Insights

New Wave of Overdraft Fee Class Action Suits Targets Indiana Financial Institutions

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Overdraft practices have been the subject of both regulatory scrutiny and civil litigation for over a decade. Prior to 2010, the allegations in overdraft cases typically focused on allegations of failure to notify consumers of their participation in overdraft programs and deceptive practices tied to the order of posting of payments.

In 2009, the Federal Reserve Board adopted amendments to Regulation E that prohibited financial institutions from assessing fees for payment of ATM and one-time debit card transactions that overdraw consumer accounts unless the consumer affirmatively consents, or opts in, to the overdraft protection program. These regulatory changes requiring customer notice, coupled with an overall heightened awareness of the attention paid to disclosure of overdraft practices, contributed to the apparent decrease in overdraft litigation. That was until the Consumer Financial Protection Bureau (the "CFPB") bought renewed attention to overdraft issues with their 2015 Winter Supervisory Highlights,[1] in which the agency identified concerns with appropriate disclosure from financial institutions switching from a "ledger balance" method to an "available balance" method when deciding whether to post or return checks and other electronic transactions, and the subsequent overdraft fees that might result. The ledger balance method determines the account balance based only on settled transactions. In contrast, an available balance method calculates the account balance based on transactions an institution has authorized, but not yet settled, along with settled transactions. The CFPB maintained that in certain circumstances, changes to the balance calculation method were not adequately disclosed to customers, and were therefore deceptive.

Since the 2015 Winter Supervisory Highlights, financial institutions across the country have been sued in class action lawsuits for their overdraft practices, regardless of whether they were using a ledger balance method or an available balance method. These lawsuits have raised various legal theories under state law, including breach of contract, breach of the covenant of good faith and fair dealing, unfair deceptive acts and practices, conversion, and in many instances' violations of Regulation E. *See, e.g., Pinkston-Poling v. Advia Credit Union,* 227 F. Supp. 3d 848 (W.D. Mich. 2016); *Roberts v. Capital One,* N.A., 2017 WL 1750445 (S.D.N.Y. May 4, 2017); *Tims v. LGE Community Credit Union,* 2017 WL 5133230 (N.D. Ga. Nov. 6, 2017); *In re TD Bank, N.A. Debit Card Overdraft Fee Litig.,* 2018 WL 1003548 (D.S.C. Feb. 22, 2018).

In many cases, the defending financial institutions have been unsuccessful in moving to dismiss the claims against them. Rather than engaging in protracted and burdensome class-wide discovery and risk a potentially lengthy and expensive trial that may expose them to significant financial liability, the financial institutions have ultimately entered into class-wide settlement agreements. Settlements in these cases have been in the millions of dollars, with one case settling for nearly $25 million. *See, e.g., Lloyd v. Navy Fed. Credit Union*, 2018 WL 1757609 (S.D. Cal. 2018).

In Indiana, one particular plaintiff's counsel has filed several lawsuits against financial institutions in different state courts over the past two years. Depending on the institution's account agreements, plaintiffs in some of these cases have alleged they were harmed by the institution's use of the ledger balance method of assessing overdraft fees ("Ledger Balance Litigation"). In other cases, plaintiffs take the opposite approach and allege they were harmed by the institution's use of the available balance method of assessing overdraft fees ("Available Balance Litigation").

<u>Ledger Balance Litigation</u>

Ledger Balance Litigation is based on the theory that the amount of actual funds in an account are irrelevant for purpose of assessing overdraft fees, because financial institutions use an available balance calculation that allegedly escrows any funds deducted from the available balance. The plaintiff's lawyers consistently label these transactions as "Authorize Positive, Settle Negative Transactions" ("APSN Transactions").

Plaintiff's counsel provides the following description of the defendant financial institution's overdraft practices (reproduced verbatim in Complaints across the country). For example, in *Boone v. MB Fin. Bank, N.A.*, No. 18-cv-1771, 375 F. Supp.3d 987, 2019 WL 1584553 (N.D. Ill. Apr. 12, 2019) plaintiffs assert:

> *A debit card transaction occurs in two parts. First, authorization for the purchase amount is instantaneously obtained by the merchant from Defendant. When a merchant physically or virtually "swipes" a customer's debit card, the credit card terminal connects, via an intermediary, to Financial Institution, which verifies that the customer's account is valid and that available funds are sufficient to "cover" the transaction amount. At the moment debit card transactions are authorized on an account with positive funds to cover the transaction, Defendant immediately decrements consumers' checking accounts for the amount of the purchase and sets aside funds in a checking account to cover that specific transaction. As a result, and with limited exceptions, customers' accounts always have sufficient available funds to cover these transactions throughout their entire life-cycle. However, Defendant still assesses $37 OD Fees on many of these transactions, in violation of its contractual promises not to do so. Despite putting aside sufficient available funds for debit card transactions, Defendant charges OD Fees on those same transactions if they purportedly settle—days later—into a negative balance ("Authorize Positive, Purportedly Settle Negative Transactions" or "APPSN Transactions").*
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> *Here is how it works. Defendant maintains a running account balance in real time, tracking funds consumers have for immediate use. This running account balance is adjusted, in real-time, to account for debit card*

transactions at the precise instant they are made. When a customer makes a purchase with a debit card, Defendant sequesters the funds needed to pay the transaction, subtracting the dollar amount of the transaction from the customer's account balance. Such funds are not available for any other use by the accountholder, and such funds are specifically associated with a given debit card transaction. Still, despite keeping those held funds off-limits for other transactions, Defendant improperly charges OD Fees on APPSN Transactions—which always have sufficient available funds for payment.

While financial institutions know the description above is not representative of how the process of paying electronic transactions actually works, plaintiff's lawyers have seized upon the smallest inconsistency or vagueness in account agreements and disclosures to assert that the defendant financial institution's overdraft assessment process is inconsistent with the contractual terms agreed to by the consumer, and as a result, represents a breach of contract, breach of the duty of good faith and fair dealing, or even a deceptive act.

Available Balance Litigation

When confronted with a financial institution using the available balance method, plaintiff's counsel takes the complete opposite position to that asserted in the Ledger Balance Litigation by describing the available balance as a secretive "artificial internal calculation" that the financial institution uses to assess overdraft fees on transactions when there is still money in the account. For example, in the case of *Tims v. LGE Community Credit Union*, Plaintiff's counsel provides the following description of the defendant financial institution's overdraft practices:

> *However, contrary to its Customer Agreements, and other marketing materials indicating that Defendant will only charge overdraft fees when there is not enough money in the checking account to cover the transaction, Defendant's practice when assessing an overdraft fee on a transaction is to ignore whether there is money in the account, and instead make the automated decision on assessing overdraft fees based on an artificial internal calculation (sometimes known as the "available balance") rather than the actual balance.*
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> *The available balance is the actual balance minus anticipated debits in the future (that may or may not occur) and deposits that have not yet cleared pursuant to its funds availability policy. The use of an internal available balance rather than the money in the account to determine whether a transaction results in an overdraft and is subject to an overdraft fee is directly contrary to Defendant 's Customer Agreements. The result is that Defendant improperly charges members overdraft fees in situations when there is money in the account to cover the transaction.*

Similar if not identical allegations are contained in all Available Balance Litigation.

Recommendations to Protect Against Overdraft Litigation

While nothing can prevent litigation, a careful review of your institution's account documents, including all account terms, conditions and disclosures, for any potential inconsistencies will reduce the likelihood of becoming targeted by plaintiff's counsel. Financial institutions should pay particular attention to whether the terms used to describe the method used to determine when an overdraft fee is assessed are consistent throughout their documents, that the definition of available balance and actual or ledger balance is clear, and reflect your actual process of assessing overdraft fees. Financial institutions should remember to review the terms used in the customer disclosures required under Regulation E, and ensure the application of terms used in their other account documents can't be considered inconsistent to the provisions of this required model federal disclosure.

Financial institutions should consider adding arbitration language to their account agreements. Financial institutions should ensure that any arbitration language they add to their agreements is broad enough to apply not only to claims arising out of transactions occurring after the customer's acceptance of these new terms and conditions, but also to claims based on transactions that occurred prior to that date. While there are no guarantees that broad arbitration provisions of this kind will protect against class action litigation for a financial institution's prior transactions (Indiana courts are yet to opine on this issue), other courts have upheld the retroactive application of arbitration clauses. *See*, e.g., *Austin Freight Sys., Inc. v. W. Wind Logistics, Inc.*, No. 18 C 4832, 2019 WL 2088056, at *3 (N.D. Ill. May 13, 2019); *Ben. Nat'l Bank v. Payton, 214 F. Supp. 2d 679, 688-89 (S.D. Miss. 2001).* Courts will reject any effort to apply arbitration provisions retroactively once a complaint has been filed, so if you are contemplating adding arbitration language to your agreements to protect against litigation for prior transactions, time is of the essence.

Finally, just because your institution uses form documents, don't assume you are immune to litigation risk. Several cases have been based on alleged inconsistencies in form or standard agreements and disclosures.

Krieg DeVault is actively monitoring developments in this area of the law, and ready to provide guidance on how best to avoid becoming the defendant in an overdraft case like those described above, including providing assistance with the drafting of arbitration provisions for incorporation into your account agreements. In the unfortunate event you have been already been sued, Krieg DeVault' s financial services litigators are ready to assist in your defense.

1 Supervisory Highlights, Consumer Financial Protection Bureau 9 (Winter 2015), available at: https://files.consumerfinance.gov/f/201503_cfpb_supervisory-highlights-winter-2015.pdf