OVERDRAFT FEE CLASS ACTIONS
AND CLASS-WAIVER ARBITRATION CLAUSES

Marc Gottridge
Hogan Lovells US LLP, New York1
NYBA Financial Services Forum, June 12, 2013

Overdraft Fee Class Actions Challenging
“High to Low” Posting of ATM and Debit Card Transactions

Overview

In recent years, plaintiffs’ class action lawyers have filed well over one hundred lawsuits in federal and state courts, alleging that banks improperly charged multiple overdraft fees for ATM and debit card transactions by posting those transactions in “high to low” order rather than chronologically. Plaintiffs allege that this practice was adopted in a bad-faith effort to increase the number of overdraft fees customers must pay.

The early cases mainly targeted larger banks. As detailed below: plaintiffs won a $203 million judgment in California in 2010, which was overturned on appeal but recently reinstated by the lower court; more than 100 cases from around the country were consolidated for pre-trial purposes in a Florida federal court; and settlements totaling over $1 billion have been announced.

In a handful of cases, banks have won motions to dismiss plaintiffs’ claims, but most such motions have been denied, and several cases have been certified as class actions. Plaintiffs’ lawyers are now filing and investigating new cases, against a wider range of banks, including community banks.

Plaintiffs’ Theories of Liability

Although “high to low” posting of checks is expressly permitted by most states’ enactments of the Uniform Commercial Code,2 the UCC does not address the propriety of this practice in connection with consumers’ ATM withdrawals and debit card purchases. Nor does any federal law or regulation directly govern the method of posting such transactions. Plaintiffs’ lawyers have stepped into this void, suing banks under various state law theories. In the overdraft cases filed since 2010, plaintiffs generally allege that “high to low” posting of ATM and debit card transactions is wrongful under the following state common law or statutory theories:

---

1 Marc is a litigation partner in the firm’s New York office and is co-head of Hogan Lovells’ global financial services litigation practice. He is NBT Bank, N.A.’s lead counsel in Costello v. NBT Bank, N.A., discussed in this paper.

2 See, e.g., N.Y. U.C.C. § 4-303(2).
• **Breach of the implied covenant of good faith and fair dealing.** In most states, including New York, a covenant of good faith and fair dealing that the parties will act in good faith in performing their obligations is implied by law in every contract. Plaintiffs have argued that banks employing “high to low” re-ordering have violated this implied covenant by performing their obligations in bad faith.

• **Unconscionability.** Unconscionability is a judge-made doctrine under which courts will not enforce certain types of agreements that are deemed too one-sided or unfair to consumers. Plaintiffs argue that “high to low” re-ordering is unconscionable, so that enforcement of agreements providing for overdraft fees to be charged on the basis of such posting of transactions should be barred.

• **Conversion.** A party commits the tort of conversion when it, intentionally and without authority, assumes or exercises control over personal property belonging to the other party, interfering with his or her right of possession.

• **Unjust enrichment.** To prevail on a claim of unjust enrichment, the plaintiff must show that the defendant was enriched, at the plaintiff’s expense, and that it is against equity and good conscience to permit the other party to retain what is sought to be recovered.

• **State consumer legislation.** State consumer protection statutes vary considerably, but all states have some version of consumer protection legislation.³

### Milestones in Overdraft Class Action Litigation

**The $203 Million Gutierrez Decision – Overturned on Appeal but then Reinstated.** Following a non-jury trial, Judge William Alsup of the Northern District of California in 2010 held that Wells Fargo’s overdraft practices violated a provision of California’s unfair competition statute.⁴ In a strongly worded opinion, Judge Alsup concluded that Wells Fargo engaged in “profiteering,” and held that the bank’s overdraft practices were “unfair or deceptive” and “misleading.” The district court issued an injunction against Wells Fargo and ordered the bank to pay $203 million in restitution to the plaintiff class.

On appeal, the United States Court of Appeals for the Ninth Circuit held that the National Bank Act (the “NBA”) preempted most of the claims, including challenges to Wells Fargo’s decisions in relation to: (1) the order in which it posted debits; and (2) any obligation to make specific, affirmative disclosure to customers.⁵ However, the Ninth Circuit also held that the NBA did not

---


⁵ Gutierrez v. Wells Fargo Bank, N.A., 704 F.3d 712 (9th Cir. 2012).
preempt state law on the subject of misrepresentations by banks relating to overdrafts, including misleading statements barred under California’s unfair competition law. The Ninth Circuit remanded the case to the district court for further proceedings.

On May 14, 2013, Judge Alsup issued an order reinstating the $203 million restitution order and injunction, on the basis of the narrower claims which the Ninth Circuit held were not preempted. Specifically, Judge Alsup concluded that the bank’s marketing materials were false and misleading as to the bank’s overdraft practices and violated the anti-fraud provisions of California’s unfair competition law. Wells Fargo has indicated that it intends to appeal.

The MDL. On June 10, 2009, the Judicial Panel on Multidistrict Litigation ("JPML") commenced transferring overdraft cases to the Southern District of Florida for pretrial purposes; tag-along cases were transferred to that Multidistrict Litigation ("MDL") until October 2011. One hundred cases from federal judicial districts around the U.S. were transferred to the docket of Judge James Lawrence King in Miami. Judge King decided on an "omnibus" basis many banks’ separate motions to dismiss, although those motions were based on different customer agreements and disclosures and varying laws. The unique features of the separate cases were not fully developed and with the exception of certain states' consumer protection laws, the judge considered it unnecessary to analyze applicable state law "on a plaintiff-by-plaintiff or state-by-state basis." 6 The court denied several banks’ “omnibus” motions to dismiss in 2010 and, largely on the basis of that ruling, later denied other banks’ motions to dismiss. In addition, Judge King:

- Granted class certification in several cases; 7
- Denied banks’ motions to strike the testimony of plaintiffs’ damages expert, holding that plaintiffs had “put forth sufficient evidence to demonstrate [the expert’s] ability to calculate damages on an account-by-account basis using the bank’s own computerized records;” 8
- Denied several banks’ motions to compel arbitration under provisions of the relevant customer agreements – although these rulings have been reversed on appeal (see page 10 below).

---

The JPML has ceased referring new overdraft cases to the MDL, because its proceedings are "mature." New cases, many targeting community banks and credit unions, are proceeding instead in various state or federal courts around the United States.

**Settlements in Overdraft Class Action Litigation**

Settlements – mainly within the MDL – thus far total over $1 billion. Notable settlements include a $410 million settlement by Bank of America approved by Judge King in November 2011.

In addition to payments to the class, some settlement agreements have provided for changes in the banks’ overdraft policies going forward. For example, some banks have agreed to post debit card transactions in chronological order (based on date and time stamp information) and to post such transactions before posting check or automatic clearing house (“ACH”) transactions over certain periods of time. In at least one settlement, a bank that had switched its overdraft posting to “low to high” before entering into the settlement agreed as part of the settlement either to continue that policy or to post chronologically for two years. Certain settlements have included provisions that the bank will, for a period of time, refrain from imposing fees until an account is overdrawn by a threshold amount and/or from charging more than a certain number of overdraft fees per day to any one account.

**The Banks’ Arguments in Court**

In response to plaintiffs’ claims, bank defendants have asserted, often in the context of motions to dismiss, the following arguments:

*As to claims for breach of the implied covenant of good faith and fair dealing:* Particularly in cases where the agreements in question expressly disclosed that the banks would or generally did post from high to low, banks have argued, sometimes successfully, that plaintiffs’ claims for breach of the implied covenant of good faith and fair dealing are barred by the language of the agreement.10

---


10 See Costello v. NBT Bank, N.A., Index No. 2011/1037, slip op. at 2 (Sup. Ct. Delaware County May 15, 2012) (the implied covenant of good faith “cannot be construed so broadly as to effectively nullify the other express terms of the agreement”); see also Hassler v. Sovereign Bank, 374 Fed. Appx. 341, 345 (3d Cir. 2010) (a plaintiff “cannot ignore” language in an account agreement by which the bank discloses that it pays items in “high to low” order, and cannot be heard to “argue that [s]he could not have expected” her bank to charge her in the precise order disclosed by the contract) (New Jersey law).
As to claims of unconscionability – Under the laws of many states, unconscionability is only a defense and may not be used as a basis for affirmative relief. 11

As to claims of conversion and unjust enrichment – In cases governed by a written contract, such as the account agreements at the heart of most overdraft actions, conversion and unjust enrichment claims should be dismissed as duplicative. Defendants argue, sometimes successfully, that “quasi-contractual” theories of liability such as conversion and unjust enrichment have no place where the bank/customer relationship is governed by a written contract. 12

As to claims under state consumer legislation – Defendants have in some cases have argued that conduct expressly permitted under an express agreement by definition cannot violate consumer protection laws. 13

The defense of federal preemption -- Banks and savings associations chartered under federal law also have asserted the defense of federal preemption of state law – i.e., that the processing of

11 This is clearly the case in New York. See, e.g., Super Glue Corp. v. Avis Rent a Car Sys., 132 A.D.2d 604, 606 (2d Dep’t 1987) (“The doctrine of unconscionability is to be used as a shield, not a sword, and may not be used as a basis for affirmative recovery. Under both the UCC and common law, a court is empowered to do no more than refuse enforcement of the unconscionable contract or clause.”); Bevilacque v. Ford Motor Co., 125 A.D.2d 516, 519, 509 N.Y.S.2d 595, 599 (2d Dep’t 1986) (“concept of unconscionability . . . does not create a new cause of action to recover damages or to enforce a contract but, rather, provides a defense for a party opposing enforcement of a contract or a cause of action for rescission of a contract”). The court in Costello (supra n. 10) dismissed plaintiffs’ unconscionability claim on this basis. Id., slip op. at 3.


13 See, e.g., Mancuso v. Rubin, 52 A.D.3d 580, 583, 861 N.Y.S.2d 79, 82 (2d Dep’t 2008) (“since the provision limiting the engineering company's liability was fully disclosed in its contract with the plaintiff, and neither that provision nor the termite inspection certification was misleading in a material way, the plaintiff failed to state a cause of action for violation of General Business Law § 349”; affirming dismissal of claim); Ludl Electrs. Prods. v. Wells Fargo Fin. Leasing, Inc., 6 A.D.3d 397, 398, 775 N.Y.S.2d 59, 61 (2d Dep’t 2004) (affirming dismissal of § 349 claim and holding that “because the conduct complained of is specifically provided for by the parties’ lease and thus was fully disclosed, such conduct is not a deceptive business practice within the meaning of General Business Law § 349(a”).
charges and debits and assessment of overdraft fees are activities governed by federal statutes and regulations that preempt state law. The question most often raised by a preemption defense is whether the state law invoked by plaintiffs prevents or significantly interferes with the institution’s exercise of powers granted pursuant to federal law. Although the Dodd-Frank Act now applies a single preemption standard commencing with the effective date of the transfer of the Office of Thrift Supervision’s powers to the Office of the Comptroller of the Currency (July 21, 2011), for claims arising before the transfer date preemption under HOLA and the OTS regulations was broader than under the NBA and OCC regulations.

In the NBA context, the courts are split as to whether overdraft claims are preempted, and even the Ninth Circuit’s preemption decision in Gutierrez has so far proved to be Pyrrhic victory for the banks. In Gutierrez, the Ninth Circuit held that to the extent plaintiffs claimed Wells Fargo’s high to low posting was an “unfair practice” in violation of California law, those claims were preempted because “[d]esignation of a posting method falls within the type of overarching federal banking regulatory power.” The court also concluded that state laws governing unfair and fraudulent business practices could not be used to force banks to make specified overdraft disclosures to consumers, finding that “[t]he requirement to make particular disclosures falls squarely within the purview of federal banking regulation and is expressly preempted.” However, the Ninth Circuit also held that to the extent the plaintiffs’ claims challenged Wells Fargo’s representations about its posting practices in marketing materials (as opposed to the posting practices themselves) as “fraudulent,” those claims were not preempted because the California statute on which plaintiffs relied – “a non-discriminating statute of general applicability” that did not conflict with the NBA or impair the ability of national banks to discharge their duties – imposed no disclosure requirements but instead merely “prohibit[ed] statements that are likely to mislead the public.” As noted above, following remand of Gutierrez to the district court, Judge Alsup found that Wells Fargo violated the provisions of the

15 12 U.S.C. § 1465 (amending the Home Owners’ Loan Act (“HOLA”) in this regard). Dodd-Frank also narrowed the scope of preemption of “state consumer finance laws” so that it is consistent with, but not broader than, the Supreme Court’s decision in Barnett Bank (see n.14 supra), unless the state law discriminates against federal (as compared with state) banks or is preempted by another federal law. Dodd-Frank Act § 1044, 12 U.S.C. § 5136C. There is some uncertainty about the application of Dodd-Frank’s preemption provisions, because the statute also preserves “contracts” entered into before the date of its enactment (July 21, 2010). Dodd-Frank Act § 1043, 12 U.S.C. § 5553. For example, it is not clear what preemption rules would apply to claims arising out of overdrafts occurring after Dodd-Frank’s effective date but governed by a contract in existence before that date.
16 Gutierrez, 704 F.3d at 723.
17 Id. at 726.
18 Id.
California statute that the Ninth Circuit held were not preempted by the NBA, and reinstated the same injunctive and restitutionary remedies contained in his original judgment.

By contrast to the Ninth Circuit’s approach, in his 2010 decision denying defendants’ “omnibus motions to dismiss” in the MDL Judge King held that the NBA did not preempt state law overdraft claims. In an earlier case, a federal judge in the Northern District of Georgia also denied a motion to dismiss an overdraft case on NBA preemption grounds.

Applying the pre-Dodd Frank standard for preemption under HOLA, however, Judge King in the MDL held that the OTS’s regulations – which purported to occupy the entire fields of the deposit and lending-related practices of federal savings banks – preempted a checking account holder's claims against a federal savings bank under state laws purporting to impose requirements regarding checking accounts, disclosure requirements, and service charges and fees, since the holder's claims against the bank had arisen out of conduct directly regulated by OTS.

**Overdraft Fee Class Action Litigation in New York Courts**

To date, we are aware of three overdraft fee actions decided by New York courts. In determining motions to dismiss, the courts reached different conclusions:

In *Costello v. NBT Bank, N.A.*, Judge John F. Lambert, in Supreme Court, Delaware County, dismissed plaintiffs’ complaint against NBT Bank, N.A. In its May 2012 decision, the court held that plaintiffs’ common law claims failed because they merely alleged that NBT acted consistently with the provision in its customer account agreement which stated, “We generally pay items in dollar amount order, high to low.” The Court also rejected Plaintiffs’ claim under Section 349 of the General Business Law because Section 349(d) specifically excludes from the statute’s remedial ambit any act or practice subject to and in compliance with federal rules, regulations or statutes.

By contrast, in *Levin v. HSBC Bank, USA, N.A.*, decided in June 2012, Justice Ellen Bransten in Supreme Court, New York County, sustained plaintiffs’ pleading of claims for breach of the covenant of good faith and fair dealing and deceptive business practices. The court concluded


22 *Costello v. NBT Bank, N.A.*, supra n. 10.

that HSBC’s disclosure did not inform customers that the bank always posted from high to low, nor that the bank would hold transactions for several days and then post them from high to low. The court also rejected HSBC’s preemption arguments. The court did, however, dismiss without prejudice plaintiffs’ attempts to plead causes of action for conversion and unjust enrichment and granted plaintiffs leave to replead those claims. The plaintiffs in Levin later commenced two actions against HSBC in the Eastern District of New York (the Levin and Jura actions) on behalf of putative nationwide classes, asserting allegations relating to the imposition by HSBC of overdraft fees on debit card transactions. A third action against HSBC (the Hanes action) was previously commenced in a Virginia court. HSBC is seeking an order from the Judicial Panel on Multidistrict Litigation to transfer Hanes and consolidate it with the Levin and Jura actions in the Eastern District for coordinated or consolidated pretrial proceedings.

A third action – Lefkowitz v. Astoria Federal Savings and Loan Assoc. 24 – was dismissed by Justice Orin R. Kitzes in Supreme Court, Queens County, in July 2012, on HOLA preemption grounds. Judge Kitzes held that plaintiff’s claims were preempted by controlling OTS regulations (as Judge King had held in the MDL) and further found that plaintiff’s claims were undermined by language in her account agreement. Plaintiff noticed an appeal, but the appeal was dismissed earlier this year for failure to perfect.

In addition, a challenge to overdraft fees outside of the “high to low” reordering context has been raised in a putative class action filed in the Southern District of New York in January 2013. Scott v. JPMorgan Chase & Co., et al. 25 concerns the bank’s “Overdraft Protection” program, under which overdrafts in customer accounts are covered by cash infusions from other accounts maintained by the customer, including credit card accounts. Plaintiff alleges that in connection with a single checking account overdraft of $95.15, she was charged more than $160.00 through the “Overdraft Protection” program. Her claims, for violations of RICO, the Electronic Funds Transfer Act, Regulation E, and various California statutes, as well as common law breach of contract (including breach of the implied covenant of good faith and fair dealing), conversion, unjust enrichment, negligent misrepresentation and fraud, are based on allegations that customers were unilaterally enrolled in the “Overdraft Protection” program and then subjected to excessive fees and interest charges.

Will the CFPB or Congress act?

The Consumer Financial Protection Bureau (“CFPB”) commenced studying overdraft-related issues in February 2012. The CFPB has not yet proposed any rules concerning overdraft practices and it has been reported that no action is expected in the near future.

On March 19, 2013, Congresswomen Carolyn Maloney and Maxine Waters for the second time introduced legislation aimed at overdraft fees. As in 2012, the bill has been referred to the

24 See n. 21 supra.

House Financial Services Committee and, once again, no action on it is anticipated. The bill would require financial institutions to obtain consumers’ affirmative opt-in to any overdraft protection plan and also require clear disclosure of coverage and fees, which would be required to be “reasonable and proportional.” The legislation also would ban the “manipulation” of transaction posting order in a way that maximizes fees paid to the institution and would cap the number of fees that can be assessed.

Regulators, however, are taking action. In April 2013, the OCC and FDIC required RBS Citizens N.A. and Citizens Bank of Pennsylvania, respectively (both subsidiaries of Royal Bank of Scotland) to pay a total of $14 million in fines and restitution based on determinations that the banks’ disclosures of their overdraft payment practices were inaccurate and misleading.

**Class Action Waivers in Arbitration Clauses**

One way of avoiding the risk of class actions relating to overdraft fees – or indeed other aspects of consumer account agreements – is to include in such agreements arbitration clauses that not only provide for disputes to be arbitrated but also contain waivers of any right customers otherwise might have to commence class actions. A 2011 decision of the United States Supreme Court has promoted the use of such provisions.

**The Concepcion Decision**

In *AT&T Mobility v. Concepcion*, the Supreme Court held that state law prohibitions on class action waivers in arbitration clauses are pre-empted by the Federal Arbitration Act (“FAA”), which embodies a policy strongly favoring arbitration agreements. In *Concepcion*, the Supreme Court reversed a decision of the California Supreme Court which applied a state-law rule – known as the “*Discover Bank* rule” – that treated arbitration agreements containing class action waivers in standard form consumer contracts as unconscionable, and therefore unenforceable.

The Supreme Court held that the *Discover Bank* rule created an obstacle to the accomplishment of the FAA’s purpose of ensuring “the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings”: because California law required that classwide arbitration be available even through the contract provided otherwise, state law interfered with “the fundamental attributes of arbitration and thus create[d] a scheme inconsistent with the FAA.”


28 *Concepcion*, 131 S. Ct. at 1748.
Application of Concepcion to Overdraft Class Actions

Even after Concepcion, Judge King in In re Checking Account Overdraft Litigation ruled against enforcement of arbitration clauses on unconscionability grounds. On appeal, however, the U.S. Court of Appeals for the Eleventh Circuit reversed these decisions. In one case,\(^\text{29}\) although the Eleventh Circuit agreed with Judge King that a one-sided cost and fee shifting provision was unconscionable and unenforceable under South Carolina law, that court nevertheless found that the offensive provision could be severed from the remainder of the account agreement, including the arbitration clause. In other cases, the Eleventh Circuit found that Judge King erred in finding the arbitration clause to be unconscionable\(^\text{30}\) and that the contract had delegated the question of arbitrability to an arbitrator, not a court.\(^\text{31}\)

What features of arbitration clauses promote or inhibit enforcement of an arbitration clause containing a class action waiver?

Although Concepcion makes it difficult for consumers to challenge arbitration clauses containing class action waivers, some courts (in addition to Judge King in the Overdraft Fee MDL cases) have continued to strike down such clauses – typically where the claimant would be burdened by such heavy costs as to prevent him from having an effective remedy. The cases so holding generally involve vindication of federal statutory rights,\(^\text{32}\) but in some cases, courts have voided


\(^{30}\) See Hough v. Regions Financial Corp., 672 F.3d 1224 (11th Cir. 2012) (arbitration clause was not unconscionable under Georgia law because the bank as prevailing party could collect costs and fees by setting off the amount against funds in the customer’s account; there was no requirement that remedies be mutual); Powell-Perry, supra (North Carolina law permitted setoff); Buffington v. SunTrust Banks, Inc., 459 Fed. Appx. 855 (11th Cir. 2012) (neither inequality of bargaining position nor placement of arbitration clause in 40 page, fine-print document justified finding of unconscionability under Georgia law).

\(^{31}\) Given v. M&T Bank Corp., 674 F.3d 1252 (11th Cir. 2012).

\(^{32}\) See, e.g., In re American Express Merchants’ Litig., 667 F.3d 206 (2d Cir.), pet. for rehearing en banc denied, 681 F.3d 139 (2d Cir. 2012). The defendants petitioned the U.S. Supreme Court for a writ of certiorari, American Express Co. v. Italian Colors Restaurant, No. 12-133 (filed July 30, 2012), which was granted (Nov. 9, 2012), and the Court heard oral argument on February 27, 2013. The Court was asked to determine “[w]hether the Federal Arbitration Act permits courts, invoking the ‘federal substantive law of arbitrability,’ to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim.” No decision has been rendered as of this writing (June 5, 2013).
arbitration clauses imposing “unconscionable” costs on claimants, even where the claimant invoked no federal statute.\textsuperscript{33}

In order to minimize the risk of invalidation of arbitration clauses, and to maximize the likelihood that a court will enforce the arbitration clause as written, many post-\textit{Concepcion} arbitration provisions feature consumer-friendly terms, especially with respect to costs and fees. For example:

- Providing that fees and costs of suit (including expert fees) are recoverable by a prevailing claimant. (In \textit{Concepcion}, the AT&T agreement provided for a successful claimant to recover twice his fees and reasonable costs).

- Providing that if the claimant ultimately obtains an arbitration award superior to the defendant’s final pre-award settlement offer, the claimant receives a “bounty.”

- Providing that the defendant will pay all of the arbitration association’s filing and administration and other fees and similar costs (perhaps except where the claimant has pursued frivolous claims), or alternatively offering to advance such fees and costs if the claimant is unable to pay.

The other side of the coin is that it is prudent to avoid including in an arbitration clause provisions that are particularly unfriendly to consumers – e.g., those requiring claimants who do not succeed in arbitration to pay the defendant’s fees and costs.

\textbf{Will the CFPB or Congress act to overrule or limit \textit{Concepcion}?}

The Dodd-Frank Act expressly required the CFPB to study and submit a report to Congress on the use of arbitration in consumer transactions.\textsuperscript{34} On April 24, 2012, the CFPB launched a public inquiry into the impact of arbitration clauses in consumer contracts in the financial services sector. The comment period closed on June 23, 2012 but the CFPB has not yet announced any action (e.g., new consumer protection regulations).

A proposed “Arbitration Fairness Act,” providing (among other things) that class action waivers are unenforceable, has been introduced on several occasions – most recently by Senators Franken and Blumenthal and Representative Johnson. The consensus is that such legislation is not likely to be enacted in the foreseeable future.

\textsuperscript{33} See, e.g., \textit{Samaniego v. Empire Today LLC}, 205 Cal. App. 4th 1138 (2012) (citing various “one-sided” provisions, including requirement that claimants pay any attorneys’ fees incurred by the defendant, without any reciprocal obligation).

\textsuperscript{34} 12 U.S.C. § 5518.