $25,000.00.…

As the case illustrates, attorneys face some risks in recovering fees, even if their client prevails. While many plaintiffs' attorneys recover all or nearly all of their fees, there is a chilling effect from the scrutiny and uncertainty. One study found that when state UDAP law had a discretionary rather than mandatory attorney's fee provision, that most consumers and attorneys were statistically less willing to bring both a "strong meritorious" case and a "good faith extension of the law" case. Debra Pogrund Stark & Jessica M.

Choplin, *Does Fraud Pay? An Empirical Analysis of Attorney's Fees Provisions in Consumer Fraud Statutes*, 56 CLEVELAND ST. L. REV. 483, 514-515 (2008). This research echoes the observation of Professor Macaulay, quoted above, that it is necessary to understand how attorneys and potential clients make decisions to design consumer remedies.

Pure economic reasoning would suggest that a consumer would never bring a claim for $1,000, if she would forego dozens of hours of lost leisure or work time in serving as plaintiff. In fact, some of the most well-publicized consumer law disputes have been raised by professors. *See, e.g., Gray v. American Express Co.*, 743 F.2d 10 (D.C. Cir. 1984) (law professor specializing in fraud brought Fair Credit Billing Dispute case); *Ben Edelman, Harvard Business School Professor Goes to War Over $4 in Chinese Food*, Boston.com (Dec. 19, 2014) (alleging that business charging prices that were higher than its online website was a violation of the Massachusetts UDAP statute). Professor Rick Hasen, a remedies expert, recently put his professional knowledge to personal use.

> I just bought a ticket for a work trip to Japan, and it turns out that Expedia failed to disclose that this a special fare that does not allow seat selection until 72 hours before flight time, and Expedia misrepresented the ticket could be changed (such as to a higher class of service, so I could do seat selection) with a change fee. It is totally non-changeable. I've now started action against Expedia in small claims court.…No doubt this is a first-world problem, and there are many more pressing things in the world. But it is one of the many examples of large corporations counting on individuals to not have the time or means or experience to file one of these lawsuits.…
>
> Most people, I know, give up and don't bother filing an actual small claims lawsuit against a big company. It's a lot of paperwork and it can be confusing. But as a professor teaching Contracts, Remedies, and Torts for over 20 years (Google me), I think I can handle the paperwork.

Rick Hasen, *Beware Buying Overseas Airline Tickets @Expedia: No Seat Selection or Changes—And No Disclosure!* Election Law Blog (Nov. 22, 2015). Ideal plaintiffs have substantive expertise, a normative commitment to the rule of law, and flexible work schedules. Consider the life realities of a low-wage shift worker, or a working parent of young children, or an elderly person in a rural area without Internet access and whether they would be able to find a lawyer, file a small claims action by themselves, or even know which regulator might hear their complaint. These obstacles to enforcement are difficult to overcome.

While lawmakers have tried to increase private litigation through rules that shift attorneys' fees for prevailing plaintiffs, countervailing measures have been stronger. Some statutes now even go the other direction, upsetting the American Rule that each party pays its own costs in favor of the business. If a consumer brings and does not win a lawsuit, he or she may be liable to the defense for its costs and attorney's fees. *See, e.g.,* Cal. Civ. Code §1780(e) (permitting the court to award "reasonable attorney's fees to a prevailing defendant upon a finding that the plaintiff's prosecution of the action was not in good faith.") Such liability is usually limited to situations of groundless, spurious, or harassing litigation, but still may chill private enforcement. Consumer advocates criticize these defendant fee-shifting statutes on the ground that baseless litigation is already barred by the professional rules of conduct, such as Federal Rule of Civil Procedure 11.

C. Class Actions

Class actions can help enable the vindication of rights that would not be litigated in an individual case. Class actions can also broaden the dissemination of relief to consumers who did not know their rights or would not have served as a plaintiff. Individual class members do not have to appear in court but their interests are represented by one or more class representatives, who are the named plaintiffs. In a world of mass production, global media, and large corporations, thousands or hundreds of thousands of consumers may have suffered nearly identical harms. It is more efficient to litigate these common legal and factual issues one time in one court. It also ensures parity of remedy to all similarly affected consumers, rather than allowing for a large judgment for the first plaintiff, with dwindling resources for each subsequent plaintiff.

Procedurally, class actions are governed by Federal Rule of Civil Procedure 23 or its state law equivalents. There are four initial criteria that must be met for class certification. First, the class must be so numerous that joinder of all members is impracticable. This typically means dozens, if not hundreds of plaintiffs. Second, there must be common questions of law or fact. Third, the claims or defenses of the class representative must be typical of those of class members. Fourth, the representatives must be able to fairly and adequately protect the interests of the class. The shorthand, which you may remember from Civil Procedure, is numerosity, commonality, typicality, and adequacy of representation. Most consumer class actions are brought on the grounds that a class action is "superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3). In making that determination a court will consider the "manageability" of the class litigation. If these requirements are satisfied, the court will certify the class. For many consumer actions, this is a critical moment. Without certification, plaintiffs may have no remedy. With certification, a business may be cowed into settling by the size of its risk, despite a meritorious defense.

If a class action settles, the court must review and approve the settlement. It will require notice through publication or other means to try to advise class members of the settlement and provide an opportunity to opt-out of the proposed relief. The court will hold a fairness hearing after the notice period expires. Along with the plaintiffs' relief, the court also will scrutinize the arrangements to pay plaintiffs' counsel.

A developing area of class action law is the requirement of "ascertainability" of class members. While this requirement is not explicit in Rule 23, courts have become increasingly stringent in scrutinizing whether plaintiffs—at the outset—can identify class members with certainty. In *Carrera v. Bayer Corp.*, 727 F.3d 300 (3d Cir. 2013), the Third Circuit denied certification because it found that the plaintiff's proposed methods of identifying purchasers of a nutritional supplement using store brand loyalty cards and consumer affidavits attesting to purchase were insufficient to determine whether someone is in the class. The court identified three justifications for a "rigorous approach at the outset" to ascertainability: 1) that a clearly identifiable class was necessary to allow potential class members to opt out; 2) that a defendant's rights are protected by the class mechanism; and 3) that class members can be identified in a manner consistent with the efficiencies of a class action. *Id.* at 307. The contrary view of ascertainability is that it is an administrative issue to be addressed at the time of dissemination of relief to avoid a windfall to those seeking the class benefits who cannot show eligibility. The Seventh Circuit refused to impose "a new requirement that plaintiffs prove at the certification stage that there is a 'reliable and administratively feasible' to identify class members." *Mullins v. Direct Digital LLC,* 795 F.3d 654 (7th Cir. 2015). It ruled that such an approach is inappropriate because it moves "beyond examining the adequacy of the class definition itself to examine the potential difficulty of identifying particular members of the class and evaluating the validity of claims they might eventually submit." *Id.* at 657.

Class actions increasingly turn on statistical social science methods. A company might present a survey of customers or a plaintiffs' firm might propose to use data mining to identify likely purchasers. Courts are sometimes uncomfortable with such methods or require more detail than plaintiffs have provided to prove their validity. In another Third Circuit case hostile to class certification, the court was skeptical that purchasers of Skinnygirl Margaritas could find receipts or recall details about the date or place of purchase. It also rejected "sophisticated and state-of-the-art data matching techniques" to identify duplicative claims. *Stewart v. Beam Global Spirits & Wine, Inc.*, 2015 WL 3613723 (D.N.J. June 9, 2015). The court rejected plaintiffs' efforts to rely on defendants' sales data to determine damages, seemingly requiring consumers to have proof of purchase. The next time someone asks why your wallet is overflowing with paper receipts, you can respond that you want to do your part to shape class action law.

D. Non-Enforcement

Problems with private enforcement mean that many, and perhaps most, consumers do not sue or even consult an attorney. The person may experience the situation as a grievance but not act to obtain a remedy. This do-nothing strategy has a name in the academic literature: "lumping it." Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 14 (1983) ("Even when injuries are perceived, a common response is resignation, that is 'lumping it.'").

Consumers may choose to lump it for a variety of reasons. As an initial issue, consumers may not know that their grievance actually is a legal violation. As you have seen this semester, consumer law is complex and public awareness of such laws is often very limited. This is a problem that can be tackled to some degree by education and public awareness campaigns, both for consumers and for lawyers.

Consumers may lump it because they wish to avoid a conflict. The consumer with an FDCPA violation claim against a debt collector may not want to engage someone who has treated them poorly (even in litigation, armed with an attorney) or the consumer may feel that they share some of the blame for the situation because they did not pay the debt. *See* Ronald J. Mann & Katherine Porter, *Saving Up for Bankruptcy*, 98 GEO. L.J. 298, 334-335 (2010). Lumping it can also result from economic pressures. Consumers may recognize that they have been wronged and be willing to fight to have it remedied, but lack the resources in the form of time, money, or expertise to pursue a claim.

Ultimately, enforcement of consumer law depends not just on the substantive remedies but on recognizing that those remedies are imbedded in a system of actors, including consumers, lawyers, and judges. Changing the level of protection requires thinking about consumers' awareness of legal rights and their incentives to vindicate wrongs of those rights, courts' behavior in "judging" in consumer disputes, and lawyers' motivations to settle or litigate cases.

Problem Set 25

25.1. Albert Hamm bought an entertainment system for $1,500 on credit from Constant Co., but defaulted on his payments when the system broke down and Constant refused to repair it. Constant filed a lawsuit to recover the unpaid balance on the loan of $1,150. Hamm hired May Marion to represent him in the lawsuit because he feared damage to his credit report and a garnishment action. She reviewed the loan disclosures and identified several TILA violations. She counseled Hamm that they would counterclaim under TILA, likely receive statutory damages, and that Constant would be required to pay Marion's fee. Hamm was delighted at the news that he could obtain representation without having to pay Marion.

After Marion filed the answer with the counterclaims, she received a call from Constant Co.'s attorney, suggesting a "wash"—a settlement in which Constant would drop the debt collection suit for $1,150 in return for Hamm releasing Constant from the TILA claims. Marion advised Hamm not to take this deal, but when she recounted the story to you over dinner the following night, you suggested that she immediately stop talking. You, by the way, are ethics counsel for the state bar. Was Marion correct in advising Hamm to continue the suit? Is Marion an ethical attorney? 15 U.S.C. §1640.

25.2. You represent a cosmetic company that marketed and sold 'Round the Clock Rouge. The advertisements and packaging said the product would "stay bright as long as you stay awake." A class action complaint alleging false advertising seeks restitution for all monies paid for the rouge, which totaled $180 million in sales since the product went on the market three years ago. The class representatives are three women who said that they chose 'Round the Clock Rouge specifically because they worked 24-hour shifts in a hospital and that the makeup did not last anywhere near 12 hours, much less 24 hours.

You've been in touch with the manufacturers, and they have offered up the following items for you to consider in crafting a response to the motion for class certification:

- A market study showing that ‘Round the Clock Rouge is priced exactly at the average cost for similar make-up;
- Customer care data showing that approximately 2,700 consumers contacted the company about ‘Round the Clock Rouge and 500 of these complaints were about the product’s staying power or performance. Each of these 500 consumers were issued a refund check for the purchase price;
- A survey of past purchasers, conducted by a marketing expert after the litigation was threatened, that found that less than 10 percent of purchasers expected the product to last 12-24 hours; and
- Analysis of data from the largest retailer selling ‘Round the Clock Rouge showing that 50 percent of people purchased the product more than one time in its three years of existence.

What legal and factual arguments will you make in your motion based on these documents? Fed. R. Civ. P. 23.

25.3. U.S. Senator Tuz is deeply committed to libertarianism. He believes most government intervention is suspect and is particularly frustrated by what he sees as “anti-democratic” institutions such as federal judges imposing “the equivalent of taxes” on businesses. He is supporting legislation that would amend about three dozen federal consumer protection statutes to require that an individual plaintiff or a representative class plaintiff show actual harm to bring suit. He wants to put an end to “no injury” cases and has asked you to identify legal and policy arguments that he can offer in support of his legislation.

Assignment 26. Alternative Dispute Resolution

Alternative dispute resolution (ADR) refers to processes for parties with a disagreement to come to a solution outside of litigation. Sometimes ADR can be incorporated into litigation, such as a settlement conference facilitated by a judge other than the person assigned to the case, but the major focus is on the system that exists outside of the courts. ADR is touted for many benefits, including being cheaper and faster than litigation. It may produce a more satisfactory outcome for all parties through negotiation and compromise, rather than a winner-take-all outcome that can follow from litigation.

ADR is an umbrella term that encompasses a wide variety of processes. In the United States, the most common forms of ADR are negotiation, mediation, and arbitration. Negotiation refers to voluntary efforts to reach a compromise, usually without third-party intervention. Mediation usually means the use of a third party to guide the parties in their discussions and sometimes to suggest a resolution, which the parties can accept or not. In consumer law, mediation is often offered as a precursor to full litigation. For example, in Problem 24.2, the state Attorney General was trying to facilitate a mediation process between disgruntled consumers who called registered complaints and the businesses of concern.

Given the problems with public and private enforcement discussed in the preceding assignments, one might expect consumers to be eager for alternatives and flock to ADR processes. Businesses, however, have been the driving force behind the expansion of ADR into consumer law. Most ADR in consumer law is not the result of parties suggesting a voluntary alternative to litigation after the dispute arises, but rather a predetermined decision that was built into the boilerplate of the contract. Limits of the right to access to courts is disfavored by consumer advocates, but that perspective is countered by the general attitude in most fields that ADR should be promoted and favored by the law.

A. Arbitration and Its Premises

Arbitration in the consumer context nearly always means predispute mandatory arbitration imposed by contract. The consumer becomes bound to arbitrate at the time of the agreement, not at the time of the dispute. The key feature of this kind of arbitration is that a private third-party will impose a resolution on the parties. The contractual agreement to arbitrate prevents the parties from choosing to pursue their rights in courts and will often specify the name of the arbitration association or the rules of the arbitration, or give one party (usually the business) the right to determine those things. The determination of the third party is not "law" in the sense that it is not precedential and is not a result of a public process. But between the parties, it is law. It is a final decision that resolves all issues. Federal law sharply curbs the right to appeal from an arbitration decision, making arbitration into a one-procedure resolution.

There are a few leading arbitration organizations in the United States that seem to garner the bulk of the work for nationwide businesses that put arbitration clauses in their consumer contracts. It is not simple to determine how frequently such businesses use arbitration clauses. First, these are private contracts, so it requires work to collect them from various businesses. Second, there seems to be a size effect. One study of credit card contracts, for which the conventional wisdom was that predispute mandatory arbitration clauses were nearly universal, found that while 95.1 percent of outstanding loans have credit card agreements, 82.9 percent of issuers do not put them in agreements. The study found that card issuers were more likely to require arbitration if they specialized in credit card loans, had larger credit card portfolios, and made riskier loans. *See* Christopher R. Drazhol & Peter B. Rutledge, *Arbitration Clauses in Credit Card Agreements: An Empirical Study*, 9 J. EMPIRICAL LEGAL STUD. 536 (2012). Third, it is not clear whether the appropriate analysis of the effects of arbitration can be globalized to all "consumer contracts" or if such clauses should be examined in a context-specific setting, for example, by looking at their use and function with various consumer products such as tangible goods, services, mortgages, car loans, deposit accounts.

B. Invalidating or Limiting Arbitration in Consumer Contracts

1. Unconscionability and State Law

Concern about the harms of predispute mandatory arbitration clauses to consumers' ability to vindicate the substantive rights of consumer law has produced numerous court challenges to ADR. Several of these have found their way to the Supreme Court, which has also ruled on several ADR issues in the context of commercial contracts. The two most recent decisions both limit the authority of courts to deny or limit the enforcement of arbitration clauses.

In *Rent-A-Center v. Jackson*, 561 U.S. 63 (2010), an employee challenged the enforceability of an arbitration agreement that he had signed in his employment contract on the grounds that requiring him to pursue arbitration was unconscionable. The Court's opinion defined when and how unconscionability may be used to challenge an arbitration provision. The Court treated as distinct two provisions in the parties' arbitration agreement: (1) the basic provision calling for arbitration of "'past, present or future disputes arising out of [the employment contract]," and (2) the provision delegating "gateway" issues to the arbitrator ("[t]he Arbitrator… shall have exclusive authority to resolve any dispute relating to the…enforceability…of this Agreement”). Justice Scalia treated the clauses as severable and held that when a contract “clearly and unmistakably” delegates gateway questions to arbitrators, unconscionability challenges brought in courts must be focused on the delegation provision alone. He concluded that such a delegation clause was enforceable under Section 2 of the Federal Arbitration Act and that the arbiter’s decision that that the contract was not unconscionable must not be disturbed. If the contract is written to give the arbiter the power to determine the enforceability of the arbitration clause, courts should heed to the delegation of that power to the arbiter and not impose independent judgment. The effect of the case is to close the court house doors so that individuals cannot even get the issue of unconscionability of arbitration to a judge.

In the case below, the Court revisits the intersection of the federal and state law, this time in the context of class action waivers that are routinely used in tandem with predispute arbitration.

AT&T Mobility LLC v. Concepcion

131 S. Ct. 1740 (2011)

SCALIA, Justice.

Section 2 of the Federal Arbitration Act (FAA) makes agreements to arbitrate “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. §2. We consider whether the FAA prohibits States from conditioning the enforceability of certain arbitration agreements on the availability of classwide arbitration procedures.

I.

In February 2002, Vincent and Liza Concepcion entered into an agreement for the sale and servicing of cellular telephones with AT&T Mobility LCC (AT&T). The contract provided for arbitration of all disputes between the parties, but required that claims be brought in the parties’ “individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding.” The agreement authorized AT&T to make unilateral amendments, which it did to the arbitration provision on several occasions. The version at issue in this case reflects revisions made in December 2006, which the parties agree are controlling.

The revised agreement provides that customers may initiate dispute proceedings by completing a one-page Notice of Dispute form available on AT&T’s Web site. AT&T may then offer to settle the claim; if it does not, or if the dispute is not resolved within 30 days, the customer may invoke arbitration by filing a separate Demand for Arbitration, also available on AT&T’s Web site. In the event the parties proceed to arbitration, the agreement specifies that AT&T must pay all costs for nonfrivolous claims; that arbitration must take place in the county in which the customer is billed; that, for claims of $10,000 or less, the customer may choose whether the arbitration proceeds in person, by telephone, or based only on submissions; that either party may bring a claim in small claims court in lieu of arbitration; and that the arbitrator may award any form of individual relief, including injunctions and presumably punitive damages. The agreement, moreover, denies AT&T any ability to seek reimbursement of its attorney's fees, and, in the event that a customer receives an arbitration award greater than AT&T's last written settlement offer, requires AT&T to pay a $7,500 minimum recovery and twice the amount of the claimant's attorney's fees.[1]

The Concepcions purchased AT&T service, which was advertised as including the provision of free phones; they were not charged for the phones, but they were charged $30.22 in sales tax based on the phones' retail value. In March 2006, the Concepcions filed a complaint against AT&T in the United States District Court for the Southern District of California. The complaint was later consolidated with a putative class action alleging, among other things, that AT&T had engaged in false advertising and fraud by charging sales tax on phones it advertised as free.

In March 2008, AT&T moved to compel arbitration under the terms of its contract with the Concepcions. The Concepcions opposed the motion, contending that the arbitration agreement was unconscionable and unlawfully exculpatory under California law because it disallowed classwide procedures. The District Court denied AT&T's motion. It described AT&T's arbitration agreement favorably, noting, for example, that the informal dispute-resolution process was "quick, easy to use" and likely to "promp[t] full or…even excess payment to the customer *without* the need to arbitrate or litigate"; that the $7,500 premium functioned as "a substantial inducement for the consumer to pursue the claim in arbitration" if a dispute was not resolved informally; and that consumers who were members of a class would likely be worse off. Laster v. T-Mobile USA, Inc., 2008 U.S. Dist. LEXIS 103712, *34, 2008 WL 5216255, *11-*12 (S.D. Cal., Aug. 11, 2008). Nevertheless, relying on the California Supreme Court's decision in Discover Bank v. Superior Court, 36 Cal. 4th 148 (2005), the court found that the arbitration provision was unconscionable because AT&T had not shown that bilateral arbitration adequately substituted for the deterrent effects of class actions. Laster, 2008 U.S. Dist. LEXIS 103712, 2008 WL 5216255, *14.

The Ninth Circuit affirmed, also finding the provision unconscionable under California law as announced in *Discover Bank*. Laster v. AT&T Mobility LLC, 584 F.3d 849, 855 (2009). It also held that the *Discover Bank* rule was not preempted by the FAA because that rule was simply "a refinement of the unconscionability analysis applicable to contracts generally in California." 584 F.3d, at 857. In response to AT&T's argument that the Concepcions' interpretation of California law discriminated against arbitration, the Ninth Circuit rejected the contention that "'class proceedings will reduce the efficiency and expeditiousness of arbitration'" and noted that "'*Discover Bank* placed arbitration agreements with class action waivers on the *exact same footing* as contracts that bar class action litigation outside the context of arbitration.'" Id., at 858 (quoting Shroyer v. New Cingular Wireless Services, Inc., 498 F.3d 976, 990 (9th Cir. 2007)).

We granted certiorari, 560 U.S. 923 (2010).

II.

The FAA was enacted in 1925 in response to widespread judicial hostility to arbitration agreements. See Hall Street Associates, LLC v. Mattel, Inc., 552 U.S. 576, 581 (2008). Section 2, the "primary substantive provision of the Act," Moses H. Cone Memorial Hospital v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983), provides, in relevant part, as follows:

> "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction…shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

9 U.S.C. §2. We have described this provision as reflecting both a "liberal federal policy favoring arbitration," Moses H. Cone, supra, at 24, and the "fundamental principle that arbitration is a matter of contract," Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 67 (2010). In line with these principles, courts must place arbitration agreements on an equal footing with other contracts, Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 443 (2006), and enforce them according to their terms, Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 478 (1989).

The final phrase of §2, however, permits arbitration agreements to be declared unenforceable "upon such grounds as exist at law or in equity for the revocation of any contract." This saving clause permits agreements to arbitrate to be invalidated by "generally applicable contract defenses, such as fraud, duress, or unconscionability," but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue. Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 687 (1996); see also Perry v. Thomas, 482 U.S. 483, 492-493, n. 9 (1987). The question in this case is whether *§2* preempts California's rule classifying most collective-arbitration waivers in consumer contracts as unconscionable. We refer to this rule as the *Discover Bank* rule.

Under California law, courts may refuse to enforce any contract found "to have been unconscionable at the time it was made," or may "limit the application of any unconscionable clause." Cal. Civ. Code Ann. §1670.5(a). A finding of unconscionability requires "a 'procedural' and a 'substantive' element, the former focusing on 'oppression' or 'surprise' due to unequal bargaining power, the latter on 'overly harsh' or 'one-sided' results." Armendariz v. Foundation Health Psychcare Servs., 24 Cal. 4th 83, 114 (2000); accord, Discover Bank, 36 Cal. 4th, at 159-161.

In *Discover Bank*, the California Supreme Court applied this framework to class-action waivers in arbitration agreements and held as follows:

> [W]hen the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then…the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the

> person or property of another.' Under these circumstances, such waivers are unconscionable under California law and should not be enforced.

Id., at 162 (quoting Cal. Civ. Code Ann. §1668). California courts have frequently applied this rule to find arbitration agreements unconscionable. See, e.g., Cohen v. DirecTV, Inc., 142 Cal. App. 4th 1442, 1451-1453 (2006); Klussman v. Cross Country Bank, 134 Cal. App. 4th 1283, 1297 (2005); Aral v. EarthLink, Inc., 134 Cal. App. 4th 544, 556-557 (2005).

III.

A.

The Concepcions argue that the *Discover Bank* rule, given its origins in California's unconscionability doctrine and California's policy against exculpation, is a ground that "exist[s] at law or in equity for the revocation of any contract" under FAA §2. Moreover, they argue that even if we construe the *Discover Bank* rule as a prohibition on collective-action waivers rather than simply an application of unconscionability, the rule would still be applicable to all dispute-resolution contracts, since California prohibits waivers of class litigation as well. See America Online, Inc. v. Superior Ct., 90 Cal. App. 4th 1, 17-18 (2001).

When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA. Preston v. Ferrer, 552 U.S. 346, 353 (2008). But the inquiry becomes more complex when a doctrine normally thought to be generally applicable, such as duress or, as relevant here, unconscionability, is alleged to have been applied in a fashion that disfavors arbitration. In Perry v. Thomas, 482 U.S. 483 (1987), for example, we noted that the FAA's preemptive effect might extend even to grounds traditionally thought to exist "'at law or in equity for the revocation of any contract.' Id., at 492, n. 9. We said that a court may not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what…the state legislature cannot." Id., at 493, n. 9.

An obvious illustration of this point would be a case finding unconscionable or unenforceable as against public policy consumer arbitration agreements that fail to provide for judicially monitored discovery. The rationalizations for such a holding are neither difficult to imagine nor different in kind from those articulated in *Discover Bank.* A court might reason that no consumer would knowingly waive his right to full discovery, as this would enable companies to hide their wrongdoing. Or the court might simply say that such agreements are exculpatory—restricting discovery would be of greater benefit to the company than the consumer, since the former is more likely to be sued than to sue. See Discover Bank, supra, at 161 (arguing that class waivers are similarly one-sided). And, the reasoning would continue, because such a rule applies the general principle of unconscionability or public-policy disapproval of exculpatory agreements, it is applicable to "any" contract and thus preserved by §2 of the FAA. In practice, of course, the rule would have a disproportionate impact on arbitration agreements; but it would presumably apply to contracts purporting to restrict discovery in litigation as well.

Other examples are easy to imagine. The same argument might apply to a rule classifying as unconscionable arbitration agreements that fail to abide by the Federal Rules of Evidence, or that disallow an ultimate disposition by a jury (perhaps termed “a panel of twelve lay arbitrators” to help avoid preemption). Such examples are not fanciful, since the judicial hostility towards arbitration that prompted the FAA had manifested itself in “a great variety” of “devices and formulas” declaring arbitration against public policy. Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 406 (2d Cir. 1959). And although these statistics are not definitive, it is worth noting that California’s courts have been more likely to hold contracts to arbitrate unconscionable than other contracts. Broome, An Unconscionable Applicable of the Unconscionability Doctrine: How the California Courts are Circumventing the Federal Arbitration Act, 3 Hastings Bus. L.J. 39, 54, 66 (2006); Randall, Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability, 52 Buffalo L. Rev. 185, 186-187 (2004).

The Concepcions suggest that all this is just a parade of horribles, and no genuine worry. “Rules aimed at destroying arbitration” or “demanding procedures incompatible with arbitration,” they concede, “would be preempted by the FAA because they cannot sensibly be reconciled with Section 2.” Brief for Respondents 32. The “grounds” available under §2’s saving clause, they admit, “should not be construed to include a State’s mere preference for procedures that are incompatible with arbitration and ‘would wholly eviscerate arbitration agreements.’” Id., at 33.[2]

We largely agree. Although §2’s saving clause preserves generally applicable contract defenses, nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA’s objectives. Cf. Geier v. American Honda Motor Co., 529 U.S. 861, 872 (2000); As we have said, a federal statute’s saving clause “‘cannot in reason be construed as [allowing] a common law right, the continued existence of which would be absolutely inconsistent with the provisions of the act. In other words, the act cannot be held to destroy itself.’” American Telephone & Telegraph Co. v. Central Office Telephone, Inc., 524 U.S. 214, 227-228 (1998).

We differ with the Concepcions only in the application of this analysis to the matter before us. We do not agree that rules requiring judicially monitored discovery or adherence to the Federal Rules of Evidence are “a far cry from this case.” The overarching purpose of the FAA, evident in the text of §§2, 3, and 4, is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings. Requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.

B.

The “principal purpose” of the FAA is to “ensur[e] that private arbitration agreements are enforced according to their terms.” Volt, 489 U.S., at 478. This purpose is readily apparent from the FAA’s text. Section 2 makes arbitration agreements “valid, irrevocable, and enforceable” as written (subject, of course, to the saving clause); §3 requires courts to stay litigation of arbitral claims pending arbitration of those claims “in accordance with the terms of the agreement”; and §4 requires courts to compel arbitration “in accordance with the terms of the agreement” upon the motion of either party to the agreement (assuming that the “making of the arbitration agreement or the failure…to perform the same” is not at issue). In light of these provisions, we have held that parties may agree to limit the issues subject to arbitration, Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985), to arbitrate according to specific rules, Volt, supra, at 479, and to limit *with whom* a party will arbitrate its disputes, Stolt-Nielsen, supra.

The point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute. It can be specified, for example, that the decision maker be a specialist in the relevant field, or that proceedings be kept confidential to protect trade secrets. And the informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution. 14 Penn Plaza LLC v. Pyett, 556 U.S. 247, 269, (2009); Mitsubishi Motors Corp., supra, at 628.

The dissent quotes Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 219 (1985), as “‘reject[ing] the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims.’” Post, at __ (opinion of Breyer, J.). That is greatly misleading. After saying (accurately enough) that “the overriding goal of the Arbitration Act was [not] to promote the expeditious resolution of claims,” but to “ensure judicial enforcement of privately made agreements to arbitrate,” 470 U.S., at 219, *Dean Witter* went on to explain: “This is not to say that Congress was blind to the potential benefit of the legislation for expedited resolution of disputes. Far from it.…” Id., at 220. It then quotes a House Report saying that “the costliness and delays of litigation…can be largely eliminated by agreements for arbitration.” Ibid. (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 2 (1924)). The concluding paragraph of this part of its discussion begins as follows:

> We therefore are not persuaded by the argument that the conflict between two goals of the Arbitration Act—enforcement of private agreements and encouragement of efficient and speedy dispute resolution—must be resolved in favor of the latter in order to realize the intent of the drafters.

470 U.S., at 221. In the present case, of course, those “two goals” do not conflict—and it is the dissent’s view that would frustrate *both* of them.

Contrary to the dissent’s view, our cases place it beyond dispute that the FAA was designed to promote arbitration. They have repeatedly described the Act as “embod[ying] [a] national policy favoring arbitration,” Buckeye Check Cashing, 546 U.S., at 443, and “a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary,” Moses H. Cone, 460 U.S., at 24. Thus, in *Preston* v. *Ferrer*, holding preempted a state-law rule requiring exhaustion of administrative remedies before arbitration, we said: “A prime objective of an agreement to arbitrate is to achieve ‘streamlined proceedings and expeditious results,’” which objective would be “frustrated” by requiring a dispute to be heard by an agency first. 552 U.S., at 357-358. That rule, we said, would “at the least, hinder speedy resolution of the controversy.” Id., at 358.[3]

California’s *Discover Bank* rule similarly interferes with arbitration. Although the rule does not *require* classwide arbitration, it allows any party to a consumer contract to demand it *ex post.* The rule is limited to adhesion contracts, Discover Bank, 36 Cal. 4th, at 162-163, but the times in which consumer contracts were anything other than adhesive are long past.[4] Carbajal v. H&R Block Tax Servs., Inc., 372 F.3d 903, 906 (7th Cir. 2004); see also Hill v. Gateway 2000, Inc., 105 F.3d 1147, 1149 (7th Cir. 1997). The rule also requires that damages be predictably small, and that the consumer allege a scheme to cheat consumers. Discover Bank, supra, at 162-163. The former requirement, however, is toothless and malleable (the Ninth Circuit has held that damages of $4,000 are sufficiently small, see Oestreicher v. Alienware Corp., 322 Fed. Appx. 489, 492 (2009) (unpublished)), and the latter has no limiting effect, as all that is required is an allegation. Consumers remain free to bring and resolve their disputes on a bilateral basis under *Discover Bank*, and some may well do so; but there is little incentive for lawyers to arbitrate on behalf of individuals when they may do so for a class and reap far higher fees in the process. And faced with inevitable class arbitration, companies would have less incentive to continue resolving potentially duplicative claims on an individual basis.

Although we have had little occasion to examine classwide arbitration, our decision in *Stolt-Nielsen* is instructive. In that case we held that an arbitration panel exceeded its power under §10(a)(4) of the FAA by imposing class procedures based on policy judgments rather than the arbitration agreement itself or some background principle of contract law that would affect its interpretation. 559 U.S., at 684-687. We then held that the agreement at issue, which was silent on the question of class procedures, could not be interpreted to allow them because the “changes brought about by the shift from bilateral arbitration to class-action arbitration” are “fundamental.” Id., at 686. This is obvious as a structural matter: Classwide arbitration includes absent parties, necessitating additional and different procedures and involving higher stakes. Confidentiality becomes more difficult.

And while it is theoretically possible to select an arbitrator with some expertise relevant to the class-certification question, arbitrators are not generally knowledgeable in the often-dominant procedural aspects of certification, such as the protection of absent parties. The conclusion follows that class arbitration, to the extent it is manufactured by *Discover Bank* rather than consensual, is inconsistent with the FAA.

First, the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment. "In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes." 559 U.S., at 685. But before an arbitrator may decide the merits of a claim in classwide procedures, he must first decide, for example, whether the class itself may be certified, whether the named parties are sufficiently representative and typical, and how discovery for the class should be conducted. A cursory comparison of bilateral and class arbitration illustrates the difference. According to the American Arbitration Association (AAA), the average consumer arbitration between January and August 2007 resulted in a disposition on the merits in six months, four months if the arbitration was conducted by documents only. AAA, Analysis of the AAA's Consumer Arbitration Caseload, online at http://www.adr.org/si.asp?id=5027. As of September 2009, the AAA had opened 283 class arbitrations. Of those, 121 remained active, and 162 had been settled, withdrawn, or dismissed. Not a single one, however, had resulted in a final award on the merits. Brief for AAA as Amicus Curiae in Stolt-Nielsen, O.T. 2009, No. 08-1198, pp. 22-24. For those cases that were no longer active, the median time from filing to settlement, withdrawal, or dismissal—not judgment on the merits—was 583 days, and the mean was 630 days. Id., at 24.[5]

Second, class arbitration *requires* procedural formality. The AAA's rules governing class arbitrations mimic the Federal Rules of Civil Procedure for class litigation. Compare AAA, Supplementary Rules for Class Arbitrations (effective Oct. 8, 2003), online at http://www.adr.org/sp.asp?id=21936, with Fed. Rule Civ. Proc. 23. And while parties can alter those procedures by contract, an alternative is not obvious. If procedures are too informal, absent class members would not be bound by the arbitration. For a class-action money judgment to bind absentees in litigation, class representatives must at all times adequately represent absent class members, and absent members must be afforded notice, an opportunity to be heard, and a right to opt out of the class. Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 811-812 (1985). At least this amount of process would presumably be required for absent parties to be bound by the results of arbitration.

We find it unlikely that in passing the FAA Congress meant to leave the disposition of these procedural requirements to an arbitrator. Indeed, class arbitration was not even envisioned by Congress when it passed the FAA in 1925; as the

California Supreme Court admitted in *Discover Bank*, class arbitration is a "relatively recent development." 36 Cal. 4th, at 163. And it is at the very least odd to think that an arbitrator would be entrusted with ensuring that third parties' due process rights are satisfied.

Third, class arbitration greatly increases risks to defendants. Informal procedures do of course have a cost: The absence of multilayered review makes it more likely that errors will go uncorrected. Defendants are willing to accept the costs of these errors in arbitration, since their impact is limited to the size of individual disputes, and presumably outweighed by savings from avoiding the courts. But when damages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the risk of an error will often become unacceptable. Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims. Other courts have noted the risk of "in terrorem" settlements that class actions entail, see, e.g., Kohen v. Pac. Inv. Mgmt. Co. LLC & PIMCO Funds, 571 F.3d 672, 677-678 (7th Cir. 2009), and class arbitration would be no different.

Arbitration is poorly suited to the higher stakes of class litigation. In litigation, a defendant may appeal a certification decision on an interlocutory basis and, if unsuccessful, may appeal from a final judgment as well. Questions of law are reviewed *de novo* and questions of fact for clear error. In contrast, 9 U.S.C. §10 allows a court to vacate an arbitral award *only* where the award "was procured by corruption, fraud, or undue means"; "there was evident partiality or corruption in the arbitrators"; "the arbitrators were guilty of misconduct in refusing to postpone the hearing…or in refusing to hear evidence pertinent and material to the controversy[,] or of any other misbehavior by which the rights of any party have been prejudiced"; or if the "arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award…was not made." The AAA rules do authorize judicial review of certification decisions, but this review is unlikely to have much effect given these limitations; review under §10 focuses on misconduct rather than mistake. And parties may not contractually expand the grounds or nature of judicial review. Hall Street Assocs., 552 U.S., at 578. We find it hard to believe that defendants would bet the company with no effective means of review, and even harder to believe that Congress would have intended to allow state courts to force such a decision.[6]

The Concepcions contend that because parties may and sometimes do agree to aggregation, class procedures are not necessarily incompatible with arbitration. But the same could be said about procedures that the Concepcions admit States may not superimpose on arbitration: Parties *could* agree to arbitrate pursuant to the Federal Rules of Civil Procedure, or pursuant to a discovery process rivaling that in litigation. Arbitration is a matter of contract, and the FAA requires courts to honor parties' expectations. Rent-A-Center, West, 561 U.S., at 67-69. But what the parties in the aforementioned examples would have agreed to is not arbitration as envisioned by the FAA, lacks its benefits, and therefore may not be required by state law.

The dissent claims that class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system. See post, at __. But States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons. Moreover, the claim here was most unlikely to go unresolved. As noted earlier, the arbitration agreement provides that AT&T will pay claimants a minimum of $7,500 and twice their attorney's fees if they obtain an arbitration award greater than AT&T's last settlement offer. The District Court found this scheme sufficient to provide incentive for the individual prosecution of meritorious claims that are not immediately settled, and the Ninth Circuit admitted that aggrieved customers who filed claims would be "essentially guarantee[d]" to be made whole, 584 F.3d, at 856, n. 9. Indeed, the District Court concluded that the Concepcions were *better off* under their arbitration agreement with AT&T than they would have been as participants in a class action, which "could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars." Laster, 2008 U.S. Dist. LEXIS 103712, [WL] at *12.

Because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," Hines v. Davidowitz, 312 U.S. 52, 67 (1941), California's *Discover Bank* rule is preempted by the FAA. The judgment of the Ninth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

[ED. NOTE: The concurring opinion of Justice Thomas is omitted.]

Justice BREYER, with whom Justice GINSBURG, Justice SOTOMAYOR, and Justice KAGAN join, dissenting.

The Federal Arbitration Act says that an arbitration agreement "shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*." 9 U.S.C. §2 (emphasis added). California law sets forth certain circumstances in which "class action waivers" in *any* contract are unenforceable. In my view, this rule of state law is consistent with the federal Act's language and primary objective. It does not "stan[d] as an obstacle" to the Act's "accomplishment and execution." Hines v. Davidowitz, 312 U.S. 52, 67 (1941). And the Court is wrong to hold that the federal Act pre-empts the rule of state law.

I.

The California law in question consists of an authoritative state-court interpretation of two provisions of the California Civil Code. The first provision makes unlawful all contracts "which have for their object, directly or in-directly, to exempt anyone from responsibility for his own…violation of law." Cal. Civ. Code Ann. §1668. The second provision authorizes courts to "limit the application of any unconscionable clause" in a contract so "as to avoid any unconscionable result." §1670.5(a).

The specific rule of state law in question consists of the California Supreme Court's application of these principles to hold that "some" (but not "all") "class action waivers" in consumer contracts are exculpatory and unconscionable under California "law." Discover Bank v. Superior Ct., 36 Cal. 4th 148, 160, 162 (2005). In particular, in *Discover Bank* the California Supreme Court stated that, when a class-action waiver

> is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then…the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.'

Id., at 162-163. In such a circumstance, the "waivers are unconscionable under California law and should not be enforced." Id., at 163.

The *Discover Bank* rule does not create a "blanket policy in California against class action waivers in the consumer context." Provencher v. Dell, Inc., 409 F. Supp. 2d 1196, 1201 (C.D. Cal. 2006). Instead, it represents the "application of a more general [unconscionability] principle." Gentry v. Superior Ct., 42 Cal. 4th 443, 457 (2007). Courts applying California law have enforced class-action waivers where they satisfy general unconscionability standards. See, e.g., Walnut Producers of Cal. v. Diamond Foods, Inc., 187 Cal. App. 4th 634, 647-650 (2010); Arguelles-Romero v. Superior Ct., 184 Cal. App. 4th 825, 843-845 (2010). And even when they fail, the parties remain free to devise other dispute mechanisms, including informal mechanisms, that, in context, will not prove unconscionable. See Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989).

II.

A.

The *Discover Bank* rule is consistent with the federal Act's language. It "applies equally to class action litigation waivers in contracts without arbitration agreements as it does to class arbitration waivers in contracts with such agreements." 36 Cal. 4th, at 165-166. Linguistically speaking, it falls directly within the scope of the Act's exception permitting courts to refuse to enforce arbitration agreements on grounds that exist "for the revocation of *any* contract." 9 U.S.C. §2 (emphasis added). The majority agrees. Ante, at __, 179 L. Ed. 2d, at 753.

B.

The *Discover Bank* rule is also consistent with the basic "purpose behind" the Act. Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 219 (1985). We have described that purpose as one of "ensur[ing] judicial enforcement" of arbitration agreements.

Ibid.; see also Marine Transit Corp. v. Dreyfus, 284 U.S. 263, 274, n. 2 (1932) ("'The purpose of this bill is to make *valid and enforcible* agreements for arbitration'" (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924); emphasis added)); 65 Cong. Rec. 1931 (1924) ("It creates no new legislation, grants no new rights, except a remedy to enforce an agreement in commercial contracts and in admiralty contracts"). As is well known, prior to the federal Act, many courts expressed hostility to arbitration, for example by refusing to order specific performance of agreements to arbitrate. See S. Rep. No. 536, 68th Cong., 1st Sess., 2 (1924). The Act sought to eliminate that hostility by placing agreements to arbitrate "'*upon the same footing as other contracts*.'" Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974) (quoting H. R. Rep. No. 96, at 2; emphasis added).

Congress was fully aware that arbitration could provide procedural and cost advantages. The House Report emphasized the "appropriate[ness]" of making arbitration agreements enforceable "at this time when there is so much agitation against the costliness and delays of litigation." Id., at 2. And this Court has acknowledged that parties may enter into arbitration agreements in order to expedite the resolution of disputes. See Preston v. Ferrer, 552 U.S. 346, 357 (2008) (discussing "prime objective of an agreement to arbitrate").

But we have also cautioned against thinking that Congress' primary objective was to guarantee these particular procedural advantages. Rather, that primary objective was to secure the "enforcement" of agreements to arbitrate. Dean Witter, 470 U.S., at 221. See also id., at 219 (we "reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims"); id., at 219, 217-218 ("[T]he intent of Congress" requires us to apply the terms of the Act without regard to whether the result would be "possibly inefficient"); cf. id., at 220, (acknowledging that "expedited resolution of disputes" might lead parties to prefer arbitration). The relevant Senate Report points to the Act's basic purpose when it says that "[t]he purpose of the [Act] is *clearly set forth in section 2*," S. Rep. No. 536, at 2 (emphasis added), namely, the section that says that an arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," 9 U.S.C. §2.

Thus, insofar as we seek to implement Congress' intent, we should think more than twice before invalidating a state law that does just what §2 requires, namely, puts agreements to arbitrate and agreements to litigate "upon the same footing."

III.

The majority's contrary view (that *Discover Bank* stands as an "obstacle" to the accomplishment of the federal law's objective, ante, at __ - __, 179 L. Ed. 2d, at 754–759) rests primarily upon its claims that the *Discover Bank* rule increases the complexity of arbitration procedures, thereby discouraging parties from entering into arbitration agreements, and to that extent discriminating in practice against arbitration. These claims are not well founded.

For one thing, a state rule of law that would sometimes set aside as unconscionable a contract term that forbids class arbitration is not (as the majority claims) like a rule that would require "ultimate disposition by a jury" or "judicially monitored discovery" or use of "the Federal Rules of Evidence." Ante, at __, __, 179 L. Ed. 2d, at 752, 753. Unlike the majority's examples, class arbitration is consistent with the use of arbitration. It is a form of arbitration that is well known in California and followed elsewhere. See, e.g., Keating v. Superior Ct., 109 Cal. App. 3d 784 (App. 1980) (officially depublished); American Arbitration Association (AAA), Supplementary Rules for Class Arbitrations (2003), http://www.adr.org/sp.asp?id=21936; JAMS, The Resolution Experts, Class Action Procedures (2009). Indeed, the AAA has told us that it has found class arbitration to be "a fair, balanced, and efficient means of resolving class disputes." Brief for AAA as Amicus Curiae in Stolt-Nielsen S. A. v. AnimalFeeds Int'l Corp., O. T. 2009, No. 08-1198, p. 25 (hereinafter AAA Amicus Brief). And unlike the majority's examples, the *Discover Bank* rule imposes equivalent limitations on litigation; hence it cannot fairly be characterized as a targeted attack on arbitration.

Where does the majority get its contrary idea—that individual, rather than class, arbitration is a "fundamental attribut[e]" of arbitration? Ante, at __, 178 L. Ed. 2d, at 753. The majority does not explain. And it is unlikely to be able to trace its present view to the history of the arbitration statute itself.

When Congress enacted the Act, arbitration procedures had not yet been fully developed. Insofar as Congress considered detailed forms of arbitration at all, it may well have thought that arbitration would be used primarily where merchants sought to resolve disputes of fact, not law, under the customs of their industries, where the parties possessed roughly equivalent bargaining power. See Mitsubishi Motors, supra, at 646 (Stevens, J., dissenting). This last mentioned feature of the history—roughly equivalent bargaining power—suggests, if anything, that California's statute is consistent with, and indeed may help to further, the objectives that Congress had in mind.

Regardless, if neither the history nor present practice suggests that class arbitration is fundamentally incompatible with arbitration itself, then on what basis can the majority hold California's law pre-empted?

For another thing, the majority's argument that the *Discover Bank* rule will discourage arbitration rests critically upon the wrong comparison. The majority compares the complexity of class arbitration with that of bilateral arbitration. See ante, at __, 179 L. Ed. 2d, at 756. And it finds the former more complex. See ibid. But, if incentives are at issue, the *relevant* comparison is not "arbitration with arbitration" but a comparison between class arbitration and judicial class actions. After all, in respect to the relevant set of contracts, the *Discover Bank* rule similarly and equally sets aside clauses that forbid class procedures—whether arbitration procedures or ordinary judicial procedures are at issue.

Why would a typical defendant (say, a business) prefer a judicial class action to class arbitration? AAA statistics "suggest that class arbitration proceedings take more time than the average commercial arbitration, but may take *less time* than the average class action in court." AAA Amicus Brief 24 (emphasis added). Data from California courts confirm that class arbitrations can take considerably less time than in-court proceedings in which class certification is sought. Compare ante, at __, 179 L. Ed. 2d, at 756 (providing statistics for class arbitration), with Judicial Council of California, Administrative Office of the Courts, Class Certification in California: Second Interim Report from the Study of California Class Action Litigation 18 (2010) (providing statistics for class-action litigation in California courts). And a single class proceeding is surely more efficient than thousands of separate proceedings for identical claims. Thus, if speedy resolution of disputes were all that mattered, then the *Discover Bank* rule would reinforce, not obstruct, that objective of the Act.

The majority's related claim that the *Discover Bank* rule will discourage the use of arbitration because "[a]rbitration is poorly suited to…higher stakes" lacks empirical support. Ante, at __, 179 L. Ed. 2d, at 757. Indeed, the majority provides no convincing reason to believe that parties are unwilling to submit high-stake disputes to arbitration. And there are numerous counterexamples. Loftus, Rivals Resolve Dispute Over Drug, Wall Street Journal, Apr. 16, 2011, p. B2 (discussing $500 million settlement in dispute submitted to arbitration); Ziobro, Kraft Seeks Arbitration In Fight With Starbucks Over Distribution, Wall Street Journal, Nov. 30, 2010, p. B10 (describing initiation of an arbitration in which the payout "could be higher" than $1.5 billion); Markoff, Software Arbitration Ruling Gives I.B.M. $833 Million From Fujitsu, N.Y. Times, Nov. 30, 1988, p. A1 (describing both companies as "pleased with the ruling" resolving a licensing dispute).

Further, even though contract defenses, *e.g.*, duress and unconscionability, slow down the dispute resolution process, federal arbitration law normally leaves such matters to the States. Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 68 (2010) (arbitration agreements "may be invalidated by 'generally applicable contract defenses'"). A provision in a contract of adhesion (for example, requiring a consumer to decide very quickly whether to pursue a claim) might increase the speed and efficiency of arbitrating a dispute, but the State can forbid it. See, e.g., Hayes v. Oakridge Home, 122 Ohio St. 3d 63, 67 ("Unconscionability is a ground for revocation of an arbitration agreement"); In re Poly-America, L. P., 262 S.W.3d 337, 348 (Tex. 2008) ("Unconscionable contracts, however—whether relating to arbitration or not—are unenforceable under Texas law"). The *Discover Bank* rule amounts to a variation on this theme. California is free to define unconscionability as it sees fit, and its common law is of no federal concern so long as the State does not adopt a special rule that disfavors arbitration

Because California applies the same legal principles to address the unconscionability of class arbitration waivers as it does to address the unconscionability of any other contractual provision, the merits of class proceedings should not factor into our decision. If California had applied its law of duress to void an arbitration agreement, would it matter if the procedures in the coerced agreement were efficient?…

What rational lawyer would have signed on to represent the Concepcions in litigation for the possibility of fees stemming from a $30.22 claim? See, e.g., Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004) ("The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30"). In California's perfectly rational view, nonclass arbitration over such sums will also sometimes have the effect of depriving claimants of their claims (say, for example, where claiming the $30.22 were to involve filling out many forms that require technical legal knowledge or waiting at great length while a call is placed on hold). *Discover Bank* sets forth circumstances in which the California courts believe that the terms of consumer contracts can be manipulated to insulate an agreement's author from liability for its own frauds by "deliberately cheat[ing] large numbers of consumers out of individually small sums of money." 36 Cal. 4th, at 162-163. Why is this kind of decision—weighing the pros and cons of all class proceedings alike—not California's to make?

Finally, the majority can find no meaningful support for its views in this Court's precedent. The federal Act has been in force for nearly a century. We have decided dozens of cases about its requirements. We have reached results that authorize complex arbitration procedures. E.g., Mitsubishi Motors, 473 U.S., at 629 (antitrust claims arising in international transaction are arbitrable). We have upheld nondiscriminatory state laws that slow down arbitration proceedings. E.g., Volt Information Sciences, 489 U.S., at 477-479 (California law staying arbitration proceedings until completion of related litigation is not pre-empted). But we have not, to my knowledge, applied the Act to strike down a state statute that treats arbitrations on par with judicial and administrative proceedings.…

These cases do not concern the merits and demerits of class actions; they concern equal treatment of arbitration contracts and other contracts. Since it is the latter question that is at issue here, I am not surprised that the majority can find no meaningful precedent supporting its decision.

IV

By using the words "save upon such grounds as exist at law or in equity for the revocation of any contract," Congress retained for the States an important role incident to agreements to arbitrate. 9 U.S.C. §2. Through those words Congress reiterated a basic federal idea that has long informed the nature of this Nation's laws. We have often expressed this idea in opinions that set forth presumptions. See, e.g., Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) ("[B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action"). But federalism is as much a question of deeds as words. It often takes the form of a concrete decision by this Court that respects the legitimacy of a State's action in an individual case. Here, recognition of that federalist ideal, embodied in specific language in this particular statute, should lead us to uphold California's law, not to strike it down. We do not honor federalist principles in their breach.

With respect, I dissent.

Taken together with *Rent-A-Center*, the *Concepcion* decision seems to sharply limit the utility of further court challenges to predispute mandatory arbitration. Consumer advocates may increasingly focus their efforts on state legislatures or Congress, where they have had recent success in limiting arbitration agreements.

2. Statutory or Other Prohibitions

Congress has enacted legislation to restrict the use of arbitration clauses in certain consumer contracts. For example, the Dodd-Frank Act gives the Securities and Exchange Commission the power to limit or prohibit agreements requiring customers of any broker or dealer to arbitrate future disputes under federal securities laws. No such rule has been forthcoming. With regard to mortgage loans, Congress took more definitive action. The Dodd-Frank Act prohibits arbitration clauses in residential mortgage loans. It amended the Truth in Lending Act to prohibit a mortgage loan or home equity line of credit from requiring arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction. 15 U.S.C. §1639c(e)(1). The statute's effect is likely to be moderate, however, given that in 2004, both Fannie Mae and Freddie Mac informed lenders that they would not purchase or guarantee any mortgages that contained mandatory arbitration language. As these two entities have been involved in the large majority of home mortgages since 2008, the Dodd-Frank statute may be mostly useful to prevent the reintroduction of arbitration clauses in non-government supported mortgages, if and when that private market is resurrected. The move by Fannie and Freddie to ban arbitration clauses in mortgages is an important example, however, of how limits on arbitration can arise without congressional action.

More broadly, Dodd-Frank gives the Consumer Financial Protection Bureau (CFPB) the authority to prohibit or impose conditions on mandatory arbitration that involves "consumer financial products or services." 12 U.S.C. §5518. As a precursor to doing so, the CFPB was to conduct a study of such issues and report its findings to Congress and decide whether the "prohibition or imposition of conditions or limitation is in the public interest and for the protection of consumers." Id. Any such rules to be enacted can only apply to new contracts entered into 180 days after the rule.

In March 2015, the CFPB issued a report on arbitration. CFPB, *Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act §1028(a)* (March 2015). Its 728 pages are great reading, if you have several months on your hands. The punchline is that the CFPB has…drumroll…not decided yet whether to regulate arbitration in consumer financial contracts.

C. Evaluating Arbitration

1. Arguments for Arbitration

The arbitration clause at issue in the *Concepcion* case contained many consumer-friendly aspects, such as the requirement that AT&T would pay all costs of arbitration for non-frivolous claims and that if the consumer received an award that was larger than the company's prior settlement offer, that AT&T would pay a minimum recovery to the consumer and twice the consumer's attorney's fees. You might have wondered as you read this, exactly why a company would agree to such provisions? Wouldn't they be better off with the litigation system, where they would not normally be liable for such things? Put another way, "well-informed people do not ordinarily pay thousands of dollars to get what they can get elsewhere for free." Christopher R. Drahozal &

Stephen J. Ware, *Why Businesses Use (or Not Use) Arbitration Clauses?,* 25 OHIO ST. J. ON DISP. RESOL. 443 (2010). The authors go on to ask why sophisticated parties choose arbitration over litigation and conclude that all the possible reasons fall into two categories: process and outcomes. The authors then list the particular reasons why parties might agree to arbitrate:

- arbitration may be faster and cheaper than litigation, at least for some types of disputes;
- arbitration may lessen the risk of punitive damages awards or aberrational jury verdicts;
- arbitration may decrease exposure to class actions or other forms of aggregate litigation;
- arbitration may result in more accurate outcomes because of arbitrator expertise and incentives;
- arbitration may better protect confidential information from disclosure;
- arbitration may enhance the ability of parties to have their disputes resolved using trade rules; and
- arbitration may enable the parties to better preserve their relationship.

Id. at 451-452.

Of course some of these features benefit only businesses. Consumers, as plaintiffs, do not benefit from eliminating punitive damages. But many of the benefits, such as faster resolution and simplified procedures are responsive to the exact problems that have been identified with private rights of action for consumers. Taking the list as a whole, it is not clear whether public policy should favor arbitration. Many of the identified benefits of arbitration, including more accurate outcomes and more efficient process, can be articulated as “system improvements” over litigation. Dispute resolution scholars have been good at pressing these points, building up an entire legal field devoted to studying and promoting the benefits of ADR.

As further evidence that alternative dispute resolution is not itself the problem—at least at a theoretical level—consider that in Europe, there are many ADR entities that are publicly funded with an explicit mission of providing a venue for consumers to raise issues with businesses. For an overview of the European Union’s ADR Directive (2013/11 EU), see Pablo Cortes, *A New Regulatory Framework for Extra-Judicial Consumer Redress.* 35 LEGAL STUDIES 114 (2015).

2. Arguments Against Arbitration

One of the principal objections to predispute mandatory arbitration is simply that it results from a term in a contract of adhesion. Because consumers do not have bargaining power and such contracts are not the result of a negotiation, such contracts should be disfavored, including by law limiting the terms that may be included therein. The lack of real choice in adhesion contracts is counter to a basic principle of ADR, which is a process that is more beneficial to both sides.

Another objection to arbitration is that it worsens the “repeat player” disparity between businesses and consumers. Because businesses will arbitrate thousands of disputes a year, and consumers will perhaps be involved in one such case in a lifetime, businesses have much stronger incentives to learn the rules, develop relationships with arbitration organizations and the arbiters themselves, and generally steer the procedural rules of the process in their favor. Of course, the rules for litigation may also favor those with expert knowledge (such as lawyers and not *pro se* consumers) but there is at least a public and transparent process for making such rules and a recourse to democratic institutions, like legislatures, if the system becomes seriously broken.

As *Concepcion* highlights, mandatory arbitration is an individual process. While one could use a variety of ADR techniques to resolve a dispute with many consumers, the outcome of mandatory predispute arbitration has typically been to prohibit the right of a consumer to join a class action. While that form of litigation is itself controversial, one of its purported benefits is that it is more likely to produce sweeping law reform because the higher stakes motivate businesses to agree to comprehensive relief, including changes in future practices. In the arbitration or single-plaintiff litigation context, the relief is more likely to be remedial instead of prospective.

3. Barriers to Effective Evaluation

The biggest disagreements between advocates and critics of ADR center on two questions: Does ADR produce different outcomes than litigation? And is ADR faster, less expensive, and more efficient? In other words, does ADR reach the “right” result, as compared to litigation, and does it do so via sleeker processes. The problem is that answers to either of these questions have proved elusive.

The data are thin and mixed on whether arbitration is less expensive or more rapid than litigation. Theorists suggest that it must be so, or businesses would not prefer it. But court processes vary, based on aspects of court design such as the level of procedural protections, judicial workload, and the like. Arbitration may better protect businesses from the worst-case scenario of a major court loss and punitive damages award, even if it costs them additional money in routine cases.

A 2007 study of credit card arbitrations found that the National Arbitration Forum arbitrators made awards in favor of creditors and debt buyers in more than 96 percent of the cases. Simone Baribeau, *Consumer Advocates Slam Credit Card Arbitration*, CHRISTIAN SCIENCE MONITOR (July 16, 2007). This is obviously an excellent success rate for business and an epic fair for consumers. The study does not, however, offer up any comparable outcomes. If one were to examine credit card collection actions filed in state courts of general jurisdiction or small claims courts, how frequently would businesses win? Would the rate of default judgments be different? The lack of data on outcomes from consumer litigation makes it difficult to know if ADR is skewing the results or if there are more widespread problems in consumer-business dispute resolution. The fundamental fact may be just that consumers infrequently have any defense to credit card collections—regardless of the method or focus of dispute resolution.

The *Christian Science Monitor* piece exposed an additional issue with law of NAF arbitrated credit card contracts. The choice of arbiter mattered dramatically, and not in a way that merely reflects diversity of opinion, as we might expect with random assignment of a judge. The ten most frequently used arbitrators—who decided almost 60 percent of the cases heard—decided in favor of the consumer only 1.6 percent of the time, while arbitrators who decided three or fewer cases decided for the consumer 38 percent of the time. Because the NAF controlled assignment of the arbiter to the case, the dispute resolution provider could stack the odds against consumers. If a provider showed a consumer bias, the solution was to assign fewer, or even no, further cases to that arbitrator. Because businesses chose the dispute resolution company, keeping them satisfied with their success rate may drive outcomes in an unfair way. The fallout from the article and related investigations was an investigation by a state attorney general (remarkably, and not coincidentally similar to that described in problem 24.1) and the subsequent decision of NAF to withdraw entirely from arbitrating any consumer disputes. *See* Robert Berner, *Big Arbitration Firm Pulls Out of Credit Card Business*, BUSINESSWEEK (July 19, 2009).

The CFPB's 2015 report on arbitration is the most wide-ranging empirical analysis available. While tens of millions of consumers are covered by arbitration clauses, the CFPB estimates only 600 arbitrations annually are filed by consumers. And only about one-third of those cases result in a decision by an arbitrator within two years. Among a sample of 1,060 decided arbitrations filed in 2010 and 2011, consumers received a combined amount of $400,000; businesses were awarded $2.8 million, predominantly for disputed debts. Most ambitiously, the CFPB analyzed whether arbitration clauses reduced prices for consumers. In the market for credit cards—the only one in which the necessary data was available (and then only because a group of card issuers agreed to eliminate arbitration clauses for a few years in a settlement)—the CFPB found no statistically significant evidence that companies changed prices in either direction relative to the use or disuse of arbitration clauses.

The hidden nature of alternative dispute resolution makes effective evaluation difficult, leaving the parties to make naked assertions and policymakers to retreat to normative perspectives or lobbying dollars to guide legislation. The resulting "policy polemic" has led to competing efforts to ban all arbitration agreements and to further entrench them in business practice. An intermediate approach would focus on procedural fairness in arbitration. For a description of the harms of "all or nothing" and the conflict between Congress' anti-arbitration leanings and the Supreme Court's pro-arbitration decisions, see Amy Schmitz, *Arbitration Ambush in a Policy Polemic*, 3 PENN STATE YEARBOOK ON ARBITRATION AND MEDIATION 52 (2011).

Problem Set 26

26.1. You have a nationally-regarded practice representing consumers in cutting-edge cases. A few years ago, before the passage of the Credit CARD Act that reined in card fees, you undertook the representation of a group of consumers who had taken out so-called subprime “fee harvester” cards. The cards charged consumers high fees and offered low amounts of credit, which reduced the issuers’ risk, but also made the products very expensive for consumers. You struggled to find anything illegal with the issuers’ practices under existing law, although you certainly found it morally despicable. Driving home from work one day after working on the case, you saw a billboard for such a card that heralded that opening an account would help consumers “improve their credit rating” and “rebuild their credit.” You had an epiphany. You would allege that such cards violated the Credit Repair Organizations Act, which applies to any person who sells services for money that have an “express or implied purpose of—(i) improving any consumer’s credit record, credit history, or credit rating; or (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).” 15 U.S.C. §1679a(3). The statute requires credit repair organizations to include a number of mandatory disclosures in contracts with consumers, none of which, of course the issuers had included. You filed a class action and started counting up your fees.

Three years later, the case is a mess. The card issuers had their own clever argument, which was that the mandatory predispute arbitration clauses in their contracts with issuers preclude the class action, and indeed, any redress from litigation. You have fought this issue before but the Supreme Court precedent is mounting against you. You plan to argue that the Credit Repair Organizations Act guarantees a right to access the courts. You plan to rely on the mandatory disclosure required by the Act: “You have a right to sue a credit repair organization that violates the Credit Repair Organizations Act.” Will this argument prevail? What will the issuers rely on to support their argument that the predispute mandatory arbitration clause eliminates litigation as a consumer remedy? 15 U.S.C. §§1679c, 1679h; 9 U.S.C. §2.

26.2. Senators Heft and Ho have introduced a bill that would amend the Federal Arbitration Act to invalidate all arbitration clauses in consumer contracts. Senator Floof is a newly elected Senator who managed to secure election without once fielding a question about alternate dispute resolution. She knows nothing about the issues and has asked you to prepare a list of issues for her consideration. She specifically wants a list of at least five intelligent questions that she should ask at the upcoming committee hearing on the bill. She wants the questions to show that she is smart and thoughtful; she is naïve enough to want to genuinely educate herself on the issues before deciding on a policy position. Make a list of five questions for her to ask the witnesses, who include: two consumers who had negative experiences with arbitration (one with a cellular telephone contract and one with a computer purchase); the president of a leading arbitration provider; the general counsel of a financial services company; and the chair of a state bar’s litigation section.

26.3. You have been hired as outside counsel to Fruity Fresh to clean up what the CEO colorfully called “a big heap.” Fruity Fresh sells a wide variety of food products through grocery stores, online shopping sites, and drug stores, including its signature applesauce. The General Counsel (on her way to being former GC) told the CEO that the best way to reduce legal costs was to begin imposing binding arbitration on all claims with consumers. To effectuate the change, the GC had the Director of Digital Strategy to add a header to the top of Fruity Fresh’s website: “Attention: We have new Legal Terms that require all disputes related to the purchase or use of any Fruity Fresh product or service to be resolved through binding arbitration." In the New Legal Terms, which could be viewed by hovering over the term or by download, consumers were bound by the terms (whether they knew it or not) "by using our websites, joining our sites as a member, joining our online community, subscribing to our email newsletters, downloading or printing a digital coupon, entering a sweepstakes or contest, redeeming a promotional offer, or otherwise participating in any other Fruity Fresh offering."

Some reporter's kid loves Fruity Fresh and when he went to the site to order a promotional stuffed Fruit toy, available for $9.99 and a dozen proofs of purchase of Fruity Fresh products, he noticed the Legal Terms. A very unfavorable news article and a bunch of negative social media followed. The Director of Digital Strategy, on orders from the CEO, then reversed the policy, and removed the website header and reverted to the prior Legal Terms. She then put out the following press release:

> A few weeks ago, we changed our Legal Terms. Those terms—and our intentions—were widely misread, causing concern among consumers.
>
> So we've listened—and we're changing them back to what they were before.
>
> We rarely have disputes with consumers—and arbitration would have simply streamlined how complaints are handled. Many companies do the same, and we felt it would be helpful.
>
> But consumers didn't like it.
>
> So we've reverted back to our prior terms. There's no mention of arbitration, and the arbitration provisions we had posted were never enforced. Nor will they be. We stipulate for all purposes that our recent Legal Terms have been terminated, that the arbitration provisions are void, and that they are not, and never have been, of any legal effect.
>
> That last bit is from our lawyers.
>
> We'll just add that we never imagined this reaction. Similar terms are common in all sorts of consumer contracts, and arbitration clauses don't cause anyone to waive a valid legal claim. They only specify a cost-effective means of resolving such matters. At no time was anyone ever precluded from suing us by purchasing one of our products at a store or liking one of our Facebook pages. That was either a mischaracterization—or just very misunderstood.
>
> Not that any of that matters now.
>
> On behalf of our company and our brands, we would also like to apologize. We're sorry we even started down this path. We also hope that you'll continue to download product coupons, talk to us on social media, or look for recipes on our websites.

Unfortunately for Fruity Fresh, some enterprising law professor was not content with the apology. In fact, she has filed a suit against Fruity Fresh alleging that the press release is deceptive because it misleads consumers about the nature of the Legal Terms. The complaint seeks $2 million in damages, noting that this is 5 percent of Fruity Fresh's gross revenue last year.

As outside counsel, your job is to determine the merits of this deception suit and provide advice to the CEO—litigate or settle? Additionally, you received a voicemail from an arbitrator stating that the professor has filed an arbitration notice and the hearing can begin in one week on the professor's claim that the Fruity Fresh toy was not delivered as promised.

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1. As support for this proposition, Defendant cites Wade v. Reg'l Credit Ass'n, 87 F.3d 1098, 1099 (9th Cir. 1996). In *Wade*, the Ninth Circuit determined that a debt collector's innocuous debt collection attempts did not violate the FDCPA, despite being in violation of state law requiring debt collectors to obtain state debt collection licenses. Id. After reviewing this case, the court is unclear how this case pertains to Defendant's argument as it does not relate to a trustee's deed of sale or the distinction between debt collection and attempts to evidence a sale.

1. The enumerated statutes are the Alternative Mortgage Transaction Parity Act, Consumer Leasing Act, Electronic Fund Transfer Act, Equal Credit Opportunity Act, Fair Credit Billing Act, Fair Credit Reporting Act, Homeowner's Protection Act, Fair Debt Collection

Practices Act, Federal Deposit Insurance Act, Gramm-Leach-Bliley Act, Home Mortgage Disclosure Act, Home Ownership and Equity Protection Act, Real Estate Settlement Procedures Act, S.A.F.E. Mortgage Licensing, Truth in Lending Act, Truth in Savings Act, and the Interstate Land Sales Full Disclosure Act.

1. The guaranteed minimum recovery was increased in 2009 to $10,000.

2. The dissent seeks to fight off even this eminently reasonable concession. It says that to its knowledge "we have not…applied the Act to strike down a state statute that treats arbitrations on par with judicial and administrative proceedings," post, at 366, 179 L. Ed. 2d, at 767 (opinion of Breyer, J.), and that "we should think more than twice before invalidating a state law that…puts agreements to arbitrate and agreements to litigate 'upon the same footing'" post, at 361, 179 L. Ed. 2d, at 763-764.

3. Relying upon nothing more indicative of congressional understanding than statements of witnesses in committee hearings and a press release of Secretary of Commerce Herbert Hoover, the dissent suggests that Congress "thought that arbitration would be used primarily where merchants sought to resolve disputes of fact…[and] possessed roughly equivalent bargaining power." Post, at __, 179 L. Ed. 2d, at 765. Such a limitation appears nowhere in the text of the FAA and has been explicitly rejected by our cases. "Relationships between securities dealers and investors, for example, may involve unequal bargaining power, but we [have] nevertheless held…that agreements to arbitrate in that context are enforceable." Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 33 (1991); see also id., at 32-33 (allowing arbitration of claims arising under the Age Discrimination in Employment Act of 1967 despite allegations of unequal bargaining power between employers and employees). Of course the dissent's disquisition on legislative history fails to note that it contains nothing—not even the testimony of a stray witness in committee hearings—that contemplates the existence of class arbitration.

4. Of course States remain free to take steps addressing the concerns that attend contracts of adhesion—for example, requiring class-action-waiver provisions in adhesive arbitration agreements to be highlighted. Such steps cannot, however, conflict with the FAA or frustrate its purpose to ensure that private arbitration agreements are enforced according to their terms.

5. The dissent claims that class arbitration should be compared to class litigation, not bilateral arbitration. Post, at __ - __, 179 L. Ed. 2d, at 765-766. Whether arbitrating a class is more desirable than litigating one, however, is not relevant. A State cannot defend a rule requiring arbitration-by-jury by saying that parties will still prefer it to trial-by-jury.

6. The dissent cites three large arbitration awards (none of which stems from classwide arbitration) as evidence that parties are willing to submit large claims before an arbitrator. Post, at __ - __, 179 L. Ed. 2d, at 766. Those examples might be in point if it could be established that the size of the arbitral dispute was predictable when the arbitration agreement was entered. Otherwise, all the cases prove is that arbitrators can give huge awards—which we have never doubted. The point is that in class-action arbitration huge awards (with limited judicial review) will be entirely predictable, thus rendering arbitration unattractive. It is not reasonably deniable that requiring consumer disputes to be arbitrated on a classwide basis will have a substantial deterrent effect on incentives to arbitrate.