Fifty Shades of Gray: Pulling Credit Reports and Complying with Privacy Laws

By Robert S. Cohen, Esq., and Stephen E. Breidenbach, Esq.

This article will summarize the law and explore best business practices for mitigating risks when obtaining and retaining credit reports. While there are several "black and white" rules pertaining to these issues, this general topic easily presents at least 50 shades of gray. This is an area of law filled with ambiguity and inconsistent laws and rules, creating uncertainty and increased risks for lenders. Examining and understanding the issues that lurk in these gray areas is crucial for maximizing defensible positions for funders.

Lenders, lessors, brokers and vendors (hereinafter referred to as "funders") routinely pull credit reports on applicants seeking loans, equipment leases and other types of financing (collectively "loans") as well as their principals and potential guarantors. While it is common for funders to request written consent before seeking those credit reports, is such a consent necessary? What privacy laws apply? Once a credit report is obtained by you as a funder, are you properly safeguarding its content?

Obtaining Credit Reports: Federal Law

The Fair Credit Reporting Act (FCRA) is intended to protect the rights of consumers by regulating when a credit reporting agency (CRA) may provide a personal credit report on that person, defined therein as a "Consumer Report" in 11 USC § 1681a and 1681b. The FCRA defines a "consumer" as an "individual," and a "Consumer Report" consists of "information [...] bearing on the consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living," according to 11 USC § 1681a. For these reasons, it was believed at first that the pulling of a Consumer Report on anyone involved in a business loan would not be covered by the FCRA as it is intended to protect consumers. Hence, it is regularly taken for granted that the FCRA cannot be applied to business loans, exposing funders to significant damages. The law at this time is not entirely clear, creating varying shades of gray, and hence is strewn with pitfalls that funders must navigate with attention to detail.

Where are these pitfalls? The FCRA applies to consumers, but not to businesses. The shades of gray start to emerge when a Consumer Report is pulled for a company employee and/or an individual guarantor of a business Loan.

According to the FCRA, it is unlawful for a CRA to provide a credit report without a statutorily defined valid reason, known as a "permissible purpose." To the extent a funder does not have a permissible purpose or that purpose is questionable, the funder is exposed to civil and/or criminal penalties.

Permissible Purpose

A permissible purpose for obtaining a credit report under the FCRA is at times specific but is also broadly open to interpretation—hence, it too is filled with gray areas. Under 11 USC § 1681b of FCRA, the most applicable reasons the equipment leasing and finance industry has for properly obtaining credit reports are generally as follows:

- With the written instructions of the specific consumer,
- In connection with the credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of the account, and
- With a legitimate business need for the information in connection with a business transaction that is initiated by the consumer.

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The Gray Areas for Funders

The Federal Trade Commission (FTC) stunned the industry by rendering an opinion (i.e., the 2000 Tatelbaum Opinion) in 2000 advising that commercial lending transactions did not provide a "permissible purpose" for pulling an individual's personal consumer credit report. The effect was to require written consent to pull a Consumer Report from *all persons* connected to the commercial Loan applicant—principals, silent and active owners, officers, family and others. Subsequently, a cross-industry commission requested that the FTC issue another informal staff opinion superseding its earlier rulings and confirming that where an individual would be personally liable for the commercial lending transactions, the lender had a "permissible purpose" to pull the individual's credit report (the 2001 Tatelbaum Opinion). On the surface, it appears that this 2001 opinion is the green light needed for funders to lawfully pull credit reports on associated individuals without written consent; however, the 2001 opinion both limits the circumstances and defers to original FCRA laws as the overriding rule. The 2001 opinion was only an advisory opinion that does not create the intended "safe harbor" for funders in the sea of gray areas, because such an opinion is not controlling on the FTC. Unfortunately, in the many years that have passed since the 2001 opinion, there has been little clarification from the FTC and/or in case law,

so the areas of gray exist and are confusing. Protecting your business requires a multifaceted approach to minimizing a funder's risk.

Privacy Laws

Funders should also remember they will be collecting personal information on persons connected to the commercial loan, which may be subject to various state privacy laws, such as The California Consumer Privacy Act of 2018 (CCPA). Many of these privacy laws have exemptions that apply when the personal information is already protected by a law such as the FCRA. However, the funder must remain diligent in determining whether the information he or she collects falls outside of the scope of the FCRA and, therefore, remains subject to the state privacy laws' obligations.

Improving/Managing Safeguards

The following are certain action items funders may take to minimize risk. Following these guidelines should improve a funder's position if he or she were accused of pulling a Consumer Report for a business loan without a permissible purpose.

1. **Identify that this is a business loan** on the loan application and all loan documents.
2. **Modify the loan application** to indicate, at a minimum, that the person signing it confirmed that he or she, the *principals of the company (and any other potential guarantors)*, gave permission to have their Consumer Reports obtained. Although such language may not be "bulletproof," it does allow the funder to argue that he or she relied upon the representations of the loan applicant.
3. **Obtain written consents, where possible.** In doing so, be mindful of proper physical placement of signature lines and check-boxes relating to authorization to pull a credit report. The physical proximities to each other are significant because there are proper and improper placements for each that are best verified by legal counsel. Avoid the use of pre-populated check-boxes. Use proper eSignatures, as they can be simpler to obtain and easier to verify as genuine.
4. **Modify your loan documents.** Work with your legal professional to modify the provisions of the guaranty to confirm that the guarantor provided the funder with consent to pull his or her Consumer Report at the *inception* of the loan application. Such a confirmation in the guaranty should materially reduce any claims that the Consumer Report was improperly pulled. This should reduce the funder's exposure to only those loan applications that were not approved–a substantial improvement.
5. A further gray area, in addition to the FCRA, is that **each state may also have different laws** that apply to obtaining personal credit reports. Engaging legal counsel to determine applicable state law and explore the specifics of your business model and market is strongly recommended.
6. **Map the data being collected.** Funders should identify the information they are collecting, the source of this information and the purposes for which it is to be used. This will help funders determine their obligations and how to comply with the various privacy laws.

Although these action items will help and hopefully enable funders to defend claims that they improperly acquired or used their consumers' information, a funder should always keep in mind the "permissible purpose" under which he or she has acquired the consumer's credit report. Developing a cost-efficient approach to minimizing funders' risk surrounding credit reports requires navigating the gray areas with practical safeguards until the law becomes more black and white.

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