

## 4 Financial Services Litigation Hot Spots To Watch In 2020

By Jon Hill

*Law360 (January 1, 2020, 12:04 PM EST)* -- Attorneys from across the financial services spectrum told Law360 that they'll be paying close attention to the battle over the Consumer Financial Protection Bureau at the U.S. Supreme Court this spring, but the new year could also bring a rising tide of overdraft fee litigation and new developments around a controversial loan validity doctrine.

Here are four hot spots of litigation that financial services attorneys said they will be watching in 2020:

### CFPB Constitutionality

The future of the Consumer Financial Protection Bureau will be on the line this year as the Supreme Court decides *Seila Law v. CFPB*, a case that presents the justices with the chance to settle a nearly decade-old fight about how Congress designed the agency.

In its simplest form, *Seila Law's* case is about whether the special job protection given to the top boss at the CFPB is constitutional. Under the Dodd-Frank Act, the president cannot fire the agency's director at will but instead must have good cause before removing him or her, a provision that critics charge leaves the agency with one too few avenues of effective oversight.

But the case has also raised thorny questions about the limits of presidential authority over independent regulators, how much freedom the justices have to reshape the CFPB if they don't like what they see and whether the agency's enforcement docket can survive intact.

The drama only builds from there. Just before the high court agreed to take the case, for example, the CFPB infuriated consumer advocates and Democrats by suddenly flip-flopping and announcing it no longer believed in the constitutionality of its current structure.

And while the justices appointed an amicus to fill this vacuum and argue that the agency is constitutionally sound, they passed on the Democratic-controlled U.S. House's offer to do the job and instead assigned it to a Republican former solicitor general: Paul D. Clement, who served under President George W. Bush and is now a partner at Kirkland & Ellis LLP.

Oral arguments in the case are set for March 3, with a decision expected by June. Given the court's current composition, the consensus forecast among financial services attorneys is that a slim majority will hold the CFPB to be unconstitutionally structured and strike down the for-cause removal provision.

Such an outcome would give President Donald Trump a stronger hand to influence policy at the CFPB, which is already run by his own appointee, Director Kathleen Kraninger. But it could also mark the beginning of the end for her: If Democrats take back the White House in November and are free to replace her, 2020 could wind up being Kraninger's last full year on the job.

"The irony is that Republican resistance to former CFPB Director Richard Cordray" — who was nominated by former President Barack Obama — "meant he ended up serving six years, while Republican support for President Trump's legal position may mean that his director ends up serving only three years," said Eric Mogilnicki, a Covington & Burling LLP financial services partner.

In the longer term, Mogilnicki said a decision to strike down the for-cause removal provision as unconstitutional could fuel legislative efforts to restructure the CFPB as a multimember commission, but in the nearer term, he said it could help "ensure that the CFPB director is in sync with the other federal banking regulators."

"Under the current system, there's the potential that there could be a sea change in administrations, but the Bureau remains a holdout," Mogilnicki said. "That wouldn't happen anymore [if the for-cause removal provision is struck down], and so it may facilitate consistency among the agencies."

### **Subpoena Showdown**

Trump is set for a showdown at the Supreme Court in the coming months as he fights to prevent House and New York investigators from subpoenaing his financial records. While the appeals have drawn attention for their constitutional implications, they could prove important for financial institution litigators as well.

"The court doesn't hear that many bank cases and especially not cases involving third-party subpoenas," said Mary C. Zinsner, a Troutman Sanders LLP partner and consumer financial services litigator. "This is kind of new territory."

The appeals, which are slated for March oral arguments, stem from a trio of lawsuits that Trump filed last year in New York and D.C. federal court seeking injunctions to block subpoenas by two House committees and the Manhattan district attorney to Deutsche Bank, Capital One and Mazars USA LLP.

The subpoenas demanded that the financial firms turn over bank records, tax returns and other financial material related to Trump, his family and his businesses, but Trump's attorneys objected to the document requests on constitutional grounds. In addition, they argued that the congressional subpoenas to the banks violated the Right to Financial Privacy Act, which regulates how government authorities can get access to customer records at a financial institution.

But Trump was rebuffed in all three cases up through the D.C. and Second circuits. In the bank subpoenas case, for example, the Second Circuit largely affirmed a New York federal judge's denial of a preliminary injunction sought by Trump, ruling in part that the RFPA doesn't apply to Congress and that Internal Revenue Service regulations didn't preclude production of tax returns held by Deutsche, either.

"It was decided based on the preliminary injunction standards, where the court considers irreparable harm, likelihood of success on the merits, public interests and considers the balancing of the various factors," Zinsner said of the bank subpoenas case.

The justices said last month that they would review that case along with the other two subpoena fights, an announcement that Zinsner said presents the high court with an opportunity to revisit some of the issues decided by the lower courts.

"There could be Gramm-Leach-Bliley Act ripple effects," Zinsner said, referring to another law regulating financial institutions' disclosure of customers' financial information. "There could be impacts on the Right to Financial Privacy Act."

But even if the Supreme Court reaches a different conclusion about whether a preliminary injunction should have been ordered in that case, Zinsner said that likely won't be the end of the road for the litigation, as there's still the question of whether a permanent injunction should be issued.

"It's a fascinating case," Zinsner said. "I'm seeing it in my practice already where, you know, a bank employee receives a subpoena and sees that other people don't have to respond or can get their cases heard by the Supreme Court, whereas the typical practice with a third-party subpoena is, if you have a client who's received a subpoena and that client has a pulse, they need to appear in court unless there's some extraordinary reason to quash the subpoena."

### **Overdraft Fee Litigation**

Lawsuits challenging overdraft fee practices were all the rage several years ago as consumer plaintiffs and even some regulators accused numerous banks of using underhanded tactics to juice revenue, like applying credits and debits to customer accounts in ways more likely to trigger overdraft fees.

Some of those cases wound up being quite costly for banks. Wells Fargo, for example, was ordered to pay restitution of \$203 million to consumers in a California class action in 2013, and the litigation prompted many financial institutions to alter their transaction processing policies.

But heading into 2020, financial services attorneys told Law360 that there's another crop of overdraft-related litigation building steam in the courts, this time focusing on banks' disclosures about their overdraft practices rather than taking issue with the practices themselves.

"The claims are more subtle," said Kristine Roberts, chair of Baker Donelson Bearman Caldwell & Berkowitz PC's financial services litigation and compliance group. "The plaintiffs seem to be trying to take advantage of places where they can argue bank customer agreements contain ambiguities and where the financial institution may not be aware of it."

According to Roberts, these new overdraft cases typically assert breach of contract and unjust enrichment claims and come in several flavors, often turning on the difference between how a customer expects to be charged for overdrafts and how a bank actually calculates the customer's account balance in those situations.

A number of these cases have succeeded in getting past the motion-to-dismiss phase, too, shaking loose some seven- and eight-figure settlements in the process.

And upping the ante still further this past year was the Eleventh Circuit's decision reviving one such overdraft case against a Georgia credit union. Although the credit union's overdraft services agreement was nearly identical to a CFPB-approved template, the appeals court concluded it didn't make sufficiently clear what balance calculation method would be used.

Whether banks can ward off additional litigation by beefing up their disclosures and what guidelines might be laid down as more overdraft cases bubble up to the circuit courts remains to be seen in 2020.

"It's one thing to attack a bank practice as somehow wrongful, but it's another thing to base a claim on something like this, which may be more difficult for a financial institution to know is even something that needs to be addressed," Roberts said.

### **Valid When Made**

Whether acquirers of bank loans can safely charge the same interest rates on those loans as their originators will be put to the test in cases around the country this year as aftershocks from the Second Circuit's 2015 Madden decision continue to ripple through the courts and regulators look to calm them.

The appeals court ruled in Madden that a nonbank buyer of charged-off credit card debt from a national bank was not legally shielded from having state interest rate caps applied to that debt even though they hadn't applied before the sale, an outcome that caused a stir in the banking and fintech worlds for its apparent inconsistency with the "valid-when-made" doctrine.

The doctrine holds that a loan's interest rate will remain legal as long as it was legal when the loan was made, regardless of who ends up holding the loan later on, and it's widely considered within the financial services industry to be a foundational principle for bank-fintech lending partnerships and secondary credit markets more broadly, where trillions of dollars in bank loans are sold and securitized.

But more than four years later, despite heavy criticism from industry and scrutiny from some lawmakers on both sides of the aisle, the Madden decision is still being cited in litigation accusing these lending partnerships of being sham arrangements designed to evade state usury laws.

The decision has also come up in two 2019 New York cases targeting credit-card securitizations, as well as a Colorado bankruptcy appeal involving a claim for a high-interest business loan that a nonbank acquired from a bank.

This past year, federal banking regulators began to push back more aggressively to contain Madden fallout, starting with an amicus brief filed in the Colorado case that criticized the Second Circuit's 2015 ruling for its "unfathomable" gaps in analysis. The regulators also released draft rules codifying the valid-when-made doctrine and could finalize those proposals sometime in 2020, although it isn't yet clear how much of an effect they will have on existing litigation.

What is clear, however, is that a number of current cases implicating Madden are at critical junctures as the new year arrives. Motions to dismiss are pending in the credit-card securitization suits, for example, and the Colorado bankruptcy appeal is fully briefed, teeing up opportunities for key rulings on banks' loan sale and securitization activity.

Against that backdrop, Catherine Brennan, a partner in Hudson Cook LLP's fintech and alternative business finance practices, said she expects 2020 still won't bring the final word on valid-when-made as the debate continues to percolate through the courts, but she does expect to see federal regulators like the OCC stepping up this year to play a more active role in supporting the doctrine's viability.

"They're pushing," Brennan said. "We see from their willingness to file that friend-of-the-court brief [in the Colorado case] and their recent proposed rules affirming valid-when-made and seeking to overturn Madden. They're not going to shy away from this discussion."

--Editing by Jill Coffey and Michael Watanabe.