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# Overdraft Fee and Credit Card Practices: New Regulations and Litigation Trends

Minimizing Litigation Exposure and Preparing for Heightened Regulatory Scrutiny

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TUESDAY, NOVEMBER 2, 2010

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Katharine F. Musso, Special Counsel, Jones Walker Waechter Poitevent Carrère & Denègre,  
Birmingham, Ala.

Kenneth C. Johnston, Director, Kane Russell Coleman & Logan, Dallas

Barry Goheen, Partner King & Spalding, Atlanta

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# Overdraft Fee and Credit Card Practices: New Regulations and Litigation Trends

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- The final rule, 12 CFR 205, Regulation E allows consumers to limit the costs of overdraft services by providing consumers a choice regarding their bank's payment of overdrafts for ATM and one-time debit card transactions
  - The rule applies whether a debit card uses a PIN or signature

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- Consumers are to be provided a clear disclosure of the fees and terms associated with the bank's overdraft service before deciding whether to opt-in
  - “Overdraft service” is defined as a service in which a bank: (i) assesses a fee on an account (ii) for paying a transaction when the consumer has insufficient or unavailable funds
  - “Overdraft service” does not include (i) overdrafts paid pursuant to a Regulation Z card or line; or (ii) overdrafts paid from another account

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- Opt-In. The final rule requires consumers to affirmatively consent to the bank's overdraft service for ATM and one-time debit card transactions, before overdraft fees may be assessed on the account
  - Any one consumer on a joint account may opt-in or opt-out and bind the account
  - Affirmative consent may be accomplished by mail, telephone, electronically or in person

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- ❑ Consumers have an ongoing right to revoke consent or opt in
  - ❑ Consumers will be liable for fees or charges invoked prior to revocation of consent
  - ❑ A bank may terminate overdraft service, notwithstanding a consumer's opt-in, if the consumer makes excessive use of the service

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- Consumers Covered. The opt-in right applies to all consumers, including existing account holders
  - A single consumer can bind joint accountholders in opt-in or revocation decisions
  - The opt-in relates to the consumer nature of the account

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- Conditioning the Opt-In. The final rule prohibits financial institutions from tying the payment of overdrafts for checks and other transactions to the consumer opting into the overdraft service for ATM and one-time debit card transactions.

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- Parity. The final rule requires banks to provide consumers who do not opt in with the same account terms, conditions and features, including price, as provided to consumers who do opt in.

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- Declination Practices. A bank may not base its decision on whether to decline a transaction based on whether the customer has opted in.



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□ What Did **Not** Make it into the Rule:

- No exceptions for “reasonable belief” there were sufficient funds. No opt-in, no fee. Period
- No exceptions for paper-based debit card transactions
- Does not address “debit holds”



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□ Misconceptions

- The rule does not require banks to pay overdrafts on checks.
- The rule allows banks to offer varying overdraft programs.



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□ Reg E or Reg Z?

- Reg E governs issuance of an “access device” that allows extension of fund (but remember, bank can offer a Reg Z alternative) under an “overdraft service.”



OTS Guidance

OTS CEO Letter #356

June 22, 2010

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## Section 1330 of the Examination Handbook

- ❑ Gift Cards
- ❑ Overdraft Fees
- ❑ Electronic Check Conversion



# Helpful Chart on Consumer Liability for Unauthorized Transfers

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Comprehensive definition of “error” for  
purposes of protection under EFTA and  
Regulation E

- 
- 
- Special record retention provisions
  - Retention may be extended beyond two years by regulator



# FDIC

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- 2008 Study of Bank Overdraft Programs
  - \$23.07 billion in costs annually
  - Average debit overdraft is \$17 but fee is \$34
  - 71% of overdraft fees caused by 16% of banking population
  - Social Security-reliant persons pay \$1.4 billion annually



# 2005 Joint Guidance

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- ❑ Starting point but failed to recognize automated overdraft payment programs
- ❑ 2005 focused on ad hoc overdrafts



# FDIC FIL-47-2010

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- The FDIC expects financial institutions to:
  - Promptly honor customers' requests to decline coverage of overdrafts (*i.e.*, opt out) resulting from non-electronic transactions;
  - Give consumers the opportunity to affirmatively choose the overdraft payment product that overall best meets their needs;
  - Monitor accounts and take meaningful and effective action to limit use by customers as a form of short-term, high-cost credit, including, for example, giving customers who overdraw their accounts on more than six occasions where a fee is charged in a rolling twelve-month period a reasonable opportunity to choose a less costly alternative and decide whether to continue with fee-based overdraft coverage;
  - Institute appropriate daily limits on overdraft fees; and
  - Not process transactions in a manner designed to maximize the cost to consumers



"I warn you, Sir! The discourtesy of this bank is beyond all limits. One word more and I — I withdraw my overdraft!"

*Punch Magazine, Volume 152, June 27, 1917*

# Overdraft Litigation



Kane Russell Coleman & Logan PC

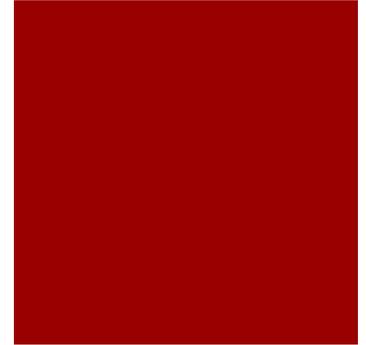
Overview and Trends  
November 2, 2010

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# Roadmap

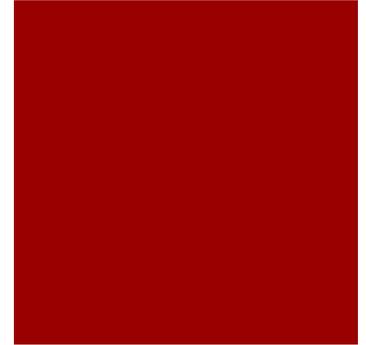
1. Framing the issue: electronic debit transactions and posting order
2. In re Checking Account Overdraft Litigation (MDL 2036)
  - Who, What, When, Where, and Why?
3. Gutierrez vs. Wells Fargo
4. What's next? New facts

# Framing the Issue: Posting-Order Backdrop



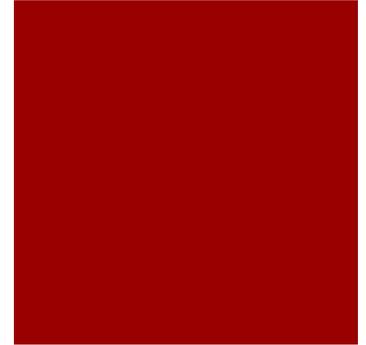
- The UCC historically authorized any posting order – the *Convenience Rule*.
  - 1962 UCC version of 4.303(2) stated that checks or other items “may be accepted, paid, certified, or charged ... in any order convenient to the bank.”
- The 1962 UCC drafters justified the *Convenience Rule* on the ground of “impossibility in stating a rule that would be fair in all cases.”
- The 1990 UCC retained the “any order” rule but deleted the words “convenient to the bank.”
- The Virginia 1990 UCC enactment restored the wording “convenient to the bank.”

# Framing the Issue: Posting-Order Backdrop



- Consider TEX. BUS. & COM. CODE § 4.303(b)(UCC § ).  
“... items may be accepted, paid, certified, or charged to the indicated account of a bank's customer *in any order* and before or after the bank's regular banking hours. A bank is under no obligation to determine the time of day an item is received and without liability may [do a lot of things].”
- Consider Fetters v. Wells Fargo, 110 S.W.3d 683 (Tex. App.—Houston [14th Dist.] 2003).  
“... even if the plaintiffs proved that the primary motivation of defendants was to maximize profits, their motive is irrelevant because their choice of the high-to-low posting method was authorized by the UCC. [and Texas Section 4.303].”
- Other considerations—but do they address posting order for electronic debits versus checks?  
UCC Article 4A; Truth in Savings Act (Regulation DD); Electronic Funds Transfer Act (Regulation E).

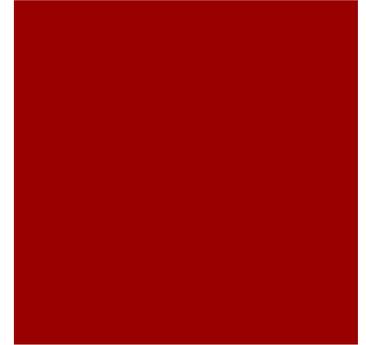
# Framing the Issue: Posting-Order Backdrop



8. The justifications for honoring checks written on insufficient account balances are not applicable to debit card transactions for “point of sale” (“POS”) transactions. Unlike the significant time lag before a check is presented to the bank for payment, as soon as a debit card is “swiped” through a card reader for a POS transaction, the bank knows immediately whether sufficient funds are available to cover the transaction. Upon “swiping” banks could simply decline to honor the POS or debit sale transaction in cases where the account holder lacks sufficient funds to execute the transaction.

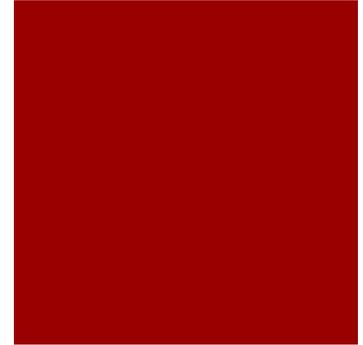
*Source:* MDL 2036 Document 369 Filed 10/25/10

*In re Checking Account Overdraft Litigation,  
MDL No. 2036, pending in the United States  
District Court for the Southern District of Florida,  
Cause No. 1:09-MD-02036.*



- Why multi-district litigation?
- Who are the litigants?
- What are the claims?
- Subject matter jurisdiction
- Major rulings – Omnibus Motion to Dismiss
  - Preemption
  - Claim-by-claim analysis
- Status

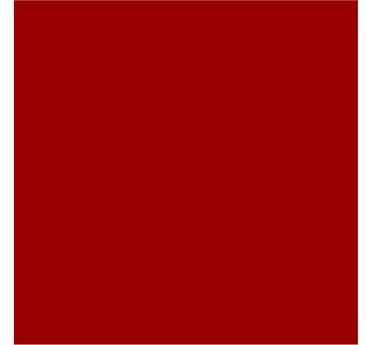
# Why did the JPML create MDL 2036 (part one)?



**Before the entire Panel\***: Plaintiff in one Southern District of Florida action (*Tornes*) has moved, pursuant to 28 U.S.C. § 1407, for centralization in the Southern District of Florida of three actions and any later-filed related actions for coordinated or consolidated pretrial proceedings. Plaintiff in the District of New Jersey action supports the motion. Defendants Wachovia Bank, N.A. (Wachovia) and Bank of America, N.A. (Bank of America) initially opposed centralization of actions involving different bank defendants in one MDL proceeding, but at the Panel's hearing session, Wachovia and Bank of America stated that they support the creation of one MDL docket encompassing all overdraft actions. Wachovia supports centralization of all actions in the Southern District of Florida. Bank of America prefers selection of the Western District of North Carolina, but alternatively supports selection of the Florida district as transferee forum. Plaintiffs in two Northern District of California actions as well as the Citibank<sup>1</sup> defendants in one of these actions oppose centralization of all overdraft actions in one MDL proceeding; if the Panel deems centralization appropriate, opponents suggest the Northern District of California as transferee district. Plaintiffs in several potential tag-along actions take a similar opposing position.

Source: MDL No. 2036 Document 20 Filed 06/10/09

# Why did the JPML create MDL 2036 (part two)?



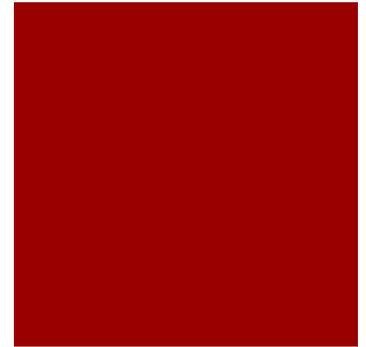
*Source:* MDL No. 2036 Document 20 Filed 06/10/09

All actions share factual questions relating to the imposition of overdraft fees by various bank defendants on their customer's checking accounts in a manner to maximize these fees. Centralization under Section 1407 will eliminate duplicative discovery; avoid inconsistent pretrial rulings; and conserve the resources of the parties, their counsel and the judiciary.

Opponents of centralization of all overdraft actions in one MDL proceeding argue that unique questions of fact predominate in actions brought against different bank defendants over any common factual questions. While there will be some unique questions of fact from bank-to-bank, these actions share sufficient factual questions relating to industry-wide bank posting policies and procedures to warrant centralization of all actions in one MDL docket.

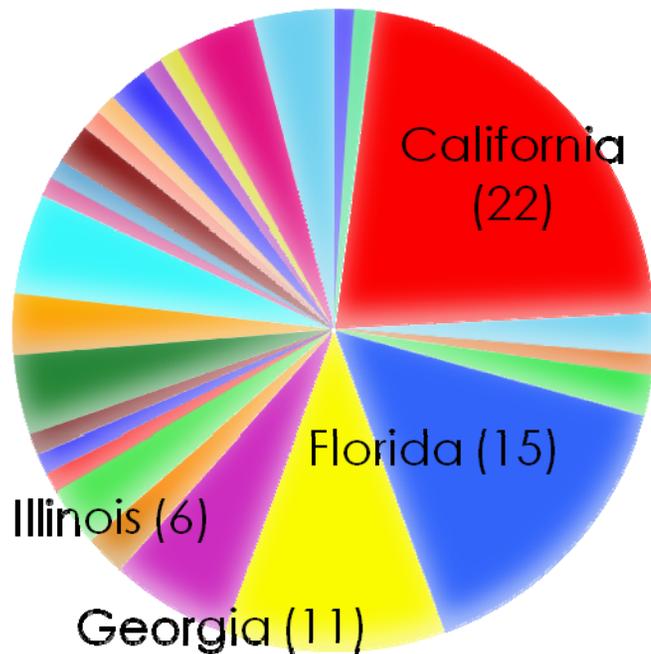
# Who are the litigants?

- Individuals and putative class representatives
- National Banks
- State-Chartered Banks
- Debt Collectors



# Source of Cases

(refer also to reference materials)



- Alabama (1)
- Arizona (1)
- California (22)
- Colorado (2)
- Connecticut (1)
- District of Columbia (2)
- Florida (15)
- Georgia (11)
- Illinois (6)
- Louisiana (2)
- Massachusetts (3)
- Maryland (1)
- Michigan (1)
- Minnesota (1)
- Missouri (4)
- New Jersey (5)
- Nevada (1)
- New Mexico (1)
- New York (2)
- North Carolina (3)
- Oklahoma (1)
- Oregon (2)
- Pennsylvania (1)
- Rhode Island (1)
- Texas (4)
- Washington (4)

# General Claim Summary

1. Breach of Contract Based on Implied Covenant of Good Faith and Fair Dealing
2. Unjust Enrichment
3. Conversion
4. State Statutory Claims
5. Unconscionability

# CAFA Subject Matter Jurisdiction

**THIS CAUSE** comes before the Court *sua sponte*. On August 2, 2010 the Court issued the first of several orders suspending briefing deadlines pending the outcome of petitions requesting an *en banc* rehearing before the United States Court of Appeals for the Eleventh Circuit on *Cappuccitti v. DirecTV, Inc.*, No. 09-14107, 2010 WL 2803093 (11th Cir. July 19, 2010). *See* (DE # 737, 790, 795). In effect those orders stayed this entire case. The Eleventh Circuit issued its order granting rehearing on October 15, 2010 holding "Specifically, [that] CAFA'S text does not require at least one plaintiff in a class action to meet the amount in controversy requirement of 28 U.S.C. § 1332(a).

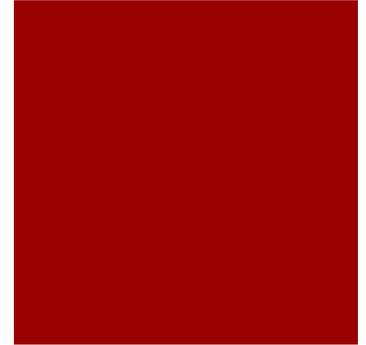
Accordingly, we construe both parties' petitions for rehearing en banc to include petitions for panel rehearing, vacate our earlier opinion, and replace it with this one." (footnote omitted.)

Accordingly, it is **ORDERED, ADJUDGED and DECREED** as follows:

1. The above-styled case is hereby and the same is set for status conference on **Thursday, November 4, 2010 at 10:00 AM**, before the undersigned Judge

*Source:* MDL No. 2036 Document 852 Filed 10/22/10

# Federal Preemption



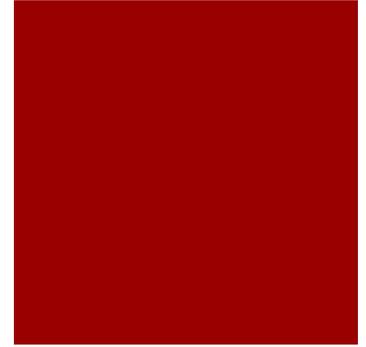
## Defendants' Argument:

- Activities of national banks in conducting the "business of banking" are subject to exclusive federal regulation.
- Defendants rely on OCC Regulations § 7.4002 and § 7.4007 and OCC Interpretative Letter 997.

## Plaintiffs' Argument:

- Plaintiffs are not challenging the banks' right to charge overdraft fees but rather are challenging the banks' practice of reordering transactions to maximize overdraft fees.

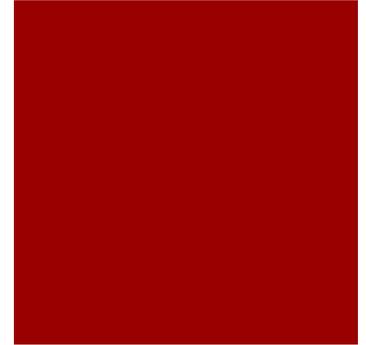
# MDL 2036 Preemption Ruling



- State laws of general applicability are not preempted.
- Plaintiffs are not challenging a bank's fundamental right to impose overdraft fees.
- As alleged, the Plaintiffs' contract and tort claims do not more than "incidentally affect the exercise of national banks' deposit taking powers."
- Section 7.4002 gives banks the right to charge overdraft fees, but it does not authorize banks to ignore general contract or tort law.
- Motion to Dismiss on federal preemption grounds DENIED.

# Breach of Contract

## Implied Covenant of Good Faith and Fair Dealing



### Defendants' Argument:

- There can be no breach of the implied covenant of good faith and fair dealing when the contract expressly permits the actions being challenged.
- The UCC generally endorses high-to-low check posting. The Court should apply this to debit card transactions as well.
- If the UCC provides that banks may order transactions from high-to-low, then banks cannot act in bad faith or violate the duty of good faith and fair dealing by ordering transactions in the authorized manner.

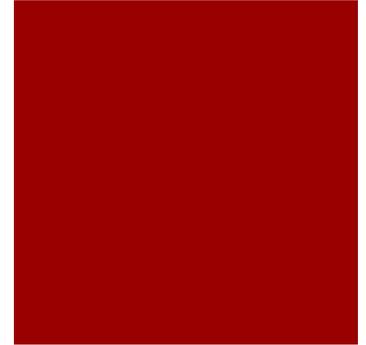
### Plaintiffs' Argument:

- Plaintiffs do not seek to vary the contract terms but instead seek to have the express contractual terms carried out in good faith.
- Where one party is given discretion to act under a contract, that discretion must be exercised in good faith.
- Instantaneous nature of debit card transactions carries much less risk to the merchant than the risk involved in accepting a check. Therefore, the UCC high-to-low check posting authority should not apply to debit card transactions.

# Court's Ruling

- Whether banks acted in good faith is a question of fact which should be deferred until discovery is taken and the facts before the Court further develop – Motion to Dismiss DENIED.
- Texas-law caveat – While in certain circumstances Texas law supports a claim for breach of contract based on the implied covenant, the facts before the Court do not satisfy the additional requirements – Motion to Dismiss claims based on Texas law GRANTED.

# Unjust Enrichment



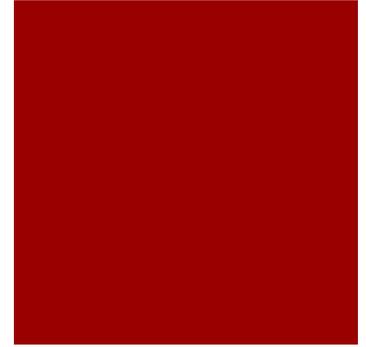
## Defendants' Argument:

- There can be no claim for unjust enrichment when an express contract exists.
- Plaintiffs fail to allege circumstances under which it would be unjust for Defendants to retain the benefit that they have allegedly received since the overdraft fees are specifically permitted by contract.

## Plaintiffs' Argument:

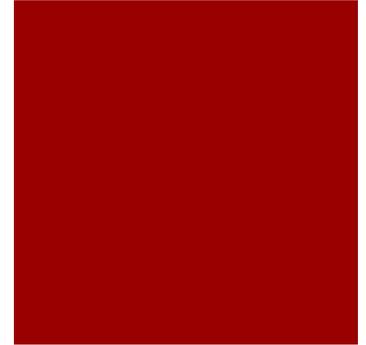
- Plaintiffs concede that they cannot recover damages under both breach of contract and unjust enrichment claims, but they argue that dismissal of the unjust enrichment claim is premature at this stage.

# Court's Ruling



- While the law does not permit a party to simultaneously prevail on an unjust enrichment theory and a contractual theory, it does not require the dismissal of an unjust enrichment claim at the motion to dismiss stage merely because an express contract exists – this argument is more properly raised in a summary judgment proceeding
- Plaintiffs have alleged sufficient facts which could lead a reasonable fact finder to conclude it would be unjust to retain the benefit of those fees.
- Motion to Dismiss DENIED.

# Conversion



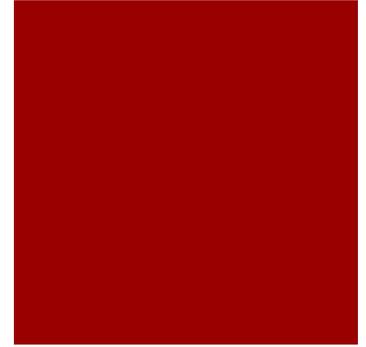
## Defendants' Argument:

- Conversion requires Plaintiffs to plead ownership of specific property and Plaintiffs do not own the funds in their accounts – they merely own a contractual right to demand those funds from the bank, and the bank's failure to comply gives rise to a contract claim, not a tort claim
- Plaintiffs fail to plead that any taking was wrongful because the overdraft fees were authorized by the deposit agreements.

## Plaintiffs' Argument:

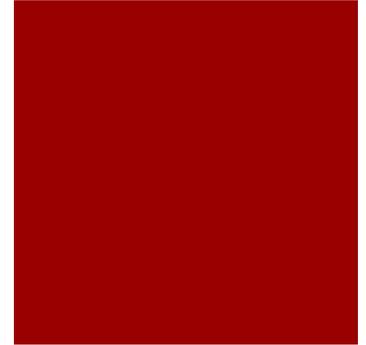
- Ownership element can be satisfied by pleading a right to possession rather than ownership.

# Court's Ruling



- Conversion requires interference with a property interest.
- Here, Plaintiffs unquestionably had the right to possess the funds in their bank accounts upon demand to the bank, and they have alleged that the banks wrongfully took funds from their accounts.
- If the terms of the deposit agreement are deemed to be unconscionable, the Defendants may be barred from relying on them.
- Plaintiffs have pled enough facts to show bad faith in intentionally causing Plaintiffs to incur overdrafts that they would otherwise not have incurred, which could lead a reasonable fact finder to conclude that the Defendants acted wrongfully.
- Motion to Dismiss DENIED.

# State Consumer Protection



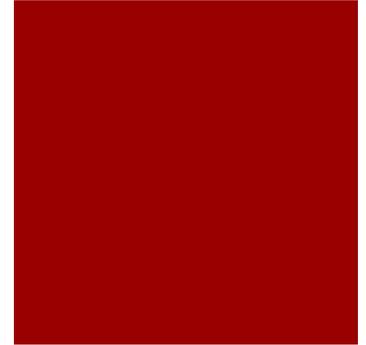
## Defendants' Argument:

- Plaintiffs don't have standing to bring claims under consumer protection laws of a state in which no Plaintiff resides and where none of the wrongs allegedly occurred.
- Plaintiffs' state statutory claims fail as a matter of law because:  
(a) Defendants' conduct is permitted under federal and/or state law; (b) Plaintiffs fail to allege "deceptive conduct"; (c) Plaintiffs fail to allege "unfair conduct"; (d) Plaintiffs fail to allege "unconscionable conduct"; (e) Plaintiffs failed to allege the Defendants violated one or more of the specifically enumerated predicate violations.

## Plaintiffs' Argument:

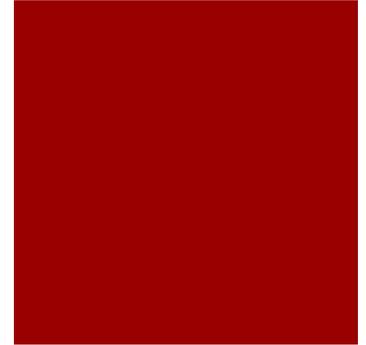
- General disagreement.

# Court's Ruling



- Plaintiffs concede that the express terms of the Montana Unfair Trade Practices and Consumer Protection Act bar the Plaintiffs from maintaining a class action and that the Ohio Consumer Sales Practices Acts and Wisconsin statute § 100.20 exempt banking transaction or transactions involving only money – Motion to Dismiss claims based on these statutes GRANTED.
- All state statutory claims where no named plaintiff resides in the state from which the claim is asserted are dismissed without prejudice – Motion to Dismiss GRANTED.
- Plaintiffs sufficiently allege "deceptive conduct," "unfair acts," and "unconscionable acts." – Motion to Dismiss DENIED.
- Plaintiffs cannot file suit under the California Legal Remedies Act or the Oregon Unlawful Trade Practices Act since these statutes only create a cause of action for transactions involving goods and services – Motion to Dismiss GRANTED.
- Plaintiffs failed to comply with Massachusetts pre-suit notice requirements, and therefore the Plaintiffs cannot rely upon the Massachusetts Regulation of Business Practices for Consumers Protection Act for relief – Motion to Dismiss GRANTED.

# Unconscionability



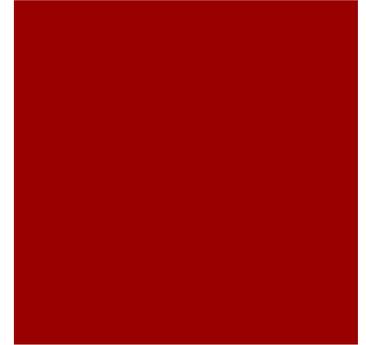
## Defendants' Argument:

- Unconscionability is not an affirmative cause of action but merely a defense to contract enforcement.
- High-to-low posting can't be substantively unconscionable because it is a standard industry practice and expressly endorsed by the UCC.

## Plaintiffs' Argument:

- Great disparity in bargaining power exists between the Plaintiffs and the Defendants.
- Deposit Agreements are contracts of adhesion.
- Plaintiffs were denied any meaningful opportunity to opt out of the overdraft protection program.
- No reasonable person would agree to allow banks to post debits in a manner designed solely to maximize overdraft fees.

# Court's Ruling



- Facts in this case weigh in favor of permitting Plaintiffs to pursue an unconscionability claim.
- Procedural Unconscionability – Plaintiffs have sufficiently pled procedural unconscionability (disparity in bargaining power is obvious; the terms at issue were contained in a voluminous boilerplate language drafted by bank; Plaintiffs had no meaningful opportunity to negotiate with bank; Plaintiffs alleged they were not notified they had the option to decline overdraft protection service)
- Substantive unconscionability –Section 4-303(b) only applies to checks, not electronic debits.
- The UCC commentary suggests that courts may apply the UCC provisions.
- "With paper checks, the customer gives a check to the merchant and leaves with the merchandise. The merchant then, at some unspecified time in the future, takes the check to his or her bank, which then presents the check to the customer's bank for payment. This guaranteed time lapse increases the risk to the bank, the merchant, and the customer that, in the intervening time period, there will not be sufficient funds in the account to cover the check. Thus banks are far more justified in adopting a specific check posting order, providing overdraft services, and charging the customer an overdraft fee to account for the risk of insufficient funds. With electronic debit cards, however, the banks can know, at least in many circumstances, instantly whether there are sufficient funds and can decline the transaction immediately, decreasing the risk to all parties and obviating the need to "hold" the debit transactions for a period of time and then post them in a specific order. Thus Defendants' reliance on UCC section 4-303(b) to defeat substantive unconscionability is misplaced."
- Motion to Dismiss DENIED.

# MDL 2036 Strategy

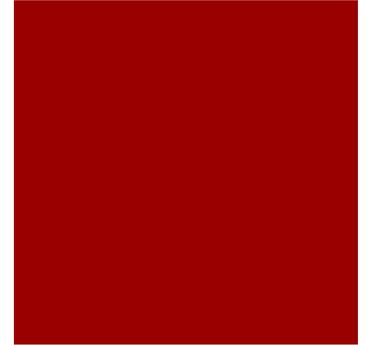
- MDL Transfer and Litigation
- Intra-district filings in Florida
- Arbitration and class waivers

*AT&T Mobility LLC v. Concepcion* (09-893)

Whether Federal Arbitration Act preempts state unconscionability law as it relates to class waivers

- Preemption

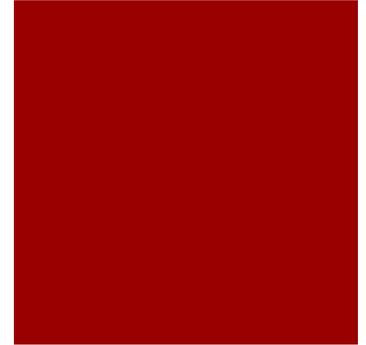
# What happened in Gutierrez v. Wells Fargo?



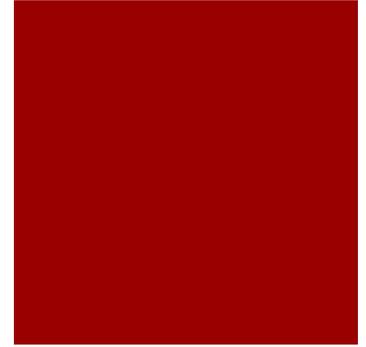
- **Gutierrez did not directly challenge the general policy of overdraft fees.** This is no surprise because regulators encourage the use of overdraft fees to deter habitual overdraft usage and to promote the safety and soundness of the banking system.
- **The Gutierrez court criticized three specific overdraft practices** that Wells Fargo used in its overdraft program. The court concluded that together these three practices **"formed a 'one-two-three' punch** to maximize the overdraft-multiplying effect of a 'high-to-low' posting order – all at the expense of customers."
- The Gutierrez court concluded that **these practices were both "unfair" and "fraudulent"** in violation of California's consumer protection statute.
- Significantly, the court found that "Wells Fargo **affirmatively reinforced the expectation that transactions were covered in the sequence made while obfuscating its contrary practice of posting transactions in 'high-to-low' order** to maximize the number of overdrafts assessed on customers."
- The court granted relief to a class of California customers: **(a) injunctive relief barring Wells Fargo from continued "high-to-low" posting effective November 30, 2010, and (b) pay restitution estimated at \$203 million.**

# The three punches:

- High-to-low posting
- Transaction commingling
- Shadow-line credit underwriting

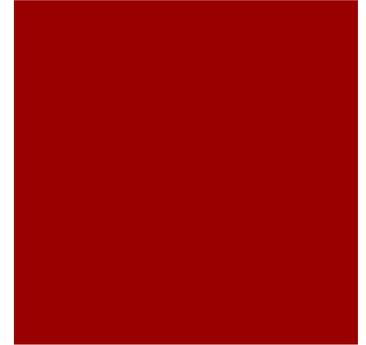


# “High-to-low” posting



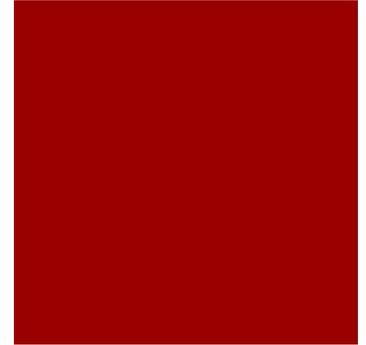
- ✓ This means that when a bank receives multiple items for payment on a customer's account, the bank will pay the largest-sum items first and the smallest-sum items last.
- ✓ Historically, many banks and regulators supported this practice to ensure that the most important items (and typically most expensive), such as a mortgage or rent payment, would be paid.
- ✓ In practice, "high-to-low" posting may lead to more overdraft fees than would otherwise be assessed if the bank had followed a "low-to-high" or chronological posting order.

# Commingling



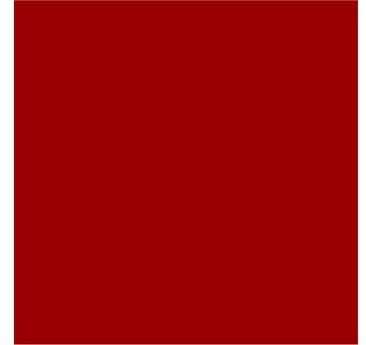
- ✓ Commingling debits entails a bank's aggregation of various debit transactions into a single batch versus posting in a pre-specified order (i.e., payment of all checks, then payment of all debit-card transactions, etc.).
- ✓ Wells Fargo commingled all checks, ACH debits, cash withdrawals and debit-card transactions when determining the order of posting payment. Under this policy, the largest items will always be paid first – no matter what type of transaction.

# The shadow line or credit matrix



- ✓ A "shadow line" refers to a credit available to cover insufficient funds availability on a checking account.
- ✓ To satisfy regulatory requirements, banks are required to establish account eligibility standards to determine which accounts qualify for overdraft protection.
- ✓ By use of a shadow line, Wells Fargo authorized various debit transactions to customer accounts despite the account having insufficient funds to pay for the item.

# What is the status of Gutierrez v. Wells Fargo?



- Notice of Appeal filed on September 8, 2010
- Deadline to stop high-to-low posting by November 30, 2010

# What's next? New Facts

- As the Gutierrez appeal and the Overdraft MDL proceed, emerging empirical data may discredit contentions that "high-to-low" posting is improper.
- A recent study of overdraft opt-in rates since implementation of amended Regulation E found that even with the alleged high cost of overdrafts, consumers still want overdraft coverage:

About 90 percent of overdraft revenue comes from frequent users. The Moebs study noted frequent users, those with 10 or more overdrafts in a year, almost all opted in. For all consumers, consent varied between 60 percent and 80 percent with a median of about 75 percent. The median overdraft price increased to \$28 per check in 2010 from \$26 in 2009. NSF's, where the institution returns the check, increased from \$25 per check returned in 2009 to \$27 in 2010. "Even with the price of overdraft protection going up, it appears from the opt-in numbers that the American consumer is saying they want and need overdrafts."

<http://www.moebs.com/Pressreleases/tabid/58/ctl/Details/mid/380/ItemID/193/Default.aspx>.

# What's next? New Facts

- The Moebs study also lends support to a 2008 report issued by the Government Accounting Office, which found relatively few consumer complaints about overdraft fees:

“[o]ur analysis of complaint data from each of the federal regulators showed that while they receive a large number of checking account complaints, a small percentage of these complaints concerned the fees and disclosures associated with either checking or savings accounts.”

<http://www.gao.gov/new.items/d08281.pdf> at p. 25.

**CREDIT CARD ACCOUNTABILITY,  
RESPONSIBILITY, AND DISCLOSURE ACT  
OF 2009: IMPORTANT NEW LAWS AND  
RULES GOVERNING FINANCIAL  
INSTITUTIONS AND CREDIT CARD  
ISSUERS**

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# CARD ACT

- \* **Credit Card Accountability And Disclosure Act Of 2009 (“Credit CARD Act” Or “CARD Act”)**
- \* **Signed Into Law May 22, 2009 After Passage By Strong Congressional Majorities**
- \* **Primarily Amends Truth-In-Lending Act (Regulation Z)**
- \* **Three-Stage Implementation: (1) August 20, 2009 (90 days from enactment); (2) February 22, 2010 (9 months from enactment); (3) August 22, 2010 (15 months from enactment)**

# CARD ACT

## KEY PROVISIONS EFFECTIVE 2/22/10

- A. Increases In Annual Percentage Rates**
- B. Marketing To Students**
- C. Transactions That Exceed Credit Limit**
- D. Payment Allocation**
- E. On-Line Posting Of Credit Card Agreements**
- F. Limitations On Fees**
- G. Double Cycle Billing**
- H. Fees Related To Method Of Payment**
- I. Minimum Payments**

# CARD ACT: 2/22/10

## A. Increases In Annual Percentage Rates

### 1. Existing Balances (TILA § 171(a); § 148)

- \* Prevents arbitrary interest rate increases on existing balances (there are exceptions for increases based on public indexes, etc.)
- \* Requires issuer which increased a cardholder's rates because of poor performance to periodically review the file and reduce rates when appropriate

### 2. New Transactions

- \* Prohibits increasing rates during the first year
- \* Requires promotional rates to last at least six months
- \* Required to wait at least 60 days before raising rates on delinquent customers

# CARD ACT: 2/22/10

## A. Increases In Annual Percentage Rates

3. Exceptions (Reg Z § 226.55(b))
  - a. Temporary rate exception -- can increase after 6 months if certain conditions are satisfied
  - b. Variable rate exception -- can adjust rate if according to an index not under card issuer's control and available to the general public
  - c. Advance notice exception -- if disclosed pursuant to proper notice requirements, but not applied to transactions occurring prior to notice and not during the first year in any event
  - d. Delinquency exception -- if minimum periodic payment is not received within 60 days, and if other regulatory processes are satisfied
  - e. Workout/temporary hardship exception -- consumer's completion of workout or temporary hardship arrangement or failure to comply with terms of such an arrangement
  - f. Servicemembers Civil Relief Act exception

# CARD ACT: 2/22/10

## B. Marketing To Students (New TILA §§ 127(r), 140(f); Reg Z § 226.57)

### 1. Prohibitions

- \* Card issuers/creditors cannot offer student at an institution of higher learning any “tangible item” to induce the student to apply for or participate in an open-end consumer credit plan if offer is made on or “near” campus (i.e. within 1,000 feet of the border of the campus as defined by that institution).
- \* Rule includes: (1) college affinity cards; (2) part-time students; (3) events sponsored by the institution of higher learning.
- \* “Tangible items” per Comment 57(c)-1: gift card, T-shirt, magazine subscription; does not include “non-physical inducements” such as discounts, reward points, promotional credit items

# CARD ACT: 2/22/10

## B. Marketing To Students

### 2. Disclosure And Reporting Requirements

- \* Institution of higher learning must publicly disclose any contract made with card issuer or creditor for purpose of marketing a credit card; institutions are barred from redacting any such contracts required to be publicly disclosed
- \* Card issuers that are parties to college credit card agreements must submit annual reports to the Board containing: (1) identifying information about card issuer; (2) copy of any college credit card agreement of issuer; (3) copy of any MOU in effect during reporting period; (4) total dollar amount of payments under agreement from issuer to the institution; (5) total number of credit card accounts opened under college credit card agreement during reporting period; (6) total accounts open at end of reporting period
- \* First report due 2/22/10; by 3/31 for all subsequent years

# CARD ACT: 2/22/10

## C. Transactions That Exceed Credit Limit (New TILA § 127k; Reg Z § 226.56)

### 1. Consumer Consent

- \* Card issuer shall not assess fee to customer's account for paying an over-the-limit transaction unless customer is given notice and reasonable opportunity to consent, or opt in, to the creditor's payment of over-the-limit transaction and customer actually has opted in.
- \* Applies to all credit card accounts, including those opened prior to 2/22/10; applies to transactions even where issuer is unable to avoid paying a transaction that exceeds a customer's credit limit
- \* General requirements: (1) oral, written, or electronic notice, "segregated from all other information," describing customer's right to opt out; (2) "reasonable opportunity" to opt in (i.e., on application, by mail, by telephone -- see Comment 56(b)-3); (3) affirmative consent/opt in obtained; (4) written or electronic confirmation of consent to customer; (5) written notice of right to revoke consent following assessment of over-the-limit charge.

# CARD ACT: 2/22/10

## C. Transactions That Exceed Credit Limit (New TILA § 127k; Reg Z § 226.56)

### 1. Consumer Consent (cont.)

- \* Initial notice must contain: (1) dollar amount of fees assessed by issuer for over-the-limit transaction; (2) any increased APRs that may be imposed as a result of over-the-limit transaction; (3) explanation of right to affirmatively consent to payment of over-the-limit transaction. Use of Model Forms G-25(A) or G-25(B) will constitute compliance with notice content requirements.
- \* This is a separate consent from any other consent obtained by card issuer, i.e., customer's signature on credit card application would not by itself constitute consent
- \* Joint accounts: consent by one is consent for all; revocation of consent by one is revocation for all
- \* Customer's affirmative consent is effective until revoked by customer, or until card issuer decides for any reason to cease paying over-the-limit transactions

# CARD ACT: 2/22/10

## C. Transactions That Exceed Credit Limit (New TILA § 127k; Reg Z § 226.56)

2. Prohibitions (effective notwithstanding customer consent to over-the-limit payment; deemed an “unfair practice” per § 226.56(j))
  - \* *Fees imposed per cycle:* Issuer may not impose more than one over-the-limit fee on account per billing cycle, and may not impose over-the-limit fee on the account for more than three billing cycles for the same over-the-limit transaction where customer has not reduced the account balance below the credit limit by the payment due date for either of the last two billing cycles (exception: if another over-the-limit transaction occurs during either of the last two billing cycles); Comment 56(j)-2 contains explanatory examples

# CARD ACT: 2/22/10

## C. Transactions That Exceed Credit Limit (New TILA § 127k; Reg Z § 226.56)

2. Prohibitions (effective notwithstanding customer consent to over-the-limit payment; deemed an “unfair practice” per § 226.56(j))
  - \* *Replenishment*: Issuer’s imposition of fees for over-the-limit transaction caused solely by issuer’s failure promptly to replenish customer’s available credit after issuer has credited customer’s payment is unfair practice; issuers not prevented from delaying replenishment “where appropriate,” for example, where issuer may suspect fraud on the account
  - \* *Conditioning*: Issuer may not condition or otherwise link the amount of credit granted to customer on the customer opting into the issuer’s payment of over-the-limit transactions; include conditioning denial/acceptance of credit card application solely because customer did not opt in to over-the-limit service
  - \* *Over-the-limit fees attributed to fees or interest*: Imposition of over-the-limit fees or charges if a consumer’s credit is exceeded solely because of the issuer’s assessment of accrued interest charges on customer’s credit card is an unfair practice; issuers may, however, assess over-the-limit fees due to accrued finance charges from prior cycles that have subsequently been added to the account balance (see Comment 56(j)-5)

# CARD ACT: 2/22/10

## D. Payment Allocation (TILA § 164(b); Reg Z § 226.53)

- \* § 226.53(a): When consumer makes payment in excess of required minimum periodic payment, card issuer must allocate the excess amount first to the balance with highest APR and any remaining portion to the other balances in descending order based on applicable APR; see Comment 53-5 for examples of allocating excess payments in compliance with Rule
- \* § 226.53(b): Card issuers may allocate payments in excess of the minimum consistent with customer's request when the account has a balance subject to a deferred interest or "similar program"; but during last two billing cycles immediately preceding expiration of the specified period, excess amount must be allocated first to the balance subject to the deferred interest or similar program, with any remaining balances allocated as required by § 226.53(a)

# CARD ACT: 2/22/10

## **D. Payment Allocation (TILA § 164(b); Reg Z § 226.53)**

- \* Consumer requests may be oral, electronic, or in writing and must specifically request that a payment that the issuer has previously allocated consistent with § 226.53(b)(1) instead be allocated in a different manner
- \* Card issuer is not required to allocate amounts paid by customer in excess of the required minimum periodic payment in the manner requested by the customer, provided that the issuer instead allocates such amounts consistent with § 226.53(b)(1)

# CARD ACT: 2/22/10

## E. On-Line Posting Of Credit Card Agreements (New TILA § 122(d); Reg Z § 226.58)

### 1. Rule

- \* Card issuers must post on their websites the credit card agreements they offer to the public and include “pricing information” as defined in § 226.58(b)(6) -- includes APRs and fees, even if not otherwise included in the basic credit contract; must submit agreements to the Board on quarterly basis for posting on Board’s public website; need not post or submit agreements that are no longer offered to the public, but must post, or make available at customer’s request, all of their agreements for open credit card accounts, even if not currently offered to the public, so any customer can assess a copy of his/her agreement
- \* If agreement has been amended (i.e., a “substantive change” that “alters the rights or obligations of the card issuer or customer” under the agreement, see examples in Comment 58(b)-2(1) and “non-substantive changes” in Comment 58(b)-2(2), entire amended agreement must be submitted by first quarterly submission deadline after last day of the calendar quarter in which the change(s) became effective

# CARD ACT: 2/22/10

## E. On-Line Posting Of Credit Card Agreements (New TILA § 122(d); Reg Z § 226.58)

### 2. Exceptions

- a. de minimus: issuers with fewer than 10,000 accounts as of last day of calendar quarter
- b. “private label”: credit card used “to make purchases only at a single merchant or an affiliated group of merchants,” which has fewer than 10,000 accounts (see Comment 58(c)(6)-3 in distinguishing de minimus and private label exceptions); does not include “co-branded credit cards,” i.e., card that displays the mark/logo of the merchant or affiliated group of merchants as well as mark/logo of payment network
- c. product testing: agreement offered as part of a product test offered to limited group of consumers for limited period of time, used for fewer than 10,000 open accounts, and is not offered to the public other than in connection with the product test

# CARD ACT: 2/22/10

## **E. On-Line Posting Of Credit Card Agreements (New TILA § 122(d); Reg Z § 226.58)**

3. Content Of Agreements Submitted To Board (Reg Z § 226.58(c)(8))
  - \* must contain the provisions of the agreement with pricing information in effect as of last business day of preceding calendar quarter
  - \* must not include any personally identifiable information (i.e., name, address, telephone number, account number)

# CARD ACT: 2/22/10

## **E. On-Line Posting Of Credit Card Agreements (New TILA § 122(d); Reg Z § 226.58)**

### **4. Posting Of Open Accounts**

- \* issuer must (i) post and maintain cardholder's agreement on its website or (ii) "promptly" provide copy of cardholder's agreement upon request, by providing cardholder with ability to request copy of agreement both by using issuer's website or calling "readily available telephone line the number for which is displayed on the issuer's website and clearly identified as to purpose" -- no later than 30 days after receipt of the request
- \* open accounts must conform to form/content requirements of agreements submitted to Board; may contain personally identifiable information, provided appropriate measures are taken to make the agreement accessible only to cardholder or other authorized person
- \* must set forth specific provisions and pricing information applicable to the cardholder accurate as of date no more than 60 days prior to (i) date on which agreement is posted on issuer's website or (ii) date cardholder's request is received

# CARD ACT: 2/22/10

## F. Limitations On Fees (New TILA § 127(n)(1); Reg Z § 226.52)

- \* *Rule:* If card issuer charges fees to account during first year after account is opened, total amount of fees customer is required to pay with respect to account during that first year must not exceed 25% of the credit limit in effect when account was opened
- \* *Exceptions:* Late-payment fees; over-the-limit fees; returned-payment fees; fee customer is not required to pay with respect to the account (i.e., fees for making expedited payment to the extent otherwise permitted, fees for optional services such as travel insurance, fees for reissuing lost or stolen card, statement reproduction fees)

# CARD ACT: 2/22/10

## G. Double-Cycle Billing (New TILA § 127(j)(1)(A); Reg Z § 226.54)

- \* *Rule:* Section 226.54 prohibits the imposition of finance charges as a result of the loss of a grace period in certain specified circumstances; it does not require the issuer to offer a grace period, or prohibit the issuer from placing limitations and conditions on a grace period; but § 226.54 prohibits “double-cycle billing,” i.e., card issuer assesses interest not only on balance for the current billing cycle but also on balances on days in the preceding billing cycle; in other words, the finance charge is calculated using a balance that is the sum of the average daily balances for two billing cycles -- the first balance is for the current billing cycle, calculated by adding the total balance for each day in the billing cycle, then dividing by the number of days in the billing cycle, while the second balance is for the preceding billing cycle (generally affects customers who pay their balance in full one month, thus qualifying for a grace period, but not the next month, thus losing the grace period)
- \* *Exceptions:* Adjustment to finance charge resulting from the “resolution of a dispute” (i.e., pursuant to TILA’s dispute resolution procedures) or resulting from the return of a payment for insufficient funds

# CARD ACT: 2/22/10

## H. Fees Related To Method Of Payment (New TILA § 127(I); Reg Z § 226.10(e))

- \* *Rule:* Creditors cannot impose “separate fee” (defined as “a fee imposed on a consumer for making a payment to the consumer’s account”) to allow consumers to make a payment by any method, such as mail, electronic, or telephone
- \* *Exception:* Separate fee permissible if it involves “expedited service,” defined as “crediting a payment the same day or, if the payment is received after any cut-off time established by the creditor, the next business day,” by a “customer service representative of the creditor,” which means “any payment made to the consumer’s account with the assistance of a live representative or agent of the creditor,” and includes “any payment transaction which involves the assistance of a live representative or agent of the creditor, even if an automated system is required for a portion of the transaction”

# CARD ACT: 2/22/10

## I. Minimum Payments (TILA § 127(b)(11)(B); Reg Z § 226.7(b)(12))

- \* Disclosure required: “**Minimum Payment Warning:** If you make only the minimum payment each period, you will pay interest and it will take you longer to pay off your balance.”
- \* Other repayment disclosures:
  - Minimum payment repayment estimate (Appx. M1)
  - Minimum payment total cost estimate (Appx. M1)
  - Statement that minimum payment repayment and minimum payment total cost estimates are based on current outstanding balance shown on periodic statement

# CARD ACT: 8/22/10

## RULES AND PROVISIONS EFFECTIVE 8/22/10

- \* Fed Proposed Rules/Public Comments Sought In March 2010
- \* More Than 22,000 Comments Received
- \* Final Rule Published June 14, 2010, Effective August 22, 2010
- \* Primary Rules:
  - (1) Reevaluation of rate increases
  - (2) Reasonable and proportional penalty fees

# CARD ACT: 8/22/10

## A. Reevaluation Of Rate Increases (New TILA § 148, Reg Z 226.59)

- \* For card issuers that increase the APR applicable to a credit card account, based on the credit risk of the consumer, market conditions, or other factors, for any rate increase imposed on or after 1/1/09, card issuers must review the account no less frequently than once each six months and, if appropriate based on that review, reduce the APR; if, based on its review, the card issuer is required to reduce the rate applicable to an account, the rate must be reduced within 45 days after completion of the evaluation
- \* Card issuer must continue to review a consumer's account each six months unless the rate is reduced to the rate in effect prior to the increase; thus, in some circumstances, issuers must reevaluate rate increases each six months for an indefinite period (In other words, there is no specific time limit on the obligation to reevaluate rate increases)

# CARD ACT: 8/22/10

## **B. Reasonable And Proportional Penalty Fees (New TILA § 149, Reg Z 226.52(b))**

- \* Credit card issuer may charge penalty fee for a particular type of violation (i.e., a late payment) if it has determined that the amount of the fee represents a reasonable proportion of the costs incurred by the issuer as a result of that type of violation; accordingly, issuers may use penalty fees to pass on the costs incurred as a result of violations but must ensure that those costs are spread evenly among consumers so that no individual consumer bears an unreasonable or disproportionate share
- \* Final rule permits, as an alternative to the cost analysis, issuers to impose a \$25 penalty fee for the first violation and a \$35 fee for any additional violation of the same type during the next six billing cycles
- \* For “seriously delinquent” accounts, i.e., the issuer has not received the required payment for two or more consecutive billing cycles, the issuer may impose a late penalty that does not exceed 3% of the delinquent balance

# RISKS AND REMEDIES

## \* **Class Action**

- Emphasis on procedures/systems and defendant's compliance with regs/statute by plaintiffs
- Learn from FACTA experience

## \* **Causes Of Action/Remedies**

- TILA: cap on punitive damages
- State consumer protection statutes
- Common law claims (contract-based; tort-based)



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Mr. Goheen has served as lead or co-counsel in over 40 class actions in all areas of the law, including antitrust, securities fraud, consumer protection, financial services and products, product liability, privacy, and general commercial disputes in state and federal courts representing such clients as The Coca-Cola Company, Wal-Mart, SunTrust Banks, Bank of America, Countrywide, Fifth Third, Brown & Williamson Tobacco Corporation, Jefferson-Pilot Life Insurance Company, Equifax, and Lockheed Martin Corporation.

His class action matters include:

- Participation in several phases of a multi-phase trial of a product liability class action in Miami, Florida.
- Co-counsel in the defense of nationwide class action brought against insurance company alleging unfair insurance practices.
- Lead counsel in the defense of a proposed nationwide RICO class action brought against automobile manufacturer alleging misrepresentation of horsepower in the vehicles.
- Co-counsel in the defense of nationwide antitrust class action brought by purchasers of souvenirs at NASCAR events.
- Lead or co-counsel in defense of over 30 proposed class actions brought by consumers of cigarette products, obtaining dismissal or denial of class certification in all but two cases.
- Lead counsel in numerous class actions arising out of financial services and products, including for SunTrust, Bank of America, Countrywide, Fifth Third, Advance America, and Harland Financial Solutions.