

When Can the FTC, CFPB, and State Consumer Credit Regulators Pierce the Corporate Veil?

2022 Online Lenders Alliance Issues Conference, February 16, 2022

Ellen T. Berge

Partner | 202.344.4704

ETBerge@Venable.com

Alexandra Megaris

Partner | 212.370.6210

AMegaris@Venable.com

Jonathan L. Pompan

Partner | 202.344.4383

JLPompan@Venable.com

VENABLE LLP

Disclaimer

Contacting us does not create an attorney-client relationship. While Venable would like to hear from you, we cannot represent you, or receive any confidential information from you, until we know that any proposed representation would be appropriate and acceptable and would not create any conflict of interest. Accordingly, do not send Venable (or any of its attorneys) any confidential information.

This presentation is for general informational purposes only and does not represent and is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can be provided only in response to specific fact situations.

This presentation does not represent any undertaking to keep recipients advised as to all or any relevant legal developments.

ATTORNEY ADVERTISING. Prior results do not guarantee a similar outcome.

Today's Discussion

- Role of Corporate Forms, General Duties and Responsibilities of Directors and Officers
- Individual Liability Under Section 5 of the Federal Trade Commission Act
- Individual Liability Under the Consumer Financial Protection Act
- State Consumer Credit and Licensing Statutes
- Consequences of Entering into a Settlement as a Named Defendant
- Ways to Minimize Risk as a Principal, Officer, Director, or Manager
- Related Topics



General Corporate Form, Duties and Responsibilities of Directors and Officers

Does Ownership and Management Structure Matter?

Fiduciary Relationships – Special confidence placed in one who in equity and good conscience is bound to act in good faith and in due regard to the one reposing confidence. Not necessary for a technical or legal relationship to exist.

Limited Liability Company

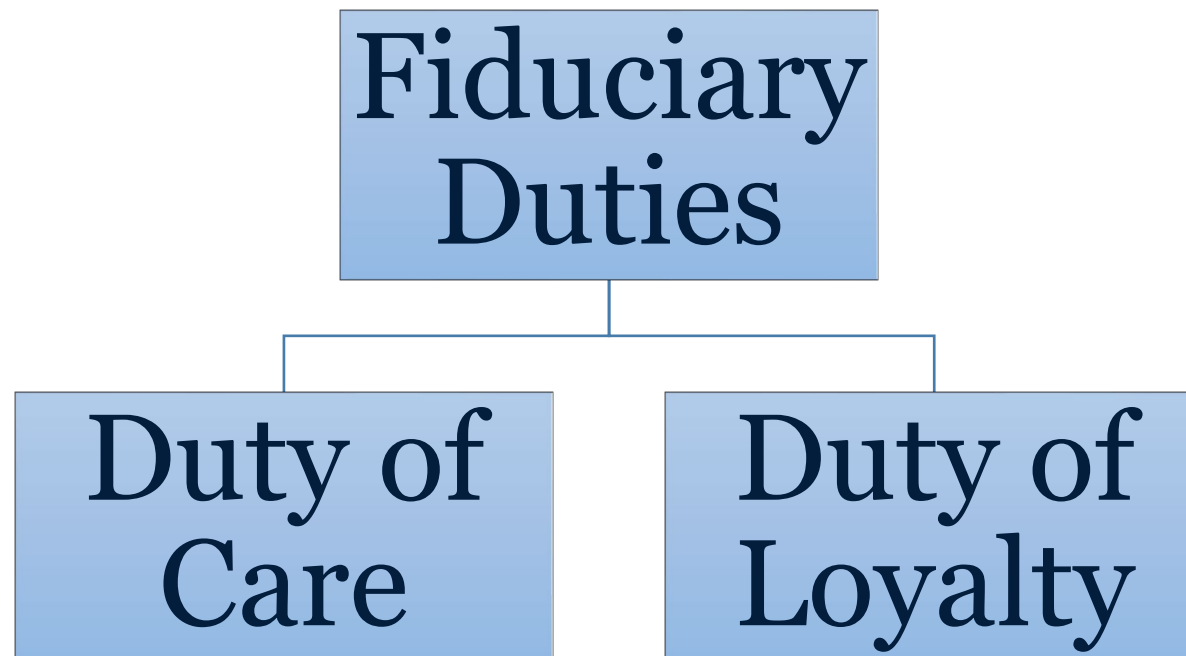
- Governed by operating agreement (and state law)
- Owned by “members”
- May be managed by members or more flexible structure, managers
- Operating agreement may impose or eliminate fiduciary duties for members and managers

Corporation

- Governed by articles of incorporation, bylaws (and state law)
- Owned by “shareholders”
- Directors serve as agents to owners of the corporation
- Board discharges the duties by appointing and supervising offices who run the day-to-day operations

Role of Directors and Their Duties to the Corporation and Stockholders

- Corporate Boards
 - Should be informed about the business, including results of operations, and should understand the company's strategies and corporate plans
 - Should be involved in and approve major decisions for the corporation



Duty of Care

The duty to make careful, informed decisions by assuming an active role throughout the entire decision-making process. In so doing, directors should:

- Assure themselves of having the information required to take action;
- Devote sufficient time to reviewing such information; and
- Obtain, if useful, the advice of experts
 - Directors may generally rely on the information, opinions, reports or statements present to any other person as to matters reasonably believed to be within such other person's professional competence when that person has been selected with reasonable care by or on behalf of the corporation.
- Non-delegation: Cannot be delegated to other decision makers
- Recordkeeping: Board should establish an adequate record of the entire decision-making process

The Duty of Care in Practice

Investigation

- Was the Board engaged in the process?
- Did directors attend meetings?
- Did the directors ask questions of management, and ask for more information?
- Did the board consult with financial and other advisors, including legal?
- What materials did the Board review and consider?

Deliberation

- How often and how frequent did the Board meet?
- Was there ample time to gather requisite information and deliberate?
- Was a decision reached?

Duty of Loyalty

The duty to act in the best interest of the corporation and its stockholders by not putting any personal interest ahead of the interests of the corporation or its stockholders. This duty is implicated when:

- Directors stand on both sides of a transaction or otherwise stand to receive a benefit not shared with stockholders (and interested director);
- Directors are beholden to a party with an interest in the transaction (a non-independent director)
- Directors can have interests that differ from those of the stockholders if they currently have or stand to receive equity or options that rollover; compensation or benefit arrangements post transaction; parachutes or other change in control payouts; or indemnification, advancement or insurance;
- Companies utilize a combination of disclosure of conflicts to the board and shareholders; procedural safeguards; and special transaction committees.

Judicial Review of Board Action

Courts evaluate Board decisions using different standards of review:

- Business judgment rule - Presumption that, in making business decisions, the directors of a corporation act on an informed basis, in good faith, and in the honest belief that the action taken was in the best interest of the company and its stockholders. Overcoming presumption requires disloyalty, bad faith, or gross negligence.
- Enhanced scrutiny – Change of control, hostile takeovers, etc.
- Entire fairness – If one of the conditions of the BJR is not satisfied, the “entire fairness” standard applies, requires directors to demonstrate the inherent fairness of the questioned transaction or decision and that they acted in good faith

Director Protection from Personal Liability

Best Practices: Act with duty of care, in good faith, and without conflict

Limited Liability: A director will not normally be liable for monetary damages to the company or the stockholders as a result of any breach of fiduciary duty, except for:

- Any breach of duty of loyalty;
- Any act or omission that involves intentional misconduct or a knowing violation of law;
- Unlawful dividends or stock repurchases.

Indemnity: Most directors are entitled to indemnity for losses by reason of being a director as long as the director: (1) acted in good faith and in a manner reasonably believed to be in, or not opposed to, the best interests of the company; and (2) in the case of a criminal matter, had a reasonable cause to believe the conduct was unlawful.

Expense Advance: Often companies will provide for director expenses to be advanced for defending a claim, subject to the director undertaking to repay these advances if indemnification is later found not to be available.

D&O insurance



Individual Liability Under Section 5 of the Federal Trade Commission Act

FTC Investigative Authority

The FTC may “prosecute any inquiry necessary to its duties in any part of the United States,” FTC Act Sec. 3, 15 U.S.C. Sec. 43, and is authorized “to gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any person, partnership, or corporation engaged in or whose business affects commerce, excepting banks, savings and loan institutions . . . Federal credit unions . . . and common carriers . . .” FTC Act Sec. 6(a), 15 U.S.C. Sec. 46(a).

Pre-complaint investigations are generally nonpublic.

FTC policies may allow identification of investigations where the Commission determines the public interest warrants it or a merging party or target has disclosed the existence of the investigation.

Means of Investigation

CIDs – Bureau of Consumer Protection may use only CIDs, rather than subpoenas, to investigate possible “unfair or deceptive acts or practices.” FTC Act Sec. 20, 15 U.S.C. Sec. 57b-1.

- The scope of a CID is different from that of a subpoena. Both subpoenas and CIDs may be used to obtain existing documents or oral testimony. But a CID may also require that the recipient “file written reports or answers to questions.” 15 U.S.C. Sec. 57b-1(c)(1).
- Section 20 expressly authorizes the issuance of CIDs requiring the production of tangible things and provides for service of CIDs upon entities not found within the territorial jurisdiction of any court of the United States. 15 U.S.C. Sec. 57b-1(c)(7)(B).
- Under Commission Rule 2.10, 16 C.F.R. Sec. 2.10, a party may raise objections to a subpoena or a CID by filing a **petition to limit or quash**. Such petitions will be resolved by the full Commission.
- The Commission may petition a federal district court to enforce the subpoena or CID in the event of noncompliance, although permissible venue is narrower in a CID enforcement action than in a subpoena enforcement case.

Reports/Questions - Section 6 of the FTC Act - Section 6(b) empowers the Commission to require an entity to file “annual or special . . . reports or answers in writing to specific questions” to provide information about the entity’s “organization, business, conduct, practices, management, and relation to other corporations, partnerships, and individuals.” 15 U.S.C. Sec. 46(b).

Other Tools – ISPs, sharing of information from other government agencies, and more

FTC Enforcement Authority

Section 5(a) of the FTC Act provides that “**unfair or deceptive acts or practices** in or affecting commerce . . . are . . . declared unlawful.” 15 U.S.C. Sec. 45(a)(1).

- Safe Web clarified that “unfair or deceptive acts or practices” in Section 5(a) include such acts or practices involving foreign commerce that cause or are likely to cause reasonably foreseeable injury within the United States or involve material conduct occurring within the United States. 15 U.S.C. Sec. 45(a)(4)(A).
- “Deceptive” practices are defined in the Commission’s [Policy Statement on Deception](#) as involving a material representation, omission or practice that is likely to mislead a consumer acting reasonably in the circumstances.
- An act or practice is “unfair” if it “causes or is likely to cause **substantial injury** to consumers which is **not reasonably avoidable** by consumers themselves and **not outweighed by countervailing benefits** to consumers or to competition.” 15 U.S.C. Sec. 45(n).

In addition, the FTC enforces a variety of other consumer protection statutes that prohibit specifically defined practices. These statutes generally specify that violations are to be treated as if they were “unfair or deceptive” acts or practices under Section 5(a); many also provide that violations are to be treated as if they were violations of a trade regulation rule issued under Section 18 of the FTC Act (and thus subject to civil penalties).

FTC Act Enforcement Authority (cont'd)

| Statute | FTC | DOJ | States | Private Parties |
|--|--|--|--------|-----------------|
| Cease and Desist | Administrative cease and desist authority [§5(b) FTCA] | | | |
| Prosecution | | Prosecution for violations of §12(a) FTCA [§14 FTCA] | | |
| Injunctive (and Other Equitable) Relief | Judicially ordered injunctive relief [<i>Impacted by AMG Capital Management v. FTC: §13(b) FTCA</i>] [<i>also §13(a) FTCA (for violations of §12(a) FTCA) and §5(l) FTCA (for violations of cease and desist orders)</i>] | | | |
| Redress | Judicially ordered redress also for rule violations [§19(a)(1) FTCA] and for “fraudulent or dishonest” conduct [§19(a)(2) FTCA] | | | |
| Civil Penalties | Judicially ordered civil penalties for violating cease and desist orders [§5(l) FTCA and Commission Rule 1.98(c); also §5(m)(1)(A) FTCA (for violations of trade regulation rules) and Commission Rule 1.98(d); also §5(m)(1)(B) FTCA (for violations of adjudicatory cease and desist orders by non-parties) and Commission Rule 1.98(e)] | | | |
| Criminal | Referral to U.S. Department of Justice [§16(b) FTCA] | | | |

Legal Standards (Injunctive Relief vs. Monetary Relief)

- ***FTC v. Ross*, 743 F.3d 886, 892 (4th Cir. 2014)**
 - **Injunctive Relief**
 - Under the FTC Act, an individual may become liable if the individual “(1) participated directly in the deceptive practices or had authority to control those practices, and (2) had or should have had knowledge of the deceptive practices.”
 - Same Standard Applies in the First, Seventh, Ninth, Tenth, and Eleventh Circuits.
 - **Monetary Relief**
 - “The second prong of the analysis may be established by showing that the individual had actual knowledge of the deceptive conduct, was recklessly indifferent to its deceptiveness, or had an awareness of a high probability of deceptiveness and intentionally avoided learning the truth.”

When Are Individuals Named as Defendants?

- **Former Commissioner Rohit Chopra:**

- “In my view, it is appropriate to charge officers and directors personally when there is reason to believe that they have meaningfully participated in unlawful conduct, or negligently turned a blind eye toward their subordinates doing the same. There is precedent for the FTC not only charging individual officers with order violations but also holding them personally liable for civil penalties, even when they were not named in the original order. This is a reasonable approach that should not be limited to cases involving smaller firms.” Dissenting Statement of Commissioner Rohit Chopra, *In re Facebook, Inc.*, Commission File No. 1823109 (July 24, 2019).

- **Commissioner Rebecca Kelly Slaughter:**

- “In considering whether naming senior leaders is necessary for a settlement to achieve specific and general deterrence, I am particularly interested not only in the evidence of the leaders’ involvement and knowledge but also in the extent to which the alleged law violations permeated a core aspect of the business and whether the corporate culture is one of compliance.” Dissenting Statement of Commissioner Rebecca Kelly Slaughter Regarding, *FTC v. Progressive Leasing*, Commission File No. 1823127 (April 20, 2020)

When Are Individuals Named as Defendants?

- **Commissioner Christine S. Wilson:**

“But the Commission traditionally has exercised its prosecutorial discretion and considered a variety of factors when deciding whether to name a CEO or principal, including whether individual liability is necessary to obtain effective relief. In some instances, for example, the CEO is the company – many FTC cases involve fraudulent or deceptive conduct by small, closely held companies that essentially serve as the alter egos of their CEO or principal. In other instances, fraudsters open and shutter companies to stay one step ahead of law enforcement, or undertake unlawful practices using multiple companies that operate as a common enterprise. In these circumstances, I support naming the CEO or principal because doing so is necessary to obtain effective relief and protect consumers going forward.”

Concurring Statement of Commissioner Christine S. Wilson, *FTC v. Progressive Leasing, LLC*, File No. 182 3127 (April 20, 2020).

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

PROG LEASING, LLC, a limited liability
company, also d/b/a Progressive Leasing,

Defendant.

Case No.

STIPULATED ORDER FOR PERMANENT INJUNCTION AND
MONETARY JUDGMENT

Plaintiff, the Federal Trade Commission (“Commission” or “FTC”), filed its Complaint For Permanent Injunction and Other Equitable Relief (“Complaint”) in this matter, pursuant to Section 13(b) of the Federal Trade Commission Act (“FTC Act”), 15 U.S.C. § 53(b).

The Commission and Defendant stipulate to the entry of this Stipulated Order for Permanent Injunction and Monetary Judgment (“Order”) to resolve all matters in dispute in this action between them.

THEREFORE, IT IS ORDERED as follows:



Individual Liability Under the Consumer Financial Protection Act

CFPB Authority Under the Consumer Financial Protection Act (CFPA)

The CFPB has made individual liability a cornerstone of Bureau enforcement activity, regularly bringing enforcement actions that involve officers and individuals who were alleged to have materially participated in the activities of the covered business.

The CFPB has the authority to regulate “**covered persons**,” defined as those who engage directly or indirectly in offering or providing a consumer financial product or service and any affiliate thereof, “if such affiliate acts as a service provider to such person.”

CFPB authority also extends to

- “**related persons**,” i.e., those who are in management or materially participate in the affairs of covered persons;
- “**service providers**,” those who provide material services to covered persons; and
- those who recklessly or knowingly provide “**substantial assistance**” to covered persons who violate federal consumer financial protection laws.

These persons and entities are prohibited from violating federal consumer financial law, which consists of (1) the eighteen “enumerated consumer laws”; (2) the provisions of the CFPA; and (3) the authorities transferred under subtitles F and H of the CFPA, including any rules and regulations prescribed under any of those laws.

What is a “covered person”?

Whether a person or entity is a “covered person” subject to the CFPB’s jurisdiction turns on whether it offers or provides a “consumer financial product or service,” as that term is defined in the CFPA.

A “consumer financial product or service” is a product or service offered or provided for use by consumers primarily for personal, family, or household purposes, or delivered, offered, or provided in connection with such a consumer financial product or service.

The CFPA expressly enumerates the following products and services as “covered”:

- extensions of credit;
- loan servicing activities;
- real estate settlement services and property appraisals;
- deposit-taking activities, transmitting or exchanging funds, or acting as a custodian of funds or any financial instrument for use on behalf of a consumer;
- selling, providing, or issuing stored value or payment card systems over which the seller exercises substantial control;
- check-cashing, collection, or guaranty services;
- financial data processing products or services;
- financial advisory services;
- consumer report and credit history information collection and provision; and
- debt collection.

CFPA §1002(15); [12 U.S.C. §5481\(15\)](#).

What is a “service provider”?

The CFPB’s jurisdiction extends to “service providers” to covered persons. CFPA §1002(26); 12 U.S.C. §5481(26).

A “service provider” is any entity that “provides a material service to a covered person in connection with” the covered person's offering of a “consumer financial product.”

A “material service” may include participating in the “designing, operating, or maintaining” of the consumer financial product or service in question or processing transactions or financial data relating to a consumer financial product or service. CFPA §1002(26)(A); 12 U.S.C. §5481(26)(A).

In addition, a service provider may constitute a covered person to the extent it engages in the offering or provision of its own consumer financial product or service. CFPA §1002(26)(C); 12 U.S.C. §5481(26)(C).

The statute specifically excludes service providers that provide “support” or “ministerial” services “of a type provided to businesses generally” or provide advertising time or space.

What are “related persons”?

CFPB has authority to seek its panoply of relief against company directors, officers, managers, and even contractors who are responsible for federal consumer financial law violations. The CFPA extends “covered person” status to “**related persons**,” which in turn means:

- any director, officer, or employee charged with managerial responsibility for a covered person;
- any controlling shareholder or agent of a covered person;
- any shareholder, consultant, joint venture partner, or other person who materially participates in the conduct of affairs of a covered person; and
- any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any (1) violation of law or (2) breach of fiduciary duty. 12 U.S.C. §5481(25).

The CFPA expressly excludes all of these persons with respect to depository institutions (banks, credit unions, and savings associations) and bank holding companies. 12 U.S.C. §5481(25).

Limited to individuals associated with nonbanks.

Legal Standards (Injunctive Relief vs. Monetary Relief)

- *Follow the FTC standard . . .*
 - *See, e.g., CFPB v. Gordon, 819 F.3d 1179, 1193 (9th Cir. 2016)* (applying the same two-prong test for individual liability of corporate violations as under the FTC Act)
- *In the Matter of Integrity Advance, LLC and James R. Carnes (CFPB 2021)*
 - **Injunctive Relief**
 - “[I]f the FTC, or the Bureau, establishes that a corporation has violated the law, and also establishes that an individual has the authority to control the corporation’s wrongful acts, the FTC, or the Bureau, is entitled to forward-looking injunctive relief against the individual.”
 - **Monetary Relief**
 - “[T]he FTC or the Bureau must make an additional showing: that the individual knew, or should have known of, the corporate defendant’s wrongful acts.”

Examples: When Are Individuals Named as Defendants?

CFPB v. 1st Alliance Lending, LLC (D. Ct.)

- **Individual 1:** CEO/Managing Member
 - Majority shareholder (~60%)
- **Individual 2:** President/Managing Member
 - Second largest shareholder (~25%)
- **Individual 3:** President/Managing Member
 - Third largest shareholder (~15%)
 - “Related Person”; “Covered Person”
- **All three:** “Related Person”; thus, deemed “Covered Person”

CFPB v. Nexus Services, Inc. (W.D. Va.)

- **Individual 1:** Nexus Services: Co-Founder, Majority Shareholder, Officer, and Director / Libre: CEO
- **Individual 2:** Nexus Services: Co-Founder and Part Owner / Libre: CFO
- **Individual 3:** Nexus Services: Part Owner and Director / Libre: Vice President
- **All three:**
 - “[E]xercised managerial responsibility for Libre and Nexus Services and has materially participated in the conduct of each company’s affairs.”
 - “Related Person”; thus, deemed “Covered Person”



State Consumer Credit and Licensing Statutes

Responsibilities of the Board and Chief Compliance Officer

- **Board of Directors Exercises Collective, Managerial authority**
 - Approves significant strategies or plans
 - Advises top officers (e.g., C-suite)
 - Appoints or removes officers
 - Establishes overall corporate goals
- **Board's Role in Risk Management**
 - Assesses risk and makes tough decisions
- **Management and Operations**
- **Role of Chief Compliance Officer (CCO)**
 - Oversees and monitors the corporation's compliance with laws, regulations, and company policies
 - Typically reports to the CEO/chief legal officer (CLO)
 - CLO and CCO roles should be separate to avoid conflicts
- **Additional Considerations**



Consequences of Entering into a Settlement as a Named Defendant

Injunctive Provisions

- Individuals will be subject to the same injunctive relief as the company
- May follow the individual to their next “job”
- Expect “fencing in” language: Designed to guard against other deceptive and unfair practices, even if they were not fundamental to the underlying conduct
- Carve-outs for named individual defendants are rare

Reporting Requirements and Disclosures

- Reporting Requirements
 - **1 Year After Order Entered:** Submit compliance report sworn under penalty of perjury
- Disclosures to Third Parties, Including Government Bodies
 - **Within 7 Days:** Deliver copy of settlement order to current personnel
 - **For XX Years (often 5-20 years):** If, individually or collectively, is majority owner or controls directly or indirectly a business, then deliver copy of settlement order to:
 - (1) all principals, officers, directors, and LLC managers and members;
 - (2) all employees having managerial responsibilities for the services and all agents and representatives who participate in providing services;
 - (3) any business entity resulting from any change in structure as set forth in the section titled Compliance Reporting; and
 - (4) in some cases, third-party vendors, banks, and others

Contempt

- Contempt investigations for noncompliance are common
- Potential litigation
- A new settlement order
 - Stronger injunctive provisions
 - Additional named defendants
 - Increased monetary penalties



Ways to Minimize Risk as a Principal, Officer, Director, or Manager

Risk Minimization Strategies and Best Practices

- **Corporate Governance**
- **Loss Prevention Steps**
- **Effective Compliance Management System**
 - Design and comprehensiveness
 - Culture of compliance, accountability for corporation and employees
 - Responsibility for, and resources dedicated to, compliance
 - Risk assessment
 - Compliance training and communication
 - Monitoring and audit
 - Reporting
 - Review, corrective action, and continuous improvement
 - Recordkeeping
- **Directors & Officers (D&O) Insurance**
 - Protects the corporation against individual liability
 - May be voided by courts based on public policy reasons

Don't violate the law!

Minimize Compliance Officer Liability

Affirmative Factors:

- Does caging help fulfil regulatory goals?

Wholesale failure factors:

- Did the CCO not make a good faith effort?
- Did the failure relate to a fundamental or central aspect of a well run compliance program at the entity?
- Did the failure persist over time?
- Relate to a discrete area?
- Was there government guidance on point?
- Aggravating factors?

Mitigating Factors:

- Did the structural or resource challenges hinder the CCO's performance?
- Did the CCO voluntarily disclose and actively cooperate?
- Were there policies and procedures proposed, enacted, or implemented in good faith?
- Was immediate remedial action taken?
- Culture of compliance?
- Third party monitoring / vendor management?

Related Topics

Attorney-Client Privilege

- Attorneys have a duty to the client, i.e., corporate entity
- Directors or officers may need separate counsel
- CLO and CCO roles should be separate to avoid conflicts
- Regulators may hold a CLO or general counsel individually liable
 - **Commissioner Wilson:** “As in-house legal departments grow and as in-house lawyers assume varied responsibilities, questions regarding dual roles can present complex challenges. An aggressive posture of routinely holding in-house counsel individually liable could chill frank conversations between lawyers and company leadership and thereby undermine compliance efforts, disincentivize qualified lawyers from assuming in-house roles, and undercut the attorney-client privilege.”

Reputational Risk



- Business relationships and opportunities may be impacted by investigation, litigation, or settlement
- Consumers may become skeptical of the company's brand or leadership

Some members of our Consumer Financial Services Team

For an index of articles and presentations on CFS topics, see www.Venable.com/cfs/publications.



Ellen T. Berge
Partner



Andrew E. Bigart
Partner



Michael J. Bresnick
Partner



Sarah B. Donovan
Senior Policy Advisor



Leonard L. Gordon
Partner



Alexandra Megaris
Partner



Jonathan L. Pompan
Partner



Christopher M. Scribner
Senior Policy Advisor



Julia Tama
Partner



Kathryn B. Marshall
Associate

When Can the FTC, CFPB, and State Consumer Credit Regulators Pierce the Corporate Veil?

2022 Online Lenders Alliance Issues Conference, February 16, 2022

Ellen T. Berge

Partner | 202.344.4704

ETBerge@Venable.com

Alexandra Megaris

Partner | 212.370.6210

AMegaris@Venable.com

Jonathan L. Pompan

Partner | 202.344.4383

JLPompan@Venable.com

VENABLE LLP



© 2022 Venable LLP.

This document is published by the law firm Venable LLP. It is not intended to provide legal advice or opinion. Such advice may only be given when related to specific fact situations that Venable has accepted an engagement as counsel to address.

VENABLE LLP