Financial Fraud Law Report

AN A.S. PRATT & SONS PUBLICATION JUNE 2013

The FINANCIAL FRAUD LAW REPORT is published 10 times per year by A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207, For subscription information and customer service, call 1-800-456-2340. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908 (phone) / 631.331.3664 (fax). Material for publication is welcomed — articles, decisions, or other items of interest.
POSTMASTER: Send address changes to the Financial Fraud Law Report, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207. *ISSN 1936-5586*

The Consumer Financial Protection Bureau Raises the Stakes

AURORA CASSIRER AND ERIC UNIS

The authors suggest steps that businesses should take to limit the risk that they will be taken to court by the Consumer Financial Protection Bureau.

The consumer finance world knows that there is a new cop on the beat. The Consumer Financial Protection Bureau (CFPB) was established in 2010 by the, Consumer Financial Protection Act, or Dodd-Frank Act. The CPFB is a regulatory behemoth with jurisdiction over virtually any entity that touches consumer finance, from banks to debt collectors, to payday lenders, to mortgage-servicing operations. Last year, the Consumer Financial Protection Bureau brought its first two civil enforcement actions and showed the business community that it is serious about its mandate. Similarly aggressive civil enforcement litigation should be expected this year, with the CPFB hauling many more businesses into court. This is in addition to the CFPB's

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Published by A.S. Pratt in the June 2013 issue of the *Financial Fraud Law Report*.

administrative enforcement activity, which last year included a $214 million settlement with Discover concerning credit card add-on products.

Under the Dodd-Frank Act, the CFPB has the authority to bring civil actions against persons violating federal consumer financial laws and to "seek all appropriate legal and equitable relief including a permanent or temporary injunction as permitted by law."[1] The CFPB has stated that it will use its authority to seek robust civil penalties, but, as its very first civil enforcement case shows, the CFPB will not refrain from using its power to obtain dramatic provisional relief, including asset freezes, the seizure of records, and the appointment of receivers to take over the subject business. These are all tools previously employed by the Federal Trade Commission and the Securities and Exchange Commission in many cases. In its first two civil enforcement actions, the CFPB sought and obtained the appointment of a receiver to wind down the target businesses.

THE *GORDON* CASE

The CFPB chose a case with an especially egregious set of facts to test out its new powers. In *CFPB v. Gordon, et al.*,[2] filed last summer in the Central District of California, the CFPB brought its full weight to bear against a Los Angeles law firm and related entities. In *Gordon*, the CFPB alleges that the defendants were providers of "mortgage assistance relief services" as defined by Regulation O and thus "covered persons" and "service providers" under the Dodd-Frank Act. The defendants allegedly operated "a mortgage relief scheme that cost individual consumers thousands of dollars each, but provides consumers with no meaningful benefit." According to the complaint, distressed homeowners were duped into paying high upfront fees with false promises of loan modification.

At issue were allegedly unlawful advance fees ranging from $2,500 to $4,500 for "forensic auditing" services as part of "Pre-Litigation Program," a bifurcated business model that is specifically designed to avoid the mandates of the Mortgage Assistance Relief Services ("MARS") Rule and Regulation O, which prohibit advance fees and deception by mortgage relief operations. The CFPB says, generally, the homeowners did not obtain the modifications that were promised. A violation of Regulation O is an unfair and deceptive

act or practice in violation of Sections 1031 and 1036 of the Dodd-Frank Act.

Further, it was charged that the law firm defendants intentionally and falsely represented an affiliation with the federal government and those consumers who paid fees and were frequently advised to stop paying their mortgages "suffered significant economic injury," including in many cases foreclosure and the loss of their properties.

The CFPB began investigating the defendants' activities after the matter was referred by the consumer complaint database reportedly received dozens of complaints against the Gordon Law Firm, which was at the center of the operation. State agencies across the country had also received complaints or had been investigating the defendants, including the state bars in California and Connecticut. In fact, the Pennsylvania Department of Banking had entered a cease and desist order against the attorney Gordon and the Gordon Law Firm in December 2011, after Gordon continually failed to respond to the agency's investigative demands.

The CFPB filed the case initially under seal and obtained immediate *ex parte* relief. The court ordered, *inter alia*,

(1) that the CFPB could obtain limited expedited discovery,

(2) that defendants must preserve their records,

(3) an accounting of the defendants' assets,

(4) that the CFPB have immediate access to the defendants' business records and premises,

(5) that the corporate defendants' assets be frozen, and

(6) the appointment of a temporary receiver over the Gordon Law Firm and the other corporate entity defendants.

The CFPB took these measures believing it needed to act quickly to obtain relief for the victims of an ongoing fraud.

The CFPB has gone to school on the enforcement tactics of other federal agencies, especially the Federal Trade Commission and the Securities and Exchange Commission. Citing a long line of cases in which the FTC and the SEC exercised their civil enforcement powers when defendants used decep-

tion to obtain money from consumers and the public interest at stake, the CFPB asserted that its invocation of the court's equitable powers meant that the "full breadth" of the court's authority was available, including the power to grant such additional preliminary relief necessary to preserve the possibility of providing effective final relief. The CFPB additionally cited two similar recent FTC cases brought against mortgage assistance relief services in which the FTC had sought and obtained an asset freeze and the appointment of a receiver.[3] In both of those cases, the FTC alleged that the defendants failed to deliver on their promises to assist homeowners and deceptively marketed "forensic loan audits" that the defendants claimed would reveal flaws in homeowners' loan documents, allowing them to negotiate lower interest rates, payments, or principal.

In *Gordon*, the CFPB argued that a temporary receiver should be appointed because a receiver was necessary to maintain the status quo so that corporate assets would not be subject to "diversion and waste" to the detriment of the fraud's victims. The CFPB claimed that the defendants' scheme demonstrated an "indifference to the law" such that they "may reasonably be expected to frustrate the [CFPB's] law enforcement efforts by destroying evidence and concealing or dissipating assets." The CFPB proposed that a "receiver can monitor the use of Defendants' assets, marshal and preserve records, identify assets, identify and segregate any attorney-client privilege materials, determine the size and extent of the fraud, and identify additional consumers who were injured." The CFPB further stated that the receiver could "penetrate Defendants' maze-like corporate structure" and ensure that they "cease their unlawful conduct and to preserve their assets pending a permanent resolution of this case." The appointment of a receiver is considered an extraordinary remedy. A primary reason that a court will appoint a receiver is to promote the orderly and efficient management of any property involved in a dispute for the benefit of the creditors.

The role of the receiver appointed in *Gordon*, Robb Evans and Associates LLC, a firm recommended to the court by the CFPB, has been particularly notable and influential in the case. Pursuant to the temporary restraining order issued by the court at the outset of the case, the receiver took over operation of the enterprise and conducted a preliminary, but thorough, audit of defendants' operations in very short order. The receiver reviewed the

defendants' sales and marketing activities and their business systems and operations, and found a far lower rate of "successful completions" than represented. The receiver found no evidence that legal services were provided, despite how the defendants marketed themselves. In November 2012, the court issued a preliminary injunction against the defendants, in large part due to facts uncovered by the receiver.

The temporary receiver faced some unique challenges in carrying out its duties. For example, shoving matches took place between Gordon and the receiver's deputy when the receiver sought to gain access to the premises; Gordon made threats against the receiver and the CFPB via his Facebook page, even posting the home addresses of the receiver's counsel and a CFPB attorney on his Facebook page. Most of the defendants' employees refused to cooperate with the receiver. At one point, upon entering the defendants' office suite, the receiver's team found a handgun on the premises. Gordon's alleged behavior was so outrageous that it caused the receiver to arrange for an armed guard.

Based on the receiver's reports, the court found, and the receiver agreed, that it did not appear that defendants' business entities could continue as going concerns. Accordingly, when the court issued the preliminary injunction, the court also directed that the receiver and the CFPB prepare for the winding down of the receivership and defendants' operations expeditiously and that any further investigation or discovery would be the responsibility of the CFPB. The receiver received authority to sell the defendants' non-liquid assets.

The receiver's motion for approval of its final report and for approval and authorization for payment of fees and expenses was granted on March 4, 2013. The court also found that the fees and expenses sought by the receiver (about $400,000) were reasonable, despite the fact that they constituted a large percentage of the entire receivership estate and diminished the potential restitution available to those allegedly defrauded should the CFPB ultimately prevail on the merits of the claim.

The defendants are vigorously opposing the CFPB's prosecution of the case, arguing that the temporary restraining order was based on a "statistically insignificant but vocal group of disgruntled consumers, most likely solicited by Plaintiff," and ignored the nearly thousand satisfied customers. The defen-

dants asserted that the pre-litigation client agreement they used is legitimate and, because no fee was collected under the Pro Bono Legal Services Agreement, that agreement does not violate MARS. The defendants also claimed that the consumer complaints were made before the FTC transferred jurisdiction over MARS to the CFPB. The defendants have also taken the position that the entire action was unauthorized, based on the D.C. Circuit Court of Appeals' recent decision in *Canning v. National Labor Relations Board*. In *Canning*, the D.C. Circuit ruled that President Obama's recess appointment of three members of the NLRB was unconstitutional. The President appointed Richard Cordray as the Director of the CFPB on the very same day as the NLRB appointments. The court, however, declined to address that issue. Even with *Canning* and unresolved questions about the validity of the CFPB's enforcement actions, the CFPB is undeterred and will not pause with its enforcement agenda.

JALAN

In December 2012, the CFPB brought its second civil enforcement action in the Central District of California, *CFPB v. Jalan*, *et al.*[4] This case is very similar to *Gordon* and also involves another mortgage assistance relief service that allegedly scammed homeowners. Like *Gordon*, the CFPB filed its complaint in *Jalan* along with an *ex parte* request for preliminary relief. The relief the CFPB sought in *Jalan* is identical to relief sought in *Gordon*, including the request that a receiver be appointed. Unlike *Gordon*, however, the defendants did not fight the request and agreed to a "Stipulated Preliminary Injunction with Asset Freeze, Appointment of Receiver, and Other Equitable Relief."

WHAT TO EXPECT FROM THE CFPB

In addition to those it accuses of scamming consumers by deceptively and misleadingly marketing consumer financial products, the CFPB has signaled that it is keeping a close eye on particular types of entities and activity. For example, Director Cordray has said that the CFPB will focus on debt collection, loan servicing, and credit reporting because consumers are unable

to choose who they have to deal with in relation to these services.

The CFPB is staffing up at a rapid pace, hiring from other agencies and hiring many others to assist with its enforcement efforts. It is busily collecting the information to fuel its cases from a wide array of sources. In its supervisory role, the CFPB has examiners reviewing the financial institutions and businesses under its jurisdiction, including credit reporting agencies and payday lenders and CFPB enforcement personnel are working closely with these examiners. The investigations conducted by state attorneys general and other state regulators are another fertile source for potential enforcement actions. The CFPB is also relying on whistleblowers within the entities it regulates to make its cases. For non-bank entities, the CFPB has indicated that it will coordinate with other agencies, such as the Federal Trade Commission. To that end, in addition to considering tips from its own recently established consumer complaint database, the CFPB is looking to the FTC's Sentinel database, which has been available to law enforcement since the 1990s.

Based on the *Gordon* and *Jalen* cases, the CFPB will seek to quickly shut down those businesses that appear to be inherently fraudulent using tools such as receivership. In connection with large settlements and in cases in which the enforcement target can continue to operate, the CFPB has said that it will seek the appointment of independent monitors and examiners. The SEC has engaged in this practice with increasing frequency over the last decade in many major cases. For example, as part of its settlement with the SEC, WorldCom agreed to retain an independent monitor to review the effectiveness of its accounting and financial reporting policies on an ongoing basis. The appointment of monitors is a frequent feature of consent orders with state attorneys general. A common thread in those consent orders is a term of three to five years, regular reporting to the governmental entities, and costs borne by the business. Confidential settlements, as an alternative to publicity and litigation, may also be something the CFPB pursues.

STAYING OUT OF THE CFPB'S NET

While the CFPB is in its relative infancy as a regulator, a review of its record thus far shows that businesses should keep a few common sense tips in mind to lessen their chances of facing a CFPB enforcement action.

- Ask whether consumers are receiving the value of services they are paying for. The CFPB will be more likely to act in any case where they see that the consumer receives less than what was promised and less than what the consumer paid for out-of-pocket, especially in cases involving services such as mortgage assistance, and not just in cases of outright fraud.
- Be fully responsive to inquiries from state and local agencies. The CFPB will coordinate with these agencies and a failure to respond to one of those agencies will get the CFPB's attention.
- Be fully responsive to any complaints from consumers. The CFPB will review such complaints for patterns and practices that may fuel an enforcement action. Depending on the nature of the complaints, a business may need to modify its practices.
- Know the law. The CFPB is continuing to propose and issue new rules at a rapid pace and businesses should be aware of all that may affect them.

NOTES

[1] 12 U.S.C. § 5564.

[2] Case No. 2:12-cv-06147-RSWL-MRW.

[3] *FTC v. Consumer Advocates Group Experts, LLC*, *et al,* Case No. 2:12-cv-04736-DDP-CW (C.D. Cal. May 30, 2012); *FTC v. Lakhany*, *et al,* Case No. 8:12-cv-00337-CJC-JPR (C.D. Cal., March 5, 2012).

[4] Case No. 8:12-cv-2088-AG-AN.