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VIA ELECTRONIC SUBMISSION

Comment Intake
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C. 20552

Enclosed please find Ballard Spahr's comments submitted in response to the Bureau of Consumer Financial Protection's February 5, 2018, Request for Information Regarding Bureau Rules of Practice for Adjudication Proceedings, Docket No. CFPB-2018-0002.

We appreciate the opportunity to provide comments on the important issues encompassed within the RFI. Our observations and comments result from our firm's extensive experience representing our bank and non-bank clients, as well as their service providers, in connection with more than fifty Bureau of Consumer Financial Protection investigations across the consumer financial services industry.

Sincerely,

BALLARD SPAHR LLP

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I. Executive Summary.

This letter is in response to the Bureau of Consumer Financial Protection's Request for Information Regarding Bureau Rules of Practice for Adjudication Proceedings (the "Rules"), Docket No. CFPB-2018-0002. We submit comments because many of our law firm's clients are providers of consumer financial products and services and thus subject to the Bureau's enforcement authority. Our comments result from our firm's extensive experience representing bank and non-bank clients, as well as their service providers, in investigations commenced by the Bureau pursuant to its civil investigative demand ("CID") powers. As a result of our experience assisting clients in responding to a wide array of issues investigated by the Bureau—including issues relating to payment processing, mortgage lending and servicing, overdraft fees, debt collection, debt buying, student lending and servicing, automobile financing and servicing, installment lending, reverse mortgages, small dollar lending, tax refund anticipation loans, marketplace lending products and credit reporting—we are very familiar with the complex nature of issues pursued by the Bureau and the amount of time, due diligence and discovery efforts needed to respond.

Put simply, the Bureau's rules for administrative adjudication create a forum in which the playing field is designed to be unfair to the respondent, and to afford maximum advantage to the Bureau's enforcement staff. For example, the existing rules for the adjudication process serve to place an enforcement target under maximum and unnecessary time pressure—after the Bureau's enforcement staff has had unlimited time to conduct an investigation. The limited discovery mechanisms available to respondents make it difficult, if not impossible, for targets to obtain information needed for a defense, either from the Bureau or third parties. The administrative restrictions on respondent-initiated discovery are unnecessary and exist despite the unlimited access that the Bureau's enforcement staff has to factual information through the Bureau's CID powers—again, highlighting the dramatic unfairness designed into the current administrative adjudication process.

Federal courts are the proper forum for enforcement actions. However, to the extent the Bureau continues to use administrative enforcement actions, the rules of practice should be modified to rectify the significant imbalance between the Bureau's investigative powers and open-ended time frame and a respondent's due process rights, including the right to conduct discovery without unreasonable time constraints. The rules should also be modified to prevent the very real possibility that a target could be found liable for a violation of law based on hearsay evidence that would never be admissible in court, and which the target would never have the opportunity to test through cross-examination.

II. The Bureau's Use of Administrative Enforcement Shows that Federal Court Should Be the Exclusive Forum for Enforcement Proceedings.

In the Matter of PHH Corporation, et al., File No. 2014-CFPB-0002, which is one of the only contested enforcement actions in which the Bureau used the administrative process, provides a cautionary tale about administrative adjudications that should persuade the

agency to take such contested matters to federal court which, by providing a neutral forum, would eliminate any doubt about the legitimacy of the Bureau's enforcement actions.

In the *PHH* matter, the Bureau asserted violations of the Real Estate Settlement Procedures Act ("RESPA") and argued that "no statute of limitations [applied to] *any* CFPB administrative actions to enforce *any* consumer protection law." *PHH Corporation v. CFPB*, 839 F.3d 1, 9-10 (D.C. Cir. 2016) (emphasis in original), *reinstating relevant statutory holdings en banc*, 881 F.3d 75 (D.C. Cir. 2018). Following an adverse decision by the administrative law judge ("ALJ"), PHH appealed the decision to the Bureau's Director, after which Director Cordray radically increased the disgorgement amount from the $6.5 million determined by the ALJ to "over $109 million." *In the Matter of PHH Corporation*, Admin. Pro. No. 2014-CFPB-0002, Decision of the Director, Doc. No. 226 at 2, 9 (Bureau of Consumer Financial Protection, June 4, 2015).

The U.S. Court of Appeals for the D.C. Circuit, in the statutory holdings reinstated en banc, determined that "the CFPB's interpretation [of RESPA] flouts not only the text of the statute but also decades of carefully and repeatedly considered official government interpretations," *PHH Corp.*, 839 F.3d at 42, and that "the CFPB violated due process by retroactively applying that new interpretation to PHH's conduct that occurred before the date of the CFPB's new interpretation." *Id.* at 44. The D.C. Circuit also held that the three-year statute of limitations in RESPA's Section 2614 applies to the Bureau's administrative actions. *Id*. at 55.

In short, the Bureau used the administrative process in the *PHH* matter to pursue a legal theory that was contrary to law and prior regulatory guidance. Worse, the history of the case—and in particular the significantly increased disgorgement amount ordered by the Bureau's Director—suggests that the Bureau used the process to punish a party for invoking its right to a fair hearing of its legal arguments, which ultimately proved correct.

The fundamental flaw of the administrative adjudication process is that it permits the Bureau to adjudicate its own enforcement actions. The Director authorizes enforcement actions. The Director participates in settlement discussions with enforcement targets. And then the Director serves as the final decision-maker on the very same enforcement actions that he or she authorized. As the final decision-maker, the Director approaches cases with knowledge of the targets' settlement posture and facts that are not a part of the record. With the deck so heavily stacked in the Bureau's favor, administrative adjudications, at best, have the appearance of bias against targets and, at worst, as the *PHH* case suggests, may reflect actual bias.

To instill confidence in Bureau enforcement actions, they should be adjudicated by a neutral tribunal—a federal court. The Bureau has utilized this avenue in almost all of its contested enforcement cases to date, with the notable exception of *PHH*. The Bureau should adopt a policy of continuing to use federal courts as the exclusive venue for such actions.

III. The Administrative Enforcement Procedures Should Be Heavily Revised to Make Them Fair to Enforcement Targets.

A. Time Limits Should be Relaxed and Subject to Extensions.

Contrary to the limits placed on respondents, the Bureau is under no time constraints in conducting investigations and exercising its broad CID powers. The apparent intent, and practical effect, of the Rule's tight deadlines is to favor the Bureau's enforcement attorneys and to create intense pressure for respondents. The arbitrarily defined timeframe of 300 days for a matter to proceed from complaint to post-hearing determination, as established by 12 C.F.R. § 1081.400(a), is not supported by any objective rationale and serves no meaningful purpose other than to disadvantage respondents. Time limits imposed on adjudicative matters should take into consideration their relative complexity and other material considerations, such as a respondent's legitimate need for discovery. The Bureau's current rule fails to do so.

The nature and types of claims brought by the Bureau do not differ between those brought administratively versus those brought in federal court. Just as in federal court, hearing officers should be authorized to set the time needed for meaningful discovery and other pre-hearing activities based on the facts and circumstances of each case. Hearing officers should have the discretion to extend deadlines as appropriate for the particular circumstances and the presumption against continuances embodied within 12 C.F.R. § 1081.115 should be stricken. There is no reason why a reasonable request for an extension of time cannot be resolved and granted by a hearing officer, and such requests should not be presumed disfavored and should not require a showing of "substantial prejudice."

A respondent in an administrative proceeding should not be disadvantaged simply because the Bureau exercised its discretion to initiate an administrative adjudication rather than a federal court case. Given the serious nature of charges typically brought by the Bureau, the time limits imposed on the process should be relaxed and conform, at a minimum, to those applicable under the Federal Rules of Civil Procedure. Accordingly, the fourteen-day deadline to respond to a complaint in 12 C.F.R. § 1081.201(a) should be increased to, at a minimum, twenty-one days to conform to Rule 12 of the Federal Rules of Civil Procedure, with extensions granted freely for good cause.

The Rules should be amended to conform to the time limits set forth in the Federal Rules of Civil Procedure, to eliminate the 300-day arbitrary deadline by which an enforcement action must result in a determination, to eliminate presumptions against extensions of time, and to authorize hearing officers to grant extensions in their discretion based on the needs of a particular case.

B. The Respondent Should Have Access to the Bureau's Discovery.

The nature of claims brought by the Bureau in its administrative adjudication proceedings mirrors complex civil cases brought in federal court. The administrative

discovery procedures should therefore align with the procedures established by the Federal Rules of Civil Procedure, rather than parallel the limited and unilateral discovery authorized in criminal cases under the Federal Rules of Criminal Procedure (upon which the Rules are currently based).

To defend itself in administrative proceedings, a respondent must have access to modern discovery tools, including depositions and written discovery. Modernization can occur without a loss of efficiency or undue delay to the administrative process, and will ensure a respondent's fundamental right to due process. The SEC recognized the same in promulgating significant amendments to its Rules of Practice in 2016. *See* Amendments to the Commission's Rules of Practice, SEC Release No. 34-78319, 81 F.R. 50211 (July 13, 2016). The Bureau should follow suit.

1. Respondents Should Be Able to Conduct Depositions and Written Discovery of the Bureau.

In enacting its original Rules of Practice, the Bureau looked to the SEC and the FTC, and drew from the experience and history of those agencies. Rules of Practice for Adjudication Proceedings, 76 F.R. 45338-01 ("The Rules adopted herein are animated by the experiences of these agencies.") The Bureau should do so once again and use the discovery techniques embraced by the FTC administrative process[1] and also draw from the SEC's recent amendments to its Rules of Practice. *See* 17 C.F.R. § 201.2. Allowing depositions and written discovery, as the SEC and FTC do, will render the administrative adjudication process more meaningful and efficient for all parties involved, including the Bureau. Transparency will facilitate, not deter, settlement opportunities. And hearings are more efficient when parties have full access in advance to witness statements, testimony, and the facts needed to present their best case.

Depositions, in particular, are necessary to test investigative testimony that is not subject to cross-examination, particularly if such statements may be offered at trial. Written discovery, including of the Bureau, is equally necessary given the volume of documents and data gathered by the Bureau, often over the course of several years. After all, the Bureau has access to the same discovery tools through its CID authority. The administrative adjudication process should allow the Bureau and respondents to have equal access to information.

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[1] *See* 16 C.F.R. § 331 ("Parties may obtain discovery by one or more of the following methods: depositions upon oral examination or written questions; written interrogatories; production of documents or things for inspection and other purposes; and requests for admission.") The FTC has mandatory initial disclosures, similar to the nature of mandatory production currently embraced by 12 C.F.R. § 1081.206, but also allows respondents to discover relevant factual information through basic civil discovery tools. *See* 16 C.F.R. § 3.31(b); *see also* § 3.32 (Admissions); § 3.33 (Depositions); § 3.34 (Subpoenas); § 3.35 (Interrogatories to parties); § 3.37 (Production of Documents).

The United States District Court of the Northern District of Georgia recognized the same and held that a defendant in a civil case is entitled to depose a Bureau representative regarding the factual basis of the Bureau's claims. *See CFPB v. Universal Debt Solutions, LLC*, Civ. No. 1:15-CV-859-RWS, 2017 WL 3887187 at *2 (N.D. Ga. Aug. 25, 2017). Respondents in administrative adjudications should, likewise, be "entitled to question the CFPB about the factual underpinnings of its allegations against them." *Id*. It is incumbent upon the Bureau, having utilized its broad statutory powers to conduct investigations to then afford respondents the discovery necessary to assess and defend against the Bureau's claims.

2. Witness Statements Should Be Produced Upon Receipt and Not Pursuant to the Jencks Act.

Witness statements obtained by the Bureau are currently subject to § 1081.207, with production required upon motion and only after a witness testifies at a hearing. 12 C.F.R. § 1081.207. However, these statements should be produced as a matter of course along with the investigative documents and records subject to 12 C.F.R. § 1081.206.

Section 1081.207 expressly incorporates the Jencks Act, 18 U.S.C. § 3500(e), which was enacted in 1957 in response to Congress's concern that potential government witnesses in criminal trials needed to be protected from bribery and coercion. The Jencks Act provides a limited amount of time following a witness's direct examination at trial for defense counsel to review the witness's prior statements for use in cross-examination. But the policy concerns that drove the enactment of the Jencks Act—fear of witness tampering and intimidation in narcotics and violent crime cases—are not relevant in the administrative arena or to the types of consumer claims investigated by the Bureau. In the absence of these policy considerations, it is appropriate to give respondents access to witness statements to allow them to prepare a meaningful defense.

Access to witness statements in Bureau enforcement actions is particularly important because the Bureau's witnesses drive the agency's investigations and ultimate claims. To adopt the Jencks Act standard of production of witness statements from criminal cases and apply it in a civil, administrative adjudication proceeding is misplaced and unfair. Statements of the Bureau's witnesses should therefore be produced during routine fact discovery.

C. Respondents Should Be Able to Obtain Third-Party Discovery and Testimony Through Subpoenas.

The Bureau has unlimited access to third-party discovery through CIDs. In addition, 12 C.F.R. § 1081.117 effectively authorizes the Bureau to conduct third-party discovery in any fashion as part of an adjudicative proceeding. By contrast, except for a witness who is unavailable to attend a hearing, a respondent may only subpoena witnesses for hearings, not depositions. 12 C.F.R. § 1081.209. This is yet another unfair restriction on a respondent's access to discovery. The process should be amended to conform to the federal court practice

of allowing parties equal access to third-party discovery, including issuance and enforcement of deposition and document subpoenas. *See* Fed. R. Civ. P. 30, 45.

The Administrative Procedure Act expressly authorizes the use of subpoenas within the administrative process, though only upon prior authorization of the hearing officer. 5 U.S.C. § 555(d) ("Agency subpoenas authorized by law shall be issued to a party on request and, when required by rules of procedure, on a statement or showing of general relevance and reasonable scope of the evidence sought."). Accordingly, the SEC permits issuance of deposition and documents subpoenas, upon a respondent's request. 17 C.F.R. § 201.232 (subpoenas), § 201.233 (depositions). The FTC similarly permits respondents to issue subpoenas for testimony and records without prior authorization. 16 C.F.R. § 3.34(a)-(b). The Bureau should do the same.

With respect to subpoenas for records, § 1081.208 requires the Bureau's hearing officer to be involved and approve all subpoena requests, and grants broad discretion to the hearing officer to limit the scope and burden of subpoenas. 12 C.F.R. § 1081.208(d). Yet § 1081.208(g) allows subpoenaed parties to articulate their own objections. We recommend that § 1081.208 be brought into conformance with Federal Rule of Civil Procedure 45 and 16 C.F.R. § 3.34 by authorizing counsel to issue subpoenas to third-parties for both records and testimony, subject to the ability of any such third-party to seek relief from the hearing officer if necessary. Allowing counsel to issue subpoenas without prior authorization will streamline the discovery process. If the hearing officer is required to authorize the issuance of subpoenas, the rules should be amended to include a presumption in favor of issuance.

With respect to depositions, allowing deposition discovery will not impair efficiency. There is no reason for the Bureau to disallow deposition practice, and the SEC's and FTC's incorporation of depositions into the administrative process confirms the Bureau's ability to do so without impairing the efficiency of the administrative forum. With respect to the mechanics and number of depositions, Federal Rule of Civil Procedure 30(a)(2) allows for depositions to be noticed without permission of the court unless the cumulative number of depositions would exceed ten by either the plaintiffs or defendants. We recommend that respondents should have an opportunity to designate a reasonable number of depositions based on the nature of the investigation record. In addition, to guarantee due process, the rules should be amended to allow parties to notice depositions of fact witnesses, and, if the government intends to use experts, then expert witnesses as well. Further, depositions needed to preserve trial testimony of unavailable witnesses should not be counted against a respondent's allowed number of depositions. The number of permitted depositions should reasonably account for the particular issues, facts, and circumstances of the case.

D. The Evidentiary Rules in Administrative Hearings Should Conform to the Federal Rules of Evidence, and Hearsay Should Be Inadmissible Except as Provided in FRE 803-804.

The Federal Rules of Evidence exist for good reason: to ensure that findings of fact are based on reliable evidence that is subject to challenge and cross-examination by the

opposing party. The Bureau's current rules depart from this principle by making hearsay evidence expressly admissible in adjudicative proceedings.

The Rules provide that "[e]vidence that constitutes hearsay may be admitted if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair." 12 C.F.R. § 1081.303(b)(3). Admissible hearsay includes, for example, transcripts from investigational hearings at which counsel for a respondent was not present. *Id.* By contrast, Federal Rule of Evidence 804 provides that a transcript is excludable as hearsay if offered against a party that was not afforded an opportunity to cross-examine the witness. Of course, targets of Bureau investigations are not permitted to attend or participate in investigational hearings of non-party witnesses. *Id.* § 1080.7(c). Accordingly, testimony at investigational hearings yields transcripts that are inadmissible under the Federal Rules of Evidence but are nevertheless admissible under the Bureau's Rules.

Of equal concern is the current ability of the Bureau to rely upon hearsay contained within or derived from consumer complaints and other unsworn statements, written or oral, made during the course of the investigation. Under the current Rules, such statements are admissible even if the consumer is unavailable to attend the hearing and thus cannot be cross-examined. Federal courts do not permit the use of such inherently unreliable and unfair evidence and neither should the Bureau.

Hearsay is not only unreliable because it seeks to prove the truth of a matter based on indirect evidence; it is also unfair because admitting it deprives the opposing party of the opportunity to cross-examine and test the source of the hearsay. Hearsay is therefore an unassailable form of "super-evidence" that is likely to go unrebutted. Accordingly, the rules should be revised to incorporate the hearsay rules set forth in the Federal Rules of Evidence.

E. The Rules Regarding Amicus Participation Should Be Even-Handed.

The Bureau's current rule, 12 C.F.R. § 1081.216, allows amici to participate in a proceeding only if the Director agrees to such participation. This permits the Director to exclude amicus briefs that do not support the Bureau's position while accepting those that do. This inherently unfair practice should be amended to permit amici supporting both sides to participate in the Bureau's administrative enforcement matters.

Section 1081.216 provides that an amicus brief may be filed only upon the following grounds: (1) a motion for leave to file the brief has been granted; (2) the brief is accompanied by written consent of all parties; (3) the brief is filed at the request of the Director or the hearing officer, as appropriate; or (4) the brief is presented by the United States or an officer or agency thereof, or by a State or a political subdivision thereof.

The first ground allows the hearing officer to effectively block amici participation for respondents. The second ground gives the Director authority to withhold consent to any amici briefs in favor of the Respondents. The third ground is unhelpful since the Director is unlikely to request that an amicus brief be filed in support of the respondents. Thus, except

as to amicus briefs that are filed by governmental entities as a matter of right under the fourth ground, the Director can exert his/her authority to block any potential amici.

This one-sided process is untenable and should be revised.

F. The Notice of Charges Should Be Amended Within a Specified Time Frame and Only If the Amendment Is Not Prejudicial to the Respondent.

Section 1081.202 permits the Bureau to amend its notice of charges against a respondent at any time, as follows: "[t]he notice of charges, answer, or any other pleading may be amended or supplemented only with the opposing party's written consent or leave of the hearing officer." 12 C.F.R. § 1081.202 (emphasis added). The only condition to amending a notice of charge is obtaining leave of the Bureau's own hearing officer. This permits the Bureau to make last-hour amendments at will.

This unfair practice should be restricted to ensure that the Bureau is required to fully plead its case in the first instance and that the respondents are not unfairly prejudiced by being required to defend against unanticipated charges. A restriction on amendments of this sort would be consistent with federal court practice in which a deadline for amending the pleadings is set forth in a scheduling order. An amendment after the deadline is only permitted under circumstances that would not prejudice the respondent, such as an appropriate extension of time and opportunity to conduct additional discovery.

G. The Ex Parte Communication Prohibitions in § 1081.110 Should Include Bureau Personnel.

The Bureau's current rule on ex parte communication, 12 C.F.R. § 1081.110, prohibits ex parte communications between any interested person *not employed by the Bureau* and the hearing officer handling the proceeding, the Director, or a decisional employee. The rule should be amended to impose similar restrictions on Bureau employees, and in particular the Bureau's enforcement staff. Although the current rules provide that Bureau employees engaged in an investigational or prosecutorial function may not participate in the decision-making function in the same or any factually related matter, without an express prohibition against ex parte communications, enforceable with sanctions, the process is prone to misuse and abuse.

IV. CONCLUSION

We appreciate the Bureau's desire to examine the issues in the RFI and the opportunity to submit comments. The Bureau's administrative adjudication procedures, which stack the deck in the Bureau's favor, should be significantly modified and replaced with procedures and rules that provide enforcement targets with fair access to evidence and a fair opportunity to develop and present defenses.