UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

IN RE WASHINGTON MUTUAL OVERDRAFT PROTECTION LITIGATION,	CASE NO.: CV 03-2566 ABC (RCx) ORDER RE: DEFENDANT'S MOTION TO DISMISS PLAINTIFF'S COMPLAINT; PLAINTIFFS' MOTION FOR LEAVE TO FILE SECOND CONSOLIDATED COMPLAINT

Pending before the Court are Defendant's motion to dismiss Plaintiffs' complaint and Plaintiffs' motion for leave to file a second consolidated amended complaint. The motions came on regularly for hearing on April 26, 2004. Upon consideration of the submissions of the parties, the case file, and the arguments of counsel, Defendant's motion is hereby GRANTED. Plaintiffs' motion is DENIED.

I. FACTUAL AND PROCEDURAL HISTORY

On October 20, 2003, Plaintiffs filed a Consolidated Class Action Complaint ("Complaint") against Defendant Washington Mutual Bank, FA ("Washington Mutual"), alleging violations of the Truth in Lending Act, 15 U.S.C. §§ 1601, et seq., the Home Owners' Loan Act, 12 U.S.C.

§§ 1461, et seq., and various Washington and California state laws.[1] This is a class action brought by bank customers who contend that Washington Mutual extended credit to its customers "in the disguised form of 'Overdraft Protection.'" (Compl. at 2:3.) Plaintiffs contend that Washington Mutual encourages customers to routinely overdraw their accounts so that a substantial charge is incurred even though there are many other, less expensive sources of credit available to them. (Compl. ¶ 16.)

In 2001, Washington Mutual issued promotional materials for an overdraft protection feature for its new and existing deposit accounts. (Compl. ¶ 6.) Plaintiffs allege that Washington Mutual agreed in these promotional materials to automatically "cover" all overdrawn items (checks, debit card purchases, and ATM withdrawals) within the assigned limit for the customer's account. (Compl. ¶¶ 8, 10.) The materials included the following two phrases: "Don't worry, we'll cover you" and "Automatic Protection." (Compl. ¶ 10.) Plaintiffs further allege that despite the promotional materials' assurances that all overdraw items would be paid, Washington Mutual issued customer account statements which stated: "THE FEE FOR EACH OVERDRAWN ITEM, WHETHER PAID OR RETURNED, IS $21.00." (Compl. ¶ 12.)

With respect to the federal law claims, Plaintiffs contend that the overdraft fees are "finance charges" in violation of the Truth in Lending Act (first cause of action) and "interest" in violation of the Home Owners' Loan Act (second cause of action). Lastly, Plaintiffs allege that Washington Mutual violated the Truth in Lending Act by

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[1] The state claims include: Washington State Unfair Business Practices Act, unjust enrichment, fraud by omission, and California's Unfair Competition statute, Cal. Bus. & Prof. Code § 17200.

issuing unsolicited ATM and debit cards (sixth cause of action).

On November 19, 2003, Washington Mutual filed a motion to dismiss Plaintiffs' Complaint. The Court received Plaintiffs' opposition on January 23, 2004, and Washington Mutual's reply on February 23, 2004.

On January 23, 2004, Plaintiffs filed a motion for leave to file a second consolidated complaint. The Court received Washington Mutual's opposition on February 24, 2004, and Plaintiffs' reply on March 1, 2004.

II. LEGAL STANDARD

A Rule 12(b)(6) motion tests the legal sufficiency of the claims asserted in the complaint. See Fed. R. Civ. P. 12(b)(6). Rule 12(b)(6) must be read in conjunction with Rule 8(a) which requires a "short and plain statement of the claim showing that the pleader is entitled to relief." 5A Charles A. Wright & Arthur R. Miller, Federal Practice and Procedure § 1356 (1990). "The Rule 8 standard contains 'a powerful presumption against rejecting pleadings for failure to state a claim.'" Gilligan v. Jamco Dev. Corp., 108 F.3d 246, 249 (9th Cir. 1997). A Rule 12(b)(6) dismissal is proper only where there is either a "lack of a cognizable legal theory" or "the absence of sufficient facts alleged under a cognizable legal theory." Balistreri v. Pacifica Police Dept., 901 F.2d 969, 699 (9th Cir. 1988); accord Gilligan, 108 F.3d at 249 ("A complaint should not be dismissed 'unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief").

The Court must accept as true all material allegations in the complaint, as well as reasonable inferences to be drawn from them. See Pareto v. F.D.I.C., 139 F.3d 696, 699 (9th Cir. 1998). Moreover, the complaint must be read in the light most favorable to plaintiff.

See id. However, the Court need not accept as true any unreasonable inferences, unwarranted deductions of fact, and/or conclusory legal allegations cast in the form of factual allegations. See, e.g., Western Mining Council v. Watt, 643 F.2d 618, 624 (9th Cir. 1981).

Moreover, in ruling on a 12(b)(6) motion, a court generally cannot consider material outside of the complaint (e.g., those facts presented in briefs, affidavits, or discovery materials). See Branch v. Tunnell, 14 F.3d 449, 453 (9th Cir. 1994). A court may, however, consider exhibits submitted with the complaint. See id. at 453-54. Also, a court may consider documents which are not physically attached to the complaint but "whose contents are alleged in [the] complaint and whose authenticity no party questions." Id. at 454. Further, it is proper for the court to consider matters subject to judicial notice pursuant to Federal Rule of Evidence 201. Mir, M.D. v. Little Co. of Mary Hospital, 844 F.2d 646, 649 (9th Cir. 1988).

III. DISCUSSION

A. Truth in Lending Act

Plaintiffs allege that Washington Mutual violated the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 et seq., by failing to comply with its disclosure requirements and by issuing unsolicited credit cards and failing to disclose the annual percentage rate. As discussed below, the Court finds that both of these allegations fail to state a claim upon which relief can be granted under TILA.

1. TILA's Disclosure Requirements Are Inapplicable

The purpose of TILA is to "assure a meaningful disclosure of credit terms . . . and to protect the consumer against inaccurate and unfair credit billing and credit card practices." 15 U.S.C. § 1601(a) (2003). To implement TILA the Board of Governors of the Federal

Reserve System issued a regulation known as Regulation Z. 12 C.F.R. § 226.1(a). Among other things, Regulation Z governs the required disclosures creditors must make to consumers. Under Regulation Z, the obligation to deliver disclosures is applicable only to a creditor who regularly extends consumer credit that is either subject to a finance charge or payable by written agreement in more than four installments. 12 C.F.R. § 226.2(a)(17)(i). Because the overdraft charges at issue here are not payable in more than four installments, the Court's discussion focuses on whether the overdraft charges are "finance charges." If there is no "finance charge" within the meaning of Regulation Z, then the financial institution that covers an item creating the overdraft is not subject to the disclosure requirements and a would-be TILA plaintiff lacks a cognizable claim.

In this case, the Court concludes that Plaintiffs have failed to allege that the overdraft fees are "finance charges." Both TILA and Regulation Z define the term "finance charge" as a charge "payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." 15 U.S.C. § 1605(a); 12 C.F.R. § 226.4(a). Section 226.4(b)(2) of Regulation Z further states that "any charge imposed on a checking account" is deemed a finance charge only if it "exceeds the charge for a similar account without a credit feature." In other words, "[i]f a charge for an account with a credit feature does not exceed the charge for an account without a credit feature, the charge is not a finance charge under § 226.4(b)(2)." 12 C.F.R. § 226.4, Supp. 1, ¶4(b)(2). Here, Plaintiffs concede that Washington Mutual's overdraft fee is the same amount for accounts with or without

the credit feature.[2] (See Opp'n at 10:1-3.) Thus, Regulation Z, Section 226.4(b)(2), compels the conclusion that the overdraft fee is not a finance charge.[3]

An additional reason supports the conclusion that the overdraft fees are not finance charges: Plaintiffs failed to sufficiently allege that the parties agreed in writing to payment of the items creating the overdraft.[4] "Unless payment of such items and the imposition of the charge were previously agreed upon in writing," the charge is not

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[2] However, Plaintiffs argue that the fees are not the "same" simply because they are the same in dollar amount. (See Opp'n at 9:22:24-10:1-3.) The Court finds Plaintiffs' argument impossible to reconcile with Regulation Z's plain language and the examples provided in Section 226.4, Supp. 1, ¶4(b)(2). As discussed above, Regulation Z defines a finance charge as a charge which "exceeds" the charge for a similar account. See 12 C.F.R. § 226.4(b)(2). By using the term "exceed," the provision is undoubtedly referring to the charge's dollar amount. The Court cannot conceive of another qualitative factor which Regulation Z could be alluding to, and Plaintiffs have provided none. Furthermore, the examples in the Supplement compare dollar amounts and nothing else when giving examples of finance charges:

"To illustrate:

i. A $5 service charge is imposed on an account with an overdraft line of credit (where the institution has agreed in writing to pay the overdraft), while a $3 service charge is imposed on an account without a credit feature; the $2 difference is a finance charge . . .

ii. A $5 service charge is imposed for each item that results in an overdraft on an account with an overdraft line of credit, while a $25 service charge is imposed for paying or returning each item on a similar account without a credit feature; the $5 charge is not a finance charge." 12 C.F.R. § 226.4, Supp. 1, ¶4(b)(2).

[3] Because the facts underlying the Court's legal analysis are undisputed, the Court dismisses this claim with prejudice.

[4] In this respect, the Court strongly disagrees with Defendant's contention that "whether [Washington Mutual] committed to pay all overdrafts up to the Overdraft Limit has no bearing on whether the Overdraft Charge is a 'finance charge.'" (Reply at 6:9-10.)

a "finance charge." 12 C.F.R. § 226.4(c)(3)[5]. Here, Plaintiffs' allegations do not show that the parties had any such agreement. Instead, Plaintiffs allege that Washington Mutual "represented in its promotional materials that it was agreeing as a matter of contract to be legally obligated to pay all overdraft items up to the 'limit' assigned to the account." (Compl. ¶ 8.) (emphasis added). However, promotional materials are not agreements. Cf. Nicolas v. Deposit Guar. Nat'l Bank, 182 F.R.D. 226, 230 (S.D. Miss. 1998) (construing depository agreement to determine whether parties agreed to payment of items creating an overdraft). In fact, it is well established that all conversations and writings which occur prior to the execution of a written agreement are inadmissible to change or modify the terms of the agreement.[6] See Cal. Civ. Proc § 1856; Maxwell v. Carlon, 30 Cal.App.2d 356, 361 (1939).

Thus, to the extent that the promotional materials directly contradict a subsequent depository agreement, they will not support Plaintiffs' legal conclusion that the parties agreed in writing to payment of the overdraft fees.[7] See Continental Airlines, Inc. v.

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[5] Section 226.4(c)(3) provides, in relevant part:
(c) Charges excluded from the finance charge. The following charges are not finance charges . . .

(3) Charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing.

[6] The written agreement "may be explained or supplemented by evidence of consistent additional terms." Cal. Civ. Pro. § 1856(b) (emphasis added). Here, Plaintiffs' complaint does not mention the account agreement, but Plaintiffs admit that the promotional materials and their bank statements are inconsistent. (Compl. ¶ 12.)

[7] However, precontract promotional materials or brochures can form the basis for a fraud claim in certain circumstances. See (continued...)

McDonnell Douglas Corp., 216 Cal.App.3d 388, 418-420 (1990). Plaintiffs admit that their bank statements included the following sentence which indicated that the payment of an item that created an overdraft was discretionary: THE FEE FOR EACH OVERDRAWN ITEM, WHETHER PAID OR RETURNED, IS $21.00. (Compl. ¶ 12.) Plaintiffs also admit that, by this statement, Washington Mutual intended to "retain[] the option of rejecting payment of any particular overdraft item." (Compl. ¶ 12.) Because Plaintiffs have not sufficiently alleged that Washington Mutual agreed in writing to the payment of the items creating an overdraft, Plaintiffs have not sufficiently alleged that the overdraft fees are finance charges within the meaning of TILA.

2. TILA's Solicitation and Periodic Statement Provisions Are Inapplicable

Plaintiffs also allege that Washington Mutual violated TILA by issuing unsolicited ATM and debit cards and failing to disclose the annual percentage rate in periodic statements. Plaintiffs' claim succeeds or fails on the strength of its premise that ATM cards and debit cards are subject to Regulation Z's disclosure requirements for credit cards. Under Regulation Z, 12 C.F.R. § 226.5a, a credit card issuer must make certain disclosures when it solicits an application to open a credit card account. However, section 226.5a(a)(3) expressly excludes "overdraft lines of credit tied to asset accounts accessed by check-guarantee cards or by debit cards; or lines of credit accessed by check-guarantee cards or by debit cards that can be used only at automated teller machines." In addition, because the overdraft fees are not "finance charges," Regulation Z does not

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[7](...continued)
Continental Airlines, 216 Cal.App.3d at 419.

require Washington Mutual to disclose an annual percentage rate.[8] See 12 C.F.R. § 226.7(g) (requiring disclosure of annual percentage rate "[w]hen a finance charge is imposed during the billing cycle"). Thus, Plaintiffs have failed to state a claim under TILA based upon these allegations.

B. Home Owners' Loan Act

Plaintiffs' second cause of action alleges that the overdraft fees constitute "interest" in excess of that permitted by the Home Owners' Loan Act ("HOLA"). Under HOLA, 12 U.S.C. § 1463(g)(1), lenders are allowed to charge interest at either one percent above the Federal Reserve discount rate on 90-day commercial paper or the rate allowed by the state in which the lender is located, whichever is greater.[9] In Washington Mutual's view, however, the overdraft fees are not "interest" within the scope of § 1463(g). For reasons articulated below, the Court agrees with Washington Mutual.

Washington Mutual cites three cases in which the courts held that the term "interest" does not encompass overdraft fees: (1) Video Trax, Inc. v. NationsBank, N.A., 33 F. Supp.2d 1041, 1050 (S.D. Fla. 1998),

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[8] The Court rejects Plaintiffs' contention that Regulation Z requires card issuers to make annual percentage rate disclosures whether or not there is a finance charge imposed. In making this argument, Plaintiffs cite a provision defining "creditor," which does not address the circumstances in which creditors must issue periodic statements and annual percentage rates. See 12 C.F.R. § 226.2(a)(17)(iii).

[9] HOLA, 12 U.S.C. §1463(g)(1), provides:

"Notwithstanding any State law, a savings association may charge interest on any extension of credit at a rate of not more than 1 percent in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district in which such savings association is located or at the rate allowed by the laws of the State in which such savings association is located, whichever is greater."

aff'd per curiam, 205 F.3d 1358 (11th Cir. 2000); (2) Terrell v. Hancock Bank, 7 F. Supp.2d 812, 816 (S.D. Miss. 1998); and (3) Nicolas, supra, 182 F.R.D. at 231. Although the cases construed the National Bank Act rather than HOLA, the Court finds the opinions persuasive authority because HOLA and the National Bank Act have virtually identical language.[10] Because of the statutes' similarity in language and goals, courts have concluded that HOLA must be "interpreted so as to remain consistent with the National Bank Act." Ament v. PNC Nat'l Bank, 849 F. Supp. 1015, 1021 (W.D. Pa. 1994), aff'd per curiam, 9 F.3d 1170 (3d Cir. 1996) (citing Gavey Properties/762 v. First Fina. Sav. & Loan Ass'n, 845 F.2d 519, 521 (5th Cir. 1988)); accord Cappalli v. Nordstrom, 155 F. Supp.2d 339, 342 n.3 (E.D. Pa. 2001) ("Due to the similarity of the language and goals of the National Bank Act and HOLA, I consider them to be *in pari materia*.[11]").

Thus, due to the dearth of cases construing the term "interest" in HOLA, the Court necessarily turns to cases construing the identical term in the National Bank Act. A review of the cases reveals that the opinions in Video Trax, Terrell, and Nicolas are parallel. Each of

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[10] The key language of both statutes allows a lender to charge interest at either one percent above the Federal Reserve discount rate or the rate allowed by state law where the lender is located. The National Bank Act, 12 U.S.C. § 85, provides, in relevant part:

"Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater[.]"

[11] It is a canon of construction that statutes that are *in pari materia* may be construed together.

the courts began by citing the definition of "interest" under the National Bank Act:

> (a) Definition. The term "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees *connected with credit extension or availability*: numerical periodic rates, late fees, *creditor-imposed not sufficient funds (NSF) fees charged when a borrower tenders payment on a debt with a check drawn on insufficient funds*,[12] overlimit fees, annual fees, cash advance fees, and membership fees.

12 C.F.R. § 7.4001(a)(2004) (emphasis added). In the courts' view, the overdraft charges were not interest imposed in connection with a credit transaction as required under § 7.4001(a), but were instead charges arising from the terms of the depository agreement and thus controlled by 12 C.F.R. § 7.4002.[13] Video Trax, 33 F. Supp.2d at

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[12] The courts relied on the 1997 version of § 7.4001, which did not include the underlined language. However, the additional language does not alter the analysis.

[13] Section 7.4002 provides, in relevant part:
(a) Authority to impose charges and fees. A national bank may charge its customers non-interest charges and fees, including deposit account service charges.
(b) Considerations.
(1) All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.
(2) The establishment of non-interest charges and fees, their amounts, and the method of calculating them are business decisions to be made by each bank, in its discretion, according to sound banking judgment

(continued...)

1050; Terrell, 7 F. Supp.2d at 816; Nicolas, 182 F.R.D. at 231.

Nicolas provides the most persuasive reasoning for this conclusion. The Nicolas Court relied on an *amicus curiae* brief filed by the Office of the Comptroller of the Currency ("OCC"), which is the exclusive supervisory agency of national banks. See 12 U.S.C. § 21. The Supreme Court has held that OCC interpretations of the National Bank Act merit substantial deference. Smiley v. Citibank, N.A., 517 U.S. 735, 739 (1996) (quoting NationsBank of N.C., N.A. v. Variable Annuity Life Ins., 531 U.S. 251, 256-257 (1995)). According to the OCC, the overdraft fee is not "interest" in connection with credit extension if the bank charges the fee without regard to whether it pays the item creating the overdraft. Nicolas, 182 F.R.D. at 231. Instead, as noted above, the fee is a deposit account service charge arising from the terms of the depository agreement. Id. In this case, Plaintiffs concede that Washington Mutual intends to charge an overdraft fee regardless of whether a check is honored or returned unpaid. (See Compl. ¶ 12.) In light of the foregoing authority, the Court concludes that the overdraft charges are not "interest" imposed in connection with credit extension under HOLA, § 12 U.S.C. § 1463(g)(1). Therefore, Plaintiffs' second cause of action fails to

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[13](...continued)
and safe and sound banking principles. A national bank establishes non-interest charges and fees in accordance with safe and sound banking principles if the bank employs a decision-making process through which it considers the following factors, among others:
(i) The cost incurred by the bank in providing the service;
(ii) The deterrence of misuse by customers of banking services;
(iii) The enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and
(iv) The maintenance of the safety and soundness of the institution.
(c) Interest. Charges and fees that are "interest" within the meaning of 12 U.S.C. 85 are governed by § 7.4001 and not by this section.

state a cognizable claim.

C. State Law Claims

Plaintiffs' remaining claims arise out of state law.[14] Where federal claims are disposed of well before trial, it is appropriate for pendent state claims to be dismissed as well. 28 U.S.C. § 1367(c)(3). As such, the Court exercises its discretion to decline supplemental jurisdiction and dismiss Plaintiffs' state law claims without prejudice.[15]

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[14] Plaintiffs concede that their state claims based on Washington law are properly dismissed because Washington Mutual is located in California, not Washington. (See Opp'n at 2:4-7.) However, Plaintiffs seek leave to amend their Complaint to allege claims based on California law. Because this Order dismisses all of Plaintiffs' federal claims and declines supplemental jurisdiction over any state claims, the Court DENIES Plaintiffs' motion for leave to file a second consolidated complaint.

[15] While Washington Mutual argues that the state law claims are preempted by implication or "field preemption," Washington Mutual does not contend that the Court has original jurisdiction over the state law claims (that is, that the "complete preemption" doctrine applies). (See Mot. at 12:10-12; Reply at 11:2-10.) Thus, the state law claims are properly dismissed pursuant to 28 U.S.C. § 1367(c)(3).

IV. CONCLUSION

For the foregoing reasons, Defendant's motion to dismiss Plaintiffs' Consolidated Class Action Complaint is GRANTED. Accordingly, Plaintiffs' federal law claims are DISMISSED WITH PREJUDICE. Plaintiffs' state law claims are DISMISSED WITHOUT PREJUDICE.

In addition, Plaintiffs' motion for leave to file a second consolidated complaint is DENIED.

SO ORDERED.

DATED: April 26, 2004

Audrey B. Collins

AUDREY B. COLLINS
UNITED STATES DISTRICT JUDGE