

Another California Court of Appeals Weighs In on Availability of Attorneys' Fees Under the FTC's Holder Rule

WRITTEN BY

David N. Anthony | Jon S. Hubbard | Scott Kelly | Timothy J. St. George | Brooke K. Conkle | Noah J. DiPasquale | Sarah Siu

On March 22, California's Fifth Appellate District Court of Appeals issued a decision on the availability of attorneys' fees under the Federal Trade Commission's (FTC) Holder Rule. This case follows recent FTC guidance and two decisions from California's Second Appellate District Court of Appeals holding that the Holder Rule does not bar recovery of attorneys' fees in excess of the amount paid pursuant to the contract. The Fifth Appellate District's decision, however, does not fall in lockstep with its sister courts' decisions: although it concludes attorneys' fees are available to the plaintiffs, it does so with substantively different reasoning that may have a profound effect on how this issue plays out in other states. The case is [Reyes v. Beneficial State Bank, 2022 Cal. App. LEXIS 233 \(Cal. Ct. App. Mar. 22, 2022\)](#).

The Holder Rule and Previous California Precedent

The FTC's Holder Rule requires certain consumer transaction contracts to include a provision authorizing the consumer to bring any legal claims against the "holder" of the contract that the consumer could assert against the original seller of the good or service, even if the claim springs from the seller's misconduct alone. The Holder Rule, however, states that a plaintiff's recovery from the holder for those claims "shall not exceed amounts paid by the debtor" under the sales contract.

California courts in particular have grappled with whether the Holder Rule's recovery cap applies to a plaintiff's recovery of attorneys' fees and costs over and above the amount paid pursuant to the contract, and divergent precedent has emerged among California's courts of appeals on the issue. In a 2018 decision, a California court of appeals held that the word "recovery" as used in the Holder Rule includes attorneys' fees, and therefore the cap prevents courts from awarding attorneys' fees against the holder defendant over and above the amount paid on the contract. In response, the California Legislature passed California Civil Code § 1459.5, a fee-shifting statute that purports to allow attorneys' fees against the holder.

The FTC appeared to answer the question definitively in 2019, issuing a rule confirmation that explicitly addressed the question of attorneys' fees, and advised that consumers cannot recover from holders beyond what they have paid under their respective contracts unless state law provides otherwise. In 2020, another California court of appeals held that the Holder Rule's recovery cap applied to attorneys' fees and, citing the 2019 rule confirmation, that the Holder Rule preempted § 1459.5.

California's Second Appellate District Court of Appeals, however, issued two recent decisions contrary to those previous decisions: *Pulliam v. HNL Automotive, Inc.*, No. S267576 (Cal. 2021), and *Melendez v. Westlake Servs., LLC*, No. B306976, 2022 Cal. App. LEXIS 70, at *9 (Jan. 28, 2022). These decisions held that the term "recovery" as used in the Holder Rule does not include attorneys' fees, that the FTC's 2019 rule confirmation is not entitled to deference, and that attorneys' fees above and beyond the amount paid under the sales contract are therefore recoverable by a plaintiff from the holder defendant. The California Supreme Court is currently considering an appeal of the *Pulliam* decision, as we reported [here](#).

The FTC also issued an advisory opinion in January 2022 that sided with courts that have refused to automatically cap attorneys' fees and costs, stating that applying the Holder Rule to preempt state laws and limit recovery of fees and costs "misconstrues" the FTC's 2019 rule confirmation. Troutman Pepper has previously reported [here](#) on the differences and apparent inconsistencies between the 2019 rule confirmation and the recent advisory opinion.

The *Reyes* Decision

The *Reyes* decision arose from the plaintiffs' appeal of a 2019 trial court decision that interpreted the Holder Rule recovery cap to bar an award of attorneys' fees. See *Reyes v. Beneficial State Bank*, No. BCV-17-100082 (Cal. Sup. Ct., Kern Co., Dec. 5, 2019). The appellate court decision follows the result of *Pulliam* and *Melendez* by allowing the plaintiffs to recover attorneys' fees from the holder defendant, but notably, the court's "reasoning differs from [*Pulliam* and *Melendez*] in certain respects." *Reyes*, 2022 Cal. App. LEXIS 233 at *8. The opinion walks through a lengthy and detailed history of the FTC's Holder Rule, the previous California courts of appeals decisions, the FTC's 2019 rule confirmation and 2022 advisory opinion, and California Civil Code § 1459.5 before reaching a result that does not perfectly line up with any of the previous decisions.

The court in *Reyes* disagreed with *Pulliam* and *Melendez* by holding that the plain meaning of the word "recovery" as used in the Holder Rule includes attorneys' fees, consulting legal and non-legal dictionaries to arrive at that conclusion. *Id.* at *27-30. The court boiled down the definition of "recovery" to "getting something back," and concluded "[u]ndoubtedly, the recovery of attorney fees restores a claimant to his previous state or condition and, absent recovery, attorney fees are lost to the claimant. Consequently, we conclude the term 'recovery,' as used in the Holder Rule provision, is sufficiently broad to include attorney fees." *Id.* at *29. The court also concluded that this interpretation is consistent with both the FTC's 2019 rule confirmation and the 2022 advisory opinion, asserting that the latter "make[s] clear that recovery of attorney fees against a holder in excess of amounts paid on the contract is contingent upon the existence of a separate federal or state law providing for such a recovery – otherwise recovery of such fees is limited by the Holder Rule provision." *Id.* at 29–30.

The court agreed with the *Pulliam* decision, however, on the issue of deference to the 2019 FTC rule confirmation and lack of preemption of § 1459.5. The court held that the 2019 rule confirmation is not entitled to deference, particularly in light of the FTC's position in its 2022 advisory opinion that courts misconstrued the rule confirmation to conclude that it preempts § 1459.5. *Id.* at *30-31. In a footnote, the court noted that despite the FTC's position to the contrary, the 2019 rule confirmation and the 2022 advisory opinion are not "completely harmonious," but it found that they agree on "at least this point: the FTC did not intend for the Holder Rule to preempt all state statutes and rules of contract in unyielding pursuit of its policy objective." *Id.* at *31 n.7. The court further noted that the FTC could have promulgated the Holder Rule as a direct, substantive rule of law, but instead only made it a

mandatory provision in consumer contracts, which the court took to mean that such a provision would be subject to “all the ways in which litigation outcomes might differ from what is expressly contemplated by a contract. One such example is when a state statute overrides a contractual provision.” *Id.* Based on this analysis, the court concluded that § 1459.5 is not preempted by the Holder Rule.

The court’s ultimate holding in *Reyes* is that the recovery of attorneys’ fees in excess of the amounts paid on the contract is *generally* precluded by the Holder Rule, but that California’s § 1459.5 allows such recovery nonetheless and is not preempted. *Id.* at *30–32.

Conclusion

The *Reyes* decision is another blow against the position that the Holder Rule recovery cap categorically bars recovery of attorneys’ fees in excess of the amount paid under the contract. However, the decision does not wholeheartedly agree with the contrary position represented by *Pulliam* and *Melendez*, in that *Reyes* only reached the same result because of the passage of Cal. Civ. Code § 1459.5. The decision’s detailed analysis of the meaning of the word “recovery” as used in the Holder Rule provides strong support for the argument that the Holder Rule in general does not allow recovery of attorneys’ fees in excess of the amount paid on the contract. Thus, the *Reyes* reasoning would only allow recovery of excess attorneys’ fees where the state legislature has expressly authorized such recovery, leaving the Holder Rule’s general prohibition intact.

Given the diverging opinions among courts nationwide, the seemingly conflicting FTC guidance, and the unfolding drama of this issue among California courts (culminating in the California Supreme Court’s forthcoming decision in *Pulliam*), the *Reyes* decision represents an interesting additional perspective on the issue of the recovery of attorneys’ fees under the Holder Rule.

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