Client Alert

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Ninth Circuit Holding Lends Support to Claims that Insurance May Be Available for Suits Challenging Debit Practices

The U.S. Court of Appeals for the Ninth Circuit recently held that the common banking practice of sequencing the processing of large debit transactions before smaller ones is not only a sound banking practice, but also useful and necessary to the banking industry, finding that federal law preempted California law. *Gutierrez v. Wells Fargo Bank, NA*, No. 10-16959 (9th Cir. Dec. 26, 2012). The decision sets the stage for banks and other financial institutions to seek insurance recovery for hundreds of millions of dollars spent litigating and settling class action lawsuits alleging bad faith and improper banking practices.

Background

The plaintiffs in *Gutierrez* brought a class action against Wells Fargo in California federal court for violations of California's Unfair Competition Law. The plaintiffs alleged that Wells Fargo's use of a "high-to-low" posting order was an unfair business practice. The "high-to-low" posting order refers to Wells Fargo's decision to post customers' daily debit transactions to their accounts in order of the highest-to-lowest dollar amount. In so doing, Wells Fargo maximized overdraft fees, which were based on the number of overdrafts rather than the total dollar amount of overdrafts. This practice, the plaintiffs claimed, was bad faith and, therefore, constituted an unfair business practice under California law.

The district court found that Wells Fargo's decision to utilize the high-to-low posting order "was made for the sole purpose of maximizing the number of overdrafts assessed on its customers." The district court concluded that Wells Fargo violated the California Unfair Competition Law because Wells Fargo imposed the posting order in bad faith. Wells Fargo was ordered to pay $203 million in restitution to the class members and was enjoined from further use of the high-to-low posting order.

On appeal, the Ninth Circuit reversed this aspect of the case.

The Ninth Circuit Endorses Wells Fargo's Posting Practice

Relying on the National Bank Act and regulations promulgated by the Office of the Comptroller of the Currency (the "OCC"), the Ninth Circuit found that federal law preempted California law prohibiting the bank's use of a "high-to-low" posting order. The National Bank Act authorizes national banks to receive deposits and broadly empowers banks with "all such incidental powers as shall be necessary to carry on the business of banking." The Ninth Circuit found that "the ability to choose a method of posting transactions is not only a useful, but also a necessary, component of a posting process that is integrally related to the receipt of deposits."

Additionally, OCC regulations "specifically delegate to banks the method of calculating fees." In fact, OCC letters interpreting the regulations "specifically consider high-to-low posting and associated overdraft fees to be a 'pricing decision authorized by Federal law' within the power of a national bank." The Ninth Circuit rejected the district court's reliance on its determination that

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Wells Fargo did not follow an OCC-mandated decision-making process in imposing the posting order. Whether Wells Fargo followed that process was a decision left to the OCC, not the federal courts, and, therefore, was “inapposite to the issue of preemption,” according to the Ninth Circuit.

Insurance Implications

The Ninth Circuit’s decision in *Gutierrez* supports the argument that amounts paid to settle class-action lawsuits challenging the manner in which banks and financial institutions sequence debit transactions should not be treated as disgorgement of ill-gotten gains, but rather as no different than settlements of other claims seeking damages. The *Gutierrez* decision thereby opens the door for banks and financial institutions to argue that the substantial amounts paid in settlement and defense of lawsuits alleging that sequencing of debit transactions amounts to bad faith and improper banking practices are, in fact, covered by insurance. Prior to *Gutierrez*, insurers found leverage in the Seventh Circuit’s 2001 decision in *Level 3 Communications v. Federal Ins. Co.*, where the court held that insurance is not intended to apply to suits seeking the disgorgement of ill-gotten gains. But, as the Ninth Circuit recognized in *Gutierrez*, because the sequencing of debit transactions is both “necessary” and “useful” to the powers granted to banks, amounts paid to settle suits challenging such practices should not amount to the disgorgement or return of improper gain. Rather, suits challenging such practices amount to ordinary suits seeking legal damages.

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