Message from the Chair

The Consumer Financial Services Committee held a very successful Winter Meeting and has been involved in several interesting activities since I last reported to you in the November 2004 CFSC eNewsletter. I would appreciate your feedback on this column and the eNewsletter, as well as your ideas for improving all aspects of the Consumer Financial Services Committee. I and the rest of the CFSC leadership serve your interests and wishes in our fascinating and rapidly-changing area of the law. We want the Committee and its meetings, events, activities and projects to reflect your individual and collective wisdom.

Jeffrey I. Langer
Katten Muchin Rosenman LLP
Chair, Consumer Financial Services Committee
ABA Section of Business Law

2005 Spring Section Meeting in Nashville

At the Business Law Section Meeting, the CFSC will meet from Thursday, March 31, at 8:00 a.m. through Saturday, April 2 at 12:30 p.m. CFSC Schedule Chart | CFSC Meeting Schedule | Full Meeting Schedules The Section will meet at the Renaissance Nashville Hotel in Nashville, Tennessee; our meetings generally will be held in the Convention Center attached to the hotel. The alternate hotel, the Hilton, is only a block from the Center. Thanks to the generosity of long-time CFSC member Ernie Williams IV and his Nashville firm, Williams & Prochaska, P.C., we will be entertained at the Committee Dinner by the Acoustic Café, several of Nashville’s top songwriters. By the time you receive this eNewsletter, the advance meeting registration (March 11) and hotel reservation (March 8) deadlines will have expired. By then (now), you should have received an invitation to register for the Committee Dinner scheduled for March 31 at 8:00 p.m., immediately following the Section Reception, at the Rhythm Kitchen just a few blocks from the hotel. If you have not yet done so, you will be able to register and, to the extent that seats are available, purchase Dinner tickets on-site.

Now that the preliminaries and fun have been addressed, it’s time to get down to business! Our meetings schedule includes a number of programs and Committee Forums on cutting-edge topics:

- The Irresistible Attractions of State Courts: Tactics, Strategies and Ethics of Forum Selection
- Consumer Debt Elimination Schemes and Scams
- The Life Story of a Prepaid Card (CFSC is co-sponsoring the Cyberspace Law Committee Forum)
- Frederick Fisher Memorial Program: Banking on the Unbanked – The Last Consumer Financial Services Frontier?
- Crash Course in Check 21 for Business Lawyers (CFSC is co-sponsoring the UCC Committee Program)

We also will have our usual coverage of recent developments, as nine of our 13 substantive subcommittees (all but those that have planned our programs and Committee Forum: Access to Services, Alternative Dispute Resolution, Consumer Litigation and Debt Collection Practices and Bankruptcy) will hold meetings. Among
them will be those of the Joint Financial Privacy Task Force (the CFSC and the Banking Law and Cyberspace Law Committees) and the CFSC Internet Delivery/Electronic Banking and Cyberspace Electronic Financial Services Subcommittees.

Click here for more information on the 2005 Business Law Spring Meeting

CFSC Winter 2005 Meeting in Key Biscayne

If you attended the stand-alone CFSC Winter Meeting January 13-16 at the Sonesta Beach Resort in Key Biscayne, Florida, you know why many attendees said that it was the best ABA, Section or Committee meeting that they ever had attended. Even some cloudiness and rain could not dampen attendees’ enthusiastic response to all of the meetings, events and activities (such as golf and tennis “tournaments,” water sports and sightseeing, shopping and restaurants in South (Miami) Beach, Miami and the surrounding area). Former five-year Committee Vice-Chair (under Amy Bizar, Immediate Past Chair Lynne Barr and me) and Truth in Lending Subcommittee Chair Stan Mabbitt was honored and presented with a gift -- a set of unique paperweights -- for his invaluable, dedicated, often behind-the-scenes CFSC work and mentoring and friendliness mixed with humility. The tributes to Stan were many and sincere, and his hilarious response brought down the house! Never to be underestimated, Stan was first on the dance floor. We were entertained by a DJ spinning ’50s to current hits. Our twenty- and lower thirty-something members finally closed down the evening of high class and low-down “boogie-ing.” Don’t miss the 2006 Winter Meeting, set for January 7-10, 2006 in Park City, Utah!

Membership Developments and Initiatives

Among a number of accomplishments for the Committee since July 2004, the CFSC has gained over 180 new members, giving us 860 members. But, the CFSC leadership is striving to increase membership and meeting attendance and participation by and among minority and in-house lawyers. Membership Subcommittee Chair Julie Caggiano (713-357-3647; Julie.Caggiano@AegisMtg.com) and Vice-Chair Joe Looney (410-865-5436; Jlooney@hudco.com) and CFSC Liaison to the Section’s Diversity Committee Elizabeth Yen (203-776-1911; eyen@hudco.com) are coordinating this initiative. All CFSC members, but especially minority and in-house lawyers, are encouraged to contact Julie, Joe or Elizabeth with ideas or to volunteer for Committee work, including such activities as recommending program and subcommittee meeting topics, planning and/or speaking at programs and meetings, assisting in membership development or long-range planning and writing for or editing the eNewsletter, the Annual Survey of CFS Law in The Business Lawyer or other ABA publications.

Projects

Your fellow CFSC members have been busy handling and completing a number of projects since the 2004 Annual Meeting last August. These projects include, among others (i) a shortened, updated live-teleconference-version of the Annual Meeting FACTA program, chaired by Joan Warrington; (ii) CFSC Co-Vice Chair Don Lampe’s, Consumer Litigation Subcommittee Chair and Consumer Fellow Nina Simon’s and Consumer Fellow
Chi Chi Wu’s participation and comments in the article entitled “Consumer Complaints” in the December 2004 issue of ABA Journal magazine; (iii) a joint CFSC and Cyberspace Law Committee primer for the public on “Gift Cards” prepared in conjunction with the ABA's Christmas 2004 Video News Release on this highly-publicized, controversial topic (Internet Delivery/Electronic Banking Subcommittee Chair Rick Hackett led the CFSC’s effort); (iv) the e-publication of the first phase of the CFSC’s Financial Literacy Education Clearinghouse, consisting of CFSC-drafted financial literacy information and compiled lists of educational websites on the topic, all of which can be viewed on the CFSC’s www.SafeBorrowing.com website (John Ropiequet is coordinating these activities) and (v) the editing and partial rewriting of the consumer credit section of an ABA book manuscript on Consumer Credit and Bankruptcy. Robin Warren, the first, and immediate past, Chair of the Compliance Management Subcommittee, assigned to CFSC volunteers the various consumer credit chapters of, and coordinated with an ABA representative on the editing process for, the manuscript. At this time, I want to recognize Robin, who retired at the end of January after many years at Bank of America (and its predecessors NationsBank and NCB), where she most recently served as Chief Compliance Officer, for her many contributions to the CFSC as the chair of several subcommittees, author of a number of articles in ABA publications and one of the nicest and most cooperative people I have had the pleasure of knowing and working with during my legal career.

Call for Volunteers

CALLING ALL CFSC MEMBERS AND PRO BONO VOLUNTEERS!

Three members of our group have expressed interest in leading three task forces to carry out projects this year:

- Charles Pearce of Credit Acceptance Corp. would like to prepare financial literacy information concerning auto finance similar to what the pro bono volunteers did with respect to mortgage lending on safeborrowing.com to add that extra dimension to our website.
- Rhonda Daniels of HUD would like to set up a speakers bureau and assemble or prepare modularized materials that speakers on financial literacy can use. This could be accessed through safeborrowing.com or publicized separately. This would entail collecting volunteers to give presentations on request in their local areas as well as collecting materials.
- Trish Obara of CIT Financial would like to make arrangements for other websites to link to our safeborrowing.com website, including the consumer websites we link to, financial institutions' websites and others.

None of these projects will happen without your assistance. Please let Charles (cap@creditacceptance.com), Rhonda (rhonda.l.daniels@hud.gov), Trish (patricia.obara@cit.com) or John Ropiequet (JLRopiequet@arnstein.com) know if you would like to work on any or all of these task forces.
Patricia E.M. Covington, Assistant Vice President & Deputy General Counsel, CarMax Auto Superstores, Inc.

There has been a flurry of legislative activity regarding privacy issues in the states and at the federal level. Click here to find a sampling of what’s been proposed and still in play.

More...

FACT Act
Michael W. Briggs, Chief Legal Officer, America’s Community Bankers

The Fair and Accurate Credit Transactions Act of 2003 precipitated one of the most comprehensive rulemaking processes in recent history. Click here to review an update about the FACT Act and read more about recent rulemakings.

More...

Utah Law Update
Thomas T. Billings, Van Cott, Bagley, Cornwall & McCarthy

Effective March 17, the following changes to Utah law went into effect upon the signature of the governor.

More...

Washington
Frank Salinger, Vice President, Government Relations, Advanta Corporation

Find out the major issues likely to be considered by the 109th Congress.

More...

Meeting Notes

The 2005 CFSC Winter Meeting was on January 13-16. Below are some programs that you should not have missed!

Alternative Dispute Resolution
Kirk Jensen, Womble Carlyle Sandridge & Rice LLP

Representatives of the arbitration administrator JAMS came to the winter meeting of the Consumer Financial Services Committee to discuss JAMS’ new class arbitration policy. Read more about what was discussed at this program and JAMS’ recent withdrawal of its class arbitration policy.

More...

California’s Proposition 64 - Before and After
William L. Stern, Severson & Werson

On November 2, 2004, California’s electorate approved Proposition 64 by a margin of 59% to 41%. Proposition 64 eliminates two problematic features of California’s UCL, but it raises even more questions, including whether it applies to pending cases.

More...

Is Payday Lending Paving the Preemption Path?
Richard P. Eckman, Pepper Hamilton LLP
Payday lending in general and the State of Georgia’s effort to regulate the payday lending industry in particular were the subject of discussion at a joint meeting of the Consumer Litigation and Preemption and Federalism Subcommittees.

More...
PRIVACY UPDATE

by Patricia E.M. Covington
Assistant Vice President & Deputy General Counsel
CarMax Auto Superstores, Inc.

There has been a flurry of legislative activity regarding privacy issues in the states and at the federal level. Here is a sampling of what’s been proposed and still in play as of the date of this writing:

Georgia legislators are very busy considering breach of security notification legislation. In at least one bill, HB 649, the notification requirement extends to information beyond computerized data. Thus far, at least six bills have been introduced, including HB 638, HB 648, HB 649, SB 230, SB 245 and SB 251. HB 648, sponsored by Representative Chuck Martin, will require that any person or business that conducts business in the state and that owns or licenses computerized data that includes personal information disclose any breach of the security of the system following discovery or notification of the breach. The notice must be sent to any resident of the state whose unencrypted personal information was, or is reasonably believed to have been, acquired by an unauthorized person. If that person or business does not own the data, it must notify the owner or licensee of the information. There is an almost identical bill in the Senate, SB 245, sponsored by Senator Bill Heath. HB 638, sponsored by Representative Gail Buckner, is very similar to HB 648 in its requirements, except that it only applies to persons or entities who, for monetary fees or dues, engage in whole or in part in the practice of collecting, assembling, evaluating, compiling, reporting, transmitting, transferring, or communicating information concerning consumers for the purposes of furnishing investigative consumer reports to third parties. The term “investigative consumer report” is not defined. Senator William Hamrick introduced an almost identical bill in the Senate, SB 230.

SB 649, sponsored by Representative Clay Cox, extends notification requirements to include breaches of non-computerized data. It also imposes a duty on persons engaged in any business involving the collection or maintenance of identifying information with respect to consumers to maintain such consumer identifying information in a manner which is secure against unauthorized disclosure. Upon learning that the security of a consumer’s identifying information has been breached by an actual or potential unauthorized disclosure of such information, written notice must be given to such consumer. The notice must include, at a minimum, the nature of the information which has been or may have been subject to unauthorized disclosure and the manner in which such information was or may have been subject to unauthorized disclosure.

Senator Dianne Feinstein has also proposed breach of security notification legislation at the federal level. The Notification of Risk to Personal Data Act, S. 115, would require government agencies and persons engaged in interstate commerce to disclose the unauthorized acquisition of unencrypted personal data, which includes social security number, driver’s license number, credit card number, and bank account number.

In Texas, legislators are considering SB 122, which would permit the attorney general to assess penalties against businesses for the mishandling of a consumer’s personal information that results in such data being used for identity theft. Under SB 122, entitled the Identity Theft
Enforcement and Protection Act, businesses are required to implement and maintain reasonable procedures to prevent the unlawful use of personal identifying information collected or maintained by the business.

Texas legislators are also seeking to expand the scope of the FACTA Disposal Rule beyond credit reports in Texas. HB 698 requires that a business dispose of all business records that contain customers’ personal identifying information by means to render such information unreadable or undecipherable, which may include shredding or erasure. A business that does not properly dispose of a business record as mandated can be held liable for civil penalties of up to $1000 for each record. Further, the attorney general may bring an action to obtain any other remedy, including injunctive relief, and recovery of its attorney’s fees.
The Fair and Accurate Credit Transactions Act of 2003 precipitated one of the most comprehensive rulemaking processes in recent history. With more than a dozen mandated rulemakings, the federal banking agencies and the Federal Trade Commission have been working diligently to complete their assignments, yet several key proposals have yet to be issued for comment, even though the principal statutory compliance deadline passed more than three months ago.

Given the uncertainty created by the lack of implementing regulations in a number of key areas, the federal banking agencies at the end of 2004 clarified their position on compliance with the provisions of the FACT Act where no final rules have been issued. In an effort to assuage concerns, the agencies stated that, for statutory provisions of the FACT Act that require an implementing rule, compliance cannot be determined until such rules have been finally adopted. Moreover, a compliance effective date will be included in all such final rules.

Among the key rulemakings that still await final (or initial) action:

- Use of medical information. A delayed final rule now is expected to be issued during the second quarter of 2005;
- Restrictions on information sharing among affiliates (a final rule also is expected during the second quarter of 2005);
- Risk-based pricing notices. This much-awaited proposal likely will be delayed until at least the third quarter of 2005;
- Identity theft “red flag” guidelines; and
- Furnisher disputes.

On January 31, the FTC issued a final rule governing the use of credit reports for prescreen marketing campaigns. The Fair Credit Reporting Act permits financial institutions to use credit reports to prescreen prospective customers. Customers who meet the prescreen criteria must receive an offer and they also must receive a notice of their right to opt out of future solicitations.

Under the final rule, financial institutions will be required to use a layered, or two-part, notice approach to inform consumers of their right to opt-out of receiving unsolicited offers of credit or insurance. The required notice must include a short-form disclosure that appears on the primary promotional document, and a long form notice with additional information about prescreening. The final rule includes model prescreen notices in both English and Spanish. For example, the model short form notice reads: “You can choose to stop receiving ‘prescreened’ offers of [credit or insurance] from this and other companies by calling toll-free [toll-free number]. See PRESCREEN & OPT-OUT NOTICE on other side [or other location] for more information about prescreened offers.”
Effective March 17, the following changes to Utah law went into effect upon the signature of the governor.

- Depository institutions are no longer subject to the $20.00 limitation of charges imposed on an NSF check. Accordingly, from this point forward a depository institution may charge whatever charge it desires for honoring or processing an NSF check, subject to the contractual terms between the parties.

- In the Utah Consumer Credit Code, the prohibition against imposition of prepayment penalties on closed-end subordinate lien loans has been removed provided that (a) the loan is not a high-cost mortgage pursuant to § 32 of Regulation Z and that (b) the lender offers that loan at a lower cost or interest rate than a loan that does not contain a prepayment penalty.

- The cap on the minimum finance charge of $1.00 has been removed so that in the event of a nominal balance on a consumer’s account, a lender may impose a minimum finance charge in any amount.

- The 10-day grace period for late payments on closed-end loans has been removed.

- The calculation of rebates on a prepaid but unearned finance charge has been modified.
WASHINGTON UPDATE
by Frank Salinger
Vice President, Government Relations
Advanta Corporation

On January 4th, the 109th Congress convened for the new two year session. You may semi-
remember from some long-ago civics class that legislation pending at the end of a session dies
and has to start all over again in the new Congress (sort of a constitutional version of Ground
Hog Day without the benefit of Bill Murray).

That’s why many financial services issues fit Yogi Berra’s old adage: “It’s déjà vu all over
again.” For example, although the last House passed regulatory relief legislation, the Senate
failed to act before the last Congress ended.

To some extent, this same again scenario applies to the entire Congress. While the presidential
race held forth a fair amount of political drama, the results of the congressional elections were
seen largely as an exercise in the status quo.

There was never any real question that the Republicans would lose control of the House.
Similarly in the Senate, where the contests tend to be more competitive, the preponderance of
open seats arising from the retirement of five Southern Democrats left the outcome essentially a
question of how many seats the Republicans would pick up.

Although every new Congress spends much of February sorting out committee assignments,
office space and other administrative matters, both the House Financial Services and Senate
Banking Committees wasted no time in starting hearings and in announcing extensive agendas
outlining both substantive legislation as well as an ambitious oversight plan.

Here are some of the major issues likely to be considered:

Government Sponsored Entities -- The continuing and well-publicized earnings restatements at
Fannie Mae and Freddie Mac (the former to the tune of over $11 billion) will spur efforts to
restructure the regulatory oversight of these government sponsored entities (GSEs to insiders).

Terrorism Risk Insurance Act (TRIA) -- Hearings have already started to deal with this
thorny topic—while many believe only the government can afford to be the insurer of last resort
in light of the huge potential for damages stemming from terror attacks, many conservatives
believe a private sector solution has not been fully explored.

Insurance Issues-- Congress will continue to examine the regulatory structure and practices of
the insurance industry. Many large insurers are seeking the regulatory efficiencies of an optional
federal charter while others prefer the current state-by-state regulatory scheme. The well-
publicized allegations of abusive sales practices of financial products and life insurance to the
military may also result in legislation.
Credit Ratings Agencies-- The Senate Banking Committee began the session with a hearing on potential conflicts of interests between credit rating agencies and the companies that they rate. The Committee also examined how the SEC designates a nationally recognized rating agency and whether that process inhibits competition.

Mutual Funds-- The mutual fund industry will continue to receive attention. In the last Congress, the House passed a sweeping law dealing with fund fees and market timing issues. The Senate once again, and to the relief of the securities industry, failed to act. Oddly enough, after opposing federal legislation, it appears some in that industry would now welcome a new law.

Deposit Insurance Reform-- Once again, efforts to reform the Federal Deposit Insurance system will continue—although the insistence of small, independent bankers that any FDIC bill will raise the level deposit insurance coverage may be enough to prevent any legislation from passing.

Regulatory Relief-- Another returning issue is the Regulatory Relief legislation. Many of the provisions in last year’s House-passed bill were sought by federal banking agencies and the Conference of State Bank Supervisors, hence it has been described by some on the Hill as “Regulators’ Relief.” Among these include removing restrictions on interstate branching, allowing payment of interest on business checking, and clarifying that state banking regulators are the primary contact for safety and soundness supervision. Although the House is likely to again pass their bill, I would expect the Senate to craft legislation that focuses on industry-to-agency relationships while avoiding the internecine struggles (such as those that pit banks versus credit unions, small banks versus industrial loan companies); and, perhaps, by dropping interstate branching provisions.

Predatory Lending-- Although its future in the Senate is murky, the House is likely to consider predatory lending legislation that will provide uniform national standards preventing unfair and deceptive practices in non-prime home mortgage lending.

Bankruptcy Reform-- Finally, although in the jurisdiction of the two Judiciary Committees, bankruptcy reform impacts financial services practitioners as it contains substantive disclosure provisions along with the obvious changes to the Code. At this writing, the Senate has started floor action to consider the newest version of the long-stalled bankruptcy reform bill. For the last eight years, credit card issuers have been campaigning for meaningful bankruptcy reform. In the last three Congresses, the bill has passed the House (and, in its high watermark, was vetoed in the waning days of the Clinton Administration). On the Senate Floor, it faces myriad amendments ranging from increasing the minimum wage to predatory lending to an abortion clinic amendment regularly offered by Senator Schumer (D-NY).

Oversight Issues-- Although not necessarily leading to legislation, the Congressional oversight function should not be minimized. Among the issues the two Committees and their combined Subcommittees are likely to examine include:

- The Basel Accords
Regulatory Agency Appointments and Confirmation Hearings

While the natural focus is on legislative matters, the Senate plays an important Constitutional role as it conducts confirmation hearing for Executive Branch and agency appointments. For example, at this writing, the White House has just announced the nomination of John Dugan as the next Comptroller of the Currency.

Currently, several of the most-senior positions at the Treasury Department that deal with financial services industry issues are vacant. Since these positions need Senate confirmation hearings, we can expect a number of the more controversial banking issues to be raised as new appointees testify—especially in light of the previous Comptroller’s aggressive expansion of the OCC’s preemptive powers.

Oversight hearings also serve another purpose as they provide insight to individual senators’ areas of concern and priorities—especially as they try to pin down nominees during questioning.

Other Issues: The Unplanned and the Unexpected

Like much of life, Congressional planning goes only so far before the unplanned and unanticipated events surface and become the new priorities. Sometimes, as in the case of the 9/11 attack on New York City and Washington, DC, it led to major legislation such as the USA PATRIOT ACT. While obviously, we can’t anticipate this year’s crisis, my personal pick is identity theft and data security. The recent days have not been kind to the status quo.

First, celebutant Paris Hilton, along with other celebrities (some of whom I’ve actually heard of) was victimized by hackers breaking into T-Mobile’s database and spreading her personal information over the internet.

Next, swindlers accessed the personal financial record of somewhere between 145,000 to 500,000 people when they duped ChoicePoint, one of the largest sellers of consumer financial data.

Then Westlaw’s PeopleFind which, among other things, gives subscribers access to social security numbers surfaced. Since, for reasons not readily apparent to me, the US Senate subscribes to this service, Senator Schumer’s (D-NY) staff was able to access the financial data
and social security numbers for Brad Pitt, Jennifer Anniston, Paris Hilton and, of all people, Senator Schumer.

As if this wasn’t bad enough, Bank of America managed to lose back-up data files containing account information for, perhaps, as many as a million customers. As luck would have it, a number of those customers live in Washington, DC including Sen. Pat Leahy (D-VT), the most senior Democrat on the Judiciary Committee and Banking Committee member Elizabeth Dole (R-NC).

What began as a bad week for Paris ended up with politicians from both parties rushing to propose new identity theft/data security hearings or legislation.

Senate Judiciary Committee Chairman Arlen Specter (R-PA) has announced hearings on the ChoicePoint fraud. Not surprisingly, Senator Schumer held his own press conference noting identity theft costs Americans some five billion dollars each year.

Senator Bill Nelson (D-FL) has asked the Federal Trade Commission to increase regulatory oversight on data collection companies and Senator Dianne Feinstein (D-CA) is also planning to introduce legislation.

This issue is complex, pitting consumers versus data warehousers; regulated entities like credit repairing agencies against less-regulated database providers; and, possibly the banking committees versus the judiciary committees.

I don’t know what the final product will look like, but, for the moment, this is my pick for the sleeper issue of the year and the most likely to get out of hand.

*   *   *

All in all, the 109th Congress promises to be the same drama with some newly-elected cast members. Obviously, this periodic eNewsletter can only give a broad overview. Both the House Financial Services and Senate Banking committees have useful websites and I urge you to check them regularly.

Most of the financial trade associations have comprehensive, although naturally specialized, reporting on their websites and many provide much of their non-confidential content to the casual browser.
Representatives of the arbitration administrator JAMS came, as they explained, to “take their lumps” by discussing JAMS’ new class arbitration policy at the winter meeting of the Consumer Financial Services committee. JAMS’ representatives provided helpful clarification on JAMS’ policy, JAMS’ intention in adopting the policy and the source of its motivation, and its views regarding who ultimately decides the enforceability of class arbitration prohibitions.

Eric Mogilnicki of Wilmer Cutler Pickering Hale and Dorr, LLP, the Chair of the ADR Subcommittee, opened the discussion with an introduction to JAMS’ new class arbitration policy, which was announced on November 12, 2004. Under that policy, JAMS will require companies in individual consumer arbitrations to waive any provision prohibiting class arbitration. The policy also indicated that JAMS will now accept cases filed as a class arbitration and not enforce any provision prohibiting class arbitration. JAMS later released an addendum to its class arbitration policy explaining that JAMS believes the determination of whether a class arbitration prohibition is enforceable rests solely with the arbitrator.

John J. “Jay” Welsh, Vice President and General Counsel of JAMS, discussed JAMS’ reasons for adopting the policy. He explained that JAMS administers very few consumer arbitrations. Nevertheless, JAMS believes that provisions in arbitration agreements that prohibit class arbitration are unfair to consumers. In response to questions from Committee members, Mr. Welsh explained that JAMS does not believe it owes any obligation to consult on rules changes with parties who previously had named JAMS as a possible arbitration administrator, since those parties selected JAMS on their own and without any input from or approval by JAMS.

Kimberly Taylor, General Manager of the New York JAMS offices and Deputy General Counsel, explained that JAMS has adopted class arbitration rules to implement its policy. In JAMS’ view, these rules protect the rights of consumers by allowing them to resolve their disputes on a class-wide basis. She also explained that JAMS’ addendum to its class arbitration policy was intended to clarify that JAMS believes that under the U.S. Supreme Court’s opinion in Bazzle v. Green Tree Fin. Corp., the arbitrator – not JAMS and not a court – determines whether a claim should be arbitrated on an individual or class-wide basis. She also stated that JAMS’ policy was not intended to influence the arbitrator’s decision in any way, and that JAMS arbitrators may enforce or not enforce class arbitration prohibitions as they believe appropriate under the law.

Mr. Welsh echoed Ms. Taylor’s statement that JAMS believes arbitrators should determine whether a prohibition on class arbitration is enforceable, and that JAMS’ policy is not intended to influence the arbitrator’s decision regarding enforceability. When asked what JAMS intended its policy to do, if not to influence arbitrators, Mr. Welsh explained that the policy was merely a statement of JAMS’ position on agreements that prohibit class arbitration – not an attempt to affect the decisions of any JAMS arbitrator. He also explained that JAMS expects companies
that wish to enforce provisions prohibiting class arbitration will obtain a ruling from a court regarding the enforceability of the provision.

Questions posed by members of the committee reflected the strong views held by many participants in the debates regarding consumer arbitration issues. Welsh expressed his willingness to engage in such dialogue before making additional changes to JAMS policies. The Committee is grateful to Mr. Welsh and Ms. Taylor for helping clarify JAMS’ position on the important issue of class arbitration.

Postscript: On March 10, 2005, JAMS announced that it is withdrawing its class arbitration policy. JAMS explained:

Recent court decisions on the validity of class action preclusion clauses have varied by jurisdiction. In this legal environment, our attempt, as a national ADR provider, to bring uniformity to the administration of class wide arbitrations stemming from these clauses has created concern and confusion about how the policy would be applied. Accordingly, we are retracting the previously announced policy and reaffirm that JAMS and its arbitrators will always apply the law on a case by case basis in each jurisdiction.

CALIFORNIA’S PROPOSITION 64—BEFORE AND AFTER
by William L. Stern
Severson & Werson

On November 2, 2004, this State’s electorate approved Proposition 64 by a margin of 59% to 41%. Proposition 64 eliminates two problematic features of California’s UCL, but it raises even more questions, including whether it applies to pending cases.

The Two Easy Questions Proposition 64 Answers

Few would disagree that Proposition 64 accomplishes at least these two things: It eliminates “unaffected-plaintiff” standing and it eliminates “private Attorney General” actions. This section discusses life before and after Proposition 64.

A. Proposition 64 Eliminates The UCL’s “No-Standing Standing” Rule

Until Proposition 64, California’s UCL contained the only known exception to a rule that had been foundational to Anglo-American jurisprudence for centuries: Standing. Only someone harmed by the defendant’s actions could sue. That seemed axiomatic. Thus, every claim in California must be brought by the “real party in interest.” CA Civ. Pro. §367.

That was not true for UCL claims. Before Proposition 64, suits under the UCL could be brought “by any person.” CA Bus. & Prof. Code §§17203, 17535. Courts construed the words “by any person” to mean, literally, exactly that. The plaintiff did not have to be affected by the business practice. “Transactional nexus” was not required, which meant that you could sue over a product or service you never bought, over advertising you never read, or over a business practice you never heard of. Perfect strangers could sue, and did. Lawyers quickly learned what law schools failed to teach, that you didn’t need a client to sue.

This “no-standing standing” rule existed nowhere else but California. Before long, class action cases that failed to get certified in plaintiff-friendly venues like Alabama would get re-filed here in California.

Perhaps the best example of “unaffected-plaintiff” suits is the one in which the California Supreme Court lent its imprimatur to this practice. In Stop Youth Addiction, Inc. v. Lucky Stores, Inc., 17 Cal.4th 553 (1998), a for-profit corporation whose sole shareholder was the mother of the plaintiff’s attorney set up a private “sting” operation. The company would hire minors to enter convenience stores and ask to buy a pack of cigarettes. If the clerk obliged, the store would draw a settlement demand, including a threat to sue if the claimant’s demands were not met. The Supreme Court held this to be perfectly permissible.

It became commonplace for lawyers to sue in the name of their secretaries or mothers. Others, having read Stop Youth Addiction, would form for-profit corporations whose sole purpose was
bringing UCL actions. These make-believe plaintiffs would often have words like “Consumer” or “Justice” in their names, suggestive of higher motives.

This led to abuses. One California lawyer alone filed over eight hundred UCL lawsuits in a single day. Many of these were over tiny infractions, yet the demand for settlement would often be ten thousand dollars or more.

In hindsight, all of this seems entirely predictable. The “real party in interest” rule exists not just to vex plaintiff’s counsel. It is there “to protect a defendant from a multiplicity of suits and from further annoyance and vexation, and to fix and determine the real liability which is alleged in the complaint. Bank of Orient v. Superior Court, 67 Cal.App.3d 588, 594 (1977). Jettison that rule, as the UCL did, and you jettison a litigant’s protection against “a multiplicity of suits.” So, far from stopping the abuses, Stop Youth Addiction became the blueprint.

Proposition 64 ends that. As the Findings to Proposition 64 state, the purpose of the measure is to prevent the UCL from “being misused by some private attorneys who … file lawsuits on behalf of the general public without any accountability to the public and without adequate court supervision.” Prop. 64, §1(2)(d). Proposition 64 accomplishes this by eliminating “unaffected plaintiff” standing.

Now, to sue under the UCL the plaintiff must have suffered “injury in fact” and have “lost money or property as a result of such unfair competition.” Prop. 64, §§2, 5.

B. Proposition 64 Eliminates the UCL’s “Non-Class Class” Action Feature

Proposition 64 achieved a second reform, almost as dramatic. It eliminates the “representative” action, sometimes called the “private Attorney General” action or “nonclass class.” Like the UCL’s “no-standing standing” rule, the “nonclass class” was an only-in-California feature.

The “nonclass class” meant that the plaintiff (even an unaffected plaintiff) had the best of all worlds. He could become a self-appointed champion of the people and recover money on behalf of absent parties without pleading or certifying a class, but he had no obligation to turn over any recovery to anyone. In short, the law licensed one-way Robin Hoods. It allowed “any person” to leverage the claims of others to exact higher settlement premiums or propound burdensome discovery, but it did not require the champion to give anything back to the people who made that recovery possible.

The “nonclass class” had other side-effects. A defendant who settled or won a judgment in such a case could not bar the real parties in interest—absent “claimants”—from suing again. That is because non-parties cannot be bound by a judgment unless they have notice of the suit and are adequately represented by parties “of the same class as those absent.” Richards v. Jefferson County, Alabama, 534 U.S. 793, 794 (2001); accord, Phillips Petroleum Co. v. Shutts, 472 U.S. 1

1 The text of Proposition 64 is at [http://vote2004.ss.ca.gov/Returns/prop/00.htm](http://vote2004.ss.ca.gov/Returns/prop/00.htm).
Proposition 64 ends that. It eliminates the ability of private litigants to bring UCL actions on behalf of the “general public.” It strikes the words “acting for …the general public” from Sections 17204 and 17535. Now, if relief is sought on behalf of others the claimant must plead, prove, and get a court to certify a real class action. It does this by adding this clause to Sections 17204 and 17535: “Any person may pursue representative claims or relief on behalf of others only if the claimant meets the standing requirements of Section 17204 and complies with Code of Civil Procedure section 382, ….” Proposition 64, §2 [italics added].

“General public” actions have not been abolished altogether, however. They can still be brought by a publicly-elected prosecutor, e.g., the Attorney General, some city attorneys, or a District Attorney.

That makes sense. Ordinarily, the executive branch of government, not private parties, enforce laws in the name of the public. Cal. Const., art. V, §13 (“It shall be the duty of the Attorney General to see that the laws of the State are uniformly and adequately enforced”); Government Code §26500 (“The district attorney is the public prosecutor, except as otherwise provided by law. The public prosecutor shall attend the courts, and within his or her discretion shall initiate and conduct on behalf of the people all prosecutions for public offenses”).

Proposition 64 is not radical. It just signals a return to normalcy.

**Proposition 64’s Applicability to Pending Cases**

So far, four out of five appellate courts have held that Proposition 64 is applicable to cases that were pending on election day, November 2, 2004. But a final answer may have to await resolution by the California Supreme Court. This section discusses that issue.

Proposition 103 became effective “the day after the election unless the measure provides otherwise.” Cal. Const. art. II, §10(a). The initiative contains no provision postponing its effective date, so it became effective November 3, 2004.

**The argument against applicability to pending cases.** The argument against Proposition 64’s applicability to pending cases goes something like this. “It is well settled that a new statute is presumed to operate prospectively absent an express declaration of retroactivity or a clear indication that the electorate, or the legislature, intended otherwise.” Tapia v. Superior Court, 53 Cal.3d 282, 287 (1993). Proposition 64 does not expressly state whether it applies to pending cases. Opponents also cite Evangelatos v. Superior Court, 44 Cal.3d 1188, 1207-09 (1988). There, the California Supreme Court held that California’s Proposition 51 affected substantive rights and therefore was not applicable to pending cases. Proposition 51 limited a tortfeasor’s liability for noneconomic damages to his or her percentage share of the fault.

Finally, opponents contend that applying Proposition 64 to already-pending cases would be unfair and unwieldy. Unfair, because of the claimants and their attorneys who have relied on the status quo and because the statute of limitations may have already run making it too late to
substitute an affected plaintiff. Unwieldy, because the different cases are at different stages of proceeding (just filed, post-judgment, on appeal, etc.) and fashioning a one-size-fits-all rule would cause “disruption.”

The first case to decide the issue was the *Californians for Disability Rights v. Mervyn’s LLC*, ___ Cal.App.4th ___, 2005 WL 230019 (Feb. 1, 2005). There, the First Appellate District, Division Four, held that Proposition 64 was not applicable to an appeal pending before it at the time of the election. There, an unaffected plaintiff organized to protect the rights of persons with disabilities filed suit in 2002 against the operator of 125 California retail stores. The claim was that the defendant failed to provide adequate pathway space between merchandise displays in violation of the UCL. The case was tried in August 2003 and resulted in judgment for the defense. While the case was pending on appeal, the voters enacted Proposition 64. A month later, the defendant filed a motion to dismiss the appeal.

The *Californians for Disability Rights* court denied the motion to dismiss the appeal. It found that Proposition 64 was silent about its applicability to pending cases and proceeded to apply the analysis, described above, from *Tapia* and *Evangelatos*. It also noted that to apply the initiative to the appeal would “exploit the voters’ silence” and “would deny parties fair notice and defeat their reasonable reliance and settled expectations.” Furthermore, though a “retroactive application of Proposition 64 would further the initiative’s intent to stop misuse of the” UCL, that could be said of any statutory amendment.

**The argument in favor of applicability to pending cases.** Two arguments have been advanced in favor of those seeking to apply Proposition 64 to pending cases. The first is the so-called “statutory repeal” argument: “[A]n action wholly dependent on statute abates if the statute is repealed without a saving clause before the judgment is final.” *Younger v. Superior Court*, 21 Cal.3d 102, 109 (1978). *Evangelatos* is therefore distinguishable, because Proposition 51 altered a common law rule, not a statutory claim. The second is the so-called “procedural rule” exception: Statutory amendments which affect only procedural rules will apply to pending cases. *Tapia v. Superior Court*, supra, 53 Cal.3d at 287; see also *Brenton v. Metabolife Int’l., Inc.*, 116 Cal.App.4th 679, 689 (2004); *Parsons v. Tickner*, 31 Cal.App.4th 1513, 1523 (1995) (statutory amendment to standing requirements held to be applicable to pending cases).

Within weeks of the *Californians for Disability Rights* decision, four other appellate courts took the opposite view. In those cases, the courts held that Proposition 64 was applicable to pending cases. *Branick* was decided by the Second Appellate District, Division Five, *Benson* was

---

2 The *Californians for Disability Rights* court does not discuss Government Code §9606, which provides that “[a]ny statute may be repealed at any time, except when vested rights would be impaired. Persons acting under any statute act in contemplation of this power of repeal.” Given that section, it is hard to understand the “reasonable reliance” argument.

decided by the Fourth Appellate District, Division Three, and *Bivens* and *Lytwyn* were both decided by the Fourth Appellate District, Division One.

Like *Californians for Disability Rights*, all four contrary cases were already on appeal at the time the voters passed Proposition 64. *Branick* was an appeal from an order granting defendant judgment on the pleadings based on federal preemption. *Benson* was tried to a plaintiff’s judgment. *Bivens* was on appeal from summary judgment for the defendant, and *Lytwyn* was an appeal from a trial court’s order enjoining plaintiff from further prosecution of the action. All four appellate courts disagreed with *Californians for Disability Rights*, and all of them based their rulings largely on the “statutory repeal” argument, discussed above. But whereas *Branick* and *Bivens* allow leave to amend to permit substitution of an “affected” plaintiff who can meet the new “standing” requirement, *Benson* allows leave only to amend the allegations, not to amend to substitute new plaintiffs.

In all likelihood, there will be more appellate decisions before this issue gets resolved. But one thing seems certain: The split among the courts of appeal virtually ensures that this question will require the California Supreme Court’s involvement.
Payday lending in general and the State of Georgia’s effort to regulate the payday lending industry in particular were the subject of discussion at a joint meeting of the Consumer Litigation and Preemption and Federalism Subcommittees. The Georgia legislation is the subject of litigation now pending in the U.S. Court of Appeals for the 11th Circuit. Nina Simon, Chairperson of the Consumer Litigation Subcommittee, moderated the program.

Rick Eckman led off with an overview of the payday lending industry, now estimated to be a $30 billion market that has seen tremendous growth over the past several years, with over 22,000 payday lending store locations. Ten payday lending companies have gone public and consumer appetite for these short term loans seems endless. Rick outlined the typical payday lending transaction, and discussed the three models that seem to be the most prevalent: (1) the finance company model, where the lender seeks compliance with the various “licensed lending” or small loan statutes in each state in which it seeks to do business; (2) the “bank model,” where the lender works with a bank, typically an FDIC-insured state-chartered bank, and “exports” the home state interest rate regardless of where the consumer resides; and (3) the internet model, where the lender has no physical location but offers the payday loan to consumers nationwide from a website.

As part of the overview, Chi Chi Wu, a consumer advocate with the National Consumer Law Center, criticized the payday lending industry, noting that payday loans are very expensive, that they are targeted to minorities and low income citizens, and that consumers should be using less expensive lenders to get short term loans.

Next, Rick discussed the legal basis for the bank model, noting that it is premised upon the right of a FDIC-insured state-chartered bank to export its home state rate pursuant to Section 27 of the National Deposit Insurance Act (codified as 12 U.S.C. §1831d(a)). Under this provision, a state-chartered FDIC-insured bank has the right, co-extensive with the right of a national bank under Section 85, to charge borrowers its home state rate of interest regardless of any state limitations imposed in the state where the borrower resides. In the bank model, a payday loan company originates the loan in a storefront, the loan is sent to partner bank for loan approval, and if approved, the proceeds are sent to the consumer, often directly to their bank account. The bank then sells a participating interest, typically a 95% interest, in the loan to the payday loan company, which services the loan for the bank.

The bank model has come under attack as being a sham and that payday lenders are merely “renting” the charters of FDIC-insured banks to get around restrictive state laws. In response to use of the bank model, and in an attempt to protect its citizens from high interest rate loans, Georgia passed anti-payday legislation. The legislation, Act 440 (codified at O.C.G.A. § 16-17-1 et seq) (the “Act”) prohibits payday lending in Georgia and imposes criminal penalties for offering the product. In an interesting wrinkle, the Act attempts to prevent payday lenders from using the bank model in Georgia. The Act provides that if an agent of the bank, the payday lender, is deemed to be a “defacto lender,” then the loan is subject to the Act’s prohibitions.
“defacto lender” is one that retains the “predominant economic interest” in the loan revenues. Because the bank model typically includes having the originator of the payday loan purchase a 95% interest in the loan, most payday loans would be prohibited by the Act.

The payday lending industry, including a number of out of state FDIC-insured banks that use the bank model, sued the State of Georgia for a preliminary injunction to enjoin enforcement of the Act. District Judge Shoob, for the U.S. District Court for the Northern District of Georgia, denied the preliminary injunction request. Bankwest, Inc. et al v. Baker, 324 F. Supp. 2d 1333 (N.D. Ga., 2004). The court held that although out-of-state FDIC-insured state-chartered banks have the right to export their home state interest rates to Georgia residents, the Act does nothing to prohibit this. In fact, out-of-state state-chartered FDIC-insured banks are specifically exempt from the Act’s coverage. The court made a distinction between the banks’ ability to make loans to Georgia residents and their ability to use de facto payday lenders to make payday loans to Georgia residents. The court stated that the Act’s “impact is focused on non-bank entities that receive a predominant share of the revenues from payday loans but, in an effort to avoid Georgia’s usury laws, contract with out-of-state banks to play the role of the lender.” Id. at 1347. Plaintiffs appealed the decision to the 11th Circuit.

The panel then heard from Alan Kaplinsky, partner at Ballard Spahr, and Sid Barrett, Senior Assistant Attorney General in Georgia's Office of the Attorney General, the attorneys who argued the case before the 11th Circuit. In a spirited and lively debate, Alan and Sid outlined the issues argued before the Court. Alan argued that the right of an FDIC-insured bank to export rates cannot be limited by a state law, that the Act impairs the right of contract between the Bank lenders and the payday lenders, and pointed out that Krispin v. May Dept. Stores Co., 218 F.3d 919, 924 (8th Cir. 2000), held, in the credit card context, that the bank was the lender for exportation purposes even though the bank immediately sold each credit card loan as it was made to an affiliate and was still deemed to be the lending bank for purposes of exportation. Sid Barrett pointed out that a state has the right to protect its citizens from high interest rates and that the real lender in these cases is the payday lender that originates the loan and funds it by purchasing the majority interest in it. He also argued that the bank is just “renting” its charter to payday lending companies solely for the purpose of exporting rates and fees.

The 11th Circuit’s decision is eagerly awaited by the payday lending industry and consumer advocacy groups interested in seeing how the court will balance states’ interest in protecting their citizens with the federally granted right of FDIC-insured state-chartered banks to export their home state interest rate.