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***The Consumer Finance Podcast: Auto Finance – The Holder Rule*****Host: Brooke Conkle and Chris Capurso****Recorded: 5/2/24****Date Aired: 5/21/24****Brooke Conkle:**

Hello and welcome to a special edition of the Troutman Pepper *Consumer Finance Podcast*, where we discuss all things driving litigation and enforcement actions in the world of auto finance. I'm Brooke Conkle. I specialize in litigation. I'm joined by Chris Capurso, who specializes in all things compliance.

Today, we're going to talk about recent developments in the Federal Trade Commission's Holder Rule. Now, the Holder Rule has been around since the 1970s and is a staple of consumer finance contracts. Specifically, the Holder Rule requires that sellers include the language in their consumer contracts that specifies that any holder of the consumer contract is subject to all claims and defenses that the debtor could assert against the seller. So, in the context of auto finance, that means that any holder of a retail installment sales contract can be held liable for legal violations that a dealer made at the point of sale.

Now, Chris, have there been any recent reexaminations of the Holder Rule?

**Chris Capurso:**

Yea, Brooke, and it's funny. As a compliance attorney, with the Holder Rule specifically, I feel like my job in applying the Holder Rule usually stops with, "Is it there? Cool. It's in the contract. We're good." It's been eye-opening dealing with the litigators that we have in our firm where we have such a focus on the Holder Rule and all the possible outcomes. And, here I am in my corner being like, "All right, check it off. That language that's straight out of a rule is all set and in the contract."

That little aside, yes, there have been some recent updates. The big thing with the Holder Rule is costs. If you're having this provision that says the buyer of the paper is subject to the same claims as the original seller or the original creditor, the first question is, okay, "what am I liable for? What are the potential costs associated with this?" It had been the position of courts and the FTC that the holder will put a cap on attorney's fees in connection with any litigation stemming from the Holder Rule.

There were some courts that were outliers that did not agree with this that thought that, no, there are no caps on attorney's fees or that state law provisions related to their own holder rules, and we'll get into that later, wouldn't be preempted, and you could recover beyond the cap for attorney's fees. And, the FTC in January 2022 went along with that line of thinking and released an advisory opinion saying, "No, it's correct. Those courts that have refused to automatically cap attorney's fees and costs have been interpreting it correctly, and the Holder Rule doesn't place those kinds of limits." And Brooke, well, one of my big questions with the Holder Rule is, as I mentioned, there's a state element to the Holder Rule, but then it's the

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FTC's Holder Rule. How do those two interplay, especially in practice? Because I know you've seen it plenty in litigation.

**Brooke Conkle:**

Yea, it's really interesting because the Holder Rule isn't necessarily a private right of action. It really is just a sort of add-on for usually what we see is state Consumer Protection Act claims and that are asserted against a dealer and then is sort of incorporated against the auto finance company through the Holder Rule. Chris, you're exactly right. The FTC really injected this uncertainty into what had been kind of a well-understood, understanding really, of the Holder Rule and the language that I mentioned earlier about the holder is subject to all of the defenses. The one line that I didn't mention is the one that really has been the subject of all the uncertainty, and that language "recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder." What's really interesting is that in 2022, the FTC quietly issued a letter opinion that really put this understanding on its head. The FTC said that if consumers sue under a state law that provides for attorney's fees, then the Holder Rule doesn't inhibit their ability to obtain attorney's fees under that state law from a holder.

And, what we see in litigation is time and time again that what consumers are suing under are state consumer protection statutes. As we all know, that's where the attorney's fee claim is. They're suing under those statutes, and that's what's providing attorney's fee claims time and time again. Where auto finance companies really could tap into their liability and understand very quickly their exposure under a holder claim, now it's kind of the Wild Wild West. We have the language that says the recovery really should be limited to the amounts paid by the consumer, but we have no idea what those attorney's fees are going to be. And so, here we are in a land that had been sort of black-letter law for years and years. Now, we're in uncharted territory.

**Chris Capurso:**

Yes. Quickly, I want to apologize. I can't remember if I said January 2019 or January 2022. Absolutely nothing happened in those three years, and it's all a blur.

**Brooke Conkle:**

That's right.

**Chris Capurso:**

So who knows, but apologies if I said 2019. But, it's interesting. As we've been talking about this and the fact that the Holder Rule has this notice that you put in there that's very black and white, it's in the rule, and that it's also a statute that there's no private right of action. It's that you have powers under other laws to sue and it like immediately brought me to the ESIGN Act, which is something else. Obviously, auto finance companies have to deal with electronic contracting, the same type of thing. It's got these black-and-white rules about what needs to go into a consent, it's not nearly as nice as the Holder Rule, where it's literally line by line. But it tells you the things you need to put in there. Then a violation isn't – you don't sue under the ESIGN Act – you sue under the disclosure law that's been violated. So, TILA, if you didn't get your proper ESIGN consent, you can sue under TILA saying you didn't get the disclosures. That's an interesting

comparison that I had really put together until we've just been talking about it. But, I was curious. As the primary compliance person, I'm not going to be seen in court unless there's been a horrible, horrible mistake. But my biggest question is what are the typical types of claims that you see arising out of the Holder Rule against finance companies or any other assignees of credit contracts?

**Brooke Conkle:**

Yes. In most cases, it's going to be those state Consumer Protection Acts, where a consumer comes in and says, "You know, something happened at the point of sale," whether it's a bait and switch, whether it's misrepresentations, anything like that, that happened at the point of sale. Suddenly, I consumer, am burdened with this contract where I'm paying on this vehicle, I'm paying the interest, and the deal was not done properly. That's where we see these type of claims being brought against the dealer and then the auto finance company incorporated through the Holder Rule.

And, what's interesting is in most cases that we see for auto finance companies, we still go back to the dealer agreement. There are usually indemnity obligations where dealers are required to indemnify the auto finance company for anything that happened at the point of sale. That's where we're really seeing kind of those litigation risks and that exposure for underlying wrongs but also with the attorney's fees.

**Chris Capurso:**

I guess another question, you kind of alluded right to it with the dealer agreement as being a way that finance companies can mitigate the risk of the Holder Rule. What are some other things that a finance company can do from a compliance standpoint? I've got some ideas too, but I'm curious, especially from the litigation perspective. What are some other things that a finance company can do to protect themselves before those Holder Rule litigation cases come in?

**Brooke Conkle:**

Yes. It's really two things that I would point to. One is to understand where the risk is. One of the developments that we haven't really talked about yet is in California specifically. And, as we know, California is a massive, massive market. Soon after the FTC's January 2022 letter, the California Supreme Court issued a decision in the Pulliam case. It's Pulliam v. H&L Automotive, Inc. The Supreme Court of California in that decision essentially took the FTC's position and said that the Holder Rule does not inhibit a consumer's ability to obtain attorney's fees on a successful claim against a auto finance company. So, that is the law of the land in California.

Now, following that decision, we're kind of on pins and needles. Those of us kind of watching the industry really concerned that the Pulliam decision was going to spread like wildfire across the nation. We really haven't seen that happen in published decisions. We are seeing instances where one-off courts are latching on to the rationale and reasoning in the Pulliam decision courts that are outside of California.

We have not seen a tsunami of other state courts adopting this reasoning. So, understanding the risk, understanding that there is, as you mentioned, that the FTC relied on and cited a lot of

different state court interpretations that had found that attorney's fees were recoverable. A lot of those were really, really old cases, though. Some from Texas, Connecticut, Rhode Island, just kind of pockets of decisions where courts had found in a one-off decision that attorney's fees were recoverable. Those decisions are out there. But outside of California, the risk is somewhat mitigated I'll say. So, just that kind of understanding the lay of the land, understanding where courts are finding that attorney's fees are recoverable is step one in understanding the risk and trying to mitigate that exposure.

The second step really is going back to that dealer agreement. That is sort of the bedrock in the relationship between auto finance companies and dealers. Going back to that dealer agreement, dusting off the warranties that the dealers are making to the auto finance companies, making sure that they're all in line, checking out what happens when a claim is made against the auto finance companies. What is the dealer required to do? Are they required to indemnify the company? Are they required to repurchase the contract? Are they required to handle the auto finance company's attorney's fees? Really looking at all of that, making sure that all of that is in line with the current industry standards is a really important step in mitigating the risk under the new uncertainty in the Holder Rule.

**Chris Capurso:**

Totally agree. I think even before the dealer agreement, or we could talk temporally, but another thing to be checking is the onboarding of the dealer. If you've just read a consent action with the FTC about this dealer, probably not the one to go to. You want to be aware of your dealer's business practices. You want to know, have they gotten in trouble before or are they above the board, these types of things.

And another way to help with some of these, especially Holder Rule claims, because what's the easiest low-hanging fruit? A disclosure issue. You know, somebody didn't include the one line of text that you needed to have a compliant disclosure. Look at the documents. I mean, I would hope most finance companies are either providing their own or really heavily reviewing any paper that is coming their way because you want to know beforehand. I mean, all you need is one document issue multiplied by God knows how many. And you all of a sudden have a big issue on your hands, thanks to the Holder Rule.

I think the dealer agreement totally makes sense. Even at the same time before, you want to do at least some due diligence on the dealer to know, is this dealer legally compliant? Have they been in trouble before for violations that could lead to Holder Rule claims? Also making sure that the paper is satisfactory and legally compliant.

**Brooke Conkle:**

Yes. That's exactly right. I would say there's one area that if we had federal regulators on the podcast with us, there's one area that they would tell us to be on the lookout for, and that's consumer complaints. Because it is very rare that a complaint is filed in state or federal court, and a consumer has not previously made a complaint, whether it's to the dealer or to the auto finance company.

That really is the first line of defense in risk management is intake of those complaints, figuring out is there one dealer in particular who's getting more complaints than any other. Maybe we

look at what's going on there. That is one specific step that the federal regulators in particular would look at as a major, major step to really mitigating risk.

**Chris Capurso:**

That's a great point. Anybody who listened to our podcast about the CFPB complaint response report, we're talking, "Oh, this is a great opportunity." To the extent, it's obviously not great. Somebody's complaining, but you take the positives. This is a great opportunity to understand where we may have something that we can fix or something that we can do better. In this case, it's even better because it's not about you. It's about someone you're going to be potentially doing business with. You can use those complaints as you sort of have eyes and ears in the dealership. You can understand if you start to see a trend there where they have certain complaints, especially maybe about sales tactics. Maybe about certain things where if you end up with the paper, there could be a claim that, "Oh. Well, I didn't validly sign that." Or, "I was put under immense pressure. Put into a room and talked about FNI for hours." You never know what kind of complaints could come through except you do. You can look.

So, I think that's a really good point. You can use those complaints wherever they're sent; BBB, FTC, anything like that, and get an inside look at anybody you're doing business with to understand potential problems before they become your problems. That's a really good point.

So, with that, we wrap up another one of our special edition episodes of the *Consumer Finance Podcast*. Just a reminder to be on the lookout not only for the next in this series but also the next in the regular, so to speak, we are the spin-off. There's the regular CFS podcast but also the other podcasts that Troutman Pepper has out there. And until next time, signing off.

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