Consumer Finance Monitor (Season 7, Episode 27): California Consumer Finance Law – Hot Topics and Recent Developments

Speakers: Melanie Vartabedian, Joel Tasca, Mike Guerrero, and John Kimble

Melanie Vartabedian:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at Ballard Spahr Law Firm. I'm Melanie Vartabedian and I'll be hosting today's show. I'm a litigation partner in Ballard's Salt Lake City and Los Angeles offices. I practice primarily in the area of consumer financial services litigation. I handle the alphabet soup of federal and state consumer protection laws for our financial services clients on both the individual and class basis.

That includes statutes such as the TCPA, FCRA, EFTA, FDCPA, and California-specific consumer protection statutes in state and federal court. And that's some of what we're going to be talking about today. For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted the blog since 2011, so there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list of our webinars, please visit us at ballardspahr.com.

If you like our podcast, let us know. Leave us a review on Apple Podcasts, YouTube, Spotify, or wherever you get your podcasts. Also, please let us know if you have ideas for other topics that we should consider covering or speakers that we should consider as guests on our show. Today I am joined by Michael Guerrero, John Kimble and Joel Tasca, and we will be discussing California consumer finance law hot topics and recent developments.

As many of you know, California tends to be different than other states, sort of a vanguard of consumer financial issues and legislation, and that's why we are focusing on it today. I'm going to turn it over to each of our guests who will tell us a little bit more about themselves and their practices. Let's start with you, Michael.

Mike Guerrero:

Thanks, Melanie. So my name is Mike Guerrero. I'm a partner in the firm's Los Angeles office. I co-lead the firm's FinTech and payment solutions industry group, and I was formerly the co-chair of the California Lawyers Association's Consumer Financial Services Committee. I focus my practice on advising clients on product compliance and helping them to maintain products to ensure that the products are compliant with California and other state and federal law.

I practice within a lot of verticals, so credit cards, installment loans, rent to own, credit sale. If it's consumer financial services, there's a good chance I might've touched one of those products. But thank you, Melanie. It's great to be here.

Melanie Vartabedian:

Thank you, Michael. John, let's go to you.

John Kimble:

Hi, John Kimble. I'm of council in the Los Angeles office. I've been practicing in the consumer financial services regulatory space for the past decade, and I've been emphasizing fair lending matters. And since moving to California, I've become sort of an expert on what's going on in California. As Melanie mentioned, the always trend setting and getting out ahead of a lot of these issues that other states follow on. So thank you. My first episode here, so I'm happy to be here.

Melanie Vartabedian:

Welcome John, thanks. And Joel.

Joel Tasca:

Thanks Melanie. My name's Joel Tasca and I am a litigation partner in Ballard's Las Vegas office. I specialize in defending consumer financial services litigation, which takes the form of individual actions, class actions, as well as arbitration. A lot of what I do is defend Fair Credit Reporting Act cases, Telephone Consumer Protection Act cases and the like. And although I sit in Ballard's Las Vegas office, I'm also barred in California and have a lot of active litigation that I'm defending in California. So thanks, Melanie. Happy to be here.

Melanie Vartabedian:

Thanks, Joel. All right, let's get into it. John, let's start with you. I understand you're going to be talking about some of the latest regulatory developments happening in California.

John Kimble:

Thanks, Melanie. Yes. So basically what I'm going to be talking about is the Department of Financial Protection and Innovation's CCFPL registration and reporting rulemaking, the status of it, the substance of it. Briefly, before I get into that, I want to back up and give an explanation of how we got to where we are. So back in September of 2020, California Governor Gavin Newsom signed AB 1864 into law establishing the California Consumer Financial Protection Law, which I'll be referring to as CCFPL throughout. The CCFPL became effective in January 2021.

It created the Department of Financial Protection Innovation, which I'll be referring to as DFPI throughout this, from the former Department of Business Oversight. It also empowered the DFPI to create registration requirements for certain covered persons offering consumer financial products or services who are not already licensed with the DFPI or another department to offer that product. And that point is key because the legislation is clear that if someone is already licensed by DFPI, formerly DBO, to offer a particular financial product or licensed by another agency to offer a particular product or service.

That these registration requirements cannot be created for those covered persons. So on April 5th, 2023, we get the initial registration and reporting requirements, and the four products that the DFPI chooses to require this registration for are what they refer to as income-based advances, including what is more commonly known as earned wage access products, private post-secondary education financing, including what is commonly known as income share agreements, debt settlement, and student debt relief. So the initial proposed regulations would've required these covered persons offering these products to register and to meet certain requirements in order to be exempt from other licensing.

So for instance, someone offering earned wage access could register under these new requirements and be exempt from having to register under the California Financing Law as a lender. However, in order to do that under the original proposed regulations, the entity had to meet the interest rate limitations and other charge limitations in the California Financing Law. This would've been particularly difficult for earned wage access, for instance, which has a short turnaround from when the money is provided and when the money is paid back. Therefore, creating a artificially high interest rate that would've potentially gone over the caps allowed under the California Financing Law.

So a lot of comments obviously came in from the industry about this particular issue not being a good fit. The charge limitations are designed for a long-term loan. They don't really fit with a short-term product like earned wage access. So in part, due to that, and in part due to this sort of requirement that in all rulemaking that there has to be this economic impact report and all these entities who are commenting are saying this is going to have a negative economic impact because it's going to push a lot of the earned wage access providers out of the state.

So the FBI responding to that on January of 2024, they released their second modifications to the proposed text and they eliminated for earned wage access providers this requirement that in order to be exempt from CFL licensing, earned wage access provider would have to limit their charges to fit under the CFL. So that particular provision was eliminated. But the rule continues to provide that the modified proposed rule still defines EWA products as loans under the CFL, and it still provides

that a provider who is making these income-based advance is a finance lender within the meaning of the California Financing Law.

So it's kind of a strange fit. They're saying, "We're taking the position that these earned wage access products are loans and that you are a finance lender within the meaning of the California Financing Law. However, you can be exempt from the licensing requirement if you register this way." It's kind of a strange thing, particularly if you go back to how these registration requirements were originally designed. The legislature saying these are for products that fall outside of other licensing regimes.

The FBI is sort of taking the position that, "No, they don't fall, earned wage access doesn't really fall outside of it, but we're creating this sort of safe harbor through registration where you can be exempt from the CFL licensing requirements." So it's a sort of odd attempt to draft these regulations in a way that will meet the requirements of the legislature without taking a position that the DFPI's uncomfortable with, i.e. that earned wage access are products not loans under the CFL. So another product that I mentioned that would be covered under these proposed regulations is income share agreements.

And these are referred to throughout the rulemaking as education financing with income driven repayment provisions. So this is sort of a product where an individual who is trying to finance post-secondary education is financed by a company, and ultimately the amount of money that the individual will pay back is determined by their income. So it sort of protects borrowers or individuals who are trying to finance their education from the situation where they pay all this money for the education, they cannot find gainful employment.

So the product has these sorts of consumer friendly features and a lot of consumers seem to like it, but regulators have sort of been a little hesitant to allow this product to continue without licensure or registration oversight. So back in 2021, the DFPI entered into a consent order with this company called Meritas who serviced income share agreements in California. And the consent order takes to position that these were loans or are loans under the Student Loans Servicing Act.

So again, this is a situation where they're pre-existing these registration requirements that the DFPI had taken a position that these products were loans under a different licensing regime. However, they have put forward these registration requirements and applied them to income share agreements. And unlike the earned wage access product where the requirement that the product meet the rate cap limitations of the CFL was removed, that requirement remains in the latest proposed regulations for providers of income share agreements. So they must meet the rate caps of the CFL in order to be exempt from the CFL.

Again, kind of a confusing setup, I think driven largely by this attempt to create registration requirements without admitting that these products are not loans or not covered by some other licensing regime. So to complicate this further, Student Loan Servicing Act licensees are exempt from registration. So if a company has gone through and gotten licensed under the Student Loan Servicing Act, they're offering income share agreements and servicing their own income share agreements with that license. They can be exempt from this registration requirement.

Similarly, if you are offering an earned wage access product and you're already licensed under a deferred deposit transaction law or under the CFL and you're offering a product that's compliant with those regulations, you can be exempt from these registration requirements. So it's very possible that we'll have entities in California offering the same product, but being subject to different licensing and rulemaking regimes having to meet different sets of requirements. It's all a little bit confusing.

But again, I think this is driven by the legislation defining registration in a certain specific way, the FBI wanting to have these registration requirements extend beyond that and attempting to fit a square peg into a round hole. So all this led up to March of 2024. The FBI filed what it intended to be its final rule and final statement of reasons with the Office of Administrative Law. This is a step in the rulemaking process. And the Office of Administrative Law had it for about 30 days and then issued a disapproval letter, a disapproval decision in late April.

The OAL did not see this as extending beyond what was allowed under the registration requirements that were created by the legislation, but instead they had some issues with some of the clarity involved in the rulemaking. The issues that the OAL had with the rulemaking are not sort of fundamental, and it seems that the DFPI can sort of fix these without substantively altering their rule, but it does seem that it's going to be difficult for a DFPI to completely fix this without triggering another 15 day comment period.

So we would expect to see something from DFPI in the next few months then triggering another comment period. The industry gets to weigh in again on these rules. And another final rule and another final statement of reasons will have to go out responding to the comments received. And we believe that substantively we're going to see the same rule as what we have now

as the final rule, just with some additions and alterations to meet these lack of clarity requirements brought on by the OAL. So with that, I will turn it over to Mike Guerrero, who is going to talk about some other developments with the DFPI.

Mike Guerrero:

Great. Thank you, John. So today I'm going to discuss the DFPI's annual report on activity under the CCFPL. As John noted, the CCFPL was enacted in 2020 and it was really viewed as the nation's first mini CFPB, if you will. It gave the DFPI authority to exercise UDAP authority over covered persons, and it largely borrowed that definition of covered person from the Dodd-Frank Act. It also gives the DFPI authority to exercise its UDAP prohibitions against service providers to covered persons. In addition, as John noted, there's registration requirements.

The CCFPL also gives the DFPI the authority to issue rules and manage a new consumer complaint process, and it requires covered persons to submit reports on activity to the DFPI. This report from the DFPI is issued pursuant to the CCFPL, where the DFPI is required to annually provide an update on its activities. So specifically the report addresses the DFPI's rulemaking efforts, enforcement efforts, oversight details about the complaints it received, and then its efforts in connection with education outreach and its Office of Financial Innovation.

So with that, jumping into the regulatory component of this, the DFPI passed or is engaging in two rulemakings, the first of which related to commercial finance products and services. Specifically the rulemaking clarified that UDAP prohibitions will apply to commercial products and services, and it required annual reporting for some of these as well. The other item is the new registration requirement, and that's what John just gave us an update on.

It's still pending, but essentially just to recap, it's going to require registration of income-based advanced providers or earned access, private post-secondary education financing or income share agreements, debt settlement and student debt relief. On the legislative front, not necessarily activities that the DFPI engaged in, but activities that will impact the DFPI. There were three bills that became law. So the first is Assembly Bill 39. This is part of the digital financial asset. This requires a license for certain crypto asset businesses and also requires that stable coins be approved by the DFPI.

Senate Bill 401, also applicable to crypto applies to crypto kiosk. And what this does, and again, I'm simplifying a lot of this, but caps fees and limits withdrawal amounts in connection with these kiosks. It also requires the DFPI to publish a list of the locations of different kiosks. And the last one is Senate bill 478, and that is part of the "junk fee initiative", which requires disclosure of all mandatory fees and connection with the sale of certain goods or services. And there's some exemptions in there that could apply to financial services providers.

The next section of the report speaks to enforcement actions or efforts. The DFPI, when the CCFPL was first enacted, noted that they were going to really focus on increasing their capacity to bring enforcement actions by hiring more folks. And they've done that and the fruits of that are really beginning to show. So in 2023, they nearly tripled the number of investigations that they conducted as it is compared to 2022. They engaged in 734 investigations as it relates to public actions that they've taken. They nearly doubled that from last year. They took 181 public actions.

And while these enforcements or investigations and actions impacted a lot of segments of the industry, ranging from crypto to RTO, to debt collection and debt relief, they were really predominantly focused on two segments of the industry. The first being crypto. So of the 734 investigations, 525 of them were crypto-related. And of the 181 actions, 132 of them were crypto-related. The other big segment would be debt collection. And here again, 172 of the 734 investigations related to debt collection and only 19 of the actions of the 181 actions related to debt collection.

The remainder, they make up a relatively small portion of the investigations and the actions, constituting about 40 in each category. The DFPI also notes continuing this focus on crypto that they created this crypto scam tracker. It's essentially a database of crypto complaints that consumers can search to determine if they're dealing with a company that has a history of complaints. The report also identifies specific enforcement actions that the DFPI took. They note that they engaged in what they call a debt collection sweep, where they took action against 15 different entities for engaging in UDAP activities in connection with the collection of debt.

There was a $4.2 million settlement with an income share provider. There was a $19 million settlement for what the DFPI called a home loan modification scheme. 16 million of that was restitution, 3 million was penalty. The DFPI took action against a debt settlement provider for violating, among other things, the telemarketing sales role. And the DFPI continues to

engage in litigation with OPFI in connection with its bank partnership program, particularly asserting that the FinTech is the true lender rather than the bank. And we've blogged and written and discussed this litigation.

The last couple components of this report go into what I would view more as the DFPI's consumer facing efforts. So the Consumer Financial Protection Division created a new complaints' portal. It's currently engaging in building out the NMLS system as it relates to new registrants. These folks, the EWA's, income share providers that will be required to register. That is two-fold. It helps the companies register on the NMLS system, and it also helps consumers track licenses through NMLS consumer access. And then it also enhanced its research practices.

So as part of its market monitoring efforts, it talks about how they have internal groups and education efforts, and they're discussing using social media tools to track trends in the market. So it's interesting to see how the DFPI is monitoring the marketplace, and a takeaway might be for companies to actively monitor their social media reputations as well. The last piece worth mentioning is that from the Innovation Office. They talk about how in 2022 they met with a lot of FinTech companies, got input on the department's regulation of these companies. And that's down quite a bit in 2023, about 50%.

The report attribute that almost solely to the economy, but I think there could be other takeaways. There may be a reluctance to engage with the Office of Innovation, but in any event, the meetings are down and that's noted. I think there's interesting takeaways, but with that, I think it makes sense, particularly because debt collection was such a big focus. To turn this over to Melanie Vartabedian, who's going to discuss developments and give us a little bit of background on the Rosenthal Fair Debt Collection Practices Act, and I'm going to actually ask her some questions.

So Melanie, thank you again for joining us, introducing us, and hoping that you can give us a background on what the Rosenthal Act or what I might say the RFDCPA is.

Melanie Vartabedian:

Thanks Mike. So in California, the Fair Debt Collection Practices Act or FDCPA for short, has a corollary in California, and that's called the Rosenthal Act. So I'll just call it the Act for short. The Act has been around for years since 1977, but for the past few years, it's become a favorite of consumer attorneys, and it does look like this trend is continuing. So it's very important that creditors with customers in California that are making attempts to collect in California comply with both the Act and the FDCPA. So some interesting things about the Act is it's broader than the FDCPA.

It does incorporate most of the requirements of the FDCPA, but also has some requirements of its own. And the main difference is that under FDCPA, original creditors such as credit card issuers, banks, finance companies, and others who extend credit directly to consumers are not considered debt collectors under the FDCPA. So when creditors are trying to collect debt from their own customers, the FDCPA doesn't apply. Any creditor who attempts to collect a debt from a California consumer likely qualifies as a debt collector under the Rosenthal Act however.

Which defines debt collector more broadly as anyone who in the ordinary course of business regularly on behalf of him or herself or others engages in debt collection. So we see that the Act is broader in terms of its definition of who is a debt collector.

Mike Guerrero:

Great. And given that the law is more broad than the FDCPA in some regards, are there any other areas in which the Rosenthal Act differs from the FDCPA?

Melanie Vartabedian:

On a more minor scale. So a couple other areas where it differs is creditors do not need to provide consumers with the so-called Mini Miranda warning in the first communication that the debt collector makes with the consumer. And so that Mini Miranda is the communication is to collect a debt and any info obtained will be used for that purpose. So that's missing from the ACT, the Rosenthal Act. The other difference of note is that creditors do not have to send consumers the validation notice that's mandated by Section 1692 (g) of the FDCPA.

Mike Guerrero:

And what other conduct is prohibited by the Rosenthal Act?

Melanie Vartabedian:

It's largely the same as the FDCPA. I mean, the broad intention here is to prohibit debt collectors from acting unfairly or deceptively in collecting consumer debts. So substantively what that means is that there are restrictions about communications by debt collectors to consumers, time restrictions, prohibiting communications with consumer, if the consumer is represented by council in connection with the debt. We'll talk a little bit more about that later and prohibits communication with the consumer at his or her place of employment if the debt collector knows or has reason to know the employer doesn't allow such communications.

It generally prohibits communications to parties other than the consumer about the debt. There are some exceptions, however, like counsel for the consumer, credit reporting agencies of course, and the creditor to which the debt is owed. It requires debt collectors to abide by written cease and desist requests by consumers. Again, we will talk about that a little bit more later. It prohibits conduct that's harassing or abusive and provides examples of that kind of behavior. And it prohibits debt collectors from using false or misleading communications and also provides examples of that type of behavior.

And then finally, it prohibits unfair practices and provides examples of those like collecting amounts that aren't actually authorized by the debt instrument or by law.

Mike Guerrero:

So it sounds like there's a lot of overlap between the RFDCPA and the federal FDCPA. What about the CFPB's implementing Regulation F under the FDCPA?

Melanie Vartabedian:

So Reg F, as you said, is the implementing regulation for the FDCPA. And that reg permits a debt collector with the consumer's consent to communicate by email and text as long as there's a right to opt out of such communications. Debt collectors may not call a particular consumer more than seven times in seven consecutive days. So that's some real helpful guidance there. Debt collectors may also not call a consumer within seven days of their previous telephone conversation with that particular consumer. So those are some nice bright line rules for our clients to go by.

It also contains a model validation notice that is a safe harbor if it is used. The Reg also defines five options for proper itemization, dates for debt collectors to use in their validation notice. The last statement date, the charge off date, the last payment date, the transaction date, or the judgment date. Reg F has record keeping requirements. It also permits limited content voicemails, basically, which is just a request that the consumer call them back. And just of note, and we won't get into this in any detail here, but one of the big questions that's out there now is Reg F the law in litigation is any agency regulation the law in litigation. Although it strictly applies to the FDCPA, a lot of first party creditors looks to Reg F for guidance on how to conduct their own collection activity.

So that gets into the Chevron Defense doctrine where deference is given to an agency's interpretation of a statute as long as the interpretation is reasonable. And as many of you know, Chevron is currently under review by the United States Supreme Court. And like I said, we won't get into that in detail here. Just kind of an interesting side note that I wanted to mention and a quick plug, we do have a great webinar on that available on our website if anybody's interested in checking it out to the extent they haven't already.

Mike Guerrero:

Great. And what damages are available under the RFDCPA?

Melanie Vartabedian:

So the Act allows consumers to recover any actual damages they incur as a result of the violation. One thing of note is it's not a strict liability statute like the FDCPA, so another little difference there. Also, if the consumer can show there was a willful or knowing violation of the Act, statutory penalties are available between $101,000, and then reasonable attorney's fees and costs are also available under the Act.

Mike Guerrero:

And as it relates to the willful or knowing violations and how they give rise to statutory damages, is that limited to $1,000 per action or can the consumer recover $1,000 per violation?

Melanie Vartabedian:

That's a really good question. I mean, we think the better reasoned decisions have held that the consumer's limited to $1,000 per action, but there are cases going the other way. For example, one California court refused to grant a creditor's motion to strike portions of a Rosenthal Act complaint that sought $1,000 per violation.

Mike Guerrero:

Got it. And what defenses are available and are you seeing any particular defense is being utilized?

Melanie Vartabedian:

I mean similar to the FDCPA, the Rosenthal Act includes a bona fide error defense, which allows a creditor to prove that any violation was not intentional and occurred, notwithstanding maintenance of procedures reasonably adopted to avoid the violation. The Rosenthal Act also has a right to cure defense, which permits a creditor within 15 days of discovering any violation, which is able to be cured or after written notice of any such violation to notify the debtor of the violation and to make any adjustments or corrections necessary to cure the violation.

Mike Guerrero:

And should creditors or debt collectors be concerned about facing class actions under the Rosenthal Act?

Melanie Vartabedian:

Probably they should. Although Section 1788.30 of the Rosenthal Act does not allow for class actions, and in fact, specifically limits consumers to pursuing claims only in an individual action. Under Section 1788.17 of the Rosenthal Act, creditors are subject to the same remedies of Section 1692 (k) of the FDCPA. And what all this means in the broad scheme of things is a number of courts have held that consumers may pursue class actions under the Rosenthal Act.

Mike Guerrero:

Great. And as it relates to litigation, are you seeing any trends or common fact patterns?

Melanie Vartabedian:

We are. I'll highlight three. So one of the most common fact patterns is contacting a customer to try to collect a debt after an attorney's cease and desist letter was sent. Sometimes these are paired with TCPA or Telephone Consumer Protection Act claims because the alleged violative attempts to collect the debt were done by phone calls. We know that most creditors, if not all, have procedures in place for dealing with consumers who are represented by attorneys.

And when a consumer notifies the creditor in writing that he or she has retained an attorney, the Rosenthal Act prohibits the creditor from a initiating communications directly with the consumer other than statements of an account in an attempt to collect the debt. But one thing that comes up is what if a creditor mails a monthly statement directly to a represented

consumer, and the statement includes language noting that the account is delinquent? Well, unfortunately, the Rosenthal Act does not define the term statements of account and courts in California are split on this issue.

So that's definitely an area where we see a lot of cases. Another area where we are seeing common fact patterns is alongside allegations that there was identity theft. So where someone stole another person's identity, proceeded to open up an account that was unknowing to the plaintiff, and then the plaintiff is getting contacted by the creditor about the debt on that account. These are oftentimes brought alongside California's Identity Theft Action statute or CITA, C-I-T-A. Before bringing the action, the consumer has some obligations.

They have to send a copy of the police report to the entity that's attempting to collect the alleged fraudulent debt. If the collection activity continues, then after a thirty-day period, the consumer can bring suit. Generally, the allegations are that creditors and debt collectors must do a reasonable investigation of claims of the fraudulent accounts upon receipt of written notice, and they have to come to a reasonable basis for whether there was or was not identity theft. Cases generally look at whether there was any prior payments on the account in their investigation, whether the personal identifying information matched or not.

So those are kind of the main things that we're seeing with those kinds of cases. And then lastly, we're seeing cases where a plaintiff is trying to make a failure to note credit dispute in credit reporting to the credit reporting agency claims bootstrapped to a Rosenthal Act claim. So what that means is a credit reported to a credit reporting agency that a consumer owed a debt. The reporting of the debt to the credit reporting agency by the creditor is a communication allegedly to which the Rosenthal Act would apply.

At some point in these kinds of cases, the customer would send a letter to the creditor disputing the debt that the creditor is attempting to collect. But then the creditor continues to report the consumer's debt without indicating that the debt was disputed. And the allegation is then that by failing to communicate that the debt was disputed, the creditor then violated Rosenthal Act. One of the main ways that we're defending against these kinds of claims is that these are preempted by the Federal Credit Reporting Act because the claims are grounded entirely in credit reporting.

And the FCRA broadly preempts any state law that regulates the furnishing of credit information. Also, I mean, regardless of the preemption are arguments that the Rosenthal Act claim fails because creditors are only subject to Rosenthal when they engage in collection activities that implicate Rosenthal. And merely reporting credit to a credit reporting agency is not a collection activity. It's just a routine servicing practice undertaken by creditors.

So particularly with that last type of case that we're seeing, it's interesting because it involves pulling in the FCRA different federal statute, not the FDCPA into how we're defending those claims.

Mike Guerrero:

This is all super helpful. If you were to leave us with any final thoughts or takeaways, what might those be?

Melanie Vartabedian:

Thanks. I think we all can take comfort sometimes in the FDCPA is not applying to the original creditor on the debt that's being collected, but it's really important to remember that... I mean, aside from California, there's around 20 or so states that have these mini FDCPA type statutes where unfortunately as a first party collector, you do need to worry about those and can't take comfort in the FDCPA in that regard of these.

Mini FDCPAs, the Rosenthal Act is probably the most well-developed with a fair amount of activity in case law and lawsuits being filed. So definitely something to keep on everyone's radar. With that, I'm going to now turn to my partner Joel Tasca. Joel's going to talk about a couple additional unique aspects of California law that we're seeing in litigation. Joel, what is the California Consumer Credit Reporting Agencies Act and why is it significant?

Joel Tasca:

Thanks, Melanie. So I think to understand the California Credit Reporting Act, we need to talk a little bit about the Federal Fair Credit Reporting Act, the FCRA, because that will put the California Act in context. So as most of you know, over the

past decade or so, federal FCRA cases arising out of credit reporting has been a huge, huge source of litigation against financial institutions. And the principle claim we see is against data furnishers, which most consumer financial institutions are.

And these claims involve alleged failure to reasonably investigate alleged inaccuracies in consumer data provided to the consumer reporting agencies, the CRAs. And these FCRA cases while annoying and costly, at least for the most part, furnishers need only worry about the FCRA and not any state law governing furnishing duties. And the reason is because the FCRA contains a preemption provision which preempts all state law relating to furnisher duties that are governed by the FCRA. So FCRA, big headache for furnishers, but at least it's only that and there's not a whole lot of state law you need to worry about.

There are two exceptions to the federal preemption provision under the FCRA. The preemption provision specifically accepts out furnisher responsibilities imposed by two states. One is Massachusetts and the other is California. And so furnisher responsibilities under California law need to be paid attention to by furnishers. So California is one of the two exceptions to the sort of general rule that if you're a furnisher, you only need to worry about complying with the FCRA. California, you need to worry about the FCRA and the California Act.

Now the relevant provision of the California law is Section 1785.25 (a) of the California Civil Code. And it's relatively short provision, very straightforward. It says, "A person shall not furnish information on a specific transaction or experience to any consumer credit reporting agency if the person knows or should know the information is incomplete or inaccurate." So that's the part of the California law that's out there. If you're a furnisher, you need to make sure you're complying with that. If you don't comply with that, consumers have the ability to bring a private cause of action for a violation.

So why is this significant, this California law? Well, there's a key difference between a claim against furnishers under the FCRA and one against furnishers under the California Act. And that is under the FCRA, there are certain procedural requirements that must be satisfied before a consumer can bring a claim. Specifically, the consumer has to make a dispute to a CRA, not directly to the furnisher, but to a CRA. The CRA must then send notice of the dispute to the data furnisher.

And the data furnisher then gets an opportunity to investigate it and correct the information if in fact it was inaccurate or misleading if the furnisher agrees based on its investigation, that it was in fact inaccurate or misleading. So the FCRA, in other words, gives the furnisher sort of a cure period before consumer can bring a case. And oftentimes we will defend against FCRA cases successfully based on these procedural requirements. Sometimes the consumer doesn't make its complaint to a CRA, instead makes its complaint directly to the furnisher.

That's not going to trigger FCRA liability. Other times the CRA may not send notice of the dispute to the furnisher. Again, you need those steps to be jumped through before there can be FCRA liability. So if the CRA didn't send the notice of the dispute to the furnisher, the furnisher gets off the hook. Complete defenses to an FCRA claim against a furnisher. A furnisher also has the ability to argue again because of that cure period, I mentioned, that even the information furnished was inaccurate or misleading, the furnisher conducted a reasonable investigation in response to receiving the dispute.

And it just wasn't able, despite that reasonable investigation, to determine that the information was inaccurate or misleading. So that's the FCRA. The California statute, on the other hand, doesn't require the same procedural steps to play out before the consumer could sue. Instead, the furnisher can be on the hook immediately if it furnished information it knew or should have known was inaccurate or incomplete. And so in some ways, the California statute is a little bit more scary for furnishers than the FCRA because there is not this cure period.

There aren't the procedural hoops that can sometimes form the basis for a defense. So the defenses I described earlier under the FCRA, for the most part, they are not going to work under the California Act. Now, there is this sort of what I'll call a mens rea requirement under the California Act. The furnisher is liable only if it knew or should have known that the information it furnished was inaccurate or incomplete. And so a furnisher in these cases can still argue that the alleged inaccuracy in the information was not known or reasonably knowable to it at the time it furnished the information.

So for example, in identity theft situation. If a furnisher is furnishing information in the name of the plaintiff on a loan obtained through an ID theft, the furnisher can argue that, "Look, it wasn't possible for us to figure out that this was actually an ID thief and not the plaintiff, him or herself. And so we didn't know or we couldn't have known that the information was inaccurate when we furnished it." So the mens rea requirement under the California Act still provides a way to try to get out of liability under the California Act. And then like I said, there is a private cause of action.

If the furnisher violates the California Act, then it's a lot like the FCRI for a negligent violation. The furnisher is going to be liable for actual damages, and that can include court costs, loss of wages, attorney's fees, pain and suffering. And then in the case of willful violation, the actual damages, again, like a negligent violation are recoverable. But then there are also punitive damages that are available in the amount of not less than a hundred dollars and not more than $5,000 in an individual action for each violation that the court finds its proper to award such damages on.

So the bottom line here is if you are in California defending against claims against furnishers, you may well see these California credit reporting act claims in addition to the FCRA claims that are asserted and the California claims need to be defended a little differently.

Melanie Vartabedian:

Thanks, Joel. That's a really helpful rundown of the key differences between those two acts. Let's pivot a minute and talk about the FTC holder rule. Is there anything unique about how that rule works in California?

Joel Tasca:

There is, Melanie. And before I get into that, I'll just give brief background in case you're not familiar with the FTC holder rule. All consumer credit contracts must contain the FTC holder rule notice and the FTC holder rule notice, or actually the FTC holder rule itself was meant to abrogate the holder and due course rule. If you remember that long ago from your negotiable instruments class in law school. The holder and due course rule says that we're a subsequent holder of a consumer credit contract who acquired the contract in good faith and without notice.

That that holder is not going to be subject to claims and defenses that the buyer may have had against the original seller of the goods or services bought pursuant to that consumer credit contract. So that was kind of for buyers of products, especially people who bought products that were defective. That was kind of an onerous rule because once the consumer credit contract was transferred to a downstream holder, the buyer wouldn't be able to point to the defective goods or services as a defense to payment. And so the FTC holder rule was meant to get rid of that whole scheme.

And so now the FTC holder rule provides... And this notice has to be in each consumer credit contract. That any holder of a consumer credit contract is subject to all the claims and defenses that the debtor could assert against the seller of the goods or services bought under the contract. And here's where the interest in California wrinkle comes in. But recovery by the debtor shall not exceed amounts paid by the debtor here under. In other words, there is a cap on the amount that a plaintiff can recover from the holder. Recovery by the plaintiff can only be up to the amount that the plaintiff actually paid under the consumer contract.

And so that cap is a very important component of the FTC holder rule for downstream holders because it means their liability is not going to be crazy. It's going to be capped at whatever the plaintiff paid already under the consumer credit contract. Now, the issue in California and in certain other states, but I believe California is the only state in which its high court has decided this issue. In California, the Supreme Court a couple of years ago addressed the question whether the cap on recovery, caps not only damages, but also recovery of attorney's fees that the plaintiff can get when the plaintiff has sued under a fee shifting statute.

And there are plenty of fee shifting statutes in California. We'll often see this come up by the way in the auto finance context. So the auto finance company finances the purchase of a car from a car dealer. The car turns out to be a lemon or allegedly a lemon, and the consumer then sues both the dealer and the auto finance company. The auto finance company being the holder sued pursuant to the FTC holder rule. And these cases are often brought under those California consumer protection statutes that permit fee shifting to prevailing plaintiffs. Just one example is the Song-Beverly Consumer Warranty Act.

That was the statute that issue in the case from a couple of years ago that the California Supreme Court decided. And that case was called Pulliam versus HNL Automotive. And the court there held that the FTC holder rule does not cap a plaintiff's ability to recover attorney's fees from the holder when the statute sued under permits recovery of fees from the holder. And so the holder isn't going to be able to say, "Well, plaintiff, you only paid $5,000 under the consumer credit contract. That's all you get."

Because the attorney's fees under that statute that are permitted based on the fee shifting component of the statute could be much more than the $5,000 if the cap does not apply to the attorney's fees. And so in the Pulliam case, the Song-Beverly Act permitted the fee shifting and the plaintiff there was able to recover almost $170,000 in attorney's fees even though her damages' recovery was only about $20,000. So her damages were capped under the FTC holder rule at the amount she paid. And so the damages award was only about 20,000, but the attorney's fees were not capped by the FTC holder rule according to the California Supreme Court.

And so the defendant there got slapped with $170,000 attorney fee award. So as of a couple of years ago, the cases were split before the Pulliam decision within California. But now in California, it's the law of the land that these attorneys' fees are not capped in this situation. Consumer finance companies need to be very wary in consumer finance litigation in California because they could have huge exposure to attorney's fees, even in cases where damages are relatively low.

Melanie Vartabedian:

Great. Well, thank you, Joel. That is a really important wrinkle I think that you mentioned there about the attorney's fees on the FTC holder rule in California. So thanks for your remarks. With that, I'd like to thank all of our speakers, John Kimble, Michael Guerrero, and Joel Tasca for their insights. To make sure you don't miss our future episodes, subscribe to our show on your favorite podcast platform, Apple Podcast, YouTube, Spotify, or wherever you listen.

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