IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT, DIVISION TWO

JTH TAX, INC. (dba LIBERTY TAX SERVICE), *Defendant and Appellant,* v. THE PEOPLE OF THE STATE OF CALIFORNIA, *Plaintiff and Respondent.*	Case No. A125474

San Francisco County Superior Court, Case no. CGC-07-460778
Hon. Curtis E.A. Karnow

APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF NATIONAL CONSUMER LAW CENTER AND NATIONAL ASSOCIATION OF CONSUMER ADVOCATES IN SUPPORT OF PLAINTIFF AND RESPONDENT THE PEOPLE OF THE STATE OF CALIFORNIA

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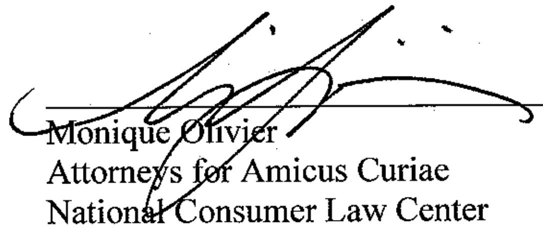
CERTIFICATE OF INTERESTED PARTIES

Pursuant to California Rule of Court 8.208, Amici and its counsel certify they know of no person or entity that has a financial or other interest in the outcome of the proceeding that the Amici and its counsel reasonably believe the Justices of this Court should consider in determining whether to disqualify themselves under canon 3E of the Code of Judicial Ethics.

Dated: August 23, 2010

THE STURDEVANT LAW FIRM



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To the Honorable Presiding Justice of Division Two of the First Appellate District of the California Court of Appeal:

The National Consumer Law Center ("NCLC") and the National Association of Consumer Advocates ("NACA") respectfully request permission to file the accompanying Brief of *Amicus Curiae* in support of Plaintiff and Respondent The People of the State of California. In support of this application, *Amici* state as follows:

NCLC is a public interest, non-profit law office established in 1969 and incorporated in 1971, with its main office in Boston, MA and a separate office in Washington DC. It is a national research and advocacy organization focusing specifically on the legal needs of low income, financially distressed and elderly consumers. NCLC works to defend the rights of consumers, concentrating on advocating for fairness in financial services, wealth building and financial health, a stop to predatory lending and consumer fraud, and protection of basic energy and utility services for low income families. NCLC devotes special attention to vulnerable populations including immigrants, elders, homeowners, former welfare recipients, victims of domestic violence, military personnel, and others, on issues from access to justice, auto fraud, bankruptcy, credit cards, debt collection abuse, predatory lending, mortgage and payday lending, refund anticipation loans, Social Security, and more.

NCLC has conducted specific research regarding loan and other banking products that are bundled and sold to consumers as part of the tax preparation process. See Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, *Major Changes In The Quick Tax Refund Loan Industry: The NCLC/CFA 2010 Refund Anticipation Loan Report*, February 2010 ("*2010 NCLC/CFA RAL Report*"). NCLC has also served as counsel on a national class action addressing the same cross-collection issues that are the subject of this case.

(See *Hood et al. v. Santa Barbara Bank & Trust et al.* (2006) 143 Cal.App.4th 526.)

NACA is a nationwide, nonprofit corporation with over 1,000 members who are private and public sector attorneys, legal services attorneys, law professors, law students and non-attorney consumer advocates, whose practices or interests primarily involve the protection and representation of consumers. Its mission is to promote justice for all consumers. NACA is dedicated to the furtherance of ethical and professional representation of consumers. Its Standards and Guidelines For Litigating and Settling Consumer Class Actions may be found at 176 F.R.D. 375 (1997), and www.naca.net at the bottom of the main page. About 150 of NACA's members are California consumer attorneys or non-attorney advocates who regularly represent and advocate for consumers residing in California. Included within these cases are numerous cases brought under California's Unfaair Competition Law, Business and Professions Code §§ 17200 et seq. ("UCL") and Consumer Legal Remedies Act, Civil Code §§ 1750 et seq. ("CLRA") against entities which market and sell consumer products like those at issue in this case. From its inception, NACA has focused primarily on issues which involve abusive and fraudulent business practices. Consistent with its goal of promoting justice for consumers, NACA has appeared as amicus curiae in a number of cases challenging such practices, including *Broughton v. Cigna Healthplans of California* (1999) 21 Cal.4th 1066, *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, and *Badie v. Bank of America* (1998) 67 Cal.App.4th 779.

As organizations that are representative of consumers throughout California and the entire United States, *Amici* are vitally interested in the resolution of the issues in this appeal and believe they can be of assistance in illuminating the legal and policy issues before the Court. In particular, in

their brief *Amici* address the application of the Truth in Lending Act (15 U.S.C. § 1601, et seq.) ("TILA"), the Fair Debt Collection Practices Act (15 U.S.C. § 1692, et seq.) ("FDCPA") and its state counterpart the Robbins-Rosenthal Act (Cal. Civ. Code § 1788, et seq.), and the California Unfair Competition Law (Business & Professions Code § 17200 et seq.), ("UCL") to Defendantss RAL lending and cross-collection practices. *Amici* also address Defendant's novel argument that franchisors are immune from liability under agency principles of general applicability.

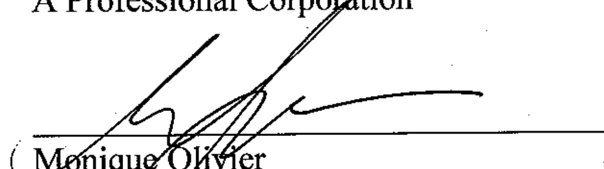
DATED: August 23, 2010

Respectfully submitted,

NATIONAL CONSUMER LAW CENTER

THE STURDEVANT LAW FIRM
A Professional Corporation

By:



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I. INTRODUCTION

This case involves particularly egregious aspects of the fringe financial industry: the misrepresentations made to consumers regarding Refund Anticipation Loans ("RALs") and Electronic Refund Checks ("ERCs"), the oppressively high cost of those products, and the use of those products, and of the tax preparation process, as a means to engage in third-party debt collection against unsuspecting consumers.

After conducting a bench trial and receiving and reviewing voluminous evidence, the trial court found that defendant and appellant JTH Tax, Inc. d/b/a Liberty Tax Service ("Liberty") had violated state and federal consumer protection laws including provisions of the Truth in Lending Act (15 U.S.C. § 1601, et seq.) ("TILA"), the Fair Debt Collection Practices Act (15 U.S.C. § 1692, et seq.) ("FDCPA") and its state counterpart the Robbins-Rosenthal Act (Cal. Civ. Code § 1788, et seq.), and the California Unfair Competition Law (Business & Professions Code § 17200 et seq.), ("UCL").

Amici the National Consumer Law Center (NCLC) and the National Association of Consumer Advocates (NACA) submit this brief to address three of Liberty's arguments on appeal. First, Liberty's claim that it is not liable for TILA violations is unsupportable because, in fact, the fee it charges for an ERC is a hidden finance charge. Second, Liberty is liable for its franchisees' false advertising, and its novel claim that franchisors are entitled to a sweeping exception to agency liability is without merit. Finally, Liberty is liable under the UCL and FDCPA for failing to make appropriate disclosures to consumers that agreeing to a RAL also exposed them to the collection of purported prior debts to third parties.

Consumers go to a business like Liberty for assistance in having their taxes prepared. As the trial court here properly found, however, when Liberty sells consumers RALs and ERCs, those consumers find themselves

unwittingly locked into high interest loans and subject to debt collection for debts to third parties that were not disclosed. Liberty's conduct violates state and federal consumer protection statutes, and the judgment against it should be upheld in its entirety.

II. BACKGROUND

A. Refund Anticipation Loans (RALs).

RALs are part of the fringe financial industry that includes payday loans, auto title loans, pawns, and rent-to-own transactions. RALs provide quick credit to vulnerable consumers at steep prices, and create the risk of ruined credit ratings and debt collection harassment. RALs target low- to moderate-income consumers with few resources and great financial needs. Consumers often are misled into thinking of RALs as "quick refunds," not understanding that they are loans. [1]

RALs puts cash into the consumer's hand one or two days after the consumer files his or her tax return. Many consumers who want refunds quickly do not realize that electronic filing of a tax return cuts the wait to 8-

[1] To fully appreciate the nature of RALs, it is important to understand the nature of the market in which they are offered. RALs are part of an industry popularly referred to as "fringe banking" or the "alternative financial sector." (See Roger Swagler, et al., *The Alternative Financial Sector: An Overview*, 7 Advancing the Consumer Interest 7 (1995); John R. Burton, et al., *The Alternative Financial Sector: Policy Implications for Poor Households*, 42 Consumer Interests Annual 279 (1996).) Fringe banking targets low-income, working poor, and minority consumers, those with blemished credit histories, and those depending on public benefits such as Social Security, who cannot access traditional sources of credit. This has resulted in a two-tiered economy, often referred to as a system of "financial apartheid" or the "second-class" marketplace, in which middle-income and affluent consumers are served by reasonably-priced credit from banks, and the poor and near-poor are relegated to expensive and, in many cases, poorly regulated alternatives. (See Lynn Drysdale & Kathleen Keest, The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society (2000) 51 S.C. L. Rev. 589-591.)

15 days, if the consumer has a bank account into which Treasury can directly deposit the refund. IRS, *Publication 2043: e-file 2010 Refund Cycle Chart* (April 2009), available at http://www.irs.gov/pub/irs-pdf/p2043.pdf. Thus, a RAL is only one to two weeks faster than an electronically delivered refund, but reduces the refund by $30 to over $100. (See Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, *Major Changes In The Quick Tax Refund Loan Industry: The NCLC/CFA 2010 Refund Anticipation Loan Report*, February 2010 ("*2010 NCLC/CFA RAL Report*"), at 8-9.)

Thus, RALs are usually outstanding only for 7 to 14 days. Because of this short time frame, the fees for these loans translate into triple-digit annualized interest rates. When all of the fees charged for the loan are included in the calculation, the estimated annual percentage rates ("APRs") for RALs can near 500%. (*Id.* at 10.)

RALs drain billions from the pockets of consumers and the U.S. Treasury. In 2008, 8.4 million consumers paid an estimated $800 million to receive their own tax refunds a week or two earlier than they could have by filing electronically and using direct deposit. (*Id.* at 7-8.) About 86% of these consumers were low-income. (*Id.* at 12.) Nearly two-thirds of RAL borrowers received the Earned Income Tax Credit, ("EITC"), a refundable credit intended to boost low-wage workers out of poverty. The EITC is often referred to as the largest anti-poverty program in the United States. In 2008, RALs skimmed $500 million from the benefits of EITC recipients. (*Id.* at 12-13.)

Indeed, the Seventh Circuit Court of Appeals has expressly noted the high cost of RALs and that the "lion's share" of borrowers are from poor, distressed neighborhoods. (*Kleven v. Household Bank* (7th Cir. 2003) 334 F.3d 638, 639-40, cert denied, 540 U.S. 1073). The Seventh Circuit

expressed that "an attack on RALs based on fairness and equity would certainly have some appeal." (*Id.* at p. 640.)

The U.S. Internal Revenue Service is also taking due note of the RAL industry's impact on consumers. Just this month, the IRS announced that it will discontinue a service that aided banks in RALs. The IRS has been providing a service called the "debt indicator" which helps banks that partner with tax preparers to make loans based on the borrower's expected tax refund. The "debt indicator" acts as a form of credit check, telling tax preparers whether a taxpayer's refund will be paid or will be intercepted for government debts, making it easier for banks and tax preparers to predict when they can earn a profit by offering RALs. (See http://www.nclc.org/images/pdf/pr-reports/pr-ral-irs-debt-indicator-08-10.pdf.)

B. Refund Anticipation Checks a.k.a Electronic Refund Checks.

Refund Anticipation Checks ("RACs"), also called Electronic Refund Checks ("ERCs"), are another product offered by tax preparers and banks that issue RALs. With ERCs, the bank opens a temporary bank account into which the IRS direct deposits the refund electronically. After the refund is deposited, the bank issues the consumer a paper check or prepaid debit card representing the amount of the refund, less tax preparation fees and the ERC fee, then closes the temporary account. The bank also pays the tax preparation fee to the tax preparer out of the deposited refund.

ERCs generally cost around $30. Based on IRS data, the National Consumer Law Center and Consumer Federation of America estimated that in 2008 about 12 million taxpayers paid for an ERC, at a cost of about $360 million. (*2010 NCLC/CFA RAL Report* at 20.)

ERCs are consistently promoted as a way to permit the taxpayer to have the price of tax preparation deducted from the refund. As such, ERCs are essentially a loan of the tax preparation fee – and an expensive one at that. Paying $30 to borrow a tax preparation fee of $187 for two weeks equates to an APR of 417%.

Consumers with a bank account can receive their refunds in the same amount of time but avoid paying a fee for an ERC, if they simply use e-file and a direct deposit to their own bank accounts. The only purpose of an ERC for these consumers is to avoid paying the tax preparation fee up front.

ERCs present other problems. Like RALs, they make taxpayers less sensitive to the price of tax preparation, permitting tax preparers to hide the ball when consumers might attempt to comparison shop.

C. **Banks and Tax Preparers Use RALs as a Means of Back Door, Third-Party Debt Collection.**

Although charging excessive fees to consumers in exchange for what is, at best, a loan product with dubious value, the RAL scheme does not stop there. Because, as the trial court in this case found, RALs are often advertised as "refunds," or as a way to get a tax refund quickly, many consumers do not understand that RALs are, in fact, loans, secured by a pledge of an individual's tax refund, which the individual must pay back if the tax refund does not come through. To recover RALs from past years that are unpaid, RAL lenders and tax preparers have agreed among themselves to collect each other's debts by seizing amounts from consumers' current year tax refunds without judicial process. To this end, RAL lenders and tax preparers such as Liberty insert a cross-lender debt collection provision, which purports to authorize this debt collection, into the middle of their RAL applications.

Under these agreements, whenever a consumer allegedly owes money to another lender or tax preparer relating to a RAL that it previously made to the customer, the RAL application is denied (regardless of whether the customer otherwise would qualify for such a loan), but the former alleged RAL debt and other fees are automatically deducted from the consumer's tax refund and paid out to the original RAL lender. Not surprisingly, customers often do not understand that they are applying for a high-interest loan, and that they also are signing a document permitting their refunds to be seized pay alleged third-party debts.

As a practical matter, consumers who apply for a RAL and who, as unilaterally determined by the banks, owe a prior RAL debt, are not approved for a RAL. Instead, relying upon the consumer's "authorization" in the RAL application, the RAL is denied but the tax refund is seized to pay the alleged past debt. (See Appellant's Appendix ("AA") 0061-63; *Hood, et al v. Santa Barbara Bank & Trust, et al.* (2006) 143 Cal.App.4th 526, 532-33.)

This cross-collection practice has been the subject of scrutiny by consumer advocacy groups. In 2009, two of the biggest players in the RAL industry, Santa Barbara Bank & Trust and tax preparer Jackson Hewitt, Inc., under the terms of a class action settlement, agreed to pay back consumers a portion of funds that had been seized through the cross-collection process and also agreed to provide improved notice to consumers about the risk of cross-collection. (See http://www.nclc.org/images/pdf/litigation/closed/hood_order-after-hearing-prelim-approval.pdf.) In addition, in 2008, HSBC Finance Corp., another large RAL lender, "decided to stop participating in cross collection activities with other refund anticipation loan providers." (See http://google.brand.edgar-

online.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?ID=5770778&SessionID=JZTMWSP2nUh2y27, p. 13.)

III. ARGUMENT

A. The Trial Court Properly Found that an ERC Fee Is a Hidden Finance Charge.

Congress enacted TILA specifically to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him." (15 U.S.C. § 1601; *Mourning v. Family Publication Services* (1973) 411 U.S. 356, 364-65.) TILA is a remedial statute, and is to be liberally construed in favor of consumers. (*Jackson v. Grant* (9th Cir. 1989) 890 F.2d 118, 120); (*Semar v. Platte Valley Fed. Sav. & Loan Ass'n*, (9th Cir. 1986) 791 F.2d 699, 704-05); (*Gibbons v. Interbank Funding Group* (N.D. Cal. 2002) 208 F.R.D. 278, 282.) In TILA cases, a court should look to the true nature of the transaction: substance, not form, should dictate. (*Williams v. Chartwell Financial Services* (7th Cir. 2000) 204 F.3d 748, 756-58.)

1. ERCs Are Explicitly Marketed as a Means to Pay the Tax Preparation Fee, and thus Constitute an Extension of Credit.

TILA defines "credit" as "the right granted by a creditor to a debtor to defer payment of a debt or to incur debt and defer its payment." (15 U.S.C. § 1602(e).) Thus, when tax preparers grant consumers the right to defer payment of the tax preparation fee in exchange for the purchase an ERC, the plain language of TILA mandates that the ERC be considered a form of "credit," as the ERC gives the consumer the right to "defer payment of a debt," *i.e.*, the tax preparation fee.

Furthermore, there is no question that ERCs are being used to defer payment of the tax preparation fee, and being explicitly marketed and promoted for that purpose. In addition to substantial evidence at trial that

ERCs are sold as a way to defer payment of tax preparation fees, Liberty admits in its brief that "[u]sing an ERC also gives taxpayers access to professional tax preparation services if they cannot pay until the IRS sends their refunds." (Appellant's Opening Brief ("AOB") at 8.)

There are also examples from mystery shopper testing by advocacy groups that demonstrate how preparers promote ERCs and RALs as a means to defer payment of tax preparation fees. For example, mystery shopper testing in 2008 revealed:

> One reason often cited for why taxpayers use RALs is to pay for tax preparation, because the fee can be deducted from the loan proceeds. Several testers (RH, TM, TR, A&VS) reported being informed that this feature was a benefit of a RAL. One tester (TM) even reported that a Hewitt preparer disparaged the option of receiving a check from the IRS because TM would have to pay the tax preparation fees upfront.

(Chi Chi Wu, et al., *Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia*, National Consumer Law Center, Community Reinvestment Association of North Carolina, Community Legal Services Philadelphia, April 2008, at p. 9.)

Liberty cites *Hanh v. Hank's Ambulance Service* (11th Cir. 1986) 787 F.2d 543, 544 in support of its proposition that an ERC is not an extension of credit. However, *Hahn* is inapposite. There, the Eleventh Circuit held that there was no credit involved because the consumer did not have the right to defer the debt to Hank's Ambulance Service, as the debt was due when services were rendered. (*Id.*) Thus, the Eleventh Circuit noted the fee involved in *Hanh* was in the nature of a late payment penalty, which is certainly not the case with an ERC fee. Instead, the ERC, and its associated fee, specifically permit the consumer the right to defer the debt to the tax preparer until the refund is received. As such, it is clearly credit.

2. The ERC Fee Is Not Exempt from Finance Charge Treatment as a Charge Payable in a Comparable Cash Transaction.

TILA provides for the exclusion from the finance charge of charges that are the same in cash transactions as in credit transactions. (15 U.S.C. § 1605(a).) Congress adopted the "comparable cash transaction" language to exempt items from the finance charge when the same charge was imposed regardless of whether the consumer used cash or credit. The examples given of fees that satisfied this exemption were sales taxes, license fees, and registration fees. (See S. Rep. No. 96-73, at p. 12 (1979) ("The bill will eliminate some current confusion by making clear that charges which would also be incurred in a similar transaction for cash, such as sales taxes, license and registration fees, are not to be included in the finance charge."); S. Rep. 96-368, at p. 26 (1979)(same).) Were these items included in the finance charge, credit would seem more expensive (relative to cash transactions) than it actually is.

However, the intent of this provision – neutrality between cash and credit transactions as a matter of public policy – has no logical application in the context of ERCs. The ERC fee is not in the nature of a license fee or sales tax that the consumer pays for goods or services, whether or not the consumer pays cash or uses credit to buy these items. The ERC fee is paid for the credit itself, *i.e.*, it is paid for the right to defer payment of the debt (the tax preparation fee).

Furthermore, the substantial evidence showed that only four customers who got an ERC paid cash for tax preparation. Thus in the vast majority of cases, if consumers had the cash to pay for tax preparation up front, they did not get an ERC. (See AA 0066-67.) The nearest cash transaction to an ERC, therefore, is tax preparation without an ERC, for which no fee equivalent to an ERC fee is paid.

This Court should examine the true nature of the ERC transaction, as the trial court did. While Liberty may claim that the ERC serves purposes other than allowing deferral of the tax preparation fees,[2] the substantial evidence shows otherwise, given that 96% of ERC customers used the product as a form of credit.

Finally, Liberty compares the ERC fee to the electronic filing fee in *Basile v. H&R Block* (E.D. Pa. 1995) 897 F. Supp. 194, 198, which was not held to be a finance charge. The court in *Basile* assumed that the electronic filing fee was charged to all customers of H&R Block, including cash customers, and not just the customers who were sold RALs or ERCs. In this case, the opposite is true. The trial evidence shows that virtually no cash customers, *i.e.* customers who paid the tax preparation fee up front in cash, were charged an ERC fee. Thus, the trial court was correct in holding that the ERC fee is a finance charge, unlike the electronic filing fee in *Basile*.

B. <u>Liberty Violated the UCL and FDCPA by Misleading Consumers into Signing Agreements with Hidden Provisions Purporting to Allow the Cross-Collection of Debts.</u>

As the trial court found, in addition to engaging in false and misleading advertising regarding RALs, Liberty also violated the UCL and FDCPA by its participation in and disclosures regarding the cross-collection of prior RAL debts. (AA 0061.) Liberty maintains on appeal that its conduct is not deceptive, but its arguments are largely its own spin

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[2] Liberty claims that ERCs also allows customers to receive funds more quickly than using regular direct deposit. The trial court found, however, that the funds are paid to the customer "[a]fter the refund is disbursed by the IRS, see, e.g., Exhs. 122-24, 132-33, and 135 (RAL/ERC applications)." (AA0031; see also id. at AA0208-00217 [Product Information Sheets].) Thus, since the ERC is not paid until the bank receives the funds from the IRS, the timeframe is the *same* as a direct deposit refund.

on select facts before the trial court. Liberty cannot avoid the conclusion that the trial court reached: its conduct is the very type the FDCPA and the UCL were designed to prevent.

The UCL prohibits "any unlawful, unfair or fraudulent business act or practice." (See, *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1266.) "Section 17200 is not confined to anticompetitive business practices, but is also directed toward the public's right to protection from fraud, deceit, and unlawful conduct. Thus, California courts have consistently interpreted the language of section 17200 broadly." (*South Bay Chevrolet v. General Motors Acceptance Corp.* (1999) 72 Cal.App.4th 861, 877-878 (citations omitted).) The statute prohibits "wrongful business conduct in whatever context such activity might occur." (*Barquis v. Merchants Collection Assn.* (1972) 7 Cal.3d 94, 111, fn. omitted.) Similarly, in the debt collection context, the FDCPA and its state counterpart were designed to ensure disclosure and fairness in debt collections. (See 15 U.S.C. §. 1692(e), (f), (g).)

As an initial matter, and as the People correctly articulate, the trial court's determination must be reviewed on appeal under the substantial evidence standard. (*People v. Toomey* (1984) 157 Cal.App.3d 1, 19; Respondent's Brief ("Resp. Br.") at 8-9.) Liberty's attempt to reframe the issue in its briefs as the People's "contentions" (see, e.g., Reply Brief ("Reply Br.") at 2) fundamentally ignores the appellate posture and the applicable standard of review. Here, the trial court conducted a lengthy bench trial and reviewed a substantial documentary record as well as witness testimony. The court made numerous factual findings in its Statement of Decision. It determination that Liberty violated the UCL and

FDCPA is based upon those facts. Upon appeal, deference is accorded that determination.[3]

It is plain that substantial evidence exists to support the trial court's conclusion that Liberty violated the UCL. Considering the factual record as a whole, the trial court found that Liberty violated the FDCPA and its state counterpart (and thus the unlawful prong of the UCL), as well as the FAL and the fraudulent and unfair prongs of the UCL, because Liberty's efforts to collect alleged past debts are "likely to confuse and mislead any reasonable consumer." (AA 0061, fn. 26.)[4]

The facts bear this out. Cross-collection of past debts through the consumer's tax preparation process is a particularly egregious form of deceptive conduct. First, the consumer goes to a tax preparer such as Liberty to have their tax returns prepared, not to pay a past debt. As the trial court found, the initial layer of deception occurs even before the consumer walks in the door: often loan products such as RALs are advertised as a form of "refund," so the consumer does not understand that they are, in fact, purchasing a loan product from a bank. (AA 0050-56.) Liberty concedes that the purpose of the RAL application is a "loan

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3 As the People also correctly note, Liberty failed to argue in its opening brief that the trial court erred in finding Liberty liable under the fraudulent and unfair prongs of the UCL and under the FAL and has thus waived these arguments on appeal. (See Resp. Br. at 48; *People v. Stanley* (1995) 10 Cal.4th 764, 793.) These violations stand as separate and independent grounds for affirming the trial court's judgment. This Court need not reach, therefore, Liberty's arguments with respect to the FDCPA. As Liberty acknowledges in its reply brief, the trial court made a specific finding that the cross-collection "scheme independently is 'fraudulent' and 'unfair' within the meaning of the UCL." (Reply Br. at p. 10 n. 3; AA 0061.)

4 The test under the FDCPA is the "least sophisticated consumer," see *Swanson v. Southern Oregon Credit Serv., Inc.* (9th Cir. 1988) 869 F.2d 1222, 1227, but the trial court found the UCL's more stringent "reasonable consumer" standard satisfied. (AA 0061, fn. 26, 61-63.)

transaction." (AOB at 32.) Even if a consumer understands that they are purchasing a loan product, there is nothing about that transaction on its face which would indicate that it *also* involves the collection of a past debt. Consumers signing RAL applications do so because they believe they are accelerating, for a fee, the receipt of their tax refund, and they view the tax preparer as an intermediary who is acting on their behalf to facilitate the transaction. (See Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, *Major Changes In The Quick Tax Refund Loan Industry: The NCLC/CFA 2010 Refund Anticipation Loan Report*, February 2010 ("*2010 NCLC/CFA RAL Report*"), at 11-12.)

Liberty makes much of the boilerplate language regarding prior debts in the RAL application. But as the trial court found, these disclosures have nothing whatsoever to do with the principal subject of the transaction – preparation and filing of tax returns – and are buried deep in a dense and lengthy document. (See AA 0062: the RAL applications are "lengthy and complex contracts that, on their face, have nothing to do with debt collection, making it unlikely consumers would read and understand the significance" of language that the bank may be acting as a "debt collector.") The trial court's conclusion is consistent with other courts' determinations that similar disclosures violated the FDCPA. (*See Rivera v. MAB Collection, Inc.* (WDNY 1988) 682 F.Supp.174; *Read v. Amana Collections Serv.* (WDNY 1991) 1991 WL 5155; see also *FTC Policy Statement on Deception.* [available at http://www.ftc.gov/bcp/policystmt/ad-decept.htm.] (the omission of material information can mislead consumers if they are likely to reach false beliefs because of the omission).[5])

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[5] Indeed, as the Federal Trade Commission has recognized, four primary factors are useful in evaluating the effectiveness of disclosures: 1) Prominence (whether the qualifying information is prominent enough for

Second, the way in which Liberty cross-collects debts is deceptive because of the distance between the consumer, the tax preparation process, and the alleged past debt. As the trial court found, the debt may be several years old, it may have been incurred as a result of the process at a different tax preparation outfit (e.g. H&R Block), and it may be owed to a different bank than the one presently offering the consumer a RAL. (AA 0061-63.) Thus even a consumer savvy enough to understand that she is applying for a loan product when she signs a RAL application must also have in mind that she may owe a debt to a *different* bank and a *different* tax preparer from any number of prior years' tax preparation processes. This is like McDonald's refusing to give change for a $20 bill from a customer buying a $5 meal on the basis that he owes the Burger King across town $15 for a meal he and his family had last year and forgot to pay for.

Third, the way in which Liberty reveals that the consumer *in fact actually has a debt* that will be collected is deceptive. The initial transaction – completion of the RAL application – does not inform the specific consumer that he or she has a specific debt. Instead, the RAL

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consumers to notice it and read it); 2) Presentation (whether the qualifying information is presented in easy to understand language that does not contradict other things said in other advertising or marketing material and is presented at a time when consumers attention is not distracted elsewhere); 3) Placement (whether the qualifying information is located in a place and conveyed in a format that consumers will read) and 4) Proximity (whether the qualifying information is located in close proximity to the claim being qualified). See FTC Staff Report (2001), "FTC Advertising Enforcement: Disclosures in Advertising," [available at http://www.ftc.gov/bcp/workshops/disclosures/cases/index.html]. (Note that the FTC views "advertising" broadly as communication with consumers over virtually any medium including point-of-sale displays, oral statements, and presentations.) These factors underscore the necessity of clear and specific disclosures on a subject the consumer is expecting, or at least where his or her attention "is not distracted elsewhere," as plainly would be the case for consumers visiting Liberty to have their tax refunds prepared.

application contains generic statements about the fact that any existing prior debts may or will be collected and "authorizes" the bank and Liberty to collect the debt. As the trial court found, customers are not told that they have a past debt until *after* they have signed the RAL application and "authorized" cross-collection. (AA 0062.) This is the case even though, as the evidence at trial demonstrated, the banks share a database which Liberty calls the "cross-collection file" which contains a comprehensive list of all individuals all participating banks and tax preparers believe have an outstanding RAL debt that should be collected from any tax refunds. (See AA0059:25-27; see Exh. 34 at 18125; see *Hood v. Santa Barbara Bank*, (2006) 143 Cal.App.4th 526, 533). There is no reason why Liberty could not have set up a system to verify the existence of a debt (e.g., by calling the banks who maintain the database) before a consumer signs the RAL application, or before "authorizing" the debt collection. As the trial court found, "before the customer has been given meaningful notice about the existence of a debt, the customer has lost control of the refund and, as a result, his or her right to effectively dispute the debt." (AA 0061.)

Liberty continues to argue that the "record proves otherwise," but of course, the trial court concluded the opposite. Indeed, all of the disclosures that Liberty points to that are provided to consumers up to and including when they sign the RAL applications merely state what action Liberty *may* take *if* a consumer owes a debt. (See, e.g., Reply Br. at 14 (emphasis added) ("*if you have a prior unpaid debt in connection with a RAL…*").)

This practice violates not only the UCL, FAL and FDCPA general proscriptions against deceptive conduct, but also the FDCPA's specific requirement that Liberty "mini-Mirandize" debtors. (See 15 U.S.C. § 1692(e)(11).) As the trial court found, Liberty's initial communications with a consumer do not effectively disclose that it is attempting to collect a debt and that any information will be used for that purpose, as the FDCPA

requires. (AA 0061-63; see *Siler v. Mgmt. Adjustment Bureau* (W.D.N.Y., Feb. 18, 1992) 1992 WL 32333, *2.

Liberty claims, however, that this is all much ado about nothing, because even if the consumer is not told of the RAL debt at the time the consumer "authorizes" the debt collection, the consumer is later provided a notice (the "validation letters") and a chance to dispute the debt. (See, e.g., Reply Br. at 16-18.) But the failure to disclose information cannot be cured by proper disclosure where that disclosure is not timely. (See *Resort Car Rental SYS., Inc. v. FTC* (9th Cir. 1975) 518 F.2d 962, *cert. denied sub nom., Mackenzie v. United States* (1975) 423 U.S. 827; *FTC v. Gill* (C.D. Cal. 1999) 71 F.Supp. 2d 1030, *aff'd* on other grounds, 265 F.3d 944 (9th Cir. 2001).) Even disclosure of important missing information (whether it was not available to the consumer because it was not included in the materials, as is the case here, provided or because the materials were not provided in an accessible manner, as is also the case here) just as the contract in being signed does not prevent the previous failure to disclose from being deceptive. (See *Miller v. William Chevrolet/Geo, Inc.* (2001) 326 Ill.App.3d 642, [762 N.E.2d 1]; *Heastie v. Community Bank* (N.D. Ill. 1988) 690 F.Supp. 716; *Phillips v. Dukes* (Bankr. E.D. Mich. 1982) 24 B.R. 404.) Further, Liberty's insistence that consumers are presumed to know every provision in every contract they have ever signed is plainly not the law and, in any event, does not prevent a finding of deceptive conduct. Proof of actual deception is not required under the UCL or the FDCPA. (See, e.g., *In re Tobacco II Cases,* (2009) 46 Cal.4th 298; *Gonzales v. Arrow Fin. Serv.* (S.D.Cal. 2007) 489 F.Supp.2d 1140, 1146.)

Perhaps more telling, however, are Liberty's attempts to persuade this Court that the way in which it engages in debt collection is simply business as usual. It is, in fact, anything but that. Debt collectors generally follow the same procedure. Typically, a creditor determines that a

consumer owes a debt, notifies the consumer that the debt is owed and should be paid, and provides information about how to contest the validity of the debt. If the consumer does not demonstrate the debt is invalid, the creditor (or often the collection agency that has purchased the debt) then initiates a debt collection process which includes dunning letters, phone calls and possibly a lawsuit to collect the debt. (See The Federal Trade Commission, *Debt Collection FAQs: A Guide for Consumers,* available at http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre18.shtm.) The FDCPA and state counterparts exist to police this process and ensure that consumers are not subjected to misrepresentations and harassment.

Liberty's cross-collection scheme differs from this typical debt collection process in one significant and material way: ***consumers' money is already out of their control before they can dispute the debt.*** The need for clear and conspicuous disclosures in such circumstances is self-evident. Under normal debt collection rules, a consumer has multiple opportunities to contest a debt and defend against a debt collector. In the unique world of tax preparation and RALs, however, a consumer loses control of her tax refund even before being told that she owes a specific debt. As the trial court found, this scheme "would confuse and mislead any reasonable consumer" and deprives consumers of "meaningful notice" and their "right to effectively dispute the debt." (AA 0054 and 61.)

The trial court's determination that Liberty violated the UCL and FDCPA is correct and should be affirmed.

C. **California Law Properly and Necessarily Applies Agency Principles to Franchisors.**

The trial court held that Liberty is liable for the illegal advertising of its franchisees regarding RALs, finding that "substantial evidence shows that Liberty's franchisees are its agents." (AA 0044.) The People adeptly addressed Liberty's erroneous argument on appeal that such evidence is

lacking. (See Resp. Br. at 23.)[6] *Amici* write separately to address Liberty's novel and unsupportable argument that all franchisees should, as a matter of law, be exempt from all agency principles. Such a conclusion would create an exception that would immunize franchisors from any potential liability for their franchisees' conduct, even as they substantially control franchisees conduct and handsomely profit from their operations.

In California, the key test of the agency relationship is the extent of the principal's right of control. (See, e.g., *Garlock Sealing Technologies, LLC v. NAK Sealing Technologies Corp.* (2007) 148 Cal.App.4th 937, 964; 3 B. Witkin, Summary of California Law, Agency s. 24 (10th ed. 2005.).) Courts have repeatedly held that agency is thus a *question of fact*. (See *Seneris v. Haas* (1955) 45 Cal.2d 811, 831 ("Unless the evidence is susceptible of but a single inference, the question of agency is one of fact for the jury."); (*Universal Bank v. Lawyers Title Ins. Corp.* (1997) 62 Cal.App.4th 1062, 1066); (*see Smith v. Shewry* (2009)173 Cal.App.4th 1163, 1174 (quoting Rest.3d Agency, § 1.01, com. c., p. 20) ("A principal's right to control the agent is a constant across relationships of agency, but the content or specific meaning of the right varies. Thus, a person may be an agent although the principal lacks the right to control the full range of the agent's activities, how the agent uses time, or the agent's exercise of professional judgment.").)

This general rule has been applied repeatedly in the franchisor-franchisee context. (See, e.g., *Cislaw v. Southland Corp.* (1992) 4 Cal.App.4th 1284, 1288 (citations omitted) ("The general rule is where a franchise agreement gives the franchisor the right of complete or substantial

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[6] As the Trial Court properly found, "the existence of an agency is a question of fact for this Court." (AA 0041.) To the extent Liberty suggests that a standard other than substantial evidence applies to this issue, it is flatly wrong. (See Resp. Br. at 2.)

control over the franchisee, an agency exists. '[I]t is the right to control the means and manner in which the result is achieved that is significant in determining whether a principal-agency relationship exists.'"); (*Wickham v. Southland Corp.* (1985) 168 Cal.App.3d 49, 59; *Kuchta v. Allied Builders Corp.* (1971) 21 Cal.App.3d 541, 547; *Nichols v. Arthur Murray, Inc.* (1967) 248 Cal.App.2d 610, 613-14.)

Relying on inapposite California cases and a handful of out-of-state cases, Liberty ignores entirely these well-developed agency principals that apply to franchisors in California. Its call for an exemption cannot withstand the slightest scrutiny.

First, its suggestion that *People v. Toomey* (1984) 157 Cal.App.3d 1 bars vicarious liability in UCL actions is seriously flawed. As the trial court explained, the *Toomey* decision did not create a rule of law that vicarious liability cannot be applied to claims under the UCL. (AA 0045–48.) In fact, *Toomey* had nothing at all to do with agency liability of the type at issue here.

Second, Liberty's reliance on *Emery v. Visa Int'l; Service* (2002) 95 Cal.App.4th 952 and *Perfect 10 v. Visa Int'l Service* (9th Cir. 2007) 494 F.3d 788 is misplaced, as these cases did *not* involve franchisees and in fact, declined to impose liability because the very type of control the trial court found here was lacking in those cases. Indeed, in *Emery*, Visa had *no relationship at all* with the merchants accused of false advertising, let alone control sufficient to create an agency relationship. (*Emery*, 95 Cal.App.4th at 960.)

Moreover, the proper balancing test with franchisor liability *already exists* in Californian law. Indeed, the trial court correctly noted that franchosirs are often between the "Scylla of failing to exercise sufficient control to protect their marks, and the Charybdis of exercising so much control" that they are liable for the conduct of their franchisees. (AA

0041.) Thus, the appropriate inquiry – well defined in California law – is whether a franchisor exerts control that goes beyond that necessary to protect its trademark and goodwill. (See AA 0041; *Nichols*, 248 Cal.App2d at pp. 613-14; *Cislaw,* 4 Cal.App.4th 1284, 1295.) This is a fact specific inquiry in which the trial court properly engaged and concluded, based upon substantial evidence, Liberty's franchisees are, at a minimum, its agents for purposes of advertising. (See AA 0041; AOB at 48; Reply Br. at 25-29.)

Struggling in vain against this conclusion, Liberty then argues what amounts to an exemption of franchisor liability through a different path, that "protecting its marks" must be construed so broadly as to encompass any and all aspects of its control over franchisee advertising. (AOB at 42-43.) Again, this risks swallowing the rule. To claim that advertising and trademark are "synonymous" would only upend the franchisor-franchisee agency analysis. The point of a franchisor "policing the mark" is to protect a franchisor's interest in its trademark and goodwill – not to control every aspect of franchisee advertising.

Further, the "right of control" test is rooted in sound public policy. If one party wishes to exert the right to control the acts of another, it is proper that the controlling party be required to answer for the controlled party's acts. The exemption Liberty seeks would bestow unprecedented immunity to franchisors, allowing them to pass liability on to their quasi-independent franchisees, and removing the necessary incentives to urge franchisee compliance with the law. This need is particularly acute as here with fraudulent advertising that targets thousands of unsophisticated consumers in matters involving thousands of dollars of consumer tax refunds. Liberty points to no authority justifying immunity from liability.

Liberty's claim of exemption by virtue of its status as "franchisor" cannot stand.

IV. CONCLUSION

For the foregoing reasons, the judgment of the trial court should be affirmed in its entirety.

DATED: August 23, 2010

Respectfully submitted,

NATIONAL CONSUMER LAW CENTER

THE STURDEVANT LAW FIRM
A Professional Corporation

By:

Monique Olivier
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Attorneys for Amicus Curiae
National Consumer Law Center and
National Association of Consumer Advocates

CERTIFICATE OF COMPLIANCE

Pursuant to California Rule of Court 8.204, I certify that the attached **AMICUS CURIAE BRIEF OF NATIONAL CONSUMER LAW CENTER AND NATIONAL ASSOCIATION OF CONSUMER ADVOCATES IN SUPPORT OF PLAINTIFF AND RESPONDENT THE PEOPLE OF THE STATE OF CALIFORNIA** has a typeface of 13 points and contains 5,617 words (including footnotes), as shown by the word-count function of the word processing program used to prepare this brief.

Dated: August 23, 2010

THE STURDEVANT LAW FIRM
A Professional Corporation

Monique Olivier
Attorneys for Amicus Curiae
National Consumer Law Center and
National Association of Consumer
Advocates

PROOF OF SERVICE

I am over the age of eighteen years and not a party to this action. I am a resident of the State of California and am employed in the County of San Francisco. My business address is The Sturdevant Law Firm, 354 Pine Street, Fourth Flr., San Francisco, California 94104. On August 23, 2010, I served a true and correct copy of the document(s) described below on the parties and/or their attorney(s) of record to this action in the manner indicated:

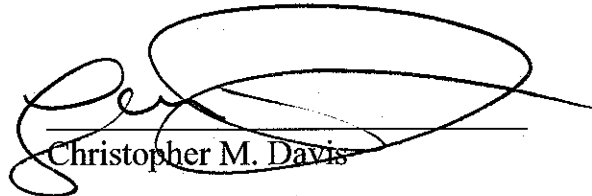
- **APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF AND AMICUS CURIAE BRIEF OF NATIONAL CONSUMER LAW CENTER AND NATIONAL ASSOCIATION OF CONSUMER ADVOCATES IN SUPPORT OF PLAINTIFF AND RESPONDENT THE PEOPLE OF THE STATE OF CALIFORNIA**

[ ] **U.S. MAIL:** I am employed in the county where the mailing occurred. I am readily familiar with this firm's practice for collection and processing of correspondence for mailing with the United States Postal Service. In the ordinary course of business, such correspondence is deposited with the United States Postal Service in a sealed envelope or package that same day with first-class postage thereon fully prepaid. On the date indicated above, I placed the document(s) listed above in a sealed envelope or package with first-class postage thereon fully prepaid, and placed the envelope or package for collection and mailing today with the United States Postal Service at San Francisco, California addressed as set forth on the attached service list. The address(es) shown on the attached service list is (are) the same as shown on the envelope or package. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after date of deposit for mailing in the affidavit. CCP §§ 1013(a)-(b), 1013a, FRCP § 5(b), FRAP §§ 5(c)-(d).

[X] **MESSENGER SERVICE:** I am readily familiar with this firm's practice for the collection and processing of correspondence for hand delivery by messenger service. In the ordinary course of business, such correspondence is deposited with a professional messenger service in a sealed envelope or package for delivery that same day.

On this date, I placed the document(s) listed above in a sealed envelope or package addressed as set forth on the attached service list. The address(es) shown on the attached service list is (are) the same as shown on the envelope or package. I delivered the envelope or package to a messenger authorized by the messenger service to receive documents. The messenger was provided with instructions that the envelope or package be personally served on the addressee(s) by same day delivery. If required, the actual server's original proof of personal service will be filed with the court. CCP § 1011, FRCP § 5(b), FRAP §§ 5(c)-(d).

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct to the best of my knowledge. CCP § 2015.5. Executed on August 23, 2010, at San Francisco, California.



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