

UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2015-CFPB-0029

_____)
)
In the Matter of:)

ENFORCEMENT
COUNSEL’S PREHEARING
STATEMENT

)
)
INTEGRITY ADVANCE, LLC and)
JAMES R. CARNES,)

)
)
Respondents.)
)
_____)

ENFORCEMENT COUNSEL’S PREHEARING STATEMENT

Pursuant to the Administrative Law Judge’s June 17, 2016 order, Enforcement Counsel hereby submits this prehearing statement in the above captioned-matter.

I. Introduction

At trial, Enforcement Counsel will present evidence establishing the three remaining issues in this matter. First, the evidence will show that Respondent Carnes was an active and involved chief executive of Integrity Advance who is liable for the use of deceptive loan agreements and is liable for the unfair use or remotely created checks (RCCs). Carnes understood and had decision making-authority over company policies and procedures, including the deceptive and unfair loan agreement. Second, Enforcement Counsel will present evidence at trial establishing that Respondents unfairly used remotely created checks. Despite a hidden and

opaque authorization, Respondents used this mechanism repeatedly against consumers after those consumers tried to block Integrity Advance's electronic access to their bank accounts. Finally, Enforcement Counsel will present evidence detailing the appropriate relief for Respondents' unlawful practices.

II. Factual Background

Integrity Advance is a Delaware limited liability company that originated and serviced short-term loans to consumers. *See* Order Partially Granting Summary Disposition ('Order') at 5. When a consumer accepted a loan from Integrity Advance, she received a Truth in Lending Act (TILA) disclosure that "contemplate[d] a single payment made up of the loan principle plus one finance charge." *Id.* at 26. However, if a consumer did not take affirmative action to contact Integrity Advance, her loan was automatically rolled over four times and then placed into 'auto workout' status. *Id.* at 10. The loan agreement did not disclose the total amount of fees and "accrued finance charges" the consumer would incur as a result of the rollover and auto-workout process. *Id.*

As a part of the loan agreement, Integrity Advance consumers were required to electronically sign an ACH agreement. *Id.* at 7. The agreement authorized both deposits of loan proceeds and the repayments that would be electronically debited from the consumer's bank account. *Id.* The ACH agreement contained no indication that a consumer could complete the loan application process or receive a loan without signing the document. *Id.* at 8. Finally, the ACH agreement also contained a provision stating that the consumer authorized Integrity Advance to "submit one more checks drawn on [their] Bank Account" as long as the consumer owed sums to Integrity Advance. *Id.* Respondents relied on this provision to debit consumers' accounts using RCCs. EC-EX-095; EC-EX-068 at 219.

III. Procedural Background

On November 18, 2015, the Consumer Financial Protection Bureau (Bureau) filed a Notice of Charges against Integrity Advance and its chief executive officer James R. Carnes. The Notice of Charges alleged violations of TILA and the Electronic Fund Transfer Act, and alleged that Respondents had engaged in deceptive and unfair acts and practices. The parties filed cross motions seeking summary disposition on May 10, 2016. On July 1, 2016, the Administrative Law Judge partially granted Enforcement Counsel's motion for summary disposition and denied Respondents' motion in its entirety. The ruling held that Integrity Advance violated the Truth in Lending Act (Counts I and II), the Electronic Fund Transfer Act (Counts V and VI), and engaged in deceptive conduct (Count III).

The only remaining issues for trial are: 1) whether Respondent Carnes 'engaged' in the deceptive and unfair practices within the meaning of 12 U.S.C. § 5536(a)(1)(B) such that he is individually liable for the deceptive disclosures in the loan agreement and the unfair use of RCCs; 2) whether Respondents committed unfair acts and practices through their use of remotely created checks; and 3) the appropriate relief (including damages, injunctive relief, civil money penalties, and any other appropriate legal or equitable relief) for Respondents' unlawful conduct.

IV. The Evidence Will Show That Respondent Carnes Engaged in the Deceptive and Unfair Conduct

The evidence will show that a finding against Respondent Carnes on Counts III and VII is warranted given his active role in running Integrity Advance. Respondent Carnes was the President and Chief Executive Officer of Integrity Advance from the formation of the company until the time that it ceased operations. Order at 5; EC-EX 065. In addition to being a founder of Integrity Advance (EC-EX 068 at 7:12-13), Carnes ultimately owned the majority share of Integrity Advance: he was the sole owner of Willowbrook Marketing LLC; Willowbrook owned

a majority share of Hayfield Investment Partners; and Hayfield was the sole owner of Integrity Advance. EC-EX-067. Respondent Carnes also profited directly from Integrity Advance's unlawful operations: he received a salary for his work as president and CEO (EC-EX-068 at 96-97), and he received distributions from Hayfield (through his ownership of Willowbrook Partners) that was at least partially, if not fully, funded by Integrity Advance's profits. EC-EX-048; EC-EX-049.

Integrity Advance had no actual employees, making Carnes, its owner and president, responsible for Integrity Advance's actions. EC-EX-068 at 11. Integrity Advance used people from other Hayfield operations (EC-EX-068 at 10-11) as its leadership team and employees, but as noted above, Respondent Carnes owned the majority share of Hayfield, so there is no argument these individuals were beyond Respondent Carnes's authority or control. Furthermore, Carnes made the final decision to hire all individuals supporting Integrity Advance's operations and he worked in the same office with those individuals on a daily basis. EC-EX 068 at 32:2-3; 40:24-25. Moreover, Carnes maintained an 'open-door policy' and was accessible to the people supporting Integrity Advance. *Id.* at 37:11-13. He also spoke with Integrity Advance's chief operating officer on a daily basis. EC-EX 068 at 22:19-24; EC-EX 069 at 35:15-17.

As chief executive, Respondent Carnes had the authority to make all decisions governing Integrity Advance's policies and procedures. EC-EX-068 at 32:15-17; EC-EX-065. He was the main decision-maker regarding Integrity Advance's underwriting policies. EC-EX 069 at 22:17-18. He had final say over what appeared on the company's website and recalled approving the website's contents. EC-EX-068 at 41:1-6. Integrity Advance also outsourced certain tasks, and Respondent Carnes signed agreements setting the terms of service with some of those vendors

and service providers on behalf of Integrity Advance. EC-EX 053; EC-EX 054; EC-EX 056; EC-EX-085.

Respondent Carnes was fully aware of how Integrity Advance's loan product operated and how that did not align with the company's loan agreement disclosures. The loan agreement used by Respondents did not change materially during the period in which Integrity Advance offered loans to consumers. EC-EX-061; EC-EX-063. Respondent Carnes knew that, absent a call from a consumer, Integrity Advance automatically rolled loans over four times, after which the company would continue debiting payments that included a finance charge plus \$50 that would be applied to the principal balance. EC-EX-068 at 228. He also understood that most consumers had their loans rolled over (*id.* at 227) and in most cases consumers would pay more than what had been disclosed in the total of payments box. *Id.* at 245:10-25. Carnes was also aware that some consumers complained that they didn't understand that their initial loan repayments did not go to principal. *Id.* at 243.

V. The Evidence Will Show that Respondents Unfairly Used Remotely Created Checks

Section 1031(c) of the CFPA provides that an act or practice is "unfair" if it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers" and that "substantial injury is not outweighed by countervailing benefits to consumers or to competition." 12 U.S.C. § 5531(c). Respondents' use of remotely created checks unfairly interfered with consumers' ability to contest the company's debits on consumer accounts and allowed the company to continue taking money from consumers even though those consumers were trying to block access to their accounts. This caused unavoidable substantial injury to consumers, and there is no alleged benefit to consumers or competition that outweighed that injury.

A. Background on Remotely Created Checks

Remotely created checks¹ differ from the checks to which most consumers are accustomed in that they do not originate from the consumer's checkbook. "Unlike a typical check or draft issued by the account holder, a remotely created check is not manually drawn up by the account holder; rather, it is created by the payee or other third party under the purported authorization of the account holder." EC-EX-098 at 1. Additionally, a RCC is not signed by the holder of the account it will be drawn upon, unlike a traditional check. Using common desktop tools, a merchant can create a RCC that "does not require or rely upon a signature or any other documentation to indicate authorization." EC-EX-094 at 2. A merchant only requires the consumer's account number and bank routing number to generate a remotely created check that can be used to debit that consumer's account using the same check clearing system as normal checks. *Id.* at 3. A consumer does not have to do anything at all for a RCC to be executed and generally does not receive immediate notice that a RCC has been made.

Government regulators and other actors involved with consumer payments have expressed concerns about RCCs for some time. "[T]he absence of a signature or other obvious evidence of authorization on the [RCC] is pretty much an open invitation to fraud, and-sure enough-there have been complaints." EC-EX-098 at 2. Concerns like this led to the outright prohibition on RCCs in Canada and the decision by the Federal Trade Commission to ban them in the context of telemarketing transactions. EC-EX-094 at 2; EC-EX-096.

¹ Sometimes these are referred to as demand drafts, telechecks, check drafts, or preauthorized drafts.

B. Respondents' Use of RCCs was Unfair

The ACH agreement used by Integrity Advance contained the following language: “[i]f you revoke your authorization, you agree to provide us with another form of payment acceptable to us and you authorize us to prepare and submit one or more checks drawn on Your Bank Account so long as amounts are owed to us under the Loan Agreement.” Order at 8; EC-EX-064. This language does not use any of the names associated with this payment mechanism (such as remotely created check or demand draft) and fails to inform the consumer that these checks can be used to debit his or her account even though the consumer has never signed, seen, or specifically authorized them. There was no way for consumers to reasonably avoid being the victim of this practice when Respondents failed to describe it in the loan agreement.

As suggested by the language quoted above, Integrity Advance admitted that when consumers revoked the company's authorization to electronically debit their accounts using the ACH network (something they have a legal right to do), the company would use remotely created checks to continue drawing money from the consumers' accounts. EC-EX-070 (“Company practice was to use demand drafts in instances in which the ACH Authorization was revoked or claimed unauthorized...”); *see also* EC-EX-075. The evidence shows that starting on July 21, 2011, Integrity Advance used remotely created checks approximately 1,200 times (withdrawing over \$250,000) after consumers had withdrawn the company's authorization to make ACH debits to their accounts. EC-EX-072. Finally, Respondents' use of remotely created checks did not benefit consumers or competition, and there is no evidence in the record to the contrary.

VI. Relief

Enforcement Counsel seeks disgorgement, restitution, damages, injunctive relief, and other legal or equitable relief deemed appropriate by the Administrative Law Judge for Respondents' unlawful conduct and practices. The CFPA allows an administrative law judge to order each of these remedies once a violation of Federal consumer financial law has been shown. 12 U.S.C. § 5565(a). Additionally, Enforcement Counsel requests that Respondent Carnes should be required to provide an accounting of all money he received from Respondent Integrity Advance's activities (through, *inter alia*, his ownership of Willowbrook and Willowbrook's ownership of Hayfield) and should be required to disgorge those amounts because Integrity Advance received them as a result of its unlawful activity. As addressed in the Notice of Charges, Enforcement Counsel requests further legal and injunctive relief, as appropriate.

Finally, Respondents are required to pay civil money penalties for their violations of consumer financial law. The CFPA states that "any person that violates...any provision of Federal consumer financial law **shall** forfeit and pay a civil money penalty..." 12 U.S.C. § 5565(c)(1) (emphasis added). In addition to establishing tiers for imposing civil money penalties, the statute provides that based on the evidence in the record the administrative law judge shall take into account the appropriateness of the penalty with respect to the enumerated mitigating factors. 12 U.S.C. § 5565(c)(3). Enforcement Counsel requests the Administrative Law Judge impose an appropriate civil money penalty for each day that each of the Respondents' unlawful practices continued.²

² Civil money penalties should be calculated from the transfer date, July 21, 2011 until the date Respondents' unlawful practices ceased.

VII. Conclusion

For all the reasons cited above, Enforcement Counsel respectfully requests that the Administrative Law Judge make appropriate findings of fact and conclusions of law and order the relief requested herein.

Respectfully submitted,

Attorneys for Plaintiff
Consumer Financial Protection Bureau

ANTHONY ALEXIS
Enforcement Director

DEBORAH MORRIS
Deputy Enforcement Director

CRAIG COWIE
Assistant Litigation Deputy

s/Alusheyi J. Wheeler

Alusheyi J. Wheeler
Wendy J. Weinberg
Vivian W. Chum
1700 G Street NW
Washington, DC 20552
Phone: (202) 435-7786
Facsimile: (202) 435-7722
Email: alusheyi.wheeler@cfpb.gov

Enforcement Counsel

CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of July 2016, I caused a copy of the foregoing Enforcement Counsel's Prehearing Statement to be filed by electronic transmission (e-mail) with the Office of Administrative Adjudication (CFPB_electronic_filings@cfpb.gov), the U.S. Coast Guard Hearing Docket Clerk (aljdocketcenter@uscg.mil), Administrative Law Judge Parlen L. McKenna (cindy.j.melendres@uscg.mil), Heather L. MacClintock (Heather.L.MacClintock@uscg.mil), and served by email on the Respondents' counsel at the following addresses:

Allyson B. Baker, Esq.
ABBaker@venable.com

Danielle R. Foley, Esq.
DRFoley@venable.com

Peter S. Frechette, Esq.
PSFrechette@venable.com

Hillary S. Profita, Esq.
HSProfita@venable.com

Joanna P. Boyd, Esq.
JPBoyd@venable.com

Christine E. White, Esq.
CEWhite@venable.com

Andrew T. Hernacki, Esq.
ATHernacki@venable.com

/s/ Alusheyi J. Wheeler
Alusheyi J. Wheeler