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DISPATCHES FROM THE TRENCHES

The Fair Credit Reporting Act —
Still Impacting Certain Commercial Leasing Transactions

By Kenneth P. Weinberg

This edition of **Dispatches from the Trenches** discusses the Fair Credit Reporting Act (FCRA) and its application on commercial leasing transactions. Although not a hot topic in the press, the FCRA still impacts commercial leasing transactions when credit reports are pulled from consumer reporting agencies. Those creditors that do not follow the FCRA can face legal consequences.

The FCRA does have an impact on the commercial leasing industry. The first section of this article provides background information about the FCRA. The second section discusses the flurry of activity, which occurred earlier this decade as a result of certain opinions from the Federal Trade Commission. The last section discusses the fact that FCRA still impacts commercial leasing transactions when credit reports are pulled from Equifax Credit Information Services, Inc., (Equifax), Trans Union LLC (Trans Union), Experian Information Solutions, Inc. (Experian) or another consumer reporting agency.

I. Background Information Regarding the FCRA

The FCRA is clearly intended as a consumer protection statute and is based upon Congressøs acknowledgment of the vital role Consumer Reporting Agencies (CRAs) have assumed with respect to assembling and evaluating consumer credit and other information on consumers that is needed by the banking system and other organizations in order to offer credit and other services to consumers. (15 USC§1681(a).) Given the important role played by CRAs and the effect their activities have on consumers, Congress passed the FCRA õto encourage the use of fair and impartial procedures by

consumer-reporting agencies by enabling individuals to protect themselves against the dissemination of inaccurate or misleading information bearing on their credit worthiness.ö *Conley v. TRW Credit Data, 381 F. Supp. 473* (1974).

The FCRA protects the rights of consumers in several ways. Among other things, the FCRA: 1.) provides that Consumer Reports prepared by CRAs can only be used for certain purposes, 2.) regulates the practices of CRAøs, the recipients of the Consumer Reports issued by the CRAs and 3.) sometimes requires certain consumers to receive notices of adverse action taken on the basis of the consumer report.

Although **Section** 603(c) of the FCRA defines the term õconsumerö to mean õan individual,ö the exact text of the FCRA clearly ties the term õConsumer Reportö to transactions intended for primarily personal, family or household use.ö See **Section** 603(d)(a), which defines õConsumer Reportö as:

[A]ny written, oral or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living, which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for í credit or insurance to be used *primarily for personal, family or household purposes…*

As a result of this clear tie to family, personal and household use and the lack of any provisions specifically addressing business transactions, the general consensus in the commercial lending industry had always been that the FCRA was not applicable to commercial lenders.

II. The FTC Opinion Resulting in the FCRA’s Application to Commercial Lending Transactions (The Tatelbaum Letter)

The Federal Trade Commission, which is the federal agency responsible for enforcing the FCRA, dropped a bombshell on the industry by way of an informal staff opinion letter (the 2000 Letter) that was dated July 26, 2000 and issued by the Commission to Charles Tatelbaum, general counsel to the National Association of Credit Management.

That letter addressed õpermissible purposesö under the FCRA. The key point is the FCRA states that consumer credit reports can only be pulled by persons or business entities that have a õpermissible purposeö for doing so. The 2000 Letter stated: a.) credit reports obtained from Experian, Equifax or other similar bureaus are õconsumer reportsö even if used for business purposes and b.) the only way a commercial lender could have a permissible purpose to pull credit reports on individuals who are

principals, owners or officers of a commercial loan applicant, or who sign personal guarantees, would be to obtain the *written consent* of that individual *prior* to pulling the credit report.

According to the 2000 Letter, the permissible purposes outlined in the FCRA that are potentially applicable to business transactions would be: 1.) upon authorization from the individual consumer, 2.) in connection with the extension of credit to the consumer or 3.) in connection with a business transaction initiated by the consumer. The Commission held in the 2000 Letter that the use of a consumer credit report in a commercial leasing transaction does not meet the requirements of numbers 2 or 3 above since the credit is being extended to, and the transaction is initiated by, the commercial entity and not the consumer. The Commission therefore concluded that written authorization was the only way to properly request a credit report on an officer, owner, principal or guarantor. Written authorization requires the individualøs signature, which may include the original signature, photocopy, facsimile or acceptable electronic signature/authentication.

III. Current State of the Law

A. Authority to Pull a Credit Report (Partial Reversal of the Tatelbaum Opinion)

In meetings with various federal regulators, a cross-industry financial services coalition argued a new Commission staff opinion was necessary to ensure õsafe and soundö lending practices and to keep down the cost of delivering commercial credit. The regulators then met with Commission officials in April and argued in part, that the FCRA does allow commercial lenders/lessors to obtain consumer reports when the consumer is or will be *personally liable* on the loan/lease, such as in the case of a sole proprietor, co-signer or guarantor. Subsequently, on June 22, 2001, the Commission issued an informal staff opinion superseding the earlier one (the 2001 Letter).

In the 2001 Letter, the Commission stated that where the consumer in question is or will be personally liable on a loan (such as in the case of an individual proprietor, co-signor or guarantor), there is a permissible purpose for the lender to obtain a consumer report under the FCRA. The Commission noted practical reasons and provided, õit is reasonable to view a business transaction in which an individual has accepted personal liability for the business debt as involving the consumer, thus providing a permissible purpose for the lender to obtain a consumer report under **section** 604(a)(3)(A) of the FCRA.ö It should also be noted that **section** 604(a)(3)(A) provides a õpermissible purposeö for a lender to pull the report during the term of the loan or other extension of credit in connection with a õreview or collection of an accountö for which the lender was authorized to pull the consumer report in the first place.

However, the Commission noted, õ[g]enerally í a lender would not have a permissible purpose under **Section** 604(a)(3)(A) of the FCRA to obtain a consumer report on an individual who will not be personally liable for repayment of the credit, such as when the individual is a shareholder, director or officer of the corporation, but does not guarantee or co-sign the loan, and is not an individual proprietor liable for the loan.ö

B. Additional Compliance Issues for Consideration

Many people in the industry believe this 2001 Letter resolved all issues. However, the letter only provides that commercial lenders have a right to pull a consumer report without written authorization in certain circumstances. It does not change the Commissionøs stance that the FCRA applies to commercial credit transactions in the event a Consumer Report is pulled from Experian, Trans Union, Equifax or another CRA.

Other aspects of the FCRA may therefore still technically apply. For example, **section** 615(a) of the FCRA requires those who take õadverse actionö based on the contents of a Consumer report to:

1. Notify the consumer of the adverse action,
2. Provide the name, address and phone number of the consumer reporting agency used,
3. Include a statement that the consumer reporting agency is not responsible for the adverse decision and cannot provide the reasons why adverse action was taken, and
4. Notify the consumer of his or her right to obtain a free copy of the consumer report within 60 days and dispute the accuracy of the information provided by the agency. See 15 U.S.C. §615(a)

If a creditor does not properly comply with the FCRA, civil or criminal penalties can be pursued. For willful noncompliance, a creditor can be liable to the consumer for certain actual damages, punitive damages and attorneyøs fees. If a creditor is negligent in complying with the requirements of the FCRA, the creditor can be liable to the consumer for any actual damages incurred and attorneyøs fees.

Unfortunately, the issue of what notices are required by the FCRA is somewhat tricky. According to a Commission Advisory Opinion to Ryan Stinneford from July 14, 2000, adverse action notices under the FCRA must only be given to õapplicantsö and do not need to be given to guarantors. However, this opinion was issued prior to the Commissionøs determination that guarantors were sufficiently related to a transaction when there was a permissible purpose for a lender to request a consumer credit report without written authorization. Perhaps this change of opinion would lead the Commission to conclude

that a guarantor is sufficiently related to be entitled to an adverse action notice. In any event, even under the Stinneford opinion, adverse action notices would be required under the FCRA when the applicant is an individual (such as when it is a sole proprietorship).

It should be noted that the FCRA notices could be combined with the notices required by the Equal Credit Opportunity Act. However, the overlap of when notices are required under the two statutes is not necessarily perfectly in sync and a careful compliance policy needs to be implemented in this regard.

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