Common Law and CFA Claims and Defenses in Credit Card Cases

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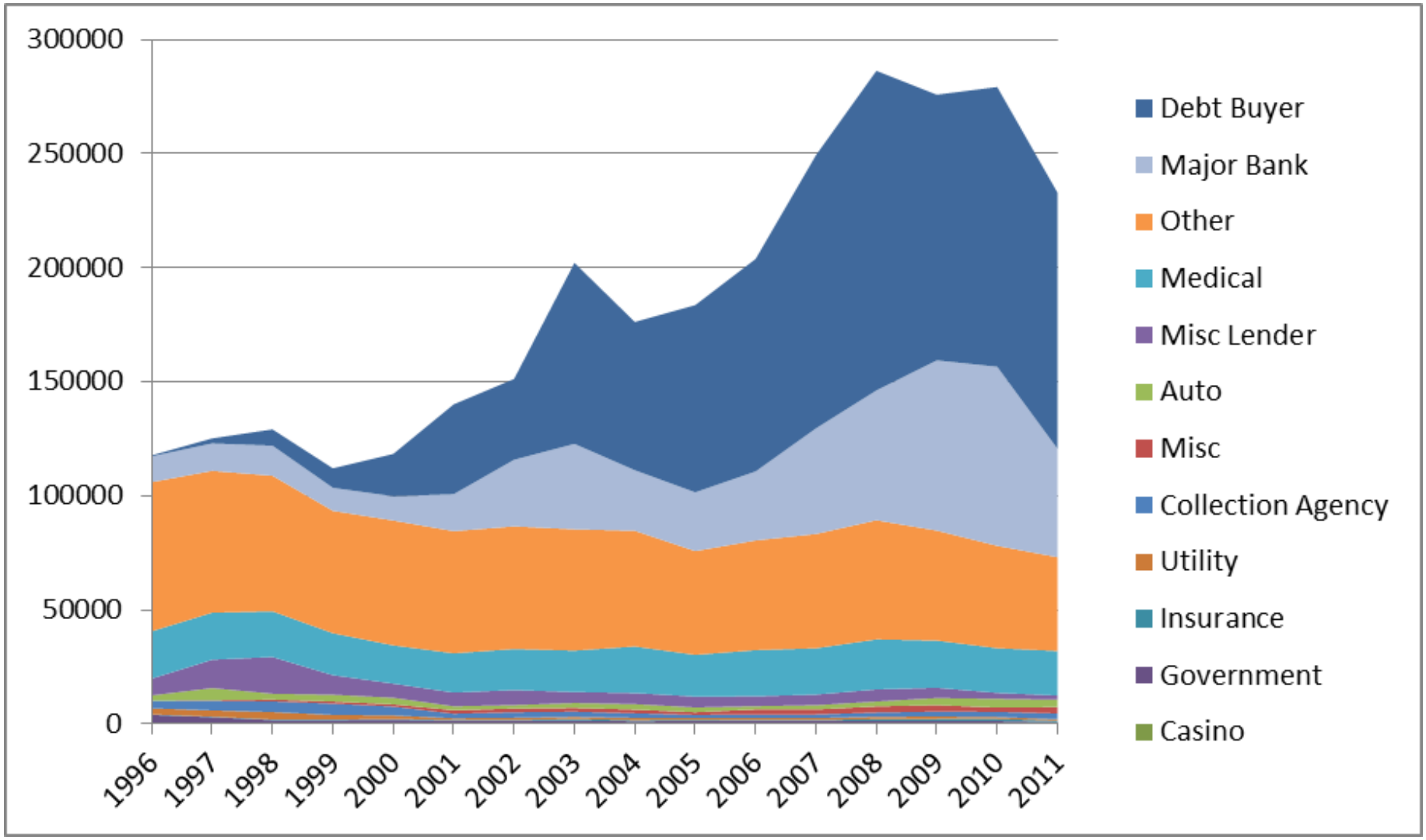
Setting the Stage

- **Staggering Numbers:** 100,000 – 200,000 debt collection lawsuits and judgments – mostly in credit card cases – in N.J. every year
- **Disparate Impact:** ProPublica analysis of Essex County data – debt collection judgments are **twice as common in predominantly minority census tracts** than in economically comparable non-minority tracts

Judgments in Special Civil Part Contract Cases by Type, 1996-2011
Source: ProPublica Analysis of ACMS PAC0600 Data



Setting the Stage (cont.)

- Predominant approach of debt collection attorneys in NJ is to **seek only the charge-off balance**, court costs, and modest statutory attorneys' fees
- Appellate Division decision in ***NCFS v. Oughla*** (2014) substantially restricts standing and "prove it" defenses
- Availability of **summary judgment** in SCP cases adds additional challenges

- **CFPB consent orders** re NCFS and Pressler & Pressler (2016) set standards similar to recently-adopted NY court rules:
  - "Properly authenticated" proof of each step in the chain of assignment, with reference to specific account
  - "Original account-level documentation" including name, account number, and claimed amount
  - Proofs in hand before threatening or initiating a lawsuit
  - UDAAP and FDCPA analysis in the orders should apply to all debt buyers and their attorneys

Generally Applicable Laws . . . Apply

- Breach of contract (by issuer or seller)
- Breach of the implied duty of good faith and fair dealing in the performance of all contracts
- Unconscionability as defense to enforcement
- Affirmative common-law fraud and unconscionability(?) tort claims
- Unenforceable contractual penalties doctrine
- Consumer Fraud Act
- Statutes of limitations

Unconscionability

- Common law/UCC
  - Common-law unconscionability as a defense to contract enforcement
  - UCC § 2-302 is similar
  - Primarily, and perhaps exclusively, defensive
- Consumer Fraud Act
  - NJ is one of 18 states that use unconscionability as an independent UDAP standard
  - Primarily provides affirmative claims, but can be raised as a defense under the recoupment doctrine

Common Law Unconscionability

- Procedural + substantive unconscionability → contract provision is unenforceable
- Longstanding doctrine – *Williams v. Walker-Thomas* is just one in a long line of cases
- *Campbell Soup Co. v. Wentz*, 172 F.2d 80, 83 (3d Cir. 1948) (Campbell soup's contract with NJ carrot growers too "tough" to enforce)
- *Mohammad v. County Bank*, 189 N.J. 1 (2006) (adhesive consumer contracts are *per se* procedurally unconscionable; SCOTUS overturned holding on class action bans in arbitration clauses (5-4), but holdings on other unconscionability challenges to enforcement of arb clauses survive)

CFA Unconscionability

- *Kugler v. Romain*, 58 N.J. 522 (1971) (absence of good faith, honesty in fact, and observance of fair dealing), *accord Meshinsky* (1988), *Cox* (1994)
- *Assocs. Home Equity Servs. v. Troup*, 343 N.J. Super. 254, 278 (App. Div. 2001) (should be interpreted liberally to effectuate public purpose of the statute)
- *Gennari v. Weichert Co. Realtors,* 148 N.J. 582, 605 (1997) (intent to deceive is not a prerequisite)

Is Preemption a Problem?

- State laws of general application apply to national banks:
  - "Federally chartered banks are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or general purposes of the National Banking Act." *Watters v. Wachovia Nat'l Bank*, 550 U.S. 1, 11 (2007).
  - "A number of state laws prohibit unfair or deceptive acts or practices, and such laws may be applicable to insured depository institutions." *OCC Advisory Letter 2002-03* at 3, n. 2.
- But there are two avenues to preemption: one direct and one indirect

Direct Preemption: *Barnett Bank*

- The National Bank Act preempts some state laws under 12 U.S.C. § 24 Seventh, giving national banks "the power . . . [t]o exercise . . . , subject to law, all such incidental powers as shall be necessary to carry on the business of banking."
- *Barnett Bank v. Nelson*, 517 U.S. 25 (1996), made clear that this is conflict preemption
- In the early 2000's, though, OCC and OTS pushed toward field preemption

Barnett Bank Today

- Dodd-Frank Act
  - explicitly adopted *Barnett Bank* as the appropriate standard
  - set forth procedures for OCC and CFPB to make preemption determinations
- OCC pushed the envelope again in rules ostensibly implementing Dodd-Frank (12 CFR § 7.4008)
  - contract, tort, and 6 other categories are subject to *Barnett Bank*
  - but enumerated ten no-go areas for state law, including "terms of credit"
  - still largely untested

Indirect Preemption - Rate Exportation *Marquette Bank* and *Smiley*

- What interest rate can a national bank charge? The National Bank Act provides that banks can charge the *greater* of
  1. One percent above the discount rate on commercial paper, or
  2. The rate allowed in the state in which the National Bank is located. (12 U.S.C. § 85)
- Where's the loophole? Right . . . It's under state law, behind door # 2

- Where is a national bank “located”?
- Two SCOTUS decisions held that under § 85 a bank is “located” not where it markets and sells its products, but where it is chartered:
  - **1978 – *Marquette National Bank* – interest rates** allowed in bank’s home state apply nationwide
    - Delaware and South Dakota quickly gave issuing banks a safe haven with no rate restrictions
  - **1995 – *Smiley v. Citibank (South Dakota), N.A.* – late fees and other charges are interest** for purposes of rate exportation.

Whither Preemption?

- Still a great deal of uncertainty
- Diciest: state laws directly limiting interest rates and/or fees
- Most leeway: common law (tort and contract)
- UDAPs (e.g., CFA)?
  - Not on either the OCC go or no-go list
  - OCC says UDAPs “may” apply, and its own regs prohibit unfair and deceptive practices
  - Courts seem comfortable with remedies for fraud and misrepresentation

Some Recent Preemption Cases

- *Trombley v. Bank of Am. Corp.*, 715 F. Supp. 2d 290, 296 (D.R.I. 2010) (claims under Delaware's common-law duty of good faith and fair dealing not preempted), *accord Williams v. Wells Fargo Bank N.A.,* 2011 WL 4901346, at *10 (S.D. Fla. Oct. 14, 2011) (collecting cases)
- *Powell v. Huntington Nat'l Bank*, __ F. Supp. 3d __, 2016 WL 7472141 (S.D.W. Va. Dec. 28, 2016) (state statute prohibiting pyramiding late fees preempted), *appeal filed*
- *In re Capital One Bank Credit Card Interest Rate Litig.*, 51 F. Supp. 3d 1316 (N.D. Ga. 2014), *aff'd* 622 F. App'x 894 (11th Cir. 2015) (bank asserted preemption as to statutory but not common-law state claims)

Where Consumers Stand Today

- The CARD Act changed the landscape, addressing some of the most abusive practices
- The CFPB has ramped up consumer protection examination
- But the CARD Act is far from comprehensive – a good first step with no second step in view for now

- Common view of complaints seeking the charge-off balance is that they are just – just asking consumers to pay for the stuff they bought
- Actual account records show this is often not the case, and may be rare. Many consumers have long payment histories with little to show for it, while high APRs, fees, and add-on products account for much if not all of the charge-off balance.

Consumers Typically Have Unasserted Substantive Defenses

Methodology

- Westlaw search for appeals from summary judgment decisions in credit cared cases
  - Plaintiff's motion papers below typically included 12+ months of recreated monthly statements
  - In all but one (a one Legal Services case), the consumer lost in both trial and appellate court
- Monthly statements in every case examined so far included enough to raise and pursue significant substantive defenses and/or counterclaims

Negative Amortization

- The most frequent problem observed
- Before defaulting, the consumer made minimum payments(+) in all or most billing cycles, but the account balance went up
- Frugal use of the card for purchases, and/or add-on product charges, meant that payments didn’t cover the interest and fees
- Typically present at the beginning of the series – how far back did this go?

Negative Amortization Examples

- MSW Capital v. A.Z.
  - Balance in $10k to $11k range; APR 16.24%
  - Over 12-month period, cardholder paid $1,572 above and beyond purchases
  - On-time minimum payment+ every month
  - Nonetheless, balance increased by about $200
  - Another $1,584 added to balance between default and charge-off, including two months at 29.99% default interest rate

- Citibank v. F.C.
  - No significant purchases; initial balance $2,800; APR 25.24%
  - Over 6 months, net payments of $364 led to balance increase of $294
- Capital One v. E.V.
  - Relatively low balance -- $1440; APR 17.9%
  - On-time minimum payments each month
  - Over 5 months, net payments of $104 led to balance increase of $5
- CACH of N.J. v. C.D.
  - Balance ~$10,400; APR 25.24% for purchases, 5.99% for transferred balances
  - On-time minimum payments+ each month
  - Over 8 months, net payments of $720 led to balance increase of $154

Potential Defenses and Claims Arising from Negative Amortization

- Breach of duty of good faith & fair dealing
- Common-law unconscionability
- CFA counterclaims
  - Unconscionable commercial practice
  - Knowing omission
- Common-law fraud counterclaims

Potential for Preemption?

- Agency focus on negative amortization – OCC/FRS/FDIC/OTC guidance:

  The Agencies **expect lenders to require minimum payments that will amortize the current balance over a reasonable period of time**, consistent with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness. Prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt and disguise portfolio performance and quality raise safety and soundness concerns and are subject to examiner criticism.

- No federal law "permission" not to act in good faith – setting the minimum payment is not addressed in CARD Act, or other federal law
- One percent of the balance plus the interest and fees charges is now common (though floor amounts and other details vary(
- Law of the cardholder's state or issuer's state?
  - Setting the monthly payment is not about "interest" -- even as broadly construed in *Smiley*
  - Thus, issuer can't export its home state law
  - Choice of law clause might apply

Add-On Products

- One case included “AccountCare” charges @ 1% of the average account balance each month, from the first month in the sequence
- While appeal was pending, CFPB Consent Order (July 2015) ordered refunds to ~4.8 million Citibank customers for deceptive practices in connection with AccountCare and other add-on products
  - How many months of AccountCare charges were there? How much interest paid on those charges at 25.24%? How many late/OTL fees triggered?
  - Unconscionability defense
  - Potential CFA counterclaim: 3x total amount of harm caused by deceptive/unconscionable practice

- Another case included annual $25 “Rewards Fee” – but no sign of any rewards
- From 2012 through 2015, the CFPB ordered 12 issuers to refund about $2.5 billion in add-on fees to more than 21 million customers

Default or “Penalty” Interest Rates

- Unenforceable contractual penalty
  - Not reasonable estimate of actual or anticipated harm
- Can the plaintiff establish the contractual basis for imposing the penalty APR?
- In one case, APR went from 15.24% to 29.99% for no apparent reason after four consecutive months of on-time minimum payments
- Issuer practices vary widely
- CARD Act rules setting some standards regarding imposition of penalty rates have been in effect in recent years

Seller-Based Defenses

- In one case, store card used for a single furniture purchase; charge disputed at the outset
- TILA § 1666i – the **issuer is subject to all claims and defenses against the merchant** (except tort claims) when the consumer uses a credit card, if
  - The amount in dispute remains unpaid, the consumer has made a good faith effort to resolve the matter with the merchant, and either
    1. The amount of the initial transaction was more than $50; and the initial transaction took place in the same state as, or within 100 miles of, the mailing address for the account;

       --or--

    2. The seller is (a) the issuer, (b) an affiliate of the issuer, (c) a franchisee of the issuer, or (d) a participant in a mail solicitation with the issuer.

Other Potential Claims and Defenses

- Spurious open-end credit
  - Single purchase on card
  - TILA violation for failure to give closed-end disclosures
  - Unconscionability defense
- Misleading disclosures
  - 0% APR or “no interest” in “same as cash” deferred interest deals

QUESTIONS?

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