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Legal Counsel

Client Alert

Court Ruling Impacts Lending Institutions' Posting Practices

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On August 10, 2010, a federal judge in the United States District Court for the Northern District of California issued a significant ruling that is likely to have a substantial impact throughout the financial services industry. The order was entered in *Gutierrez v. Wells Fargo*, 07-05923, U.S. District Court, Northern District of California (San Francisco). U.S. District Judge William Alsup held that Wells Fargo & Co. had improperly posted transactions on debit card accounts in a manner designed to increase Wells Fargo's revenue from overdraft fees while failing to disclose its practices to consumers. The judge ordered Wells Fargo to pay roughly $203 million in restitution to consumers and enjoined the posting practice.

In April 2001, Wells Fargo instated a "resequencing" policy, pursuant to which it switched how it posted daily debit transactions and cash withdrawals from a low-to-high amount basis to a high-to-low basis. Under the low-to-high posting method (which Judge Alsup found to be prevalent in the industry today), a bank would pay items from lowest-to-highest dollar amount, minimizing the likelihood that multiple overdraft fees would be charged if one item for an amount close to the account balance was scheduled to be processed on the same day as several smaller items. By "resequencing," Wells Fargo made it more likely that a large item could wipe out the entire account balance before smaller items could be paid and the customer would incur multiple overdraft fees when the smaller items were paid. Shortly thereafter, in December 2001, Wells Fargo also began "comingling" various types of debits (debit card transactions, checks and ACH withdrawals) during posting, again processing them from highest to lowest, rather than in the order in which the debits occurred. Finally, in 2002, Wells Fargo instituted a practice of extending its customers a "shadow line" of credit, authorizing debit card transactions even when the account was already overdrawn.

Judge Alsup found that these practices led customers to overdraw their accounts by small amounts multiple times a day, instead of causing only one or two overdrafts. Because Wells Fargo imposed an overdraft fee for each instance of an overdraw transaction, the judge found that the practice was unfair, deceptive and fraudulent, and that National Bank Act and OCC regulations did not preempt plaintiffs' claims.

Wells Fargo argued that its method of processing debit transactions is legal and consistent with customers' interests, since most customers would prefer that larger transactions, such as mortgage, rent or car payments, receive priority. But Judge Alsup rejected that argument, based in part on internal communications by Wells Fargo executives that indicated that the practice was intended to boost revenue from the overdraft fees. The judge found that customers did not expect to incur multiple overdraft fees and that Wells Fargo failed to provide adequate disclosures regarding this practice to its customers. Wells Fargo "went to great lengths to bury the words deep in a lengthy fine-print document and the words selected were too vague to warn depositors," Judge Alsup wrote.

In his order, the judge said Wells Fargo must end the resequencing practice related to debit card transactions by Nov. 30, 2010, and ordered that the bank must pay restitution to customers who paid multiple fees due to the policy change.

Vorys is prepared to leverage its extensive experience in advising lending institutions in assessing their practices in light of the *Gutierrez* decision and advising on best practices going forward.