CONSUMER FINANCIAL SERVICES LAW REPORT

FOCUSING ON SIGNIFICANT CASELAW AND EMERGING TRENDS

DECEMBER 27, 2018 | VOLUME 22 | ISSUE 13

OFFER OF JUDGMENT

FULL TENDER OF PAYMENT DOES NOT MOOT TCPA CLASS ACTION

A 2d U.S. Circuit Court of Appeals panel recently concluded that a corporate defendant could not moot a putative class action by tending full payment to the named plaintiff. (*Radha Geismann, M.D., P.C. v. ZocDoc, Inc.*, No. 17-2692, 2018 WL 6175291 (2d Cir. 11/27/18).

Sr. Judge Robert D. Sack, writing for the unanimous appellate panel, remanded the case to the U.S. District Court, Southern District of New York. It was the third time the case had wound up in that district court, beginning in 2014 with Judge Louis L. Stanton's dismissal of Radha Geismann MD PC's original action against ZocDoc Inc. for allegedly violating the Telephone Consumer Protection Act by sending unauthorized faxes.

After Geismann filed the complaint and moved for class certification, ZocDoc made a settlement offer to Geismann as to its individual claims pursuant to Fed. R. Civ. P. 68. Geismann rejected the offer. The district court dismissed the action for lack of subject matter jurisdiction. (*Radha Geismann, M.D., P.C. v. ZocDoc, Inc.*, 60 F.Supp.3d 404 (S.D.N.Y. 09/26/14) ("*Geismann I*").

The district court reasoned that the rejected offer rendered the entire action moot and therefore entered judgment in favor of Geismann, which appealed. Relying in large part on the U.S. Supreme Court's 2016 ruling in *Campbell-Ewald v. Gomez*, 136 3 S. Ct. 663 (2016), which was decided while Geismann's appeal of the district court's first decision was pending before the 2d Circuit.

Campbell-Ewald presented the question of whether class-action defendants can effectively end litigation by offering named plaintiffs all of the money they could possibly obtain. The *Campbell-Ewald* Court said that an unaccepted offer of judgment did not moot the class action — but maintained that the court was not answering the question of whether a tender of judgment might lead to a different result.

"We need not, and do not, now decide whether the result would be different if a defendant deposits the full amount of the plaintiff's

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individual claim in an account payable to the plaintiff, and the court then enters judgment for the plaintiff in that amount," wrote Justice Ruth B. Ginsburg for the 6-3 *Campbell-Ewald* majority. "That question is appropriately reserved for a case in which it is not hypothetical."

Justice Ginsburg was responding to the following remarks made in a dissent written by Chief Justice John Roberts in *Campbell-Ewald*:

"The good news is that this case is limited to its facts," Justice Roberts wrote. "The majority holds that an *offer* of complete relief is insufficient to moot a case. The majority does not say that *payment* of complete relief leads to the same result. [*Emphases in original.*]

"For aught that appears, the majority's analysis may have come out differently if Campbell had deposited the offered funds with the district court," the Chief Justice concluded. "This Court leaves that question for another day — assuming there are other plaintiffs out there who, like Gomez, won't take 'yes' for an answer."

The 2d Circuit appellate panel, after considering the result in *Campbell-Ewald*, vacated the district court's judgment and remanded the matter for further proceedings. (*Radha Geismann, M.D., P.C. v. ZocDoc, Inc.*, 850 F.3d 507 (2d Cir. 2017) ("*Geismann II*").

The second time the case appeared before the district court, ZocDoc attempted on remand to use Rule 67 to settle Geismann's individual claims, requesting and obtaining leave from the district court to deposit funds in the court's registry. Those funds

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represented what ZocDoc regarded as the maximum possible damages Geismann could receive for its individual TCPA claims.

The district court agreed with ZocDoc that its deposit mooted Geismann's individual claim, accordingly entered judgment in favor of Geismann, and dismissed what remained of the action. (*Radha Geismann, M.D., P.C. v. ZocDoc, Inc.*, 268 F.Supp.3d 599 (S.D.N.Y. 2017) ("*Geismann III*"). The 2d Circuit appellate panel concluded that the district court was in error and returned the case for the third time to the district court for further proceedings.

The 2d Circuit effectively closed the Campbell-Ewald loophole, and warned class action defendants to stop trying to pick off named plaintiffs. The appellate panel — including Judge Sack, Judge Reena Raggi, and U.S. District Judge Paul Gardephe of the Southern District of New York, sitting by designation — ruled that ZocDoc could not moot the class action by tending full payment to the named plaintiff in a court-overseen account.

The 2d Circuit panel echoed the 7th Circuit in *Fulton Dental v. Bisco*, 860 F.3d 541 (7th Cir. 2017), which said there's no meaningful difference between the unaccepted offer of payment the Supreme Court addressed in *Campbell-Ewald* and the unaccepted tender of payment in the ZocDoc scenario.

"Other than their labels, once rejected, the two do not differ in any meaningful way," the 2nd Circuit panel said, citing *Fulton Dental*. "In each case, 'all that exists is an unaccepted contract offer, and as the Supreme Court recognized, an unaccepted offer is not binding on the offeree.'"

But the 2nd Circuit went beyond the technical question about whether defendants can accomplish through Rule 67 of the Federal Rules of Civil Procedure what the *Campbell-Ewald* decision disallowed under Rule 68. The appeals court broadly shut down defendants' attempts to end class actions by attempting to force default judgments upon named plaintiffs who won't take their money.

When Geismann rejected ZocDoc's settlement offer and returned the clerk's check, the 2nd Circuit said, the plaintiff effectively told ZocDoc and the court that the case is about more than individual statutory damages. It's also about Geismann's service as the lead plaintiff for a class of similarly affected class members. A named plaintiff who seeks class certification has not obtained full relief even if defendants pay individual damages and agree to an injunction, the appeals court said.

Named plaintiffs who reject settlement offers, the 2nd Circuit said, quoting *Campbell-Ewald*, must have a fair opportunity to show their claims can be certified.

The 2nd Circuit sent the ZocDoc case back to Judge Stanton with an instruction that he resolve Geismann's pending motion for class certification before entering a judgment, regardless of ZocDoc's attempts to force money and a default judgment upon the named plaintiff.

"If the motion is granted, the class action may proceed," the appellate panel said. "A conclusion otherwise would risk placing the defendant in control of a putative class action, effectively allowing the use of tactical procedural maneuvers to thwart class litigation at will."

Glenn L. Hara and David M. Oppenheim of Anderson & Wanca in Rolling Meadows, Ill., represented Geismann.

Blaine C. Kimrey, Charles J. Nerko (in New York), and Bryan K. Clark (in Chicago) of Vedder Price in New York represented ZocDoc.

ALSO IN THE COURTS

QUICK TAKES ON NOTABLE DECISIONS RELATED TO CONSUMER FINANCIAL SERVICES

Financing/Retailers/Hidden fees/Class action. *Silverman v. Wells Fargo & Co., et al.*, No. 18-3886 (N.D. Cal. 11/20/18). The U.S. District Court, Northern District of California dismissed a putative class action by a Texas jewelry company accusing Wells Fargo & Co. of encouraging thousands of retailers nationwide to charge hidden fees to customers using a finance program created by the bank. Judge Yvonne G. Rogers said claims by Texas-based J Edwards Jewelry Distributing that Wells Fargo violated California's unfair competition law cannot proceed because there was no evidence that any wrongful conduct occurred in California.

Judge Rogers also dismissed claims that Wells Fargo violated the Truth in Lending Act as time-barred and tossed unjust enrichment claims as inapplicable.

J Edwards Jewelry and its president John Silverman brought a putative class action on behalf of over 5,000 jewelry, home furnishing, and other retailers nationwide who participated in Wells Fargo finance programs, which went by names such as Wells Fargo Jewelry Advantage or Wells Fargo Home Projects. Wells Fargo's program provided purported "zero interest" financing to retailers' customers, directing participating stores to advertise the financing as having no interest.

Retailers were required to pay Wells Fargo up to 22.5 percent for the financing and were told they could raise their prices to cover the finance charges,

according to the lawsuit. The retailers advertised the financing on their websites, but Wells Fargo controlled how they could describe it.

A customer might pay $3,000 for a ring in a typical transaction, getting zero interest financing, with the retailer paying Wells Fargo $675 for the financing. Customers could buy the same ring for just $2,325 if they paid in cash, saving $675. The customer using Wells Fargo financing was thus paying $675 in undisclosed finance charges, Silverman said.

Wells Fargo moved to dismiss, denying that it encouraged retailers to inflate sticker prices to cover payments to the bank. An agreement it had with retailers prohibited them from raising prices for customers who financed purchases. Wells Fargo said J Edwards itself misrepresented the financing charge and settled a lawsuit by the New Mexico attorney general over those practices in 2013.

Judge Rogers said non-California plaintiffs cannot sue under the California UCL unless the alleged wrongdoing occurred in California. J Edwards failed to allege that it had any stores in California or sold any goods there, or that the advice it supposedly received about how to advertise the financing came from Wells Fargo's California employees.

Unjust enrichment claims are not allowed under California law when the parties' rights are defined by a binding agreement, which was the case in this dispute, Judge Rogers added. The plaintiffs were granted leave to amend the UCL and unjust enrichment claims. Plaintiffs conceded that the TILA claim was time barred.

Matthew A. Berliner of Fortis in Costa Mesa, Calif.; Robert A Skipworth in El Paso, Texas; Scott D. Williams of Robinson Calganie in Newport Beach, Calif., and Walt D. Roper in Dallas represented Silverman. Regina J. McClendon, Lindsey E. Kress (in San Francisco), Robert T. Mowrey, and Taylor F. Brinkman (in Dallas) of Locke Lord represented Wells Fargo.

FHA/Discrimination. *In re National Fair Housing Alliance v. Deutsche Bank, et al.*, No. 18-839 (N.D. Ill. 11/20/18). The U.S. District Court, Northern District of Illinois dismissed a lawsuit by a group of fair housing organizations accusing Deutsche Bank and Ocwen Financial Services of racial discrimination by not properly maintaining foreclosed homes in minority neighborhoods. Judge Harry Leinenweber rejected the groups' allegations of Fair Housing Act violations, saying the FHA generally applies to discrimination in real estate sales or rentals, not maintenance of properties.

Lawsuits can be brought under the FHA if failure to maintain a property renders it unavailable for sale, but the housing groups failed to allege that specific properties were neglected to that extent, Judge Leinenweber said. He gave them 45 days to file an amended complaint.

National Fair Housing Alliance and nearly 20 other fair housing groups across the country filed the lawsuit, saying that foreclosed homes in minority neighborhoods owned by Deutsche Bank and serviced by Ocwen were not maintained as well as homes in predominantly white neighborhoods. Deutsche Bank served as trustee for several mortgage-backed securities trusts, which received titles for the homes after foreclosure.

The groups said they examined 1,141 properties owned and maintained by the defendants, collecting evidence on 39 conditions such as accumulated trash and overgrown grass. Maintenance was so poor on some homes in minority neighborhoods that they were uninhabitable, discouraging buyers from considering them for purchase, the groups said. They accused defendants of violating FHA provisions that make it unlawful to make homes unavailable to consumers because of race or national origin.

Defendants' practices also perpetuated segregation by discouraging white buyers from buying homes in minority neighborhoods, the groups said. Deutsche Bank and Ocwen moved to dismiss, denied that they discriminated against minorities and said the fair housing groups' statistical methods were flawed. The groups made just a single visit to some properties, which did not show what its condition was when the defendants took it over or whether it was improving, the companies said.

Plaintiffs' data, moreover, was collected from 2011 through 2017 and was not representative of conditions during the FHA's statute of limitations. The statute of limitations extended back only to February 2012 for Deutsche Bank and February 2015 for Ocwen, according to Monday's court order. Plaintiffs also failed to point to specific properties where maintenance problems made homes unavailable for sale or rent, as their FHA claims require, the defendants said.

Judge Leinenweber agreed that a significant part of the plaintiffs' data was inapplicable because of the statute of limitations. Plaintiffs must replead their statistical findings if they wish to amend the complaint, he said.

Jennifer Soule, James G. Bradtke, and Kelly K. Lambert of Soule Bradtke & Lambert in Elmhurst; Morgan Williams of the NHFA; and Stephen M. Dane and Yiyang Wu of Relman Dane & Colfax in Washington, D.C., represented the plaintiffs. Elizabeth A. Frohlich, Kevin M. Papay (in San Francisco), and Kenneth M. Kliebard (in Chicago) of Morgan Lewis & Bockius; and Debra L. Bogo-Ernst and Stephen J. Kane of Mayer Brown in Chicago.

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MBS. *IKB International SA v. Wilmington Trust Co., et al.*, No. 18-2312, 2018 WL 4782926 (3d Cir., *appellees' brief filed* 10/03/18). Wilmington Trust Co. recently a brief asserting that a federal district court properly dismissed a lawsuit accusing Wilmington of breaching its agreements as trustee to oversee several mortgage-backed securities trusts worth a combined $168 million. A brief filed with the 3rd U.S. Circuit Court of Appeals says that the agreements do not impose a duty on the trustee to "protect" the trusts, as MBS purchasers IKB Deutsche Industriebank AG and IKB International SA argue.

The suit against Wilmington started in 2017 with the claim that it failed to hold mortgage lenders accountable for loading the trusts with securities backed by bad loans. Judge John E. Jones III of the U.S. District Court, District of Delaware granted Wilmington Trust's motion to dismiss the suit. (*IKB Int'l v. Wilmington Trust Co.*, No. 17-cv-1351, 2018 WL 2210564 (D. Del. 05/14/18).)

The case stems from the IKB companies' purchase of MBS issued by 15 Delaware statutory trusts for which Wilmington Trust acted as the "owner trustee." According to the banks' complaint, the loans that lenders sold to the trusts purportedly met certain agreed-upon guidelines and quality standards, and mortgage servicers subsequently handled collecting payments from borrowers and pursuing foreclosure actions.

As owner trustee, Wilmington Trust oversaw the trusts' nonparty indenture trustees, which were responsible for taking physical possession of the complete mortgage files, enforcing the lenders' and servicers' obligations, and providing notice if loans were found to violate the guidelines, the suit said.

The indenture trustees allegedly failed to act on claims that the loans did not meet promised standards and that the loan servicers failed to properly foreclose on properties. As a result, most of the loans underlying the securities defaulted in 2008, making the securities "almost worthless," the suit said. The plaintiffs alleged Wilmington Trust failed to protect investor interests because it did not prudently oversee the indenture trustees.

Judge Jones first dismissed the claims relating to four securities purchased by IKB International, saying it lacked standing to sue because it had sold the securities to third parties and had not retained its litigation rights. The judge next turned to IKB AG's claims and found that Wilmington Trust had not breached its obligations under the trust agreements.

The plaintiff failed to point to any specific provisions in the agreements that made Wilmington Trust responsible for the indenture trustees' alleged failure to monitor and hold lenders and servicers accountable for noncompliance with loan guidelines, the judge said.

"A plain reading of the unambiguous terms of the agreements fails to support IKB AG's allegations," Judge Jones said. The complaint also mistakenly conflated Wilmington Trust's contractual authority with its contractual duties, Judge Jones said.

The IKB companies have appealed the decision, arguing Judge Jones' reading of the agreements leads to an "absurd result." The trust documents explicitly require Wilmington Trust to ensure that the trusts perform their duties, the banks say.

"This is a necessary and essential element of the governing agreements, because the 'trusts' or 'issuers' are legal fictions that have no capacity to act other than by contracting with others to act on their behalf," their appellants' brief says.

Wilmington Trust counters by arguing in its brief that the plaintiffs missed the opportunity to go after the indenture trustees and are now trying to blame the owner trustee for "failing to take the very action appellants themselves failed to take."

The trustee is an "accommodation party" that ensures the trust complies with the Delaware Statutory Trust Act, 12 Del. Code Ann. § 3807, and is not responsible for the indenture trustees or for the origination or servicing of the underlying loans, the appellees' brief says. *Michael Luskin and Stephan E. Hornung of Luskin Stern & Eisler in New York; and Stephen B. Brauerman of Bayard Law in Wilmington, Del., represent Wilmington Trust. John J.D. McFerrin-Clancy in New York; John M. Lundin of Schlam Stone & Dolan in New York; and Kurt M. Heyman and Samuel T. Hirzel II of Heyman Enerio Gattuso & Hirzel represented IKB.*

REGULATORY TRENDS

STATES DIVERGE FROM FEDERAL REGULATORS ON DISPARATE IMPACT

By Bradford Hardin, Jonathan Engel, and Juliana Gerrick

Bradford Hardin, ***Jonathan Engel***, and ***Juliana Gerrick*** are members of ***Davis Wright Tremaine***'s consumer financial services team, which advises leading financial institutions, emerging fintechs, technology companies, and other financial services providers on a wide range of consumer regulatory, transactional, and litigation, supervision, and enforcement matters. To learn more about DWT's practice as well as for updates and insight on emerging consumer financial services issues, please visit the *www.paymentlawadvisor.com.*

Federal and state fair lending regulators are charting different courses for the future of "disparate impact" liability under the Equal Credit Opportunity Act and analogous state law. For its part, the federal policymaking apparatus is working to limit or eliminate disparate impact liability under ECOA, basing the change on the Supreme Court's 2015 *Inclusive Communities* decision. (*Texas Dept. of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S.Ct. 2507 (2015).)

Some state regulators — who share ECOA enforcement authority with their federal counterparts and can also bring actions to enforce state fair lending law — have raised public objection and acted to replace rescinded federal disparate impact guidance.

The first notable development in this area came in May 2018, when Congress approved a joint resolution expressing disapproval[1] of CFPB Bulletin 2013-02[2], titled "Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act" (Bulletin) — long a target of Congressional Republicans. The bureau's bulletin was viewed by many as an end-run around an express exclusion of auto dealers from bureau jurisdiction and some argued the Bureau's disparate impact program was based on flawed statistical methods.

The bulletin had warned indirect auto lenders that they may be liable under ECOA if dealer markup and compensation practices result in disparities on a prohibited basis, and the Bureau brought several enforcement actions predicated on the legal theory announced in the Bulletin.

In response to the joint resolution disapproving of the bulletin, acting bureau director Mick Mulvaney issued a statement[3] "thank[ing] the President and the Congress for reaffirming that the bureau lacks the power to act outside or federal statutes" and announcing that the bureau would be "reexamining the requirements of the ECOA." The statement referred to the Supreme Court's *Inclusive Communities* decision as "distinguishing between antidiscrimination statutes that refer to the consequences of actions [a reference to the Fair Housing Act] and those that refer only to the intent of the actor [a reference to ECOA]."

Mulvaney's statement confirmed that the new bureau leadership credits industry's view that ECOA only applies to intentional, or "disparate treatment," discrimination. Most recently, the Bureau included a potential ECOA rulemaking in the "Future Planning" section of its October 2018 Rulemaking Agenda[4], stating:

> The bureau announced in May 2018 that it is reexamining the requirements of the ECOA concerning the disparate impact doctrine in light of recent Supreme Court case law and the congressional disapproval of a prior bureau bulletin concerning indirect auto lender compliance with ECOA and its implementing regulations.

Meanwhile, industry trade associations and others have already begun to advocate before the bureau that ECOA "does not provide for disparate impact claims," as one comment letter put it.

At the same time, in direct response to the *Inclusive Communities* decision, the U.S. Department of Housing and Urban Development is reconsidering[5] its implementation of disparate impact under the Fair Housing Act, drawing over 500 public comments on a range of issues including HUD's longstanding burden-shifting framework, the relevant decisions, the causation standard, and whether any other changes to HUD's rules would be appropriate.

States respond

These developments drew a quick rebuke from state authorities that remain committed to monitoring for disparate impact in auto lending and beyond.

On August 23, 2018, the New York Department of Financial Services released updated guidance[6] on fair lending compliance for indirect auto lending. The NYDFS guidance, in effect, re-imposes the requirements of the bureau's earlier (now voided) bulletin, at least within the scope of the NYDFS' authority.

And on September 5, 2018, nineteen state Attorneys General wrote[7] to Acting Director Mulvaney warning that "any action to reinterpret ECOA not to provide for disparate impact liability could be set aside by a court as arbitrary, capricious, and otherwise not in accordance with law."

With four new Democratic Attorneys General installed following the November 2018 elections (in Colorado, Michigan, Nevada, and Wisconsin); a new, purpose-built consumer financial protection body within the Attorney General's office in Pennsylvania; and the legislatively created Maryland Financial Consumer Protection Commission, these state-level trends are sure to continue.

Fair-lending tension builds

These fair lending developments illustrate two cross-cutting initiatives currently at work in the area of financial regulation.

First is the federal regulators' deregulatory push, exhibited recently by the federal banking agencies denunciation of informal agency guidance as a tool of regulation. Institutions have been constrained by, but also benefited from, informal issuances such as the bureau's indirect auto bulletin. Industry has sometimes resisted so-called "guidance" that agencies issue without notice and comment process or the other trappings of rulemaking.

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Evidently responding to these criticisms, the federal banking agencies recently announced[8] (through guidance, no less) a new set of principles for the use of supervisory guidance for regulated institutions. The interagency announcement:

- "Confirms" that supervisory guidance does not have the force and effect of law.
- States that the agencies will not take enforcement actions based on supervisory guidance, but rather, any such action will be predicated on a law or rule.
- Explains that supervisory guidance can outline supervisory expectations or priorities and articulate general views regarding appropriate practices in a given area.

By not altogether dismissing the relevance of supervisory guidance, the agencies' announcement implicitly recognizes the fundamental tension in this area — that guidance often benefits regulated institutions by providing certainty, even if some guidance is not well-considered.

Second, as the bureau and other regulators retrench and adopt a deregulatory posture, state authorities (particularly of the opposing party) are stepping into the breach.

State authorities have their own laws to enforce fair lending, in addition to the ability to advance disparate impact cases under the federal ECOA. The states' authority is not constrained by acting director Mulvaney's disapproval of the disparate impact theory of liability. State authority to enforce federal would be significantly limited, however, if the bureau were to effectuate its "reexamination" with a rulemaking.

In the meantime, the bureau's official interpretation[9] of ECOA continues to provide for liability through disparate impact, and at least some states have signaled their faith in this approach.

Notes

1 *Joint Resolution*, S.J. Res. 57: Congressional Record, Vol. 164 (2018), 132 Stat. 1290, Public Law 115-72 — May 21, 2018, 115th Congress, 1 page, https://www.congress.gov/115/plaws/publ172/PLAW-115publ172.pdf.

2 *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act*, Consumer Financial Protection Bureau Bulletin 2013-02, 6 pages, dated March 21, 2013, found at https://www.dwt.com/files/Uploads/Documents/Publications/Auto%20Finance%20Bulletin.pdf.

3 *Statement of the Bureau of Consumer Financial Protection on enactment of S.J. Res. 57*, Consumer Financial Protection Bureau – Newsroom, dated May 21, 2018, found at https://www.consumerfinance.gov/about-us/newsroom/statement-bureau-consumer-financial-protection-enactment-sj-res-57/.

4 Cochran, Kelly, *Fall 2018 rulemaking agenda*, Consumer Financial Protection Bureau – Blog, dated October 17, 2018, found at https://www.consumerfinance.gov/about-us/blog/fall-2018-rulemaking-agenda/.

5 *Reconsideration of HUD's Implementation of the Fair Housing Act's Disparate Impact Standard – A Proposed Rule by the Housing and Urban Development Department on 06/20/2018*, 83 FR 28560-28562, found at https://www.federalregister.gov/documents/2018/06/20/2018-13340/reconsideration-of-huds-implementation-of-the-fair-housing-acts-disparate-impact-standard.

6 *Indirect Automobile Lending and Compliance with New York's Fair Lending Statute*, Memo from Maria T. Vullo, Superintendent of Financial Services, New York State Department of Financial Services, 4 pages, dated August 23, 2018, found at https://www.dfs.ny.gov/legal/industry/il180823.pdf.

7 Letter to Mick Mulvaney, Acting Director of the Consumer Financial Protection Bureau, from Josh Stein, Attorney General, North Carolina Department of Justice, 5 pages, dated September 5, 2018, found at https://ncdoj.gov/getattachment/36142f21-0b34-4955-8f8a-c5d92051662b/ECOA-disparate-impact-letter-to-CFPB-final.pdf.aspx.

8 *Agencies issue statement reaffirming the role of supervisory guidance*, Board of Governors of the Federal Reserve System – Press Release, dated September 11, 2018, found at https://www.federalreserve.gov/newsevents/press?releases/bcreg20180911a.htm.

9 Bureau of Consumer Financial Protection, Pt. 1002, Supp. I, pages 91-107, found at https://www.gpo.gov/fdsys/pkg/CFR-2014-title12-vol8/pdf/CFR-2014-title12-vol8-part1002-appI.pdf.

CONSUMER & ENFORCEMENT UPDATE

9TH CIR. JUDGES URGE *EN BANC* REVIEW OF ITS $1.3B DECISION

A 9th U.S. Circuit Court of Appeals panel recently affirmed a district court judge's $1.27 billion award of restitution to the Federal Trade Commission in a deceptive practices case against a payday lender. (*Federal Trade Commission v. AMG Capital Management, LLC, et al.*, No. 16-17197, 2018 WL 6273036 (9th Cir. 12/03/18).)

But in a highly unusual move, two of the three judges on the panel, while concurring with the unanimous opinion, called for the 9th Circuit to convene *en banc* and revisit its 2016 decision setting the precedent that compelled the ruling.

The case began in April 2012 when the FTC brought an action against racecar driver Scott A. Tucker, and several related corporate defendants and certain tribal entities in federal court. The agency alleged that the high-fee payday loans the defendants offered violated Section 5 of the FTC Act, codified at 15 U.S.C. § 45(a)(1). The district court in May 2014 ruled that the large-font prominent print in the defendants' loan note and disclosure documents was deceptive in that it implied that borrowers would incur only one finance charge.

The district court found that the fine print that followed in the note and documents created a process under which multiple finance charges would automatically be incurred unless borrowers took affirmative action. (*FTC v. AMG Services, Inc., et al.*, 29 F.Supp.3d 1338 (D. Nev. 05/28/18), *as clarified*, No. 12-536, 2014 WL 12788195 (D. Nev. 07/16/14).) Some of the payday lender defendants reached settlements with the FTC. The agency then moved for summary judgment against the remaining defendants.

The district court in September 2014, citing its power to order equitable monetary relief under § 13(b) of the FTC Act, ruled that the FTC was entitled to $1.27 billion in equitable monetary relief from the payday lender defendants. The FTC call this the largest litigated judgment it had ever obtained. (*FTC v. AMG Services, Inc., et al.*, No. 12-536, 2016 WL 5791416 (D. Nev. 09/30/16).) The defendants appealed.

Section 13(b) of the FTC Act allows judges to order injunctions against FTC defendants. However, as Judge Diarmuid O'Scannlain explained in the 9th Circuit panel's decision affirming the district court's order, § 13(b) has been widely interpreted by federal appellate courts. The 4th, 7th, 8th, and 11th Circuits hall permit money awards for defendants deemed liable for deceiving consumers.

The 9th Circuit itself has repeatedly said, most recently in 2016's *FTC v. Commerce Planet, Inc., et al.*, 815 F.3d 593 (9th Cir. 2016), that § 13(b) gives trial judges the power to grant whatever relief they deem appropriate "to accomplish complete justice, including restitution." Tucker argued that the U.S. Supreme Court's 2017 ruling in *Kokesh v. SEC*, 137 S.Ct. 1635 (2017), means that *Commerce Planet* is no longer good law.

The *Kokesh* Court said that disgorgement orders imposed as sanctions for securities law violations are penalties. Tucker asserted that the monetary relief awarded to the FTC was similarly a penalty and that § 13(b) can't be used to award penalties. Judge O'Scannlain, writing for the unanimous panel that, although there was merit to the argument that *Kokesh* supersedes the 9th Circuit's *Commerce Planet* precedent, it fell short.

"A three-judge panel may not overturn prior circuit authority unless it is 'clearly irreconcilable with the reasoning or theory of intervening higher authority,'" Judge O'Scannlain wrote. "Such threshold is not met here." The Supreme Court expressly limited the implications of its *Kokesh* ruling, the court said, and the 9th Circuit in *Commerce Planet* specifically rejected the argument that § 13(b) limits trial judges to traditional means of equitable relief.

"Because *Kokesh* and *Commerce Planet* are not clearly irreconcilable, we remain bound by our prior interpretation of § 13(b)," the opinion said. But Judge O'Scannlain also thinks the 9th Circuit was wrong in *Commerce Planet.*

In his concurrence, joined by Judge Carlos T. Bea, he urged the 9th Circuit *en banc* to use the Tucker case as a vehicle to correct "our circuit's unfortunate interpretation of the Federal Trade Commission Act." Judge O'Scannlain said the 9th Circuit's holding that § 13(b) empowers judges to award monetary relief to the FTC is no longer tenable.

"Because the text and structure of the statute unambiguously foreclose such monetary relief, our invention of this power wrests from Congress its authority to create rights and remedies," he wrote. "And the Supreme Court's recent decision in *Kokesh v. SEC* undermines a premise in our reasoning: that restitution under § 13(b) is an 'equitable' remedy at all. Because our interpretation wrongly authorizes a power that the statute does not permit, we should rehear this case *en banc* to relinquish what Congress withheld."

Judge O'Scannlain noted that the Supreme Court has explicitly ended the "*ancien regime*" in which courts empowered themselves to fashion equitable remedies. Now the justices are far more cautious about finding implied causes of action, Judge O'Scannlain said, which means limiting the interpretation of a law like the FTC Act to what Congress actually said.

Paul C. Ray in North Las Vegas, Nev., represented the AMG defendant-appellants. Imad D. Abyad, Theodore P. Metzler. Joel Marcus, and David C. Shonka of the FTC in Washington, D.C., represented the plaintiff-appellee.

MASS. D.C.: STATE COURTS CAN INTERPRET FTC's TSR

The U.S. District Court, District of Massachusetts recently concluded that state courts are capable of interpreting the Federal Trade Commission's

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telemarketing sales rule and its impact on the Massachusetts Consumer Protection Act (Ch. 93A) and will not undermine the national regulatory framework. (*Commonwealth of Massachusetts v. DMB Financial, LLC, et al.*, No. 18-11120, 2018 WL 6199566 (D. Mass. 11/28/18).)

Judge Allison D. Burroughs found that debt relief company DMB Financial and Global Client Solutions, the transaction servicer that worked with DMB, will be forced to defend claims of violating Ch. 93A in state court. The state did not assert a federal cause of action and the defendants could not establish federal jurisdiction through complete preemption or by showing a significant federal interest.

The state alleges that DMB and Global violated Chapter 93A by making unfair and deceptive representations about DMB's debt-restructuring program. The state also alleges that DMB provided unauthorized legal advice and enriched itself by pilfering the accounts that Global established and maintained for consumers in the debt-restructuring program.

Global is also accused of distributing settlement fees to DMB without consumer authorization and before payments were made pursuant to a negotiated settlement, and distributing a fee calculated on an inflated amount of debt. While the complaint does not cite the FTC's TSR, it shows an awareness of the TSR, and the state acknowledges that Chapter 93A incorporates laws under the FTC Act.

Global sought removal of the case to federal district court, arguing that the action should have been filed under federal law pursuant to 15 U.S.C. § 6103(a), under which state attorneys general may bring civil actions in the federal district courts based on a pattern or practice of telemarketing which violates any FTC rule. The state filed for remand.

Global argued that it operates within a specific niche created by the 2010 amendments to the TSR, which allows certain entities to provide services in connection with consumer accounts that are not insured depositories or debt relief providers. Here, Global said there are two circumstances whereby federal courts have arising-under jurisdiction when a plaintiff raises no federal cause of action: complete federal preemption and state-law claims implicating significant federal issues.

The district court disagreed with the account provider's complete preemption argument because Congress was clear through statutory language that it intended for the states to enforce their laws in state courts. Moreover, it did not establish an exclusive federal cause of action for the claims.

Secondly, the court relied on the four-prong significant-federal-interest test created by the U.S. Supreme Court in *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308 (2005), and determined that the state law cause of action could not form the basis for federal arising-under jurisdiction.

The court recognized that federal issues could be raised or disputed here and, while the complaint does not cite the TSR, the state showed awareness of the TSR. However, the federal issues are not substantial because Massachusetts state courts are competent to interpret the TSR and Ch. 93A, and would not undermine the FTC's regulatory framework. Plus, Global did not argue that a significant number of cases would be affected by the outcome of this case.

The district court observed that the case involves fact-specific claims under Ch. 93A — whether the companies committed unfair or deceptive acts and whether the account provider had knowledge of the debt relief company's settlement-fees calculation. Vesting federal jurisdiction for this fact-specific case would disturb the congressionally approved balance of federal and state judicial responsibilities, the court found.

Benjamin Golden and Max Weinstein of the Mass. Attorney General's office in Boston represents the state. Richard W. Epstein (in Fort Lauderdale, Fla.), Meredith H. Leonard (in New York) of Greenspoon Marder; and Michael S. Gardener of Mintz Levin Cohn Ferris Glovsky & Popeo in Boston represent Global. Shepard Davidson and Gregory S. Paonessa of Burns & Levinson in Boston represent DMB.

D.C. STUDENT-LOAN SERVICER LAW INVALIDATED

The U.S. District Court, District of Columbia has found that Washington, D.C., cannot impose its own licensing requirements on servicers of federally owned student loans. (*In re Student Loan Servicing Alliance v. Taylor, et al.*, No. 18-640, 2018 WL 6082963 (D.D.C. 11/21/18).)

Judge Paul Friedman said the regulations are preempted by the U.S. Higher Education Act, which gives the federal government the right to contract with servicers for federal student loans. By imposing additional licensing requirements, the district's regulations would interfere with that right, Judge Friedman said.

The regulations were issued by the D.C. department of insurance, securities and banking pursuant to a local law passed in 2016 to regulate student loan servicers in the district. The rules required servicers to apply for a license, post a bond, and pay a variety of fees before they can operate in the district. The Student Loan Servicing Alliance sued the district in March 2018 to have the regulations overturned.

The decision bars enforcement of the district's rules against servicers of student loans, issued under

the Ford Federal Direct Loan Program, which accounts for about $1.1 trillion in loans — more than 79 percent of all federal student loans. However, court found that the D.C. rules can stay in place for servicers of commercial Federal Family Education Loan Program loans, owned by banks and other entities rather than the government. (FFELP loans were discontinued by Congress in 2010; over 90 percent of new student loans today are made through the FDLP.)

In its lawsuit, SLSA had said the regulations are preempted because they would allow the DISB to decide who is fit to be a servicer, substituting its judgment for that of the federal government. The DISB had argued preemption does not apply because its rules concern consumer protection, an area that traditionally has been the domain of the states.

The states' historic police powers cannot be superseded by federal law unless Congress clearly states that intention, which it did not do in the Higher Education Act, DISB said. However, Judge Friedman said preemption applies when a state law "stands as an obstacle" to the goals of a federal law.

Because the district's rules impede the federal government's ability to contract with servicers, they are preempted, Judge Friedman said. *David Meschke, Richard Benenson, and Christopher O. Murray of Brownstein Hyatt Farber Schreck in Denver represented SLSA. Gregory M. Cumming and Jessica N. Krupke of the D.C. Office of Attorney General in Washington, D.C., represented the DISB.*

SANTANDER TO PAY $11.8M OVER AUTO LOANS, GAP INSURANCE

The Bureau of Consumer Financial Protection in an administrative proceeding has fined fines Santander Consumer USA Holdings Inc. $11.8 million to settle claims that it misled customers about the cost and terms of auto loans and insurance.

Santander Consumer, an affiliate of the Spanish banking group Banco Santander SA, had promised drivers lower monthly fees by allowing them to make interest-only payments without explaining this would increase the total cost of the loan, the BCFP said. The bank also allegedly failed to explain to customers that guaranteed auto protection insurance policies would not always cover the costs of replacing a car that was destroyed in an accident.

Santander Consumer is one of the largest U.S. subprime auto lenders and manages about $52 billion in loans to 2.7 million customers, according to the lender. The BCFP penalty is less than half the $26 million penalty that state officials in Massachusetts and Delaware fined the subprime lender in a separate settlement reached in March 2017, as reported by *Reuters*. (https://reut.rs/2ON2Gm6)

As described in the consent order, the bureau found that Santander violated the Consumer Financial Protection Act of 2010 by not properly describing the benefits and limitations of its S-GUARD GAP product, which it offered as an add-on to its auto loan products. Santander also failed to properly disclose the impact on consumers of obtaining a loan extension, including by not clearly and prominently disclosing that the additional interest accrued during the extension period would be paid before any payments to principal when the consumer resumed making payments.

Under the terms of the consent order, Santander must, among other provisions, provide approximately $9.29 million in restitution to certain consumers who purchased the add-on product, clearly and prominently disclose the terms of its loan extensions and the add-on product, and pay a $2.5 million civil money penalty. *Find the BCFP consent order with Santander at* files.consumerfinance.gov/f/documents/bcfp_santander-consumer-usa_consent-order_2018-11.pdf.

PENSION BUYOUTS BRING $52M IN PENALTIES

The Virginia Attorney General's office won more than $50 million in debt relief and civil penalties from Future Income Payments LLC, FIP LLC, and their owner, Scott Kohn, for making illegal, high-interest loans to more than 1,000 Virginia veterans and retirees in violation of the Virginia Consumer Protection Act. (*Commonwealth of Virginia v. Future Income Payments, LLC, et al.*, No. CL18000527-00 (Va. Circuit Court 10/22/18).)

The court also found that FIP's agreements were usurious and issued an injunction preventing further violations of the state's Consumer Protection Act. The suit was filed in March 2018, alleging that FIP had made a significant number of illegal loans that were believed to be concentrated in Northern Virginia and Hampton Roads, two areas of Virginia with large populations of retired veterans and civil servants with pensions.

The suit claimed that FIP disguised its illegal, high interest loans as "pension sales" that could provide Virginia pension holders with a quick lump sum of cash. The complaint cited the outrageous exploitation of one Virginia veteran who received a $5,500 loan from FIP and was required to pay $40,920 over five years.

Judge Bonnie L. Jones awarded the following:

- $20,098,159.63 in debt forgiveness for borrowers.
- $31,740,000.00 as a civil penalty.
- $414,473.72 in restitution.
- $198,000.00 for costs and attorneys' fees.

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James Scott, Mark Herring, and Cynthia Hudson of the Virginia Attorney General's office in Richmond, Va., represented the state. Conrad M. Shumadine in Norfolk, Va., represented FIP.

UBS SUED OVER CRISIS-ERA RMBS

The U.S. government filed a civil fraud lawsuit accusing UBS Group AG, Switzerland's largest bank, of defrauding investors in its sale of residential mortgage-backed securities leading up to the 2008-09 global financial crisis. (*U.S. v UBS Securities LLC, et al.*, No. 18-06369 (E.D.N.Y., *complaint filed* 11/08/18).)

UBS was accused of misleading investors about the quality of more than $41 billion of subprime and other risky loans backing 40 RMBS offerings in 2006 and 2007, the U.S. Department of Justice said in a complaint filed in U.S. District Court, Eastern District of New York. The lawsuit came after UBS rejected a government proposal that it pay nearly $2 billion to settle, according to a person familiar with the talks who was not authorized to speak publicly about them, according to *Reuters*.

While UBS was not a big originator of U.S. residential home loans, U.S. Attorney Richard Donoghue in Brooklyn said investors suffered "catastrophic losses" from the bank's failure to fully disclose the risks of mortgage securities it helped sell. A UBS spokesman and a Justice Department spokeswoman declined to comment on the settlement talks, but the bank said it will fight the lawsuit.

"The DOJ's claims are not supported by the facts or the law," it said in a statement. "UBS is confident in its legal position and has been fully prepared for some time to defend itself in court."

U.S. officials are seeking unspecified fines against UBS under a federal law allowing it to pursue penalties up to the amounts the bank gained or others lost from alleged misconduct. The case is one of the last addressing alleged misconduct in the pooling and sale by large banks of RMBS that have been deemed a major cause of the financial crisis.

Bank of America Corp, Barclays Plc, Citigroup Inc, Credit Suisse Group AG, Deutsche Bank AG, Goldman Sachs Group Inc, HSBC Holdings Plc, JPMorgan Chase & Co, Morgan Stanley and Royal Bank of Scotland Group Plc previously settled similar suits.

The DoJ faulted UBS for having a business culture that placed a higher priority on profits than full disclosure to investors, who were deprived of crucial information about the quality of the loans underlying the securities they bought. The complaint quoted a UBS trader who in a 2006 instant message said "our crack due diligence effort is a joke," and a UBS mortgage employee who the same year complained to his bosses about the bank's ethics, including that "lying is ok."

Like UBS, Barclays had also resisted settling prior to being sued by the Justice Department. That case ended in March with a $2 billion settlement. UBS was among the banks hardest hit in the financial crisis and has said it lost more than $45 billion after the U.S. housing market collapsed.

It was not immediately clear how much UBS has set aside for the U.S. case, though analysts said it might be more than half the $1.20 billion it has reserved for so-called non-core legal risks. UBS is also fighting charges by investigators in France that it helped wealthy clients avoid taxes in that country, and turned down a $1.25 billion settlement offer, sources have told *Reuters*.

Bonni J. Perlin, Michael J. Castiglione, and Richard K. Hayes of the U.S. Attorneys Office in Brooklyn, N.Y., and Armen Adzhemyan of the USAO in Atlanta represent the U.S. Amanda F. Davidoff, Harry F. Murphy, Hilary Williams, Jacob Croke, Justin J. DeCamp, Michael T. Tomaino Jr., and Robert J. Giuffra Jr. of Sullivan & Cromwell in New York represent UBS.

SCOTUS DENIES NET NEUTRALITY PETITION

A truncated U.S. Supreme Court refused to grant *certiorari* to a telecommunications industry effort to wipe away an appellate court decision that had upheld the Federal Communications Commission's net neutrality rules that were in place prior to their 2017 repeal. (*US Telecom Ass'n v. Federal Communications Commission*, No. 17-504, 2018 WL 5779073 (U.S., *certiorari denied*, 11/05/18).)

The High Court's decision not to throw out the 2016 District of Columbia U.S. Circuit Court of Appeals ruling does not undo the 2017 repeal of the earlier policy. However, it leaves in place a legal precedent that might assist net neutrality supporters in any future legal battle if that policy is ever reintroduced. (*U.S. Telecom Ass'n v. FCC*, 825 F.3d 674 (D.C. Cir. 2016).

The industry had wanted to erase the 2016 ruling even though the Republican-led Federal Communications Commission in December 2017 voted to repeal the net neutrality rules. The policy reversal went into effect in June 2018.

The Supreme Court's brief order noted that three of the court's conservative justices — Clarence Thomas, Samuel Alito, and Neil Gorsuch — would have thrown out the appeals court decision. Significantly, neither Chief Justice John Roberts nor new appointee Brett Kavanaugh participated in the decision.

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Industry trade group US Telecom, one of the groups that challenged the 2015 net neutrality rules, said the high court's action was "not surprising." US Telecom said it would "continue to support" the repeal "from challenges in Washington, D.C., and state capitals."

The U.S. department of Justice also had filed suit to block California's state net neutrality law from taking effect in January 2019. The state agreed in October to delay enforcement of the law pending appeals of the net neutrality reversal.

The FCC voted 3-2 in December 2017 to reverse the earlier rules that had barred internet service providers from blocking or throttling traffic or offering paid fast lanes, also known as paid prioritization. The new rules, which gave internet service providers greater power to regulate the content that customers access, are now the subject of a separate legal fight after being challenged by many of the groups that backed net neutrality.

The net neutrality repeal was a win for providers like Comcast Corp., AT&T Inc., and Verizon Communications Inc. It was opposed by internet companies like Facebook Inc., Amazon.com Inc., and Alphabet Inc., Google's parent, which have said the repeal could lead to higher costs.

US Telecom's petition for a writ of certiorari was filed by Michael k. Kellogg, Scott H. Angstreich, and Dietrich Hill of Kellogg Hansen Todd Figel & Frederick in Washington, D.C.; and Jonathan Banks and Diane G. Holland of the USTA in Washington, D.C.

REGULATORY TRENDS

THE CURRENT ENVIRONMENT OF U.S. CRYPTOCURRENCY REGULATION

By Mauricio S. Beugelmans and Krista M. Hess

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As regulators grapple with how — or whether — to apply federal securities and commodities laws and regulations to cryptocurrencies and related products and entities, the regulatory framework continues to evolve quickly. This expert analysis is intended to serve as general guidance on the current regulatory environment within this new asset class.

The Commodity Futures Trading Commission was among the first regulatory authorities to assert jurisdiction over cryptocurrency-related products. In September 2015 the CFTC concluded in *In re Coinflip Inc.*, CFTC No. 15-29, 2015 WL 5535736 (09/17/15), that cryptocurrencies such as Bitcoin fit within the definition of "commodity" under the Commodity Exchange Act. Thus, derivatives markets in cryptocurrency are subject to the CFTC's supervision.

The U.S. District Court for the Eastern District of New York affirmed the CFTC's view in *CFTC v. McDonnell et al.*, No. 18-361, 2018 WL 1175156 (E.D.N.Y. 03/06/18). The court also held in *McDonnell* that the CFTC can use its enforcement powers to police fraud and market manipulation in cryptocurrency spot markets.

The CFTC in action

The CFTC has continued to focus on cryptocurrency and related derivatives products since those decisions were issued. It has taken action against unregistered cryptocurrency contract markets, disseminating warnings related to virtual currency markets and proposing interpretations related to its treatment of virtual currency transactions.

For example, the CFTC on Dec. 15, 2017, issued a proposed interpretation to inform the public of the agency's views as to the meaning of "actual delivery" within the specific context of retail commodity transactions in virtual currency.[1]

Also, on May 21, 2018, the CFTC staff issued an advisory providing guidance to exchanges and clearinghouses on listing virtual currency derivative products.[2] The advisory clarifies the staff's priorities and expectations in its review of such listings in an effort to help the subject entities meet their statutory and self-regulatory obligations.

The CFTC also launched a virtual currency resource webpage in December 2017. The page is designed to educate the public about virtual currencies, including by providing information about the potential risks of investing or speculating in cryptocurrencies or related products.

It contains links to CFTC primers on virtual currency and related topics and podcasts featuring

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CFTC staff discussing virtual currency and customer advisories — among other resources.

The role of the SEC

The Securities and Exchange Commission staff has opined informally that certain popular cryptocurrencies such as Bitcoin and Ethereum are not securities, the agency and its staff have also provided statements and guidance on initial coin offerings, online trading platforms, cryptocurrency and exchange traded funds, among other things.

- ***ICOs.*** Companies and individuals are increasingly using initial coin offerings to raise capital. ICOs typically involve investors exchanging either traditional fiat currency or cryptocurrency for a digital asset called a coin or token, which affords them certain rights or interests.

In July 2017 the SEC issued a report concluding that certain ICO tokens constituted investment contracts and therefore were securities under the federal securities laws.[3] Under the "*Howey* test" set forth in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), a coin or token constitutes an investment contract when there is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

Many ICOs promote the prospective increase in value of the tokens they offer and the ability to potentially trade those tokens on a secondary market, which gives them the characteristics of a security. SEC Chairman Jay Clayton stated during congressional testimony earlier this year his belief that every ICO token he had seen up to that time constituted a security. If an ICO involves an offering of securities, the entity conducting the ICO must follow all the processes and requirements mandated by the federal securities laws for registration, offering, and disclosure unless it qualifies for an exemption from registration.

The SEC has already launched investigations and brought enforcement actions against companies and individuals whose ICOs constituted an unregistered offering and sale of securities in violation of the federal securities laws.[4] To date, no ICOs have been successfully registered with the SEC, although the Praetorian Group became the first to file a registration statement for an ICO on March 6, 2018.

Some market professionals have restructured their tokens to provide some utility and rebranded them as "utility tokens" to prevent them from being deemed securities. The SEC has rejected this approach, believing it elevates form over substance. Such tokens will likely still be considered securities if they incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others.

- ***OTPs.*** Online trading platforms have emerged to allow investors to buy and sell the digital assets — coins and tokens — initially sold in ICOs. The SEC staff released a statement in March[5] warning that such platforms may have to register as national securities exchanges or operate pursuant to an exemption from registration, such as the exemption for alternative trading systems.

The statement added that online trading platforms that do not operate as an exchange under the federal securities laws, but offer digital wallet services or transact in digital assets that qualify as securities, may still be subject to other registration requirements such as those applicable to broker-dealers, transfer agents or clearing agencies.

- ***Cryptocurrency ETFs.*** The SEC has repeatedly rejected proposals by securities exchanges to list ETFs linked to cryptocurrency and related products.[6] The SEC has disallowed both ETFs that track the value of a cryptocurrency through investments in the spot market and ETFs that track the value of a cryptocurrency by investing in cryptocurrency futures contracts. In so doing, it has expressed concern about the increased potential for fraud and manipulation associated with the spot markets for these products.

An SEC staff letter, issued in January by Dalia Blass, director of the SEC's division of investment management, reflected the same concerns. The letter also said it would be inappropriate for the agency to allow registration of cryptocurrency ETFs until outstanding questions as to how the products would satisfy the requirements of the Investment Company Act of 1940 are answered.[7] Blass identified key outstanding questions relating to the valuation, liquidity and custody of cryptocurrency.

FINRA activity

The 2018 regulatory and examination priorities letter released Jan. 8 by the Financial Industry Regulatory Authority, the self-regulatory organization responsible for overseeing broker-dealers, reflected the organization's growing concern about the role broker-dealers play in cryptocurrency transactions and ICOs.

FINRA stated that "where such assets are securities or where an ICO involves the offer and sale of securities, FINRA may review the mechanisms — for example, supervisory, compliance and operational infrastructure — firms have put in place to ensure compliance with relevant federal securities laws and regulations and FINRA rules."

On July 6, FINRA issued a regulatory notice requesting that member firms notify the agency if they currently engage, or intend to engage, in activities related to cryptocurrency. The types of activities of interest to FINRA if undertaken (or planned) by a member, its associated persons or affiliates include, among other things, accepting cryptocurrency from customers, maintaining custody or similar arrangements of digital assets, managing a cryptocurrency fund, participating in ICOs and offering advice relating to cryptocurrency.[8] This request signals increased scrutiny by FINRA of its members' involvement in cryptocurrency-related endeavors.

State regulators: NASAA

State securities regulators also have the authority to bring enforcement actions against companies or individuals who make unregistered state securities offerings. These regulators have been investigating offerings and cryptocurrency exchanges in their states.

The North American Securities Administrators Association has issued statements warning investors of the risks of cryptocurrency-related investment products, and several states have brought enforcement actions regarding unregistered ICOs and related fraud. These states include Alabama, California, Massachusetts, New Jersey, North Carolina, South Carolina and Texas. In April the New York Attorney General's Office launched a virtual markets integrity initiative aimed at investigating the policies and practices of cryptocurrency exchanges.[9]

On May 21, 2018, NASAA announced a new initiative called Operation Crypto-Sweep.[10] State and provincial securities regulators from over 40 jurisdictions participated in this effort to crack down on cryptocurrency-related fraud, resulting in nearly 70 inquiries and investigations as well as 35 enforcement actions in the sweep's first few weeks.

NASAA also entered into a memorandum of understanding with the CFTC in May to increase coordination and information-sharing between state securities regulators and the CFTC. The MOU is intended to assist the participating regulators in enforcing the Commodity Exchange Act, particularly in relation to cryptocurrency derivatives.

A work in progress

Regulators are faced with the challenge of developing a balanced approach to cryptocurrency that protects investors without stifling innovation and the development of new technology. For now, cryptocurrency regulation remains a work in progress.

But in light of the continued focus on cryptocurrency by federal and state regulators, market participants and their counsel should pay close attention to the regulatory requirements and continue to diligently monitor new developments. Additional initiatives, regulatory guidance and enforcement actions are sure to materialize in the coming year.

Notes

1 Commodity Futures Trading Comm'n, Retail Commodity Transactions Involving Virtual Currency, 82 FR 60335 (Dec. 20, 2017), https://bit.ly/2O4Jik1.

2 Commodity Futures Trading Comm'n, Advisory with Respect to Virtual Currency Derivative Product Listings, CFTC Staff Advisory No. 18-14 (May 21, 2018), https://bit.ly/2s97Lsv.

3 Sec. & Exch. Comm'n, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Release No. 81207 (July 25, 2017), https://bit.ly/2uySAZs.

4 *See, e.g.,* Press Release, Sec. & Exch. Comm'n, Company Halts ICO After SEC Raises Registration Concerns (Dec. 11, 2017), https://bit.ly/2z1zcbq; Press Release, Sec. & Exch. Comm'n, SEC Halts Alleged Initial Coin Offering Scam (Jan. 30, 2018), https://bit.ly/2DVU3An; Jean Eaglesham & Paul Vigna, Cryptocurrency Firms Targeted in SEC Probe, WALL ST. J. (Feb. 28, 2018), https://on.wsj.com/2HQfYIa.

5 Sec. & Exch. Comm'n, Statement on Potentially Unlawful Online Platforms for Trading Digital Assets: Joint Public Statement of Divisions of Enforcement and Trading and Markets (Mar. 7, 2018), https://bit.ly/2Fm6T8s.

6 *See* Bats BZX Exch. Inc., Exchange Act Release No. 34-83723 (July 26, 2018), https://bit.ly/2zqlQFT; NYSE Arca Inc., Exchange Act Release No. 34-83904 (Aug. 22, 2018), https://bit.ly/2w7rYkf; NYSE Arca Inc., Exchange Act Release No. 34-83912 (Aug. 22, 2018), https://bit.ly/2IcFzvt; CBOE BZX Exch. Inc., Exchange Act Release No. 34-83913 (Aug. 22, 2018), https://bit.ly/2Mr8npj.

7 Dalia Blass, Dir., Sec. & Exch. Comm'n, Div. of Inv. Mgmt., Staff Letter: Engaging on Fund Innovation and Cryptocurrency-related Holdings (Jan. 18, 2018), https://bit.ly/2DpXsaj.

8 Fin. Indus. Regulatory Auth., Digital Assets: FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets, Regulatory Notice 18-20 (July 6, 2018), https://bit.ly/2IbnE8n.

9 Press Release, N.Y. Atty. Gen.'s Office, A.G. Schneiderman Launches Inquiry into Cryptocurrency "Exchanges" (Apr. 17, 2018), https://on.ny.gov/2ERCFJn.

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[10] Press Release, N. Am. Sec. Admin'rs Ass'n, State and Provincial Securities Regulators Conduct Coordinated International Crypto Crackdown (May 21, 2018), https://bit.ly/2IVARFf.

PRIVACY & SECURITY MATTERS

PREMERA BLUE CROSS SANCTIONED FOR DESTROYING BREACH EVIDENCE

The U.S. District Court, District of Oregon approved sanctions against Premera Blue Cross for destroying a computer hard drive and server logs that may have contained evidence relevant to an ongoing data-breach class action against the insurer. Judge Michael H. Simon of the District of Oregon on Nov. 5 ruled that the class-action plaintiffs, whose information was compromised, may inform the jury about the destruction of evidence. (*In re Premera Blue Cross Customer Data Security Breach Litigation*, MDL No. 2633, 2018 WL 5786206 (D. Or. 11/05/18).)

Judge Simon prohibited Premera from arguing the hard drive and server logs did not contain relevant information. However, he added that the court "will not instruct the jury that it must or even may make certain 'adverse inferences' against Premera," or about what could have been on the hard drive or logs.

The breach occurred in March 2015 when hackers stole the personally identifiable information of an estimated 11 million members and employees from the company's computer network. The stolen PII included victims' names, dates of birth, Social Security numbers, member identification numbers, mailing addresses, telephone numbers, email addresses, medical claims information, financial information, and other protected health information.

Premera was hit with eight lawsuits in two federal courts after announcing the breach. The Judicial Panel on Multidistrict Litigation consolidated the suits in the District of Oregon in June 2015. The amended consolidated complaint, filed in September 2016, includes 10 common law and statutory claims, including claims for negligence, breach of contract and violations of several state consumer protection and data breach notification laws.

Earlier the plaintiffs in the consolidated class action asked the court to approve discovery sanctions against Premera for destroying the hard drive of a computer the company identified as having been compromised in the breach. The plaintiffs also accused the insurer of destroying logs that recorded network activity on the company's servers and would have revealed whether the hackers exfiltrated victims' PII using outside e-mail addresses.

The plaintiffs asked Judge Simon to order instructions for the jury to presume that victims' PII had been exfiltrated and to prohibit Premera from arguing that there was no evidence of exfiltration. They also asked the judge to bar the insurer from introducing any expert testimony about the destroyed computer or logs.

Premera argued it had destroyed the computer hard drive and server logs inadvertently and that the plaintiffs suffered no prejudice because the destroyed evidence contained no relevant information. Judge Simon found that Premera had failed to take reasonable steps to preserve the evidence.

"With a massive data breach, many lawsuits, including putative class actions, and federal and state investigations, it was not reasonable for Premera not to track all ... affected computers and confirm that they all were being adequately preserved," Judge Simon wrote. However, the judge accepted Premera's argument that it destroyed evidence inadvertently. He therefore refused to instruct the jury to make adverse inferences against Premera based on the destroyed evidence.

Instead, Judge Simon said the plaintiffs could inform the jury that Premera destroyed the hard drive and server logs and make appropriate arguments about the implications of their destruction. The judge also precluded Premera from introducing expert testimony to suggest that the destroyed hard drive and server logs contained no evidence about whether the hackers had successfully exfiltrated victims' PII.

Kim D. Stevens, Christopher I. Brain, and Jason T. Dennett of Tousley Brain Stephens in Seattle; Keith S. Dubanevich, Steve D. Larson, and Yoona Park of Stoll Berne Lokting & Shlachter in Portland, Or.; Tina Wolfson of Ahdoot & Wolfson in West Hollywood, Calif.; James Pizzirusso of Hausfeld in Washington, D.C.; and Karen H. Riebel and Kate M. Baxter-Kauf of Lockridge Grindal Nauen in Minneapolis represented the plaintiffs. Paul G. Karlsgodt (in Denver), James A. Sherer (in New York), Daniel R. Warren, and David A. Carney (in Cleveland of Baker-Hostetler; and Darin M. Sands of Lane Powell in Portland, Or., represented Premera.

DATA-BREACH CLASS ACTION DISMISSED AGAINST RESTAURANT CHAIN

The U.S. District Court, Middle District of Florida dismissed for lack of standing a putative class action brought against fast-food chain PDQ over a data breach that exposed customers' credit-card details for

almost a year. (*Tsao v. Captiva MVP Restaurant Partners LLC*, No. 18-1606, 2018 WL 5717479 (M.D. Fla. 11/01/18).)

PDQ owner Captiva MVP Restaurant Partners LLC, which operates nearly 70 restaurants in multiple states, announced in June that an unknown hacker had gained access to its point-of-sale system from May 2017 through April 2018, exposing customers' names, credit card numbers, expiration dates and verification codes.

Florida resident I Tan Tsao sued Captiva in Tampa federal court in July, alleging he had made multiple purchases at PDQ restaurants during the breach period using two Visa Rewards credit cards. The breach forced Tsao to cancel the cards, costing him the opportunity to earn additional rewards while waiting for replacements to arrive, the suit said. Tsao and the rest of the putative class suffered an increased risk of identity theft due to the breach, according to the suit.

The complaint included claims for breach of implied contract, negligence, negligence per se, unjust enrichment, declaratory judgment and violations of Florida's Unfair and Deceptive Trade Practices Act.

Captiva moved to dismiss the suit, saying that Tsao lacked standing to sue because he failed to allege his credit card information had actually been misused as a result of the breach. The motion also cited previous federal court decisions rejecting the argument that plaintiffs have standing to sue based on the increased risk of identity theft following a data breach. (*Stapleton v. Tampa Bay Surgery Ctr. Inc.*, 2017 WL 3732102 (M.D. Fla. 08/30/17).)

Judge William F. Jung agreed and dismissed the suit without prejudice. Tsao lacked standing because he could not point to any instances of actual identity theft linked to the breach, and his fear of future identity theft was too speculative to form the basis of a federal lawsuit.

Judge Jung also rejected Tsao's argument concerning his lost opportunity to accrue rewards points while waiting for replacement cards, using a Latin phrase that means "the law does not concern itself with trifles."

Francis J. Flynn Jr. in Los Angeles; James J. Rosemergy of Carey, Danis & Lowe in St. Louis; and Steven W. Teppler of Edelson McGuire in Jacksonville, Fla., represented Tsao. Marie A. Borland and Robert A. Shimberg of Hill Ward Henderson in Tampa, Fla., represented Captiva.

BOTS BLOCKED FROM BIG TICKET BUYS

Ticketmaster has settled its claims against a software firm for allegedly developing automated bots that allowed online resellers to quickly buy large numbers of tickets in violation of Ticketmaster's terms of use. (*Ticketmaster LLC v. Prestige Entertainment West Inc., et al.*, No. 17-cv-7232, 2018 WL 5668631 (C.D. Cal., *stipulation re: permanent injunction filed* 10/31/18).

The software firm, Fast Software Solutions LLC, agreed to support Ticketmaster's request that Judge Otis D. Wright II of the U.S. District Court, Central District of California enter a permanent injunction barring the firm from continuing to create or use the ticket-buying bots.

The litigation began in October 2017 when Ticketmaster sued two online ticketing outfits, Prestige Entertainment West and Renaissance Ventures, for allegedly using automated software to place more than 300,000 online ticket orders from 2015 to 2016. The terms of use from Ticketmaster's website and mobile app prohibit users from deploying bots to automatically purchase tickets, and the company has implemented various security measures in an attempt to block such purchases.

Ticketmaster claimed that the use of automated software by online resellers such as Prestige and Renaissance harms Ticketmaster by depriving legitimate users of the opportunity to purchase tickets for popular events from its website or app. Ticketmaster's first amended complaint accused Prestige and Renaissance of breach of contract, copyright infringement, and violation of the Digital Millennium Copyright Act and the Computer Fraud and Abuse Act.

The suit also accused several unknown defendants of assisting Prestige and Renaissance by creating and marketing automated software that had the capacity to circumvent Ticketmaster's online security measures and to allow users to automatically purchase tickets in bulk. Ticketmaster filed a second amended complaint in June, identifying Fast Software as the entity that developed the ticket-buying bots and continuously upgraded them to bypass the company's security measures.

Ticketmaster notified Judge Wright that it had reached a settlement with Fast Software and its owner Christopher Walsh before the software firm officially responded to the allegations. In exchange for Ticketmaster agreeing to drop its claims, Fast Software supports a proposed order that would enjoin it from creating or using software that automatically purchases tickets from the company's website or mobile app.

The proposed order also expressly prohibits Fast Software from attempting to circumvent Ticketmaster's online security measures, exceeding per-event ticket limits as posted on the website, or maintaining more than one user account at a time. *Andrew M. Gass, Daniel M. Wall, and Kirsten M. Ferguson of Latham & Watkins in San Francisco; and Alexandra N. Hill, Donald R. Brown, Mark S. Lee, and Robert H.*

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Platt of Manatt Phelps & Phillips in Los Angeles represented Ticketmaster. Benjamin K. Semel (in New York), Thomas H. Vidal, and Benjamin S. Akley (in Los Angeles) of Pryor Cashman represented the defendants.

BIPA SUIT STAYS DEAD

The U.S. District Court, Northern District of Illinois has refused to reconsider his dismissal of a proposed class-action lawsuit accusing Southwest Airlines of collecting its workers' fingerprint data without following the notice and consent requirements of Illinois' Biometric Information Privacy Act. U.S. District Judge Marvin E. Aspen said the proposed amendments to the complaint did not change his conclusion that the workers' claims were subject to mandatory arbitration under their collective bargaining agreement with Southwest. (*Miller v. Southwest Airlines Co.*, No. 18-86, 2018 WL 5249230 (N.D. Ill. 10/22/18).)

The litigation began in November 2017 when three Chicago-based Southwest employees sued the airline in the Cook County Circuit Court for requiring them to scan their fingerprints on biometric devices to verify their attendance at work. The complaint accused Southwest of failing to comply with the notice and consent requirements of BIPA.

Southwest removed the suit to federal court in January and the workers filed an amended complaint in April with additional claims for intrusion upon seclusion, conversion, negligence, fraud, breach of contract, and breach of implied contract. Southwest moved to dismiss, arguing that each of the claims was subject to mandatory arbitration under the terms of the workers' collective bargaining agreement.

Judge Aspen granted Southwest's motion to dismiss without prejudice and entered judgment for the airline. He reasoned that arbitration was the proper venue for the workers' claims because they could not be resolved without interpreting the language of the parties' labor agreement. The agreement provided that Southwest had the "right to manage and direct the workforce," which could be interpreted to include its decision to require employees to use the biometric timekeeping system.

The workers moved for reconsideration, arguing that the judge had erred by entering judgment for Southwest after dismissing the amended complaint without prejudice. The workers proposed second amended complaint focused solely on the airline's alleged BIPA violations and did not include any additional common law or contract claims.

The privacy rights that Southwest allegedly violated by not following BIPA's notice and consent requirements existed independently of the collective bargaining agreement and were therefore not subject to mandatory arbitration, the workers argued. Judge Aspen denied their motion.

Judge Aspen concluded that the workers' proposed second amended complaint did nothing to change his conclusion that their claims were subject to mandatory arbitration under the terms of their collective bargaining agreement with Southwest. The court would still be required to interpret the language from the parties' labor agreement granting Southwest the "right to manage and direct the workforce" in order to resolve the workers' claims under BIPA.

Steven A. Hart, Brian H. Eldridge, John S. Marrese, Kyle Pozan, and Robert J. McLaughlin of Hart McLaughlin & Eldridge in Chicago; and Antonia M. Romanucci of Romanucci & Blandin in Chicago represented the plaintiffs. Melissa A. Siebert, Bonnie K. DelGobbo, Erin B. Hines, Suzanne M. Alton de Eraso (in Chicago), and Jeremiah L. Hart (in Columbus, Ohio) of Baker & Hostetler represented Southwest.

WALMART SUED OVER VIDEO-PURCHASE DISCLOSURES TO FACEBOOK

Consumers who purchased DVDs from walmart.com are suing the retail giant in California state court for allegedly disclosing information about their purchases to Facebook without their consent for targeted advertising. (*Cappello v. Walmart Inc. et al.*, No. 18923367, 2018 WL 4853315 (Cal. Super. Ct., *complaint filed* 10/04/18).)

The putative class action, filed in California Superior Court, accuses Walmart of violating the federal Video Privacy Protection Act and state consumer privacy laws that prohibit companies from sharing information about customers' video purchases to third parties without first obtaining written consent.

Walmart, which sells video media, installed code on its website that allows it to track consumers' purchases and provide targeted advertising related to those purchases through Facebook. The code, called a "Facebook pixel," automatically discloses information about the customer's identity and the items he or she purchased on Walmart's website to the social media platform. Walmart does not seek consumers' express written consent before transmitting their data to Facebook, according to the suit.

Named plaintiffs Alicia Cappello and Catherine Mosqueda each allege that they bought DVDs from walmart.com and that as a result, the Facebook pixel automatically shared information about their purchases. They sued Walmart in California state court, saying that the retailer violated the VPPA; Cal. Civ. Code § 1799.3 (which also prohibits the unauthor-

ized disclosure of video purchasing information), and California's unfair competition law.

The plaintiffs seek to represent a nationwide class of consumers who purchased DVDs or other video media from Walmart's website within the past two years, in addition to a California subclass. The complaint asks the court to order Walmart to stop disclosing consumers' personal information to Facebook and to award the class liquidated damages of at least $2,500 per statutory violation. *Ray E. Gallo, Dominic R. Valerian, and Nathaniel M. Simons of Gallo Law in Berkeley, Calif., represent the plaintiffs.*

TECH TALK

BLOCKCHAIN AND THE FUTURE OF BANKING

By Michael A. Holmes

Michael A. Holmes is a senior business and technology attorney at ***Godwin Bowman PC*** in Dallas, where he represents startups and mature Fortune 500 players across the United States in corporate transactions and complex dispute resolution matters. His practice focuses on emerging and disrupting technology, enabling him to position his clients' businesses to minimize risk and maximize potential success. Reach him at *MHolmes@GodwinBowman.com.*

"That'll be $40.69."

"OK. Do you take American Express?"

"No ma'am, but we do take bitcoin, Litecoin, Zcash, Ethereum, and Ripple."

"Excuse me? What?"

By now, everyone has heard of bitcoin, blockchain's infamous spawn. However, bitcoin and its innumerable cryptocurrency clones are just one application of blockchain technology.

While blockchain is gaining recognition and acceptance in many industries, its future in the banking world is still very uncertain, especially in light of the Securities and Exchange Commission's repeated rejection of cryptocurrency exchange-traded fund proposals.

For example, in August the SEC rejected ProShares' proposal to track bitcoin futures contracts. The Winklevoss twins of Facebook fame also had their "Winklevoss ETF" rejected after the SEC cited concerns of fraud and manipulation in the cryptocurrency world.

Explanations of bitcoin — and associated get-rich-quick schemes — already litter the Internet and won't be addressed here. Rather, this commentary will explain blockchain technology in general and then discuss how that technology is being gradually applied to the banking world.

Finally, we'll explore some of the additional, experimental uses of blockchain, its potential benefits and detriments and how businesses and their counsel can prepare for the new blockchain era.

What is blockchain?

Blockchain is a computer algorithm that organizes data in a way that is self-validating, decentralized, and therefore secure. Traditional data organization on a hard drive puts only one copy of the data together in a linear string of ones and zeros. While this method is simple and convenient, the data is prone to theft if the hard drive is compromised.

In contrast, blockchain uses a peer-to-peer network, also known as P2P (people connected using a specific sharing software via the Internet) to store a copy of the blockchain data with multiple peers on their storage drives.

From a macro perspective, this ensures that the data is decentralized because there is never just one copy to be lost/corrupted/stolen. Having multiple, identical copies of the data across multiple storage drives also allows the blockchain to be self-validating — meaning that each copy can verify itself against other copies on the P2P network to ensure the blocks in the chain have not been changed.

If someone tampers with a block in the chain, and that block is checked against the system and found to be changed, the system rejects the offending block and replaces it with a correct copy from another peer in the P2P network. Each block contains thousands of bits of user data, such as transactions for bitcoin or internet traffic.

In addition to the user data in the blocks, the chain contains two bits of important information: the location of that block within the larger chain (known as the "hash") and the hash of the previous block in the chain.

The use of cryptography, which allows security from a micro perspective, enables the data to be both self-validating and secure. The hash for each block is a completely unique string of numbers and letters (for example, f03jr5bh6iyu8fbnm10) with no two identical hashes, producing a cryptocurrency fingerprint.

If any data inside a block changes — for instance, if the data is somehow tampered with — the hash changes to reflect that the block has been changed.

Including the previous hash in each subsequent block ensures that the chain's order and integrity is maintained because each block can self-validate by checking its current hash with the previous block's

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record of its hash. If a hash changes and doesn't validate with the chain, the block is rejected as invalid.

This ensures that the data in the block stays the same or, at the very least, a user is made aware of any changes to the data. Any data change can be verified by looking to the previous block's hash, because if a block is rejected it is replaced with a correct copy from another peer. This also keeps the chain order from being modified, as each block in that chain has a record of what block should follow it.

If you've watched or read any news in the past five years, you have heard about the prevalence of data breaches. What is the potential for blockchain hacking? While nothing is ever 100 percent secure, blockchain is much more secure than any other commercially available system currently on the market.

The argument has been made that you could (theoretically) force all the hashes in a chain to change simultaneously, making the hash-verification system in blockchain fail. To avoid this potential problem, the blockchain algorithm also requires a proof of work. This means a block cannot be instantly created or modified.

Instead, there is a waiting period of about 10 minutes before a new block can be created within a chain. In that time, the block is verified and authenticated extensively (think back to showing your math work in grade school).

So, the blockchain algorithm itself, through the required proof of work mechanism, does not allow you to force-change all the blocks and steal entire chains. Simply put, blockchain is a superior algorithm for data organization in our current technological landscape because it allows data to be decentralized and much less vulnerable to attack, loss or corruption.

Any attack that tampers with the data in the block or the chain will be discovered and fixed because the system has built-in checks and balances to ensure its validity and integrity. And any loss or corruption can be easily replaced with numerous other copies of the blockchain on other peer storage drives.

Blockchain usage in banking

Blockchain and the banking world are a match made in heaven — a technology that is decentralized, self-validating and secure sounds like something the banking industry should have created itself! While no one knows who authored the final blockchain algorithm, and the banking world is a bit late to the party, the industry is doing its best to catch up, just as it did with the rise of the Internet.

IBM has predicted that in four years, about 70 percent of the banking industry will be utilizing blockchain for various transactions. An estimated 200 international banks are already utilizing blockchain mobile payments, and a handful of domestic banks may be doing so by the end of the year.

Banks also rely on blockchain to manage customer investment portfolios in a more secure and reliable manner that, in addition to providing the benefits previously discussed, makes in-house or third-party investment portfolio software unnecessary. Indeed, cost-cutting and operational efficiencies are some of the biggest reasons banks are already implementing blockchain into their business models, as it can reliably replace costly systems including those for verification, security, backup, big data, fraud and even secure customer communications. Banks will likely create in-house blockchain systems that can handle everything an institution offers within one secure, decentralized system.

Blockchain also provides a much easier to way to identify and verify banking clients. When your client has a verifiable hash that has been duplicated across the entire P2P network, identify theft becomes a thing of the past. Customers can be identified and verified, no matter where they are in the world, so long as they possess their hash in some secure form. Secure cards that contain encrypted keys are already being utilized.

Further, if your identity is compromised somehow (you clicked on that link you shouldn't have, didn't you?) the problem can be easily rectified by having your blockchain identity verified and repaired on the P2P network.

Additionally, many banks are looking at blockchain for what are known as smart contracts. In the simplest terms, this means utilizing blockchain to write a set of criteria, such as the terms of the contract. When the criteria are met, the transaction is completed automatically. If the criteria are not met, the transaction is automatically rejected without further input from the user.

For example, suppose you have found a buyer for your 1,000 widgets. However, the price of the widgets is too high for the buyer to pay cash, and you and the buyer have yet to agree on terms such as delivery and refunds.

Through blockchain, the bank can provide a system for you and the buyer to establish a smart contract. The smart contract will have your acceptable terms and the buyer's acceptable and unacceptable terms, along with potential payment.

If the smart contract determines that the range of terms between you and the buyer matches up, then the contract self-executes (no concern about signatures/dates/authority when blockchain can self-validate), payment self-executes (via a secure blockchain transaction) and the order is sent (via blockchain secure communications). Because the bank's work is done once it puts the smart contract in place,

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it should be apparent how much time, money, liability and overhead the banking world can save with this technology.

The future of blockchain, banking ... and you

One of the biggest advantages of applying blockchain to the banking industry is that it eliminates the middleman while increasing the transparency of transactions. Blockchain enables banks to provide secure and transparent transactions to their own customers — and indeed the entire world of customers — all with less direct involvement.

Which begs the question: If blockchain eliminates the middleman, will big banks still be needed? The answer is yes, but probably not in the role they play now.

Banks have historically been the bastions of transactions — including day-to-day deposits and withdrawals, storage of money and loans of all sizes. But picture the scenario of a strictly online company, instead of a bank, offering instant, secure and untraceable blockchain transactions between you and anyone else in the world from a smartphone.

That same company could issue you a digital wallet that could hold all your currency in a secure blockchain form on your smartphone, so you no longer need a savings account. And if your smartphone is stolen, your account wouldn't be compromised because your wallet is continually verified with the other copies of your wallet on the P2P network.

For loans, combine the smart contract technology we discussed earlier with secure currency transfers like bitcoin. Now online services can offer loans that are self-executing and self-verifying when the terms are met, issue the loan proceeds securely and directly into your smartphone wallet, securely withdraw your monthly interest payments and terminate the loan if certain conditions aren't met or maintained.

The benefits of future applications of blockchain to the banking world are obvious: massive savings in cost and time. But what about the detriments? Well, as a cynic of human nature might foresee, untraceable purchases using cryptocurrency transactions, without human oversight, could result (as we have already seen) in unscrupulous buying and selling.

How is a bank or online institution supposed to ensure the ethics and integrity of the purchases and sales ultimately made by the transactions it facilitates? One of cryptocurrency's inherent strengths and weaknesses is that it arguably cannot. Blockchain will magnify the massive struggle between privacy and security and transparency.

Further, as many lenders and mortgage professionals will tell you, a significant part of their due diligence comes from meeting with the potential borrowers face to face. Will creditworthiness decrease, and the potential for default increase, when people can take out loans or mortgages via an automatic blockchain transaction system on their smartphone without ever stepping inside a bank and experiencing the fear of God that comes from a mountain of paperwork?

And from the customer's perspective, how will they know if a particular online institution is reputable and will honor the terms of the loan?

From knowing that a person can likely be found again to seeing how they present themselves, there is something to be said for face-to-face meetings between a customer and banker. Then again, maybe blockchain loan and mortgage transactions will help erase some of the inherent, systemic or unconscious biases and prejudices otherwise resident in the current financial system, thus providing more equal access to investment money.

What can businesses and their counsel do to prepare for the impending shift to blockchain? First, think through the processes and procedures for your business, or your client's business, and ask where blockchain might provide some operational efficiencies or the potential for increased security and transparency.

Write out the pros and cons of investing in blockchain now versus waiting until the early-adopter stage has passed. Evaluate your customer base to see if blockchain would be a benefit or detriment to your clients' use of your product or service. If you find potential efficiencies that would make you more attractive to your client base, speak with blockchain experts about the practicalities of implementing it into your business model.

Most importantly, meet with an attorney who understands blockchain and your business, and can provide insight into any potential risks, liabilities or other relevant business issues.

Above all, a decision to harness blockchain's power should involve input from all aspects of the company, both for its current implementation, as well as long-term viability and scalability. But if a business can wade into the blockchain world now, it will establish itself as a forerunner for the next big technological shift.

LAWS, RULES & REGULATIONS

COMMODITY FUTURES TRADING CORPORATION

Consumer information privacy. The CFTC is proposing to revise its regulations requiring covered persons to provide annual privacy notices to customers.

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The proposed revisions implement the Fixing America's Surface Transportation Act's December 2015 statutory amendment to the Gramm-Leach-Bliley Act by providing an exception to the annual notice requirement under certain conditions.

The GLB Act's Title V mandates that financial institutions provide their consumers with whom they have customer relationships with annual notices regarding those institutions' privacy policies and practices. Further, subject to certain exceptions, if financial institutions share nonpublic personal information with particular types of third parties, the financial institutions must also provide their consumers with an opportunity to opt out of the sharing.

The CFTC and entities subject to its jurisdiction were originally excluded from Title V's coverage. The regulation was later amended to include CFTC-related entities — all futures commission merchants, retail federal exchange dealers, commodity trading advisors, commodity pool operators, introducing brokers, major swap participants, and swap dealers — regardless of whether they are required to register with the CCFTC, provide a clear and conspicuous notice to customers that accurately reflects their privacy policies and practices not less than annually during the life of the customer relationship.

Congress amended Title V as part of the FAST Act. added section 503(f) to the GLBA to limit the circumstances under which a financial institution must provide a privacy notice to its customers on an annual basis. Specifically, a financial institution is excepted from the requirement to send privacy notices on an annual basis if that financial institution (1) does not share nonpublic personal information except as described in certain specified exceptions; and (2) has not changed its policies and practices with regard to disclosing nonpublic personal information from those policies and practices that the institution disclosed in the most recent disclosure it sent to consumers.

The CFTC has proposed to amend its regulations to implement the FAST Act amendments to the GLBA with respect to "covered persons." Comments are due by Feb. 8, 2019. *Find the CFTC's proposed revision to GLBA privacy notices requirements at* govinfo.gov/content/pkg/FR-2018-12-10/pdf/2018-26523.pdf.

FEDERAL FINANCIAL REGULATORS

Appraisals exemption. The FDIC, FRB, and OCC are seeking comment on a proposal to raise the threshold for residential real estate transactions requiring an appraisal from $250,000 to $400,000. The appraisal threshold has remained unchanged since 1994, and the agencies believe an increase would provide burden relief without posing a threat to the safety and soundness of financial institutions.

Rather than requiring an appraisal for transactions exempted by the threshold, the proposal would require the use of an evaluation consistent with safe and sound banking practices. Evaluations provide an estimate of the market value of real estate but could be less burdensome than appraisals because the agencies' appraisal regulations do not require evaluations to be prepared by state licensed or certified appraisers.

In addition, evaluations are typically less detailed and costly than appraisals. Evaluations have been required for transactions exempted from the appraisal requirement by the current residential threshold since the 1990s.

The proposal also would incorporate the appraisal exemption for rural residential properties provided by the Economic Growth, Regulatory Relief and Consumer Protection Act and similarly require evaluations for these transactions. In addition, the proposal would require institutions to appropriately review all appraisals required by the agencies' appraisal rules to ensure their compliance with appraisal industry standards.

Comments are due Feb. 5, 2019. *Find the federal financial regulators' notice of proposed rulemaking regarding real estate appraisals in the* Federal Register *at* govinfo.gov/content/pkg/FR-2018-12-07/pdf/2018-26507.pdf.

FEDERAL TRADE COMMISSION

Identity theft. The FTC released a request for public comment regarding possible changes to its identity theft detection rules — the Red Flags Rule and the Card Issuers Rule — which require financial institutions and creditors to take certain steps to detect signs of ID theft affecting their customers.

The Red Flags Rule requires financial institutions and some creditors to implement a written ID theft prevention program designed to detect the "red flags" of identity theft in their day-to-day operations, take steps to prevent it, and mitigate its damage.

The Card Issuers Rule requires that debit- or credit-card issuers implement policies and procedures to assess the validity of a change of address request if, within a short period of time after receiving the request, the issuer receives a request for an additional or replacement card for the same account. This rule bars a card issuer from issuing an additional or replacement card until it has notified the cardholder about the request or otherwise assessed the validity of the address change.

The questions that the FTC wants answers to include:

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- Is there a continuing need for the specific provisions of the rules?
- What benefits have the rules provided to consumers?
- What significant costs, if any, have the rules imposed on consumers?
- What significant costs, if any, have the rules imposed on businesses, including small businesses?
- Are there any types of creditors that are not currently covered by the Red Flags Rule but should be, because they offer or maintain accounts that could be at risk of ID theft?

Comments are due by Feb. 11, 2019. *Find the FTC's proposed ID theft rules' changes at* ftc.gov/system/files/documents/federal_register_notices/2018/12/p188402_identity_theft_reg_review_frn.pdf.

PROPOSED FEDERAL LEGISLATION

Small Business Credit Protection Act. Sens. Marco Rubio (R-FL) and John Kennedy (R-LA) introduced the Small Business Credit Protection Act, which would require credit bureaus to inform small businesses within 30 days of a nonpublic personal data breach. The bill would also prohibit credit bureaus from charging small businesses for a credit report within 180 days following a breach.

The drafters noted that, in response to the recent Equifax data breach, Congress amended the Fair Credit Reporting Act to enhance some federal credit protections for "consumers." However, business credit is excluded from the statutory definition of "consumers." Thus, while small business' nonpublic information was subject to the breach, the changes did not apply to those using business credit.

Find a one-page summary of the bill at rubio.senate.gov.

VETERANS AFFAIRS

Re-fi loan revisions. The VA has published an advance notice of rulemaking in compliance with the Economic Growth, Regulatory Relief, and Consumer Protection Act. EGRRPA requires VA to amend its regulation on VA-guaranteed or insured cash-out refinance loans and to publish the amended regulation within a shortened time frame. The VA determined that urgent and compelling circumstances exist and therefore issued this announcement regarding its intent to promulgate an interim final rule.

"VA believes there are several urgent and compelling circumstances that make advance notice and comment on this rule contrary to the public interest," the ANPR said. "First, VA is concerned about lenders who seem to continue to exploit legislative and regulatory gaps related to seasoning, recoupment, and net tangible benefit standards, despite anti-predatory lending actions that VA and Congress have already taken. ... VA believes that VA must immediately seal these gaps to fulfill its obligation to veterans, prudent lenders, and those who invest in securities that include VA-guaranteed loans.

"VA is also gravely concerned about constraints in the availability of program liquidity if VA does not act quickly to address early pre-payment speeds for VA-guaranteed cash-out refinance loans," the ANPR continued. "VA believes that, unless VA promulgates rules quickly, a loss of investor optimism in the VA product could further restrict veterans from being able to utilize their earned VA benefits."

Given the lending industry's varied interpretation of the EGRRPA, the VA sees lender uncertainty in how to implement a responsible cashout refinance program — causing prudent lenders to employ a high degree of caution, *e.g.*, refraining from providing veterans with crucial refinance loans that are not predatory or risky.

"Absent swift implementation of clear regulatory standards, cautious lenders are less likely to make cash-out refinance loans," the ANPR said. "Unfortunately, such caution has the potential to compound the risk of predatory lending, as irresponsible lenders have more opportunity to prey upon veterans by stepping into areas where prudent lenders may have stopped competing.

At the same time, VA is concerned that certain lenders are exploiting cashout refinancing as a loophole to the responsible refinancing Congress envisioned when enacting section 309 of the EGRRPA.

VA is seeking public comment on the interim final rule, with no deadline for response. The rule became effective Nov. 30, 2018. *Find the VA's interim final rule ore-fi loan revisions in the* Federal Register *at* govinfo.gov/content/pkg/FR-2018-11-30/pdf/2018-26021.pdf.

CASEWATCH

RECENT EVENTS IN CASES OF INTEREST TO CONSUMER FINANCIAL SERVICES LITIGATORS

Truth in Lending/RICO/Force-placed insurance. *Ramnauth v. Freedom Mortgage Corp., et al.*, No. 18-16477 (D.N.J., *complaint filed* 11/27/18). Freedom Mortgage Corp. faces a putative class action accusing it of violating the Truth in Lending Act and

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the Racketeer Influenced and Corrupt Organizations Act by making illegal profits on homeowners' force-placed insurance.

Filed in U.S. District Court, District of New Jersey, the nationwide putative class-action complaint said that Freedom Mortgage took kickbacks from American Security Insurance Co., an indirect subsidiary of Manhattan-based Assurant, in exchange for giving the company the exclusive right to provide the insurance. ASIC was also named as a defendant in the lawsuit.

The class action accuses Freedom Mortgage of breach of contract, breach of a duty of good faith, unjust enrichment and violations of TILA. It accuses both Freedom and ASIC of violating RICO by improperly inflating the amount charged for insurance. The lawsuit said the defendants committed mail and wire fraud by sending letters and other communications to homeowners misrepresenting the true cost of insurance they were forced to buy.

Letters to borrowers often said Freedom or its affiliates might earn commissions or other compensation for arranging force-placed coverage, according to the complaint. In reality, no work was done by Freedom to procure insurance because it had a master policy in place with ASIC to obtain the insurance, and the insurance placement process was largely automated, the lawsuit alleged.

The homeowners are asking for actual and punitive damages including triple damages for RICO violations. More than 4.7 million homeowners across the country have already received more than $5.2 billion from nationwide settlements over the force-placed insurance, the complaint stated. *Kyle Tognan of Bathgate Wegener & Wolf in Lakewood, N.J., represents Ramnauth.*

Preemption/Mortgage escrow interest. *Bank of America NA v. Lusnak*, No. 18-212, 2018 WL 4006331 (U.S., *cert. denied* 11/19/18). The U.S. Supreme Court has denied Bank of America's petition seeking review of an appellate panel's decision that could require banks to pay interest on mortgage escrow accounts under California law, despite BofA's prediction that the ruling will disrupt the financial services industry.

A 9th U.S. Circuit Court of Appeals panel in March decided that federal law does not preempt a California statute requiring banks to pay interest on such accounts. (*Lusnak v. Bank of Am.*, 883 F.3d 1185 (9th Cir. 2018).) The high court's decision to let the ruling stand allows borrower Donald M. Lusnak to proceed with his putative class action against BofA in U.S. District Court, Central District of California.

Lusnak alleges the bank's failure to pay interest on mortgage escrow accounts violates California's unfair-competition law, Cal. Bus. & Prof. Code § 17200. He sued BofA in 2014 saying a state statute, Cal. Civ. Code § 2954.8(a), required the bank to pay 2 percent interest on mortgage escrow accounts.

BofA won dismissal of the suit by convincing the district court that the state law is preempted by the National Bank Act at 12 U.S.C. § 38, which does not require national banks to pay interest on escrow accounts. But the 9th Circuit panel reversed, saying the Dodd-Frank Act at 12 U.S.C. § 53 indicates that federal law does not preempt state laws such as § 2954.8(a).

BofA then filed its cert petition. It urged the High Court to review the decision because the question of whether state and local governments can regulate national banks' mortgage lending activity is one of "exceptional importance" to the banking industry, and that the 9th Circuit panel got it wrong. The decision will cause disruption in the industry and divergent regulation, and it conflicts with prior Supreme Court decisions and regulations issued by the Office of the Comptroller of the Currency, the bank said.

Lusnak's brief opposing the certiorari petition said BofA was ignoring Dodd-Frank provisions that limit the NBA's preemptive reach, set a limited level of deference owed to OCC regulations, and "expressly" invite state regulators to assist in national bank oversight. He also said the 9th Circuit correctly ruled that the state law at issue does not "prevent or significantly interfere" with a national bank's exercise of its powers — the standard for NBA preemption.

Robert A. Long Jr. of Covington & Burling in Washington, D.C., represented BofA, and Samuel Issacharoff of New York University School of Law in New York represented Lusnak before the High Court.

Fair Debt/Debt collection/Non-judicial foreclosures. *Obduskey v. McCarthy & Holthus LLP, et al.*, No. 17-1307 (U.S., *amicus brief submitted* 11/14/18). The Bureau of Consumer Financial Services has filed its first-ever amicus brief to the U.S. Supreme Court since acting director Nick Mulvaney took the reins of the BCFP. The bureau, along with the U.S. Solicitor General's Office, wrote to support the law firm that won a 10th U.S. Circuit Court of Appeals decision holding that it was not a debt collector under the Fair Debt Collection Practices Act when it pursued a non-judicial foreclosure under Colorado law.

Dennis Obduskey, the original named plaintiff that brought the putative class action against law firm McCarthy & Holthus and others, was granted *certiorari* by The Court in June 2018 to review the 10th Circuit opinion (*Obduskey v. Wells Fargo, et al.*, 879 F.3d 1216 (10th Cir. 01/19/18). The Supreme Court granted the review because of the deepened circuit split on the issue caused by the 10th Circuit's decision. The 9th and 10th Circuits now have held

that non-judicial foreclosure proceedings are not covered under the FDCPA. The 4th, 5th, and 6th Circuits, as well as the Colorado Supreme Court, have held that they are.

Looking to the definitions of a debt collector in the FDCPA at 15 U.S.C. § 1692, the BCFP argues in its *amicus* that the enforcement of a security interest by itself is generally not debt collection under the FDCPA. Therefore, the can be no FDCPA violation when a person takes actions that are legally required to enforce a security interest — as in Obduskey, where Colorado law presented the requirement.

Daniel L. Geyser of Dallas represents Obduskey and Kannon K. Shanmugam of Williams & Connolly represents McCarthy & Holthus before the High Court. Mary McLeod, John R. Coleman, Steven Y. Bressler, Nandan M. Joshi, and Kristin Bateman of the CFPB in Washington, D.C., and Noel J. Francisco, Jeffry B. Wall, and Jonathan C. Bond of the Solicitor General Office in Washington, D.C., presented the amicus brief supporting McCarthy & Holthus.

MBS/Trustee/Settlement. *BlackRock Core Bond Portfolio v. Wells Fargo Bank, N.A.*, No. 656587/2016 (N.Y. Supr. Ct., *notice of proposed settlement* 11/09/18). In what appears to be the first class-action settlement in a wave of noteholder suits against banks that served as trustees for mortgage-backed securities trusts, Wells Fargo recently agreed to a $43 million deal to resolve claims by BlackRock, Pimco and other noteholders in 271 trusts that lost nearly $35 billion in the financial crisis. If the proposed settlement is approved by New York State Supreme Court Justice Charles E. Ramos, shareholders will also receive $70 million from an indemnity fund Wells Fargo reserved to litigate noteholder suits.

The question that remains is what this settlement might mean in the larger context of MBS investor suits against the trustees they accuse of failing to protect noteholders when problems showed up in the home mortgage loans underlying the securities. These trustee suits are the last big tranche of MBS litigation by noteholders who lost untold billions of dollars in the MBS market. Should investors read the Wells Fargo settlement as a sign the hard-fought MBS trustee litigation is about to pay off — or as an acknowledgment that their claims aren't very valuable?

A hint that it may be the latter can be found in Wells Fargo's press release announcing the deal. The noteholders' lawyer who led the class action against Wells Fargo, Timothy DeLange of Bernstein Litowitz Berger & Grossmann, is actually quoted in the Wells Fargo press release announcing the deal.

"Following more than four years of litigation, including fact and expert discovery, we concluded that this agreement provides a fair and reasonable resolution of the claims," DeLange said. "While we believe the claims are meritorious, the settlement provides an immediate and concrete benefit for class members, while bringing the litigation to a close."

In the memo asking Judge Ramos to approve the deal, noteholders acknowledged some of the litigation setbacks investors have experienced in their suits against trustees. Although noteholders have broadly survived defense dismissal motions, post-dismissal rulings have turned the litigation into an expensive quagmire for investors.

Class certification has been one big problem, with Southern District of New York federal judges issuing a series of rulings denying class certification to MBS noteholders because, according to the decisions, individual issues of standing and timeliness predominate over classwide concerns. A BlackRock investors' class certification motion against Wells Fargo was pending before S.D.N.Y. Judge Katherine Failla when the two sides agreed to settle their parallel case in state court. (*BlackRock Allocation Target Shares: Series S Portfolio v. Wells Fargo Bank, N.A.*, No. 1:14-cv-9371 (S.D.N.Y., *order of discontinuance filed* 11/19/18).)

Courts have also foreclosed evidentiary shortcuts for noteholders, ruling that noteholders must prove trustees were aware of problems in underlying mortgage pools on a loan-by-loan, trust-by-trust basis. Judges have generally refused to allow investors to prove deficiencies by extrapolating from a sample of underlying mortgage loans.

And at least one, S.D.N.Y. Judge Valerie Caproni, has ruled on a summary judgment motion that noteholders must show trustees had actual knowledge that individual underlying loans failed to live up to representations and warranties. (A New York state appeals court took an easier line on trustees' knowledge, concluding that investors need not allege trustees' actual knowledge on a loan-by-loan basis.)

Black Rock and the other noteholders suing Wells Fargo acknowledged their tough road ahead in the memo requesting settlement approval.

"To defeat summary judgment and prevail at trial, plaintiffs would have been required to prove, among other things, that Wells Fargo discovered breaches of representations and warranties and had actual knowledge of servicing violations with respect to individual loans in the trusts," the memo said. "Wells Fargo would have had substantial arguments to make concerning each of these issues. For example, Wells Fargo would have argued that plaintiffs must prove, on a loan-by-loan basis, Wells Fargo's discovery of breaches of representations and warranties and actual knowledge of servicing violations. ...

"In addition, Wells Fargo would have argued that any damages to plaintiffs and the class were caused by factors unrelated to the purported breaches of

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representations and warranties or servicing violations," the noteholders' memo continued. "Had any of these arguments been accepted in whole or in part, it could have eliminated or, at a minimum, drastically limited any potential recovery."

Looking only at the math, the settlement seems more of a business decision by Wells Fargo than an admission of the merits of claims that the bank failed to live up to its MBS trustee responsibilities. The settlement is for only $42 million. The Black Rock investors alleged losses of nearly $35 billion across the 271 trusts covered by the settlement, and their amended complaint sought to hold Wells Fargo liable for all of those losses.

Wells Fargo, in its capacity as MBS trustee, apparently expected the litigation to cost at least that much: It reserved about $90 million from MBS trusts to pay legal expenses stemming from its trustee duties. (BlackRock actually sued Wells Fargo over the reserve fund, asserting that the bank had looted trust assets, but Judge Ramos dismissed the suit in 2017.) By releasing $70 million of the reserve fund to investors as part of Friday's settlement, Wells Fargo effectively said it would have cost more to defend the Black Rock class action than to settle it.

Notably, Wells Fargo kept $20 million in the reserve fund, presumably to fend off MBS trustee claims by investors in another 58 trusts. Based on the bank's per-trust payout in the BlackRock case, however, Wells Fargo's exposure in those cases is less than $10 million.

That calculation assumes Wells Fargo — as well as other MBS trustees such as Bank of New York Mellon, U.S. Bank, and Deutsche Bank — will present the Black Rock class settlement as a ceiling for future settlements, not a floor. *Timothy DeLange of Bernstein Litowitz Berger & Grossmann in New York is lead counsel for the noteholders. Howard Sidman of Jones Day is lead counsel for Wells Fargo.*

RMBS. *In re Deutsche Bank AG Securities Litigation*, No. 18-3036, 2018 WL 5076510 (2d Cir., *petition for permission to appeal filed*, 10/16/18). Deutsche Bank AG is asking the 2d U.S. Circuit Court of Appeals to review a trial judge's order certifying two classes of preferred securities holders in a 2009 lawsuit alleging the German bank misrepresented its exposure to the housing market that collapsed in 2008. Deutsche Bank and its underwriters say Judge Deborah A. Batts of the U.S. District Court, Southern District of New York was wrong to certify the classes because the named plaintiffs had profited from their investments. (*In re Deutsche Bank AG Sec. Litig.*, No. 9-1714, 2018 WL 4771525 (S.D.N.Y. Oct. 2, 2018).

The underwriters are Banc of America Securities LLC, Citigroup Global Markets Inc., Merrill Lynch Pierce Fenner & Smith, Morgan Stanley & Co. LLC, UBS Securities LLC, and Wachovia Capital Markets LLC. Deutsche bank and the underwriters want the 2nd Circuit to review the decision because it involves an important and recurring issue in securities class actions.

Deutsche Bank sold $5.4 billion worth of preferred securities in five offerings between May 2006 and May 2008. The offerings' marketing materials, however, did not fully disclose the bank's mortgage-backed securities and collateralized debt obligations holdings tied to the subprime housing market bubble, the suit said.

Deutsche Bank's investments in the products went sour, forcing it to write down billions of dollars in losses.

In late 2008, Deutsche Bank's investments in the products went sour, forcing it to write down billions of dollars in losses. The suit, filed by Deutsche Bank shareholders Belmont Holdings Corp., Norbert G. Kaess and others, accused the bank of failing to inform investors about its true housing market exposure in financial statements and stock-offering materials.

Judge Batts dismissed the suit in 2012, saying it failed to allege that Deutsche Bank did not believe its "opinions" about market risk and subprime exposure at the time it expressed them. (*In re Deutsche Bank Sec. Litig.*, No. 09-cv-1714, 2012 WL 3297730 (S.D.N.Y. Aug. 10, 2012).)

A 2nd Circuit panel upheld the decision and Belmont asked the Supreme Court for review, saying the case presented questions similar to those then pending before the court in (*Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015). *Kaess v. Deutsche Bank AG*, 572 F. App'x 58 (2d Cir. 2014).)

In *Omnicare*, the top court said a company's opinions that allegedly omit certain facts are actionable if the omitted information would have been "material to a reasonable investor." The Supreme Court remanded the Deutsche Bank case to the panel, which then sent the case back to Judge Batts. (*Belmont Holdings Corp. v. Deutsche Bank AG.*, 135 S. Ct. 2805 (2015).)

The plaintiffs filed a third amended complaint and the judge dismissed claims relating to three of the five offerings for lack of standing, leaving allegations regarding offerings in November 2007 and February 2008. (*In re Deutsche Bank AG Sec. Litig.*, 2016 WL 4083429 (S.D.N.Y. 07/25/16).)

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After plaintiff Belmont was dismissed from the suit for lack of standing, Kaess and shareholder Maria Farruggio moved for certification of a class of investors for November 2007 offering. Judge Batts certified the class, finding that issues of law and fact are common to the class members. She also allowed the pair to step in as class representatives for investors in the February 2008 offering under the "class standing" doctrine from *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145 (2d Cir. 2012).

In *NECA*, the 2nd Circuit allowed a plaintiff who bought Goldman securities to represent the interests of other investors who had "the same set of concerns" despite their not having bought securities in the same offering.

Deutsche Bank and the underwriters say in their petition that Kaess and Farruggio profited from their trading of the November 2007 securities, despite the judge's finding they had a "minimal loss," and that they should not have been permitted to represent the February 2008 class.

"A plaintiff who makes multiple purchases of the issued securities within the class period — profiting on some, losing on others, yet profiting overall — should not be certified as a class representative," the petition says.

As to the February 2008 class, the bank and underwriters say the plaintiffs clearly profited on that offering and that the *NECA* class standing doctrine should not be expanded to circumvent the loss requirement for standing. *Charles Gilman of Cahill Gordon & Reindel in New York represents Deutsche Bank. Scott Musoff of Skadden Arps Slate Meagher & Flom in New York represents the underwriters. Stephen F. Hubachek, Eric I. Niehaus, and Lucas F. Olts represent the shareholders.*

Attorney's fees/Class action. *In re EasySaver Rewards Litigation*, 906 F.3d 747 (9th Cir. 2018). A 9th U.S. Circuit Court of Appeals panel struck down an $8.7 million attorney's fee award in a consumer class action against a group of online retailers. Judge Michelle T. Friedland, writing for the unanimous appellate panel, said that the trial judge erroneously treated millions of dollars of potential store credit as cash rather than coupons.

Judge Friedland vacated a settlement resolving claims that Provide Commerce Inc., Regent Group Inc., and several affiliates illegally enrolled customers for years in a third-party "EasySaver Rewards" program that charged them $14.95 a month without their consent after they ordered flowers online. A federal district court in 2016 approved the agreement, which included a $20 merchandise credit for each of the estimated 1.5 million class members — whether they submitted a claim or not — as well as a $12.5 million fund to cover administration costs, attorney fees and cash claims. (*In re EasySaver Rewards Litig.*, No. 09-cv-2094, 2016 WL 4191048 (S.D. Cal. 08/09/16).)

The panel reversed, saying that the judge had overestimated the deal's value — and therefore underestimated the percentage going to fees — by including millions of dollars in store credits that should have qualified as coupons, which do not count under the Class Action Fairness Act, 28 U.S.C.A. § 1712, until they are redeemed.

CAFA "provides no definition of 'coupon,' so courts have been left to define that term on their own," Judge Friedland wrote. "The million — here, multimillion — dollar question [is] whether defendants' credits are coupons. We hold that, applying the correct legal standard, the only logical conclusion is that they are."

The panel cited the three-part test from *In re Online DVD-Rental Antitrust Litigation*, 779 F.3d 934 (9th Cir. 2015), for determining within the 9th Circuit's jurisdiction whether a store credit in a class-action settlement counts as a coupon under CAFA. That test asks whether the credits are flexible or transferrable, whether they can be used at any time on any product, and whether a customer must spend more money to take advantage of them, according to the appellate opinion.

The EasySaver credits expired after a year, are subject to blackouts on most desirable shopping days, and would likely require class members to spend more of their own money, Judge Friedland said. The judge explained: "Defendants only claim to sell '15 to 25 products for under $20,'" she wrote. "And that meager list does not even account for shipping charges."

Reversing and remanding the case, the appellate panel ordered the trial judge to look into the redemption rate of the credits, saying it would be impossible to approve or reject the fee request without that information. The district court had valued the credits at $25.5 million when it concluded that the fees represented a reasonable 23 percent of the deal's $38 million total.

The district court also approved the fees under the lodestar method, calculating that the $8.7 million fee award to be about twice the $4.3 million a lawyer billing by the hour would have charged, meaning the fees involved a lodestar multiplier of about two, which the court found reasonable.

The 9th Circuit panel disagreed, saying the district court's one major error had also tainted her lodestar analysis. The judge reverse-engineered the multiplier from a fee amount that was originally derived as a percentage of the artificially inflated settlement value, the panel noted.

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"Although the $4.3 million figure was derived independently of any specific consideration of the coupons, it lost this independence when the district court used a multiplier to match the lodestar fee to the percentage-of-recovery fee," Judge Friedland wrote. "The value of the coupon relief therefore impermissibly informed the district court's approval of the lodestar fee."

Theodore H. Frank and Adam E. Schulman of the Competitive Enterprise Institute, Center for Class Action Fairness in Washington, D.C., represented objector-appellant Brian Perryman. Bruce Steckler in Dallas; Jennie L. Anderson of Andrus Anderson in San Francisco; James R. Patterson in San Diego; and Michael Singer of Cohelan Khoury & Singer in San Diego represented plaintiffs-appellees. Leo P. Norton, Michael G. Rhodes, and Michelle C. Doolin of Cooley in San Diego, represented Provide Commerce. Myron M. Cherry and Jacie C. Zolna of Cherry & Associates in Chicago represented Regent Group.

INDUSTRY ROUNDUP

KRANINGER CONFIRMED AS BCFP DIRECTOR

Kathy Kraninger has been confirmed by the U.S. Senate for a five-year term as the new director of the Bureau of Consumer Financial Protection.

Kraninger takes over from acting BCFP director Mick Mulvaney, who had this to say following the confirmation:

"The American consumer and our economy's financial sector will benefit from her commitment, expertise, and professionalism," Mulvaney said. "This last year has been an important step in the history of the bureau as we take our place among the most notable regulatory bodies of our country — and frankly the world.

"Like all transitions, it was not always as smooth as we would've all liked, but the bureau has emerged stronger for it," Mulvaney concluded.

DOJ REVISEDS CRIMINAL GUIDELINES IN CORPORATE WRONGDOING

U.S. deputy attorney general Rod Rosenstein in a recent speech announced a revised U.S. Department of Justice policy of "pursuing individuals responsible for wrongdoing will be a top priority in every corporate investigation."

Rosenstein, speaking before the American Conference Institute's 35th International Conference on the Foreign Corrupt Practices Act, explained: "The most effective deterrent to corporate criminal misconduct is identifying and punishing the people who committed the crimes. So we revised our policy to make clear that absent extraordinary circumstances, a corporate resolution should not protect individuals from criminal liability.

"Our revised policy also makes clear that any company seeking cooperation credit in criminal cases must identify every individual who was substantially involved in or responsible for the criminal conduct," Rosenstein said. "We want to focus on the individuals who play significant roles in setting a company on a course of criminal conduct. We want to know who authorized the misconduct, and what they knew about it."

CUBITA JOINS DAVIS WRIGHT

Peter N. Cubita, recognized as an influential consumer financial services expert and perhaps the most knowledgeable auto finance and leasing attorney in the nation, has joined Davis Wright Tremaine LLP.

Cubita joins Davis Wright from Ballard Spahr LLP, where he was of counsel. He is a member of the Governing Committee of the Conference on Consumer Finance Law and a member of the American College of Consumer Financial Services Lawyers. He is also a former co-chair of the Legal Committee of the Association of Consumer Vehicle Lessors.

He has practiced consumer financial services law for more than 35 years. He became a partner with Weil Gotshal & Manges LLP, which he left in 2008 to become an in-house attorney at Ally Financial Inc.

Now of counsel with Davis Wright, Cubita will work out of its New York office as part of the firm's consumer financial services group. A long-time member of the editorial board of *Consumer Financial Services Law Report*, Cubita's wide-ranging experience includes regulatory compliance, transactional work, government enforcement, and class action matters, with extensive experience in the motor vehicle retail finance and leasing areas.

Earlier this year, Davis Wright also added Bradford Hardin, another leading practitioner in fair-lending and closed-end credit matters. Hardin joined the firm's consumer financial services practice from WilmerHale in Washington, D.C.

BANKS EASED RESIDENTIAL LOAN STANDARDS IN Q3 2018

Loan officers at U.S. banks reported easing lending standards for residential real estate loans while leaving standards largely unchanged for auto loans.

Lending standards also eased for commercial and industrial loans, while terms for commercial real estate loans were almost unchanged in Q3 2018, a Federal Reserve Board survey showed.

However, bank officials responding to the FRB's Q3 2018 Senior Loan Officer Opinion Survey on Bank Lending also said they were seeing weaker demand for commercial and industrial loans from firms of all sizes, which banks said was partially in response to reduced investment by some customers in plants and equipment. The FRB surveyed loan officers at 70 domestic banks and 22 U.S. branches and agencies of foreign banks.

The FRB has raised interest rates eight times since December 2015, including three times so far in 2018. The FRB is widely expected to raise rates again by the end of 2018. *Find a complete summary of the FRB's Q3 2018 Senior Loan Officer Opinion Survey on Bank Lending, as well as links to the full survey and relevant charts at* federalreserve.gov/data/sloos/sloos-201810.htm#aboutMenu.

FRB BANK SUPERVISION REPORT HIGHLIGHTS SMALL BANKS CHANGES

The Federal Reserve Board's November 2018 semiannual Supervision and Regulation report says that the U.S. banks appears safer, sounder, better capitalized, and in stronger liquidity positions post-crisis. Significantly, the report's summary of banking conditions and the FRB's supervisory and regulatory activities also points to changes that the agency has made to promote efficiency, transparency, and simplicity at banks, particularly smaller ones.

"Since the crisis, the Federal Reserve has substantially strengthened its supervisory programs for the largest institutions," says the report's summary. In addition, the FRB says it has taken steps to improve its regional and community bank supervision programs, "focused on tailoring its supervisory expectations to minimize regulatory burden whenever possible without compromising safety and soundness."

The FRB notes that, along with other federal regulators, "has recalibrated supervisory programs to ensure [that banks] are effectively and efficiently achieving their goals." Among the several burden-reducing supervisory changes are:

- Reducing the volume of financial data that smaller, less-risky banks must submit to the agencies each quarter.
- Increasing the loan size under which regulations require banks to obtain formal real estate appraisals for commercial loans.
- Proposing changes to simplify regulatory capital rules.

The FRB stresses that it has taken steps to reduce the amount of undue burden associated with examinations, including conducting portions of examinations offsite. *Find the FRB's November 2018 Supervision and Regulation repot at* federal reserve.gov/publications/files/201811-supervision-and-regulation-report.pdf.

CONFERENCE CALENDAR

JANUARY 10 – 12, 2019

2019 Banking Law Committee Meeting
American Bar Association
Ritz Carlton
Washington, D.C.
(800) 285-2221
shop.americanbar.org

JANUARY 10 – 13, 2019

2019 Consumer Financial Services Committee Meeting
American Bar Association
JW Marriott Turnberry Miami Resort and Spa
Miami, Florida
(800) 285-2221
shop.americanbar.org

JANUARY 23 – 28, 2019

2019 ABA Midyear Meeting
American Bar Association
Caesars Palace
Las Vegas, Nevada
(800) 285-2221
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JANUARY 24 – 25, 2019

Understanding Financial Products 2019*
Practising Law Institute
PLI Center New York
New York, New York
(800) 260-4754
pli.edu
**Alternative Web cast*
**Alternative groupcasts: Atlanta; Cleveland; Mechanicsburg, Pa.; New Brunswick, N.J.; Philadelphia; Pittsburgh*

JANUARY 28 – 29, 2019

Advanced Forum on False Claims and Qui Tam Enforcement
American Conference Institute
Park Lane Hotel
New York, New York
(888) 224-2480
americanconference.com

JANUARY 28 – 31, 2019

Independent Mortgage Bankers Conference
Mortgage Bankers Association
Hyatt Regency San Francisco
San Francisco, California
(800) 793-6222
mba.com

JANUARY 29, 2019

Presentation Skills for Attorneys 2019
Practising Law Institute
PLI Center New York
New York, New York
(800) 260-4754
pli.edu

JANUARY 29 – 30, 2019

Prepaid Card Compliance
American Conference Institute
Omni Shoreham Hotel
Washington, D.C.
(888) 224-2480
americanconference.com

JANUARY 31 – FEBRUARY 2, 2019

24th Annual Conference of the Forum on Communications Law
American Bar Association
Eden Roc
Miami, Florida
(800) 285-2221
shop.americanbar.org

FEBRUARY 1, 2019

Government Investigations 2019: Investigations Arising from Data Breach and Privacy Concerns and Parallel Proceedings*
Practising Law Institute
PLI Center New York
New York, New York
(800) 260-4754
pli.edu
**Alternative Web cast*
**Alternative groupcasts: Atlanta; Boston; Cleveland; Columbus, Ohio; Mechanicsburg, Pa.; Nashville, Tenn.; Philadelphia*

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