Supreme Court Case No. S267576

In the Supreme Court

OF THE

State of California

TANIA PULLIAM
Plaintiff and Respondent,

VS.

TD AUTO FINANCE LLC
Defendant and Petitioner.

After A Decision By The Court Of Appeal For the Second Appellate District
Division Five
2nd Civil No. B293435

After An Appeal From the Superior Court of Los Angeles County
Hon. Barbara M. Scheper, Judge
Case Number BC633169

OPENING BRIEF ON THE MERITS OF DEFENDANT AND APPELLANT TD AUTO FINANCE LLC

MCGUIREWOODS LLP
TANYA L. GREENE SBN 267975
JAMIE D. WELLS SBN 290827
ANTHONY Q. LE SBN 300660
WELLS FARGO CENTER, SOUTH TOWER
355 S. GRAND AVE., SUITE 4200
LOS ANGELES, CA 90071-3103
TEL: 213.627.2268 / FAX: 213.457.9899
TGREENE@MCGUIREWOODS.COM
JWELLS@MCGUIREWOODS.COM
ALE@MCGUIREWOODS.COM

Attorneys for Defendant and Appellant TD Auto Finance LLC

CERTIFICATE OF INTERESTED PARTIES

TD Auto Finance LLC is a Michigan Limited Liability Company, and a wholly-owned subsidiary of TD Bank, N.A., a national banking association, which is a wholly-owned subsidiary of TD Bank US Holding Company, a Delaware Corporation, which in turn is a wholly-owned subsidiary of the Toronto-Dominion Bank, a Canadian-chartered bank, the stock of which is traded on the Toronto and New York Stock Exchanges under the symbol "TD."

DATED: June 28, 2021

Respectfully submitted,

MCGUIREWOODS LLP

By: */s/ Tanya L. Greene*
Tanya L. Greene
Jamie D. Wells
Anthony Q. Le
Attorneys for TD AUTO FINANCE LLC

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ISSUES PRESENTED

The Holder Rule, 16 C.F.R. § 433.2, states: "recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder."

1. Does the Holder Rule's limit on "recovery" include and thus cap attorney's fees, as the Court of Appeal held in *Lafferty v. Wells Fargo Bank, N.A.* (2018) 25 Cal. App. 5th 398, or exclude and thus allow uncapped attorney's fees, as the Court of Appeal held in this case?

The Federal Trade Commission has interpreted the Holder Rule by stating that "payment that the consumer may recover from the holder—including any recovery based on attorneys' fees—cannot exceed the amount the consumer paid under the contract." Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 84 Fed. Reg. 18711, 18713 (May 2, 2019).

2. Is the FTC's interpretation entitled to deference so that it controls the meaning of the Holder Rule if the Rule is otherwise ambiguous, as the Court of Appeal held in *Spikener v. Ally Fin., Inc.* (2020) 50 Cal. App. 5th 151, or not, as the Court of Appeal ruled in this case?

INTRODUCTION

The Court of Appeal wrongly decided two questions about the scope of the Federal Trade Commission's Holder Rule that have divided this state's appellate courts: (1) whether the Holder Rule limits the amount of attorney's fees a consumer may recover to amounts paid under her loan contract, and (2) whether the FTC's view that the Holder Rule does so limit recovery warrants deference. The Court of Appeal here ruled that the Holder Rule allows uncapped attorney's fees, even those that cause a consumer to recover more than what she paid under her loan contract. In doing so, the Court of Appeal also erred in refusing to give the deference owed to the FTC's contrary interpretation. This Court should confirm that the Holder Rule bars recovery of attorney's fees that exceed amounts paid by a consumer under her loan contract and reverse.

The Holder Rule reflects an obvious compromise. *See* 16 C.F.R. § 433.2. On one hand, the Rule broadens creditor liability. Under the Rule, innocent creditors that "hold" the note on any consumer loan are liable to consumers for the misdeeds of whoever sold the consumer the goods. On the other hand, the Rule balances this expanded liability by *limiting* its scope: "recovery hereunder by the debtor shall not exceed amounts paid by the debtor." *Id.* Without this limit, consumers can sue creditors for far more money than the consumers ever paid under the contract. This risk of liability

would far exceed the economic benefit creditors stand to gain for financing the transaction.

The FTC itself, as well as two published decisions of the California Courts of Appeal, have accepted the delicate balance the Holder Rule strikes. *Lafferty v. Wells Fargo Bank, N.A.* (2018) 25 Cal. App. 5th 398; Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 84 Fed. Reg. 18711 (May 2, 2019); *Spikener v. Ally Fin., Inc.* (2020) 50 Cal. App. 5th 151. All three agree that under the Holder Rule, attorney's fees—which often rise to tens or hundreds of thousands of dollars—cannot be "recover[ed]" by consumers from creditors if they "exceed amounts paid" by the consumer under the subject loan. 16 C.F.R. § 433.2.

The Court of Appeal here rejected this correct reading of the Holder Rule. Rather than accept the regulation's plain meaning or accord deference to the FTC's consistent interpretation, the Court of Appeal instead adopted its own purposivist reading of the Holder Rule. In the Court of Appeal's view, "recovery" does not include, and the Rule thus does not limit, attorney's fees. According to the Court of Appeal, an innocent creditor is liable for $170,000 or more based on a contract under which a consumer spent just $12,500 on a used car.

The Court of Appeal's interpretation is remarkable because the Holder Rule's plain language makes clear that consumers cannot obtain many times

their spend under a provision that limits "recovery" to "the amount paid." This Court can and should adopt this proper interpretation based on those unambiguous terms alone.

This reading also reflects the Rule's purpose. The FTC designed the Holder Rule to strike a balance: consumers may now recover amounts they paid on a consumer contract, but they may not recover more than those amounts. Reading the Rule to limit attorney's fees ensures this balance. Under this reading, harmed consumers have more protection, but innocent creditors do not face unlimited liability. Indeed, if creditors risked uncapped attorney's fees when financing consumer contracts, they would be less likely to take that risk and finance those contracts. And in Holder Rule actions, blameless creditors would be discouraged from mounting a defense by the threat of paying hundreds of thousands in attorney's fees for a several thousand dollar consumer claim.

The FTC's interpretation of the Rule reflects this view: that the Rule extends liability on the one hand and limits it on the other. The FTC's Rule Confirmation reflects its official position on a matter within the agency's substantive expertise. *See Kisor v. Wilkie* (2019) 139 S. Ct. 2400, 2416–17. It is also the product of the FTC's fair and considered judgment on the issue, one that should come as no surprise to regulated parties given the many courts that had reached the same conclusion and the FTC's earlier endorsement of those decisions. *See id.* at 2417–18. Should this Court view

the Rule as ambiguous, therefore, it should defer to the FTC's view that the Rule limits attorney's fees.

This Court has two routes by which to reach the same conclusion: the Holder Rule does not allow a consumer to recover attorney's fees greater than the amount she paid under her contract. Whichever course it takes, this Court should arrive at the same end: it should reverse the Court of Appeal and remand for a reevaluation of the fee award consistent with the Holder Rule's unambiguous limits on consumer recovery.

STATEMENT OF THE CASE

I. The Holder Rule caps a debtor's "recovery" at "the amounts paid by the debtor" under her credit contract.

The FTC's Holder Rule, 16 C.F.R. § 433.2, addresses consumer credit contracts funded by commercial lenders. *See Lafferty*, 25 Cal. App. 5th at 410. Such contracts involve a consumer buying goods or services from a seller and financing that purchase under a consumer loan contract. The seller often assigns these contracts to third-party creditors. Before the Holder Rule, even if the seller did not perform its contractual obligations, the buyer still had to pay the creditor the amount the buyer owed under the contract, pursuant to the assignment. *See id.* at 410–11.

The Holder Rule changed this system. The Rule, which the FTC promulgated in 1975, makes it unlawful to accept payment on any consumer credit contract that does not have the following provision:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

16 C.F.R. § 433.2.

The Holder Rule "is directed at the preservation of consumer claims and defenses." Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, 40 Fed. Reg. 53506, 53524 (Nov. 18, 1975). The buyer maintains all claims and defenses she could assert against the seller and may now assert them against not just the seller but also any creditor holding the contract. *Lafferty*, 25 Cal. App. 5th at 411; *see also* U.S. Fed. Trade Comm'n, Opinion Letter on The Holder Rule, at 2 (May 3, 2012) ("2012 Opinion Letter") ("The Holder Rule protects consumers who enter into credit contracts with a seller of goods or services by preserving their right to assert claims and defenses against any holder of the contract."). As a result, a creditor cannot "collect on a debt for a defective product or deficient service." *Lafferty*, 25 Cal. App. 5th at 411. Meanwhile, the consumer may sue the creditor "for a return of monies paid on account." *Id.*

This new system "reallocate[d] the cost of seller misconduct to the creditor." *Id.* The FTC believed this shift would better protect consumers

than the old system, in which seller misconduct would not necessarily affect the consumer's obligation to pay the debt she incurred under the contract. *Id.*

Under the Holder Rule, therefore, a consumer may (among other options) sue a creditor for a seller's breach. But while extending liability to creditors in this way, the Holder Rule also "expressly constrained" the liability those creditors face. *Id.* at 412. The Rule provided that "recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder." 16 C.F.R. § 433.2. Thus, while consumers may sue creditors for sellers' misconduct even if the creditors themselves have done nothing wrong, such lawsuits focus on returning to the consumer only the monies she paid under the contract.

II. The majority of courts apply the Holder Rule's plain terms to limit recovery of attorney's fees.

In the decades since the Holder Rule's enactment, the FTC has consistently described the regulation's language and limitations as "plain" and "unambiguous," and has made clear that courts should apply the Rule's clear terms. 2012 Opinion Letter at 3; *see also id.* at 1 ("[T]he plain language of the Rule is clear—which FTC staff confirmed in a 1999 opinion letter."). Consistent with this directive, "virtually all" courts to address whether the Rule limits attorney's fees held that the Rule expresses this limitation. *See* Scott J. Hyman & Tara Mohseni, *California Court of Appeal Finds That the FTC Holder Rule Limits A Holder's Liability for A Consumer's Attorneys'*

Fees, 72 Consumer Fin. L.Q. Rep. 432, 441 (2018); *see also id.* at 442–443 (citing *Reagans v. Mountain High Coachworks, Inc.* (Ohio 2008) 881 N.E.2d 245; *Nebraska ex rel. Stenberg v. Consumer's Choice Foods, Inc*. (Neb. 2008) 755 N.W.2d 583, 594; *Alduridi v. Cmty. Tr. Bank*, No. 01A01-9901-CH-00063, 1999 WL 969644, at *12 (Tenn. Ct. App. Oct. 26, 1999); *Riggs v. Anthony Auto Sales, Inc.* (W.D. La. 1998) 32 F. Supp. 2d 411, 417; *Simpson v. Anthony Auto Sales, Inc.* (W.D. La. 1998) 32 F. Supp. 2d 405, 410–11.

The FTC cited several such decisions with approval in a 2012 advisory letter addressing whether the Holder Rule limited a consumer's affirmative recovery to situations involving rescission of her contract. *See* 2012 Opinion Letter at 3 & n.7. There, the FTC asserted again that the Holder Rule contains just one limit: recovery may not "exceed amounts paid." *Id.* at 2. And the FTC pointed, with approval, to decisions holding that the Rule's "plain language" limits recovery of attorney's fees to amounts paid, describing these courts as properly applying the Rule's unambiguous terms. *Simpson*, 32 F. Supp. 2d at 410; *Riggs,* 32 F. Supp. 2d at 417; *see also* 2012 Opinion Letter at 3 & n.7.

The first California appellate court to address the Rule's import for attorney's fees followed this majority, FTC-sanctioned approach. In 2018, the Third District Court of Appeal held that the Holder Rule's plain language limits a plaintiff's total recovery, including attorney's fees, to the amount of

money "actually paid by the consumer under the contract." *Lafferty*, 25 Cal. App. 5th at 414. *Lafferty* interpreted the Holder Rule's plain terms to reach this conclusion, reasoning (1) that "recovery" regularly includes all kinds of damages, attorney's fees, and costs, and (2) the phrase "shall not exceed amounts paid by the debtor" limits the broad term "recovery" to include only "those monies actually paid by the consumer under the contract." *Id.* at 413–14. The term "hereunder" clarifies that this "constraint on recovery" applies only to those claims brought under the Holder Rule. *Id.* at 414.

Under *Lafferty*, "a consumer cannot recover more *under the Holder Rule* . . . than what has been paid on the debt." *Id.* at 414 (emphasis in original). This is true no matter "what kind of a component of the recovery it might be—whether compensatory damages, punitive damages, or attorney fees." *Id.* A consumer may only "assert uncapped claims against a creditor . . . if another state or local cause of action" independent of the Holder Rule would support such claims. *Id.* In *Lafferty*, therefore, California joined "the overwhelming majority" of courts and the FTC's own approach to its regulation. Hyman & Mohseni, *supra*, at 441.

III. The FTC interprets its regulation as applying to and capping recovery of attorney's fees.

The year after *Lafferty*, the FTC issued a Rule Confirmation validating the Holder Rule's straightforward limits and *Lafferty*'s application of the same. 84 Fed. Reg. 18711. The FTC issued that confirmation after

requesting and receiving public comments on the Holder Rule, including comments about whether the Rule caps consumer recovery of attorney's fees. *Id.* at 18713. After addressing those comments, the FTC concluded that the Holder Rule does not allow a plaintiff to recover more than what she paid under the contract. *Id.* ("[P]ayment that the consumer may recover from the holder—including any recovery based on attorneys' fees—cannot exceed the amount the consumer paid under the contract.").

According to the FTC, a plaintiff may only recover uncapped attorney's fees "if a federal or state law separately provides for recovery of attorneys' fees independent of" the claims specifically established by the Holder Rule. *Id.* Not only had the Holder Rule always meant this, the FTC confirmed, but the FTC also saw no reason to change this meaning. *See id.*

IV. An appellate court rejects the legislature's effort to duck *Lafferty* and the FTC's Rule Confirmation.

Despite *Lafferty*'s correct reasoning and the FTC's confirmation of the same, California's legislature sought to circumvent both by enacting Civil Code § 1459.5. That statute provides that a plaintiff that prevails under the Holder Rule against a creditor "may claim attorney's fees, costs, and expenses from that defendant to the fullest extent permissible if the plaintiff had prevailed on that cause of action against the seller." The provision's "legislative history makes clear that the Legislature's intent was to reverse the decision in *Lafferty* and restore [what the Legislature viewed as]

California's original interpretation of the Holder Rule" by allowing uncapped attorney's fee awards. *Spikener*, 50 Cal. App. 5th at 160.

In 2020, the First District Court of Appeal found this effort unsuccessful. The *Spikener* court instead agreed with *Lafferty* that the Holder Rule limits *all* recovery, including attorney's fees, to the amount paid on the loan. It reached that conclusion by a different path, however—by assuming without deciding that the Rule is ambiguous, but holding that the FTC's reasonable interpretation warrants deference in the face of any such ambiguity. *Spikener*, 50 Cal. App. 5th at 158–59 (agreeing that *Lafferty*'s view of the Holder Rule was reasonable, then assuming, without deciding, that the Holder Rule could also be read to exclude attorney's fees from "recovery").

Spikener also held that the FTC's interpretation satisfied all of the requirements for *Auer* deference—the deference owed to an agency's reasonable interpretation of its own, ambiguous regulation. *See Kisor*, 139 S. Ct. at 2408. The Rule Confirmation "was indisputably the FTC's official position" because the FTC issued it and published it in the Federal Register. *Spikener*, 50 Cal. App. 5th at 159. Interpreting the Holder Rule fell within the FTC's substantive expertise because the FTC is statutorily authorized to prevent unfair or deceptive acts or practices. *Id.* And the FTC issued the Rule Confirmation after soliciting and reviewing public comments, meaning the Confirmation reflected "the agency's considered judgment." *Id.*; *see also*

Kisor, 139 S. Ct. at 2408 (explaining the deference given to "agencies' reasonable readings of genuinely ambiguous regulations").[1]

When this appeal arose, therefore, two California appellate courts had construed the Holder Rule to cap attorney's fees. So had most other courts to address the issue, and so had the very agency that promulgated the Rule. Yet the Court of Appeal rejected all of these authorities.

V. The Court of Appeal wrongly permits Respondent to recover from TDAF attorney's fees exceeding the amounts she paid under the contract.

The Court of Appeal here refused to accept the Holder Rule's clear meaning, the FTC's view of the same, and the compelling reasoning of two other California appellate courts. Thus, although the plaintiff had contracted to pay less than $12,500 for the used car, the court affirmed an attorney's fee award of nearly $170,000. CT 133, 332. As a result, the fee award against the creditor, TD Auto Finance LLC ("TDAF"), far exceeds "the amounts paid by the debtor" under her contract. 16 C.F.R. § 433.2.

This action arose from the plaintiff's purchase of a Nissan "Certified Pre-Owned" car. Op. 2. The plaintiff bought the car from HNL Automotive,

[1]The *Spikener* court then addressed California Civil Code § 1459.5, and found it preempted by the Holder Rule. 50 Cal. App. 5th at 162. *Spikener* was correct on this point, but preemption is not presented now based on the posture of this appeal.

Inc. under a retail installment sales contract that contained the Holder Rule notice. Op. 2. TDAF accepted assignment of the sales contract. Op. 3.

When the car turned out not to meet the Nissan Certified Pre-Owned criteria as advertised, the plaintiff sued for breach of implied warranty under California law. *Id.* The jury found for the plaintiff on that claim and awarded damages of $21,957.25. Op. 4. The plaintiff moved for an award of attorney's fees, as authorized by the Song Beverly Act she sued under. Cal. Civ. Code § 1794(d). Although TDAF argued to the trial court that, under the Holder Rule, it was not liable for fees that far exceeded what the plaintiff paid under her contract, the trial court granted the plaintiff's fee request in full, for $169,602. Op. 6.

TDAF appealed this final judgment, arguing to the Court of Appeal that the trial court abused its discretion by awarding fees in excess of amounts paid under the contract. The Court of Appeal affirmed the trial court's fee award and held that the Holder Rule did not limit the plaintiff's recovery of those attorney's fees.

In reaching this conclusion, the Court of Appeal adopted a narrow definition of "recovery" that is limited to consequential damages even though the history of the term's statutory and judicial usage fails to adopt any such limitation. Op. 23. It added that capping attorney's fees would frustrate the Holder Rule's apparent purpose of helping consumers enforce their rights in court. Op. 19–24. The court thus adopted its own reading of the Holder Rule

as permitting recovery of attorney's fees far beyond amounts paid under the contract.

Along with refusing to apply the Holder Rule's plain meaning, the Court of Appeal also refused to give any deference to the FTC's contrary view of its own regulation—one that adheres to the regulation's clear import. The Court of Appeal held that the Rule Confirmation "was not an exercise of [the FTC's] substantive expertise" or the product of its "fair and considered judgment," and thus no *Auer* deference was warranted. Op. 30–31.

Having determined that the "Holder Rule cap does not include attorney's fees within its limit on recovery" and that "the FTC's interpretation to the contrary is not entitled to deference," the Court of Appeal saw fit to affirm the plaintiff's entire award. Op. 33. The Court of Appeal did not reach any preemption analysis between the Holder Rule and California Civil Code § 1459.5 because its interpretation meant there was no conflict between the two.[2]

This Court granted TDAF's timely petition for review.

[2] The preemption issue is therefore not before this Court, and this Court should not reach the question of whether the Holder Rule preempts § 1459.5.

STANDARD OF REVIEW

This appeal presents legal questions that this Court reviews de novo. *See California Bldg. Indus. Assn. v. Bay Area Air Quality Mgmt. Dist.* (2015) 62 Cal. 4th 369, 381; *see also Carmona v. Div. of Indus. Safety* (1975) 13 Cal. 3d 303, 310 ("The interpretation of a regulation, like the interpretation of a statute, is, of course, a question of law."); *Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 8 ("The standard for judicial review of agency interpretation of law is the independent judgment of the court, giving deference to the determination of the agency appropriate to the circumstances of the agency action.").

ARGUMENT

I. The Holder Rule unambiguously limits recovery of attorney's fees.

The Holder Rule's clear terms bar recovery of attorney's fees that "exceed amounts paid by the debtor" on her loan contract. And that view matches the regulation's aims. The Court of Appeal's contrary view lacks any basis in the statute's text or its purpose. This Court should reject the lower court's atextual decision and side instead with the "overwhelming majority of decisions" that correctly read the Holder Rule to cap attorney's fees. Hyman & Mohseni, *supra*, at 441–42.

A. "Recovery" includes attorney's fees.

Interpreting a regulation's meaning begins with "looking to the [regulatory] language." *Carmack v. Reynolds* (2017) 2 Cal. 5th 844, 849–

50; *see also Hoitt v. Dep't of Rehab.* (2012) 207 Cal. App. 4th 513, 523 ("Rules of statutory construction govern our interpretation of regulations promulgated by administrative agencies."). This Court gives a provision's language "its usual, ordinary import and accord[s] significance, if possible, to every word, phrase and sentence in pursuance of the [regulation's] purpose." *Carmack*, 2 Cal. 5th at 849–850. "The [regulation's] plain meaning controls the court's interpretation." *Imperial Merch. Servs., Inc. v. Hunt* (2009) 47 Cal. 4th 381, 387–88. Courts do not look beyond the provision's express terms unless those terms are ambiguous. *See id.* Only if the regulation "permits more than one reasonable interpretation" may courts "consider other aids, such as the statute's purpose, legislative history, and public policy." *Id.* at 388.

Here, the Court's inquiry should begin and end with the Holder Rule's unambiguous language limiting recovery of attorney's fees to amounts paid under the consumer's contract. The Rule's terms are straightforward: "recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder." 16 C.F.R. § 433.2. "Recovery" has a broad definition not limited to actual damages. It means "an amount awarded in or collected from a judgment or decree," or "[t]he obtainment of a right to something (esp. damages)"—but not exclusively damages—"by a judgment or decree." Recovery, Black's Law Dictionary (11th ed. 2019). "[A]n amount awarded,"

or "a right to something" includes anything given to a litigant by a judgment or decree. As a result, it includes attorney's fees.

Common usage by courts and in statutes confirms that "recovery" means all "recoverable litigation costs," and that "recoverable litigation costs do include attorney fees." *Santisas v. Goodin* (1998) 17 Cal. 4th 599, 606 (Cal. Code Civ. P. § 1033.5 treats attorney's fees as "recoverable litigation costs"); *see also Reynolds Metals Co. v. Alperson* (1979) 25 Cal. 3d 124, 129 (en banc) ("[T]he prevailing party may *recover attorney's fees* (emphasis added)). The very statute under which the plaintiff sued TDAF as a "holder" refers to "recover[ing]" attorney's fees "as part of [a] judgment." Cal. Civ. Code § 1794(d). Indeed, as the *Lafferty* court recognized, both California courts and courts around the country use recovery to "include the entire remedy effectuated and thus encompass[] the total benefit conferred upon a party through the efforts of counsel." 25 Cal. App. 5th at 412 (quoting *Highway Truck Drivers and Helpers Local 107, of Intern. Broth. of Teamsters, Chauffeurs, Warehousemen and Helpers of America v. Cohen* (E.D. Pa. 1963) 220 F. Supp. 735, 737). In common parlance, then, "recovery" includes attorney's fees as well as all other components of a consumer's recovery.

This standard, broad definition of "recovery" fits with its use in the Holder Rule. The Rule does not modify or otherwise limit the term "recovery" by, for example, referring only to "recovery of actual damages."

Instead, the Rule broadly speaks of all "recovery *hereunder*"—meaning all recovery against a creditor under the Holder Rule. The Rule's use of "recovery" thus unambiguously includes attorney's fees sought by a consumer seeking to hold a creditor liable under the Holder Rule.

Confirming "recovery's" broad sweep is the fact that when the Rule limits a consumer's "recovery," it does so not by kind, but by amount. Like the Rule's use of "recovery," the relevant limit is plain and unambiguous: "recovery . . . shall not exceed amounts paid by the debtor hereunder." This express limitation means that "a consumer cannot assert an uncapped claim under . . . the Holder Rule." *Lafferty*, 25 Cal. App. 5th at 414. Instead, by limiting recovery to the "amounts paid . . . hereunder," the Rule "limits recovery to money actually paid under the contract" giving rise to the consumer's action against the creditor. *Hernandez v. Apple Auto Wholesalers of Waterbury*, *LLC*, —A.3d—, 2021 WL 1846090, at *10 (Conn. May 7, 2021).

In its second sentence, therefore, the Holder Rule (1) adopts the common, ordinary meaning of "recovery" as including everything awarded to a consumer against a creditor, including attorney's fees, and (2) provides that such "recovery" must not exceed the monies paid in relation to any contract governed by the Holder Rule. Put differently, the regulation broadly defines "recovery" and then limits that recovery's amount. *Lafferty*, 25 Cal. App. 5th at 414 ("[T]he language of the Holder Rule plainly defines the

amount subject to the rule broadly by using the word 'recovery' to include more than just compensatory damages but narrows the amount that may be recovered to those monies actually paid by the consumer under the contract.'"). As a result, a consumer may not recover attorney's fees that exceed amounts she paid under her contract.

The Rule's plain language resolves this appeal: the Court of Appeal wrongly allowed recovery in excess of amounts paid. *See Simpson*, 32 F. Supp. 2d at 410 ("[Th]e purpose of this language is clearly to not permit a consumer to recover more than he has paid.").

B. The Rule's clear limit on recovery serves the regulation's purpose.

The Rule's plain text comports with its purpose. The Rule does not allow uncapped attorney's fees because doing so would run contrary to the Rule's goal of efficiently reallocating the risks of seller misconduct without making creditors the guarantors of sellers' performance.

"[T]he magnitude . . . of consumer injury" owed to "forfeited claims and defenses in credit sale transactions" motivated the Holder Rule. 40 Fed. Reg. at 53510. The Rule shifts the risk of loss to creditors and preserves consumer's claims and defenses "to provide both a shield and a (small) sword to consumers, thus enabling them with a level of self-protection against creditor claims that they would not otherwise have." *Crews v. Altavista Motors, Inc.* (W.D. Va. 1999) 65 F. Supp. 2d 388, 391. Without the Rule,

consumers "otherwise would be legally obligated to make full payment to a creditor" on their consumer loan, "despite breach of warranty, misrepresentation, or even fraud on the part of the seller." 2012 Opinion Letter at 3. A consumer could only escape this obligation by proving that the creditor knew of the seller's misconduct or obtained the consumer contract in bad faith—a difficult endeavor. 40 Fed. Reg. at 53512. The Holder Rule empowers consumers to defend against their payment obligations without making any such showing.

This defensive aspect of the Rule is central. The Rule is not just about giving consumers an ability to sue innocent creditors. It is focused primarily on giving consumers an out from their payment obligations, and an ability to defend against any creditor suit seeking payment, when a seller's misconduct renders a consumer contract valueless.

At the same time, the Rule does give consumers the ability to seek affirmative recovery from a holder rather than (or in addition to) a seller for a seller's wrongdoing. Before the Rule, consumers could only recover from sellers, but faced obstacles in seeking such recovery. *See* 40 Fed. Reg. at 53511. Although consumers could "theoretically . . . seek damages or other relief from the seller," such relief would not erase the consumer's separate obligation to pay the holder of the loan. *Id.* at 53511–53512. And the costs of pursuing a separate claim against the seller would often outweigh the consumer's likely recovery, not just because the consumer's damages would

be relatively small, but also because the consumer would still have to pay the holder. *Id.* at 53512. Meanwhile, collecting on judgments against "the worst sellers" would prove difficult given their "volatile" nature. *Id.* The FTC thus authorized consumers to sue holders—thereby enabling consumers to *both* escape the obligation to pay a holder *and* recover from that holder.

Although the FTC reallocated liability from the seller to the creditor, it did not intend the Holder Rule as a fee-shifting "weapon to exact statutory and punitive damages against otherwise innocent creditors." *Crews,* 65 F. Supp. 2d at 391. Nor was the Rule meant to "place the creditor in the position of an insurer or guarantor of the seller's performance." *Riggs*, 32 F. Supp. 2d at 417. Nothing in the Rule's text or history reflects such a goal. To the contrary: the FTC stated that the Rule entitled the consumer only to a "set-off" (if defending) or "to a refund of monies paid on account" (if affirmatively suing)—not to attorney's fees well above either amount. 40 Fed. Reg. at 53524, 53527.

Had the FTC wished to go further, it would have said so. The Rule already shifts liability from sellers engaged in wrongdoing onto blameless creditors with no role in the seller misconduct supporting the consumer's claims. It does not go farther by making creditors responsible for all uncapped fees a consumer might be able to recover from a seller. And indeed, a consumer could still sue a seller while defending against a creditor's claim for payment—the Holder Rule would still benefit that

consumer by absolving her obligation to pay the creditor, and the consumer could seek whatever recovery (including uncapped fees) is available from the seller. This is the balance the Holder Rule struck. It goes far enough: placing liability on innocent creditors and allowing consumers to defend themselves, but not giving consumers an unlimited recovery from creditors.

The Holder Rule takes this balanced approach in part because imposing uncapped fees of any kind—attorney or otherwise—on creditors would make creditors leery of financing consumer contracts in the first place. Uncapped attorney's fees would threaten liability far in excess of the economic benefit creditors stand to gain for financing California consumers.

And when creditors did take that risk, they would later be deterred from defending themselves on the merits of Holder Rule claims arising from those contracts. Attorney's fees will almost always far exceed—by many multiples—the amount paid under a consumer's contract. Any creditor sued by a consumer under the Rule is already facing liability in that contract's amount for a separate party's purported misconduct. If uncapped attorney's fees are also available, the risk of defending against a Holder Rule claim would outweigh the benefit, because a loss would mean paying thousands or hundreds of thousands in attorney's fees above the consumer's recovery on the contract. These disincentives, first to finance contracts, then to defend against claims on those contracts, would upset the careful balance the FTC intended by promulgating the Holder Rule. The FTC would not have taken

this course without explicitly separating attorney's fees from its clear limit on recovery.

The Rule's legislative history (consistent with its text) thus shows the FTC was exclusively focused on giving consumers these corresponding abilities to (1) defend against paying their loan obligation to creditors and (2) affirmatively recover from creditors loan amounts paid. The FTC did not seek to punish creditors and thereby disincentivize them from providing financing for consumer loans or defending against consumer claims. The FTC accomplished the former goal by giving consumers a new shield and (small) sword—both tied to amounts owed and paid under the contract. But it avoided discouraging creditor financing of consumer contracts by limiting a consumer's recovery from a creditor to the contract amount paid. As a result, the Rule leaves consumers better off without subjecting creditors to unlimited liability.

C. The Court of Appeal's misreading of the Holder Rule lacks any basis in the regulation's language or purpose.

Despite the Rule's unambiguous terms limiting attorney's fees, a reading that furthers the Rule's purposes, the Court of Appeal adopted an approach to the Rule untethered to its text or aims.

1. The Court of Appeal misread the term "recovery."

Rather than properly interpret the Holder Rule's plain language before looking to other interpretive sources, the Court of Appeal cursorily adopted

a narrow view of "recovery" colored by its own misconception of the Holder Rule's purpose and legislative history. The court's textual analysis is improperly intertwined with its view of the regulation's legislative history. And both are wrong.

At the outset, the court misread the Black's Law Dictionary definition of "recovery." Again, that definition defines "recovery" as "an amount awarded in or collected from a judgment or decree," or "[t]he obtainment of a right to something (esp. damages) by a judgment or decree." Recovery, Black's Law Dictionary (11th ed. 2019). Because that definition refers to "esp. damages," the court read it to mean that recovery includes *only* damages. Op. 20. That reading ignores the definition's clear and broad terms, and its listing of damages as just one, non-exclusive example of "recovery." Yet the court focused exclusively on the word "damages" to reach a false equivalence between "recovery" and "damages."

After misconstruing the dictionary definition of the term, the court rejected as unpersuasive examples of "recovery" in common usage. In fact, the Court of Appeal refused altogether to "give the regulatory language its plain, commonsense meaning." *Hoitt*, 207 Cal. App. 4th at 523. Instead, the court insisted that the term must take on a unique meaning in the Holder Rule context. Op. 20 (rejecting cases "in contexts outside the Holder Rule" as not "persuasive in defining recovery for the purpose of the Holder Rule"). From

this offhand rejection of the typical meaning of "recovery," the court launched into a long discussion of the Rule's legislative history.

The Court of Appeal thus failed to follow this Court's prescribed course for statutory interpretation, which begins with a regulation's language and gives that language "its usual, ordinary import." *Carmack*, 2 Cal. 5th at 849. This approach is especially warranted with respect to the Holder Rule's language, which, most "[f]undamentally, . . . constitutes a notice to consumers," meaning "[i]t would be antithetical to the language and its typographic emphasis to hold that the Holder Rule language does not mean what it says." *Lafferty*, 25 Cal. App. 5th at 412. Rather than adopt the Rule's clear import meant to inform consumers as to their rights (and the limits on those rights), the court construed the statutory language to reach the result the court thought best served what it viewed as the Rule's purpose. But the Court misread the Rule's legislative history and aims just as it did its text.

2. The Rule's purpose and history do not support the Court of Appeal's ruling.

The Court of Appeal asserted that because the Holder Rule was meant to reallocate the costs of seller misconduct to creditors and remove impediments to consumer actions, uncapped attorney's fees *must* be available because they further these purposes. Op. 20–24. But the FTC's goals are satisfied by allowing consumers (capped) recovery from creditors along with the ability to defend against creditor suits. The consumer is

relieved of her payment obligations and can affirmatively recover the amounts she has already paid under the contract. She is protected from the situation that the Holder Rule sought to remedy. But she is not *further* benefitted by uncapped recovery, and the blameless holder is not subject to uncapped recovery based on another's wrongdoing. Instead, the FTC balanced the benefit to consumers with a limit on that benefit that ensures that creditors will continue to finance consumer contracts.

The Court of Appeal not only misunderstood what remedy is needed (and sufficient) to effect the Rule's purposes, but it also misread the legislative history reflecting what the FTC intended the Rule to do. Nothing in the Rule's legislative history even remotely suggests an intent to provide consumers with uncapped attorney's fees. The FTC used the Holder Rule to shift risk from consumers to creditors—but showed no intent to give those consumers unlimited recovery or make the innocent creditors pay the consumers' uncapped attorney's fees. The FTC instead focused narrowly on the "set-off" of loan obligations and the "return of monies paid" on an account. 40 Fed. Reg. at 53524. That limited focus is reflected in the Holder Rule's second sentence limiting all recovery to amounts paid.

Nor does legislative discussion of obstacles facing consumer actions show any intent to permit uncapped fee awards. Such discussion focused on the "no-win situation" consumers faced when they could only recover from a seller, yet still owed a creditor the loan amount. *Tinker v. De Maria*

Porsche Audi, Inc. (Fla. 3d DCA 1984) 459 So. 2d 487, 492. Without the Holder Rule, these consumers faced obstacles to recovery that made litigating "uneconomic," including problems collecting on judgments against sellers and the inability to defend against creditor claims absent a showing of creditor bad faith. *See supra* at 20; Fed. Reg. at 53512.

The Holder Rule fixed these problems, not by allowing excess attorney's fees, but by allowing consumers to defend against the third-party creditor's suit or affirmatively sue that creditor for a refund of monies paid—without having to pursue a judgment-proof seller or prove bad faith by a creditor. As written and properly interpreted, the Rule's power lies in giving consumers new defenses against and new authority to sue creditors. And Rule has that effect *without* authorizing consumers to recover uncapped attorney's fees. Allowing such fees is an unnecessary step too far, as it turns the Holder Rule into "a weapon to exact" uncapped fees from "otherwise innocent creditors." *Crews*, 65 F. Supp. 2d at 391. The Rule's purpose and history do not support this approach, and the Rule operates to protect consumers without adopting it.

Finally, the Court of Appeal emphasized one post-enactment reference by an Acting FTC Director to "consequential damages." *See* Op. 23. That off-hand reference cannot overcome the Rule's text and evident purpose or the weight of the relevant legislative history. *Barrett v. Rosenthal* (2006) 40 Cal. 4th 33, 54 n.17 ("Ordinarily, subsequent legislative history is

given little weight in statutory interpretation."). At most, that discussion confirms that the Holder Rule expressly limits "a creditor's exposure" to consumer claims: that exposure may never "exceed the amount of the credit contract." Op. 23.

This Court should correct the Court of Appeal's misconstruction of the Holder Rule and reverse.

II. The FTC's interpretation of its own regulation merits deference.

As explained above, the FTC interpreted the Holder Rule to mean that "payment that the consumer may recover from the holder—including any recovery based on attorneys' fees—cannot exceed the amount the consumer paid under the contract." 84 Fed. Reg. at 18713. The FTC issued that confirmation after requesting and receiving public comments on the Holder Rule, including comments about whether the Rule "allows or should allow consumers to recover" attorney's fees outside the general cap on all "recovery hereunder." *Id.* Even if the Court of Appeal's erroneous reading of the Holder Rule were reasonable, and the Rule ambiguous, the FTC's reasonable interpretation of its own regulation is entitled to *Auer* deference. The Court of Appeal wrongly concluded the opposite.

This Court defers to a federal agency's interpretation of its own regulation under the standards set by the U.S. Supreme Court. *See RCJ Med. Servs., Inc. v. Bonta* (2001) 91 Cal. App. 4th 986, 1010; *Reilly v. Marin Hous. Auth.* (2020) 10 Cal. 5th 583, 602–03; *see also Spikener*, 50 Cal. App. 5th at

158. The U.S. Supreme Court recently clarified the standards for such deference, generally known as *Auer* deference. Deference is owed if the regulation is ambiguous and the agency's interpretation is reasonable. That interpretation must also (1) reflect the agency's authoritative or official position, (2) implicate its substantive expertise, (3) reflect its fair and considered judgment, and (4) avoid unfairly disrupting the expectations of regulated parties. *Kisor*, 139 S. Ct. at 2416–18.

Although the Holder Rule is not ambiguous, if it were, the FTC's Rule Confirmation reasonably interpreting that Rule would satisfy each requirement and warrant deference. Should this Court view the Rule as ambiguous, therefore, it should reverse the Court of Appeal and require deference to the FTC's (correct) interpretation of its own regulation.[3]

First, as the Court of Appeal assumed, the FTC's Rule Confirmation was its "authoritative or official position, rather than any more ad hoc statement not reflecting the agency's views." *Kisor*, 139 S. Ct. at 2416. This element merely requires that an interpretation "emanate from those actors, using those vehicles, understood to make authoritative policy in the relevant context." *Id*. Internal memoranda or speech by a "mid-level official" may not suffice, but "official staff memoranda" published in the Federal Register

[3]Because the FTC's interpretation of the Holder Rule is the one consistent with and compelled by the Rule's plain terms and purpose, it is, at the very least, reasonable.

do. *See id.*; *see also Wolfington v. Reconstructive Orthopaedic Assocs. II PC* (3d Cir. 2019) 935 F.3d 187, 206 (interpretation published in Federal Register had the necessary "character and context" for deference). A Rule Confirmation published in the Federal Register by the full Commission clearly emanates from those that make the FTC's authoritative policy, using the vehicle meant to express such policy, and thus constitutes the FTC's official position on the matter.

Second, interpreting its own consumer protection regulation falls well within the FTC's substantive expertise. It is hard to imagine what would be within the FTC's substantive expertise if this effort were not. 15 U.S.C. § 45 "empower[s] and direct[s]" the FTC to prevent "unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce." Issuing regulations to prevent these unfair or deceptive acts or practices thus constitutes the FTC's "ordinary duties" and falls directly "within the scope" of its own authority and no other agency's. *Kisor*, 139 S. Ct. at 2417. And the FTC acted on this authority to promulgate the Holder Rule, making it "an unfair or deceptive act or practice" to fail to include the Holder Rule notice in consumer contracts. 16 C.F.R. § 433.2. Interpreting the regulation it wrote and administers implicates the FTC's policy expertise. *See Kisor*, 139 S. Ct. at 2417.

Further, and contrary to the Court of Appeal's assertion, interpreting the Holder Rule does not and did not require the FTC to analyze state

attorney's fee statutes or data. *See* Op. 30. All it required was for the FTC to interpret its own regulation. Those terms state that for any Holder Rule claims, there is a blanket cap on recovery—no matter what any state statute says. In other words, there is no statute-specific interaction between state provisions and the Holder Rule to evaluate, because all Holder Rule claims are so limited.

The FTC could take this position without evaluating cost-benefit data, because it interpreted the Rule to have always imposed this recovery cap. *See* 84 Fed. Reg. at 18714 ("The Commission does not believe that the record supports *modifying the Rule* to authorize recovery of attorneys' fees from the holder . . . if that recovery exceeds the amount paid by the consumer." (emphasis added)). Perhaps changing its stance on the Rule or changing the Rule itself would have warranted more analysis. But reading and interpreting the Rule's terms was well within the FTC's purview.

Third, the Rule Confirmation reflects the FTC's fair and considered judgment after soliciting, reviewing, and addressing comments on the Rule. *Kisor*'s "fair and considered judgment" requirement does not mandate any particular level of formality (or specificity) in agency decisionmaking or interpretation. 139 S. Ct. at 2417. Instead, it simply provides that "court[s] should decline to defer to a merely convenient litigating position or post hoc rationalization advanced to defend past agency action against attack." *Id.* The Rule Confirmation does not arise under either of these scenarios. The

FTC did not adopt the Rule Confirmation without analysis as a litigation defense in a one-off case or raise it for the first time in a legal brief. *Id.* at 2417 & n.6. Indeed, this interpretation arose outside the litigation context, as the product of the agency soliciting and reviewing multiple comments on the Rule's scope.

That the FTC did not expressly solicit comments on the Rule's impact on attorney's fees also does not speak to whether the agency reached a considered judgment on that issue. The FTC did receive six written comments providing arguments on the issue, including four asserting that the Holder Rule should "hav[e] no cap on recovery of attorneys' fees," one arguing that the Rule's "plain language . . . limits all recovery," and one "propos[ing] a set fee schedule in some circumstances." 84 Fed. Reg. at 18713. The FTC adopted its position on fees in its formal, published Rule Confirmation reached after considering all the comments as well as the import of the Rule's own language. *Kisor* does not require anything more.

Fourth and finally, the FTC's announcement of this interpretation caused no surprise, much less unfair surprise, to regulated parties. Such surprise generally occurs "when an agency substitutes one view of a rule for another" or its new interpretation would "impos[e] retroactive liability on parties for longstanding conduct that the agency had never before address." *Kisor*, 139 S. Ct. at 2418. The Rule Confirmation did neither.

Not only has the Holder Rule's text remained unambiguous and unchanged for decades, but the FTC has long made clear that courts should apply the Rule's plain terms. *See* 2012 Opinion Letter at 1, 3. And the FTC *never* took the stance that the Rule permits uncapped attorney's fees. To the contrary: as long ago as 2012, it cited with approval decisions holding the opposite. *Id.* at 3; *supra* at 7. No regulated party can seriously assert unfairness under these circumstances, especially when the "overwhelming majority" of courts have taken the same view as the FTC, including in California. Hyman & Mohseni, *supra*, at 441.

Nor would deference to the FTC's reasonable interpretation of its Rule impose any retroactive liability for longstanding conduct. In fact, the opposite would happen if this Court refused to defer to the agency's interpretation and allowed creditors to face liability for uncapped attorney's fees. This Court should not reach a result that disrupts the longstanding regulatory and majority view of the Holder Rule and subjects creditors to liability many multiples more than the consumer's contractual damages.

In sum, by dismissing the FTC's substantive expertise and diminishing the consideration it gave the Rule Confirmation, the Court of Appeal incorrectly cast the FTC's interpretation as nonbinding. This error compounds the court's misreading of the Holder Rule's clear terms. This Court should either confirm the Holder Rule's unambiguous meaning or hold

that courts owe deference to the FTC's authoritative confirmation of that meaning.

CONCLUSION

For these reasons, this Court should reverse the Court of Appeal and remand for further proceedings.

DATED: June 28, 2021

Respectfully submitted,

MCGUIREWOODS LLP

By: */s/ Tanya L. Greene*

Tanya L. Greene
Jamie D. Wells
Anthony Q. Le
Attorneys for TD AUTO FINANCE LLC

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Respectfully submitted,

MCGUIREWOODS LLP

By: */s/ Tanya L. Greene*
Tanya L. Greene
Jamie D. Wells
Anthony Q. Le
Attorneys for TD AUTO FINANCE LLC

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

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Sherlynn Hicks

SERVICE LIST

Hallen D. Rosner Arlyn L. Escalante Michelle A. Cook ROSNER, BARRY & BABBITT, LLP 10085 Carroll Canyon Rd., Suite 100 San Diego, CA 92131 858.348.1005 / Fax 858.348.1150 hal@rbblawgroup.com arlyn@rbblawgroup.com michelle@rbblawgroup.com **(VIA TRUEFILING)**	Attorneys for Respondent TANIA PULLIAM
Duncan J. McCreary, Esq. MCCREARY PC 11601 Wilshire Boulevard, 5th Floor Los Angeles, CA 90025 310.575.1800 djm@mccrearypc.com **(VIA TRUEFILING)**	Counsel for Appellants HNL AUTOMOTIVE, INC. AND TD AUTO FINANCE LLC
John A. Taylor Horvitz & Levy LLP Business Arts Plaza 3601 W. Olive Ave., 8th Floor Burbank, CA 91505 818.995.0800 jtaylor@horvitzlevy.com **(VIA TRUEFILING)**	Pub/Depublication Requestor HORVITZ & LEVY LLP
Jan T. Chilton Severson & Werson One Embarcardero Center. Suite 2600 San Francisco, CA 94111 415.398.3344 / Fax 415.956.0439 jtc@severson.com **(VIA TRUEFILING)**	Pub/Depublication Requestor AMERICAN FINANCIAL SERVICES ASSOCIATION
William N. Elder, Jr. Foell & Elder 3818 E. La Palma Ave. Anaheim, CA 92807 714.999.1100 / Fax 714.630.3300 bill@foellandelder.com **(VIA TRUEFILING)**	Pub/Depublication Reqestor CALIFORNIA FINANCIAL SERVICES ASSOCIATION

Hon. Barbara M. Scheper
c/o Clerk of the Court
Los Angeles Superior Court
111 N. Hill Street
Los Angeles, CA 90012
(VIA U.S. MAIL)

Office of the Attorney General
1300 "I" Street
Sacramento, CA 95814-2919
916.445.9555
(VIA UPLOAD TO AG WEBSITE)

STATE OF CALIFORNIA
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Lisa Perrochet Horvitz & Levy LLP 132858	lperrochet@horvitzlevy.com	e-Serve	6/28/2021 4:18:05 PM
Tanya Greene McGuireWoods LLP 267975	tgreene@mcguirewoods.com	e-Serve	6/28/2021 4:18:05 PM
John Taylor Horvitz & Levy 129333	jtaylor@horvitzlevy.com	e-Serve	6/28/2021 4:18:05 PM
Michelle Cook Rosner, Barry & Babbitt, LLP 319340	michelle@rbblawgroup.com	e-Serve	6/28/2021 4:18:05 PM
Arlyn L. Escalante 272645	arlyn@rbblawgroup.com	e-Serve	6/28/2021 4:18:05 PM

Duncan J. McCreary 225034	djm@mccrearypc.com	e-Serve	6/28/2021 4:18:05 PM
Anthony Le 300660	ale@mcguirewoods.com	e-Serve	6/28/2021 4:18:05 PM
Jamie Wells	jwells@mcguirewoods.com	e-Serve	6/28/2021 4:18:05 PM

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Date

/s/Sherlynn Hicks

Signature

Greene, Tanya L. (267975)

Last Name, First Name (PNum)

McGuireWoods LLP

Law Firm