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A Review of the Third Quarter, 2013

The third quarter of 2013 was marked by the dismissal of a challenge by several state Attorneys General to aspects of the Dodd-Frank Act – a challenge that will be continued on appeal. It also brought increased activity by some Attorneys General and other state level regulators regarding online payday lending. The following paragraphs review some of the more significant developments during the quarter.

Dismissal (and Appeal) of State Attorneys Generals' Challenge to the Dodd-Frank Act's "Orderly Liquidation Authority" Framework

On August 1 the U.S. District Court for the District of Columbia dismissed in its entirety a lawsuit that had challenged Titles I, II and X of the Dodd-Frank Act (DFA) as unconstitutional. The lawsuit was initially brought by three private plaintiffs and later joined by the Attorneys General of South Carolina, Oklahoma, and Michigan (to contest certain aspects of Title II only). In time, the Attorneys General of Alabama, Georgia, Kansas, Montana, Nebraska, Ohio, West Virginia and Texas also joined in the litigation. In dismissing their suit the court determined that all of the plaintiffs lacked standing, as they had not demonstrated injury sufficient to permit a challenge to the DFA on any of their claims.

The private plaintiffs' challenge to Title X, which created the Consumer Financial Protection Bureau (CFPB) was based on financial injuries allegedly directly caused by the unconstitutional formation and operation of the CFPB. Those included substantial compliance costs, increased costs of doing business, and the forced discontinuance of certain business practices in order to avoid the risk of agency action. The court concluded that such "self-inflicted" harm could not confer standing to challenge Title X. With respect to the private plaintiffs' challenge to the Financial Stability Oversight Council (FSOC) that was created by Title I the court concluded that while an unregulated party is not precluded from establishing standing to challenge the creation and operation of the FSOC, standing is "substantially more difficult to establish" under such circumstances and the theories asserted by the plaintiffs were too remote.

Both the private plaintiffs and the state Attorneys General challenged the DFA's Title II, claiming that its "orderly liquidation authority" (OLA) provisions ignore the separation of powers, deny due process to creditors of a liquidated entity, and violate the requirement for uniformity in bankruptcy. The court again concluded that the plaintiffs had not established either present or future injury sufficient to merit standing.

Following the dismissal of their suit by the District Court both the private plaintiffs and the Attorneys General (as "State Appellants") successfully petitioned the U.S. Circuit Court of Appeals for the D.C. Circuit to hear their appeals. The State Appellants' Statement of Issues was presented to the court in September and the issues it posed will be subject to review over the coming months. We will continue to update the status of this important litigation as it develops.

Payday Lending Related Initiatives

Georgia Attorney General Sues Tribal-Affiliated Online Lender to Enforce State Law. On July 29 Georgia Attorney General Sam Olens announced a lawsuit against a payday lending business that is affiliated with a Native American Tribe. The Attorney General asserted that the Georgia's Pay Day Lending Act specifically prohibits the making of payday loans, including the making of such loans to

Georgia residents through the Internet. The suit was filed after the Attorney General's office received numerous consumer complaints, some of which alleged that the lender continued to electronically withdraw funds from consumers' bank accounts even after they had repaid the full amount of the loan principal, and that the loan servicer harassed borrowers with repeated telephone calls and threats of wage garnishment or other legal action. In his complaint Attorney General Olens rejected claims by the defendants that their lending activities are governed solely by tribal law. He asserted that only Georgia law governs loan agreements made with Georgia borrowers. According to the Attorney General's media release, efforts to resolve issues without litigation were undermined by the defendants' continuing with their allegedly illegal activity. The suit seeks (i) to enjoin the defendants from making or collecting on any loans, (ii) a declaration that any pending loans are null and void, and (iii) civil penalties and attorneys' fees. Georgia is among several states to take action against this business; for example, earlier in July Minnesota Attorney Lori Swanson filed a similar suit against the tribal-affiliated lending operation that was named in the Georgia lawsuit.

New York Department of Financial Services Seeks to Halt Online Payday Loans. On August 6 the Superintendent of the New York Department of Financial Services (DFS), Benjamin M. Lawsky announced that he had sent letters to 35 online lenders, including some affiliated with Native American Tribes demanding that they cease and desist offering allegedly illegal payday loans to New York borrowers. The letters required the companies to confirm within 14 days that they were no longer soliciting or making payday loans in excess of the state's usury caps. The letters also advised the recipients that it is illegal to collect on loans that exceed the state's usury cap. A separate letter to third-party debt collectors from Superintendent Lawsky included the same type of notice. In addition, the DFS sent letters to 117 banks and to the National Automated Clearing House Association (NACHA) in which Superintendent Lawsky requested that they work with the DFS to create model safeguard procedures designed to deny ACH access to the targeted online lenders, and to provide the DFS with information on steps the institutions are taking to halt allegedly illegal activity.

New York Attorney General Acts Against Online Payday Lenders. On August 12 New York Attorney General Eric Schneiderman announced a lawsuit against tribal-affiliated payday lending businesses and their owners for allegedly violating the state's usury and licensed lender laws in connection with their issuing of personal loans over the Internet. The Attorney General claimed that the companies charged annual interest rates ranging from 89% to more than 355% to thousands of New York consumers, rates which far exceed the 16% rate cap set by the state's law. In taking action against the firms and their owners he joined his counterparts in Georgia and Minnesota, who had earlier sued some of the same business entities. Attorney General Schneiderman's action followed the payday lending related actions announced a week earlier by the New York Department of Financial Services (DFS). The relief sought by Attorney General Schneiderman's suit included a court order prohibiting the enforcement of existing loan contracts, cancellation of outstanding loans, restitution for borrowers of all interest collected above the legal limit of 16%, the disgorgement of profits, and penalties of up to $5,000 per violation for allegedly deceptive acts and practices.

Mortgage and Servicing-Related Developments

Massachusetts Attorney General Reaches Settlement on Residential Mortgage Backed Securities (RMBS) Related Claims. On September 9 Massachusetts Attorney General Martha Coakley announced a settlement had been reached in her office's fourth mortgage-securitization related enforcement action. The Attorney General's office alleged that during 2006 and 2007 a bank headquartered in the United Kingdom has financed, purchased, and securitized residential loans that were presumptively unfair under Massachusetts law. Under the terms of an Assurance of Discontinuance the bank, without admitting the allegations, agreed to pay $36 million to resolve the claims against it. The agreement called for over $25 million to be dedicated to residential mortgage principal reduction and other related relief for more than

450 subprime borrowers, while approximately $2 million will compensate municipalities that claimed to be impacted by foreclosures resulting from allegedly faulty loans.

State Attorney General and Federal Agency Interactions

Illinois Attorney General and Federal Agencies Act Jointly on Criminal Indictment. On August 6 the Special Inspector General for the Troubled Asset Relief Program (TARP), the Federal Deposit Insurance Corporation's Office of Inspector General, and Illinois Attorney General Lisa Madigan announced criminal charges against former members of the board of directors and senior executives at a bank that received funds under the TARP program. The indictment that was filed in Cook County (Illinois) Criminal Court alleged that the indicted parties concealed the bank's financial condition from state regulators, while one of them, the former board chairman allegedly solicited and demanded bribes in exchange for business loans and lines of credit. The indictment further claimed that over a six year period, the officers submitted numerous fraudulent reports to their state regulator and used money from third parties to make payments on several bank loans that were past due. During the same period, the bank applied for and obtained TARP funds that were used to further the alleged criminal scheme. According to the TARP Inspector General the joint state-federal action represented the first criminal enterprise charges that had been brought against officers and directors of a TARP-assisted bank.

Data Security (and Online Privacy) Matters

Connecticut Attorney General Settles Suit Over Alleged Online Account Security Breaches. On August 29 Connecticut Attorney General George Jepsen announced that his office had reached a settlement with a major national bank related to claims of unauthorized access to consumers' online credit card accounts. The Attorney General had filed a suit which alleged that over 5,000 Connecticut consumers were impacted by a breach that occurred in May of 2011. The suit further claimed that the breach was preventable and that notifications of the breach were not made "without unreasonable delay", in violation of Connecticut's Unfair Trade Practices Act. The terms of the stipulated settlement agreement called for the bank to engage an independent third party to conduct an information security audit of the online account service that had allegedly been hacked, and for a detailed report of the audit to be provided to the Attorney General. The settlement also called for a payment of $55,000, composed of a $15,000 civil penalty and a payment of $40,000 to the state's general fund.

Summary

The activities outlined in this Review indicate that investigative and enforcement actions related to online lending are increasingly a focus of state Attorney General activity. We will look for further developments regarding that issue, as well as other subjects over the next quarter and present the results in our next Review.