ORAL ARGUMENT NOT YET SCHEDULED

No. 17-5045

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

ADVANCE AMERICA, CASH ADVANCE CENTERS, INC., *et al.*,

Plaintiffs-Appellants

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, *et al.*,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA (No. 14-953-GK)

BRIEF OF PLAINTIFFS-APPELLANTS

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

I. Parties and Amici.

Advance America, Cash Advance Centers, Inc.; Check Into Cash, Inc.; NCP Finance Limited Partnership; NCP Finance Ohio, LLC; Northstate Check Exchange; and PH Financial Services, LLC are Appellants here and Plaintiffs in the district court. Richard Naumann is also a plaintiff in the district court, but he did not join in the motion that is subject to review in this Court and accordingly is not a party to this appeal. Community Financial Services Association of America, Ltd. also appeared as a plaintiff in the district court, but it was dismissed and is also not a party to this appeal.

The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and Thomas J. Curry, in his official capacity as the Comptroller of the Currency, are Appellees here and Defendants in the district court.

The Third Party Payment Processors Association, the LIBRE Initiative Institute, the State of South Carolina, William Isaac, Aubrey Stone, the National Organization of African Americans in Housing, and the Teamsters National Black Caucus appeared as *amici curiae* in the district court.

II. Rulings Under Review.

Plaintiffs-Appellants appeal an opinion and order issued on February 23, 2017 by United States District Judge Gladys Kessler denying Plaintiffs-Appellants' motions for a preliminary injunction. The opinion and order may be found on pages JA1129 and JA1163 of the joint appendix, respectively. The opinion has not yet been published in the Federal Supplement.

III. Related Cases.

This case has not previously been heard on appeal before this Court or any other court. Counsel is aware of no related cases within the meaning of Circuit Rule 28(a)(1)(C).

CORPORATE DISCLOSURE STATEMENT

Plaintiff-Appellant Advance America, Cash Advance Centers, Inc. is a Delaware Corporation. Advance America owns and operates stores offering short-term small-dollar loans, including payday loans, and other financial products. Advance America is a wholly-owned subsidiary of Eagle U.S. Sub, Inc., a Delaware Corporation, which is in turn a wholly-owned subsidiary of Grupo Elektra, S.A.B. de C.V. Grupo Elektra is a publicly-held company. No other publicly-held company has a 10% or greater ownership interest in Advance America.

Plaintiff-Appellant Check Into Cash, Inc. is a Delaware Corporation. Check Into Cash, through its state specific operating entities, owns and operates storefronts offering payday loans and other products in many states. Check Into Cash is a wholly owned subsidiary of Creditcorp, a privately-held company. No publicly-held company owns a 10% or greater ownership interest in Check Into Cash.

Plaintiff-Appellant NCP Finance Limited Partnership is an Ohio Limited Partnership. NCP Finance Limited Partnership funds and services payday loans that are brokered by storefront payday lenders in the State of Texas. NCP Finance Limited Partnership is a wholly owned subsidiary of NCP Holdings, LLC, a privately-held company that is in turn owned by NMCapital, Inc., Needmore

Capital Partners, Inc., DRKE NCP, LLC, NCP Investors, L.P., and NCP Investors II, L.P.—all of which are also privately held entities. No publicly-held company owns a 10% or greater ownership interest in NCP Finance Limited Partnership.

Plaintiff-Appellant NCP Finance Ohio, LLC is an Ohio Limited Liability Company. NCP Finance Ohio funds and services payday loans that are brokered by storefront payday lenders in the State of Ohio. NCP Finance Ohio is a wholly owned subsidiary of NCP Holdings, LLC, a privately-held company that is in turn owned by NMCapital, Inc., Needmore Capital Partners, Inc., DRKE NCP, LLC, NCP Investors, L.P., and NCP Investors II, L.P.—all of which are also privately held entities. No publicly-held company owns a 10% or greater ownership interest in NCP Finance Ohio.

Plaintiff-Appellant Northstate Check Exchange is a California General Partnership. Northstate Check Exchange is a money service business, operating in Redding, California, that provides, among other services, payday advance loans to the community. Northstate Check Exchange has no parent corporations, and no publicly-held company owns a 10% or greater ownership interest in it.

Plaintiff-Appellant PH Financial Services, LLC is a Missouri Limited Liability Company. PH Financial Services provides administrative services to several affiliated limited liability companies that own and operate storefront payday lenders. PH Financial Services is a wholly-owned subsidiary of PineBrook

Holdings, LLC, a privately-held Missouri Limited Liability Company. No publicly-held company owns a 10% or greater ownership interest in PH Financial Services.

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GLOSSARY

ACH	Automated Clearing House
APA	Administrative Procedure Act
CFSA	Community Financial Services Association of America, Ltd.
DOJ	Department of Justice
FDIC	Federal Deposit Insurance Corporation
NCRI	National Council of Resistance of Iran
OCC	Office of the Comptroller of the Currency

STATEMENT IN SUPPORT OF ORAL ARGUMENT

Plaintiffs request oral argument. This appeal present important questions regarding the requirements the Due Process Clause places upon the federal banking regulators, and Plaintiffs respectfully submit that oral argument will assist this Court in addressing those questions.

INTRODUCTION

The United States Constitution provides that no person shall "be deprived of life, liberty, or property, without due process of law." U.S. CONST. amend. V. The Constitution's guarantee of due process is a bulwark of the rule of law, and it "was designed to protect the citizen against all mere acts of power, whether flowing from the legislative or executive branches of the government." *Hurtado v. People of Cal.*, 110 U.S. 516, 527 (1884). The risk of rule through mere acts of power rather than constitutional procedures is particularly heightened in the banking context, where Defendants, the regulators of this Nation's banks, wield expansive authority. In this case, that authority has been weaponized by the regulators to target law-abiding, but disfavored, businesses that need banking services to survive, and this has been done without a modicum of due process of law.

Plaintiffs operate in the payday lending industry. A payday loan is an advance on the borrower's paycheck or other source of income. Payday loans provide short-term credit to millions of American households, especially those that are underbanked, by helping them to address financial needs between income installments. Payday loans are more readily available than more traditional forms of credit and less costly than the informal credit systems on which many consumers must rely in the absence of payday advances, such as overdraft protection, bounced checks, and late bill payment fees.

Despite the fact that payday lenders provide these essential services, and despite the fact that Plaintiffs are law-abiding businesses operating under state regulation, Defendants have engaged in a campaign of regulatory abuse aimed at depriving payday lenders of access to the banking system. Defendants unilaterally determined that law-abiding payday lenders are "high risk" customers that threaten the safety and soundness of banks, on par with peddlers of drug paraphernalia, Ponzi schemes, and escort services. This view was broadly disseminated in a series of guidance documents by Defendant Federal Deposit Insurance Corporation ("FDIC") making clear that banks serving customers deemed "high risk" by the regulators would, at a minimum, be forced to incur increased regulatory compliance costs and scrutiny. Defendants also leveraged this regulatory guidance to apply backroom pressure to banks aimed at coercing them into terminating relationships with payday lenders. Several specific instances of this activity have been documented by the Committee on Oversight and Government Reform of the U.S. House of Representatives and by the FDIC's Office of Inspector General.

In the wake of Defendants' campaign against the payday lending industry, banks have been terminating their relationships with payday lenders en masse. Plaintiff Advance America, for example, has been terminated by more than twenty banks, and these terminations have affected more than one thousand storefronts.

Other payday lenders have been forced out of business entirely due to their inability to access the banking system.

The Due Process Clause does not permit the Government to attack the law-abiding members of a lawful industry in this manner. Indeed, Plaintiffs are likely to succeed on three distinct but related due process theories. First, under *Wisconsin v. Constantineau*, 400 U.S. 433 (1971), due process must be afforded before the Government can distinctly alter a person's pre-existing liberty or property rights. *Constantineau* itself involved the liberty to purchase alcohol; the liberty to access the banking system at issue in this case is much more consequential. Second, under *Board of Regents of State Colleges v. Roth*, 408 U.S. 564 (1972), due process must be afforded before the Government can make stigmatizing statements in connection with the extinguishment of a right or benefit. Here, Plaintiffs have lost bank accounts against the backdrop of the stigmatizing charge that having payday lenders as customers poses safety and soundness risks to banks. Third, under this Court's precedents, due process must be afforded before the Government can broadly preclude a person from pursuing a chosen trade or profession. Defendants' campaign against the payday lending industry threatens to do just that by seeking to eliminate payday lenders' access to the banking services that they need to survive.

Because Plaintiffs are likely to succeed on the merits of their due process claims, it necessarily follows that the rest of the preliminary injunction factors weigh

in their favor as well. It is essential that Plaintiffs obtain a preliminary injunction to maintain the status quo during the pendency of this litigation. Absent an injunction, Plaintiffs' access to the banking system, and thus their ability to stay in business, will continue to be imperiled. The district court's decision denying Plaintiffs the preliminary relief they need and are entitled to should be reversed.

JURISDICTION

The district court has jurisdiction under 28 U.S.C. § 1331, as Plaintiffs' claims arise under the Constitution and laws of the United States. This Court has jurisdiction under 28 U.S.C. § 1332(a)(1), as this appeal is taken from an interlocutory order of the district court refusing Plaintiffs' motions for a preliminary injunction. The order being appealed was entered on February 23, 2017, JA1163, and Plaintiffs timely noticed their appeal on March 14, 2017, JA1165. *See* FED. R. APP. P. 4(a)(1)(B).

STATEMENT OF ISSUES

Whether the district court erred in denying Plaintiffs' motions to preliminarily enjoin Defendants from violating Plaintiffs' due process rights through their actions affecting Plaintiffs' rights to hold bank accounts, access the banking system, and pursue their chosen line of business.

STATUTES AND REGULATIONS

Pertinent statutes and regulations are included in an addendum bound with this brief.

STATEMENT OF THE CASE

I. Factual Background.

In January 2014, the Committee on Oversight and Government Reform of the U.S. House of Representatives ("Oversight Committee") began investigating reports that the Department of Justice ("DOJ") was improperly using its investigatory powers to target legitimate, law-abiding businesses. JA99. The DOJ dubbed the project "Operation Choke Point" since, as described by an Oversight Committee staff report, it was designed "to 'choke out' companies the Administration considers a 'high risk' or otherwise objectionable, despite the fact that they are legal businesses" by "deny[ing] these merchants access to the banking and payments networks that every business needs to survive." JA98.

The staff report found that "Operation Choke Point was primarily focused on the payday lending industry." *Id.* But it also found that executive-branch animus against the payday lending industry was not limited to DOJ. Rather, this animus extended to the federal banking regulators. A follow-up staff report found that the FDIC, "the primary federal regulator of over 4,500 banks, targeted legal industries," particularly the payday lending industry. JA195. "Documents produced to the Committee reveal that senior FDIC policymakers oppose payday lending on personal grounds, and attempted to use FDIC's supervisory authority to prohibit the practice." *Id.* Indeed, the "high risk" label that DOJ leveraged in Operation Choke

Point had its genesis in banking regulation, and it is the regulatory tool that federal regulators have themselves used to target the payday lending industry.

A. Defendants develop and expand the concept of "reputation risk" to increase the reach of their regulatory authority.

"Banking is one of the longest regulated and most closely supervised of public callings," *Fahey v. Mallonee*, 332 U.S. 245, 250 (1947), and Defendants—the FDIC, the Office of the Comptroller of the Currency ("OCC"), and the Board of Governors of the Federal Reserve (the "Board")—have expansive authority as the safety and soundness regulators of this Nation's banks. They often operate under a veil of secrecy pursuant to their claims of "bank examination privilege." They are statutorily charged with establishing standards for banks' operations. *See* 12 U.S.C. § 1831p-1. Violating these standards can have severe consequences for banks, up to and including seizure of control by Defendants by placement in conservatorship or receivership. *See id.* §§ 1831o(f)(2), 1831p-1(e)(1).

Exercising their supervisory authorities, Defendants have published high-level "interagency guidelines establishing standards for safety and soundness." 12 C.F.R. Pt. 364, App. A. These guidelines "set out the safety and soundness standards that the agencies use to identify and address problems at insured depository institutions before capital becomes impaired." *Id.* § I(vi). Among other things, the guidelines provide that a banking "institution should have internal controls and information systems that are appropriate to the size of the institution and the nature,

scope and risk of its activities and that provide for . . . [e]ffective risk assessment." *Id.* § II(A). The specifics of what this requirement entails—including what risks banks should be assessing—are not defined in any detailed way in the guidelines, but rather have been the subject of an evolving set of guidance documents.

One category of risk that Defendants have identified is "reputation risk." Traditionally, reputation risk has been understood to reflect the potential that a bank's own practices could cause it to have a negative reputation in the community and that this impaired reputation could threaten the bank's safety and soundness. *See, e.g.*, JA111 ("Reputational risk is the risk that potential negative publicity about a financial institution's business practices will cause a decline in the customer base, costly litigation, or the loss of revenue.").

Recently, however, Defendants have expanded the meaning of reputation risk to encompass not only the risks posed by a bank's own operations but also those posed by a bank's *customers*. The first, transitional step in this expansion occurred in June 2008, in the context of the relationships of banks with third party agents performing functions on the banks' behalf. Under the traditional conception of reputation risk, a third party's activities could affect a bank's reputation risk only when those activities were undertaken on behalf of the bank. In June 2008, however, the FDIC issued a guidance letter stating that "any negative publicity involving the third party, *whether or not the publicity is related to the institution's use of the third*

party, could result in reputation risk." JA62 (emphasis added). The expansion was completed later that year with the release of a guidance document addressing banks' relationships with payment processors—entities that use banking services to process payments for their own customers. *See* JA71. That guidance directed banks to be attuned to "reputation . . . risks" posed by having payment processors as customers, JA72, and it directed them to perform extensive due diligence and monitoring activities of not only the payment processors themselves but also the payment processors' customers, JA73. Neither the expansion of reputation risk to include the reputation of banks' customers nor the identification of purportedly risky categories of bank customers has been subject to notice and comment rulemaking or to any other proceeding giving affected entities notice and an opportunity to be heard.

The expansion of reputation risk to include the reputation of a bank's customers gave Defendants a powerful new regulatory tool. Defendants could now distinctly alter the ability of businesses they disfavor to access the banking system, because banks servicing businesses identified as "high risk" would be required to incur significant additional regulatory compliance costs and to face the risk of increased regulatory scrutiny. And Defendants promptly wielded this tool against the payday lending industry.

B. Defendants use reputation risk to target the payday lending industry.

Like other financial institutions, payday lenders need access to the banking system to operate—indeed, to survive. It is particularly important that payday lenders be able to cash checks and access the Automated Clearing House ("ACH") network—through which they can directly debit customers' bank accounts—because these are the methods that payday lenders use to ensure payment for the loans that they issue. *See* JA504 ¶ 4.

Because access to the banking system is a matter of life and death for payday lenders, they are especially vulnerable to the authority Defendants have claimed for themselves to define "high risk" customers for banks, and Defendants have sought to exploit this vulnerability. Indeed, the progression of Defendants' actions with respect to payday lending in many ways tracks the expansion of Defendants' concept of reputation risk generally.

Initially, Defendants targeted banks that were themselves involved in payday lending, whether directly or through arrangements with third parties. In March 2005, for example, the FDIC issued a Financial Institution Letter addressing payday lending programs that some banks had initiated. *See* JA50. The letter expressly identified payday lending as "a high-risk activity," and it identified a number of "concerns" it had about banks' payday lending programs. JA51. "As a result of the

guidance and related supervisory actions, the relatively few FDIC-supervised institutions that were making payday loans stopped doing so in 2006." JA445.

Defendants, however, were not satisfied with getting banks themselves out of the payday lending business, and they next turned their attention to payday lenders that used banking services in connection with their business—whether indirectly through payment processors or directly through their own relationships with banks. "[A] number of FDIC officials," for example, "had concerns about ACH payment processing for payday lenders," because "such services facilitate payday lending." *Id.*

These "concerns" soon began to manifest themselves in guidance documents. In the summer of 2011, the FDIC published a Supervisory Insights article entitled "Managing Risks in Third Party Payment Processor Relationships." JA80. According to the article, "[a]lthough many clients of payment processors are reputable merchants, an increasing number are not and should be considered 'high risk.' " JA83. The article went on to list "merchant categories that have been associated with high-risk activity," and the list included "PayDay Loans" along with activities such as "Drug Paraphernalia," "Escort Services," "On-line Gambling," "Ponzi Schemes," and "Racist Materials." JA84.[1] The article made clear that banks

[1] The full list consisted of the following merchant categories: Ammunition Sales, Cable Box De-scramblers, Coin Dealers, Credit Card Schemes, Credit Repair

servicing high risk customers through payment processors would incur additional regulatory compliance burdens, including being required to perform "ongoing monitoring of high-risk accounts . . . ." JA86. In a January 2012 Financial Institution Letter offering guidance on payment processor relationships, the FDIC reiterated its view that merchants offering payday loans "pose elevated risk" to banks and that servicing such entities would require banks to engage in increased compliance activities. *See* JA91 n.1. And in a September 2013 Financial Institution Letter, the FDIC made clear that its guidance applied not just to banks serving payday lenders indirectly through payment processors but also to banks servicing payday lenders directly as customers: "The FDIC is issuing this letter to clarify its policy and supervisory approach related to facilitating payment processing services directly, or indirectly through a third party, for merchant customers engaged in higher-risk activities. Facilitating payment processing for merchant customers engaged in higher-risk activities can pose risks to financial institutions and requires due diligence and monitoring, as detailed in prior FDIC and interagency guidance and

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Services, Dating Services, Debt Consolidation Scams, Drug Paraphernalia, Escort Services, Firearms Sales, Fireworks Sales, Get Rich Products, Government Grants, Home-Based Charities, Life-Time Guarantees, Life-Time Memberships, Lottery Sales, Mailing Lists/Personal Info, Money Transfer Networks, On-line Gambling, PayDay Loans, Pharmaceutical Sales, Ponzi Schemes, Pornography, Pyramid-Type Sales, Racist Materials, Surveillance Equipment, Telemarketing, Tobacco Sales, and Travel Clubs. JA84.

other information"—including the Summer 2011 Supervisory Insights article and the January 2012 Financial Institution Letter expressly listing payday lending as a high risk activity. *See* JA517 & n.3.[2]

Although the district court has yet to permit discovery to commence in this case, evidence uncovered by the Oversight Committee provides some indication about what was going on behind the scenes at the FDIC during the development of these guidance documents, as well as what has transpired in communications between Defendants and the banks that they regulate. This evidence reveals deep

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[2] In July 2014—shortly after the filing of this lawsuit and the release of the Oversight Committee's initial staff report on Operation Choke Point—the FDIC issued a Financial Institution Letter "clarifying" its prior guidance by removing the lists of "high risk" merchant categories from the 2011 Supervisory Insights article and the January 2012 Financial Institution Letter. JA519. The July 2014 letter did not, however, retract the assertion that payday lenders or other merchants on the lists are high risk. To the contrary, the letter reiterated that the listed merchant categories "had been associated by the payments industry with higher-risk activity." *Id.* (An FDIC-Office of Inspector General report released in September 2015 makes clear that the agency continued to consider payday lenders to be high risk, stating that "[i]n the context of this audit, merchants associated with high-risk or higher-risk activities include . . . payday lenders." JA428.) What is more, the July 2014 letter reiterated that servicing allegedly high-risk businesses such as payday lenders would continue to subject banks to increased regulatory compliance costs: "FDIC guidance indicates that insured institutions that engage in customer relationships with [third party payment processors] should assess their risk tolerance for this type of activity and develop an appropriate risk management framework, which includes policies and procedures that address due diligence, underwriting, and ongoing monitoring." JA519. It is thus not surprising that banks continue to terminate their relationships with payday lenders, as detailed in the text below.

antipathy to the payday lending industry and coercive pressure tactics employed against banks servicing them as customers.

The evidence uncovered by the Oversight Committee reveals that antipathy to the payday lending industry reached the FDIC's senior leadership. A briefing with Acting Chairman Martin Gruenberg, for example, led to the list of high-risk businesses in the January 2012 Financial Institution Letter being advanced to the beginning of the document. JA199. Emails between staff members indicate that this was intended to ensure that the list would "grab some attention" and to avoid the risk that "the reader may not get the message." JA199-200. In another incident, a Senior Counsel in FDIC's Legal Division explained that the agency was developing talking points for a meeting Acting Chairman Gruenberg was having with bankers "as to how banks facilitate payday lending and why the FDIC is concerned." JA204. Another email in the same chain provides a blueprint for how the FDIC could use the regulatory guidance it had issued to pressure banks to terminate payday lenders: "Those due diligence requirements definitely give us (the FDIC) grounds for asking banks to keep track of what [banks'] payday lender/[third party payment processor] account holders are doing and a failure of banks to perform that due diligence may be grounds for an enforcement action . . . in the right situations." JA326.

Other examples of animus against the payday lending industry involve Mark Pearce, the Director of the FDIC's Division of Depositor and Consumer Protection.

In a February 2013 email, the Director of FDIC's Atlanta region informed Pearce that he was "pleased we are getting banks out of ach (payday, bad practices, etc.)." JA202. Pearce responded that he was glad they were "on the same page" and that "failure to be proactive on this will lead to enforcement agencies [sic] or reputational issues, which is not in [the] best interest of our institutions." *Id.* Emails between members of FDIC's Legal Division further indicate that Director Pearce was "interested in trying to find a way to stop our banks from facilitating payday lending." *Id.* (quotation marks omitted).

The opinions of FDIC's leadership extended into the field, and the regulatory guidance FDIC had promulgated was used to apply backroom pressure to banks to terminate payday lenders. This is particularly evident in the emails of Atlanta Regional Director Thomas Dujenski, whose jurisdiction covered several states including South Carolina, where Plaintiff Advance America is headquartered. In one email to Director Pearce, for example, Director Dujenski emphasized that he was "sincerely passionate" about the fact that "I literally cannot stand pay day lending. They are abusive, fundamentally wrong, hurt people, and do not deserve to be in any way associated with banking." JA208. Other emails from the same official published by the FDIC's Office of Inspector General reveal similar sentiments. In December 2012, for example, Director Dujenski informed members of his staff that "[a]ny banks even remotely involved in payday [sic] should be promptly brought to my

attention," and in March 2013 he similarly informed his staff that "[p]ay day lenders bring reputational risk . . . nothing good for our banks." JA456. Director Dujenski's message apparently got through to his staff. In one message published by the Oversight Committee, an FDIC field supervisor in the Atlanta region wrote to a bank contemplating providing ACH services to a payday lender that "the arrangement will receive close regulatory scrutiny from the FDIC," and that "[e]ven under the best circumstances, if the venture is undertaken with the proper controls and strategies to try to mitigate risks, since your institution will be linked to an organization providing payday services, your reputation could suffer." JA207.

Regulatory pressure tactics such as this were not limited to the Atlanta region. In 2013, for example, the Chicago Regional Office engaged in an effort to get a bank to terminate a payday lender customer that had been using the bank to facilitate ACH payment processing. *See* JA458. As part of this campaign, the Director of the Chicago Region informed the bank's board of directors that it was "unacceptable" for the bank to continue serving payday lenders:

> It is our view that payday loans are costly, and offer limited utility for consumers, as compared to traditional loan products. Furthermore, the . . . relationship carries a high degree of risk to the institution . . . Consequently, we have generally found that activities related to payday lending are unacceptable for an insured depository institution.

JA229.[3] The FDIC pressured the bank for months until it finally capitulated and terminated the relationship. In notifying the FDIC of its decision, the bank "expressed disappointment with the FDIC's supervisory approach, particularly its ability to pressure an institution to terminate a business relationship . . . ." JA460.

The Oversight Committee also reported that a senior FDIC official in the Kansas City region threatened a bank considering serving a payday lender with severe regulatory consequences: "The official told the banker, 'I don't like this product, and I don't believe it has any place in our financial system. Your decision to move forward will result in an immediate unplanned audit of your entire bank.' " JA206.

C. Banks terminate payday lenders en masse.

Around the same time that the FDIC began labelling payday lenders as high-risk customers and pressuring them not to service payday lenders, banks regulated by Defendants began terminating their payday lender customers, often en masse, and often with little warning and with little to no explanation. While many termination

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[3] The district court reasoned that this letter "appears to be evidence of a targeted enforcement action against a single scofflaw," JA1150, but that conclusion is belied by the language quoted above—"we have *generally* found that activities related to payday lending are unacceptable for an insured depository institution." (emphasis added.) Indeed, the FDIC field supervisor on the account expressly recognized that, "In the end, we are getting them out of [ACH processing for a payday lender] through moral persuasion and as you know from a legal perspective we don't have much of a position, if any." JA460.

letters from banks have not specified the reasons for the banks' actions, *see* JA1040-1128, reasons that have been offered are consistent with the cause being Defendants' regulatory activities. For example:

- In February 2014, Hancock Bank/Whitney Bank sent a notification indicating that "[w]e are unable to effectively manage your Account(s) on a level consistent with the heightened scrutiny required by our regulators for money service businesses"—a category that includes payday lenders—"due to the transactional characteristics of your business." JA1082.
- In August 2014, WesBanco informed a payday lender that it would be terminating its accounts, explaining that it "must reluctantly discontinue such account services to all payday lenders" because of, among other things, "warnings of future adverse consequences to financial institutions who provide deposit and transaction services to payday lenders from the . . . bank regulatory agencies . . . ." JA1102.
- In June 2014, Chemical Bank informed Plaintiff Advance America that it would be closing an account "due to the overall risks associated with Money Services Business transactions." JA1099.
- In June 2014, Bank of America notified a payday lender that it was closing its account "based on the nature of your business and associated risks." JA172.

- In August 2014 SunTrust issued a press release stating that it was discontinuing relationships with payday lenders "due to compliance requirements." Press Release, SunTrust Statement on Certain Account Closures, SUNTRUST (Aug. 8, 2014), https://goo.gl/Tyytrv.
- In March 2014, Fifth Third Bank informed a payday lender that it would be closing its accounts because the services provided by payday lenders were "outside [the bank's] risk tolerance." JA133.
- In October 2016, Central Bank of Minnesota informed a payday lender that it could not open a deposit account for it "based on an evaluation of the account risk factors, and the resources we would have available to manage a higher risk account." JA1123.

While banks typically did not expressly blame their regulators in written communications with payday lenders, evidence in the record indicates that some bankers were more forthcoming in personal discussions.[4] Examples include the following:

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[4] The district court discounted this evidence as "anonymous double hearsay," JA1149, but, as Plaintiffs argue *infra*, the district court was wrong to do so. Another declaration from a banker names the regulator that allegedly pressured the bank to terminate its relationship with a payday lender, *see* JA500 ¶ 6, but that banker's account is contested by a declaration submitted by Defendants, *see* Sealed Ward Declaration, JA1241. Of course, neither declarant's testimony has been tested by cross-examination at this point in the proceedings.

- Check Assist, a third party payment processor, terminated its relationship with several payday lenders managed by PH Financial. Check Assist informed PH Financial that examiners of the bank that it used—Bank of Kentucky—had informed the bank that they did not want it to have anything to do with the payday lenders. *See* JA168 ¶ 10; JA1168 ¶ 11.[5]
- Bank of Kentucky verbally communicated to another payday lender that it was terminating its banking relationship because bank regulators had directed the bank to terminate its relationship with all payday lenders. JA123 ¶ 5.
- Richard Naumann was told by the local branch manager at Umpqua Bank that Umpqua was terminating its relationship with his payday lending company because of the pressure the bank was receiving from its federal regulators not to do business with payday lenders. JA808 ¶ 3.[6] Another banker told him that to try to do business with a payday lender would put the bank in regulatory hell. JA808 ¶ 4.
- Based on conversations with bank managers, the Managing Partner of Plaintiff Northstate Check Exchange understands that both Tri Counties Bank and Wells Fargo Bank terminated relationships with Northstate because of the

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[5] We cite this second, post-preliminary injunction motion declaration because it clarifies that the payment processor terminated payday lenders managed by PH Financial, not PH Financial itself.

[6] Mr. Naumann is a Plaintiff below but not a party to this appeal.

regulatory pressure placed on them that made continuing to do business with payday lenders untenable. JA828 ¶ 3.

- A bank official told the Chief Financial Officer of Plaintiff Check Into Cash that the bank was "instructed" to cease doing business with payday lenders, and an official with another bank told him that the bank's decision to stop doing business with payday lenders was due to "Chokepoint." JA813 ¶ 7.

D. Payday lenders suffer from restricted access to the banking system.

Because payday lenders need access to the banking system to survive, the bank terminations that they have suffered have taken a toll on their businesses. This is well illustrated by Plaintiffs in this case. Smaller operators have felt the negative effects particularly quickly, as they tend to have fewer resources available to them to try to combat the effects of losing banking relationships than larger enterprises. Richard Naumann, for example, owned and operated Calaveras Cash, a payday lender located in Calaveras County, California. Calaveras Cash began banking with Umpqua Bank before the store opened for business, and Mr. Naumann had an excellent relationship with the bank for several years. *See* JA807-08 ¶¶ 2-3. Then, in 2014, the bank suddenly terminated its accounts with Calaveras Cash. JA808 ¶ 4. Unable to find another bank to service the business, Mr. Naumann was forced to shut it down shortly thereafter. *Id.*

At the other end of the size spectrum is Plaintiff Advance America. Advance America is a leader of the payday lending industry and operates storefronts across the Nation. Since February 2013, Advance America has received termination notices from at least 21 banks. *See* JA509 ¶ 3. The terminations have intensified in pace and scope recently. In October and November 2016 alone, Advance America received termination notices from five banks, affecting accounts serving 1380 storefronts. JA509 ¶ 5. Also in November and December of 2016 alone, approximately 150 additional banks refused to enter a banking relationship with the company. JA841 ¶ 6.

Unlike Calaveras Cash, Advance America has not yet been forced out of business, but its continued survival is in jeopardy. JA843 ¶ 11. The company has incurred substantial costs as a result of the banking relationships it has lost. For example, the company projects that it will spend over $3 million on armored courier services in 2017—a 500% increase over what it spent in 2012. JA842 ¶ 8. The company also expects a four-fold increase in its ACH processing expenses from 2016 to 2017 as a result of the latest round of terminations. *Id.*

Like Advance America, the other Plaintiffs also have suffered the effects of bank terminations in recent years, losing relationships with banks including Bank of America, Capital One Bank, Fifth Third Bank, JP Morgan Chase, and U.S. Bank. *See* JA813 ¶ 5; JA815-16 ¶¶ 3-7; JA827-28 ¶¶ 2-3; JA1168 ¶ 12.

II. Procedural History.

Advance America filed this lawsuit in June 2014 along with the Community Financial Services Association of America ("CFSA"), a membership organization for businesses offering payday loans and other financial products and services. The complaint asserted statutory claims under the Administrative Procedure Act ("APA") and constitutional claims under the Due Process Clause of the Fifth Amendment. Defendants moved to dismiss, and in September 2015 the district court granted the motion in part and denied it in part. In particular, the district court granted Defendants' motion to dismiss the APA claims, but it held that Plaintiffs had stated a due process claim. "Plaintiffs have sufficiently alleged," the court held, "that their liberty interests are implicated by Defendants' alleged actions and that the alleged stigma has deprived them of their rights to bank accounts and their chosen line of business, so as to state a claim for violation of constitutional due process." JA423.

While typically the denial of a motion to dismiss would be followed by discovery in anticipation of summary judgment motions or trial, Defendants instead filed a second motion to dismiss, and the district court made clear that discovery would not begin until that motion was resolved. *See* JA1182; JA1189. Defendants' motion asserted that CFSA lacked organizational standing to assert the remaining live claims, and the district court granted the motion in December 2016. JA770.

Despite resolving this motion, the district court did not allow discovery to begin right away, and indeed it has not even started yet.[7]

In light of the dismissal of CFSA as a plaintiff, Plaintiffs moved to amend the complaint to add additional parties as plaintiffs, and the district court granted the motion in February 2017. JA844. And in light of their disagreement with the district court's disposition of their APA claims and CFSA's standing, Advance America and CFSA moved for entry of a final judgment on those issues under Federal Rule of Civil Procedure 54(b) to facilitate an immediate appeal. By granting the Rule 54(b) motion, the district court could have given this Court the opportunity to address the APA claims and CFSA's standing along with the due process claims that are at issue in this appeal. The district court, however, denied the Rule 54(b) motion in April 2017. JA1171.

In the meantime, Advance America moved for a preliminary injunction in November 2016, following a wave of termination notices from banks. The new plaintiffs filed their own preliminary injunction motion when moving to join the case in January 2017, adopting Advance America's arguments. The district court held argument on February 16 and issued an order denying the preliminary injunction

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[7] Finally, on May 8, 2017, the district court entered an order recognizing that "there is no justification whatsoever" for denying Plaintiffs the ability to take discovery any longer, and the court therefore directed the parties to submit a joint discovery plan by May 26 and made clear that it "expect[s] the Parties to move forward [with discovery] as soon as possible." JA1172.

motions a week later. The district court held that Plaintiffs were unlikely to succeed on the merits because, in the district court's view, they were required to show that they had already "effectively been cut off from the banking system" or that they "soon" would be, *see* JA1137; JA1142, and the district court concluded that they had failed to make such a showing. The district court also reasoned that to succeed Plaintiffs "ultimately" would be required to prove that "Defendants made stigmatizing statements about them" that "*caused* banks to terminate their business relationships with Plaintiffs," and it concluded that Plaintiffs were unlikely to be able to make such a showing. JA1147-48. On March 14, Plaintiffs timely noticed their appeal to this Court. JA1165.

SUMMARY OF ARGUMENT

Plaintiffs are likely to succeed on the merits of their procedural due process claims under three related but distinct theories. First, Plaintiffs are likely to succeed on a "stigma-plus" theory, because Defendants' designation of payday lenders as high risk customers for banks distinctly alters Plaintiffs' right to access the banking system in common with other law-abiding enterprises. Second, Plaintiffs are likely to succeed on a "reputation-plus" theory, because Defendants caused Plaintiffs to have their banking relationships terminated in the midst of stigmatizing charges about the purported riskiness of their businesses for banks. Third, Plaintiffs are likely

to succeed on a "broad preclusion" theory, because Defendants' actions threaten to broadly preclude them from pursuing their chosen line of business.

The district court erred in concluding that Plaintiffs are unlikely to succeed on the merits. First, the district court wrongly reasoned that Plaintiffs would be required to show that they have been or are threatened with being entirely cut off from the banking system in order to succeed. Second, the district court wrongly reasoned that Plaintiffs would be required to show that defamatory statements by Defendants caused them to be terminated by banks. Third, the district court wrongly found that the evidence in the record neither supported a finding that Defendants' actions are the cause of the bank termination Plaintiffs have suffered nor a finding that Plaintiffs' businesses are facing an existential threat.

Because Plaintiffs claim a violation of the Due Process Clause, and because Plaintiffs are likely to succeed on that claim, the other preliminary injunction factors—irreparable harm, balance of the equities, and the public interest—uniformly favor the entry of an injunction.

STANDARD OF REVIEW

"On a motion for a preliminary injunction, the district court must balance four factors: (1) the movant's showing of a substantial likelihood of success on the merits, (2) irreparable harm to the movant, (3) substantial harm to the nonmovant, and (4) public interest." *Davis v. Pension Benefit Guar. Corp.*, 571 F.3d 1288, 1291 (D.C.

Cir. 2009). A movant who "makes an unusually strong showing on one of the factors . . . does not necessarily have to make as strong a showing on another factor." *Id.* at 1291-92. While this "sliding-scale" approach has been questioned in light of Supreme Court precedent, this Court has not abandoned it. *See League of Women Voters of United States v. Newby*, 838 F.3d 1, 7 (D.C. Cir. 2016).

On appeal, this Court reviews "the district court's weighing of the preliminary injunction factors under the abuse of discretion standard." *Serono Labs., Inc. v. Shalala*, 158 F.3d 1313, 1318 (D.C. Cir. 1998) (quotation marks omitted). "To the extent the district court's decision hinges on questions of law" this Court's "review is essentially *de novo*," while findings of fact are reviewed "under the clearly erroneous standard." *Id.* (quotation marks omitted).

ARGUMENT

I. Plaintiffs Are Likely To Succeed on the Merits of Their Due Process Claims.

Whether Plaintiffs are entitled to a preliminary injunction turns on whether their due process claims are likely to succeed. That is because once Plaintiffs satisfy the likelihood of success factor in this constitutional challenge, the rest of the preliminary injunction factors fall into place. Alleged violations of constitutional rights may constitute irreparable harm, *see Chaplaincy of Full Gospel Churches v. England*, 454 F.3d 290, 304 (D.C. Cir. 2006), and this Court has expressly held this to be the case with respect to alleged violations of the Due Process Clause, *see*

Gordon v. Holder, 721 F.3d 638, 653 (D.C. Cir. 2013). The remaining two factors—the balance of the equities and the public interest—"merge when the Government is the opposing party." *Nken v. Holder*, 556 U.S. 418, 435 (2009). And when the Government is likely violating the Constitution, these factors favor the plaintiff, for "enforcement of an unconstitutional law is always contrary to the public interest." *Gordon*, 721 F.3d at 653. Thus, while Plaintiffs will address all four preliminary injunction factors, they turn first to the outcome determinative one—likelihood of success.

A. Plaintiffs are likely to succeed on three distinct due process theories.

In guidance documents and in one-on-one communications with banks, Defendants have made clear that they consider businesses involved in the payday lending industry to be "high risk" customers for the banks that they regulate. The regulatory guidance documents included payday lenders in lists of high risk industries, on par with peddlers of Ponzi schemes, drug paraphernalia, and escort services. *See* JA84. And the guidance documents made clear that there would be steep compliance costs for banks choosing to serve purportedly high risk businesses. Agency officials, however, were not content to rely on general regulatory guidance alone to get their anti-payday lending message to banks. Internal FDIC emails indicate that senior officials thought that payday lenders "do not deserve to be in any way associated with banking," JA208, and that they thus sought to "find a way to

stop our banks from facilitating payday lending," JA202. To achieve this goal, Defendants have used the high risk label attached to payday lenders as a basis for threatening banks and seeking to coerce them to cut off their relationships with payday lenders, as several specific, documented examples attest. *See* JA206-08.

Against the backdrop of the regulatory environment Defendants have created, this high risk label significantly alters the right of payday lenders to access the banking system. Predictably, many banks have stopped serving Plaintiffs and other payday lenders altogether, which is precisely the result Defendants have aimed to achieve. Plaintiff Advance America alone has lost relationships with at least 21 banks and has been denied service by hundreds more, and the terminations it has suffered affect more than one thousand storefront locations. *See* JA840 ¶ 3; JA841 ¶ 5-6. Defendants' actions in seeking to exclude payday lenders from the banking system violate the Due Process Clause under three distinct but related theories.

The district court held that Plaintiffs are unlikely to succeed for two basic reasons. First, the district court held that Plaintiffs have not shown that the "level of injury" they have suffered or are likely to suffer is sufficient to sustain their due process claims. JA1136. Second, the district court concluded that Plaintiffs' evidence that Defendants' stigmatizing statements caused the termination of their bank accounts is unpersuasive. The district court committed legal error in reaching these conclusions. As an initial matter, the district court committed legal error by

misapprehending what Plaintiffs need to prove in order to sustain their claims, particularly under a stigma-plus theory. Furthermore, even on its own terms, the district court's reasoning lacks merit because facts in the record establish that Plaintiffs are likely to succeed in showing both that they are threatened with broad preclusion from the banking system and, hence, the payday lending industry, and that Defendants' actions are the source of this threat and of the terminations they have suffered to date. *Cf. United States v. McGill*, 815 F.3d 846, 945 (D.C. Cir. 2016), *cert. petition docketed*, No. 16-8128 (Feb. 28, 2017) (challenges to "sufficiency of the evidence" are reviewed "de novo").[8]

1. Plaintiffs are likely to succeed on a stigma-plus theory.

a. While it is well-established that government defamation, standing alone, does not amount to a violation of the Due Process Clause, it is equally well-established that due process is implicated when the government stigmatizes a person in connection with an alteration of their background legal rights. This "stigma-plus" doctrine finds its genesis in *Wisconsin v. Constantineau*, 400 U.S. 433 (1971). That case involved the application of a Wisconsin statute allowing government officials to prohibit businesses from selling alcohol to certain persons through "postings" that labelled them as excessive drinkers. In *Constantineau*, the chief of police posted

[8] Even if the district court's conclusions on these matters are deemed to be factual rather than legal, Plaintiffs still should prevail because those conclusions are clearly erroneous for the reasons explained in the text.

such notice about the plaintiff in all retail liquor establishments in a particular town. The Court held that the Wisconsin statute violated the Due Process Clause, because it allowed the government to label individuals as excessive drinkers and alter their background legal rights without providing them with any procedural protections: "Where a person's good name, reputation, honor, or integrity is at stake because of what the government is doing to him," the Court explained, "notice and an opportunity to be heard are essential." *Id.* at 437. The Court reaffirmed *Constantineau*'s central holding in *Paul v. Davis*, 424 U.S. 693 (1976). "Posting," the Court reasoned, "deprived the individual of a right previously held under state law . . . to purchase or obtain liquor in common with the rest of the citizenry. . . . "[T]hat alteration of legal status . . . combined with the injury resulting from the defamation . . . justified the invocation of procedural safeguards." *Id.* at 708-09.

Under *Constantineau* and *Paul*, procedural safeguards are required in this case. Here, the background legal right at issue is the right to access the banking system in common with the rest of the citizenry. "Many people" would consider the right to "hold bank accounts" to be "more important than the right to purchase liquor," and it therefore deserves at least as much procedural protection. *See National Council of Resistance of Iran v. Department of State*, 251 F.3d 192, 204 (D.C. Cir. 2001) ("*NCRI*"). This procedural protection must be available before a business or industry is labelled "high risk," for the high risk label distinctly alters a

business's right to access the banking system by the increased regulatory scrutiny a bank receives when servicing purportedly high risk clients. In this way, the "high risk" label is akin to the "excessive drinker" label in *Constantineau*.

To be sure, while the posting of the plaintiff as an "excessive drinker" in *Constantineau* completely prohibited the target from purchasing alcohol from establishments in her hometown, the "high risk" label here does not necessarily flatly forbid a bank from letting a payday lender hold a bank account. But this distinction does not undermine Plaintiffs' claims, for due process protections are required before a pre-existing right is "distinctly altered *or* extinguished." *Paul*, 424 U.S. at 711 (emphasis added). Indeed, in *Constantineau* itself it cannot be said that the plaintiff's right to purchase alcohol was extinguished, because the application of the state law at issue in that case prohibited her only from purchasing alcohol in one particular town. *Paul* thus described the right at issue in *Constantineau* as the right "to purchase or obtain liquor *in common with the rest of the citizenry*," not the right to purchase or obtain liquor *at all*. *Id.* at 708 (emphasis added).

Similarly, this Court, in *Bartel v. Federal Aviation Administration*, 725 F.2d 1403 (D.C. Cir. 1984), held that the plaintiff had successfully stated a due process claim when government-imposed stigma caused him to be denied the "right to reemployment with the FAA at the GS-13 level," and he was instead "rehired only in a temporary GS-12 position." *Id.* at 1415. "The crux of the complaint," this Court

explained, was "that Bartel was not considered for FAA employment on a basis equal with others of equivalent skill and experience—*i.e.*, that he was wrongfully denied the 'right to be considered for government employment in common with all other persons.' " *Id.* (brackets omitted) (quoting *Mosrie v. Barry*, 718 F.2d 1151, 1161 (D.C. Cir. 1983)). In this case, as a result of being labelled "high risk" due to their connection to the payday lending industry, Plaintiffs have been wrongfully denied the right to be considered for bank accounts in common with other law-abiding entities.

Other Circuits too have expressly rejected any requirement that a right be fully extinguished before due process protections are mandated. The Second and Ninth Circuits provide two examples in circumstances analogous to this case in *Valmonte v. Bane*, 18 F.3d 992 (2d Cir. 1994), and *Humphries v. County of Los Angeles*, 554 F.3d 1170 (9th Cir. 2009), *rev'd sub nom. Los Angeles Cty. v. Humphries on other grounds*, 562 U.S. 29 (2010). Both cases involved the placement of individuals on state-wide registries of child abusers, and in both cases the legal effect of that placement was to alter, but not necessarily to extinguish, certain rights. In *Valmonte*, child care providers in New York were required to consult the registry when making hiring decisions and, if they decided to hire someone on the registry, they were required to explain why in writing. The Court concluded that "the requirement that puts burdens on employers wishing to hire individuals on the list results in a change

of that individual's status significant enough to satisfy the 'plus' requirement of the 'stigma plus' test." *Valmonte*, 18 F.3d at 1002.

In *Humphries*, similarly, agencies in California were required to consult the registry and to conduct an additional investigation of listed individuals before conferring rights and benefits such as a license to work in child care or receiving custody of a relative's child. As in *Valmonte*, the court held that the burdens imposed by this regime were sufficient to require due process protections: "A tangible burden exists in this context where a law effectively requires agencies to check a stigmatizing list and investigate any adverse information prior to conferring a legal right or benefit . . . . This requirement places a tangible burden on a legal right that satisfies the 'plus' test." *Humphries*, 554 F.3d at 1188.

Here, Plaintiffs have similarly been stigmatized—by being labelled high risk—and the consequences of that label are to similarly burden their rights—here, their rights to access the banking system, which are burdened by the additional regulatory scrutiny that is brought to bear on banks servicing purportedly high risk customers.

b. The district court's reasoning does nothing to undermine Plaintiffs' likelihood of success on this stigma-plus theory. First, the district court erred by concluding that Plaintiffs would need to show that they have "effectively been cut off from the banking system" to prevail on their claims. JA1137. This conclusion is

refuted by *Paul v. Davis*, which reasoned that the Due Process Clause is implicated when "a right or status previously recognized by state law [is] distinctly altered *or* extinguished," not only when it is extinguished entirely. 424 U.S. at 711 (emphasis added). What is more, *Paul* reaffirmed the Court's holding that there was a deprivation of due process in *Constantineau*, despite the fact that the plaintiff in that case could drive to a neighboring town to purchase the alcohol that she was barred from purchasing in her hometown. The district court's conclusion is also foreclosed by this Court's decision in *Bartel*, which held that a plaintiff who was hired by the government in a temporary GS-12 position, rather than a permanent GS-13 position, had successfully stated a due process claim. 725 F.2d at 1415. Furthermore, were this Court to adopt the district court's reasoning, it would needlessly bring the Court into conflict with the Second and Ninth Circuit's decisions in *Valmonte* and *Humphries*, which expressly rejected the assertion that extinguishment, as opposed to alteration, of a right must be at stake before due process protections are required.

The district court relied on two cases for its conclusion that Plaintiffs would be required to show that they have been effectively cut off from the banking system, but those cases do not support the district court's conclusion. First, the district court noted that in *NCRI* the designation of the plaintiffs as terrorist organizations prohibited banks from transacting with them. *See* JA1137 n.1. All this goes to show, however, is that a flat prohibition is *sufficient* to trigger the Due Process Clause, not

that it is *necessary*. Second, the district court cited *Kartseva v. Department of State*, 37 F.3d 1524 (D.C. Cir. 1994), for the proposition that "[t]he loss of some discrete number of bank accounts does not constitute a change in legal status." JA1136 (quotation marks omitted). But *Kartseva*, in fact, makes clear that wholesale extinguishment of a right is *not* necessary to sustain a stigma-plus claim, for the Court there held that the plaintiff could prevail if she showed that the government's action had the legal effect of barring her from "some category of future State contracts or from other government employment opportunities." 37 F.3d at 1528. It was only in the context of the alternative "broad preclusion" theory that the Court reasoned that the plaintiff would be required to show that she was effectively "foreclosed from reentering [her] field." *Id.* at 1529.

Second, the district court erred by concluding that, "[t]o succeed on the merits, Plaintiffs must ultimately prove that Federal Defendants made stigmatizing statements about them and that these stigmatizing statements *caused* banks to terminate their business relationships with Plaintiffs." JA1147. This conclusion is erroneous because, as this Court has made clear, a stigma-plus claim "does not depend on official speech, but on a continuing stigma *or disability* arising from official *action*." *O'Donnell v. Barry*, 148 F.3d 1126, 1140 (D.C. Cir. 1998) (emphases added); *see also San Jacinto Sav. & Loan v. Kacal*, 928 F.2d 697, 704 (5th Cir. 1991) (holding that plaintiff "does not and need not show that . . . alleged

defamatory remarks actually caused" injuries to maintain due process claim). All that a plaintiff needs to show to succeed under the Due Process Clause is that government officials have "sought to remove or significantly alter [the plaintiff's] liberty and property interests . . . without due process of law." *San Jacinto Savings*, 928 F.2d at 704. In other words, even if Plaintiffs had not suffered a single termination, they would still have established a violation of due process because their standing to obtain bank accounts has been altered. And the issue of defamation "is a red herring." *Id.* Here, Defendants' actions relating to their labelling of payday lenders as high risk customers for banks have imposed a continuing disability upon payday lenders by subjecting banks that nevertheless choose to maintain them as customers to increased regulatory scrutiny and compliance costs. That is all that is required to implicate the Due Process Clause.

2. Plaintiffs are likely to succeed on a reputation-plus theory.

a. In addition to their stigma-plus theory, Plaintiffs also are likely to succeed under the related, but distinct, reputation-plus theory. This theory has its genesis in *Board of Regents of State Colleges v. Roth*, 408 U.S. 564 (1972), decided in the year following the Court's decision in *Constantineau*. There, Roth, who had been a non-tenured assistant professor in political science at a university in Wisconsin, was informed that he would not be rehired when his teaching contract expired. Roth argued that the decision violated his due process rights, but the

Supreme Court rejected his claim. The Court did not hold that the lack of tenure or any other property right to continued employment necessarily foreclosed due process protection. Rather, the Court emphasized that the "State, in declining to rehire the respondent, did not make any charge against him that might seriously damage his standing and associations in his community. . . . Had it done so, . . . due process would accord an opportunity to refute the charge before University officials." *Id.* at 573. As with *Constantineau*, the Court reiterated *Roth*'s reasoning in *Paul v. Davis*: "*Roth* recognized that governmental action defaming an individual in the course of declining to rehire him could entitle the person to notice and an opportunity to be heard as to the defamation." 424 U.S. at 709. Following *Roth* and *Paul*, this Court too has recognized that "defamation in the course of the termination of employment is" actionable under the Due Process Clause. *O'Donnell*, 148 F.3d at 1140 (quotation marks omitted).

Plaintiffs' claims satisfy the elements of a reputation-plus due process claim. First, each of the Plaintiffs has had its relationship with at least one bank terminated. Because these terminations were caused by and attributable to Defendants' actions, they are akin to the loss of government employment. *Cf. Old Dominion Dairy Prods., Inc. v. Secretary of Defense*, 631 F.2d 953, 964 (D.C. Cir. 1980) (extending reasoning of *Roth* to reach denial of government contracts, explaining that to "rule otherwise would drain *Roth* of meaning"). Furthermore, these terminations occurred

against the backdrop of Defendants falsely claiming that the reputational risks incurred by having payday lenders as customers threaten the safety and soundness of banks. The stigmatizing nature of the high risk label Defendants have affixed to payday lenders has been heightened by the association of law-abiding payday lending with Ponzi schemes, online gambling, and other unsavory—if not illegal—activities, *see* JA84, and it has been reinforced by Defendants in one-on-one communications with banks pressuring them to cease serving payday lenders, *see* JA206-08. Whether or not Defendants' defamation *caused* the terminations Plaintiffs have experienced (as opposed to, say, the terminations being caused by the allegations in conjunction with Defendants' pressure tactics), the "stigmatizing charges certainly occurred in the course of the termination of" the accounts, which is all that is required for a reputation-plus claim to succeed. *See Owen v. City of Independence*, 445 U.S. 622, 633 n.13 (1980) (alterations and quotation marks omitted). Indeed, to this day the Defendant agencies have yet to unequivocally retract the allegation that payday lenders are reputationally risky customers for banks, and all of the terminations in this case have taken place against the backdrop of that allegation. This allegation is a particularly stigmatizing one in the context of the regulatory regime that Defendants have created.

b. Like the stigma-plus theory, the reputation-plus theory does not require Plaintiffs to show that they have been cut off from the banking system entirely, nor

does it require them to show that Defendants' defamatory statements caused them to lose bank accounts. Rather, under *Roth*, Plaintiffs simply need to show that Defendants defamed them "in the course of the termination" of their accounts. *See O'Donnell*, 148 F.3d at 1140; *see also Owen*, 445 U.S. at 633 n.13. As just explained, Plaintiffs satisfy these requirements.

To be sure, Plaintiffs' reputation-plus theory does require them to show that Defendants' *actions* (whether defamatory or not, and whether consisting of statements or not) caused their banks to terminate them—that is what makes the loss of bank accounts in this case equivalent to the loss of government employment in *Roth* and other reputation-plus cases. The evidence in the record demonstrates that Plaintiffs are likely to succeed in making this showing.

The staff report of the Oversight Committee made several key findings that support Plaintiffs' theory of causation, and those findings are supported by substantial evidence in the record of this case. First, the report found that senior policymakers at FDIC were steeped in "animus" toward payday lending. JA195. Indeed, one senior official wrote that he "literally cannot stand payday [lending]," and internal FDIC records show that senior officials sought "to find a way to stop our banks from facilitating payday lending." JA195; JA202. Second, the report found that the FDIC "targeted legal industries" and equated them with "inherently pernicious or patently illegal activities such as Ponzi schemes, debt consolidation

scams, and drug paraphernalia." JA195. This fact is undeniable, as it is in black and white in the FDIC's own publications. *See* JA84; JA91 n.1. Third, the report found that the FDIC sought to "influence banks' business decisions" and discussed how "to ensure that bank officials saw the list [of high-risk merchants] and 'get the message.' " JA195. Again, this cannot be disputed, as internal records from FDIC published by the Oversight Committee show that officials moved the list of high-risk merchants to the front of the January 2012 Financial Institution Letter to ensure that it would "grab some attention" and mitigate the risk that "the reader may not get the message." JA199-200. The Oversight Committee also published communications between FDIC officials and banks in which the FDIC officials pressured the banks not to service payday lenders, informing them that "we have generally found that activities related to payday lending are unacceptable for an insured depository institution" and threatening them with "close regulatory scrutiny" should they nevertheless serve payday lenders as customers. JA207. Fourth, the report found that scores of banks had "terminated business relationships with payday lenders," JA206—a conclusion that is amply supported by the experience of Plaintiffs in this case. *See supra* Statement of the Case Part I.D. What is more, the termination letters sent by banks to payday lenders, to the extent they attempted to justify the terminations at all, have been entirely consistent with Defendants being the cause of the banks' actions, citing factors such as "heightened scrutiny required

by our regulators," JA1082, "warnings of future adverse consequences . . . from the . . . bank regulatory agencies," JA1102, and the "risks" posed by payday lenders, *see* JA133; JA172; JA1099; JA1123.

Adding all of this together, it is not difficult to conclude, as the staff report did, that payday lenders' bank terminations have been *caused* by Defendants' targeting. JA206. Columbia University Professor Charles Calomiris, who has extensive expertise in the regulation of financial institutions, reached the same conclusion for similar reasons: "the evidence clearly shows that the unprecedented wave of bank terminations of relationships with Payday Lenders coincided with, and was caused by, regulatory actions, working through guidance and alleged concerns about 'reputation risk,' which successfully discouraged banks from maintaining relationships with Payday Lenders that were profitable and viable." JA929-30. In addition to the evidence recounted above, Professor Calomiris also performed a comprehensive review of the academic literature on payday lending, and he concluded that the literature shows that far from being risks for banks, payday lenders tend to be profitable and stable businesses that benefit society. *See* JA930-31. This bolstered Professor Calomiris's conclusion that the regulators have caused banks to terminate payday lenders, because there is no alternative business rationale that would explain the recent wave of terminations. *See* JA921-22.

Despite all of this, the district court concluded that Plaintiffs could not "demonstrate a causal link between bank terminations and Federal Defendants' conduct." JA1148. The district court's rationale for this conclusion does not withstand scrutiny.

First, the district court questioned whether there even has been a wave of bank terminations of payday lenders, asserting that Plaintiffs failed "to establish whether or not banks frequently terminated accounts with payday lenders prior to the alleged initiation of Operation Choke Point in 2013." JA1152. But this is false. Undisputed evidence in the record, for example, shows that Advance America lost only six banking relationships from 2007 through 2011, while it has been terminated by at least 21 banks since 2013 (and been refused service by hundreds more). JA840-41 ¶¶ 3-4, 6. Evidence submitted by other Plaintiffs likewise indicates the unprecedented nature of what has been taking place. Northstate did business with its bank for 24 years before it was terminated in 2015. JA827 ¶ 2. Richard Naumann's business used the same bank for years, starting before his store opened, before it was terminated in 2014. JA808 ¶¶ 3-4. And PH Financial's first experience with a bank termination came in August 2013. JA833 ¶ 2.

Second, the district court asserted that Plaintiffs introduced "little direct evidence of . . . a wide-ranging campaign" against the payday lending industry, JA1148, and instead relied on "problematic" evidence including "anonymous double

hearsay" that the district court effectively disregarded, JA1149. But this reasoning suffers from manifold errors. As an initial matter, the district court consistently declined to allow discovery to begin despite the fact that over a year and a half has passed since the court denied Defendants' motion to dismiss the original Plaintiffs' due process claims in September 2015. *See* JA377. Thus, any lack of "direct evidence" is not Plaintiffs' fault, nor is it any indication that such evidence does not exist. Furthermore, the factual argument Plaintiffs set forth at the outset of this sub-part, which itself is sufficient to establish causation, relies entirely on direct evidence, in the form of agency publications, internal agency communications, agency communications with banks, bank communications with payday lenders, and Plaintiffs' descriptions of the account terminations they have suffered.

For these reasons, Plaintiffs have established causation wholly apart from the reliability of "anonymous double hearsay" evidence that the district court dismissed as "unreliable and of little persuasive value." JA1149. But to the extent the Court reaches the issue, it should hold that the district court was wrong to disregard this evidence. The rules of evidence, of course, do not apply at the preliminary injunction stage, so there is no *per se* legal impediment to considering double hearsay evidence. *See, e.g.*, *Cobell v. Norton*, 391 F.3d 251, 261 (D.C. Cir. 2004) ("A preliminary injunction may be granted based on less formal procedures and on less extensive evidence than in a trial on the merits."); *Kos Pharm., Inc. v. Andrx Corp.*, 369 F.3d

700, 718 (3d Cir. 2004) (rejecting argument that evidence was "an inadequate basis for preliminary relief because it contain[ed] multiple levels of hearsay").[9] The district court cited another district court decision holding that "double hearsay . . . inherently lacks sufficient indicia of reliability," *FTC v. CCC Holdings, Inc.*, 2009 WL 10631282, at *1 (D.D.C. Jan. 30, 2009), but this is not true of the anonymous double hearsay evidence at issue here. That evidence consists of sworn declarations recounting statements bankers have made to payday lenders about the circumstances of their account terminations. *See supra*, Statement of the Case Part I.C. While bank officials often have insistently refused to discuss their reasons for terminating payday lenders, when they have spoken they have said that they were "instructed" to stop doing business with payday lenders, JA813 ¶ 6, that bank regulators had "directed" the bank to terminate its relationships with payday lenders, JA123 ¶ 5, and that the bank was being "forced" to terminate by pressure from federal regulators not to do business with payday lenders, JA808 ¶ 3. This evidence does not exist in a vacuum, but rather must be viewed in the context of the substantial additional evidence of regulatory pressure Plaintiffs have adduced and the many non-anonymous, non-double-hearsay termination letters from banks in the record that

[9] The district court's rules view the use of hearsay as the norm in preliminary injunction proceedings, as they provide that "[t]he practice in this jurisdiction is to decide preliminary injunction motions without live testimony where possible." D.D.C. LCvR 65.1(d).

blame regulators or regulatory concepts like reputation risk for the terminations. *See supra*, Statement of the Case Part I.C. In addition, the reluctance of bankers to voluntarily come forward should not be surprising in light of the tactics Defendants have used and the enormous power Defendants wield over banks. As the Seventh Circuit has recognized, "the target" of "lawless government coercion" generally will be "reluctant to acknowledge that he is submitting to threats." *Backpage.com, LLC v. Dart*, 807 F.3d 229, 237-38 (7th Cir. 2015). These considerations lend credence to the anonymous double-hearsay evidence in the record, and the district court was wrong to discount it entirely.[10]

Third, the district court credited a declaration from an official with U.S. Bank's regulator, the OCC, "stating unequivocally that they never pressured U.S. Bank to terminate its relationship with payday lenders." JA1150. (Defendants likely focused on U.S. Bank due to the far-reaching consequences of its termination for Advance America. *See* JA510-11 ¶¶ 10-14.) What the OCC official said, however, is not inconsistent with Defendants being the cause of U.S. Bank's decision to terminate payday lenders. The official stated that "[n]either I nor anyone on my team

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[10] At a bare minimum, the Court can consider the fact that the bankers made the statements the payday lenders reported they made. Double hearsay concerns are not implicated when viewing the statements in this light because by definition hearsay concerns only statements offered for the truth of the matter asserted. And, of course, Professor Calomiris was fully entitled to rely upon hearsay in reaching his conclusions. *See* FED. R. EVID. 703.

directed or otherwise pressured U.S. Bank's management or U.S. Bank's Board of Directors or any other bank employee to terminate the Bank's banking relationship with Advance America or with any other customer or with members of any specific industry or line of business, such as payday lending." JA514 ¶ 4. Plaintiffs' theory of causation is not limited to direct and explicit pressure to terminate payday lenders' accounts. Rather, that result also may be accomplished by increasing the regulatory costs of servicing purportedly "high risk" customers to the point where banks are left with little choice but to terminate them, and the OCC's untested declaration, even if credited, in no way refutes such a causal mechanism for the U.S. Bank terminations. What is more, the circumstances surrounding the U.S. Bank terminations are very suspicious. U.S. Bank was Advance America's primary provider of banking and financial services, servicing over 1,200 storefronts and providing services for Advance America's corporate offices. *See* JA510. Advance America was a U.S. Bank customer for 14 years, it paid U.S. Bank approximately $3 million a year in fees, and U.S. Bank treated Advance America as a valued client. JA510 ¶ 11. Yet in November 2016, U.S. Bank suddenly notified Advance America that their relationship would be terminated, and the bank steadfastly refused to explain its actions. JA510 ¶ 9; JA511 ¶ 13. And Advance America was not U.S. Bank's only victim, as the bank terminated several other payday lenders in November 2016. *See* JA505-06 ¶ 6(g)-(i). Plaintiff NCP Finance was among those

that received a termination notice, and it did so despite the fact that it had been a U.S. Bank customer for nearly 10 years and despite the fact that the bank had expressed interest in expanding the relationship just months before. *See* JA815-16 ¶¶ 5-7. Something happened to cause U.S. Bank to suddenly terminate its payday lending customers, and the most plausible explanation in light of the evidence in the record is that Defendants were the cause. *See* JA904-30.

3. Plaintiffs are likely to succeed on a broad preclusion theory.

a. There is a third way in which government-imposed stigma may give rise to a due process claim. Because the Due Process Clause protects the liberty "to engage in any of the common occupations of life," *Meyer v. Nebraska*, 262 U.S. 390, 399 (1923), or, in other words, "to follow a chosen trade or profession," *Cafeteria & Rest. Workers Union, Local 473 v. McElroy*, 367 U.S. 886, 895-96 (1961), "government stigmatization that broadly precludes individuals or corporations from a chosen trade or business deprives them of liberty in violation of the Due Process Clause," *Trifax Corp. v. District of Columbia*, 314 F.3d 641, 644 (D.C. Cir. 2003). Defendants' efforts to cut Plaintiffs out of the banking system threatens to broadly preclude them from the payday lending business because conducting that business requires access to banking services.

b. The district court did not disagree that this Court's cases establish that the Due Process Clause is implicated when government action "threaten[s] the very

existence of [a] business." *Old Dominion Dairy Products*, 631 F.2d at 955. Nor did the district court disagree that being cut off from the banking system would threaten Plaintiffs' businesses; indeed, the Court found that proposition "plausible on its face." JA1144. Rather, the Court based its conclusion that Plaintiffs were unlikely to succeed on a broad preclusion theory on its insistence that Plaintiffs' fears of being cut off from the banking system and being put out of business are too speculative. *See* JA1142; JA1144.

Plaintiffs' fears, however, are not speculative, but are grounded in reality. The district court's error stems, in part, from its dismissal of the existence of Defendants' campaign against the payday lending industry in the first place. Once it is accepted that Defendants have been engaged in a years-long campaign to cut off payday lenders' access to the banking system, the probability of this campaign succeeding becomes much more plausible.

The district court also appears to have misapprehended the nature of the threat faced by Plaintiffs. Particularly for larger enterprises like Advance America, the looming threat of execution is less akin to a bullet to the head than to a gradual strangulation—hence the "Operation Choke Point" moniker adopted by the Government. As more and more banks refuse to do business with payday lenders, the costs of doing business increase, as does the threat of being cut off from the banking system entirely. This is demonstrated by Advance America's experience.

The company has been forced to spend millions of dollars since 2013 to mitigate the effects of the banking relationships it has lost, including costs relating to items such as the installation of safes and the use of armored courier services. JA842 ¶¶ 7, 8. Advance America's most consequential bank termination yet—that of U.S. Bank, which affects over 1,200 storefronts and had not even been implemented at the time of the district court's decision, *see* JA841 ¶¶ 5-6—will only increase Advance America's costs further. The district court dismissed this evidence by reasoning that it was not clear that the loss of this relationship would cause the 1,200 stores to close, and that even if it did this approximately 60% loss in Advance America's storefronts would not suffice to show broad preclusion. *See* JA1145-46 & n.5. This reasoning, however, reflects a misunderstanding of the importance of this evidence. The point is not that the termination by U.S. Bank, standing alone, violates the Due Process Clause. Rather the U.S. Bank termination shows that the effects of Defendants' campaign against the payday lending industry is continuing and worsening. The U.S. Bank termination makes the business environment for Advance America even more difficult, as reflected by the fact that the company expects a four-fold increase in its ACH processing expenses from 2016 to 2017. *See* JA842 ¶ 8.

A financial company that is slowly but steadily being denied access to the banking system cannot survive indefinitely. Either the costs associated with work-arounds will increase to the point where they become prohibitive, or the lack of

access will become so severe that continuing to operate is impossible. Plaintiffs should not be forced to wait until they are on the brink of shutting down to get relief from Defendants' unlawful acts.

The evidence from Advance America substantiates Plaintiffs' claims that they are facing an existential threat. *See, e.g.*, JA512 ¶ 17 (Advance America's "ability to continue operating in its chosen line of business is in jeopardy"); JA818 ¶ 11 ("NCP's survival could be in serious jeopardy."); JA828 ¶ 4 (Northstate's "ability to continue in the payday lending line of business is in serious jeopardy"). The district court erred by concluding otherwise.

II. Plaintiffs' Assertions of a Constitutional Violation Establish Irreparable Harm.

The district court properly held that Plaintiffs established irreparable harm. *See* JA1159. "Within the irreparable harm analysis itself—which assumes, without deciding, that the movant has demonstrated a likelihood that the non-movant's conduct violates the law—[this Court] examine[s] only whether that violation, if true, inflicts irremediable injury." *Chaplaincy of Full Gospel Churches v. England*, 454 F.3d 290, 303 (D.C. Cir. 2006). That is undoubtedly the case here, where Plaintiffs assert that Defendants are violating their due process rights. This Court has squarely held that the asserted violation of due process rights establishes irreparable harm for these purposes. *See Gordon v. Holder*, 721 F.3d 638, 653 (D.C. Cir. 2013).

III. The Balance of Equities and the Public Interest Weigh in Favor of an Injunction.

The balance of the equities and the public interest "merge when the Government is the opposing party." *Nken v. Holder*, 556 U.S. 418, 435 (2009). And where, as here, the Government is likely violating the Constitution, these factors favor an injunction, for "enforcement of an unconstitutional law is always contrary to the public interest." *Gordon*, 721 F.3d at 653. *See also Republican Nat'l Comm. v. FEC*, 172 F.3d 920, 1998 WL 794896, at *1 (D.C. Cir. 1998) (unpublished) (balance of the equities and public interest "largely merge with the likelihood of success on the merits" when plaintiff alleges a constitutional violation).

The district court held that Plaintiffs failed to establish these factors, but that holding was based on the district court's erroneous conclusion that Plaintiffs are unlikely to succeed on the merits: "[E]njoining an agency's statutorily delegated enforcement authority is likely to harm the public interest, *particularly where plaintiffs are unable to demonstrate a likelihood of success on the merits*." JA1160 (emphasis added). The district court also cited 12 U.S.C. § 1818(i)(1), which limits the jurisdiction of federal courts to hear equitable challenges to Defendants' enforcement actions against banks. *See* JA1160-61. But the district court did not suggest that this provision ousted its jurisdiction, *see* JA1161 n.12, nor could it have, given the fact that Plaintiffs do not seek to enjoin or otherwise affect any particular enforcement action. Rather, the district court stated that it was "especially hesitant

to grant an injunction *when Plaintiffs are unable to establish a likelihood of success on the merits*," in light of the solicitude for Defendants shown by Section 1818(i)(1). JA1161 (emphasis added). Thus, the district court's reasoning once again hinged on its erroneous conclusion that Plaintiffs are unlikely to succeed on the merits. Once that likelihood of success is established, the public interest follows, for "the Constitution is the ultimate expression of the public interest," and it "does not permit" the Government "to prioritize any policy goal over the Due Process Clause." *Gordon*, 721 F.3d at 653.

CONCLUSION

For the foregoing reasons, this Court should reverse the district court's decision denying Plaintiffs' preliminary injunction motions and remand with instructions for the district court to enter the injunction Plaintiffs have requested.

Date: May 19, 2017

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitations of FED. R. APP. P. 32(a)(7)(B) because this brief contains 12,525 words, excluding the parts of the brief exempted by FED. R. APP. P. 32(f) and Circuit Rule 32(e)(1).

This brief complies with the typeface requirements of FED. R. APP. P. 32(a)(5) because this brief has been prepared in a proportionately spaced typeface using Microsoft Word 2013 in 14-point Times New Roman font.

Dated: May 19, 2017

s/ Charles J. Cooper
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ADDENDUM OF PERTINENT STATUTES AND REGULATIONS

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12 U.S.C. § 1818(i)(1)

(i) Jurisdiction and enforcement; penalty

(1) The appropriate Federal banking agency may in its discretion apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the depository institution is located, for the enforcement of any effective and outstanding notice or order issued under this section or under section 1831*o* or 1831p-1 of this title, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section or under section 1831*o* or 1831p-1 of this title no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under any such section, or to review, modify, suspend, terminate, or set aside any such notice or order.

12 U.S.C. § 1831o(f)

(f) Provisions applicable to significantly undercapitalized institutions and undercapitalized institutions that fail to submit and implement capital restoration plans

(1) In general

This subsection shall apply with respect to any insured depository institution that--

(A) is significantly undercapitalized; or

(B) is undercapitalized and--

(i) fails to submit an acceptable capital restoration plan within the time allowed by the appropriate Federal banking agency under subsection (e)(2)(D) of this section; or

(ii) fails in any material respect to implement a plan accepted by the agency.

(2) Specific actions authorized

The appropriate Federal banking agency shall carry out this section by taking 1 or more of the following actions:

(A) Requiring recapitalization

Doing 1 or more of the following:

(i) Requiring the institution to sell enough shares or obligations of the institution so that the institution will be adequately capitalized after the sale.

(ii) Further requiring that instruments sold under clause (i) be voting shares.

(iii) Requiring the institution to be acquired by a depository institution holding company, or to combine with another insured depository institution, if 1 or more grounds exist for appointing a conservator or receiver for the institution.

(B) Restricting transactions with affiliates

(i) Requiring the institution to comply with section 371c of this title as if subsection (d)(1) of that section (exempting transactions with certain affiliated institutions) did not apply.

(ii) Further restricting the institution's transactions with affiliates.

(C) Restricting interest rates paid

(i) In general

Restricting the interest rates that the institution pays on deposits to the prevailing rates of interest on deposits of comparable amounts and maturities in the region where the institution is located, as determined by the agency.

(ii) Retroactive restrictions prohibited
This subparagraph does not authorize the agency to restrict interest rates paid on time deposits made before (and not renewed or renegotiated after) the agency acted under this subparagraph.

(D) Restricting asset growth
Restricting the institution's asset growth more stringently than subsection (e)(3) of this section, or requiring the institution to reduce its total assets.

(E) Restricting activities
Requiring the institution or any of its subsidiaries to alter, reduce, or terminate any activity that the agency determines poses excessive risk to the institution.

(F) Improving management
Doing 1 or more of the following:

(i) New election of directors
Ordering a new election for the institution's board of directors.

(ii) Dismissing directors or senior executive officers
Requiring the institution to dismiss from office any director or senior executive officer who had held office for more than 180 days immediately before the institution became undercapitalized. Dismissal under this clause shall not be construed to be a removal under section 1818 of this title.

(iii) Employing qualified senior executive officers
Requiring the institution to employ qualified senior executive officers (who, if the agency so specifies, shall be subject to approval by the agency).

(G) Prohibiting deposits from correspondent banks
Prohibiting the acceptance by the institution of deposits from correspondent depository institutions, including renewals and rollovers of prior deposits.

(H) Requiring prior approval for capital distributions by bank holding company

Prohibiting any bank holding company having control of the insured depository institution from making any capital distribution without the prior approval of the Board of Governors of the Federal Reserve System.

(I) Requiring divestiture

Doing one or more of the following:

(i) Divestiture by the institution

Requiring the institution to divest itself of or liquidate any subsidiary if the agency determines that the subsidiary is in danger of becoming insolvent and poses a significant risk to the institution, or is likely to cause a significant dissipation of the institution's assets or earnings.

(ii) Divestiture by parent company of nondepository affiliate

Requiring any company having control of the institution to divest itself of or liquidate any affiliate other than an insured depository institution if the appropriate Federal banking agency for that company determines that the affiliate is in danger of becoming insolvent and poses a significant risk to the institution, or is likely to cause a significant dissipation of the institution's assets or earnings.

(iii) Divestiture of institution

Requiring any company having control of the institution to divest itself of the institution if the appropriate Federal banking agency for that company determines that divestiture would improve the institution's financial condition and future prospects.

(J) Requiring other action

Requiring the institution to take any other action that the agency determines will better carry out the purpose of this section than any of the actions described in this paragraph.

12 U.S.C. § 1831p-1

(a) Operational and managerial standards

Each appropriate Federal banking agency shall, for all insured depository institutions, prescribe--

(1) standards relating to--

(A) internal controls, information systems, and internal audit systems, in accordance with section 1831m of this title;

(B) loan documentation;

(C) credit underwriting;

(D) interest rate exposure;

(E) asset growth; and

(F) compensation, fees, and benefits, in accordance with subsection (c) of this section; and

(2) such other operational and managerial standards as the agency determines to be appropriate.

(b) Asset quality, earnings, and stock valuation standards

Each appropriate Federal banking agency shall prescribe standards, by regulation or guideline, for all insured depository institutions relating to asset quality, earnings, and stock valuation that the agency determines to be appropriate.

(c) Compensation standards

Each appropriate Federal banking agency shall, for all insured depository institutions, prescribe--

(1) standards prohibiting as an unsafe and unsound practice any employment contract, compensation or benefit agreement, fee arrangement, perquisite, stock option plan, postemployment benefit, or other compensatory arrangement that--

(A) would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees or benefits; or

(B) could lead to material financial loss to the institution;

(2) standards specifying when compensation, fees, or benefits referred to in paragraph (1) are excessive, which shall require the agency to determine whether the amounts are unreasonable or disproportionate to the services actually performed by the individual by considering--

(A) the combined value of all cash and noncash benefits provided to the individual;

(B) the compensation history of the individual and other individuals with comparable expertise at the institution;

(C) the financial condition of the institution;

(D) comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the loan portfolio or other assets;

(E) for postemployment benefits, the projected total cost and benefit to the institution;

(F) any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution; and

(G) other factors that the agency determines to be relevant; and

(3) such other standards relating to compensation, fees, and benefits as the agency determines to be appropriate.

(d) Standards to be prescribed

(1) In general

Standards under subsections (a), (b), and (c) of this section shall be prescribed by regulation or guideline. Such regulations or guidelines may not prescribe standards that set a specific level or range of compensation for directors, officers, or employees of insured depository institutions.

(2) Applicability of other laws

Paragraph (1) shall not affect the authority of any appropriate Federal banking agency to restrict the level of compensation, including golden parachute payments (as defined in section 1828(k)(4) of this title), paid to any director, officer, or employee of an insured depository institution under any other provision of law.

(3) Senior executive officers at undercapitalized institutions

Paragraph (1) shall not affect the authority of any appropriate Federal banking agency to restrict compensation paid to any senior executive officer of an undercapitalized insured depository institution pursuant to section 1831*o* of this title.

(4) Safety and soundness or enforcement actions

Paragraph (1) shall not be construed as affecting the authority of any appropriate Federal banking agency under any provision of this chapter other than this section, or under any other provision of law, to prescribe a specific level or range of compensation for any director, officer, or employee of an insured depository institution--

(A) to preserve the safety and soundness of the institution; or

(B) in connection with any action under section 1818 of this title or any order issued by the agency, any agreement between the agency and the institution, or any condition imposed by the

agency in connection with the agency's approval of an application or other request by the institution, which is enforceable under section 1818 of this title.

(e) Failure to meet standards

(1) Plan required

(A) In general

If the appropriate Federal banking agency determines that an insured depository institution fails to meet any standard prescribed under subsection (a) or (b) of this section--

(i) if such standard is prescribed by regulation of the agency, the agency shall require the institution to submit an acceptable plan to the agency within the time allowed by the agency under subparagraph (C); and

(ii) if such standard is prescribed by guideline, the agency may require the institution to submit a plan described in clause (i).

(B) Contents of plan

Any plan required under subparagraph (A) shall specify the steps that the institution will take to correct the deficiency. If the institution is undercapitalized, the plan may be part of a capital restoration plan.

(C) Deadlines for submission and review of plans

The appropriate Federal banking agency shall by regulation establish deadlines that--

(i) provide institutions with reasonable time to submit plans required under subparagraph (A), and generally require the institution to submit a plan not later than 30 days after the agency determines that the institution fails to meet any standard prescribed under subsection (a), (b), or (c); and

(ii) require the agency to act on plans expeditiously, and generally not later than 30 days after the plan is submitted.

(2) Order required if institution fails to submit or implement plan

If an insured depository institution fails to submit an acceptable plan within the time allowed under paragraph (1)(C), or fails in any material respect to implement a plan accepted by the appropriate Federal banking agency, the agency, by order--

(A) shall require the institution to correct the deficiency; and

(B) may do 1 or more of the following until the deficiency has been corrected:

(i) Prohibit the institution from permitting its average total assets during any calendar quarter to exceed its average total assets during the preceding calendar quarter, or restrict the rate at which the average total assets of the institution may increase from one calendar quarter to another.

(ii) Require the institution to increase its ratio of tangible equity to assets.

(iii) Take the action described in section 1831***o***(f)(2)(C) of this title.

(iv) Require the institution to take any other action that the agency determines will better carry out the purpose of section 1831***o*** of this title than any of the actions described in this subparagraph.

(3) Restrictions mandatory for certain institutions

In complying with paragraph (2), the appropriate Federal banking agency shall take 1 or more of the actions described in clauses (i) through (iii) of paragraph (2)(B) if--

(A) the agency determines that the insured depository institution fails to meet any standard prescribed under subsection (a)(1) or (b)(1) of this section;

(B) the institution has not corrected the deficiency; and

(C) either--

(i) during the 24-month period before the date on which the institution first failed to meet the standard--

(I) the institution commenced operations; or

(II) 1 or more persons acquired control of the institution; or

(ii) during the 18-month period before the date on which the institution first failed to meet the standard, the institution underwent extraordinary growth, as defined by the agency.

(f) Definitions

For purposes of this section, the terms "average" and "capital restoration plan" have the same meanings as in section 1831***o*** of this title.

(g) Other authority not affected

The authority granted by this section is in addition to any other authority of the Federal banking agencies.

12 C.F.R. Pt. 364, App. A §§ I-II

I Introduction

i. Section 39 of the Federal Deposit Insurance Act[1] (FDI Act) requires each Federal banking agency (collectively, the agencies) to establish certain safety and soundness standards by regulation or by guidelines for all insured depository institutions. Under section 39, the agencies must establish three types of standards: (1) Operational and managerial standards; (2) compensation standards; and (3) such standards relating to asset quality, earnings, and stock valuation as they determine to be appropriate.

ii. Section 39(a) requires the agencies to establish operational and managerial standards relating to: (1) Internal controls, information systems and internal audit systems, in accordance with section 36 of the FDI Act (12 U.S.C. 1831m); (2) loan documentation; (3) credit underwriting; (4) interest rate exposure; (5) asset growth; and (6) compensation, fees, and benefits, in accordance with subsection (c) of section 39. Section 39(b) requires the agencies to establish standards relating to asset quality, earnings, and stock valuation that the agencies determine to be appropriate.

iii. Section 39(c) requires the agencies to establish standards prohibiting as an unsafe and unsound practice any compensatory arrangement that would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees or benefits and any compensatory arrangement that could lead to material financial loss to an institution. Section 39(c) also requires that the agencies establish standards that specify when compensation is excessive.

iv. If an agency determines that an institution fails to meet any standard established by guidelines under subsection (a) or (b) of section 39, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. In the event that an institution fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan, the agency must, by order, require the institution to correct the deficiency. The agency may, and in some cases must, take other supervisory actions until the deficiency has been corrected.

v. The agencies have adopted amendments to their rules and regulations to establish deadlines for submission and review of compliance plans.[2]

vi. The following Guidelines set out the safety and soundness standards that the agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The agencies believe that the standards adopted in these Guidelines serve this end without dictating how institutions must be managed and operated. These standards are designed to identify potential safety and soundness concerns and ensure that action is taken to address those concerns before they pose a risk to the Deposit Insurance Fund.

A Preservation of Existing Authority

Neither section 39 nor these Guidelines in any way limits the authority of the agencies to address unsafe or unsound practices, violations of law, unsafe or unsound conditions, or other practices. Action under section 39 and these Guidelines may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the agencies. Nothing in these Guidelines limits the authority of the FDIC pursuant to section 38(i)(2)(F) of the FDI Act (12 U.S.C. 1831(o)) and Part 325 of Title 12 of the Code of Federal Regulations.

B Definitions

1. In general. For purposes of these Guidelines, except as modified in the Guidelines or unless the context otherwise requires, the terms used have the same meanings as set forth in sections 3 and 39 of the FDI Act (12 U.S.C. 1813 and 1831p–1).
2. Board of directors, in the case of a state-licensed insured branch of a foreign bank and in the case of a federal branch of a foreign bank, means the managing official in charge of the insured foreign branch.
3. Compensation means all direct and indirect payments or benefits, both cash and non-cash, granted to or for the benefit of any executive officer, employee, director, or principal shareholder, including but not limited to payments or benefits derived from an employment contract, compensation or benefit agreement, fee arrangement, perquisite, stock option plan, postemployment benefit, or other compensatory arrangement.
4. Director shall have the meaning described in 12 CFR 215.2(d).[3]
5. Executive officer shall have the meaning described in 12 CFR 215.2(e).[4]
6. Principal shareholder shall have the meaning described in 12 CFR 215.2(m).[5]

II Operational and Managerial Standards

A. Internal controls and information systems. An institution should have internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities and that provide for:

1. An organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies;
2. Effective risk assessment;
3. Timely and accurate financial, operational and regulatory reports;
4. Adequate procedures to safeguard and manage assets; and
5. Compliance with applicable laws and regulations.

B. Internal audit system. An institution should have an internal audit system that is appropriate to the size of the institution and the nature and scope of its activities and that provides for:

1. Adequate monitoring of the system of internal controls through an internal audit function. For an institution whose size, complexity or scope of operations does not warrant a full scale internal audit function, a system of independent reviews of key internal controls may be used;
2. Independence and objectivity;
3. Qualified persons;
4. Adequate testing and review of information systems;
5. Adequate documentation of tests and findings and any corrective actions;
6. Verification and review of management actions to address material weaknesses; and
7. Review by the institution's audit committee or board of directors of the effectiveness of the internal audit systems.

C. Loan documentation. An institution should establish and maintain loan documentation practices that:

1. Enable the institution to make an informed lending decision and to assess risk, as necessary, on an ongoing basis;
2. Identify the purpose of a loan and the source of repayment, and assess the ability of the borrower to repay the indebtedness in a timely manner;
3. Ensure that any claim against a borrower is legally enforceable;
4. Demonstrate appropriate administration and monitoring of a loan; and

5. Take account of the size and complexity of a loan.

D. Credit underwriting. An institution should establish and maintain prudent credit underwriting practices that:
   1. Are commensurate with the types of loans the institution will make and consider the terms and conditions under which they will be made;
   2. Consider the nature of the markets in which loans will be made;
   3. Provide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower's character and willingness to repay as agreed;
   4. Establish a system of independent, ongoing credit review and appropriate communication to management and to the board of directors;
   5. Take adequate account of concentration of credit risk; and
   6. Are appropriate to the size of the institution and the nature and scope of its activities.

E. Interest rate exposure. An institution should:
   1. Manage interest rate risk in a manner that is appropriate to the size of the institution and the complexity of its assets and liabilities; and
   2. Provide for periodic reporting to management and the board of directors regarding interest rate risk with adequate information for management and the board of directors to assess the level of risk.

F. Asset growth. An institution's asset growth should be prudent and consider:
   1. The source, volatility and use of the funds that support asset growth;
   2. Any increase in credit risk or interest rate risk as a result of growth; and
   3. The effect of growth on the institution's capital.

G. Asset quality. An insured depository institution should establish and maintain a system that is commensurate with the institution's size and the nature and scope of its operations to identify problem assets and prevent deterioration in those assets. The institution should:
   1. Conduct periodic asset quality reviews to identify problem assets;

2. Estimate the inherent losses in those assets and establish reserves that are sufficient to absorb estimated losses;
3. Compare problem asset totals to capital;
4. Take appropriate corrective action to resolve problem assets;
5. Consider the size and potential risks of material asset concentrations; and
6. Provide periodic asset reports with adequate information for management and the board of directors to assess the level of asset risk.

H. Earnings. An insured depository institution should establish and maintain a system that is commensurate with the institution's size and the nature and scope of its operations to evaluate and monitor earnings and ensure that earnings are sufficient to maintain adequate capital and reserves. The institution should:

1. Compare recent earnings trends relative to equity, assets, or other commonly used benchmarks to the institution's historical results and those of its peers;
2. Evaluate the adequacy of earnings given the size, complexity, and risk profile of the institution's assets and operations;
3. Assess the source, volatility, and sustainability of earnings, including the effect of nonrecurring or extraordinary income or expense;
4. Take steps to ensure that earnings are sufficient to maintain adequate capital and reserves after considering the institution's asset quality and growth rate; and
5. Provide periodic earnings reports with adequate information for management and the board of directors to assess earnings performance.

I. Compensation, fees and benefits. An institution should maintain safeguards to prevent the payment of compensation, fees, and benefits that are excessive or that could lead to material financial loss to the institution.

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of Court for the United States Court of Appeals for the District of Columbia Circuit by using the appellate CM/ECF system on May 19, 2017. Service will be accomplished on the following parties by the appellate CM/ECF system:

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