

THE FUTURE OF PLASTIC

BY KAREN NEELEY AND ERIN FONTÉ

On July 21, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, which establishes a new Bureau of Consumer Financial Protection (BCFP) and directs it to implement new regulations regarding credit and debit cards.

Over the next couple of years, the Credit CARD Act of 2009 and the Dodd-Frank Act will bring about several changes for credit cards, debit cards and stored-

value cards. These changes will impact retailers and merchants, government agencies, banks and financial institutions, and any other business that accepts or issues such payment cards. In-house attorneys whose companies issue or accept credit, debit or stored-value cards must advise their clients on how to comply with the new laws and regulations.

Major changes include opt-in requirements for overdraft protection,

new federal regulations regarding gift cards, more regulation and oversight from the new BCFP, and changes to interchange fees.

Electronic funds transfers have evolved significantly since the initial passage of the Electronic Funds Transfer Act (EFTA) in 1978. Within the past two years alone, the Federal Reserve Board several times has amended Regulation E (Reg E), which fleshes out rules for the EFTA.

Reg E mandates certain disclosures (initial disclosures and certain periodic statements) and provides a framework for disputing unauthorized transactions. However, Reg E presently does not apply to reloadable stored-value cards, flexible spending account cards or travel cards. Reg E also includes slightly different rules for periodic statements and dispute resolution for payroll cards, perhaps acknowledging that the card user (the payroll recipient) is different from the person funding the payroll card payments (the employer). It

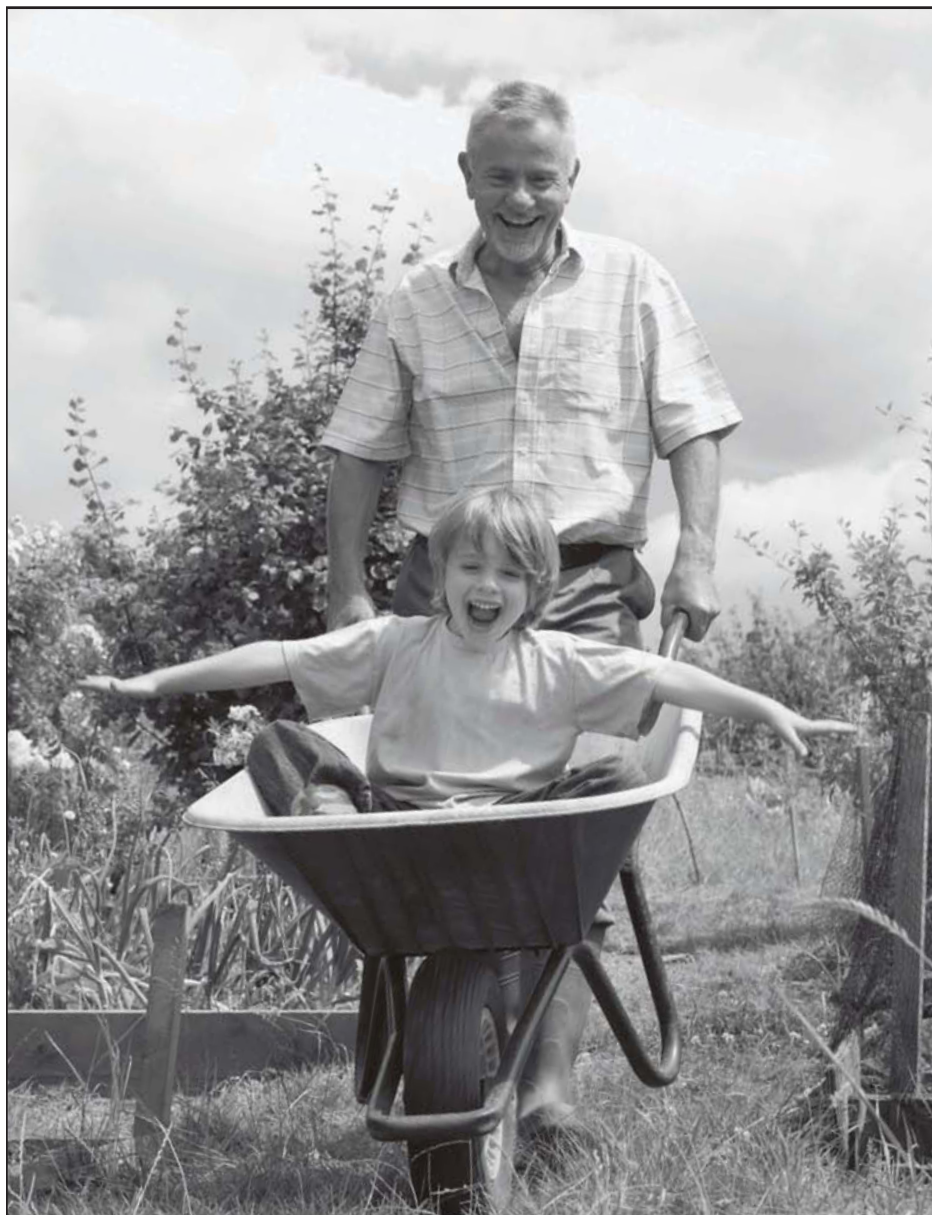
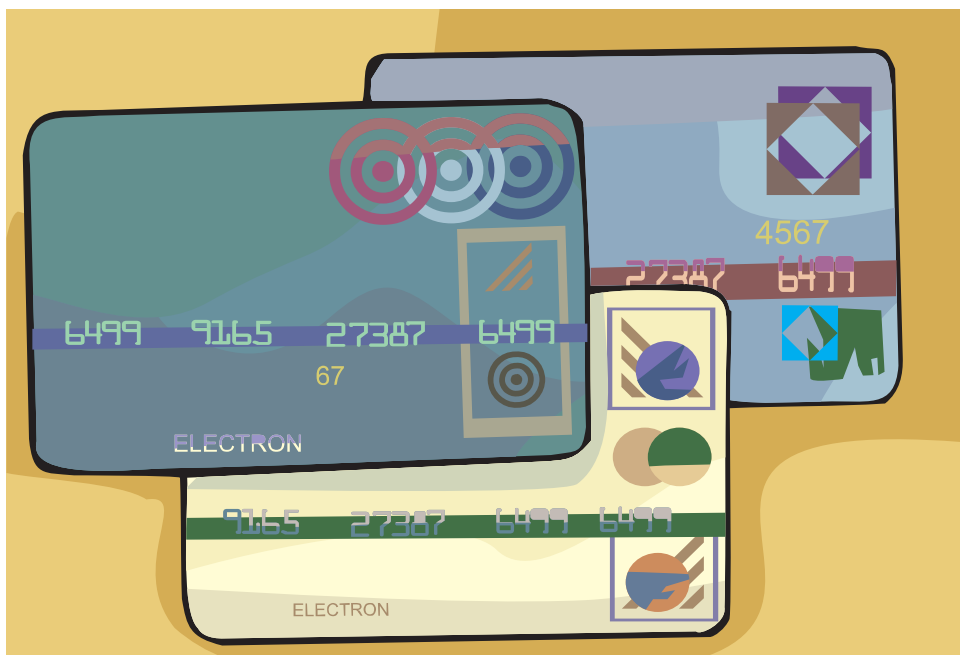


is likely that these exclusions will go away as the BCFP begins cranking out new regulations.

• *Overdraft protection:* A major amendment to Reg E in 2009 was a final rule requiring consumers to opt in to participation in a bank or financial institution's overdraft protection program's coverage of electronic transactions

(debit cards and recurring automated clearing house payments). A financial institution may not enroll customers automatically in such coverage. Rather, customers must opt-in after receiving specific disclosures from their bank. As of July 1, banks and financial institutions had to implement the new opt-in program for new accounts. Effective Aug. 14, the opt-in program also must be in place for existing consumer accounts. Federal regulators also rigorously are enforcing best practices for overdraft protection programs. Attorneys counseling banks or financial institutions must ensure

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their clients meet the Aug. 14 deadline for existing accounts.

• **Gift cards:** The federal Credit CARD Act of 2009 directed the Federal Reserve Board to enact new regulations for gift cards and for loyalty, award and promotional cards. Effective Aug. 22, the gift card itself must include certain disclosures regarding expiration date, fees and contact information. The card or the underlying funds must be good for at least five years from issuance. The issuer cannot impose any inactivity, dormancy or service fee unless there has been a one-year period

could lead to changes in state unclaimed property laws.

The new regulations exclude loyalty, award or promotional cards but do require such cards to include disclosures to qualify for the exclusion. The loyalty/award/promotional card or certificate must include a statement that it is for loyalty, award or promotional purposes. The expiration date for the funds must be on the card, along with the amount of any fees that may be imposed. Finally, a toll-free telephone number (and website, if any) must be listed where a consumer may obtain fee information. Attorneys must ensure that their clients meet the Aug. 22 deadline for these

chants. The Dodd-Frank Act also regulates payment card association rules regarding universal card acceptance. Previously, merchants had to agree to accept all card types issued by that payment-card network (from expensive rewards cards to basic debit cards) no matter the price of interchange for each type of card. Merchants now will be allowed to discriminate in card type acceptance; give consumers a discount on the price of goods or services based on payment-card type, to encourage use of card types with lower interchange fees charged to merchants; and set minimum dollar payment amounts for acceptance of debit and credit cards. Once

products and services. With the ease of filing comments to proposed rules electronically, there are likely to be thousands of comments to digest and incorporate for all new Federal Reserve Board regulations and the activities of the BCFP.

The result of all these changes will be increased regulatory requirements, costs and restrictions on various practices for financial institutions. Such changes likely will translate to higher costs for consumers. Merchants probably will see a reduction in their payment-card processing costs, but there may also be fewer card issuers and card types for consumers.

Bottom line: There will be winners and losers, but plastic will continue its expansion and use in everyday life, until the next big payment revolution takes over.

AS OF JULY 1, BANKS AND FINANCIAL INSTITUTIONS HAD TO IMPLEMENT THE NEW OPT-IN PROGRAM FOR NEW ACCOUNTS. EFFECTIVE AUG. 14, THE OPT-IN PROGRAM ALSO MUST BE IN PLACE FOR EXISTING CONSUMER ACCOUNTS.

of inactivity. However, a one-time card issuance fee is still allowed.

The new regulation conflicts with many existing state unclaimed property laws, such as the Texas unclaimed property law, which provides that inactive gift cards become unclaimed property that “escheats” (i.e., is turned over to) the Texas comptroller three years from the date of issuance (if there is no cardholder activity at all) or date of last cardholder activity. The different time period conflict

new regulations, which affect retailers as well as financial institutions.

• **Interchange regulation:** The Dodd-Frank Act grants the Federal Reserve Board the authority to set debit-card interchange rates for debit-card issuing banks with more than \$10 billion in assets. Interchange rates are fees that a merchant’s bank pays a cardholder’s bank when a merchant accepts card payments. Certain card types (such as rewards cards) can carry a higher interchange fee to mer-

chants. The final regulations are enacted, all entities involved in payment-card issuing and acceptance must comply with the final regulations (and general counsel for any such entities may want to comment during the rulemaking process).

THE FUTURE

So, what’s ahead? The new BCFP must write and finalize new rules regarding its organization, structure and priorities for regulating consumer financial

Karen Neeley is of counsel at and Erin Fonté is an associate with Cox Smith Matthews in Austin. Neeley has more than 30 years of experience in financial institution regulatory and compliance law. Fonté’s practice focuses on financial-services, regulatory, compliance and payment-systems law, with emphasis on stored-value card programs and other emerging payment methods.

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UNDERSTANDING THE LIMITS OF THE BONA FIDE ERROR DEFENSE

BY JEFFREY D. DUNN

In-house counsel need to be aware of the outer limits of the bona fide error defense to suits alleging violations of the federal Fair Debt Collection Practices Act (FDCPA) and the Texas Debt Collection Act (TDCA). A recent U.S. Supreme Court decision held that mistakes of law cannot excuse debt collectors from liability under the FDCPA, instead confining the defense to clerical mistakes. A federal court applying the TDCA subsequently examined the meaning of clerical errors, suggesting that these errors require a fact-intensive analysis that likely will preclude summary judgment. These decisions indicate that attorneys engaging in consumer debt collection who allegedly make innocent mistakes that technically violate these laws may find it more difficult to rely on the bona fide error defense.

The FDCPA covers any entity or attorney regularly engaged in consumer debt collection. This law does not encompass creditors collecting their own debts, but the TDCA covers creditors as well as their third-party debt collectors. In-house attorneys for companies that engage in any form of consumer debt collection need to be aware of these laws and implement procedures to maximize the applicability of the bona fide error defense in the event innocent violations should occur.

The FDCPA aims to eliminate abusive consumer debt collection practices. The pervasiveness of alleged abuses is apparent from the 2010 Federal Trade Commission (FTC) Annual Report on the FDCPA, which indicates 119,364 debt collection complaints filed in 2009 alone. That's 22.8 percent of all complaints received by the FTC in 2009.

Most action enforcing the FDCPA occurs through private litigation. In these suits, attorney debt collectors risk personal liability to debtors for statutory violations. Damages can be imposed for violations that may result from seemingly innocuous conduct or innocent mistakes, but both the FDCPA and the TDCA offer a safe harbor for unintentional violations: the "bona fide error" affirmative defense.

Under the FDCPA, consumer debt collectors avoid liability if they show "by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error notwithstanding maintenance of procedures reasonably adapted to avoid any such error."

Under the TDCA, there is no liability "if the action complained of resulted from a bona fide error that occurred notwithstanding the use of reasonable procedures adopted to avoid the error."

Although the wording of these statutes is slightly different, federal courts have

held that the two statutes should be similarly construed.

The term "bona fide" means "good faith" in Latin, which arguably suggests that a bona fide error means any conduct that is an honest mistake.

The problem with the bona fide error defense in the context of the debt collection statutes is that the line between an excused and unexcused statutory violation is often elusive. This distinction arose in *Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich*, a suit filed against a firm in the U.S. District Court for the Northern District of Ohio in 2006. The district court grappled with conflicting case law on the proper wording of a debt-validation notice under the FDCPA. It sided with cases holding that the validation-notice form in that case violated the FDCPA because the notice required the debtor to dispute the debt in writing. In a 2007 decision the court nonetheless held that the error was an excusable "mistake of law" under the bona fide error defense, entitling the firm to summary judgment.



The 6th U.S. Circuit Court of Appeals in 2008 recognized a split of authority on the applicability of the defense to a mistake of law, but affirmed the district court by concluding that mistakes of law are encompassed within the defense.

The U.S. Supreme Court overturned this decision in April of this year. In a 7-2 decision, the high court held that mistakes of law cannot qualify for the bona fide error defense, relying in part on the old maxim that "ignorance of the law will not excuse any person, either civilly or criminally."

What the U.S. Supreme Court decision seems to mean is that if an attorney debt collector relies on judicial precedent to comply with the FDCPA, the attorney will not avoid personal liability if a court later overrules that precedent and determines that the conduct did constitute a violation. In other words, an attorney relying on a court case to make a decision about what the FDCPA requires does so at his or her peril.

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The majority remarked that attorneys could ask the FTC for an advisory opinion when ambiguities arise. Reliance on an FTC advisory opinion is a safe harbor under the FDCPA. But the practical reality of debt collection is that few attorneys can delay collection actions to seek a discretionary FTC advisory opinion and wait for a response that may never come. Moreover, FTC advisory opinions rarely are issued, and there is no Texas state agency with authority to issue comparable safe harbor advisory opinions under the TDCA.

What impact does the Supreme Court opinion have on the TDCA? The

Texas Supreme Court has not ruled on whether the TDCA's bona fide error defense can encompass mistakes of law. Houston's 14th Court of Appeals implied that it could in its 2008 decision in *CA Partners v. Spears*. A federal court opinion in 2008 by the U.S. District Court for the Southern District of Texas, *FIA Card Services, NA v. Gachiengu*, held that the bona fide error defense applied to a mistake of law that occurred in a debt-collection suit filed outside the statute of limitations because of a split of authority on the application of the limitations defense. But whether mistake of law could still be a defense under the TDCA after *Jerman* is an open question, given language



by courts saying the federal and state statutes should be construed similarly.

CLERICAL ERRORS

It is not always self-evident when a clerical error occurs, sufficient to fall within the bona fide error defense as a matter of law.

A May 17 decision from the U.S. District Court for the Southern District of Texas, *Liu v. Arrow Financial Services, LLC and Regent & Associates, PC*, illustrates this point. According to the opinion, a debt collector purchased delinquent accounts but mistakenly failed to remove some of the accounts from the list of debts outstanding when the seller sought to buy back those accounts. Consequently, the debt collector's attorney filed suit on a debt that the named consumer did not owe. When the error was discovered, the suit was dismissed, but the purported debtor then sued the attorney and collector under the FDCPA and TDCA. Focusing on the meaning of "clerical error," the court held that material issues of fact precluded summary judgment for the attorney under the bona fide error defense. The opinion includes an extensive discussion on how courts have defined clerical errors.

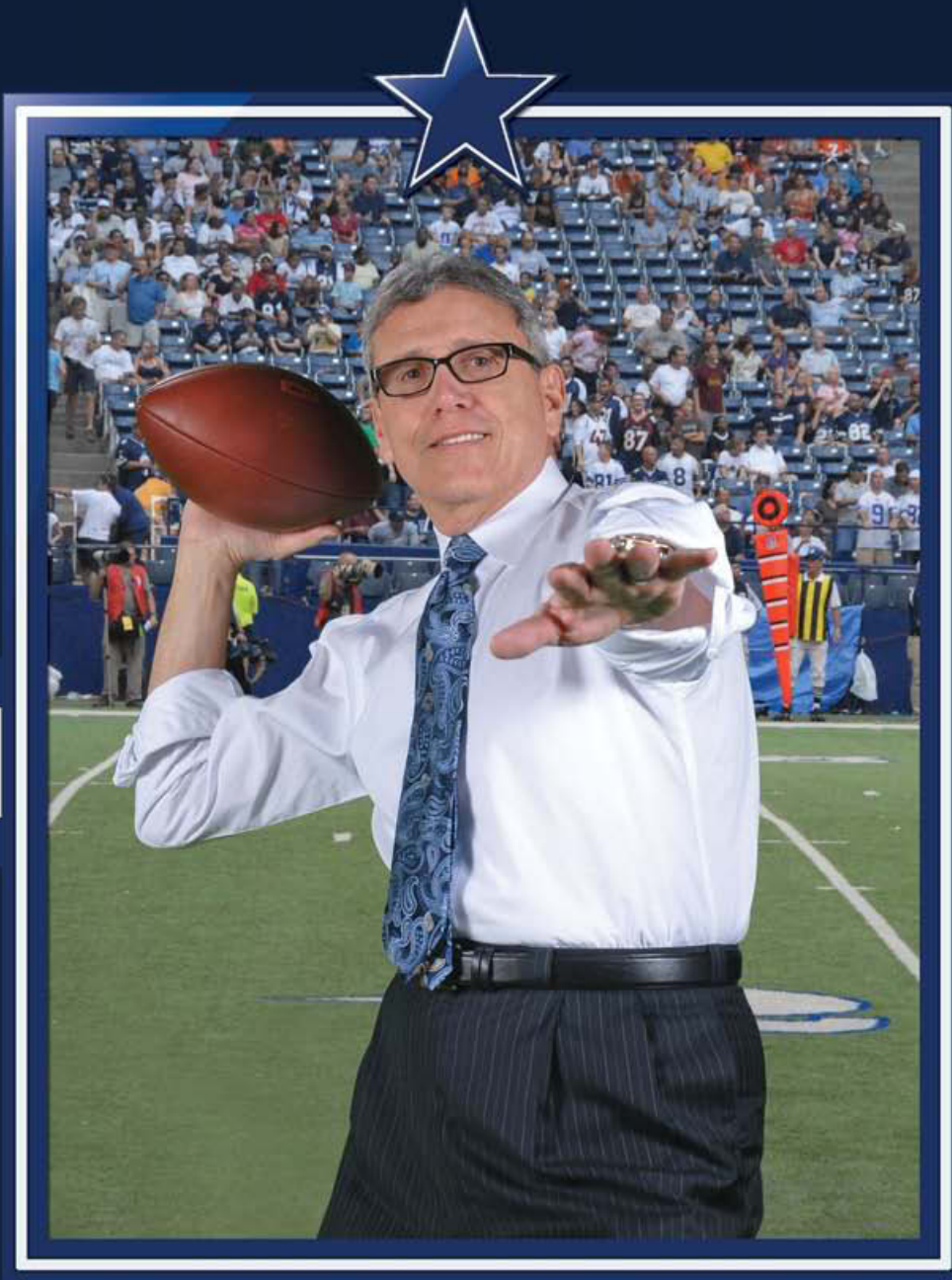
Even if a debt collector facing an alleged violation can prove that the violation resulted from a clerical error, the defense will not apply unless the collector establishes that reasonable procedures were used to prevent the error that caused the violation in question.

Toward this end, attorneys and companies who engaged in consumer debt collection can help mitigate their risk by training themselves on the intricacies of these laws, establishing procedures that aim to prevent clerical errors and scrupulously following those procedures.

Within the past month, the federal government has signaled heightened attention to consumer debt collection abuses. In an extensive report titled "Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration," issued in July, the FTC concludes that litigation and arbitration do not provide adequate protection for consumers. The FTC advocates a series of reforms to strengthen the consumer protection features of the FDCPA and state debt collection laws.

Subsequently, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, which, in part, creates the Bureau of Consumer Financial Protection (BCFP). This new agency largely will supersede the FTC's enforcement authority under the FDCPA and other federal consumer financial statutes. In contrast to current law, the Dodd-Frank Act gives the BCFP rule-making authority. It remains to be seen whether the FTC report and the new consumer-focused agency will further change the landscape of attorney debt collector liability.

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