

IN THE SUPREME COURT  
STATE OF NORTH DAKOTA

CybrCollect, Inc.,	)	
	)	
	)	
Appellee/	)	<b>Case No. <u>08-03-C-03271</u></b>
Cross-Appellant,	)	
	)	
v.	)	
	)	
North Dakota Department of	)	<b>Supreme Court No. 20040214</b>
Financial Institutions and	)	
Timothy J. Karsky, Commissioner	)	
of the North Dakota Department	)	
of Financial Institutions,	)	
	)	
Appellants/	)	
Cross- Appellees.	)	

---

Appeal from Judgment dated December 15, 2004  
Burleigh County District Court, South Central Judicial District  
The Honorable Gail Hagerty

---

**APPELLEE/CROSS-APPELLANT'S BRIEF**

---

Ronald H. McLean (ID# 03260)  
Timothy G. Richard (ID# 05454)  
SERKLAND LAW FIRM  
10 Roberts Street  
P.O. Box 6017  
Fargo, ND 58108-6017  
Telephone No. (701) 232-8957

ATTORNEYS FOR APPELLEE/  
CROSS-APPELLANT

**TABLE OF CONTENTS**

STATEMENT OF ISSUES .....1

STATEMENT OF THE CASE.....1

STATEMENT OF THE FACTS .....2

    A. Background .....2

    B. Procedural History .....4

        1. Pre-Hearing .....4

        2. The ALJ Hearing.....6

        3. July 29, 2003 Correspondence .....7

        4. DFI’s disregarding of the ALJ decision and  
           CybrCollect’s Appeal.....8

LAW AND ARGUMENT .....9

    A. STANDARD OF REVIEW .....9

    B. CYBRCOLLECT’S PRACTICE IS PROPER UNDER  
       BOTH FEDERAL AND NORTH DAKOTA LAW .....9

        1. Initiating electronic fund transfers in compliance  
           with Federal law does not violate chapter 13-05 of  
           the North Dakota Century Code or any rule  
           promulgated thereunder .....10

          a. Electronic fund transfers from consumer  
              accounts in North Dakota are regulated by federal law .....10

          b. CybrCollect complies with EFTA and Regulation  
              E in conducting its business .....11

          c. The NACHA Rules are not law .....13

          d. The NACHA Rules do not provide greater consumer  
              protection than EFTA and Regulation E.....14

          e. The NACHA Rules should not be treated as a  
              benchmark for “fair practices” .....16

f.	NACHA itself recognizes that contractual provisions imposing NACHA Rules may be superseded by federal law .....	17
2.	The DFI failed to meet its burden of proof.....	18
a.	The DFI must prove its case by a Preponderance of the Evidence .....	18
b.	The DFI did not meet its Burden of Proof in this Case .....	20
3.	The DFI's conclusion that the NACHA rules are incorporated into North Dakota law constitutes unauthorized rulemaking .....	22
4.	There is no evidence of a violation of FDCPA.....	23
C.	THE DFI HAS NOT FOLLOWED PROPER PROCEDURE UNDER NDCC 28-32 .....	24
1.	Right to Notice and Opportunity to Present Evidence Under Chapter 28-32.....	24
2.	Request for additional issue briefing is not authorized under Chapter 28-32 .....	27
D.	CYBRCOLLECT HAS BEEN DENIED DUE PROCESS AND A FAIR HEARING BECAUSE OF THE DFI'S CHANGING POSITIONS.....	27
1.	CybrCollect was not given adequate notice of what specific violations were being claimed by the DFI.....	28
2.	Ex-post facto justification .....	29
E.	CYBRCOLLECT IS ENTITLED TO AWARD OF ATTORNEYS' FEES AND COSTS INCURRED.....	30
1.	The DFI's position was never substantially justified.....	30
2.	District Court erred in limiting CybrCollect's fees to only it's ND counsel .....	32
	CONCLUSION.....	33

## TABLE OF AUTHORITIES

### FEDERAL CASES

<u>Chevron v. Nat'l Resources Defense Council</u> , 467 U.S. 837, 845 (1984).....	12
<u>In re Ruffalo</u> , 390 U.S. 544, 550; 88 S.Ct. 1222 (1968).....	29
<u>Tuttle v. Equifax Check</u> , 190 F.3d 9, 15 (2 <sup>nd</sup> Cir. 1999) .....	3

### STATE CASES

<u>Bashus v. North Dakota Dep't of Human Servs.</u> , 519 N.W.2d 296, 298 (N.D. 1994) .....	27
<u>Duchscherer v. W.W. Walwork, Inc.</u> , 534 N.W.2d 13, 17 (N.D. 1995).....	32,33
<u>Huber v. Jahner</u> , 460 N.W.2d 717, 719 (N.D. 1990).....	22,27
<u>Huff v. North Dakota State Board of Medical Examiners</u> , 2004 ND 225, ¶ 8; 690 N.W.2d 221, 226.....	9
<u>In re Disciplinary Action Against McKechnie</u> , 2003 ND 37, ¶ 12; 657 N.W.2d 287, 291 .....	29
<u>Jacobson v. North Dakota Workers Compensation Bureau</u> , 2000 ND 225, ¶ 19; 621 N.W.2d 141, 147 .....	28
<u>Johnson v. North Dakota Workers' Compensation Bureau</u> , 428 N.W.2d 514 (N.D. 1988) .....	23,27
<u>Jones v. North Dakota State Board of Medical Examiners</u> , 2005 ND 22, ¶11 .....	9
<u>Lamplighter Lounge, Inc. v. State</u> , 523 N.W.2d 73, 75 (N.D. 1994) .....	30,31
<u>Little v. Spaeth</u> , 394 N.W.2d 700 (N.D. 1986).....	23,27
<u>Montana-Dakota Utilities, Co. v. Public Service Commission</u> , 413 N.W. 2d 308, 312 (N.D. 1987) .....	9
<u>Morrell v. North Dakota Department of Transportation</u> , 1999 ND 140, ¶ 9; 598 N.W.2d 111, 114.....	18,29
<u>North Central Good Samaritan Center v. North Dakota Department of Human Services</u> , 2000 ND 96, ¶20, 611 N.W.2d. 141,145 (ND 2000) .....	18

<u>Renault v. North Dakota Workers' Compensation Bureau, 1999 ND</u> 187, ¶16, 601 N.W.2d. 580 .....	19
<u>Sjostrand v. North Dakota Workers' Compensation Bureau, 2002 ND</u> 125, ¶7, 649 N.W.2d. 537,542 .....	19

**FEDERAL STATUTES AND REGULATIONS**

15 U.S.C. § 1693 et seq.....	10,14
15 U.S.C. § 1693a(6) .....	10
15 U.S.C. § 1693(b).....	10
15 U.S.C. § 1692c(b) .....	7
15 U.S.C. § 1692g(a) .....	7
15 U.S.C. § 1693m(d).....	11
12 C.F.R. § 205.10.....	11
12 C.F.R. § 205.1(b) .....	11
12 C.F.R. § 205.2(k) .....	11,12
12 C.F.R. § 205.3(b) .....	10
12 C.F.R. § 250.3(c).....	12
12 C.F.R. § 205.3(c)(1).....	11
12 C.F.R. § 205.3(c)(3).....	11

**STATE STATUTES AND RULES**

Conn. Gen. Stat. § 42a-2-709.....	3
Mass. Stats. 167B § 1 et seq. ....	14
N.D.C.C. § 6-08-16.....	3,4,10,15,16
N.D.C.C. § 28-32-02.....	23
N.D.C.C. § 28-32-08.....	23

N.D.C.C. § 28-32-09.....	23
N.D.C.C. § 28-32-10.....	22,23
N.D.C.C. § 28-32-11.....	22,23
N.D.C.C. § 28-32-12 .....	22,23
N.D.C.C. § 28-32-13.....	22,23
N.D.C.C. § 28-32-14.....	23
N.D.C.C. § 28-32-21(2).....	25,26
N.D.C.C. § 28-32-21(3)(c).....	24,25,26
N.D.C.C. § 28-32-25.....	8,27
N.D.C.C. § 28-32-46.....	9,19
N.D.C.C. § 28-32-49.....	9
N.D.C.C. § 28-32-50.....	30
N.D.C.C. § 28-32-50(1).....	30
N.D.C.C. § 41-04.1 .....	13
N.D.C.C. § 41-04.1-08.....	13
N.D.C.C. § 41-04-03.....	5,6
N.D.C.C. § 41-03-04.....	16
N.A.C.C § 13-04-02-08 .....	7
N.A.C.C § 13-04-02-09 .....	7

**MISCELLANEOUS**

53 Fed. Reg. 50097, 50108 .....	4
66 Fed. Reg. 15187, 15190 .....	15

69 Fed. Reg. 55996, 56010 .....17

## STATEMENT OF ISSUES

I. Whether the Department of Financial Institutions' Order prohibiting CybrCollect, Inc. from electronically collecting NSF Fees is unenforceable because it does not sufficiently explain the Department's rationale for rejecting the recommendations of the Administrative Law Judge.

II. Whether the Department of Financial Institutions violated the North Dakota Administrative Agencies Practice Act by violating CybrCollect, Inc.'s due process rights and failing to provide a fair hearing before issuing its Order.

III. Whether CybrCollect, Inc. is entitled to recover all of its attorneys' fees and costs because the Department of Financial Institutions had no substantial justification for its position(s) in this matter.

## STATEMENT OF THE CASE

The Statement of the Case set forth by the North Dakota Department of Financial Institutions ("DFI") is essentially accurate with respect to the origin of this administrative dispute. Therefore, CybrCollect, Inc. ("CybrCollect") will not repeat that procedural background. However, the DFI fails to acknowledge that both before and after issuing the Cease and Desist Order, it has attempted to justify, on one basis after another, its belief that CybrCollect should not be able to collect NSF Fees electronically in North Dakota. These ever-shifting and occasionally contradictory bases for the DFI's attempt to provide a legal foundation for its belief are set forth in the Supplemental Appendix<sup>1</sup> to this Brief. (See Supp.App. 45-55.) Yet despite the pages and pages of arguments and counterarguments, the question before this Court remains the same as the

question that was before Judge Hoberg nearly two years ago: *Does the electronic collection of NSF Fees, in compliance with the federal law which governs such activity, constitute a violation of Chapter 13-05 of the North Dakota Century Code?*<sup>2</sup>

## STATEMENT OF THE FACTS

### **A. Background**

CybrCollect is a Wisconsin corporation that, like many other companies in the United States, contracts with retail merchants to electronically collect checks that have been returned for insufficient funds (“NSF Checks”). CybrCollect at this time does business in all 50 states. As compensation for its services, CybrCollect receives all or a portion of the fee (the “NSF Fee”) that is typically recoverable under state law as the cost of collecting NSF Checks. In North Dakota, N.D.C.C. § 6-08-16 specifically provides that a person who writes an NSF Check “*is also liable*” for collection fees or costs not in

---

<sup>1</sup> CybrCollect’s Supplemental Appendix will hereafter be cited as “Supp.App. \_\_\_\_.” The DFI’s Appendix will hereafter be cited as “DFI App. \_\_\_\_\_.”

<sup>2</sup> The DFI and NACHA would prefer to have this Court consider whether a failure to comply with the Rules of the National Automated Clearing House Association (“NACHA”), the large, private organization of financial institutions headquartered in Herndon, Va., constitutes a violation of Ch. 13-05. Indeed, Commissioner Karsky concluded as a matter of law that “NACHA Operating Rules [the “NACHA rules”] have been incorporated into state law.” (DFI App. 40.) NACHA has been actively encouraging state regulators to adopt such a position. For a short time, NACHA successfully persuaded the Wisconsin Department of Financial Institutions to treat a violation of the NACHA rules as a violation of Wisconsin’s debt collection law. However, during the pendency of this case, a Wisconsin court found that conduct to be unauthorized rulemaking. (Supp.App. 62-78.) Thereafter, NACHA and the Wisconsin DFI attempted to have a regulation passed that would codify NACHA’s rule requiring written authorization. On July 27, 2004, the Wisconsin Senate Committee on Agriculture, Financial Institutions and Insurance formally objected to the proposed rule with a unanimous bi-partisan 5-0 vote. Shortly thereafter, the DFI’s Division of Banking decided to withdraw the proposed rule. During the Senate hearing, NACHA had to concede that no other state has adopted such a rule as law.

excess of \$25, which are recovered by the holder, or its agent or representative, of the check . . . .” (Emphasis added). In other cases, courts have allowed such fees as “incidental damages” under a state’s version of the Uniform Commercial Code.<sup>3</sup> The Federal Trade Commission has taken the position that even a clear and conspicuous sign at a point of sale may be sufficient to create an “agreement” between the check writer and the payee regarding collection of the fee.<sup>4</sup>

Merchant clients of CybrCollect authorize their financial institutions to forward all NSF Checks directly to CybrCollect. When CybrCollect receives a NSF Check from the merchant’s bank, it uses proprietary software to scan the check into CybrCollect’s computer, which converts the information into electronic data in the form of two debits: the first debit is for the face amount of the check, and the second debit is for the amount of the NSF Fee. CybrCollect electronically processes these two debits, collecting the face value of the check for its merchants and the NSF Fee which it retains as compensation for services rendered. If after two attempts at re-presentment there are still insufficient funds in a consumer’s account, CybrCollect sends the check to a traditional collection agency for collection.

Although the DFI argues that N.D.C.C. § 6-08-16 requires the consumer’s consent before a holder can collect an NSF Fee (DFI Brief at 9), such interpretation is not supported by the plain language of the statute (*see infra*, p. 13). CybrCollect’s *right* to

---

<sup>3</sup> See Tuttle v. Equifax Check, 190 F.3d 9, 14-15 (2<sup>nd</sup> Cir. 1999)(finding Conn. Gen. Stat. § 42a-2-709, UCC Article II as adopted in Connecticut, authorizes a debt collector to impose and collect a service charge for an NSF check).

<sup>4</sup> See Staff Commentary on the Fair Debt Collection Practices Act, Comment 4 to Section 808(1): “A debt collector may establish an “agreement” without a written contract. For example, he may collect a service charge on a dishonored check based on a posted sign

collect the NSF Fee has never been an issue in this case. Instead, the DFI has attacked the *means* by which CybrCollect collects the NSF Fee. The DFI, supported by NACHA, takes the position that an NSF Fee may not be collected from the checkwriter's account without the checkwriter's *written* authorization. The District Court, Judge Gail Hagerty, held that the DFI lacked substantial justification for its position because North Dakota law does not require written authorization, and federal law expressly permits the collection of NSF Fees without written authorizations. (DFI App. 75-76.)

**B. Procedural History**

**1. Pre-Hearing**

On March 7, 2003, a Cease and Desist Order was issued against CybrCollect that has prevented CybrCollect from engaging in the business that it is lawfully pursuing throughout the United States. The Cease and Desist Order, in pertinent part, stated simply:

WHEREAS, it appears to the Commissioner CybrCollect, Inc. is engaging, has engaged, or is about to engage in acts and practices which may constitute a violation of the North Dakota Collection Agency Act (N.D.C.C. ch.13-05). . . .

NOW THEREFORE, IT IS HEREBY ORDERED that CybrCollect, Inc., its directors, officers, employees, agents and successors, cease and desist from engaging in further acts and practices in violation of N.D.C.C. ch. 13-05.

(DFI App. 6-7.)

In its letter to Gary Doherty, President of CybrCollect, accompanying the Order, the DFI identified three apparent bases for the DFI's action: (1) as first articulated by Commissioner Karsky and reiterated by Greg Meidinger, the DFI's investigator, "North

---

on the merchant's premises allowing such a charge, if he can demonstrate that the

Dakota law is considered permissive and does not authorize the collection of returned check fees electronically”; (2) the failure of CybrCollect to obtain a license; and (3) an apparent violation of the NACHA rules. (DFI App. 3-5.) At CybrCollect’s request, the DFI and its counsel met with CybrCollect and its counsel on March 20, 2003 for the purpose of understanding the nature of the alleged violations of N.D.C.C. ch. 13-05 (the “Collection Agency Act”) that gave rise to the Cease and Desist Order. In particular, CybrCollect sought clarification of two points: (1) the concept of North Dakota “permissive law” that prohibited electronic fee collection, and (2) the relationship between the NACHA rules and the Collection Agency Act, as this was the first time the DFI had asserted the NACHA rules as a basis for its order. (Supp.App. 18-20.)

At the March 20, 2003 meeting, the DFI did not mention its prior argument that North Dakota law is considered permissive and thus prohibited CybrCollect’s practice. However, the DFI did articulate two new alleged violations: First, the DFI alleged a violation of the licensing provisions of the Collection Agency Act. Second, the DFI asserted that the NACHA rules were incorporated by reference into N.D.C.C. § 41-04-03, and noncompliance with the NACHA rules is therefore a violation of North Dakota law.

At the conclusion of the meeting, CybrCollect agreed to obtain licensure through the DFI.<sup>5</sup> CybrCollect also signed an agreement that provided it would be granted a license in North Dakota, but that the DFI’s “restriction of the electronic collection of fees

---

consumer knew of the charge.” 53 Fed. Reg. 50097-50110 (Dec. 13, 1988).

<sup>5</sup> CybrCollect’s failure to obtain a license earlier was the result of a bona fide misunderstanding. The record demonstrates that the DFI itself believed that licensing was not required. (Supp.App. 9-10.) In fact, at the time that the Cease and Desist Order was issued, CybrCollect was already in the process of preparing its application for a license.

shall remain in force” pending a final determination of CybrCollect’s administrative appeal. (DFI App. 10-11.)

At this point, based on the DFI’s position stated at the March 20, 2003 meeting, CybrCollect believed the only issues that were to be addressed at the administrative hearing were (1) whether the NACHA rules were incorporated into N.D.C.C. § 41-04-03; and (2) if the NACHA rules are incorporated into that statute, whether a failure to comply with § 41-04-03 constitutes a violation of the Collection Agency Act that justifies the Cease and Desist Order. (See Agency Doc. #6 – CybrCollect’s Pre-Hearing Brief.)

## **2. The ALJ Hearing**

The hearing on this matter took place on May 12, 2003 (the “ALJ hearing”). Much to CybrCollect’s surprise, at the ALJ hearing, the DFI abandoned its argument that the NACHA rules are incorporated into N.D.C.C. ch. 41-04. Instead, the DFI argued that North Dakota banks could be penalized for not following NACHA rules based on CybrCollect’s practice. (Supp.App. 29-30.) Although CybrCollect attempted to respond to this new argument in its post-hearing brief, CybrCollect did not have the opportunity to call witnesses or to prepare cross-examination of the DFI’s witnesses on that issue. Furthermore, the DFI raised additional arguments for the first time by asserting that a failure to comply with the NACHA rules constitutes a “fraudulent, deceptive, misleading, unfair and/or unconscionable means of collecting a debt” in violation of N.D.A.C §§ 13-04-02-08 and 13-04-02-09, adding further confusion as to the true basis of the alleged violation of Chapter 13-05.

Administrative Law Judge Allen C. Hoberg’s Recommended Finds of Fact, Conclusions of Law, and Order, dated on June 24, 2003, properly focused on the issue as

it had been presented to CybrCollect in the Notice of Hearing and Specification of Issues and found that:

[t]here is simply nothing in stated North Dakota law or policy that would allow DFI to prohibit CybrCollect from interpreting the law in a reasonable fashion, as it has, based on Federal Reserve Board interpretation, to do what it currently does in business activities . . . . If one of the interpretations of the law offered by the parties in this matter is to be authoritative in North Dakota, it is up to the DFI to adopt a rule or for the North Dakota Legislative Assembly to pass a statute to deal with this situation of consumer risk and risk for financial institutions, if indeed there is a risk.

(DFI App. 11.)

**3. July 29, 2003 Correspondence**

After receiving ALJ Hoberg's Recommended Findings, Commissioner Karsky wrote a letter dated July 29, 2003 in which he asked the parties to brief two *new* issues under the Fair Debt Collection Practices Act ("FDCPA"). Commissioner Karsky requested that CybrCollect address the following issues: 1) whether CybrCollect's debiting of a debtor's account is a "communication with third parties" that is prohibited by 15 U.S.C. § 1692c(b); and 2) whether CybrCollect's debiting of a debtor's account is a communication with the debtor that necessitates CybrCollect's sending of a written notice to the debtor pursuant to 15 U.S.C. § 1692g(a). (DFI App. 26-27.)

In response to Commissioner Karsky's letter, CybrCollect provided a brief substantive answer to the issues raised. (Supp.App. 45-55.) CybrCollect also objected on various procedural grounds, primarily that the issues raised were new legal theories that were not part of the Cease and Desist Order and thus could not be raised after the hearing. CybrCollect requested a hearing in order to present additional factual background. Although Commissioner Karsky believed that an additional factual hearing

was not necessary since the issues briefed were legal rather than factual, the Commissioner granted the hearing. (Supp.App. 56-57.) The hearing was held on September 29, 2003. The DFI presented no evidence or witnesses, and therefore, CybrCollect had no opportunity to examine any new evidence or cross-examine any of the DFI's witnesses as permitted under N.D.C.C. § 28-32-25.

**4. DFI's Disregarding of the ALJ Decision and CybrCollect's Appeal**

On November 13, 2003, Commissioner Karsky disregarded the Recommended Findings of Fact, Conclusions of Law, and Order of ALJ Hoberg and entered his own decision. (DFI App. 28-51.) CybrCollect timely filed its Notice of Appeal and Specifications of Errors to appeal this matter to the District Court. (DFI App. 52-65.)

Like ALJ Hoberg, District Judge Gail Hagerty properly focused on the issue that was originally raised in this case, i.e., whether CybrCollect's electronic collection of NSF Fees violates the Collection Agency Act, N.D.C.C. ch. 13-05. Judge Hagerty held that "CybrCollect's activities are permissible under the EFTA, Regulation E, and North Dakota law." (DFI App. 69.) Judge Hagerty further explained that the DFI's Order was improper because state law does not require a written authorization:

State law or regulation could prohibit check collectors' ability to electronically collect NSF Fees from a debtor's bank account without a debtor's signed authorization. However, current law does not prohibit CybrCollect from electronically collecting NSF Check fees from a debtor's bank account without written authorization.

(DFI App. 71.)

## LAW AND ARGUMENT

### A. STANDARD OF REVIEW

Sections 28-32-46 and 28-32-49, N.D.C.C., provide the standard of review of administrative orders. “An [administrative] agency’s decisions on questions of law are fully reviewable.” Huff v. North Dakota State Board of Medical Examiners, 2004 ND 225, ¶ 8; 690 N.W.2d 221, 226; Jones v. North Dakota State Board of Medical Examiners, 2005 ND 22, ¶ 11. As found by the DFI, “[t]his case involves very little, if any, factual dispute but does involve serious and complex questions of law.” (DFI App. 30.) Since this matter involves the review of almost exclusively legal conclusions of the DFI, the standard of review is essentially de novo. The DFI’s Order cannot stand if even one of the eight criteria set forth in § 28-32-46 is present. Although the expertise of the DFI would be entitled to deference if the subject matter were of a highly technical nature, Montana-Dakota Utilities, Co. v. Public Service Commission, 413 N.W.2d 308, 312 (N.D. 1987), this is not a case which rests on such expertise. Indeed, it is precisely the DFI’s lack of familiarity with the federal law of electronic fund transfers that caused the DFI to disregard Judge Hoberg’s Recommended Findings.

### B. THE CONCLUSIONS OF LAW AND ORDER OF THE DFI DO NOT SUFFICIENTLY EXPLAIN THE DFI’S RATIONALE FOR NOT ADOPTING THE CONTRARY RECOMMENDATIONS BY THE ADMINISTRATIVE LAW JUDGE.

As Judge Hagerty noted, the DFI virtually ignored Judge Hoberg’s Recommended Findings. Instead, the DFI inexplicably substituted its own characterization of the case to justify upholding the Cease and Desist Order. The DFI rested its decision on four principal conclusions, one of which the DFI has already abandoned, and the other three of

which lack any support in the record.<sup>6</sup> The DFI did not, and indeed could not, rebut that the “evidence shows that CybrCollect is operating as a collection agency in North Dakota under a reasonable interpretation of the laws . . . .” (DFI App. 20.)

1. **Initiating Electronic Fund Transfers in Compliance with Federal Law Does Not Violate Chapter 13-05 of the North Dakota Century Code or Any Rule Promulgated Thereunder.**

a. **Electronic fund transfers from consumer accounts in North Dakota are regulated by federal law**

An electronic fund transfer (“EFT”) is a

transfer of funds . . . which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but is not limited to, point-of-sale transfers, automated teller machine transactions, direct deposits or withdrawals of funds, and transfers initiated by telephone.

15 U.S.C. § 1693a(6).

In 1978, Congress passed the Electronic Fund Transfer Act, 15 U.S.C. §§ 1693, *et seq.* (“EFTA”) in order to provide “a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems. The primary objective of [the statute], however, is the provision of individual consumer rights.” *Id.* § 1693(b). Regulation E (12 CFR Part 205), issued by the Federal Reserve Board (“FRB”), carries out the purposes of EFTA, and reiterates that the purpose of EFTA and Regulation E is “the protection of individual consumers engaging in electronic fund transfers.” 12

---

<sup>6</sup> (1) State law does not allow CybrCollect to unilaterally debit a check-writer’s account without notice and an opportunity for a hearing; (2) CybrCollect’s “intentional and knowing” violation of contracts would bring reproach on the industry, cause financial harm to CybrCollect, and was a fraudulent and deceptive practice; (3) CybrCollect’s failure to comply with the NACHA Rules constitutes a failure to comply with state law; and (4) CybrCollect’s “communications” are a violation of the Fair Debt Collection

C.F.R. § 205.1(b). Transfers between businesses are outside the scope of EFTA and Regulation E. 12 C.F.R. § 205.3(c)(3).

Congress accorded the FRB great deference. EFTA provides that there is no civil or criminal liability under the statute for “any act done or omitted in good faith in conformity with any rule, regulation or interpretation thereof” by the FRB. 15 U.S.C. § 1693m(d). In its Official Interpretation of Regulation E (the “Commentary”), the FRB has taken the position that an RCK entry<sup>7</sup> is the outside the scope of EFTA and Regulation E because “the transaction originated by check.” Commentary to 12 C.F.R. § 205.3(c)(1), paragraph 1. However, electronic debits for NSF Fees are subject to the statute and regulation. See Commentary to 12 C.F.R. § 205.3(b) at para. 1(v), and Commentary to 12 C.F.R. § 205.3(c)(1) at para. 1.

**b. CybrCollect complies with EFTA and Regulation E in conducting its business**

Under EFTA and Regulation E, electronic fund transfers from a consumer’s account must be authorized by the consumer. Indeed, the purpose of such authorization is to prevent the sort of “invasion” of a consumer’s account that concerns the DFI. Under Regulation E, “*preauthorized* electronic fund transfers from a consumer’s account may be authorized only by a writing signed or similarly authenticated by the consumer.” 12 C.F.R. § 205.10 (emphasis added). A preauthorized electronic fund transfer is “an electronic fund transfer authorized in advance to recur at *substantially regular intervals*.”

---

Practices Act. (DFI Appx. At 41-41) As discussed below at p. 14, the DFI apparently has already abandoned the first of these arguments.

<sup>7</sup> Since 1998, in a transaction in which the customer pays by check, and the check is returned for insufficient or held funds, the payee (or its agent or assignee) may re-present the check electronically through the ACH system. This re-presentation is described by NACHA as an “RCK Entry”.

12 C.F.R. § 205.2(k) (emphasis added). By contrast, no written authorization is required for non-recurring debits, such as NSF Fees. These EFT transactions may be authorized by *notice to the consumer*:

Regulation E does apply. . . to any fee authorized by the consumer to be debited electronically from the consumer's account because the check was returned for insufficient funds. Authorization occurs where the consumer has received notice that a fee imposed for returned checks will be debited electronically from the consumer's account.

Commentary to 12 C.F.R. § 205.3(c), para. 1.

Significantly, nowhere does the FRB require an originator of an electronic fund transfer to verify that a sign "is always placed in an area that might sufficiently give a check writer notice of the contents of that sign, or notice of the possibility that the fee would be electronically debited from the writer's account." (DFI App. 38 - Finding of Fact No. 10).

In conducting its business, CybrCollect has relied on EFTA and Regulation E, which expressly permit CybrCollect to initiate a one-time electronic fund transfer upon notice to the consumer. The record clearly indicates that CybrCollect requires the merchants to display a sign at the point-of-sale, and that CybrCollect's representatives routinely confirm that the signs are posted. (Supp.App. 26-28.) The DFI erred in finding that CybrCollect does not provide sufficient notice to the consumer under Regulation E. Moreover, the DFI exceeded its authority by attempting to interpret Regulation E. Not only is such interpretation outside the scope of its jurisdiction and its expertise, but it is a well-established principle that the administrative agency charged by Congress to interpret a statute or regulation is to be accorded great deference. See Chevron v. Nat'l Resources Defense Council, 467 U.S. 837, 845 (1984) (the Supreme Court has "long recognized that

considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations").

**c. The NACHA rules are not law.**

The DFI asserts that the North Dakota Legislature has enacted the NACHA rules into law by adopting references to "clearinghouse rules" and "funds-transfer system rules". (DFI Brief at 17). This argument is unpersuasive for at least five reasons. *First*, all but one of the citations to "clearinghouse rules" appear in North Dakota's version of Article 4 of the Uniform Commercial Code (the "UCC") (the other appears in the law of negotiable instruments, and is inapplicable here). As discussed by CybrCollect in its Post-Hearing Brief at p.19, Article 4 applies to "items", which by definition must be written. Electronic debits for NSF Fees are not "items", and therefore are outside the scope of Article 4.

*Second*, the references to clearinghouse rules in Article 4 are very specific and limited, and were intended to provide flexibility to financial institutions in the rapidly evolving technology of payment processing. (See CybrCollect's Post-Hearing Brief at p. 20 (discussing the Official Comment to UCC § 4-101.)) Nowhere are the NACHA rules incorporated in their entirety into law. Indeed, the North Dakota Legislature enacted Article 4A of the UCC, entitled "Uniform Commercial Code – Funds Transfers," to address commercial funds transfers. See N.D.C.C. ch. 41-04.1.

*Third*, the DFI cites seven references to "funds-transfer system rules" in Article 4A as additional support for its argument that the NACHA rules are incorporated into North Dakota law. However, N.D.C.C. § 41-04.1-08 states that "[t]his chapter does not

apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act of 1978 [Title XX, Pub. L. 95-630; 92 Stat. 3728; 15 U.S.C. 1693 et seq.] as amended from time to time.” Therefore, the North Dakota Legislature *expressly acknowledges* that consumer EFT transactions, such as those engaged in by CybrCollect, are subject to EFTA.

*Fourth*, NACHA itself does not even argue that the NACHA rules are incorporated into the UCC. Instead, NACHA merely mentions the right of a financial institution under UCC § 4-402 to be liable to a checking account holder for the wrongful dishonor of a check. (NACHA Brief at para. 23).

*Fifth*, some states have enacted their own versions of EFTA. *See, e.g.*, Mass. Stats. 167B § 1, et seq. The North Dakota legislature could also adopt legislation regulating EFTs from consumer accounts. As of this date, however, it has not done so. Therefore, consumer EFT transactions in North Dakota remain subject only to EFTA and Regulation E.

**d. The NACHA rules do not provide greater consumer protection than EFTA and Regulation E.**

Woven throughout the arguments by the DFI and NACHA in support of the Cease and Desist Order is the premise that consumers in North Dakota would be better protected if they had to provide written authorization for NSF Fees to be collected electronically. Indeed, the FRB itself, in its *introduction*<sup>8</sup> to the 2001 revisions to the Commentary, states:

---

<sup>8</sup> The DFI erroneously attributes this introductory remark, which never went through the process of notice and comment, to the Official Commentary of the FRB. (DFI Brief at 5.)

The Board views, as separate transactions, the RCK and any fee assessed and debited from the consumer's account as a result of insufficient funds, whether or not the fee is permitted by the [Uniform Commercial Code ("UCC")] to cover incidental damages. Authorization is required to electronically debit the fee from the consumer's account, but because the transfer is nonrecurring, notice to the consumer is sufficient for purposes of compliance with the regulation. (NACHA Operating Rules currently provide greater consumer protection in that they require written authorizations.)

66 Fed. Reg. 15187, 15190 (March 16, 2001) (emphasis added).

With due respect to the FRB, NACHA and the DFI, CybrCollect believes that the assertion that written authorization provides "greater consumer protection" is based on erroneous assumptions and is therefore misguided. The fallacy becomes apparent when one asks, "*Protection from what?*" States generally agree as a matter of policy that it is unfair and unreasonable for an individual to issue a check for which he or she knows there are insufficient funds in the account.<sup>9</sup> Indeed, it is a criminal act in North Dakota *regardless* of the check writer's state of mind. See N.D.C.C. § 6-08-16.

It cannot be said that a consumer who issues an NSF Check in North Dakota has a choice about whether to pay the NSF Fee. Section 6-08-16 of the North Dakota Century Code imposes *unconditional liability* on the check writer for the fee: "The person *is also liable* for collection fees or costs, not in excess of twenty-five dollars, which *are recoverable* by the holder, or its agent or representative."<sup>10</sup> (Emphasis added). A

---

<sup>9</sup> See Larry Lawrence ad Bryan D. Hull, *Payment Systems*, §6:40 ("Virtually every state has specific statutes prohibiting the issuing and/or passing of bad checks", with list of statutory cites attached).

<sup>10</sup> Although the DFI argues that "the statute allows a creditor or collection agency to collect that amount from a debtor's account without a lawsuit, but only with the debtor's permission." (DFI Br. at 11.), the statutory language clearly does not require consent. Moreover, the DFI's current position contradicts Commissioner Karsky's Conclusion of Law that "State law does not allow CybrCollect to unilaterally debit a check-writer's account without notice and an opportunity for a hearing." (DFI App. 40.)

consumer therefore cannot be “protected” against a merchant’s legal right to the fee. Just as a check, as a negotiable instrument, creates an “unconditional . . . order to pay a fixed amount of money” (N.D.C.C . § 41-03-04 (U.C.C. 3-104)), in the same way N.D.C.C. § 6-08-16 creates an unconditional obligation to pay the \$25.00 NSF Fee.

For both an RCK entry and the collection of an NSF Fee in North Dakota, the recipient has an underlying right to the funds that does not depend on the means of collection. The risk of fraud in collecting an NSF fee, therefore, is no greater than the risk of fraud in collecting an RCK debit. According to NACHA, *notice at the point-of-sale* is sufficient authorization for an RCK entry.<sup>11</sup> Notice should also be sufficient authorization for the NSF Fee that arises in connection with that RCK entry. There is no reason for NACHA (or this court) to treat the two types of electronic debits of pre-existing legal obligations differently.<sup>12</sup>

**e. The NACHA rules should not be treated as a benchmark for “fair practices”**

NACHA is the largest association of financial institutions engaged in automated clearinghouse transactions.<sup>13</sup> Their mission is *not* consumer protection, but “to promote

---

<sup>11</sup> See discussion in CybrCollect’s Post-Hearing Brief at pp. 15-16.

<sup>12</sup> The illogical nature of the disparate treatment is highlighted by NACHA’s argument that an electronic fund transfer authorized by notice “may cause an overdraft in the account, leading to the return of checks written by the consumer or the inability of the consumer to access funds that should properly be in his or her account.” NACHA Brief at para. 23. A check that is re-presented electronically in an RCK entry authorized by notice alone could *also* cause such an overdraft. The consumer has no control over the timing of the re-presentation, and is therefore just as vulnerable to an “inability to access funds”. Although NACHA repeatedly refers to the unhappy consequences of an “unauthorized” transaction by CybrCollect, the transaction is really “authorized” in the same manner as the RCK entry that NACHA itself promotes as advantageous to consumers.

<sup>13</sup> Contrary to the implications of the NACHA brief, however, NACHA is not the *only* association. There are smaller competitors, such as the privately-owned Electronic

the development of electronic solutions that improve the payments system for the benefit of its members and their customers.”<sup>14</sup> The FRB, charged under EFTA with protecting consumers in electronic fund transfers, could have adopted the NACHA Rule regarding authorization of electronic NSF Fee collection, but it chose not to. Although NACHA characterizes the FRB approach as “lenient”, it would be more accurate to characterize the NACHA requirement as unnecessary. In fact, in September 2004, the FRB proposed an amendment to the very section of the commentary at issue to make clear that a consumer who receives notice and goes forward with the transaction is deemed to have “authorized” the electronic fund transfer under federal law. 69 Fed.Reg. 55996, 56010 (Sept. 17, 2004) (See Addendum). The proposal did not mention the NACHA rules at all. Authorization of an electronic fund transfer of NSF Fees by notice, so recently reaffirmed by the FRB, could not be an unfair or deceptive practice.

**f. NACHA itself recognizes that contractual provisions imposing NACHA rules may be superseded by federal law.**

According to the NACHA Operating Guidelines, the “Originator [of an ACH transaction] must execute an agreement or contract with the [originating financial institution] that, at a minimum, binds the Originator to the NACHA Operating Rules.” (Agency Doc. #9-Ex. 17.) However, “in some instances provisions of the agreement may be superseded by applicable federal or state law (e.g., . . . the Electronic Fund Transfer Act.)”. (Id.) Therefore, NACHA itself recognizes that the Electronic Fund Transfer Act (and by extension Regulation E) may take precedence over a provision in an agreement

---

Payments Network, that are governed by their own rules. See <http://www.epaynetwork.com/> (“More than 1,600 Financial Institutions of all sizes rely on EPN for its high quality service, reliability, industry leadership, and innovative approach to the business.”)

that requires an originator to obtain written authorization. Although the DFI argues that “Regulation E does not pre-empt the NACHA rules” (DFI Brief at 16), the DFI offers no support for its conclusion. Nor does the section of EFTA relied upon by NACHA in its brief<sup>15</sup> necessitate a conclusion that the NACHA rules control, inasmuch as the rules, by their terms, bind only member financial institutions. (Agency Doc. #9-Ex. 17.)

The Order’s other bases for upholding the Cease and Desist Order were never presented to Judge Hoberg at the Hearing. Consequently, the Recommended Findings do not address them. As CybrCollect argues below, the DFI’s other arguments, regarding CybrCollect’s alleged breach of contract and alleged violation of the Fair Debt Collection Practices Act, are without foundation in either the law or the testimony presented at the ALJ Hearing.

**2. The DFI Failed to Meet Its Burden of Proof**

**a. The DFI must prove its case by a Preponderance of the Evidence.**

“It is ‘well-settled’ the moving party has the burden of proof in an administrative hearing.” North Central Good Samaritan Center v. North Dakota Department of Human Services, 2000 ND 96, ¶20, 611 N.W.2d. 141, 145; Morrell v. North Dakota Dept. of Transp., 1999 ND 140, ¶14, 598 N.W.2d. 111, 115. The DFI issued a Cease and Desist Order precluding CybrCollect from further acts and practices in violation of N.D.C.C. ch. 13-05. As the moving party, the DFI was thus charged with the burden of proving at the

---

<sup>14</sup> See <http://www.nacha.org/About/mission.htm>.

<sup>15</sup> The statement that “nothing in [EFTA] . . . prohibits . . . any writing or other agreement which grants to a consumer a more extensive right or remedy or greater protection than contained in this subchapter or a waiver given in settlement of a dispute or action” merely describes the circumstances in which no violation of EFTA will be deemed to occur.

hearing by a preponderance of the evidence that CybrCollect violated Chapter 13-05 by collecting NSF Fees electronically. N.D.C.C. § 28-32-46; see also Sjostrand v. North Dakota Workers' Compensation Bureau, 2002 ND 125, ¶7, 649 N.W.2d. 537, 542.

In Sjostrand, this Court explained that upon reviewing a bureau's finding of facts, the reviewing court does not make an independent finding or substitute their judgment for that of the bureau, rather the court decides whether a reasoning mind reasonably could have decided that the bureau's findings were proven by the weight of the evidence from the entire record. Id. (emphasis added); see also Renault v. North Dakota Workers' Compensation Bureau, 1999 ND 187, ¶16, 601 N.W.2d. 580. In the present case, a reasoning mind could not reasonably believe that the DFI's findings were proven by the weight of the evidence from the entire record. Simply stated, the DFI continuously created new, unforeseen theories of liability as the case progressed and then rested its Order on CybrCollect's failure to submit evidence to rebut those theories.

In that respect, the DFI's approach changed little from that taken toward CybrCollect in 2002, when Commissioner Karsky wrote to CybrCollect's counsel:

As discussed with Gary Doherty in September 2002, North Dakota law is considered a permissive law and no where does it authorize the collection of [the NSF] fee electronically. If you can provide me the statutes that allow this under North Dakota law, please do so at this time.

(Supp.App. 16-17.) The failure of CybrCollect's counsel to draw such authorizing statute to the attention of the DFI was later cited as a reason for issuing the Cease and Desist Order. (See DFI Post-Hearing Reply Brief at 3 (“[T]he DFI only issued the March 7, 2003 Cease and Desist Order after a prolonged period of time during which the DFI patiently awaited, but failed to receive, a reply to the DFI's October 22, 2002 correspondence.”)) However, just as the onus was not on CybrCollect's counsel to scour

North Dakota law in search of authorization for a practice that was already expressly permitted under federal law, the onus was not on CybrCollect at the hearing to prove its compliance with Chapter 13-05 in every conceivable respect.

**b. The DFI did not meet its Burden of Proof in this Case**

Although the Order is replete with examples of the DFI's failure to meet its burden of proof, in the interest of brevity, CybrCollect will address only two: Finding of Fact No. 3 and Finding of Fact No. 4. The issues raised in Finding of Fact No. 3 are similar to the issues raised in opposition to Finding of Fact No. 10. In Finding of Fact No. 3, the DFI states:

*There was no evidence that the signs are posted in every instance, or that the signs are posted in an area that might plausibly give the customer notice of the information on the signs.*

It is clear simply from the previously quoted sentence that the DFI relies upon a lack of evidence as its evidentiary basis for a finding that signs are not posted. The DFI cites testimony of Gary Doherty in which Gary testifies that CybrCollect instructs each merchant to post a sign at the point of sale to provide a check writer with notice that a fee will be collected electronically for checks written with insufficient funds. Gary further testifies that while they cannot be 100% sure that each merchant complies with these instructions, nonetheless each merchant is instructed to post the sign. The DFI cannot point to any evidence that signs were not posted or that a particular bad check writer ever had his or her account debited without receiving notice. In fact, this finding is in direct contradiction to the ample testimony provided by Cory Back. (Supp.App. 27-28.)

The ultimate effect of such a finding is to shift the burden upon CybrCollect to show that in every single instance every single check writer was given notice. Yet the

DFI can cite no testimony or evidence to show that a sign was in fact not posted or that a consumer did not receive notice. To shift the burden to CybrCollect in this manner would require CybrCollect to show that every person that ever wrote a bad check did see a sign posted at the point of sale giving that check writer notice of consequences of writing a check with insufficient funds. Such a requirement would cause CybrCollect to call as a witness every person who has written a bad check to a CybrCollect merchant in the State of North Dakota. Clearly, the Legislature did not intend to create such a burden upon a participant to an administrative hearing.

The DFI addresses Finding of Fact No. 4 twice in its Brief:

*CybrCollect has joined the Wisconsin section of the National Automated Clearing House Association (NACHA), and has agreed to operate in conformance with the ACH rules promulgated by NACHA (emphasis added).*

*Although CybrCollect did not introduce that agreement into evidence, the NACHA rules require that contracts between originators and ODFIs "bind [] the Originator to the NACHA Operation Rules." Exhibit 17 While there was testimony and argument that the NACHA rules could be amended by agreement, I find nothing in the NACHA rules or CybrCollect's brief indicating that the written authorization requirements discussed below is one of the provisions that can be amended. Further, there is no evidence that CybrCollect's agreement with Wells Fargo attempts to alter that requirement. Since the agreement was not submitted by CybrCollect, I conclude the agreement did not alter that written authorization requirement, even if it could have.*

It should be noted from the outset of this argument that CybrCollect has never denied that it entered into an agreement commonly known as a Bank Processing Agreement with Wells Fargo. Rather, CybrCollect takes issue with the fact that the DFI is relying upon, and drawing conclusions about, an agreement that concededly is not in evidence.

Although the DFI suggests that CybrCollect should have had the foresight to anticipate the DFI's argument and introduce the agreement into evidence, the DFI forgets that *it* bears the burden of proof. If the Bank Processing Agreement was indeed the basis for CybrCollect's alleged violation of Chapter 13-05, then the DFI should have obtained a copy and introduced it into evidence. The DFI failed to do so. Furthermore, the DFI suggests that because CybrCollect is a member of the Wisconsin Section of NACHA, and because CybrCollect has entered into a Bank Processing Agreement, CybrCollect has agreed to comply with the NACHA Rule regarding authorization of electronic NSF Fee collection. Yet, the DFI has not supported this "Finding of Fact" regarding CybrCollect's legal obligations with any testimony or other evidence. Finally, the DFI does not support its finding about the effect of fines on the finances of CybrCollect with *any* evidence, much less a preponderance. Indeed, the DFI has morphed this Finding of Fact into an argument that cannot be supported under state or federal law.

3. **The DFI's conclusion that the NACHA rules are incorporated into North Dakota law constitutes unauthorized rulemaking**

Judge Hagerty and ALJ Hoberg both reviewed the North Dakota Administrative Code and did not find that the DFI has ever adopted the NACHA rules. (DFI App. 22-23, 71.) If the DFI were to adopt the NACHA rules, the DFI has to follow the procedures set forth in the Administrative Agencies Practice Act, specifically, N.D.C.C. §§ 28-32-10, 28-32-11, 28-32-12 and 28-32-13, which require notice and a hearing. These rulemaking requirements have been vigorously enforced by this Court. As stated in Huber v. Jahner, 460 N.W.2d 717, 719 (N.D. 1990), administrative agencies must adopt all administrative rules in substantial compliance with N.D.C.C. § 28-32-02. Failure to do so makes a rule invalid and unenforceable. Id.

No argument can be made that the NACHA rules have ever been adopted by the DFI. There are a multitude of requirements under the Administrative Agencies Practice Act before a regulation can be enforceable. See id. §§ 28-32-08 through 28-32-14. The DFI has never followed these formal procedures to adopt the NACHA rules. Absent such an adoption, the NACHA rules are not North Dakota law and cannot serve as a legal basis for the DFI's Order. See Little v. Spaeth, 394 N.W.2d 700 (N.D. 1986); Johnson v. North Dakota Workers' Compensation Bureau, 428 N.W.2d 514 (N.D. 1988)

**4. There is no evidence of a violation of FDCPA**

The DFI attempts to justify its Cease and Desist Order against CybrCollect by alleging that CybrCollect has violated the FDCPA. This issue was independently raised by the DFI after the ALJ hearing. (DFI App. 26-27.) The procedural defects regarding this issue will be raised below. However, on a substantive basis, because this issue was not addressed at the ALJ hearing, there is no evidence of record to support the DFI's conclusion.

In Conclusion No. 4, the DFI determines that "CybrCollect's actions in calling the check-writers' banks to verify funds" is a violation of the FDCPA. (DFI App. 41.) This conclusion, by the DFI's own admission, is entirely outside the scope of this proceeding.

In Finding of Fact No. 2, note 2, the DFI writes:

The DFI earlier agreed that the electronic representment of the check was permitted by law and was not part of this proceeding. However, given the facts and law that have surfaced in the interim, specifically the fact that CybrCollect telephones' debtors' banks to inquire about funds available, and the prohibitions found in the Fair Debt Collection Practices Act, the DFI's agreement was probably incorrect. *The DFI may address the legality of contacting debtors' banks for the purpose of submitting electronic checks, as well as the submission itself, in a different proceeding.*

(DFI App. 31-32 (emphasis added)). The DFI acknowledges that this issue is beyond the scope of the instant case and makes no findings of fact on this issue. Despite this, the DFI goes on to conclude as a matter of law that CybrCollect violates the FDCPA. The DFI's conclusion on this issue is both procedurally and legally invalid.

Assuming, *arguendo*, that CybrCollect's telephone inquiries (which when they occur, as the testimony reflects, consist merely of checking on whether there are sufficient funds in a bank account to cover a lump sum dollar amount, see DFI App. 100) even do constitute a violation of the FDCPA, which CybrCollect denies, such a violation bears no relationship to the stated basis for the DFI's Order, i.e., the collection of the statutory NSF Fee by means of an electronic debit. (DFI App. 31-32.) If the DFI indeed believes the brief testimony that CybrCollect introduced in response to the Commissioner's July 29, 2003 letter serves as the basis for a new Order, then it should follow the proper procedure under the Administrative Agencies Practice Act and issue one. CybrCollect will refute it at the proper time, in a proper hearing in which both sides present a full evidentiary case and subject themselves to cross-examination. However, this issue has no place in the current proceeding. A novel issue introduced in a post-hearing brief should not serve as the basis for upholding the DFI's Order against CybrCollect.

**C. THE DFI HAS NOT FOLLOWED PROPER PROCEDURE UNDER NDCC 28-32**

**1. Right to Notice and Opportunity to Present Evidence Under Chapter 28-32**

Chapter 28-32, N.D.C.C., affords CybrCollect certain rights in an adjudicative hearing. Pursuant to N.D.C.C. § 28-32-21(3)(c), an adjudicative administrative hearing

may not be held unless the parties have been properly served with a written specification of issues for hearing or other document indicating the issues to be considered and determined at the hearing. Additionally, pursuant to N.D.C.C. § 28-32-21(2), CybrCollect is afforded the right to present evidence and to examine and cross-examine witnesses. These two requirements set out the most basic legal notion of fairness in an adjudicative hearing. CybrCollect has consistently been denied these rights.

First, the notice provisions of N.D.C.C. § 28-32-21(3)(c) require that CybrCollect receive notice of the issues to be addressed at the hearing. The documents capable of conveying notice include the Cease and Desist Order and the Notice of Hearing and Specification of Issues. The Cease and Desist Order issued by the DFI in this matter orders CybrCollect to “cease and desist from engaging in further acts and practices in violation of N.D.C.C. ch. 13-05.” (DFI App. 6.) The Notice of Hearing and Specification of Issues was issued by ALJ Hoberg on April 17, 2003. (DFI App. 8-9.) The Notice specifies the issue as “[w]hether CybrCollect has engaged in acts, practices, or transactions in violation of N.D.C.C. ch. 13-05 such that the Commissioner may impose a cease and desist order . . . .” These two documents clearly set forth that the issue to be decided was whether CybrCollect’s business is in violation of N.D.C.C. ch. 13-05.

Despite the various arguments raised prior to the Cease and Desist Order, the DFI raised several new arguments following the Cease and Desist Order. (See Supp.App. 45-55.) Indeed, of the four Conclusions of Law cited in the Order as the bases on which to ignore the Recommended Findings of ALJ Hoberg, three are based on theories that have

been raised since the ALJ hearing. The fourth merely rejects the ALJ's Recommended Findings without an adequate basis in fact or law.

Nonetheless, it is clear that the DFI did not comply with the notice requirements of N.D.C.C. § 28-32-21(3)(c). The issues raised at the hearings go far beyond the scope of the issues raised in the Cease and Desist Order, the Specification of Issues and the other correspondence and documents provided to CybrCollect by the DFI. This notice requirement cannot be waived by giving a party the opportunity to brief the issue after the fact. Merely having an opportunity to brief the issue after the fact deprives CybrCollect of its right to present evidence and to examine and cross-examine witnesses pursuant to N.D.C.C. § 28-32-21(2).

On the issue that was properly noticed, i.e., whether CybrCollect violated N.D.C.C. ch. 13-05, both ALJ Hoberg and Judge Hagerty concluded:

by the greater weight of the evidence, the evidence does not show that CybrCollect has engaged in acts, practices, or transactions in violation of N.D.C.C. ch. 13-05, or rules adopted under ch. 13-05, such that the Commissioner may impose a cease and desist order against CybrCollect under the provisions of N.D.C.C. ch. 15-05, or rules adopted under ch. 13-05.

(DFI App. 70.) Both judges that have reviewed this matter properly focused on the relevant issue and did not consider all of the new and additional arguments the DFI attempted to raise. This Court should likewise find that these additional issues raised by the DFI were not properly noticed under N.D.C.C. ch. 28-32, and therefore cannot form a valid basis for its Order.

2. **Request for additional issue briefing is not authorized under Chapter 28-32**

CybrCollect recognizes that an administrative agency, pursuant to N.D.C.C. § 28-32-25, may consider “information or evidence” not presented at the adjudicative proceeding, so long as notice is given and there is an opportunity for an additional hearing. “Information or evidence” means facts or documents. See Bashus v. North Dakota Dep’t of Human Servs., 519 N.W.2d 296, 298 (N.D. 1994). However, what the DFI sought in its letter of July 29, 2003 is not the consideration of additional “information or evidence.” Instead, the DFI was considering new legal theories and issues against CybrCollect. Section § 28-32-25 cannot be interpreted as allowing an administrative agency to present a “moving target,” as such an interpretation would make it nearly impossible for a party to get a fair hearing.

The actions of the DFI in expanding the scope of this case to include new legal theories raised after the first ALJ hearing violates of the procedural requirements of the Administrative Agencies Practice Act. Such violations render the actions of the DFI unenforceable. Johnson v. North Dakota Workers Compensation Bureau, 428 N.W.2d 514, 518 (N.D. 1988); Little v. Spaeth, 394 N.W.2d 700, 704 (N.D. 1986); Huber v. Jahner, 460 N.W.2d 717 (N.D. 1990).

**D. CYBRCOLLECT HAS BEEN DENIED DUE PROCESS AND A FAIR HEARING BECAUSE OF THE DFI’S CHANGING POSITIONS**

There are two ways of viewing the DFI’s violation of CybrCollect’s Due Process rights. First, the Cease and Desist Order issued by the DFI is vague with respect to both the facts and the law. Second, the DFI has sought ex-post-facto justification for its numerous positions.

1. **CybrCollect was not given adequate notice of what specific violations were being claimed by the DFI**

As stated above, the Cease and Desist Order alleges that CybrCollect “is engaging, has engaged or is about to engage in acts and practices which may constitute violations of the North Dakota Collection Agency Act (N.D.C.C. Ch. 13-05).” No specific facts are referenced in the Cease and Desist Order and no specific provision of the Collection Agency Act is referenced. The same is true of the Notice of Hearing and Specification of Issues.

ALJ Hoberg’s Recommended Findings considered CybrCollect’s claim for Due Process violations, but denied such claims based upon the agreement entered into between the DFI and CybrCollect. (DFI App. 20-21.) The ALJ suggests that the Agreement entered into by the parties regarding CybrCollect’s licensure had the effect of nullifying the notice issue. This is simply not true. CybrCollect did enter into an Agreement to obtain conditional licensure within the State of North Dakota until the issue of electronic collection of fees under North Dakota Law could be addressed. (DFI App. 10-11.) However, this Agreement did not change the scope of the issue being disputed between CybrCollect and the DFI and did not provide CybrCollect with any additional notice of the DFI’s basis for claiming a violation of N.D.C.C. ch. 13-05.

A review of the Cease and Desist Order, the Notice of Hearing and Specification of Issues, and the agreement will show that the issues noticed by the DFI include only a violation of N.D.C.C. ch. 13-05. This Court has previously explained in the context of a worker’s compensation hearing, Due Process requires that the notice “must be sufficiently detailed to frame the precise issues.” Jacobson v. North Dakota Workers Compensation Bureau, 2000 ND 225, ¶ 19; 621 N.W.2d 141, 147. “Notice is sufficient if

it informs the party of the nature of the proceedings so there is no unfair surprise.” Morrell v. North Dakota Department of Transportation, 1999 ND 140, ¶ 9; 598 N.W.2d 111, 114; see also In re Disciplinary Action Against McKechnie, 2003 ND 37, ¶ 12; 657 N.W.2d 287, 291 (holding that a lawyer facing disbarment is “entitled to procedural due process, which includes fair notice of the charge,” quoting In re Ruffalo, 390 U.S. 544, 550; 88 S.Ct. 1222 (1968)). In like fashion, CybrCollect is entitled to fair notice of the charge that includes notice of the law violated.

However, the inquiry does not end here. A party denied Due Process must generally show that prejudice resulted from the defective notice. Morrell v. North Dakota Department of Transportation, 1999 ND 140, ¶ 9; 598 N.W.2d 111, 114. In the present case, CybrCollect has been required to continue with needless litigation and has incurred substantial attorneys’ fees as a result of the continued litigation. More importantly, CybrCollect has lost customers and has been effectively forced out of doing business in North Dakota. CybrCollect has been prejudiced as a result of the DFI’s procedural Due Process violations, and therefore, the DFI’s Order is invalid.

**2. Ex-post facto justification**

The DFI’s failure to provide adequate notice violated CybrCollect’s Due Process rights and allowed the DFI to create ex-post facto legal justification for its position. Prior to issuing its Order, the DFI raised a total of nine different positions regarding CybrCollect’s improper acts. (Supp.App. 45-55.) However, none of the reasons offered by the DFI relate to a specific violation of N.D.C.C. ch. 13-05. The DFI states in its Order that “CybrCollect has been given every opportunity to address the issues raised.” (DFI App. 42.) Due Process requires prior notice and an opportunity to be heard. The

“opportunity to be heard” refers to a litigant’s day in court. Briefing an issue after the fact does not equate to a fair opportunity to be heard.

CybrCollect’s Due Process rights were violated by the DFI’s continuous re-characterization of the issues to be decided. Essentially, the DFI continued to create new arguments in the hopes that eventually one of the arguments raised would provide justification for the initial Cease and Desist Order. Such actions should simply not be allowed.

**E. CYBRCOLLECT IS ENTITLED TO AWARD OF ATTORNEYS’ FEES AND COSTS INCURRED**

After determining that “Commissioner Karsky had no basis for substituting his own findings in place of Judge Hoberg’s” and reversing the DFI’s Order, Judge Hagerty further held that the DFI “acted without substantial justification” and awarded CybrCollect its attorneys’ fees and costs under N.D.C.C. § 28-32-50. (DFI App. 75-76.) The standard of review applicable to Judge Hagerty’s award of attorneys’ fees and costs is whether the trial court abused its discretion. Lamplighter Lounge, Inc. v. State, 523 N.W.2d 73, 75 (N.D. 1994). As this Court has noted on its website, district courts rarely abuse their discretion. In light of the lack of an adequate factual or legal basis for its Order and the continual moving target the DFI presented, Judge Hagerty properly found that the DFI’s position was not substantially justified.

**1. The DFI’s position was never substantially justified**

Pursuant to N.D.C.C. § 28-32-50(1), “the court must award the party not the administrative agency reasonable attorneys’ fees and costs if the court finds in favor of that party and, in the case of a final agency order, determines that the administrative agency acted without substantial justification.” (emphasis added) An award of

reasonable attorneys' fees and costs is a serious consequence for an administrative agency, and for the taxpayers of North Dakota. However, this is a case where the conduct of the DFI has been so egregious, and has resulted in so much unnecessary expense and loss of business for CybrCollect, that the award is justified. CybrCollect has been forced to continually brief new issues and to incur the cost of a second hearing in order adequately defend itself. CybrCollect has generated pages and pages of documentary evidence and testimony because it has had to repeatedly rebut the ever-shifting bases on which the DFI's Order allegedly rests. CybrCollect was forced to do this in order to protect its ability to do business in North Dakota.

The DFI states in Finding of Fact No. 3 that “[w]hat is at issue in this matter is the second part of CybrCollect’s business model: the collection of the statutory NSF Fee by means of an electronic debit.” (DFI App. 31.) And yet time and time again, the DFI raised different issues and arguments, ranging from North Dakota’s “permissive law” to an alleged violation of the FDCPA. At no time, however, has the DFI been able to cite a section of Chapter 13-05 that CybrCollect has actually violated.

The DFI failed to persuade ALJ Hoberg or Judge Hagerty that CybrCollect’s business model violates North Dakota law. As Judge Hagerty found, the DFI “had no basis for substituting his own findings in place of Judge Hoberg’s.” (DFI App. 70.) A position may be justified, despite being incorrect, so long as a reasonable person could think that it has a reasonable basis in law and fact. Lamplighter Lounge, Inc., 523 N.W.2d at 75 (N.D. 1994). In this case, the Order does not have a reasonable basis in law or fact, and the DFI kept changing its theories to try find one. The District Court properly found the DFI’s position lacked substantial justification.

2. **District Court erred in limiting CybrCollect's fees to only its ND counsel**

The only error CybrCollect contends the District Court made is limiting its award of attorneys fees and costs to only that of its North Dakota counsel. Judge Hagerty limited the award of attorneys' fees based on her concern that the fees of CybrCollect's Wisconsin counsel, Foley & Lardner, LLP ("Foley & Lardner") were duplicative, were higher than the hourly rates charged locally and would result in an unreasonably high award.

The reasonableness of any attorney fee award is based upon the "lodestar" amount, i.e., a the number of hours reasonably expended times a reasonable hourly rate. Duchscherer v. W.W. Walwork, Inc., 534 N.W.2d 13, 17 (N.D. 1995). What is considered a reasonable hourly rate depends on the complexity of the matter and the expertise and experience of the attorney. Id.

Foley & Lardner, specifically Attorney Jennifer Karron, has represented CybrCollect throughout this matter, even prior to the undersigned becoming involved. Foley & Lardner has successfully represented CybrCollect in similar proceedings in other states, as well as in other legal matters. More importantly, they have special expertise and experience in federal law issues regarding the EFTA, Regulation E and the FD CPA. They also have expertise with the NACHA rules and the ACH network in general. Knowledge and expertise in these specialized areas were critical to CybrCollect's defense in this case. While the hourly rates charged by Foley & Lardner may be higher than those charged locally, these rates are nonetheless reasonable in light of the complexity of the legal issues in this case and Foley & Lardner's special expertise in these areas. See

Duchscherer, 534 N.W.2d at 17 (noting the 12 factors that may be considered in determining what constitutes a reasonable fee or in adjusting the lodestar amount).

The District Court was also concerned about the fees of Foley & Lardner being duplicative. A review of the detailed billings submitted by both the Serkland Law Firm and Foley & Lardner show that such is not the case. Foley & Lardner's time in this matter was necessary because of the specialized and complex nature of the federal law issues involved. In fact, Foley & Lardner's expertise in these areas actually reduced the total amount of time incurred in this matter. Without their input and review of the numerous briefs that have been submitted in this case, the undersigned and his law firm would have incurred significantly more time researching these issues in order to vigorously and competently defend CybrCollect.

Because the fees of Foley & Lardner were necessary and reasonable in this case, CybrCollect should have been awarded those fees as well. It is specifically requested that this Court order these fees to be included in the judgment or remand this matter to the District Court with instructions to calculate the fees and add them to CybrCollect's judgment.

### **CONCLUSION**

As correctly determined by ALJ Hoberg and Judge Hagerty, CybrCollect's practice of electronically collecting NSF Fees based posted notice is proper and legal under federal and North Dakota law. The DFI's Order prohibiting CybrCollect's business is not based on sufficient facts and misapplies existing North Dakota law and/or exceeds its authority when it attempts to unilaterally interpret state law. Moreover, the DFI has failed to follow the procedures established in the Administrative Agencies

Practice Act and has violated CybrCollect's Due Process right to a fair hearing. Finally, the DFI position in this case has not been substantially justified, entitling CybrCollect to an award of all its reasonable attorneys' fees and costs. CybrCollect respectfully requests that this Court reverse the DFI's Order and award CybrCollect its attorneys' fees incurred with Foley & Lardner in addition to those awarded by the District Court.

Dated this 8th day of February, 2005.

/s/ Ronald H. McLean

Ronald H. McLean (ID# 03260)

Timothy G. Richard (ID# 05454)

SERKLAND LAW FIRM

10 Roberts Street

P.O. Box 6017

Fargo, ND 58108-6017

Telephone No. (701) 232-8957

ATTORNEYS FOR APPELLEE/

CROSS-APPELLANT

**CERTIFICATE OF COMPLIANCE**

The undersigned, as attorney for the Appellee/Cross-Appellant in the above matter, and as the author of the above brief, hereby, certify, in compliance with Rule 28(g) of the North Dakota Rules of Civil Procedure, that the above brief was prepared with proportional typeface and total number of words in the above brief, excluding words in the table of contents, table of authorities, signature block, certificate of service and this certificate of compliance, totals 10,197.

Ronald H. McLean (ID# 03260)  
Timothy G. Richard (ID# 05454)  
SERKLAND LAW FIRM  
10 Roberts Street  
P.O. Box 6017  
Fargo, ND 58108-6017  
Telephone No. (701) 232-8957  
ATTORNEYS FOR APPELLEE/  
CROSS-APPELLANT

By /s/ Ronald H. McLean  
Ronald H. McLean  
Timothy G. Richard

## PROPOSED RULES

## FEDERAL RESERVE SYSTEM

## 12 CFR Part 205

[Regulation E; Docket No. R-1210]

## Electronic Fund Transfers

Friday, September 17, 2004

AGENCY: Board of Governors of the Federal Reserve System.

**\*55996 ACTION:** Proposed rule; official staff interpretation.

**SUMMARY:** The Board is publishing for comment a proposal to amend Regulation E, which implements the Electronic Fund Transfer Act. The proposal would also revise the official staff commentary to the regulation. The commentary interprets the requirements of Regulation E to facilitate compliance primarily by financial institutions that offer electronic fund transfer services to consumers.

Proposed revisions to the regulation would address its coverage of electronic check conversion services and those providing the services. Among other things, persons, such as merchants and other payees, that make electronic check conversion services available to consumers would have to obtain a consumer's authorization for the electronic fund transfer. In addition, the regulation would be revised to provide that payroll card accounts established directly or indirectly by an employer on behalf of a consumer for the purpose of providing salary, wages, or other employee compensation on a recurring basis are accounts covered by Regulation E. Proposed commentary revisions would provide guidance on preauthorized transfers, additional electronic check conversion issues, error resolution, and other matters.

**DATES:** Comments must be received on or before November 19, 2004.

**ADDRESSES:** Comments, which should refer to Docket No. R-1210, may be mailed to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Because paper mail in the Washington area and at the Board of Governors is subject to delay, please consider submitting your comments by e-mail to [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov), or faxing them to the Office of the Secretary at 202-452-3819 or 202-452-3102. Members of the public may inspect comments in room MP-500 in the Board's Martin Building between 9 a.m. and 5 p.m. on weekdays pursuant to section 261.12, except as provided in section 261.14, of the Board's Rules Regarding the Availability of Information, 12 CFR 261.12 and 261.14.

**FOR FURTHER INFORMATION CONTACT:** Ky Tran-Trong, Senior Attorney, or Daniel G. Lonergan, David A. Stein, Natalie E. Taylor or John C. Wood, Counsels, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452-2412 or (202) 452-3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263-4869.

SUPPLEMENTARY INFORMATION:

I. Background

The Electronic Fund Transfer Act (EFTA) (15 U.S.C. 1693 et seq.), enacted in 1978, provides a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer (EFT) systems. The EFTA is implemented by the Board's Regulation E (12 CFR part 205). Examples of types of transfers covered by the act and regulation include transfers initiated through an automated teller machine (ATM), point-of-sale (POS) terminal, automated clearinghouse (ACH), telephone bill-payment plan, or remote banking service. The act and regulation require disclosure of terms and conditions of an EFT service; documentation of electronic transfers by means of terminal receipts and periodic account activity statements; limitations on consumer liability for unauthorized transfers; procedures for error resolution; and certain rights related to preauthorized EFTs. Further, the act and regulation also prescribe restrictions on the unsolicited issuance of ATM cards and other access devices.

The Official Staff Commentary (12 CFR part 205 (Supp. I)) is designed to facilitate compliance and provide protection from liability under sections 915 and 916 of the EFTA for financial institutions and persons subject to the Act. 15 U.S.C. 1593m(d)(1). The commentary is updated periodically, as necessary, to address significant questions that arise.

II. Summary of Proposed Revisions

Electronic Check Conversion

In an electronic check conversion (or "ECK") transaction, a consumer provides a check to a payee and information from the check is used to initiate a one-time EFT from the consumer's account. Specifically, the payee electronically scans and captures the MICR-encoding on the check for the routing, account, and serial numbers, and enters the amount to be debited from the consumer's asset account. The EFTA expressly provides that transactions originated by check, draft, or similar paper instrument are not governed by the Act. In response to an industry request that the Board clarify EFTA coverage of ECK transactions, the Board's March 2001 amendments to the Official Staff Commentary to Regulation E established a bright-line test for the regulation's coverage of these transactions. See 66 FR 15187 (March 16, 2001).

The staff commentary provides that electronic check conversion transactions are covered by the EFTA and Regulation E if the consumer authorizes the transaction as an EFT. This is the case regardless of whether the check conversion occurs at point-of-sale ("POS") or in an accounts receivable conversion ("ARC") transaction where the consumer mails a fully completed and signed check to the payee that is converted to an EFT. The commentary provides that a consumer authorizes an EFT if notice that the transaction will be processed as an EFT is provided to the consumer and the consumer completes the transaction.

Since issuing the March 2001 commentary update, several issues have arisen relating to electronic check conversion transactions in general, and ARC transactions in particular. Concerns have been raised about the uniformity and adequacy of some of the notices provided to consumers about ECK transactions. Some in the industry would like the flexibility to obtain a consumer's authorization to process a transaction as an EFT or as a check. Board staff also has received

inquiries from financial institutions and other \*55997 industry participants concerning their obligations under Regulation E in connection with ECK services. For example, merchants and other payees have inquired whether a single authorization is sufficient to convert multiple checks submitted as payment after receiving an invoice or during an individual billing cycle, in the case of a credit card bill, for example. Banks and credit unions have asked about the extent of their disclosure obligations to both existing and new consumers about the addition of ECK services to the terms of consumer accounts.

Proposed revisions to the regulation would address its coverage of electronic check conversion services and those providing the services. The proposal would provide additional guidance regarding the rights, liabilities, and responsibilities of parties engaged in ECK transactions. First, the regulation would be revised to include the guidance on Regulation E coverage of ECK transactions currently contained in the commentary. Where a check, draft, or similar paper instrument is used as a source of information to initiate a one-time EFT from the consumer's account, that transaction is not deemed to be a transfer originated by check, and thus is covered by Regulation E. Second, pursuant to its authority under section 904(d) of the EFTA, the Board would require persons, such as merchants and other payees, that make ECK services available to consumers to obtain a consumer's authorization for the electronic transfer. (See §§ 205.3(a) and (b)(2); comment 3(b)(2)-1.) This requirement would enable the Board to promote consistency in the notice provided to consumers by merchants and other payees.

Generally, a notice about authorizing an ECK transaction would have to be provided for each transaction. The notice can be a generic statement posted on a sign or a written statement at POS, or provided on or with a billing statement or invoice, and must be clear and conspicuous. The regulation would also provide that obtaining authorization from a consumer holding the account on which a check will be converted is sufficient to convert multiple checks submitted as payment for a particular invoice or during an individual billing cycle.

To help consumers understand the nature of an ECK transaction, the regulation would require persons initiating an EFT using information from a consumer's check to provide notice to the consumer that when the transaction is processed as an EFT, funds may be debited from the consumer's account quickly. In addition, as applicable, the person initiating the EFT would be required to notify the consumer that the consumer's check will not be returned by the consumer's financial institution.

Proposed model clauses would be provided to protect merchants and other payees from liability under Sections 915 and 916 of the EFTA, if the payee uses these clauses accurately to reflect its services. (See Appendix A, Model Clauses in A-6.)

A proposed revision to the commentary would explain that a payee may use the consumer's check as a source document for an ECK transaction or to process a check transaction, if the payee obtains the consumer's authorization. (See comment 3(b)(2)-2.) The commentary would also clarify that electronic check conversion transactions are a new type of transfer requiring new disclosures to the consumer to the extent applicable. (See comments 7(b)-4 and 7(c)-1.) Model clauses for initial disclosures would be revised to reflect that one-time EFTs may be made from a consumer's account using information from the consumer's check and to instruct consumers to notify their account-holding institutions when an unauthorized EFT has occurred using information from their check. (See Appendix A, Model Clauses in A-2.)

checks submitted as payment after receiving an invoice or during a single billing cycle, for example, in the case of a credit card account. Where an accountholder receives notice of check conversion and mails multiple checks to make a payment owed during a single billing cycle, it is reasonable to apply the ECK authorization notice to all checks provided--regardless of whether the checks are mailed within the same envelope or mailed separately during the billing cycle. Also, where an accountholder receives notice of check conversion and someone other than the accountholder, or in addition to the accountholder, provides a check to make a payment owed during the billing cycle, notice of check conversion to the accountholder is imputed as notice to those persons.

\*56002 As noted above, model clauses are provided in proposed Appendix A-6 to protect merchants and other payees from liability under Sections 915 and 916 of the EFTA if such clauses are used properly to accurately reflect the merchant or other payee's practices. A merchant or other payee should construct a notice that best describes its individual practices. For example, for ARC transactions, a payee that opts to convert checks only in certain instances would generally provide notice that the customer authorizes the payee to use the check either to process an EFT or to process a check. In contrast, if a payee opts to convert all checks received by mail, the payee would provide notice to its customers stating that when the customer provides a check as payment, the customer authorizes the check to be used to make an EFT from the customer's account. Whether the payee in an ARC transaction intends to convert checks received in certain instances, or in all instances, the payee would be required to notify its customer that where the customer's check is converted, funds may be debited from the customer's account quickly, and that the customer will not receive his or her check back from the customer's financial institution. Similarly, to the extent that the payee intends to collect a fee for insufficient funds electronically, that fact must also be included on the notice.

Where a merchant or other payee initiates an EFT in error, the transaction would not be covered by Regulation E where the transaction does not meet the definition of an EFT. For example, if a merchant or other payee uses information from a consumer's money order mailed in by a consumer or from a convenience check tied to a line of credit to initiate an EFT, the transaction is not covered by Regulation E because there is no transfer of funds from a consumer account. Rather, the funds are transferred from an account held by the issuer of the money order or are extensions of credit. The transaction would be considered to have originated by check, even where notice has been provided that the transaction will be processed as an EFT.

### 3(c) Exclusions From Coverage

Comment 3(c)(1)-1 would be revised to clarify that a consumer authorizes a merchant or other payee to electronically debit a fee for insufficient funds from the consumer's account when the consumer goes forward with the transaction after receiving notice that the fee will be collected electronically.

### Section 205.5 Issuance of Access Devices

Section 911 of the EFTA, which is implemented by § 205.5 of Regulation E, generally prohibits financial institutions from issuing debit cards or other access devices except (1) in response to requests or applications or (2) as renewals or substitutes for previously accepted access devices. Existing comment 5(a)(2)-1 provides that, in general, a financial institution may not issue more than one access device as a renewal of or substitute for an accepted device (the "one-for-one rule"). These provisions were modeled on provisions in the Truth in Lending Act

h. Under Section 205.7--Initial Disclosures, under 7(b) Content of Disclosures, under Paragraph 7(b)(4)--Types of Transfers; Limitations, paragraph 4. would be added;

i. Under Section 205.7--Initial Disclosures, a new heading "7(c) \*56010 Addition of EFT Services" would be added, and paragraph 1. would be added;

j. Under Section 205.10--Preauthorized Transfers, under 10(b) Written Authorization for Preauthorized Transfers from Consumer's Account, paragraphs 3. and 7. would be revised;

k. Under Section 205.10--Preauthorized Transfers, under 10(c) Consumer's Right to Stop Payment, paragraph 2. would be revised, and paragraph 3. would be added;

l. Under Section 205.10--Preauthorized Transfers, under 10(d) Notice of Transfers Varying in Amount, under Paragraph 10(d)(2)--Range, paragraph 2. would be added;

m. Under Section 205.11--Procedures for Resolving Errors, under 11(b) Notice of Error from Consumer, under Paragraph 11(b)(1)--Timing; Contents, paragraph 7. would be added;

n. Under Section 205.11--Procedures for Resolving Errors, under 11(c) Time Limits and Extent of Investigation, under Paragraph 11(c)(4)--Investigation, paragraph 5. would be added; and

o. Under Section 205.16--Disclosures at Automated Teller Machines, under 16(b) General, under Paragraph 16(b)(1), paragraph 1. would be revised.

#### Supplement I to Part 205--Official Staff Interpretations

\* \* \* \* \*

#### Section 205.2--Definitions

##### 2(b) Consumer Asset Account

\* \* \* \* \*

.2. One-time EFT of salary-related payments. The term payroll card account does not include a card used for a one-time EFT of a salary-related payment, such as a bonus, or a card used solely to disburse non-salary-related payments, such as a petty cash or a travel per diem card. To the extent that one-time EFTs of salary-related payments and any other EFTs are transferred to or from a payroll card account, these transfers would be covered by the act and regulation, even if the particular transfer itself does not represent wages, salary, or other employee compensation. [ltrif]

[2.] .3.[ltrif] \* \* \*

\* \* \* \* \*

#### Section 205.3--Coverage

\* \* \* \* \*

##### 3(b) Electronic Fund Transfer

\* \* \* \* \*

[3. Authorization of one-time EFT initiated using MICR encoding on a check. A consumer authorizes a one-time EFT (in providing a check to a merchant or other payee for the MICR encoding), where the consumer receives notice that the transaction will be processed as an EFT and completes the transaction. Examples of notice include, but are not limited to, signage at POS and written statements.]

.3. NSF fees. If an EFT or a check is returned unpaid due to insufficient funds in a consumer's account, an EFT from the consumer's account to pay a NSF fee charged is covered by Regulation E and, therefore, must be authorized by the consumer. [ltrif]

.Paragraph 3(b)(2)--Electronic Fund Transfer Using Information From a Check.

1. Authorization of one-time EFT initiated using MICR encoding on a check. A consumer authorizes a one-time EFT (in providing a check to a merchant or other payee for the MICR encoding, that is, the routing number of the financial institution, the consumer's account number and the serial number), where the consumer receives notice that the transaction will be processed as an EFT and goes forward with the transaction. These transactions are not transfers originated by check. Examples of notice include, but are not limited to, signage at POS and individual written statements provided to consumers. (See model clauses in Appendix A-6.)

2. Authorization to process a transaction as an EFT or as a check. If a payee obtains a consumer's authorization to use a check solely as a source document to initiate an EFT, the payee cannot process the transaction as a check. In order to process the transaction as an EFT or alternatively as a check, the payee must obtain the consumer's clear authorization to do so. A payee may specify the circumstances under which a check may not be converted to an EFT. (See model clauses in Appendix A-6.)

3. When checks are returned at POS. A payee initiating an EFT that returns a consumer's check to the consumer at POS need not notify the consumer that the check will not be returned by the consumer's financial institution.

4. Multiple payments/multiple consumers. If a merchant or other payee will use information from a consumer's check to initiate an EFT from the consumer's account, notice to a consumer holding the account that a check provided as payment during a single billing cycle or after receiving an invoice will be processed as a one-time EFT constitutes notice for all checks provided for the billing cycle or invoice--whether from the consumer or someone else. [ltrif]

\* \* \* \* \*

### 3(c) Exclusions From Coverage

#### Paragraph 3(c)(1)--Checks

1. Re-presented checks. The electronic re-presentation of a returned check is not covered by Regulation E because the transaction originated by check. Regulation E does apply, however, to any fee authorized by the consumer to be debited electronically from the consumer's account because the check was returned for insufficient funds. Authorization occurs where the consumer has received notice that a fee imposed for returned checks will be debited electronically from the

