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Litigation Update

Presentation to SWABC

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Topics:

- Notable Supreme Court Cases from 2023-24 Term:
  - *Consumer Fin. Prot. Bureau v. Cmty. Fin. Servs. Assoc. of Am., Ltd.*
  - *Coinbase, Inc. v. Suski*
  - *SEC v. Jarkesy*
  - *Loper Bright v. Raimondo*
- *NVIDIA Corp v. Ohman* (Supreme Court 2024-25 Term)
- Social Media and Financial Advice
- *Nat'l Ass'n of Indus. Bankers v. Weiser* (10th Circuit)
- *Foris DAX Inc. v. SEC* (E.D. Tex.)
- Continued Rise in FCRA Litigation
- Attacks on "Junk Fees"
- Texas Business Courts

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Consumer Fin. Prot. Bureau v. Cmty. Fin. Servs. Assoc. of Am., Ltd., 601 U.S. 416 (May 16, 2024)

- CFPB unique funding scheme = Federal Reserve as opposed to the ordinary Congressional appropriations process.

- The Fifth Circuit held in 2022 that this funding scheme violates the Constitution's appropriations clause: "[n]o Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."

- But the CFPB argued that Congress previously authorized the CFPB to use a *specified amount* of funds from a *specified source* for *specified purposes*, and its funding through the Federal Reserve was thus a proper "appropriation" of Congress.

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Consumer Fin. Prot. Bureau v. Cmty. Fin. Servs. Assoc. of Am., Ltd., 601 U.S. 416 (May 16, 2024)

- **Held**: The CFPB's funding scheme satisfies the appropriations clause and is constitutional. Fifth Circuit **REVERSED** in a 7-2 opinion by Justice Thomas.

- Justice Thomas relied heavily on textualism and historical context to explain that because Congress specified the source of the CFPB's funding (the Federal Reserve), the funding scheme fell within the historical definition of a congressional "appropriation."

- The dissent (Justice Alito joined by Justice Gorsuch) opined that the CFPB's "unprecedented combination of funding features" afforded it "the very kind of financial independence that the Appropriations Clause was designed to prevent." Justice Alito expressed concern over the "real-world consequences" of allowing the CFPB to operate without sufficient Congressional control of its funding to implement new rulemaking.

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Consumer Fin. Prot. Bureau v. Cmty. Fin. Servs. Assoc. of Am., Ltd., 601 U.S. 416 (May 16, 2024)

- Takeaway
  - The Fifth Circuit's ruling would have effectively gutted the CFPB by eliminating its funding.
  - Following the Supreme Court's reversal, the agency will be able to continue its increasingly expansive role in overseeing a wide-ranging consumer protection agenda, including guidance and rulemaking impacting banks and lenders. This includes, among other things:
    (a) new guidance on lending based on immigration status,
    (b) proposed caps on credit card charges and overdraft fees,
    (c) requiring certain non-bank financial firms to register with the CFPB in some conditions; and
    (d) removing the reportability of certain debts from credit reports.

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Coinbase, Inc. v. Suski, 602 U.S. 143 (May 23, 2024)

- Dispute about a Dogecoin sweepstakes on Coinbase, the nation's largest cryptocurrency exchange. In the underlying contract dispute over the sweepstakes, the parties relied to two seemingly inconsistent agreements: (1) Coinbase's user agreement (which included a broad arbitration clause); and (2) the specific sweepstakes rules distributed by Coinbase (which contained no reference to arbitration).

- Notably, a "delegation clause" in the user agreement specified that an arbitrator (not a court) would resolve any questions about arbitrability.

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Coinbase, Inc. v. Suski, 602 U.S. 143 (May 23, 2024)

- There are 3 traditional "levels" of arbitration disputes:
  - (1) the underlying contest over the *merits* of the dispute;
  - (2) a dispute about whether the parties agreed to arbitrate the merits (arbitrability);
  - (3) a dispute about whether the arbitrator or the court has authority to decide the "second-level" arbitrability dispute.

- This case presented a novel, "fourth-level" question about what happens when multiple agreements of the parties disagree as to the resolution of the "third-level" question.
  - Question Presented: "Where parties enter into an arbitration agreement with a delegation clause, should an arbitrator or a court decide whether that arbitration agreement is narrowed by a later contract that is silent as to arbitration and delegation?"

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Coinbase, Inc. v. Suski, 602 U.S. 143 (May 23, 2024)

- **Held**: Where parties have agreed to two contracts—one sending arbitrability disputes to arbitration and the other either explicitly or implicitly sending arbitrability disputes to the courts—a *court* must decide which contract governs. Ninth Circuit **AFFIRMED** in a 9-0 opinion by Justice Jackson.

- Justice Jackson, writing for the unanimous Court, explained that traditional contract principles limit a party's obligation to arbitrate disputes only to cases where the parties have waived their right to trial by agreeing to send a given dispute to arbitration. Where there is disagreement over that question, it must be resolved by the courts, not an arbitrator.

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Coinbase, Inc. v. Suski, 602 U.S. 143 (May 23, 2024)

- Takeaway
  - To maintain enforceability of arbitration agreements that require all disputes (including arbitrability) to be submitted to an arbitrator, ensure that any subsequent amendments to an existing customer agreements or any supplemental/additional agreements created later incorporate the same arbitrability provisions and the same delegation clauses as the original agreement, avoiding any conflict at the 'fourth level.'

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SEC v. Jarkesy, 144 S. Ct. 2117 (Jun. 27, 2024)

- The SEC brought an agency enforcement action against hedge fund founder and investment advisor George Jarkesy, specifically seeking penalties for misleading statements made to investors. An Article I administrative law judge imposed a $300,000 civil penalty based on findings of fraud, which the SEC upheld.

- Jarkesy challenged the penalty as unconstitutional, and the Fifth Circuit vacated the SEC's final order as a violation of Jarkesy's Seventh Amendment right to a jury trial.

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SEC v. Jarkesy, 144 S. Ct. 2117 (Jun. 27, 2024)

- **Held**: When the SEC seeks civil penalties against a defendant for securities fraud, the Seventh Amendment entitles the defendant to a jury trial. Fifth Circuit **AFFIRMED** in a 6-3 opinion by Chief Justice Roberts.

- Chief Justice Roberts, writing for the majority, determined that the right to a jury is not limited to common-law actions but extends to any claim that is "legal in nature." By seeking the "prototypical common law remedy" of civil penalties as a form of punitive damages, the SEC brought a "legal" claim and exceeded its authority for an administrative court because civil penalties are a form of remedy that can only be awarded by a court of law.

- Justice Sotomayor (joined by Justices Kagan and Jackson) dissented and called the opinion "a devastating blow to the manner in which our government functions."

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SEC v. Jarkesy, 144 S. Ct. 2117 (Jun. 27, 2024)

- Takeaway
  - Notwithstanding difference of opinion about whether this is a good or bad outcome for the administrative state, Justice Sotomayor is factually correct that the opinion will be a "devastating blow" to the scope of agency enforcement power (not just the SEC).
  - The opinion immediately and substantially curtails the power of many regulatory agencies that have typically imposed civil penalties for regulatory violations, including the SEC, the FCC, and the CFPB.

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Loper Bright Enters. v. Raimondo / Relentless v. Dep't of Commerce, 144 S. Ct. 2244 (Jun. 28, 2024)

- *Chevron* Deference – in 1984, the Supreme Court held in *Chevron v. Natural Resources Defense Council* that where an authorizing statute is silent or ambiguous on a matter, federal courts must defer to an agency's interpretation of that statute so long as it is based on a "permissible construction" of the statutory language (broad deference).

- In these related cases, a group of commercial fisherman challenged a rule of the National Marine Fisheries Service that required them to carry third-party observers on their vessels and also required the fisherman to pay for those observers.

- The D.C. Circuit and the First Circuit upheld the rules under *Chevron* as a permissible interpretation of the Magnuson-Stevens Act.

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Loper Bright Enters. v. Raimondo, 144 S. Ct. 2244 (Jun. 28, 2024)

- **Held:** The Administrative Procedure Act requires courts to exercise their independent judgment in deciding whether an agency has acted within its statutory authority, and courts may not defer to an agency interpretation of the law simply because a statute is ambiguous. ***Chevron* is overruled**. The D.C. and First Circuit opinions are **VACATED** and remanded in a 6-2 opinion authored by Chief Justice Roberts.

- Justice Kagan (joined by Justice Sotomayor and joined in part by Justice Jackson) dissented and was sharply critical of the Court's departure from established precedent.

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Loper Bright Enters. v. Raimondo, 144 S. Ct. 2244 (Jun. 28, 2024)

- Takeaway
  - Likely to have a significant impact on agency power, as federal courts are now definitively no longer bound by *Chevron* deference to an agency's own interpretation of its authority.
    - Expect to see new litigation challenging a wide variety of agency rulemaking and enforcement actions in the years to come.
  - But note Justice Gorsuch's concurring opinion: "… all today's decision means is that, going forward, federal courts will do exactly as this Court has since 2016, exactly as it did before the mid-1980s, and exactly as it had done since the founding: resolve cases and controversies without any systematic bias in the government's favor."

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NVIDIA Corp. v. Ohman, 23-970 (cert. granted Jun. 17, 2024)

- Private Securities Litigation Reform Act of 1995 ("PSLRA") – imposes many substantive and procedural requirements for federal securities cases, including a "scienter" pleading requirement.

- A Swedish investment management firm brought a class action on behalf of NVIDIA stockholders claiming the company intentionally understated its reliance on inherently volatile sales to cryptocurrency miners. After the district court dismissed the complaint under the PSLRA's heightened pleading standards, a divided panel of the Ninth Circuit reversed, holding in part that the plaintiffs' expert report evaluating NVIDIA's finances was sufficient to survive a motion to dismiss.

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NVIDIA Corp. v. Ohman, 23-970 (cert. granted Jun. 17, 2024)

- Questions Presented:
  - (1) Whether plaintiffs seeking to allege scienter under the PSLRA based on allegations about internal company documents must plead with particularity the contents of those documents; and
  - (2) Whether plaintiffs can satisfy the PSLRA's falsity requirement by relying on an expert opinion to substitute for particularized allegations of fact.

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Social Media and Financial Advice

- Surprising Statistics
  - 79% of Americans between ages 18-41 have taken some level of financial advice from social media. *Forbes Advisor / Prolific* (Mar. 4, 2023).
  - 22% of Generation Z relies on TikTok for financial advice. That's higher than their reliance on friends (17%), financial advisors (16%), or traditional news sites and blogs (15%). *Yahoo Finance* (Sep. 4, 2024).
  - Just 41% of so-called "FinTok" users independently fact-check advice they get through the app. *Nasdaq / The Motley Fool* (Feb. 12, 2023).
  - Yet only about 20% of TikTok "influencer" content containing investment recommendations includes any form of disclosures. *CNBC* (Jan. 30, 2024).

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Social Media and Financial Advice

- Last month, a so-called "infinite money glitch" involving Chase Bank went viral.
  - Chase, like many banks, allows customers to withdraw a portion of a deposited check before the check actually clears. In early September, a technical glitch lasting a few days inadvertently allowed the customer to withdraw the entire amount of the check while the deposit was still pending.
  - "Influencers" on TikTok and other social media platforms quickly spread this information to tens of millions of viewers in a matter of hours, showing people how to withdraw tens of thousands of dollars from their Chase checking accounts using this glitch.

- Unlimited free money?
  - Nope. Just an electronic version of check kiting.

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Social Media and Financial Advice

- On September 6, 2024, the Wall Street Journal reported that Chase had frozen the accounts of customers who exploited the technical glitch and was reporting thousands of incidents of alleged check fraud to authorities for further investigation and potential prosecution (a felony under federal law and in many states, especially with the amounts some users "withdrew").

- Offenders will also be subject to likely civil litigation for damages.

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Nat'l Assoc. of Indus. Bankers v. Weiser, No. 24-1293 (10th Cir., appeal filed Jul. 18, 2024)

- 12 U.S.C. § 1831d (part of the Depository Institutions Deregulation and Monetary Control Act of 1980, or "DIDMCA"), caps interest rates that state-chartered, FDIC-insured banks may charge on loans and expressly preempts any lower state law caps.
  - But states are allowed to opt-out of this particular provision of DIDMCA "with respect to loans **made in**" that state.

- Colorado adopted such "opt-out" legislation, attempting to require state-chartered banks and credit unions to adhere to lower caps on interest rates and fee limitations imposed by Colorado state law.

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Nat'l Assoc. of Indus. Bankers v. Weiser, No. 24-1293 (10th Cir., appeal filed Jul. 18, 2024)

- The dispute in this case is what it means for a loan to be "made in" the state.
  - Colorado essentially interpreted this to include all loans made to borrowers located in Colorado, regardless of the lender's location (forcing even lenders in other states to adhere to Colorado's lower caps on interest).
  - Plaintiffs contended that the phrase naturally applied only to banks and credit unions actually located in Colorado.

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Nat'l Assoc. of Indus. Bankers v. Weiser, No. 24-1293 (10th Cir., appeal filed Jul. 18, 2024)

- On June 18, 2024, the U.S. District Court for the District of Colorado agreed with the Plaintiffs' interpretation and preliminarily enjoined Colorado's opt-out of section 1831d.

- First court to interpret how to determine where a loan is "made" under section 1831d. In a lengthy and detailed statutory analysis, the District of Colorado held:

  - "The plain language of Section 1831d's opt-out provision, viewed int eh context of the statutory scheme as a whole, indicates that loans are 'made' by the bank, and that where a loan is 'made' does not depend on the location of the borrower."

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Foris DAX Inc. v. SEC, No. 6:24cv00373 (E.D. Tex., filed Oct. 8, 2024)

- The SEC served notice on Foris DAX Inc. (d/b/a Crypto.com) stating that it believed Foris was operating as an unregistered broker-dealer and clearing agency (i.e. that the digital assets traded on Crypto.com constitute securities transactions).

- Taking issue with what it described as an "unlawful de facto rule" adopted by the SEC without notice and comment that nearly all tokens are subject to federal securities laws, Foris filed suit last week in the U.S. District Court for the Eastern District of Texas seeking to enjoin any SEC enforcement.

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Foris DAX Inc. v. SEC, No. 6:24cv00373 (E.D. Tex., filed Oct. 8, 2024)

- Note that a similar "pre-enforcement challenge" brought by crypto software firm Consensys was dismissed by the Northern District of Texas last month as "unripe" because the SEC's notice did not constitute a final agency action. *Consensys Software Inc. v. Gensler*, No. 4:24cv00369 (N.D. Tex. Sept. 19, 2024).

- Likely to see continued litigation / enforcement actions in the cryptocurrency arena as federal and state regulators attempt to define and regulate this market.

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Continued Rise in FCRA Litigation:

- Fair Credit Reporting Act (FCRA).
  - Aims to promote accuracy, fairness, and privacy of consumer information on credit reports.
  - Places certain duties on Consumer Reporting Agencies (CRAs) as well as on companies furnishing information to CRAs.

- FCRA-related litigation has continued to rise significantly, despite cases involving other consumer protection laws (TCPA / FDCPA) drastically decreasing.

  - **21% increase** YOY from 2023 to 2024.

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Continued Rise in FCRA Litigation:

- Recent litigation trends include:
  - Individual inaccuracy claims: allegations of identity theft or incorrect information.
  - Challenges to public record reporting: challenges to the accuracy or completeness of information in public records such as civil judgments, criminal records, etc.
  - Amended FCRA rules dealing with deferrals and other consumer relief under the CARES Act.

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Continued Rise in FCRA Litigation:

- Lenders and CRAs contributing to consumer credit reporting must remain diligent about ensuring data quality and accuracy to avoid potential liability in the face of these rising complaints.

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Attacks on "Junk Fees"

- In January, the CFPB proposed a new rules to significantly eliminate or reduce overdraft and NSF fees charged by a large segment of national banks as part of President Biden's agenda to target so-called "junk fees."

- "Regulation Z" provides consumer credit protections for credit cards and other types of consumer loans. But overdraft services tied to debit cards and checking accounts are carved out of these protections. The CFPB seeks to change this by closing the regulatory "loophole" and significantly limiting the ability of banks and credit unions with more than $10 billion in assets to rely on Regulation Z's exemptions.

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Attacks on "Junk Fees"

- Under the proposed rule, affected banks would have to limit overdraft fees to breakeven levels, calculated by certain allowable costs or determined by the CFPB's "benchmark fee" which could be set as low as $3.

- Final agency rule is expected no sooner than October 2025 following procedural rulemaking requirements.

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Attacks on "Junk Fees"

- In May 2024, the CFPB similarly implemented a final rule reducing Regulation Z's safe harbor threshold for credit card late fees from $30 to $8 for most credit card issuers.

- The U.S. District Court for the Northern District of Texas enjoined the new rule from taking effect earlier this year and litigation over that rule is ongoing. *Chamber of Commerce v. CFPB*, No. 4:24cv00213 (N.D. Tex. 2024).

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Attacks on "Junk Fees"

- California recently became the first state to adopt similar measures under new *state* legislation.

- A.B. 2017 / S.B. 1075 – new California legislation largely tracking the CFPB's proposed new rules on overdraft fees:
  - Prohibits certain banks and credit unions from charging NSF fees;
  - Sets limits on the amount credit unions can charge for overdraft fees;
  - Requires state-chartered credit unions to provide at least 5 business days notice before requiring payment of a fee so that the customer can repay the delinquent amount and avoid fees.

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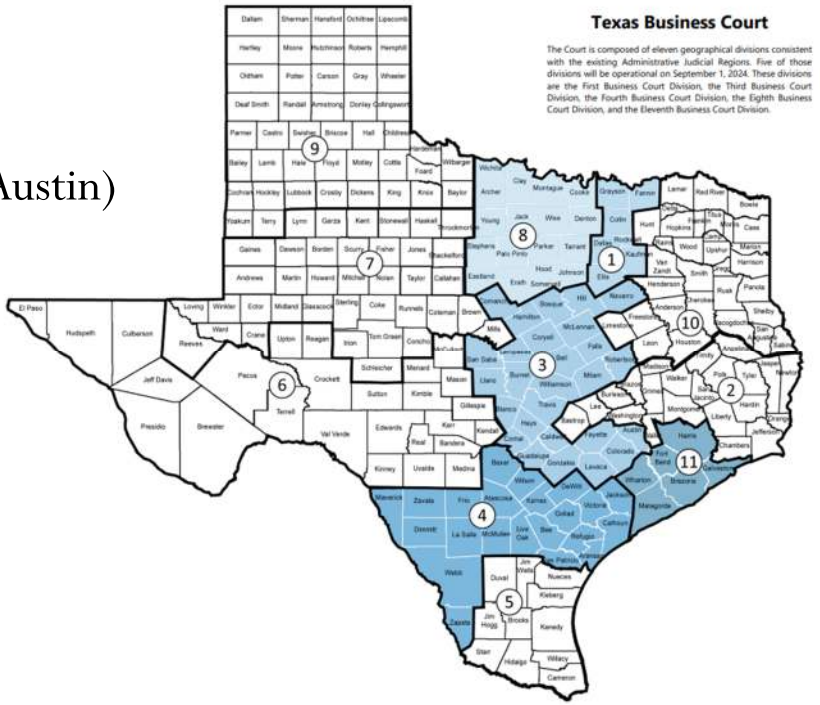
Texas Business Courts

- September 1, 2024
  - Dallas (1st), Austin (3rd), San Antonio (4th), Fort Worth (8th), Houston (11th)
  - 6 other divisions coming

- Fifteenth Court of Appeals (Austin)



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Texas Business Courts

- Jurisdiction (concurrent with District Courts)
  - Contract disputes > $10 million
  - Corporate disputes > $5 million
  - Tex. Fin. Code & Tex. Bus. Code > $10 million
  - "Qualified Transaction" disputes > $10 million
  - Supplemental JX over other claims if the parties and judge agree

- But **NO JX** over excluded categories: probate, family law, DTPA/consumer, insurance, injury/death, malpractice, actions by/against government

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Texas Business Courts

- Original Filings
  - Motions to dismiss for lack of jurisdiction = transfer to district/county court or dismiss without prejudice
- Removal
  - Timing
    - (1) when agreed – at any time; or
    - (2) when contested – within 30 days of discovering removability (or reasonably "should have" discovered)
  - Remand (sua sponte or by motion)
- Separate rules (streamlined process)

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Contact and Further Resources

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- KRCL Blog: The Law of Banking
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