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THE PIB REPORT

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Court Finds Extended Overdraft Fees Could Constitute Interest Under National Bank Act

On December 19, 2016, the question of whether extended overdraft fees constitute interest under the National Bank Act survived a motion to dismiss in a California federal court – which calls into question a relatively ubiquitous fee charged by banks on deposit accounts.

In *Joanne Farrell v. Bank of America, NA,* Case No. 3:16-cv-00492-L-WVG (S.D. Cal.), filed in February 2016, Plaintiff claims that the $35 fee that Bank of America charges account holders who fail to replenish an overdrawn account within five days is actually interest – not simply a fee – and therefore violates applicable usury laws.

Bank of America's fee schedule for deposit accounts is relatively typical within the industry, and includes both a $35 fee any time an account holder writes a check against insufficient funds (the "Initial Charge"), as well as a second $35 charge if the bank extends funds to cover the overdraft and the negative balance is not cured by the account holder within five days ("Extended Charge").

It is this second "Extended Charge" that is at issue in the *Farrell* case. Plaintiff's sole cause of action alleges a violation of the National Bank Act, 12 U.S.C. §§ 85, 86, which prohibits a national bank from charging usurious interest rates. While Bank of America argued that the Extended Charge is an allowable service charge on a deposit account, Plaintiff alleged it is actually interest on an extension of credit. Because most extended overdrafts are low dollar amounts and generally cured within a short period of time, the $35 fee would typically exceed the allowable threshold if it was in fact considered to be interest. The Supreme Court has held that "interest," as used in § 85, is ambiguous. *See Smiley v. Citibank* (South Dakota), N.A., 517 U.S. 735, 739 (1996).

In resolving this ambiguity, the *Farrell* Court first differentiated the Initial Charge from the Extended Charge, finding the Initial Charge to be a fee charged for a service regardless of whether the bank advanced money to cover an overdraft. Turning to the Extended Charge, the *Farrell* Court noted that while there is no binding authority, at least three other district court cases found the Extended Charge does not constitute interest under § 85. *See McGee v. Bank of America, N.A.,* 2015 WL 4594582 (S.D. Fla 2015); *Shaw v. BOKF, N.A.,* 2015 WL 6142903 (N.D. Okla. 2015); *In re TD Bank, N.A.,* 150 F. Supp.3d 593 (D.S.C. 2015).

The Court then walked through the four arguments presented in these cases and Bank of America's motion papers as to why Extended Fees are not interest. These arguments include that: (i) there is no substantive difference between the Initial Charge and the Extended Charge; (ii) the Extended Charge is not interest because it is a flat fee; (iii) the Extended Charge is contingent on the account holder triggering the fee; and (iv) any fee arising from a deposit agreement rather than a classical credit arrangement

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is *per se* not interest. The *Farrell* Court found each of these arguments unavailing, and ultimately concluded that "[a]s a matter of plain language, 'the provision of money, goods, or services with the expectation of future payment' amounts to an extension of credit." *See* Order Denying Defendant's Motion to Dismiss at 8 (quoting Merriam-Webster Dictionary). The Court also found this "plain meaning" interpretation consistent with other regulatory guidance from the Federal Reserve and the OCC. This supporting guidance includes Regulation O, which regulates extensions of credit to bank insiders and considers "an advance by means of an overdraft" to be an extension of credit (12 C.F.R. § 215.1(b)) and Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127, 9129 (Feb. 24, 2005), in which the OCC stated "[w]hen overdrafts are paid, credit is extended."

Other district courts considering this same question have held that the extended overdraft charge is not a fee. And, indeed, Bank of America may ultimately prevail in the litigation, as the case progresses past the motion to dismiss phase. At minimum, however, *Farrell* presents an increased litigation and regulatory risk for banks charging extended overdraft fees. ■

PIB Law regularly advises clients on consumer banking and deposit account regulatory matters and successfully defends and settles customer litigation. If we can assist you with your institution's strategy regarding extended overdraft or other account-related fees, please contact James P. Berg at james.berg@piblaw.com, or Brian Turetsky at brian.turetsky@piblaw.com.

PIB Law Obtains Favorable Ruling from New York's Appellate Division Regarding Standing to Foreclose

On December 1, 2016, in *JP Morgan Chase formerly known as The Chase Manhattan Bank v. Kaba et al.*, New York's Appellate Division, First Department, reversed the lower court's order dismissing a foreclosure complaint filed by Chase, based upon the Court of Appeals' decision in *Aurora v Taylor*, 25 NY3d 355 [2015].

In April 2014, the lower court denied Chase's motion for an order of reference, and granted borrower's cross-motion to dismiss, on the grounds that Chase did not have standing to bring the foreclosure action. Specifically, the lower court held that, while Chase may have held the note, the chain of title of the mortgage was not in the name of the Chase entity that was the named plaintiff.

On appeal, PIB Law argued on behalf of Chase that the lower court's decision should be reversed. Under the Court of Appeals' decision in *Aurora*, a plaintiff was not actually required to demonstrate chain of title of the mortgage. As *Aurora* held, in order for a plaintiff to have standing, "it is not necessary to have possession of the mortgage at the time the action is commenced." Accordingly, "[t]he validity of the ... assignment of mortgage is irrelevant to [the plaintiff's] standing."

The First Department agreed. It unanimously reversed the lower court's decision, granted Chase's motion for an order of reference, and denied borrower's cross-motion to dismiss. The First Department found that the lower court "did not have the benefit of *Aurora*," which held that "the note, and not the mortgage, is the dispositive instrument that conveys standing to foreclose under New York law." The First Department concluded that the lower court's decision "cannot stand." ■

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