Comment #: 30

April 23, 2004

Federal Trade Commission
Office of the Secretary
Room 159-H (Annex C)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: FACTA Interim Final Rule Prohibiting Circumvention, Project No. P044804

Dear Mr. Clark:

The Consumer Data Industry Association ("CDIA") respectfully submits its comments on the Federal Trade Commission's ("Commission") Interim Final Rule ("Interim Rule") to implement section 211(b) of the Fair and Accurate Credit Transactions Act of 2003 ("Fact Act") (15 U.S.C. § 1681x), published at 69 Fed. Reg. 8532 *et seq.* (Feb. 24, 2004).[1]

CDIA is an international trade association, founded in 1906, representing over 500 consumer information companies, including the publicly-traded and privately-held consumer reporting agencies that compile and maintain files on consumers on a nationwide basis ("nationwide consumer reporting agencies"), as described under section 603(p) of the Fair Credit Reporting Act ("FCRA"). Because these agencies are the only entities covered by the Interim Rule, they have a vital interest in the final outcome of this rulemaking process.

[1] Although the Interim Rule was effective March 3, 2004, the Commission has requested comments on the Interim Rule, which amends the FCRA to prohibit consumer reporting agencies from circumventing or evading treatment as nationwide consumer reporting agencies. In the Supplementary Information to the Interim Rule, the Commission explained that the Administrative Procedures Act ("APA") permits an agency to publish an interim final rule before any opportunity for public comment if the agency for good cause finds that the notice is "impracticable, unnecessary, or contrary to the public interest." 69 Fed. Reg. at 8533, quoting 5 U.S.C. § 553(b)(3)(B). The Commission made such a good cause finding because of the short time limit that the FACT Act imposed upon the Commission to promulgate the rule in final form before the prohibitions in the rule become effective. The publication of an interim final rule, of course, does not eliminate the requirement under the APA that the Commission consider public comments in its determination as to the final form of this rule.

The FACT Act required the Commission to prescribe regulations to prevent a consumer reporting agency from circumventing or evading treatment as a nationwide consumer reporting agency. FACT Act § 211(d), codified as FCRA § 629, 15 U.S.C. § 1681y. As the Commission observed in the Supplementary Information to the Interim Rule, the FACT Act does not prohibit circumvention directly, but rather only requires the promulgation of the Rule. Without the Rule, there is no prohibition on circumvention. 69 Fed. Reg. at 8533. For this reason, it is vitally important that the Final Rule provide clear and definitive guidance to the industry, the courts and the public.

Several aspects of the Interim Rule should be modified to provide clear guidance. First, the Final Rule should make clear that the purpose of the Rule is to assure that the nationwide consumer reporting agencies continue to meet their obligations under the FCRA. Therefore, as section 603.3 provides, a nationwide consumer reporting agency will not be liable unless it fails to comply with the requirements for the agency. The Final Rule should amplify this provision by example, as discussed below. Moreover, because the Rule implements the statutory requirement that a nationwide consumer reporting agency not circumvent or evade treatment as such, the Final Rule should not "prohibit transactions." Instead, the Final Rule should make clear what actions constitute circumvention or evasion. For that reason, the Rule must clearly define key terms, including "circumvention" or "evasion."

Finally, the Final Rule should make clear that the standard for evaluating whether certain actions do or do not constitute circumvention or evasion shall be the same for new market entrants, as well as for existing nationwide consumer reporting agencies. In other words, if a particular reorganization or restructuring would constitute circumvention or evasion of treatment for an existing nationwide consumer reporting agency, the same organization or structure should constitute circumvention or evasion of treatment as a nationwide consumer reporting agency if engaged in by another consumer reporting agency. It is essential that the Final Rule create a level playing field for all consumer reporting agencies and not place the existing nationwide consumer reporting agencies at a competitive disadvantage.

Definitions

In order to provide meaningful guidance, there should be no ambiguity as to the meaning of key terms. The Final Rule should define or otherwise provide clear guidance as to their meaning.

Circumventing or Evading Treatment

FCRA section 629 requires the Commission to promulgate regulations to prevent a consumer reporting agency from "circumventing" or "evading" treatment as a nationwide consumer reporting agency for purposes of the FCRA. The quoted terms were not defined under the FACT Act and the Interim Rule provides no interpretive guidance regarding these key terms.

The term "circumvent" generally means to go around, bypass or avoid or to get around by artful maneuvering. The term "evade" generally means to escape or avoid by cleverness or

deceit. Both definitions mean that an action must be taken with the intent to avoid or escape the required conduct. Section 603.2(a) does not, however, indicate whether intent is a factor in determining whether an entity's action violates the prohibition against evading or circumventing treatment as a nationwide consumer reporting agency.

Based on the limited guidance provided in section 603.2(a), it appears that any divestiture or sale of a business unit by a nationwide consumer reporting agency would be considered problematic if the remaining entity would no longer be considered a nationwide consumer reporting agency, even if the sale of the business unit were for legitimate business reasons and not for the purpose of avoiding treatment as a nationwide consumer reporting agency under the FCRA. Section 603.2(a) does not outline any exceptions that would permit a nationwide consumer reporting agency to reorganize or restructure its operations in response to future business conditions if the resulting entity would no longer be considered a nationwide consumer reporting agency. Indeed, section 603.2(a) prohibits circumvention or evasion *by any means*, a standard that presumably does not factor into the evaluation whether the purpose of taking any covered action was to circumvent or evade the Rule rather than to promote a legitimate business purpose. The effect of the Rule is to lock the nationwide consumer reporting agencies into their current business structure even if that structure eventually becomes unprofitable. In that event, the agencies are left with two alternatives; either stay in business and continue to lose money for some period, or cease operations altogether. The Rule should be revised to permit the nationwide consumer reporting agencies to adjust to market conditions that require such adjustments.

Moreover, the Interim Rule omits any discussion of a necessary requirement in FACT Act section 211(b) for circumvention. The Act provides that the Commission shall prescribe regulations to prevent a consumer reporting agency from circumventing or evading treatment as a nationwide consumer reporting agency *for purposes of this title.* FACT Act § 211(b) (emphasis added). That language makes clear that the circumvention or evasion must be for the purpose of avoiding being subject to the requirements of the FCRA as a section 603(p) agency. The Final Rule should provide that a no circumvention or evasion occurs when a nationwide consumer reporting agency takes action for any other reason, such as a legitimate business reason.

For these reasons, the Final Rule should provide that, in order for there to be a circumvention or evasion of treatment as a nationwide consumer reporting agency under the Rule, the following elements must be present: (1) an intentional act (2) by a consumer reporting agency (3) in a transaction or series of transactions (4) for which there is no valid business purpose other than to circumvent or evade the Rule. To evidence these elements, the Final Rule should include the following statement:

> "The purpose and intent of this Rule is solely to prevent a consumer reporting agency from entering into any transaction, or series of transactions, with the intent or purpose of circumventing or evading treatment under the FCRA as a consumer reporting agency as described of §603(p). The Rule does not prohibit, and is not intended to prevent, any consumer reporting agency from entering into any transaction, or series of transactions, for a valid business purpose or purposes."

With this language, the Final Rule would make clear that it prohibits only intentional actions by a consumer reporting agency to structure transactions that have no purpose other than to circumvent or evade the characterization of that organization as an entity meeting the definition under section 603(p) of the FCRA. Even this standard could, however, prove problematic. No one can predict the future changes that will take place in the United States or in the global economy. As the economy grows and contracts and technological advancements continue to fundamentally change business practices, both publicly-traded and privately-held consumer reporting agencies need the flexibility to respond to these conditions. The Final Rule should provide additional guidance regarding the actions that would *not* constitute circumvention or evasion of treatment as a nationwide consumer reporting agency, as well as those actions that may raise such concerns.

The Final Rule should recognize that the nationwide consumer reporting agencies need to retain the flexibility to respond to changing market conditions and that legitimate business reasons often factor into the organization or reorganization plans of businesses in a competitive marketplace. For these reasons, the Final Rule's examples should provide more detailed guidance.

Bona-fide, Arms-length Transaction

Example 4 in Section 603.2(b) of the Interim Rule indicates that a nationwide consumer reporting agency will be permitted to sell a business unit to an "unaffiliated company in a bona fide, arms-length transaction" and cease operations as a nationwide consumer reporting agency. This example appears to indicate that a nationwide consumer reporting agency may reorganize or restructure in such a way that would otherwise be considered a circumvention of the Interim Rule under Section 603.2(a), provided that the transaction was (1) bona fide, (2) arms-length, and (3) entered into with an unaffiliated company, and thus not for the purpose of circumventing or evading treatment as a nationwide consumer reporting agency under the FCRA

If one or more of these conditions would shield an entity from liability, the Final Rule should formally incorporate them into the substantive provisions, rather than by implication in an example. The Final Rule should also provide additional guidance on the factors to be evaluated in determining whether these conditions are met. The terms "bona fide" and "arms-length" should have established legal meanings, and the Final Rule should provide they will be interpreted in accordance with applicable legal precedent. Additionally, the Final Rule should provide more detailed examples of the types of transactions that would meet each of these conditions.

Procedure for Review of Proposed Actions

The Commission should, upon request, take an active role in the determination of whether proposed actions by consumer reporting agencies would be considered circumventing or evading the general prohibition under section 603.2(a). The Final Rule should provide a formal procedure under which an existing or prospective consumer reporting agency could elect to submit a written request to the Commission for a determination in this regard. This procedure would give needed assurance to parties involved in any organization, reorganization, divestiture

or other covered transaction that the nationwide consumer reporting agency will not violate the Final Rule by virtue of its participation. Such a procedure could be based on that currently used by the Commission in evaluating pre-merger notifications submitted under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. If the Commission did not respond within a specified time period (such as 30 days) to a request for a determination that a proposed action by the nationwide consumer reporting agency would not constitute circumvention or evasion of treatment under the FCRA within a prescribed time period, it would be presumed that the action was not a violation of section 603.2(a).

If the Commission did respond to a request for a determination, it could offer guidance to consumer reporting agencies that may need to reorganize or restructure their operations for legitimate business reasons. A voluntary pre-clearance procedure would provide all parties in such transactions, including the seller, buyer and financing sources, with definitive guidance on whether they should proceed with the proposed transaction. Moreover, such a procedure would prevent actions that circumvent or evade the Final Rule before such actions occur. Finally, the procedure would create a safe harbor for nationwide consumer reporting agencies and other parties to the business reorganization or restructuring against potential liability and it would assist the courts in determining compliance with the FCRA.

Other Concerns

Application of Other Laws

The Final Rule should make clear that it does not alter, impact or modify current legal standards, federal or state, that would be applicable to the determination of the elements of compliance, and that the Rule does not create a new legal standard. The Rule should also make clear that it does not interfere with the operation of other federal and state laws. For example, the Rule should clarify the circumstances when it will yield to federal bankruptcy laws with respect to transactions covered under section 603.2(a). When appropriate to do so for reasons other than circumvention of the FCRA, a nationwide consumer reporting agency should be able to file for bankruptcy if the remaining entity would no longer be a nationwide consumer reporting agency or if the nationwide consumer reporting agency would be liquidated in its entirety. The Rule should make clear that it is not intended to interfere with the application of the federal bankruptcy laws or with the ability of a nationwide consumer reporting agency to file for protection under such laws, even when such a filing may necessitate the dissolution of the nationwide consumer reporting agency or the disposition of one or more business units with the remaining entity losing its status as a nationwide consumer reporting agency.

Moreover, the Final Rule should make clear that applicable state law, such as the business judgment rule, may provide a valid reason for a covered action to be excluded from the prohibition under section 603.2(a). A nationwide consumer reporting agency should be able to divest a business unit if compliance with a particular state's licensing or substantive laws becomes problematic, even if such action changes the status of the nationwide consumer reporting agency. The Final Rule should clarify the circumstances under which consumer reporting agencies may reorganize in order to eliminate compliance obligations imposed under state law without violating the prohibitions under section 603.2(a).

For these reasons, the Final Rule should provide:

> This Rule is not intended to modify any legal standards or impact any other federal or state laws, rules or regulations that may govern the business transactions of consumer reporting agencies.

Limits on Liability

Interim Rule section 603.3 provides:

> Any person who is otherwise in violation of § 603.2 shall be deemed to be in compliance with this part if such person is in compliance with all obligations imposed upon consumer reporting agencies that compile and maintain files on consumers on a nationwide basis under the FCRA.

69 Fed. Reg. at 8536.

This provision is essential to implement the Congressional purpose underlying FCRA Section 629. The Final Rule should explain that a consumer reporting agency's potential liability would be based upon an allegation that the consumer reporting agency is a nationwide consumer reporting agency under the FCRA but fails to comply with the requirements for such agencies. In an action based upon the alleged failure to comply with the FCRA's obligations for nationwide consumer reporting agencies, there could be an issue as to whether the agency should be treated as a nationwide consumer reporting agency for purposes of the act, and thus an issue as to whether the consumer reporting agency structured its organization or maintained files for the purpose of circumventing or evading treatment as a nationwide consumer reporting agency. However, there would be no independent basis for liability under the rule, unless the agency failed to comply with the obligations for nationwide consumer reporting agencies when it should have done so. The Final Rule should make this clear.

Specific Suggestions Regarding Provisions of Interim Final Rule

Section 603.2(a)

As noted above, this section should be expanded to include definitions of the key terms used in both the statute and the Rule and an identification of the specific elements that must be present to determine whether conduct would constitute circumvention or evasion of treatment as nationwide consumer reporting agency under the FCRA.

Section 603.2(b)

CDIA appreciates the Commission's attempt to provide guidance in the four examples outlined in the Interim Rule. CDIA believes the current examples should be expanded to address

other concerns under the Rule and, as noted above, at least one of the current examples raises more questions than it answers.

- **Suggested Revisions to Examples Provided in Interim Rule**

Example 1 refers to a nationwide consumer reporting agency that restructures its operations so that public record information is assembled and maintained only by its corporate affiliate. The example indicates that this reorganization is a circumvention of the Interim Rule with little additional guidance. The example does not indicate whether the parent entity continues to provide consumer reports containing both public record and credit account information. If the parent entity no longer includes public record information in its consumer reports, it no longer meets the definition of a nationwide consumer reporting agency. Based on the guidance provided, this transaction would be considered problematic, even if the organizational change was made for a purely legitimate business reasons.

If the Final Rule does not include an exception permitting organizational changes under limited circumstances, this example should, nevertheless, be revised to clarify that if the parent entity continues to sell full consumer reports by obtaining the public record information from its affiliate, but no longer complies with the obligations imposed on a nationwide consumer reporting agency, the transaction would be considered a circumvention in violation of section 603.2(a). As noted in section 603.3, if the parent entity continued to comply with the obligations placed on nationwide consumer reporting agencies after the organizational change, it would be deemed to be in compliance with the Interim Rule, even if the organizational change otherwise violates section 603.2(a).

Example 2 also addresses the reorganization of a nationwide consumer reporting agency. In this example, the nationwide consumer reporting agency restructures its operations so that corporate affiliates in each state assemble and maintain information on consumers in their respective states. The Interim Rule notes that this organizational change is a circumvention of treatment as a section 603(p) agency under the FCRA because the parent entity continues to operate as a consumer reporting agency but ceases to comply with the obligations imposed on nationwide consumer reporting agencies. This example should also state, as provided in section 603.3, that if the parent entity continues to comply with the obligations placed on nationwide consumer reporting agencies after the organizational change, there is no violation.

Example 3 addresses the formation of a new consumer reporting agency with two affiliated agencies, one that assembles and maintains credit account information on consumers residing nationwide and another that maintains public record information on consumers residing nationwide. The example notes that this organizational structure is a circumvention of the Rule. CDIA agrees that such a structure indicates intent to circumvent or evade the requirements imposed on nationwide consumer reporting agencies. CDIA believes that the example should further clarify the applicability of the Rule to new market entrants by stating that if a new consumer reporting agency entered into an organization or structure that would constitute circumvention or evasion of treatment as an nationwide consumer reporting agency if engaged in by an existing entity, it would also be circumvention or evasion by the new consumer reporting

agency. In other words, the same standard for evaluating compliance with the Final Rule will be applied to new entrants as well as to existing nationwide consumer reporting agencies.

Example 4 deals with an arms-length transaction by a nationwide consumer reporting agency with an unaffiliated third party. As noted above, this example appears to create an exception to the general prohibition under section 603.2(a) that would permit a nationwide consumer reporting agency to shed the obligations imposed by that status by selling a business unit "to an unaffiliated company in a bona fide, arms-length transaction." The example does not, however, provide any additional guidance regarding whether each of these conditions must be present. More importantly, the example does not provide an explanation of why such a transaction would not be considered a "divestiture" in violation of section 603.2(a).

- **Suggested Additional Examples**

The Commission has requested suggestions on whether additional examples in the Final Rule might be helpful. The CDIA encourages the Commission to provide additional examples in the Final Rule to clarify the scope and applicability of the Final Rule. Example 4 in the Interim Rule appears to sanction certain actions that would otherwise be considered in violation of section 603.2(a). The Commission should provide additional examples in the Final Rule to address other actions that would meet the test or tests enunciated in Example 4. The Final Rule should also provide examples of other actions that would also be permitted under section 603.2(a).

The examples should clarify that the Final Rule does not require an entity currently organized in a manner that would be considered problematic under Section 603.2(a) to reorganize. A suggested example follows:

> *Example* – Acme, Inc. is a consumer reporting agency that has been in business since 1990. Acme, Inc. compiles and maintains files on consumers on a nationwide basis and sells such files to lenders and others for purpose of determining the creditworthiness or insurability of individuals. Acme, Inc. does not have or sell public record information to lenders or others. A subsidiary of Acme, Inc. was formed in 1991 to maintain public record information on consumers on a nationwide basis. The subsidiary sells such records to employers and landlords. It does not include these records with any product sold by its parent company to lenders and others for use in determining the creditworthiness or insurability of individuals. It is not a circumvention of the Rule for the two business operations to remain separate. The Rule does not mandate that Acme, Inc. and its subsidiary combine their operations in order to become a nationwide consumer reporting agency or mandate that an existing business alter its current product offerings in order to become a consumer reporting agency. If a consumer reporting agency does not provide public record and credit information for credit and/or insurance purposes, it is not considered a nationwide consumer reporting agency.

The examples should be expanded to address conduct, such as that described in Example 4, that may be entered into for legitimate business purposes. Suggested examples follow:

Example – JKL, Ltd., a nationwide consumer reporting agency, has agreements with several unaffiliated regional consumer reporting agencies to purchase public record and credit information from the agencies on consumers who reside within the respective service areas of the unaffiliated consumer reporting agencies. JKL, Ltd. and a regional unaffiliated consumer reporting agency have been unable to agree to new terms for the renewal of their contract and wish to end their relationship. The Rule does not require JKL, Ltd. to maintain or renew its agreement with any unaffiliated consumer reporting agency. The Rule is not intended to force the parties to remain in an untenable contractual relationship in order for a nationwide consumer reporting agency to maintain its status as a nationwide consumer reporting agency. To do so would place the nationwide consumer reporting agency in a weakened bargaining position each time it renegotiated a contract with any entity providing the nationwide consumer reporting agency with one or more of the components required for the nationwide consumer reporting agency to maintain its status. The other entity would in turn be placed in a much stronger bargaining position. The Rule should not be applied to alter contractual bargaining positions. If there is a valid business purpose for the business decision, even if the result of that decision is that the entity may forego its status as a nationwide consumer reporting agency, the business decision to sever a relationship with another entity would not violate the mandate under Section 603.2(a).

The Final Rule should also make clear that there can be no circumvention or evasion by consumer reporting agencies if there is no action taken, regardless of the action considered. A suggested example of this fact pattern follows:

Example – XYZ, Ltd, a consumer reporting agency, is in discussions with another consumer reporting agency to purchase the business of the other consumer reporting agency in its entirety. XYZ, Ltd. declines to bid for or agrees to purchase only selected assets or business units of the other consumer reporting agency solely because XYZ, Ltd. does not wish to become a nationwide consumer reporting agency. XYZ, Ltd. may make such a business decision without violating section 603.2(a). Section 603.2(a) prohibits only those affirmative and intentional actions by a consumer reporting agency designed to circumvent or evade treatment as a nationwide consumer reporting agency. The election by a consumer reporting agency to not act, *i.e.*, to not become a nationwide consumer reporting agency, is not considered an attempt to circumvent or evade treatment under the FCRA as an agency described in section 603(p) of that Act.

Finally, the Final Rule's examples should make clear that the Rule is not intended to, and does not, usurp the authority of directors and management of any organization from controlling the destiny of that organization. The Rule only prohibits actions for the purpose of circumvention or evasion of the FCRA's requirements as applied to nationwide consumer reporting agencies. As long as there is a valid business purpose for the decisions that are made and the transactions that are pursued, those actions are not prohibited, even if a result is that an entity may cease from being a nationwide consumer reporting agency or not being able to meet the duties of a section nationwide consumer reporting agency under the FCRA.

Section 603.3

The Interim Rule provides limited protection from liability under section 603.2(a) if an entity otherwise complies with the obligations imposed on nationwide consumer reporting agencies. The Final Rule should clarify that if an entity has voluntarily pre-notified the Commission of a proposed organization, reorganization, structure, restructure, file maintenance or merger and the Commission does not disapprove the proposed action within 30 days of receipt of all information necessary for the Commission's determination with respect to compliance with this Rule, the action will not constitute a violation of section 603.2(a).

* * *

CDIA appreciates the opportunity to submit these comments on the Interim Rule. CDIA commends the Commission for adopting the Interim Rule within the time constraints imposed under the FACT Act. The absence of these time constraints now affords the Commission the opportunity to provide greater guidance to the industry, the courts and consumers on the scope and applicability of the general prohibition under section 603.2(a). CDIA urges the Commission take advantage of this opportunity and provide additional guidance in the Final Rule as discussed in this letter. CDIA members face a unique challenge by operation of the Rule and deserve appropriate guidance in meeting this challenge.

Sincerely yours,

Stuart K. Pratt
President