Nos. 18-55407, 18-55479

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CONSUMER FINANCIAL PROTECTION BUREAU,
Plaintiff-Appellant/Cross-Appellee,

v.

CASHCALL, INC.; WS FUNDING, LLC; DELBERT SERVICES CORP.; J. PAUL REDDAM,
Defendants-Appellees/Cross-Appellants.

On Appeal from the United States District Court
for the Central District of California
Hon. John F. Walter
Case No. 2:15-cv-07522

OPENING BRIEF OF APPELLANT/CROSS-APPELLEE CONSUMER FINANCIAL PROTECTION BUREAU

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INTRODUCTION

This case involves a consumer lending operation in which CashCall, Inc., and affiliated companies demanded and collected payment on high-interest, small-dollar loans that consumers did not actually owe. In particular, CashCall made loans to consumers across the country without complying with the licensing and usury laws of the consumers' home states. In many of those states, the relevant laws rendered the loans void such that CashCall had no right to collect on them and consumers had no obligation to pay. But CashCall collected on those loans anyway and, in the process, gave consumers the impression that they were legally obligated to make payments—an impression that the district court found "patently false." Appellant/Cross-Appellee's Excerpts of Record ("ER") 213:13. As the district court correctly held, this violated the Consumer Financial Protection Act's (CFPA's) prohibition on deceptive practices.

With this violation proven, the Bureau sought a straightforward remedy: for the defendants to return to consumers the interest and fees they took that consumers did not actually owe. Yet the district court refused to order restitution of those amounts. This not only left consumers uncompensated, but also seriously undermined effective enforcement of the Act—for it allowed the defendants to keep more than $200 million that they unlawfully took from consumers. Those

results cannot be squared with the statutory scheme that Congress enacted or with this Court's precedents.

The only consequence that the district court imposed for the defendants' years-long deceptive practice was a $10.3 million civil penalty. That penalty amount was inappropriately low under the CFPA's penalty framework because it did not account for the recklessness of the defendants' violations. Outside counsel warned CashCall as early as 2009 that its attempt to avoid state lending laws would "likely" fail; more than 20 states brought enforcement actions challenging the operation; and the company's primary counsel repeatedly advised the company to make changes, which CashCall never made. And even once the defendants concluded that the legal risks were too great to continue making loans, they continued to collect on the void loans for another three years—despite the overwhelming signs that consumers did not actually owe those amounts. This conduct was reckless and warranted a higher civil penalty.

JURISDICTIONAL STATEMENT

The district court had jurisdiction over this enforcement action because it is "brought under Federal consumer financial law," 12 U.S.C. § 5565(a)(1), presents a federal question, 28 U.S.C. § 1331, and is brought by an agency of the United states, *id.* § 1345. The district court entered final judgment disposing of all of the Bureau's claims on January 26, 2018 (ER 321), and the Bureau appealed on March

27, 2018 (ER 325). That appeal was timely, *see* Fed. R. App. P. 4(a)(1)(B), and this Court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF ISSUES

1. The defendants in this case collected on loans that state licensing and usury laws rendered void such that consumers had no obligation to pay them. The district court concluded, based on the undisputed facts, that the defendants committed a deceptive practice in violation of the Consumer Financial Protection Act (CFPA) in representing to consumers that they were legally obligated to pay amounts that they in fact had no obligation to pay. Did the district court apply erroneous legal principles or otherwise abuse its discretion in declining to require the defendants to pay restitution of those amounts?

2. The CFPA authorizes higher civil penalty amounts for defendants that recklessly violate the law. *See* 12 U.S.C. § 5565(c)(2)(B). The defendants here demanded and collected amounts that consumers did not owe despite outside counsel's warnings that courts would "likely" reject their attempts to avoid state law and despite multiple state regulatory actions challenging their operation. Even after the defendants themselves concluded that the risks were too great to continue making the loans, they continued to collect on the void loans for another three years. Did the district court clearly err in concluding that the defendants did not act recklessly in violating the CFPA?

PERTINENT STATUTES

Pertinent statutes are set forth in the addendum to this brief.

STATEMENT OF THE CASE

A. Facts

For years, CashCall, Inc., and affiliated companies demanded and collected payment on small-dollar loans that consumers had no obligation to pay. In particular, CashCall made loans without complying with the licensing and usury laws of consumers' home states. In at least 13 states (the "Subject States"),[1] the applicable laws rendered the loans void such that consumers had no obligation to pay. But CashCall and its affiliates told consumers that they had to pay and collected on those loans anyway. This enforcement action challenges that collection of amounts that consumers did not actually owe.

At first, CashCall carried out its small-dollar consumer lending business by partnering with federally-regulated banks in what one court described as a "'rent-a-bank' scheme." *CashCall, Inc. v. Md. Comm'r of Fin. Regulation*, 139 A.3d 990, 995 n.12 (Md. 2016). With those partnerships, CashCall aimed to take advantage of the banks' statutory exemption from state usury limits. ER 282:5. The bank would make the loan, and then CashCall would immediately buy it, effectively

[1] The Subject States are Arizona, Arkansas, Illinois, Indiana, Kentucky, Massachusetts, Minnesota, Montana, New Hampshire, New Jersey, New York, North Carolina, and Ohio.

"rent[ing] the bank's charter in order to make loans that exceed state interest caps." *Md. Comm'r of Fin. Reg.*, 139 A.3d at 995 n.12; *see also* ER 282:5 (¶ 15). This arrangement came under increasing scrutiny from state regulators, however. For example, in 2008, the West Virginia Attorney General sued CashCall alleging that it was the "true lender" on these loans, and the banks' exemption from state laws therefore did not apply. ER 314:5-7 (Trial Tr. at 36-38); *see also CashCall, Inc. v. Morrisey*, No. 12-1274, 2014 WL 2404300 (W. Va. May 30, 2014). Similarly, Maryland regulators issued an order in 2009 finding that CashCall "engaged in illegal and predatory business activities" in the state. *Md. Comm'r of Fin. Regulation*, 139 A.3d at 995-96 (quoting Commission's 2009 Summary Order to Cease and Desist). Ultimately, CashCall's bank partners terminated the arrangement after they, too, began to face scrutiny from their federal regulators. ER 282:6-7 (¶¶ 21, 23-24).

CashCall then looked for a new way to make loans without following state lending laws. CashCall's outside counsel, Claudia Callaway, recommended that CashCall could shift to a similar "tribal model" by partnering with a tribally-affiliated company instead of a bank. ER 163-3:6-7 (¶ 22). That model gave rise to the practices at issue in this case—a years-long operation that collected amounts from consumers that consumers did not actually owe.

To implement this new model, CashCall worked with a member of the Cheyenne River Sioux (CRS) Tribe, Martin Webb. ER 163-3:8-9, 11 (¶¶ 25-26, 35). In 2009, Webb incorporated a new business, Western Sky Financial, for the purpose of making loans that CashCall would buy. ER 163-3:11 (¶ 35). Although Western Sky was the lender on paper, the substance of the transactions told a different story. CashCall, through its wholly-owned subsidiary WS Funding LLC, fronted the money that Western Sky used to make loans. ER 163-3:15-16 (¶ 50). And CashCall, through WS Funding, agreed to buy the loans that Western Sky made. ER 163-3:4, 14-15 (¶¶ 6, 47). CashCall bought the loans within a few days, before any consumer had made a payment. ER 163-3:17, 19 (¶¶ 53, 57). Once CashCall bought the loans, it bore all of the risk of default. ER 163-3:19 (¶ 58). CashCall even took on Western Sky's regulatory risk: It agreed to fully indemnify Western Sky for all expenses arising out of legal actions against it, including by paying any fines or penalties imposed. ER 163-3:21 (¶ 63). CashCall also reimbursed Western Sky for many business expenses and performed a wide range of functions, including application processing, customer support, and marketing. ER 163-3:20-22, 23-24 (¶¶ 61-62, 64, 77-78).

With Western Sky's (nominal) participation, CashCall sought to avoid the laws of borrowers' home states and instead to be subject only to the laws of the CRS Tribe (of which Western Sky's owner was a member). To this end, the loan

agreements contained provisions that purported to make the loans exclusively subject to the laws and jurisdiction of the CRS Tribe, and to exempt them from state and federal laws. ER Ex.503A:1; 163-3:25-26 (¶¶ 92-93).

The legality of CashCall's small-dollar consumer lending business depended on the validity of this choice-of-law provision, for it was clear that the loans CashCall made did not comply with the laws of borrowers' states. *See* ER 163-3:5 (¶ 19). Callaway—the outside counsel who had recommended the "tribal model"—drafted legal memoranda opining that the choice-of-law provision would be effective in the states in which CashCall did business. *E.g.*, ER Ex.500C, Ex.500H. But even those opinions made clear that there was "significant" legal risk. *E.g.*, ER Ex.500C:2, Ex.500H:2. Those opinions, moreover, did not actually cover every state in which CashCall did business. No opinion letter addressed whether Massachusetts or New Hampshire laws would apply to the loans, and it was not until the end of 2012 that any opinion letter addressed the applicability of Minnesota law—but CashCall collected on loans in those states anyway. *See* ER Ex.16:8-15, Ex.18:11-17, Ex.396:8-15, Ex.500G:6-13, Ex.500H:9-15, Ex.500I:6-13.

Other outside lawyers raised larger red flags. A law firm that a potential outside investor hired to evaluate the legality of the model concluded in 2009 that "state law would likely still apply to the loans." ER Ex.400:2. A professor that

CashCall consulted in mid-2013 was even more blunt, explaining that "the model should work but likely won't," as "the lower courts will shun our model and … if we reach the Supreme Court, given its current composition, we will lose." ER Ex.528:1.

Even Callaway repeatedly urged CashCall to make changes to avoid legal problems, but CashCall did not make those changes. *See, e.g.*, ER 353:7, 365:1, Ex.510:1, Ex.513:1-2. In early 2011, for example, Callaway advised that she felt "more strongly than ever" that Western Sky needed to "firm up its structure." ER Ex.353:7. Otherwise, she explained, it "will be marquee quarry for a state or for the Bureau [of Consumer Financial Protection]." ER Ex.353:7; ER 314:10 (Trial Tr. at 111). CashCall's General Counsel agreed "for 100 different reasons" (ER Ex.353:9), yet the company never made the recommended changes (ER 282:21 (¶ 83)). Over time, counsel's warnings became more and more urgent, and by early 2013, Callaway recommended that CashCall significantly scale back its involvement and participate in the lending operation in only one of three limited ways. ER Ex.365:1. CashCall did not make those changes either.

During the same time period, CashCall and Western Sky faced regulatory actions by one state after the other. The Washington Department of Financial Institutions sued CashCall in August 2011 for violating Washington law in collecting on Western Sky loans. ER 314:15 (Trial Tr. at 152); ER 282:24 (¶ 89).

By then, regulators in Colorado, Maryland, and Missouri had all also already brought their own actions against Western Sky. ER 314:16-17 (Trial Tr. at 153-54). In September 2012, a West Virginia court ruled against CashCall in a case brought by that state's Attorney General and concluded that state law applied because CashCall, not its bank partner, was the de facto lender. ER 314:6 (Trial Tr. at 37). Although that case involved CashCall's earlier bank model, CashCall's General Counsel understood that the new tribal model was "almost identical" to the bank model. ER 314:7 (Trial Tr. at 38). Other states followed suit, with a total of at least 23 state regulators bringing enforcement actions against CashCall and/or Western Sky.[2]

In the face of this regulatory firestorm, CashCall's outside counsel recommended in August 2013 that it cease the program because "the regulatory and litigation environments have risen from dangerous to near extinction." ER Ex.357:4. In response, CashCall finally stopped buying new Western Sky loans in

[2] *See* https://go.usa.gov/xPx4e (Arkansas); https://go.usa.gov/xPqWP (Colorado); https://go.usa.gov/xPcjm (Connecticut); https://go.usa.gov/xPx4M (District of Columbia); https://tinyurl.com/y8kynro4 (Florida); https://go.usa.gov/xPcja (Georgia); https://tinyurl.com/y8whosm8 (Illinois); https://go.usa.gov/xPcb5 (Iowa); https://tinyurl.com/ybvwubss (Kansas); https://go.usa.gov/xPcbU (Maryland); https://go.usa.gov/xPx2V (Massachusetts); https://go.usa.gov/xPx2E (Michigan); https://go.usa.gov/xPCSy (Minnesota); https://tinyurl.com/ycg88ftj (Missouri); https://go.usa.gov/xPx2k (Nevada); https://go.usa.gov/xPcbw (New Hampshire); https://go.usa.gov/xPcbG (New York); https://tinyurl.com/yaerb5zm (North Carolina); https://go.usa.gov/xPc8A (Oregon); https://go.usa.gov/xPcbF (Pennsylvania); https://go.usa.gov/xPx2W (Vermont); https://go.usa.gov/xPcbu (Washington); https://go.usa.gov/xPcbJ (West Virginia).

early September 2013. ER 314:11 (Trial Tr. at 132); ER 316:9 (Trial Tr. at 361). But CashCall and its affiliates still collected on the unlawful loans that they had already made for another three years. ER 314:11-12 (Trial Tr. at 132-33); ER 316:9-10 (Trial Tr. at 361-62). They only stopped collecting on the loans in all Subject States once the court in this case held in August 2016 that the collection was unlawful. ER 282:30 (¶ 110).

All told, CashCall and its affiliates collected over $200 million in interest and fees from consumers in the Subject States from July 21, 2011 (the beginning date for the Bureau's claims) until the operation shut down. ER 264:9 (¶ 19).

B. Statutory Background

The Consumer Financial Protection Act makes it unlawful for entities that offer consumer financial products and services "to engage in any unfair, deceptive, or abusive act or practice." 12 U.S.C. § 5536(a)(1)(B). Under the Act, the Bureau of Consumer Financial Protection (Bureau) is empowered to enforce this prohibition (as well as other federal consumer financial laws). *See id.* §§ 5531(a), 5564(a). The Act provides for a broad range of relief for violations of the laws that the Bureau enforces: A court "shall have jurisdiction to grant any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law." *Id.* § 5565(a)(1). That relief "may include, without limitation," remedies such as

"restitution," "payment of damages or other monetary relief," and "civil money penalties." *Id.* § 5565(a)(2).

The Act sets forth a detailed framework for determining the amount of any civil penalty. *See id.* § 5565(c). First, the Act establishes three tiers of maximum civil penalties based on the defendant's mental state. *Id.* § 5565(c)(2). Under the "[f]irst tier," a civil penalty "may not exceed $5,000 for each day during which such violation … continues." *Id.* § 5565(c)(2)(A). The second tier establishes a per-day maximum of $25,000 for "any person that recklessly engages in a violation of a Federal consumer financial law." *Id.* § 5565(c)(2)(B). And the third tier establishes a per-day maximum of $1 million for persons that "knowingly" violate the law. *Id.* § 5565(c)(2)(C).[3] Next, the Act instructs courts, in determining the appropriate penalty amount, to account for various "mitigating factors," such as "the size of financial resources … of the person charged," that person's "good faith," and "the history of previous violations." *Id.* § 5565(c)(3).

C. Proceedings and Decision Below

1. The Bureau's Complaint

The Bureau brought an enforcement action against CashCall under the CFPA in December 2013. ER 0:10. The Bureau's suit also named WS Funding (CashCall's wholly-owned subsidiary that bought the Western Sky loans), Delbert

[3] As a result of statutorily mandated inflation adjustments, the amounts for all tiers are now higher. *See* 12 C.F.R. § 1083.1.

Services Corp. (a company that CashCall established to collect on defaulted loans), and those companies' owner, J. Paul Reddam (together with CashCall, "Defendants"). ER 27:2-3. The Bureau alleged that Defendants committed unfair, deceptive, and abusive acts and practices by demanding and extracting payments on loans that consumers in fact had no obligation to pay because the laws of the Subject States rendered them void.[4] ER 27:24-27 (¶¶ 58-71).

2. Summary Judgment for the Bureau on Liability

The parties eventually filed cross-motions for summary judgment, and the district court granted summary judgment to the Bureau on liability, concluding that Defendants "violated the CFPA by servicing and collecting on loans where payments were not due and owing." ER 213:12. At the outset, the court concluded that state law, not the laws of the CRS Tribe, applied to the loans. ER 213:6, 11. The court held that the loan agreements' choice-of-law provisions were not effective under federal conflict-of-laws principles, in part because "CashCall, not Western Sky, was the true lender," as it bore "the entire monetary burden and risk of the loan program." ER 213:8; *see also* ER 213:6-10. Under the laws of the borrowers' home states, Western Sky loans were void or otherwise uncollectible. ER 213:12.

[4] The Bureau's operative complaint named 16 Subject States. ER 27:11-12 (¶ 18). For various reasons, by the time of trial, this case addressed Defendants' practices in only the 13 states listed on page 4, footnote 1.

Thus, the court concluded that Defendants committed a deceptive practice in violation of the CFPA "[b]y servicing and collecting on Western Sky loans." ER 213:13. In particular, in collecting on the loans, Defendants created the "patently false" impression that "the loans were enforceable and that borrowers were obligated to repay" them. ER 213:13. Defendants' alleged "reasonable belief" that the law of the CRS Tribe, and not state laws, applied did not provide a defense to liability. ER 213:14. Because the court concluded that Defendants' conduct was deceptive, it deemed it unnecessary to address whether the conduct was also unfair and abusive. *Id.*

The court also held that Reddam was individually liable for the companies' violations because he participated directly in the deceptive acts, had authority to control them, and was, "[a]t the very least, … recklessly indifferent to the wrongdoing." ER 213:14-15.

3. Findings of Fact and Conclusions of Law on Remedies

The case proceeded to trial on remedies. The Bureau sought $235.6 million in restitution—an amount representing all the interest and fees that consumers in the Subject States paid on void loans originated on or after July 21, 2011 (the effective date of the CFPA's prohibition on deceptive practices), less amounts already refunded pursuant to state settlements. ECF No. 313 at 16. It also sought a tier-three civil penalty of $51.6 million and a permanent injunction. *See* ER

319:14. After a two-day bench trial, the court rejected the Bureau's claims for restitution and a permanent injunction and imposed a tier-one civil penalty of $10.3 million, for which it held Defendants jointly and severally liable.[5] ER 319:20.

a. Restitution

In rejecting the Bureau's claim for restitution, the court first held that "it is not required to award restitution merely because a defendant violates the CFPA." ER 319:14. Rather, it held, the Bureau bears the burden to prove that "restitution is an appropriate remedy." *Id.* The court concluded that the Bureau did not satisfy this burden because it did not show that "Defendants intended to defraud consumers or that consumers did not receive the benefit of their bargain" from the loans. ER 319:15. In particular, the court reasoned that cases dealing with the appropriateness of restitution typically involve "a type of fraud that is akin to what is commonly referred to as that of a 'snake oil salesman'"—*i.e.*, defendants who dupe consumers into believing they are buying something other than what they actually receive. *Id.* The court found these cases "inapposite." *Id.* According to the court, Defendants did not "act[] in bad faith" or "structure the Western Sky Loan program to defraud borrowers." ER 319:15, 16. Rather, they attempted to structure their business "to minimize exposure to unfavorable laws and

[5] The district court denied a permanent injunction because there was no evidence that Defendants were continuing to collect on Western Sky loans. ER 319:20. This appeal does not challenge the denial of the permanent injunction.

regulations" after "consulting with prominent legal counsel." ER 319:15. The court concluded that this reliance on counsel was reasonable because, at the time, no case law held the tribal lending model unlawful, and "it was not until this Court's true lender determination that Defendants could have known that the program violated the CFPA." ER 319:16. Finally, the court concluded that consumers "received the benefit of their bargain—*i.e.*, the loan proceeds." *Id.* It reasoned that no evidence showed that the loan agreements themselves were deceptive or that consumers were confused about the terms they would receive, so Defendants did not deceive consumers "in connection with the origination of the loans." *Id.*

The court further held that even if restitution were appropriate, the Bureau had not proven that the amount it sought was warranted. ER 319:17. The court acknowledged that it "may use a defendant's net revenues as a basis for measuring restitution," but concluded that there was no evidence that "the total interest and fees Defendants collected on the void loans at issue in this case, less any previous settlement payments" represented Defendant's "net revenues," apparently because that amount was not "netted to account for expenses." *Id.* The court further found that there was no evidence that the interest and fees collected (less settlement payments) "approximates Defendants' unjust gains." *Id.* In particular, the court concluded that that amount does not account for "the payment status of individual

loans" or consider whether the restitution "would create a windfall for borrowers," including those who never made any payments. *Id.*

b. Civil Penalty

The court next imposed a civil penalty of $10.3 million—the maximum amount allowed under tier one. ER 319:19. The court declined to impose a higher tier-three penalty for knowing violations because, it concluded, the evidence did not show that they "knew … that the structure of the program would subject them to liability under the CFPA." *Id.* Likewise, the court concluded that a tier-two penalty for reckless violations was not warranted because Defendants relied on counsel's advice and, at the time of the program's inception, no case law clearly established that the "tribal lending model" was unlawful. *Id.* The court declined to reduce the maximum tier-one penalty based on any mitigating factors, however. *Id.* No reduction was warranted, the court held, "in light of [Defendants'] willingness to continue the Western Sky Loan Program in the face of increased regulatory pressure and advice from their counsel that the model was becoming increasingly susceptible to attack." *Id.*

SUMMARY OF ARGUMENT

I. The district court held, based on undisputed facts, that Defendants deceived consumers by demanding payments that the consumers did not actually owe. As a result of that unlawful conduct, Defendants collected over $200 million

from consumers in interest and fees alone. Yet the district court declined to require Defendants to pay restitution of those amounts. That decision rested on erroneous legal principles and therefore must be reversed.

A. The district court misapplied the law in several ways in concluding that restitution was not "an appropriate remedy," ER 319:14. As an initial matter, in deeming restitution inappropriate, the district court appeared to make a discretionary decision based on its view of the equities. But the district court had no such discretion. The CFPA authorizes "any appropriate *legal or* equitable relief" for violations of the Act, 12 U.S.C. § 5565(a) (emphasis added), and the Bureau sought legal, not equitable, restitution here. Courts do not have discretion to deny legal relief based on equitable factors. Rather, if a plaintiff proves a violation and resulting harm, it is entitled to the legal relief that Congress has authorized. The Bureau undoubtedly made that showing here: As the district court itself held, Defendants violated the CFPA by giving consumers the "patently false" impression that they owed amounts that they did not actually owe. And this caused harm by inducing consumers to pay interest and fees that they had no obligation to pay—amounts that the Bureau established with unrefuted evidence. The Bureau was therefore entitled to legal restitution as a matter of course.

In any event, even if the district court did have equitable discretion to exercise in awarding restitution, it abused that discretion by applying two

erroneous legal principles. First, the district court denied restitution because (in its view) Defendants had not acted in bad faith. Even accepting that (dubious) factual finding, denying restitution on that basis was legally erroneous. As the Supreme Court and this Court have held in the context of other statutes, denying restitution based on a defendant's lack of bad faith is improper because that conflicts with the restitutionary remedy that Congress enacted and undermines effective enforcement of the law. So too with the CFPA. Congress authorized restitution to compensate consumers affected by unlawful financial-services practices—but by denying restitution based on Defendants' good faith, the district court improperly converted that compensatory remedy into a punishment for bad intent. Denying restitution based on Defendants' lack of bad faith also undermined effective enforcement of the CFPA's protections. Under the district court's decision, Defendants get to keep hundreds of millions of dollars that they unlawfully took from consumers while paying only a $10.3 million penalty. That result undeniably leaves companies with little incentive to follow the law—a result that the Supreme Court and this Court have disapproved.

Second, the district court erred for similar reasons in denying restitution on the ground that Defendants did not deceive consumers about the costs of the loans. The Bureau did not charge Defendants with such conduct, but rather with deceiving consumers into paying amounts that they did not actually owe. Denying

restitution of those amounts leaves companies with little incentive to shun that particular brand of deceptive conduct. The CFPA does not support such a result.

B. The district court likewise applied erroneous legal principles in concluding that the Bureau had not established the proper *amount* of restitution. This Court applies a two-step burden-shifting framework for calculating restitution amounts under the CFPA. Under this framework, the government must first establish a reasonable approximation of the defendant's unjust gains. At this step, the government can meet its burden by proving a defendant's net revenues. The burden then shifts to the defendant to show that the net revenues amount overstates the defendant's unjust gains.

The district court misapplied this framework in two ways when it rejected the Bureau's proposed restitution amount. First, it erroneously required the Bureau to deduct Defendants' expenses from the restitution to be paid to consumers. That flatly contradicted this Court's precedent, which holds that restitution is measured by a defendant's net revenue, not net profits. Expenses are relevant only to the calculation of net profits. And, besides, allowing a deduction for expenses cannot be squared with the CFPA, as that would seriously undermine the compensatory purpose of restitution and the effective enforcement of the Act. Under the district court's reasoning, consumers get nothing, while Defendants get to deduct the costs incurred committing their illegal acts.

Second, the district court also erroneously put the burden on the Bureau to account for the payment status of individual loans to ensure that no consumer would receive a windfall. Under this Court's precedent, the Bureau met its burden by establishing Defendants' net revenues—the interest and fees they collected that consumers did not actually owe, minus previous refunds. If this somehow overstated Defendants' unjust gains, the burden was on Defendants to make that showing.

II. The district court also erred in assessing the civil penalty in this case. The CFPA provides for three "tiers" of penalty amounts based on the defendant's mental state. The district court imposed a penalty under the lowest tier because it concluded that Defendants' violations were neither knowing nor reckless. That conclusion was clearly erroneous.

Conduct is reckless when it poses an unjustifiably high risk of harm that is known or so obvious that it should be known. The evidence shows that Defendants ran such risks. Multiple lawyers warned CashCall that its attempts to avoid state law "likely" would not work. Even CashCall's primary counsel flagged "significant" legal risk and repeatedly advised the company to make changes, which CashCall never made. And state after state brought enforcement actions challenging the operation. All this gave Defendants ample reason to know that they ran an unjustifiably high risk of collecting amounts that consumers did not

owe. Indeed, Defendants ultimately stopped making new loans once they saw that the regulatory risks were beyond "dangerous." But, even then, they continued to collect on the loans for another three years—disregarding all indications that consumers did not actually owe those amounts.

Despite this evidence, the district court concluded that Defendants did not act recklessly because CashCall's primary counsel opined that CashCall could contract around state law. This improperly put near-dispositive weight on the (cautious) approval of counsel. Even if counsel had expressed unqualified confidence in the model (which she did not), her approval could not erase the other significant warning signs that Defendants were collecting amounts that consumers did not actually owe. Defendants' conduct was reckless and warranted a higher civil penalty.

STANDARDS OF REVIEW

Restitution: A district court's decision to grant or deny restitution "is reviewed for abuse of discretion or the application of erroneous legal principles." *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1102 (9th Cir. 1994). Where a party "claim[s] that the district court relied on an erroneous legal premise in reaching its decision, [the court of appeals] review[s] the underlying legal issue de novo." *El Pollo Loco, Inc. v. Hashim*, 316 F.3d 1032, 1038 (9th Cir. 2003). Similarly, the district court's "selection of the correct legal standard for measuring" monetary

relief "is reviewed de novo." *Gayle Mfg. Co., Inc. v. Fed. Sav. & Loan Ins. Corp.*, 910 F.2d 574, 578 (9th Cir. 1990).

Civil Penalty: A district court's findings of fact following a bench trial "are reviewed for clear error." *FTC v. Garvey*, 383 F.3d 891, 900 (9th Cir. 2004). Under that standard, the court of appeals "view[s] the evidence in the light most favorable to the prevailing party," *SEC v. Rubera*, 350 F.3d 1084, 1094 (9th Cir. 2003), and will reverse "only when, after reviewing the record, [it] is left with a definite and firm conviction that a mistake has been made below." *Plumber, Steamfitter & Shipfitter Indus. Pension Plan & Tr. v. Siemens Bldg. Techs. Inc.*, 228 F.3d 964, 968 (9th Cir. 2000). This clear-error standard of review applies to the district court's conclusion that Defendants' violations were not knowing or reckless, such that tier-three or tier-two penalties were not justified. *Cf. United States v. Ritter*, 752 F.2d 435, 439 (9th Cir. 1985) ("The district court's conclusion about whether the defendant has demonstrated recklessness … is a finding of fact reviewed under the clearly erroneous standard.").

ARGUMENT

I. Defendants Must Pay Restitution of the Amounts They Took that Consumers Did Not Actually Owe.

The CFPA authorizes courts "to grant any appropriate legal or equitable relief" for "violation[s] of Federal consumer financial law," and specifies that such relief can include "restitution." 12 U.S.C. § 5565(a)(1), (2)(C). Based on

undisputed facts, the district court concluded that Defendants committed a deceptive practice in violation of federal consumer financial law by creating the "patently false" impression that borrowers were obligated to repay their loans, when in fact the loan agreements were void and borrowers had no obligation to pay. ER 213:13. As relief for this violation, the Bureau sought restitution of all interest and fees that consumers paid despite not owing those amounts. The district court declined to order restitution, however, because it concluded that the Bureau did not show that restitution was "an appropriate remedy" or that the amount it sought was proper. Both of these conclusions were legally erroneous.

A. Restitution is an appropriate remedy here.

The district court concluded that restitution was not an "appropriate" remedy for Defendants' deceptive collection of amounts that consumers did not actually owe because Defendants (1) did not "intend[] to defraud consumers" or "act[] in bad faith" and (2) did not mislead consumers about the loans' terms or the benefits that consumers would "receive under the loan agreements." ER 319:15, 16. But the CFPA imposes no such limitations on the availability of restitution—and, indeed, the district court did not suggest that any statutory provision precluded the relief the Bureau requested. Rather, the district court appeared to make a discretionary decision to deny consumers relief based on its view of the equities. That was not proper. Because the Bureau sought legal, not equitable, restitution,

the district court did not have discretion to deny relief based on equitable factors. And, in any event, even if the district court did have such discretion, it exceeded the bounds of that discretion because its reasons for denying restitution conflict with the statutory scheme that Congress established.

1. *The district court lacked discretion to deny relief based on equitable factors because the Bureau sought legal, not equitable, restitution.*

The district court erred in holding that it had discretion to deny restitution based on equitable factors. Restitution may be legal or equitable. *FTC v. Commerce Planet, Inc.*, 815 F.3d 593, 601 (9th Cir. 2016); Restatement (Third) of Restitution and Unjust Enrichment § 4 (2011); *see also* 12 U.S.C. § 5565(a)(1) (authorizing "legal or equitable" relief). Although courts generally have some discretion when awarding equitable relief, Dan B. Dobbs, *Law of Remedies* at 12, § 1.2 (2d ed. 1993) (hereinafter, "Dobbs"), the restitution that the Bureau sought here was legal, not equitable. As this Court has explained, "'[e]quitable' restitution requires tracing the money or property the plaintiff seeks to recover to identifiable assets in the defendant's possession …, whereas 'legal' restitution seeks imposition of 'a merely personal liability upon the defendant to pay a sum of money.'" *Commerce Planet*, 815 F.3d at 601 (quoting *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 212 (2002)). The Bureau did not seek identifiable assets in Defendants' possession, but rather a judgment ordering Defendants to pay a sum of money—*i.e.*, legal restitution.

In general, courts do not have discretion to deny "legal" relief. *See Curtis v. Loether*, 415 U.S. 189, 197 (1974). Rather, a "legal remedy" is awarded "as a matter of course when the right [is] established." Dobbs at 12, § 1.2 (contrasting legal remedies with equitable remedies, which could be refused "even if the plaintiff proved a good case and the defendant proved no defense that would defeat the plaintiff's legal rights"). Thus, for example, the Supreme Court has held that while "an equitable remedy" is "committed to the discretion of the trial judge," "there is no comparable discretion" for an award of damages because that is not "equitable relief." *Curtis*, 415 U.S. at 197; *see also United States v. City of Hayward*, 36 F.3d 832, 839 (9th Cir. 1994) (explaining that Supreme Court had "found no discretion with respect to actual damages" under statute because the claim was "a legal claim for damages, not an equitable claim for restitution" (citing *Curtis*, 415 U.S. 189)). Rather, where a plaintiff proves both a violation and resulting harm, it "is entitled to judgment for that amount." *Curtis*, 415 U.S. at 197 (holding that "if a plaintiff proves unlawful discrimination and actual damages, he is entitled to judgment for that amount").

Nothing in the CFPA displaces this background principle that legal relief—such as the legal restitution that the Bureau sought here—is non-discretionary. To be sure, the statute provides only that a court "shall have jurisdiction to grant" relief for violations of federal consumer financial law, not that it "shall grant" such

relief. But this permissive language is not enough to override the principle that legal relief is mandatory once the violation and resulting harm have been established. In *Curtis v. Loether*, the Supreme Court held that the legal relief of damages was non-discretionary even though the statute there provided, in similarly permissive terms, that courts "may" grant such relief. 415 U.S. at 189-90, 197 (quoting 42 U.S.C. § 3612).

Likewise, the fact that the statute authorizes courts to grant any "appropriate" legal or equitable relief, 12 U.S.C. § 5565(a), does not grant courts discretion to deny legal relief based on their own views of what is "appropriate." Rather, viewed in context, "appropriate" relief is best understood as a type of relief that is suitable for the violations at issue. For instance, the "return of real property"—one form of relief that the CFPA specifies is available, 12 U.S.C. § 5565(a)(2)(B)—is appropriate only if the violation in fact caused a loss of real property. And while equitable remedies remain subject to courts' equitable discretion, nothing in the statute suggests that Congress intended to make legal remedies subject to such equitable discretion as well. Certainly, the mere use of the word "appropriate" cannot be read to change so fundamentally the nature of legal relief.

Because the Bureau sought legal, not equitable, restitution, the district court lacked discretion to deny that relief based on its view of the equities.[6] And because the Bureau proved both that Defendants violated the law and that those violations caused harm to consumers—namely, the payment of interest and fees that they did not actually owe—it was entitled to judgment in the amount of that harm "as a matter of course." Dobbs at 12, § 1.2; *see also Curtis*, 415 U.S. at 197.

2. *Even if the district court had discretion to deny restitution based on equitable factors, it abused that discretion.*

In any event, even if the district court did have discretion to deny relief based on its view of the equities, it exceeded the bounds of that discretion. It is well established that "[a] district court by definition abuses its discretion when it makes an error of law." *Koon v. United States*, 518 U.S. 81, 100 (1996). Consistent with this principle, both the Ninth Circuit and the Supreme Court have repeatedly held that, although district courts have discretion when awarding equitable relief, they may not deny relief for reasons "contrary to the purposes" of the underlying statute. *Pantron I*, 33 F.3d at 1103 (holding that it is legal error to

[6] The Bureau did not make this argument below and instead agreed with Defendants that restitution was discretionary. ECF No. 302 at 10. This Court may nonetheless consider this argument on appeal because "the issue presented is purely one of law and … does not depend on the factual record developed below." *Ruiz v. Affinity Logistics Corp.*, 667 F.3d 1318, 1322 (9th Cir. 2012) (describing circumstances in which court of appeals "has discretion to make an exception to waiver"). Moreover, Defendants cannot show that considering this argument now would allow the Bureau to "derive an unfair advantage or impose an unfair detriment" on Defendants. *In re Hoopai*, 581 F.3d 1090, 1097 (9th Cir. 2009).

deny restitution under FTC Act for reasons that are "contrary to the purposes of the Act"); *see also, e.g.*, *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 416 (1975) (holding that although decision to award backpay under Title VII was left to court's equitable discretion, "[a] court must exercise this power in light of the large objectives of the Act"); *id.* at 421 (holding that "backpay should be denied only for reasons which, if applied generally, would not frustrate the central statutory purposes"); *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 296 (1960) (holding that "the statutory purposes" of the Fair Labor Standards Act leave "little room for the exercise of discretion not to order reimbursement" for lost wages); *Marshall v. Chala Enters., Inc.*, 645 F.2d 799, 802 (9th Cir. 1981) (rejecting district court's reasons for denying restitutionary relief because they were "at odds with the policy of the Fair Labor Standards Act"). An order denying restitution for such reasons must be reversed because it involves "the application of erroneous legal principles." *Pantron I*, 33 F.3d at 1103. Here, the district court denied restitution for Defendants' deceptive collection of amounts that consumers did not actually owe on the grounds that, in the court's view, Defendants (1) did not act in bad faith and (2) did not deceive consumers about the terms of the loans. Both of these grounds for denying restitution flatly contradict the CFPA's purposes and are therefore legally erroneous.

a. It was legally erroneous to deny restitution based on Defendants' supposed lack of bad faith.

The district court erred in denying restitution based on the Bureau's supposed failure to show that Defendants "acted in bad faith." ER 319:16. As an initial matter, ample evidence shows that Defendants did, in fact, act in bad faith. As explained further in Section II, Defendants carried out their business in the face of repeated warnings by counsel that their business model could be—or even would "likely" be—found unlawful, failed to make changes that counsel recommended to avoid legal problems, and continued to collect on the void loans even after deciding that the program was too legally risky to continue. Indeed, as the district court itself found in granting summary judgment to the Bureau on liability, Defendant Reddam (who ran the operation) was "[a]t the very least … recklessly indifferent to the wrongdoing." ER 213:15.

But, putting that factual issue aside, even assuming Defendants did not act in bad faith, denying restitution on that basis was legally erroneous because it (1) conflicts with the remedial scheme that Congress enacted and (2) undermines effective enforcement of the CFPA.

1. As the Supreme Court held in *Albemarle Paper Co. v. Moody*, denying restitution based on a defendants' lack of bad faith improperly undermines the compensatory purpose of that remedy. 422 U.S. 405, 422-23 (1975). In *Albemarle Paper*, a district court denied backpay for the victims of a discriminatory practice

that violated Title VII on the ground that the violation "had not been in 'bad faith,'" as evidenced by the fact that "judicial decisions had only recently focused directly on" the discriminatory practice at issue. *Id.* at 405, 422 & n.15. The Supreme Court held that this was "not a sufficient reason for denying backpay." *Id.* at 422. The Court explained that "[i]f backpay were awardable only upon a showing of bad faith, the remedy would become a punishment for moral turpitude, rather than a compensation for workers' injuries"—a result that "would read the 'make whole' purpose right out of Title VII, for a worker's injury is no less real simply because his employer did not inflict it in 'bad faith.'" *Id.* Denying backpay based on a lack of bad faith conflicted with Title VII because "Congress directed the thrust of the Act to the consequences of employment practices, not simply the motivation." *Id.* (internal quotations omitted).

So too here. As in *Albemarle Paper*, denying restitution merely because the defendants did not act in bad faith would make the remedy "punishment for moral turpitude, rather than a compensation" for consumers' injuries. 422 U.S. at 422. That would fundamentally conflict with the remedial scheme that Congress enacted in the CFPA. The CFPA authorizes restitution without limiting it to those

who have violated the law in bad faith.[7] *See* 12 U.S.C. § 5565(a). And nothing else in the Act suggests that restitution can or should be so limited.

Indeed, other remedial provisions suggest just the opposite. Those provisions contemplate that *civil penalties*—a non-compensatory remedy—can be imposed against defendants who did not act in bad faith: It expressly authorizes penalties for violations that were neither knowing nor reckless. *Compare* 12 U.S.C. § 5565(c)(2)(A), *with id.* § 5565(c)(2)(B), (C). And it provides that the "good faith of the person charged" can be a factor relevant to "the *amount* of any penalty assessed," not that those who act in good faith will be immune from penalties. 12 U.S.C. § 5565(c)(3) (emphasis added). Given that Congress authorized *penalties* against those who act in good faith, it is particularly implausible that it intended to allow defendants' good faith to excuse them from paying *compensatory* remedies like restitution. Indeed, as in *Albemarle Paper*, denying restitution based on a defendant's good faith would undermine the compensatory purpose of the remedy, for a consumer's "injury is no less real simply because [the defendant] did not inflict it in 'bad faith.'" 422 U.S. at 422. Whether or not Defendants acted in bad faith, the consumers here were deceived

[7] Nor do any background principles of restitution make a defendant's lack of bad faith relevant. On the contrary, under common law restitution principles, rescission and restitution are available for material misrepresentations that are entirely "innocent." Restatement (Third) of Restitution and Unjust Enrichment § 13, cmt. c (2011).

into paying amounts that they did not actually owe. They were therefore entitled to restitution.

2. Denying restitution based on Defendants' supposed lack of bad faith was also legally erroneous for the independent reason that it undermines effective enforcement of the law. This Court made just that point in *Wirtz v. Malthor, Inc.*, 391 F.2d 1, 3 (9th Cir. 1968). In that case, the district court had denied restitution of unpaid minimum wages and overtime compensation under the Fair Labor Standards Act in part because the defendant employers "acted in a good faith belief" that their conduct was lawful. *Id.* at 2. This Court reversed, holding that "any lack of willfulness on the part of these [employers] does not justify freeing them from having to make restitution." *Id.* at 3. As the Court explained, denying restitution on this basis would, among other things, fail to "depriv[e] a violator of … gains accruing to him through his violation," which would diminish "the effectiveness of the enforcement of the Act." *Id.*

Similarly, in reversing the denial of backpay in *Albemarle Paper*, the Supreme Court held that denying that relief left employers with "little incentive to shun practices of dubious legality." 422 U.S. at 417. A "reasonably certain prospect" of having to pay back wages is what "provides the spur or catalyst which causes employers" to come into compliance with the statute. *Id.* at 417-18.

This reasoning applies with full force here. As in *Wirtz* and *Albemarle Paper*, denying restitution in this case would allow Defendants to retain the "gains accruing to [them] through [their] violation," *Wirtz*, 391 F.2d at 3—namely, the amounts that they were not owed and had no right to collect. This, in turn, would diminish "the effectiveness of the enforcement of the Act." *Id.*; *see also Albemarle Paper*, 422 U.S. at 417-18. Indeed, the impact on effective enforcement is quite stark in this case. The district court required Defendants to pay a $10.3 million penalty for their unlawful practices but allowed them to keep over $200 million in funds that they had no right to collect—leaving Defendants with more than $200 million in *gains* from their unlawful conduct. Such a result undeniably leaves regulated entities with "little incentive to shun practices of dubious legality." *Albemarle Paper*, 422 U.S. at 417.

The district court did not consider these precedents holding that a defendant's good faith does not justify denying restitution. Instead, it relied on a single line in a case stating that a pension plan's "reliance on counsel's" advice in improperly accepting certain pension contributions "weighs against restitution" of the contributions under the Employee Retirement Income Security Act (ERISA). ER 319:15-16 (quoting *Chase v. Trs. of W. Conference of Teamsters Pension Tr. Fund*, 753 F.2d 744, 753 (9th Cir. 1985)). This Court, however, made that statement in passing, without explanation or citation to any supporting authority.

See Chase, 753 F.2d at 753. It is therefore not binding precedent—and in any event carries little weight here given the notable differences in the purposes of ERISA and the CFPA. *See Flexible Lifeline Sys., Inc. v. Precision Lift, Inc.*, 654 F.3d 989, 997 (9th Cir. 2011) ("Statements made in passing, without analysis, are not binding precedent." (internal alteration and quotations omitted)); *see also Chase*, 753 F.2d at 749 & n.4 (restitution under ERISA is limited because overarching concern is "the actuarial soundness of the plan").

For these reasons, even if Defendants did not act in bad faith, it was legally erroneous to deny restitution on that basis.

b. It was legally erroneous to deny restitution on the ground that Defendants did not deceive consumers about the terms of the loans, but rather only about consumers' obligation to pay.

The district court also erred in denying restitution on the ground that Defendants did not deceive consumers about the costs of the loans or the benefits they would receive. ER 319:16. The district court reasoned that "the majority" of cases awarding restitution involve "fraud that is akin to what is commonly referred to as that of a 'snake oil salesman'"—namely, "misrepresentations [that] dupe consumers into believing they are purchasing something other than what they actually receive." ER 319:15. The court emphasized that there was no evidence of such conduct here: Nothing showed that "consumers anticipated receiving a

benefit that they did not actually receive under the loan agreements" or that Defendants otherwise "tainted borrowers' decision to enter into the loans." *Id.*

This reasoning disregarded the nature of the Bureau's claims. The Bureau did not charge Defendants with deceiving consumers about the terms of the loans, but rather about their validity[8]—by creating the "patently false" impression that consumers were obligated to pay amounts that they in reality had no obligation to pay. ER 213:13. As a result of that deception, consumers paid amounts that they did not in fact owe.

Denying restitution of these amounts conflicts both with the CFPA's purposes and with common law restitution principles. The CFPA aims to eradicate "unfair, deceptive, [and] abusive" practices in the consumer-financial marketplace. *See* 12 U.S.C. §§ 5531(a), 5536(a)(1)(B). Denying restitution of the fruits of a deceptive practice—as the district court did here—seriously undercuts that goal. Under the district court's reasoning, so long as a company told consumers upfront about the amounts that the company would (illegally) collect, it could collect those amounts with near impunity. This undeniably would leave companies with "little

[8] As the district court's decision notes, the Bureau attempted to show at the trial on remedies that Defendants also engaged in deception about the loans' terms. *See* ER 319:14-16. The Bureau attempted to make that showing in response to remarks by the district court indicating that it thought such evidence was relevant. *See* ECF No. 217 at 16-18; ECF No. 302 at 17-18. To be clear, the Bureau does not believe that whether Defendants also deceived consumers about the terms of the loans is relevant to whether they must pay restitution for their unlawful collection of amounts that consumers did not owe.

incentive to shun" such unlawful conduct—a result that flatly contradicts Congress's goals. *Cf. Albemarle Paper*, 422 U.S. at 417 (concluding that denying restitution was inconsistent with "the purposes which inform Title VII" because it left companies with "little incentive to shun practices of dubious legality"). For just this sort of reason, the Supreme Court and this Court have repeatedly required restitution—as that provides the "spur or catalyst" to comply with the law. *Albemarle Paper*, 422 U.S. at 417-18; *see also Pantron I*, 33 F.3d at 1103 (requiring restitution because denying it would "preserve the unjust enrichment" of the defendant, a result "contrary to the purposes of the" FTC Act); *Wirtz*, 391 F.2d at 3 (requiring restitution, as that remedy is "meant to increase the effectiveness of the enforcement of the Act by depriving a violator of any gains accruing to him through his violation"); *cf. also Chala Enters.*, 645 F.2d at 803 (reversing denial of restitution and explaining that "restitutionary injunctions are an essential tool in effectuating the policy of the Act" because they "encourage [the conduct] the Act requires"). The district court's denial of restitution here removed any "spur" for companies to avoid collecting amounts that consumers do not actually owe. That cannot be reconciled with the CFPA's purposes.

The denial of restitution here also cannot be reconciled with common law restitution principles. Under those common law principles, a person who pays money that "was not due" is generally entitled to restitution. Restatement (Third)

of Restitution and Unjust Enrichment § 6 (2011). Contrary to the district court's suggestion, it does not matter if a contract "disclosed the material terms" (ER 319:16), because restitution is available for "[p]ayments resulting from a misunderstanding of the extent or existence of a valid contractual obligation." Restatement (Third) of Restitution and Unjust Enrichment § 6, cmt. c (2011). Thus, as a leading restitution treatise explains, if a consumer pays late fees that are purportedly authorized by a contract but are in fact "illegal and unenforceable" under local law, the consumer can generally recover restitution of those fees. *Id.* § 6, Ill. 21. The same principles apply here. Consumers are entitled to the amount they paid pursuant to "illegal and unenforceable" contracts because there was "no valid contractual obligation," *id.* § 6, cmt. c.

For these reasons, the district court also committed legal error in denying restitution on the ground that Defendants did not deceive consumers about the terms of the loans, but rather only about consumers' obligation to pay them. Because both of the district court's reasons for deeming restitution inappropriate were based on "erroneous legal principles," this Court should reverse. *See Pantron I*, 33 F.3d at 1102 ("Because the district court's refusal to award monetary equitable relief was based on the application of erroneous legal principles, we reverse.").

B. The Bureau met its burden to establish the proper restitution amount.

The district court also applied erroneous legal principles in concluding that the Bureau did not prove that the *amount* of restitution it sought was appropriate. As the district court correctly acknowledged, the Ninth Circuit uses a "two-step burden-shifting framework" for calculating restitution awards under the CFPA. *CFPB v. Gordon*, 819 F.3d 1179, 1195 (9th Cir. 2016); *see also* ER 319:17. Under this framework, "the government 'bears the burden of proving that the amount it seeks in restitution reasonably approximates the defendant's unjust gains.'" *Gordon*, 819 F.3d at 1195 (quoting *Commerce Planet*, 815 F.3d at 603). At this step, "a defendant's net revenues" can be used "as a basis for measuring unjust gains." *Id.* Once "the government makes this threshold showing, the burden shifts to the defendant to demonstrate that the net revenues figure overstates the defendant's unjust gains." *Id.* At this second step, "[a]ny risk of uncertainty … falls on the wrongdoer whose illegal conduct created the uncertainty." *Commerce Planet*, 815 F.3d at 604.

The Bureau met its burden under this framework to show that the amount it sought—$235,597,529.74—reasonably approximated Defendants' unjust gains. In particular, the Bureau put forth unrefuted evidence that this amount represents Defendants' net revenues from their unlawful practice—the total interest and fees

that they collected that consumers did not actually owe, minus the amounts that Defendants already refunded pursuant to settlements of state enforcement actions.[9]

The district court, however, concluded that the Bureau did not meet its burden under the burden-shifting framework for two reasons. ER 319:17. First, the district court held that the Bureau did not present "credible evidence" that the amount it sought "represents Defendants' net revenues," apparently because it was not "netted to account for expenses."[10] *Id.* Second, the district court faulted the

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[9] In fact, this amount *under*-estimates Defendants' unjust gains. Under most of the Subject States' laws, consumers were not obligated to repay *principal* either, and thus Defendants unlawfully collected those amounts as well. *See, e.g.*, Ariz. Rev. Stat. Ann. § 6-613(B) (unlicensed lender "has no right to collect, receive or retain any principal, finance charges or other fees in connection with that consumer lender loan"); 205 Ill. Comp. Code § 670/20 (unlicensed lender "shall have no right to collect, receive, or retain any principal, interest, or charges related to the loan"); Ind. Code § 24-4.5-5-202(2) ("the debtor is not obligated to pay either the principal or loan finance charge" on loan from unlicensed lender); Ky. Rev. Stat. § 286.4-991 (unlicensed "lender shall have no right to collect any principal, charges or recompense whatsoever"); Minn. Stat. § 47.601 subdiv. 6(a) ("the borrower is not obligated to pay any amounts owing" if loan is made by unlicensed lender or exceeds interest-rate limits); Mont. Code Ann. § 32-5-103(4) (unlicensed lender "does not have the right to collect, receive, or retain any principal, interest, fees, or other charges"); N.H. Rev. Stat. Ann. § 399-A:15(V) (lender "shall have no right to collect, receive, or retain any principal, interest, or charges whatsoever on any purported small loan contract" that exceeds interest-rate limits); N.C. Gen. Stat. § 53-166(d) (lender "shall not collect, receive, or retain any principal or charges whatsoever"); Ohio Rev. Code Ann. § 1321.02 (unlicensed "lender has no right to collect, receive, or retain any principal, interest, or charges"). The Bureau did not seek return of principal payments.

[10] To the extent that the district court meant that "no credible evidence" established Defendants' net revenues for some other reason, that factual finding was clearly erroneous. The Bureau's evidence showing the total interest and fees that Defendants collected minus refunds was taken from Defendants' own verified

Bureau for not accounting for "the payment status of individual loans" and whether the restitution award "would create a windfall for borrowers." *Id.* Both of these reasons were legally erroneous.

1. *Defendants cannot deduct their expenses from the restitution to be paid to consumers.*

The district court's suggestion that the restitution amount must be "netted to account for expenses" disregards the "well established" principle that defendants "are not entitled to deduct costs associated with committing their illegal acts." *FTC v. Bronson Partners, LLC*, 654 F.3d 359, 375 (2d Cir. 2011) (discussing equitable disgorgement). Consistent with this principle, this Court has made clear that restitution is "measured by the defendant's net revenues …, not by the defendant's net profits." *Commerce Planet*, 815 F.3d at 603 (citing, *inter alia*, *FTC v. Wash. Data Res., Inc.*, 704 F.3d 1323, 1327 (11th Cir. 2013) (per curiam)); *see also Gordon*, 819 F.3d at 1195 (holding that, under the CFPA, "[r]estitution may be measured by the full amount lost by consumers rather than limiting damages to a defendant's profits" (internal quotations omitted)). A defendant's "net revenue" is "typically the amount consumers paid for the product or service

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interrogatory responses, and Defendants did not contest the accuracy of the Bureau's calculations. ER 264:2-4, 9 (¶¶ 4-13, 20), 264-1:2 (specifying total of interest and fees Defendants collected); ER 280-1:3-4 (indicating amounts Defendants refunded consumers pursuant to state settlements); *see also* ECF No. 299 at 2, 12 (parties agree on calculation of interest and fees).

minus refunds and chargebacks"—expenses are not deducted.[11] *Commerce Planet*, 815 F.3d at 603; *see also Wash. Data Resources*, 704 F.3d at 1326-27 (holding that "the amount of net revenue (gross receipts minus refunds), rather than the amount of profit (net revenue minus expenses), is the correct measure of unjust gains" for purposes of monetary relief under FTC Act). This is exactly what the Bureau showed here: The amount that consumers paid that they did not actually owe, minus refunds.

In addition to disregarding this Court's precedent, the district court's requirement that Defendants' expenses be deducted also undermines the statutory scheme that Congress enacted in at least two ways. For one, allowing a deduction for Defendants' expenses would leave consumers uncompensated for amounts they paid that they did not actually owe. This cannot be squared with Congress's goal of providing relief for consumers injured by unlawful practices, as evidenced by the CFPA's broad grant of authority for the Bureau to obtain "any appropriate legal or equitable relief" for violations of federal consumer financial law," 12 U.S.C. § 5565(a)(1); *see also* S. Rep. No. 111-176, at 177 (2010) (explaining that this section "provides for relief for consumers").

[11] Rather, expenses are deducted from revenues to calculate net *profits*. *Wash. Data Resources*, 704 F.3d at 1327 (describing profits as "net revenue minus expenses"). This Court has expressly held that restitution is *not* measured "by the defendant's net profits." *Commerce Planet*, 704 F.3d at 1327.

Second, deducting expenses from a restitution award would seriously undermine effective enforcement of the Act. If companies that violate the law did not have to pay back anything more than their profits, they would have "little incentive to shun practices of dubious legality," *Albemarle Paper*, 422 U.S. at 417. Indeed, here, if expenses were deducted, Defendants would get to keep *all* of the amounts they took from consumers because, according to Defendants, their loan program in the Subject States operated at a loss. ER 271:11 (¶ 31). In other words, deducting expenses would allow Defendants to escape all liability for restitution, and leave consumers completely uncompensated, simply because Defendants spent all the unlawfully collected funds in carrying out their unlawful endeavor. Nothing in the CFPA supports such a result.

2. The Bureau did not need to account for the payment status of individual loans to meet its burden.

The district court also rejected the Bureau's proposed restitution amount on the ground that it did not account for "the payment status of individual loans" and whether it "would create a windfall for borrowers." ER 319:17. This misapplied the burden-shifting framework that this Court has established for restitution awards under the CFPA. As explained above, the Bureau "bears the burden of proving that the amount it seeks in restitution reasonably approximates the defendant's unjust gains," which may be measured by the "defendant's net revenues." *Gordon*, 819 F.3d at 1195 (internal quotations omitted). The Bureau met this burden by

establishing Defendants' net revenues from their unlawful collection of amounts that consumers did not owe—namely, the total interest and fees that consumers paid, minus previous refunds. ER 264:9 (¶ 20). The burden then shifted to Defendants to show "that the net revenues figure overstates [their] unjust gains." *Gordon*, 819 F.3d at 1195. Thus, if the "payment status of individual loans" or the possibility of windfalls meant that Defendants' net revenues overstated their unjust gains for some reason, it was Defendants' burden to show that. The district court erred by putting this burden on the Bureau instead.

The Bureau did make one error in calculating net revenues that could have resulted in windfalls for borrowers "who may not have made any payments on their loans" (ER 319:17)—but that error did not justify denying restitution altogether. In particular, the Bureau included in its revenue calculation all "origination fees," but Defendants did not actually receive some of those fees. Rather, "origination fees" were included in the loan amount and deducted from the amount disbursed. ER 271:7-8 (¶ 20). So, for instance, a consumer who took out a $1500 loan received only $1000 in funds, and the other $500 was retained as an origination fee. ER 316:5-6 (Trial Tr. at 263-64). Thus, Defendants did not receive the origination fee as revenue until the consumer actually repaid that amount. The Bureau's calculations, however, treated as revenues all fees that Defendants recorded as origination fees, including those that consumers never

repaid. Although this was erroneous, "the proper solution [was] for the district court to reduce" the net revenue calculation accordingly, "not to deny the request entirely." *Cf. Fischer v. SJB-P.D. Inc.*, 214 F.3d 1115, 1122 (9th Cir. 2000) (holding that district court abused discretion in denying request for attorneys' fees on ground that hourly rate was excessive, and holding that "the proper solution is for the district court to reduce it to the prevailing market rate, not to deny the request entirely"); *cf. also FTC v. Direct Mktg. Concepts, Inc.*, 548 F. Supp. 2d 202, 221 (D. Mass. 2009) (concluding that "[t]he equitable monetary relief" that the FTC sought was "too broad" and accordingly awarding a lower amount, not denying relief altogether). Evidence admitted at trial shows that with the unpaid origination fees excluded, Defendants' net revenues totaled $197,310,812. *See* Trial Ex. 219 (Excel spreadsheet showing Defendants' collections); ER 280-1:3-4 (listing amounts refunded pursuant to state settlements). The Bureau is entitled to restitution in that amount.

II. A Higher Civil Penalty Is Warranted Because Defendants' Violations Were At Least Reckless.

Defendants' conduct warranted a higher civil penalty than what the district court imposed. Defendants collected amounts that consumers did not owe for years—despite facing increasingly urgent warnings from counsel and regulatory actions by one state after the other. The recklessness of these violations warranted a higher civil penalty.

As explained above (at 11), the CFPA provides for three "tiers" of civil penalties, with different per-day maximum penalty amounts based on whether the defendant's violations were "knowing[]," "reckless[]," or neither. 12 U.S.C. § 5565(c)(2). The Bureau sought penalties under tier three (for knowing violations), but the district court concluded that only "a Tier One penalty is appropriate" because the evidence did not show that Defendants "knowingly" or "recklessly" violated the CFPA. ER 319:19. It then imposed a penalty of $10.3 million—the maximum penalty allowed under that tier. *Id.* The court concluded a reduction was not warranted given Defendants' "willingness to continue the Western Sky Loan Program in the face of increased regulatory pressure and advice from their counsel that the model was becoming increasingly susceptible to attack." *Id.* The penalty imposed was over $40 million less than the $51.3 million penalty that the Bureau sought under tier three.[12] *See* ECF No. 313 at 22.

The district court erred in awarding penalties only under tier one, as the evidence plainly shows that Defendants' violations were at least reckless—and the

[12] The $51.3 million penalty that the Bureau sought was far below the maximum penalty allowable under tier three and would be allowable under tier two. *See* ECF No. 313 at 22. Under the CFPA, the amount of a penalty must account for various mitigating factors, including "the size of financial resources … of the person charged." 12 U.S.C. § 5565(c)(3). The Bureau sought less than the maximum tier-three amount because, given Defendants' "financial resources," they would likely not be able to pay a higher penalty in addition to the more than $200 million in restitution that the Bureau sought. Defendants made clear at trial that they did not claim an inability to pay the $51.3 million penalty that the Bureau sought. ER 316:12 (Trial Tr. at 367).

district court's contrary conclusion was clearly erroneous. Although the CFPA does not define "recklessness," the Supreme Court has explained that "[t]he civil law generally calls a person reckless who acts … in the face of an unjustifiably high risk of harm that is either known or so obvious that it should be known." *Farmer v. Brennan*, 511 U.S. 825, 836 (1994).

The evidence shows that Defendants ran such risks. In concluding otherwise, the district court emphasized that Defendants got multiple opinions from outside counsel that their business model could lawfully circumvent state lending laws, and that counsel "never revoked their opinions." ER 319:19; *see also id.* (counsel "did not change their original opinions"); ER 319:10 (counsel "never withdrew her opinion"); ER 319:11 (counsel "continued to maintain" that loans were lawful); *id.* (counsel "never withdrew or changed her opinion"); ER 319:12 ("Notwithstanding that advice, [counsel] never specifically withdrew or modified her previous opinion"); ER 319:13 (counsel "continued to defend" the model). This improperly put near-dispositive weight on the imprimatur of counsel. Despite these legal opinions, Defendants still had ample reason to know that their attempts to avoid state lending laws posed unjustifiably high legal risks.

Before CashCall even began its tribal lending model, it had already faced regulatory scrutiny for a similar endeavor. CashCall previously attempted to avoid state lending laws through the so-called "bank model," under which CashCall

partnered with federally-regulated banks to take advantage of those banks' exemption from the usury limits of borrowers' home states. ER 282:5 (¶ 15). But CashCall faced state regulatory action challenging that model. *See CashCall, Inc. v. Morrisey*, No. 12-1274, 2014 WL 2404300 (W.Va. 2014); *CashCall, Inc. v. Md. Comm'r of Fin. Regulation*, 139 A.3d 990 (Md. 2016). And CashCall ultimately had to end that model when the banks pulled out in the face of increasing scrutiny from federal regulators. ER 282:6-7 (¶¶ 21, 23-24). Despite the signs of that model's illegality, CashCall sought to replicate it with an "almost identical" model that substituted a tribally-affiliated lender for the bank.[13] ER 314:7 (Trial Tr. at 38).

As the district court emphasized, Defendants did obtain legal advice in structuring their new model. But although outside counsel signed off on their new approach, the advice that Defendants received nonetheless shows that they ran an "unjustifiably high risk" of making void loans and then collecting amounts that consumers did not actually owe. Counsel repeatedly warned Defendants that their lending model was subject to "significant" legal risk (*e.g.*, ER Ex.500C:2,

[13] State regulators charged that CashCall could not take advantage of banks' exemption from state lending laws including because CashCall, not the banks, was the de facto lender. *See Morrisey*, 2014 WL 2404300, at *7, 14-15; *Md. Comm'r of Fin. Regulation*, 139 A.3d at 1005. CashCall nonetheless remained the de facto lender under its new tribal model—and, as a result, could not take advantage of any exemption that a tribal choice-of-law provision might give a tribally-affiliated lender either.

Ex.500H:2), with two outside lawyers even advising that the model would "likely" be rejected by the courts (ER Ex.528:1, Ex.400:2). Indeed, although the district court found that one outside expert confirmed CashCall's primary counsel's view that the model was viable (*see* ER 319:12), the evidence shows that expert's opinion was not nearly so supportive. He in fact opined that "the model should work but likely won't," as "the lower courts will shun our model and … if we reach the Supreme Court, given its current composition, we will lose." ER Ex.528:1.

Defendants did not get even that level of tepid legal endorsement for all of their activities. No opinion letter addressed whether the laws of Massachusetts or New Hampshire would apply to the loans, but Defendants made and collected loans there anyway. *See* ER Ex.16:8-15, Ex.18:11-17, Ex.396:8-15, Ex.500G:6-13, Ex.500H:9-15, Ex.500I:6-13. Similarly, Defendants made and collected loans in Minnesota beginning in 2010, even though no legal opinion addressed the applicability of that state's laws until the end of 2012 and even though Minnesota law expressly prohibits short-term loans to Minnesota borrowers that contain a choice-of-law provision "selecting a law other than Minnesota law under which the contract is construed or enforced," Minn. Stat. § 47.601 subdiv. 2(1). ER 163-3:27 (¶ 194), Ex.16:8-15, Ex.18:11-17, Ex.396:8-15, Ex.500G:6-13, Ex.500H:9-15, Ex.500I:6-13.

Moreover, Defendants did not even follow the legal advice they received. As early as 2009, outside counsel began urging Defendants to change the structure to avoid legal problems, but Defendants did not make those changes. *See, e.g.*, ER Ex.510:1, Ex.513:1-2, 353:7, 365:1. In early 2011, CashCall's primary counsel told CashCall that she felt "more strongly than ever" that Western Sky (the lending partner) needed to "firm up its structure." ER 353:7. If it did not, she explained, it "will be marquee quarry for a state or for the Bureau." *Id.* CashCall's General Counsel agreed "for 100 different reasons" (ER 353:9), yet Defendants never made the recommended changes (ER 282:21 (¶ 83), ER 314:9 (Trial Tr. at 109)). These warnings became increasingly dire with time, with Defendants' counsel recommending in early 2013 that CashCall significantly limit its involvement to one of three discrete areas—but Defendants did not make those changes either. ER 365:1; *see also* ER 314:11-12 (Trial Tr. at 132-33).

Regulatory actions by states further put Defendants on notice that their conduct ran a high risk of collecting amounts that consumers did not actually owe. By August 2011 (just a few weeks into the time period that the Bureau's claims cover), four states had already brought legal actions addressing the Western Sky loan program. ER 314:15-17 (Trial Tr. at 152-54); ER 282:24 (¶ 89). Over the years, that number swelled to at least 23 state regulators with enforcement actions against Defendants and/or Western Sky. *See supra* at 9 n.2.

At the same time, CashCall also incurred liability for its old bank model. ER 314:6 (Trial Tr. at 37). In particular, a West Virginia court ruled in September 2012 that state law applied to loans made under CashCall's bank model because CashCall, not the bank, was the de facto lender. *See id.* Although CashCall's General Counsel understood the bank model to be "almost identical" to the new tribal model at issue in this case (ER 314:7 (Trial Tr. at 38)), Defendants made no changes to avoid similarly being the de facto lender under their new model. *See* ER 282:21 (¶ 83) (explaining that "there were no material changes to the program or business structure" after February 2010).

Ultimately, in August 2013, Defendants' primary outside counsel recommended that they cease the program because "the regulation and litigation environments have risen from dangerous to near extinction." ER 357:4. In the face of this warning, Defendants finally stopped buying Western Sky loans in September 2013. ER 314:11 (Trial Tr. at 132); ER 316:9 (Trial Tr. at 361). But, even then, they continued to *collect* on the existing loans for another three years—despite all indications that borrowers had no obligation to pay them. ER 314:11-12 (Trial Tr. at 132-33; ER 316:9-10 (Trial Tr. at 361-62).

In light of this evidence, the district court committed clear error in concluding that Defendants' violations were not at least reckless. Outside counsel may have opined that Defendants could lawfully disregard state lending laws, but

that did not give Defendants license to ignore the many other signs that they were running an "unjustifiably high risk" of collecting from consumers amounts that they did not actually owe. *See Farmer*, 511 U.S. at 836. Counsel's warnings, the repeated unheeded suggestions for changes, and the multiple regulatory actions made these risks either known or "so obvious that [they] should [have been] known," *id.* Indeed, even after Defendants recognized that the risks were too high to continue making new loans, they nonetheless continued—for three more years—to violate the CFPA by collecting amounts that consumers did not actually owe. That conduct was reckless and warranted a civil penalty under tier two.

CONCLUSION

For the foregoing reasons, this Court should reverse the district court's judgment denying restitution and imposing a civil penalty of only $10.3 million, and it should remand the case for the district court (1) to order Defendants to pay restitution in the amount of the interest and fees that consumers paid that they did not actually owe, and (2) to impose an appropriate civil penalty in light of the "tier two" maximum penalty amounts that the statute establishes for reckless violations.

Dated: October 19, 2018

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STATEMENT OF RELATED CASES

Counsel is aware of no cases pending in this Court that are related within the meaning of Ninth Circuit Rule 28-2.6.

CERTIFICATE OF COMPLIANCE

This brief complies with the length limits permitted by Ninth Circuit Rule 28.1-1(b). The brief is 12,315 words, excluding the portions exempted by Ninth Circuit Rule 28.1-1(e) and Federal Rule of Appellate Procedure 32(f).

The brief's type size and type face comply with Fed. R. App. P. 32(a)(5) and (6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman.

Dated: October 19, 2018 /s/ Kristin Bateman

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STATUTORY ADDENDUM

12 U.S.C. § 5536. Prohibited acts

(a) In general

It shall be unlawful for--

(1) any covered person or service provider--

(A) to offer or provide to a consumer any financial product or service not in conformity with Federal consumer financial law, or otherwise commit any act or omission in violation of a Federal consumer financial law; or

(B) to engage in any unfair, deceptive, or abusive act or practice;

….

12 U.S.C. § 5565. Relief available

(a) Administrative proceedings or court actions

(1) Jurisdiction

The court (or the Bureau, as the case may be) in an action or adjudication proceeding brought under Federal consumer financial law, shall have jurisdiction to grant any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law, including a violation of a rule or order prescribed under a Federal consumer financial law.

(2) Relief

Relief under this section may include, without limitation--

(A) rescission or reformation of contracts;

(B) refund of moneys or return of real property;

(C) restitution;

(D) disgorgement or compensation for unjust enrichment;

(E) payment of damages or other monetary relief;

(F) public notification regarding the violation, including the costs of notification;

(G) limits on the activities or functions of the person; and

(H) civil money penalties, as set forth more fully in subsection (c).

(3) No exemplary or punitive damages

Nothing in this subsection shall be construed as authorizing the imposition of exemplary or punitive damages.

(b) Recovery of costs

In any action brought by the Bureau, a State attorney general, or any State regulator to enforce any Federal consumer financial law, the Bureau, the State attorney general, or the State regulator may recover its costs in connection with prosecuting such action if the Bureau, the State attorney general, or the State regulator is the prevailing party in the action.

(c) Civil money penalty in court and administrative actions

(1) In general

Any person that violates, through any act or omission, any provision of Federal consumer financial law shall forfeit and pay a civil penalty pursuant to this subsection.

(2) Penalty amounts

(A) First tier

For any violation of a law, rule, or final order or condition imposed in writing by the Bureau, a civil penalty may not exceed $5,000 for each day during which such violation or failure to pay continues.

(B) Second tier

Notwithstanding paragraph (A), for any person that recklessly engages in a violation of a Federal consumer financial law, a civil penalty may not exceed $25,000 for each day during which such violation continues.

(C) Third tier

Notwithstanding subparagraphs (A) and (B), for any person that knowingly violates a Federal consumer financial law, a civil penalty may not exceed $1,000,000 for each day during which such violation continues.

(3) Mitigating factors

In determining the amount of any penalty assessed under paragraph (2), the Bureau or the court shall take into account the appropriateness of the penalty with respect to--

(A) the size of financial resources and good faith of the person charged;

(B) the gravity of the violation or failure to pay;

(C) the severity of the risks to or losses of the consumer, which may take into account the number of products or services sold or provided;

(D) the history of previous violations; and

(E) such other matters as justice may require.

(4) Authority to modify or remit penalty

The Bureau may compromise, modify, or remit any penalty which may be assessed or had already been assessed under paragraph (2). The amount of such penalty, when finally determined, shall be exclusive of any sums owed by the person to the United States in connection with the costs of the

proceeding, and may be deducted from any sums owing by the United States to the person charged.

(5) Notice and hearing

No civil penalty may be assessed under this subsection with respect to a violation of any Federal consumer financial law, unless--

> (A) the Bureau gives notice and an opportunity for a hearing to the person accused of the violation; or
>
> (B) the appropriate court has ordered such assessment and entered judgment in favor of the Bureau.

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on October 19, 2018.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

Dated: October 19, 2018 /s/ Kristin Bateman

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