



January 19, 2007

Honorable Ronald M. George, Chief Justice,
and Associate Justices
California Supreme Court
350 McAllister Street
San Francisco, CA 94102-4783

RE: *Miller v. Bank of America, NT & SA, et al.*, Case No. S149178
Amicus Letter in Support of Respondent's Petition for Review

To The Honorable Chief Justice and Associate Justices of the California Supreme Court:

The Center for Responsible Lending (CRL) respectfully submits this letter in support of the Petition for Review of the decision of the First District Court of Appeal in *Miller v. Bank of America, NT & SA*, 144 Cal. App. 4th 1301 (Ct. App. Nov. 20, 2006).

WHY REVIEW SHOULD BE GRANTED

The Court of Appeal's decision represents an unsupported and unsupportable restriction of this Court's ruling in *Kruger v. Wells Fargo Bank*, 11 Cal. 3d 352 (1974). *Kruger* recognized the strong public policy underlying the exemption of governmental benefits from seizure by creditors: that these funds remain available to meet the recipient's basic survival needs. Critical to the instant case, it further recognized that neither the identity of the creditor nor the name of the particular form of seizure was sufficient to override that policy. It did not leave room for creating classes of debts owed to the bank—some above the exemption law, and others not. In restricting this Court's holding in *Kruger*, the Court of Appeal elevated nomenclature over substance and substituted an uncritical acceptance of hyperbole for acknowledged factual findings of the trial court. The appellate court's decision also threatens to significantly undermine the economic security of the more than three million Californians who receive Social Security benefits by creating a gaping loophole in the exemption law. Such reversal of prevailing California law, contradiction of the public policy articulated in *Kruger*, and contravention of appellate standards, should not stand without review by the state's highest court.

STATEMENT OF INTEREST

CRL is a non-profit, non-partisan research and policy organization dedicated to eliminating abusive financial practices so that low and moderate-income households can protect their assets and build wealth. It has testified numerous times before Congress, regularly provides written and oral testimony to federal and state regulatory agencies, and has appeared as amicus before many courts.

CRL has offices in California, North Carolina, and the District of Columbia, and is an affiliate of the Center for Community Self-Help, which includes a credit union and a loan fund. The Self-Help Credit Union has \$260 million in assets and some 12,700 deposit accounts. Self-Help's loan fund has provided more than \$5 billion in financing to help over 50,000 low-wealth borrowers in forth-seven states buy homes, build businesses, and strengthen community resources. CRL's affiliation with Self-Help provides it with important insight into the business needs of financial institutions and the responsibilities of such institutions to their customers and to communities.

CRL has conducted extensive research and policy work on issues related to bank overdraft practices. The banking industry has dramatically changed the character of demand accounts themselves, as well as that of their attendant fees, in recent years. The accounts have become dual-purpose, acting as both a payment system and as a mechanism for delivering credit to bank customers. This method of providing credit – by funding overdrafts and charging “not sufficient funds” (NSF) fees in return – is now the primary driver behind the increasingly significant NSF fee income collected by banks. In 2005, CRL issued a research report titled *High Cost and Hidden From View: The \$10 Billion Overdraft Loan Market*, which was one of the first attempts to quantify the amount of overdraft fees paid by consumers in this new world of checking-account credit.

I. THE COURT BELOW CREATED AN EXCEPTION TO *KRUGER* NOT SUPPORTED BY LAW OR POLICY

A. *Kruger* protects exempt funds from banks' setoff rights, irrespective of whether the obligation arises from the same or independent transactions.

The legal principle established by this court in *Kruger v. Wells Fargo Bank*, 11 Cal. 3d 352 (1974) is straightforward and has played a vital role in protecting the integrity of the safety net of legal exemptions. Federal law governs the first two threads of this safety net as Social Security income is 1) exempt from legal process, 42 U.S.C. § 407, and 2) retains its exempt character when deposited into a bank account, *Philpott v. Essex County Welfare Board*, 409 U.S. 413, 416 (1973). *Kruger* added the third thread, holding that a bank's self-help remedy of setoff is no different from third-party seizure of exempt funds by legal process. *Kruger*, 11 Cal. 3d at

370 (holding that “[t]he assertion of a bankers’ setoff has exactly the same effect as a third party’s levy of execution on the account . . .”).¹

It is, and was at the time *Kruger* was decided, well-established in California law that both obligations arising from the same transaction and obligations arising from independent transactions are equivalent for purposes of that self-help remedy. The elements necessary to create an obligation subject to a bank’s right of setoff are: a) the debt must be “mutual,” b) the debt must be mature, c) the account must be in the debtor’s name, and d) the deposit must not be for a special purpose. See 2 Barkley Clark & Barbara Clark, *The Law of Bank Deposits, Collections and Credit Cards* § 18.06 (2006). None of these elements has been interpreted to require that the origin of the debt be an independent transaction.

The Court of Appeal seems to reason that NSF fees do not create a debt subject to setoff because the overdraft and its attendant fee occur “within a single account.” 144 Cal. App. 4th at 1311. This flawed logic conflicts with the principle that “debts *need not be of the same character or arise out of the same transaction*” in order to meet the mutuality requirement. See *id.* (emphasis added). Indeed, its holding would turn this rule of black-letter law on its head - from the debt *need not* arise out of the same transaction, to the debt *cannot* arise out of the same transaction. The Court of Appeal’s decision is also contrary to well-established case law that overdrafts create debts. Indebtedness may be created by “an overdraft, a discount, an acceptance, or other species of advance or loan . . .” *Melander v. Western Nat’l Bank*, 21 Cal. App. 462, 467 (Ct. App. 1913); see also 9 Cal. Jur. Banks 3d § 150 (an indebtedness within the meaning of the statutory provision for the banks lien may consist of overdrafts of the depositor); 5A Michie on Banks & Banking § 114 (in explaining the rationale behind the banks’ self-help rights, treatise cites obligations arising from both overdrafts and notes).

In the law of bank setoff, which *Kruger* held to be subject to the exemption law’s limitations, there is no hierarchy among different kinds of debts. “The right of a bank to a lien or setoff *is not tested by the character in which the customer becomes indebted* to the bank, but solely by the fact that he or she is indebted to it in a balance due and accruing in the course of business.” 9 Cal. Jur. 3d Banks § 150 (2006). The appellate court ignored the command not to “test the character” by which plaintiff Paul Miller became obligated, using the character of his debt as a rationale for ignoring this Court’s *limitation* on the bank’s self-help rights as to exempt property.

There is no basis for picking and choosing among the kind of debts subject to the law governing bank self-help collection rights – allowing the protection of exemption law for some and not for others. Contrary to its contention that the trial court’s decision was an *extension* of *Kruger* better left to statute or regulation, 144 Cal. App. 4th at 1314, the Court of Appeal’s decision is a *restriction* of *Kruger*. Such a restriction may only be made by the Supreme Court of California.

¹ See also *id.* at 368 (citing California cases limiting non-bank setoff rights in order to carry out policy of protecting debtors and noting that “a different doctrine would operate a practical repeal of the exemption laws.”) (internal quotations omitted).

Still more fundamental, the Court of Appeal forgot that *Kruger* was not focused on the nature of the debt or setoff, but on the nature of the exempt assets. This Court in *Kruger* clearly stated: “the exercise of a banker’s setoff against unemployment and disability benefits diverts money intended by the state to pay the current living expenses of the unemployed and disabled . . . leaving the intended beneficiaries with no choice but to seek additional relief from the state.” *Id.* Thus the rationale elaborated in *Kruger* was primarily concerned with the preservation of benefits necessary to survival, in recognition of the “Legislature’s objectives in providing such benefits and in protecting them from seizure” *Id.* at 370.

Any ability of the bank to dissipate the funds of Social Security recipients would frustrate the holding in *Kruger*. The *Kruger* decision emphasized that the key feature is the *effect on the account holder* – not the nature of the debt or the definition of setoff. As this Court wrote: “[t]he assertion of a banker’s setoff has exactly the *same effect* as a third party’s levy of execution *on the account* – it deprives the depositor of the income which the state provided him to meet subsistence expenses.” *Id.* at 371 (emphasis added). The Bank’s actions here have the exact same effect on depositors, whether termed “account balancing” or “banker’s setoff” – it is the depletion of Social Security income granted to ensure their ability to survive at the most basic level. Giving the Bank free reign to usurp these funds under the guise of terminology would produce the same result deemed unacceptable in *Kruger*, “compelling the state either to give [the recipient] additional money or leave him without any means of physical survival.” *Id.*

B. Post hoc re-characterization of obligations and the self-help collection of those obligations cannot support restriction of the *Kruger* doctrine protecting exempt funds from banks’ self-help remedies.

The bank setoff law described above makes clear that the act of overdraft creates an obligation equivalent to debt created by a separate promissory note, effecting a change from the normal process of debit and credit accounting in the account *qua* payment system. It recognizes that overdraft effectuates that transformation.

While denying that nomenclature matters, 144 Cal. App. 4th at 1312 n. 7, the appellate court nonetheless engages in semantic convolution to evade the clear import of *Kruger*. The accounting mechanism by which setoff occurs is irrelevant to whether there is a debt. *See, e.g.*, 9 Cal. Jur. Banks 3d. § 150 (“Although the charging back to the customer of checks deposited by him or her and found worthless is simply the enforcement of the bank’s right against the customer as an endorser of checks, an indebtedness due the bank within the meaning of the statutory provision for the bank’s lien may consist of overdrafts of the depositor.”). That debt in the instant case happens by virtue of accounting entries is overbroad, making this distinction a useless heuristic. As a general principle, the right of setoff – bank or otherwise – “is constantly exercised by business men in *making book entries* whereby one mutual debt is applied against another.” *Studley v. Boylston Nat’l Bank of Boston*, 229 U.S. 523, 528 (1913) (emphasis added).²

² The court below cites the 2004 Black’s Law Dictionary’s definition of general setoff, 144 Cal. App. 4th at 1312, as support for its proposition that the source of the obligation must be an independent transaction. The dictionary, however, has a separate definition for *bank setoff*, which cites only the well-established requirements of mutuality and maturity referenced in Section IA, above. Black’s Law Dictionary (6th ed. 2004) (“The equitable right to setoff.

It is well established that a “debt” is a certain obligation to pay money or some other valuable thing, defined in Black’s Law Dictionary as “[l]iability on a claim; a specific sum of money due by agreement or otherwise.” Black’s Law Dictionary (8th ed. 2004). The California courts also recognize that an obligation to pay money is broadly termed a debt. *See, e.g., Chalmers v. Sheehy*, 132 Cal. 459, 465 (1901) (“‘debt,’ used in our statutes, ‘should be given its modern legal significance, as including any sort of obligation to pay money.’”); *Certified Grocers of California, Ltd. v. San Gabriel Valley Bank*, 150 Cal. App. 3d 281, 288 (Ct. App. 1983). And the obligation to pay debts arising out of overdrafts is long-settled to be subject to bank setoff rights. *See, e.g., 5A Michie on Banks and Banking* § 114 (“any credit the bank extends to its customers by way of *loans or overdraft* is given on the faith that money . . . sufficient to meet *the debt* . . . will come into possession of the bank . . .”). Bank setoff rights, in turn, must honor exemption law under *Kruger*. Thus, post hoc re-characterization of new obligations created by NSF fees cannot stand either legally or factually. Moreover, the evidentiary record established that the bank knew it was engaged in debt collection at the time it seized plaintiff’s Social Security benefits. *See infra* Section III.

The practice of providing revolving credit through a checking account, discussed in Section II, *infra*, provides the starkest example of the unintended consequences of the Court of Appeal’s restriction of *Kruger*. However, the NSF fees at issue in this case, whether for funded or unfunded overdrafts, are not merely a netting out of internal debits and credits. They are *additional* debt of extra fees and charges that the bank imposes and the depositor/debtor is obligated to pay.

II. NSF FEES CHARGED FOR OVERDRAFTS ARE FUNCTIONALLY EQUIVALENT TO THE DEBTS INCURRED WITH THE CREDIT CARDS AT ISSUE IN *KRUGER*.

The NSF fees at issue in the instant case are, in all practical terms, the same as the disputed credit card debts in *Kruger*. Over the past 10 years, there has been a dramatic change in how banks view NSF fees.³ Previously, banks assessed these charges as penalties designed to discourage customers from overdrawing their accounts. Now, they see them as potential profit centers, and have adopted policies and practices that encourage – even create new opportunities for – overdrafts in order to increase their fee income.⁴ The NSF fee paid by a customer when the bank covers a withdrawal that exceeds their account balance is actually a finance charge for a

The right to cancel cross demands, usually used by a bank to take from a customer’s deposit accounts the amount equal to the customer’s debts that have matured and that are owed to the bank.”).

³ In this brief we use “NSF fee” to refer to both the fee banks charge when they refuse to honor a customer’s overdraft (NSF fee) and the fee banks charge when they cover a transaction drawn on an account that lacks sufficient funds (overdraft fee).

⁴ These include allowing overdrafts on ATM withdrawals, debit card purchases, automatic bill pay, etc., without notifying the customer at the time of the transaction that it would overdraw the account and result in a fee. This is a striking departure from the historical practice of declining ATM and debit card transactions when there was not enough money in an account to pay them. A new statistical analysis by CRL of checking account data from the country’s 15 largest banks found that 72 percent of overdrafts are caused by electronic debits, with debit card point-of-sale purchases in first place. Eric Halperin, et al., *Debit Card Danger* (Ctr. For Responsible Lending) forthcoming Jan. 2007, *will be available at* <http://www.responsiblelending.org/issues/overdraft>.

very short-term – and typically very expensive – loan. The amount of the “overdraft loan,” plus the fee, is automatically recovered by the bank from the customer’s next deposit.⁵ In 2004, banks reaped more than \$17 billion in NSF fees.⁶ More than two-thirds of these fees were finance charges on overdraft loans.⁷

In *Kruger*, the court noted that bank credit cards were, at the time, a new substitute for what in the past would have been a multitude of third-party debts.

[W]ith the growth of bank-sponsored credit systems, a bank may gather unto itself the debts incurred by a depositor for past living expenses and satisfy by setoff debts which, in the days before Master Charge and Bank Americard, would have been held by many separate merchants and enforceable only through execution. To permit a bank which has thus collected the past obligation of its depositor to satisfy those claims from [exempt] deposits would completely defeat the state policy of preserving such deposits for the daily living expenses of the depositor.”

11 Cal. 3d at 370 (internal footnote omitted). Now, some thirty years after *Kruger*, another credit innovation has emerged that is fast eclipsing credit cards: overdraft lending. Today, depository institutions including Bank of America not only allow, but even encourage, the use of checking and savings accounts as a source of recurring credit for depositors through overdraft loans.

Like the credit card accounts in *Kruger*, by paying overdrafts and charging NSF fees a bank can “gather unto itself” debts incurred by the depositor for past living expenses. In the days before banks adopted this practice, these debts would be owed to credit card companies or purveyors of short-term loans, such as payday lenders. Like the credit cards in *Kruger*, the use of deposit accounts as a source of credit represents an evolution of the form by which credit is provided to consumers. When you look beyond form to the substance of the transaction, however, it is no different than any revolving credit program, including the credit card accounts in *Kruger*. As one banking law treatise has noted:

The allowance of overdrafts was long considered in this country as a very special service only provided for very special customers. Now it has become a way of life that, along with the credit card, provides a handy device by which banks have entered the explosive world of revolving credit. Through the adoption of ‘check credit’ plans, banks have turned the overdraft in a standard checking account into a prearranged line of credit extended to the customer-depositor on demand.

⁵ The plaintiff in this case is challenging the bank’s seizure of NSF or overdraft fees, but not the underlying loan extended by the bank if it pays the overdraft.

⁶ This figure is based on the conservative assumption that 45% of the \$38 billion in service charge income is attributable to NSF fees, a figure below other analysts’ estimates. Jacqueline Duby, et al., *High Cost and Hidden From View: The \$10 Billion Overdraft Loan Market* (Ctr. For Responsible Lending), May 26, 2005, at 3-4, available at <http://www.responsiblelending.org/issues/overdraft/reports/page.jsp?itemID=28012539>.

⁷ Howard Mason, *The Criminal Risk of Actively-Marketed Bounce Protection Programs*, Bernstein Research Call, Feb. 18, 2005, at 1; Bruce Mohl, *Banks Rapped on Cost of Bounce Protection*, Boston Globe, Feb. 23, 2005, at A1.

1 Barkley Clark et al., *The Law of Bank Deposits, Collections and Credit Cards* § 3.04, at 3-107 (emphasis added).

The Court of Appeal has gutted *Kruger* by creating an exception for credit programs that operate through a checking account. This carve out for a multi-billion dollar credit program is not supported by the facts or the applicable law. Moreover, it reduces to a hollow promise the statutory exemption from setoff for the Social Security income of more than three million Californians.

III. THE COURT OF APPEAL VIOLATED THE SUBSTANTIAL EVIDENCE STANDARD AND SUBSTITUTED ITS OWN JUDGMENT FOR THAT OF THE TRIAL COURT IN ORDER TO REACH A DECISION CONTRARY TO THE FACTS PROVEN AT TRIAL.

In general, the trial court decides questions of fact and the appellate court decides questions of law. *Tupman v. Haberkern*, 208 Cal. 256, 263 (1929). Where there are facts in dispute, the appellate court is bound by the trial court's factual determination so long as it is supported by "substantial evidence," even if the reviewing court would have reached a different conclusion. *Green Trees Enterprises, Inc. v. Palm Springs Alpine Estates, Inc.*, 66 Cal. 2d 782, 784-785 (1967); *Bowers v. Bernards*, 150 Cal. App. 3d 870, 874 (Ct. App. 1984). "Substantial evidence" is evidence of ponderable legal significance, evidence that is reasonable, credible and of solid value. *Kuhn v. Dep't. of Gen. Services*, 22 Cal. App. 4th 1627, 1633 (Ct. App. 1994).

The facts in dispute on appeal hinged, in part, on Bank of America's assertions regarding its knowledge of wrongdoing, its characterization of overdraft and NSF fee setoffs, and the consequences of complying with *Kruger* for the banking industry and consumers. The Court of Appeal, therefore, is constrained by the substantial evidence standard to "consider the evidence in the light most favorable to the prevailing party, giving that party the benefit of every reasonable inference, and resolving conflicts in support of the judgment." *Nordquist v. McGraw-Hill Broadcasting Co.*, 32 Cal. App. 4th 555, 561 (Ct. App. 1995). The appellate court violated this standard by disregarding the substantial evidentiary record and, in so doing, reached a decision that flies in the face of the important public policy concerns underlying *Kruger*.

A. The Court of Appeal ignored substantial evidence that the Bank knew it acted illegally when it seized exempt government benefits from direct deposits to recover overdraft and NSF debts.

The Court of Appeal's conclusion that a refusal to gut *Kruger* would undermine settled expectations or cause upheaval in the industry is refuted by the fact that the Bank was aware of wrongdoing and, therefore, was not entitled to reliance. The appellate court contended that charging overdraft and NSF fees against direct deposit government benefits was "standard bank practice." 144 Cal. App. 4th at 1306. Yet, the Bank provided substantial evidence that, even in the judgment of its own legal department, it knew it was violating the law – routinely. By focusing on the frequency with which the Bank ignored exemption law, and neglecting to consider its state of mind, the Court of Appeal depicted the plaintiff's effort to enforce a thirty-

year old law as seeking a sweeping change in the banking industry.⁸ This characterization, however, cannot be sustained in light of the Superior Court’s findings of fact. Rather, there is ample evidence that the Bank repeatedly acknowledged the illegality of assessing fees against exempt funds and reversed overdraft and NSF debits when a customer cognizant of their rights objected.

The Superior Court found that “there was considerable evidence in the record to establish that the Bank in fact knew that its conduct was unlawful.” *Miller v. Bank of America N.T. & S.A.*, No. CGC-99-301917, 2004 WL 3153009, at *24 ¶ 53 (Sup. Ct. Dec. 30, 2004). This finding was supported by substantial evidence at trial. For example, Bank branch manager Ronald Hahr, after consulting with the legal department regarding Miller’s complaint, wrote on a credit slip: “per authorization of Legal ... cannot offset against SS.” *Id.* at *4 ¶ 23. One of the account adjustor’s in the Bank’s Retail Collections Department, Dolores Smirke, stated that she was instructed by her boss not to offset Social Security direct deposit accounts. *Id.* at *5 ¶ 30. The Bank’s legal department responded to class member Terri Derischebourg’s complaint that her SSI funds were seized to pay back an overdraft by ordering Bank personnel to return the funds; personnel noted on a Bank document that “we *may not* withhold SSI direct deposits to cover any ODS (overdrafts) *on any accounts.*” *Id.* at *7 ¶ 49 (emphasis added). When it reversed the setoff of another class member’s Social Security funds to pay an overdraft, an apparently exasperated Bank employee wrote: “this was the third time the Bank debited account and had to reverse the debit. If possible, would like a message on account stating customer received SSI/SSA. Reversed NSF fee Bank error.” *Id.* at *7 ¶ 48.⁹

The Superior Court gave the Bank an opportunity to submit contrary evidence as to its state of mind on the applicability of *Kruger* to its policy of taking Social Security funds to pay debts of class members. Over plaintiff’s objections, the trial court granted the Bank’s demand that it be allowed to call two high-level Bank attorneys – ostensibly responsible for the Bank’s position on charging fees and repaying overdrafts – to testify, subject to being deposed and producing applicable records. Resp’t Paul Miller’s Opp’n to Appellant Bank of America’s Pet. for Writ of Supersedeas or Other Approp. Stay Order and Resp. to Amicus Curiae Briefs Filed in Supp. of the Pet. by the U.S. et al. at 42 n.12, *Miller v. Bank of America, NT & SA*, 144 Cal. App. 4th 1301 (Ct. App. Nov. 20, 2006) (No. A110137). The Bank, however, did a complete about-face. It refused to produce the employees for deposition, produced no documents, and ultimately informed the court that it was withdrawing the witnesses. *Id.*

B. The Court of Appeal ignored substantial evidence that the Bank understood its own conduct as engaging in setoffs for the purpose of debt collection.

The Court of Appeal distinguished the instant case from *Kruger* on the grounds that *Kruger* involved “setoffs,” 144 Cal. App. 4th at 1309, while here the Bank was taking monies

⁸ In any event, widespread flouting of the law is not a defense. *See, e.g., Chern v. Bank of America*, 15 Cal. 3d 866 (1976).

⁹ The trial court made the factual determination that “the Bank’s practices and procedures regarding direct deposit social security benefits in the case of Paul Miller, Barbara Washington, Trina Gardley and Terri Derischebourg are representative of the Bank’s practices and procedures regarding accounts held by members of the class.” *Miller*, 2004 WL 3153009, at *7 ¶ 50.

from an account based upon fees levied against the same account, a process it termed “account balancing.” 144 Cal. App. 4th at 1311. This is no more than semantic sleight of hand. The substantial evidentiary record and the trial court’s fact finding establishes that the Bank understood it was engaged in setoff and debt collection, and drew no distinction between independent debts and debts arising from the account.

1. The Bank understood its debiting of overdraft and NSF funds as a setoff.

The factual record shows that the Bank seized Social Security funds from separate accounts to pay back debts incurred by the plaintiff and other class members. The undisputed facts show that after Miller, upon the Bank’s advice, opened a new account with his previously seized benefits in order to protect them and future direct deposits from setoff, the Bank took those funds as well. *Miller*, 2004 WL 3153009, at *4-5 ¶¶ 23-31. As noted above, the third time the Bank snatched Trina Gardley’s Social Security direct deposit funds, it was to recover a debt in another of her accounts. *Id.* at *7 ¶ 48. Bank employees testified at trial that it was Bank policy to treat multiple accounts belonging to the same depositor as fungible when it came to recovering a debt owed the Bank. *Id.* at *8 ¶ 57. The fact that one account was being offset to pay back a debt charged to another discredits any claim by the Bank that it was merely balancing the books, not collecting a debt.¹⁰

The trial court made a specific finding of fact that: “The Bank refers to the amount seized as a setoff for the amount owed.” *Id.* at *7 ¶ 46. This finding of fact was supported by substantial evidence, among which were written representations made by the Bank to its customers, in the ordinary course of business, regarding its right of setoff. These representations did not restrict that right to independent debts. On the contrary, the Bank’s language was expansive, stating that its setoff may be used for “any debts” the customer allegedly owes the Bank. The Bank’s FACTS booklet, which according to its employees is intended for all account holders, states:

The right of set off law grants us the right of setoff – the right, under certain circumstances, to use funds in your account to pay any debt you owe us. We may recover funds you owe us from any of your accounts. If you own an account with other persons, we may use funds in the account to pay the individual debts you or they owe us. We may also use funds in an account you own separately to pay debts owed to us on the account you own with other persons.

Id. at *11 ¶ 80.¹¹

¹⁰ Here the rationale of the Court of Appeal in distinguishing *Kruger* falls apart on its own terms: even if, *arguendo*, there were a “conceptual and practical distinction between banking operations carried out within one account and those that involve charging debits and credits between multiple accounts,” 144 Cal. App. 4th at 1312, n.7, the distinction would not apply in the instant case because the Bank expressly reserved the right to offset any account to recover overdraft and NSF fees, and actually did so.

¹¹ The language of every FACTS booklet introduced into evidence at trial was the same. Paul Miller's Combined Respondent's Br. and Cross-Appellant's Opening Br. at *51, *Miller v. Bank of America, NT & SA*, 144 Cal. App. 4th 1301 (Ct. App. Nov. 20, 2006) (No. A110137) [hereinafter Miller’s Combined Br.].

2. The Bank, internally and in communications with customers, characterized its actions as collecting on a debt.

The Bank's unsupported post-trial claim that it was "account balancing," Bank of America, N.A.'s Reply and Cross-Response Brief and Response to Amici AARP et al. at *8-9, *Miller v. Bank of America, NT & SA*, 144 Cal. App. 4th 1301 (Ct. App. Nov. 20, 2006) (No. A110137), as opposed to debt collecting, cannot be sustained since at the time it was conducting the activities, it viewed them as debt collection.¹² The Bank's own employees testified that the overdraft and NSF fee deductions from customer accounts constituted debt collection. Stiehr referred to funds being confiscated when the Bank deducted money from Miller's account, and described her communications with the "Collections Department," which was responsible for authorizing the debit. *Miller*, 2004 WL 3153009, at *5 ¶ 30. Smirke testified that if the Bank had known that Miller's account constituted direct deposit Social Security benefits, the Bank would have handled his account for collection purposes differently – by not "offset[ing]" the account as it had done. *Id.*

At every turn, the Bank referred to its setoff actions as debt collection. Bank branch manager Kathy Bader testified that Miller's Social Security direct deposit funds would be deducted from his account to recover the "debt," *Id.* at *4 ¶ 25, a characterization that was echoed by Hahr, *Id.* at *7. Hahr went so far as to refer to seizure by the Bank of Miller's direct deposit funds as the work of "an over-eager collector in the back room." Miller's Combined Br., *supra* note 11, at *32. One class member received a letter from the Bank threatening to make good its attempt to repay itself for an overdraft by "turn[ing] the matter over to a collection agency to help us recover the funds." *Id.* at *8 ¶ 53. Indeed, the Bank's FACTS booklets intended for all account holders described the "right of setoff" as existing so that customers could "pay any debts you owe us." *Id.* at *11 ¶ 80. The appellate court flagrantly abused its discretion when it disregarded the Bank's statements revealing its state of mind at the time it offset accounts, and instead gave credence to semantic obfuscation contrived after the fact.

C. The Court of Appeal accepted the Bank's unsupported conjecture that adhering to *Kruger* would result in adverse consequences, but ignored proven facts to the contrary showing that the Bank could readily follow the law without reducing access to banking services.

The Court of Appeal ignored substantial evidence that the Bank could readily comply with *Kruger* and, moreover, already had mechanisms in place to differentiate among accounts. It further ignored substantial evidence that, because the direct deposit accounts held by class members were valuable to the Bank even without the NSF fee income, the Bank would be unlikely to deny accounts to public benefit recipients. Instead, the Court of Appeal credited speculative testimony that was given little weight by the trial court.¹³ The inappropriateness of

¹² Whether or not the Bank's conduct constituted debt collection also has significance for the federal preemption question. OCC regulations do not preempt state debt collection laws, and the OCC – in contrast to the Bank – conceded in its brief that plaintiff's claims were not expressly preempted. The Court of Appeal did not reach the issue of preemption.

¹³ The Court of Appeal emphasized the testimony of William Zuendt, a former Wells Fargo executive, regarding the restrictions that a bank would have to place on accounts if it were forced to follow the law. 144 Cal. App. 4th at 1306. Because Zuendt was entirely unfamiliar with the Bank's specific policies and practices, his testimony was

the appellate court's choice was all the more striking because it expressly recognized the trial court's authority to determine witness credibility before discounting it wholesale. *Miller*, 144 Cal. App. 4th at 1314 (first writing “[a]s a reviewing court we acknowledge that it was within the trial court’s purview to give such testimony little weight,” but then disregarding the trial court’s findings on the grounds that these facts “are debatable, and being debated . . .”).

The Bank argued that it would be unable to identify the accounts containing direct deposit government benefits in order to exempt them from setoff under the *Kruger* rule. But a computer systems expert who analyzed the Bank’s system of accounts testified to that the Bank already programmed its computers to classify accounts for different types of handling. *Miller*, 2004 WL 3153009, at *9 ¶ 64. So-called “V.I.P.” accounts belonging to depositors with large balances, for example, were flagged so as not to be charged NSF fees, or to receive special attention when account holders called the on-line information system. *Id.* at *9-10 ¶¶ 65-66. Despite the Bank’s demonstrated ability to designate individual accounts for specific treatment, the Superior Court found that the Bank had not implemented any system to flag the accounts of government benefit recipients. *Id.* at *10 ¶ 66.

The Court of Appeal contended that banks would be obliged to restrict services for class members if the *Kruger* rule were enforced, including denying them access to ATMs, limiting debit card point-of-sale transactions, refusing to honor certain automatic bill payments, and even closing their accounts altogether. 144 Cal. App. 4th at 1313. In parroting back the unsubstantiated assertions of the Bank, the appellate court disregarded the facts proven at trial. These facts show that the Bank gets value from its relationship with these customers, even when their accounts *per se* are not profitable. This is because the Bank actively markets a range of financial products and services – including savings accounts, credit cards, credit protection, loans, and check cards – to all checking account customers, including those who receive government benefits. *Miller*, 2004 WL 3153009, at *10 ¶ 72. The Superior Court noted that at least one Bank employee recommended to Miller that he could repay his debt to the Bank by obtaining a Bank credit card, charging the debt on it, and then paying it off over time (with interest, of course.) *Id.* at *10 ¶ 73.

The Bank itself offered testimony that it considers some 62% of its 16.2 million checking accounts unprofitable because they generate less in fees than they cost to maintain. Yet it has made no effort to close these accounts or single them out for differential treatment or reduced services. *Id.* at *10 ¶ 70. The Superior Court emphasized that the Bank provided no evidence – substantial or otherwise – that it used lack of profitability as a basis for closing a checking account, nor had it ever closed an account for this reason. *Id.* at *11 ¶ 71. There is no evidence to support the contention that the Bank would treat its Social Security direct deposit accounts any differently.

given little weight by the Superior Court. *Miller*, 2004 WL 3153009, at *11 ¶ 79. The Court of Appeal also highlighted the testimony of Bank executive Dan Carretta, who speculated on actions the Bank might take if the prohibition on setoffs against government benefits were not lifted. *Id.* at 1306. Yet, Carretta was only mentioned by reference in the trial court’s findings of fact, and only on the issue of bank policy with respect to the order of debit processing and its implications for creating additional opportunities to charge overdraft and NSF fees. *Id.* at *8 ¶ 56.

Moreover, as the findings of fact show, accounts belonging to class members have been cash cows for the Bank because of their lower administration costs (direct deposit accounts are cheaper to administer) compared to their potential to generate service fee and cross-sales income. For this reason, the Bank aggressively markets direct deposit accounts to Social Security recipients. *Id.* at *10 ¶ 68 & *13 ¶ 90. The record showed that class member accounts alone generate an estimated \$92 million a year in profits for the Bank, according to an analysis of Bank data conducted by a plaintiff's expert. *Id.* at *10 ¶ 69. The Bank itself admitted charging \$284,211,273 in NSF and overdraft fees on these accounts over the period January 1994 to December 2003. *Id.* at *10 ¶ 74. Nevertheless, expert testimony concluded, and the trial court found, that even without the NSF fee income, class members' accounts would remain profitable because these depositors provided a customer base for other products and services offered by the Bank. *Id.* at *10 ¶ 69.

Finally, the Court of Appeal highlighted Treasury Department testimony on the risk that *Kruger* compliance would thwart the government's goal of "affording recipients of public benefits the same *consumer protections* offered other account holders," 144 Cal. App. 4th at 1314, (emphasis added), while ignoring the demonstrable harm caused to the class members by the Bank's ostensible "protections."

The demographic characteristics of the nearly 1.1 million Social Security recipients with direct deposit accounts at the Bank evoke a picture of extreme vulnerability: in excess of 50% estimated to suffer from a significant disability, 70% over the age of 65 and 8% over the age of 85. *Miller*, 2004 WL 3153009, pp. 5-6 ¶¶ 34-45. Nearly 50% had cognitive deficits that impaired their ability to understand Bank documentation. *Id.* Some 82% of disabled Social Security recipients in California have annual incomes under \$20,000, and 41% less than \$10,000. *Id.* Approximately 85% of all NSF fees collected by the Bank are assessed against customers whose accounts have average monthly balances of less than \$1,000. *Id.* at *11 ¶ 76.

The Bank "protections" extended to plaintiff Paul Miller, a former photojournalist who was permanently disabled by a head injury suffered in a physical assault, left him at risk of eviction when, because the Bank seized his funds and refused to honor his rent check (the Bank helpfully directed Miller to the local housing authority for assistance). *Miller's Combined Br.*, *supra* note 11, at *5-6. The Banks "protections" deprived class member Linda Lupe Rios, who has cancer, renal failure, diabetes and bipolar disorder, of food and heat because it helped itself to NSF fees from her \$790 monthly Social Security benefit. *Id.* at *10. The Bank's "protections" left former mechanic William Hawkrigde, who is deaf and learning disabled, without money to pay his bills because of onerous NSF fees deducted from his direct deposit of \$750 in monthly Social Security benefits – in one instance, \$160 in a single day. *Id.* at *11.

The Court of Appeal's decision shows flagrant disregard for the factual record in this case. It must not be allowed to stand.

IV. CONCLUSION

The Court of Appeal has arrogated to itself the power to radically restrict the public policy articulated in *Kruger*. Its decision is neither supported by the facts nor the law and should be reversed.

Respectfully Submitted,

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