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STATE OF NORTH DAKOTA

IN THE SUPREME COURT

STATE OF NORTH DAKOTA

**Supreme Court Case No.: 20100024
Ransom County District Court No.: 08-C-151**

**Quality Bank and
Timothy Cavett,**

Plaintiffs and Appellees,

v.

Lynette Cavett, a/k/a Lynnette Cavett,

Defendant and Appellant.

APPELLANT'S REPLY BRIEF

**APPEAL FROM THE OCTOBER 14, 2009 MEMORANDUM OPINION
AND NOVEMBER 16, 2009 SUMMARY JUDGMENT ISSUED BY
JUDGE JOHN T. PAULSON
RANSOM COUNTY DISTRICT COURT**

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FACTUAL ERRORS IN REPLY BRIEF OF QUALITY BANK

1. In Its Statement of the Issues, Plaintiff/Counterclaim Defendant/Appellee Quality Bank (“Quality”) asserted that Defendant/Counterclaim Plaintiff/Appellant Lynette Cavett (“Cavett”) is seeking recovery only of the \$11,776 of overdraft fees paid from June 3, 2008 through December 3, 2008. This is incorrect. Cavett’s original Answer and Counterclaim sought “Monetary damages equal to all overdraft fees Cavett has paid Quality.” Appellant’s Appendix 14-18. The Conclusion of Cavett’s Appellant’s Brief (Paragraph 36) sets forth Cavett’s claim: “This matter should be remanded to the Trial Court with instructions to compute all the *overdraft charges* and *daily overdraft fees* that Cavett has paid, subtract a reasonable amount for interest on the amounts loaned by Bank to Cavett, subtract Bank’s actual administrative costs in paying Cavett’s overcharges, and refund the balance to Cavett.” Cavett’s Appellant’s Brief focused on one month, May 25 – June 24, 2004, and alleged that nearly all of the *overdraft charges* and *daily overdraft fees* for the month examined, and during the existence of the account were unconscionably excessive. Cavett has consistently alleged that all of the overdraft fees that Quality collected from Cavett had an unconscionable component.
2. Cavett’s Appellant’s Brief does not set forth the sum total of the unconscionable portion of all fees that Cavett claims are due from the lifetime of the subject account because Cavett concedes that \$4 of each *overdraft charge* was an administrative cost for which Quality was justified in collecting. Furthermore, Quality did advance funds to Cavett to cover Cavett’s overdrafts, and Quality is entitled to a reasonable interest rate on the amounts advanced. A reasonable interest rate may

be more than the prime rate as it varies from time to time, but certainly is less than the 360% per annum that Quality asserts it was entitled to charge Cavett, based on a \$100 *daily overdraft fee* when the overdraft balance exceeds \$10,000.

3. In Paragraph 9, page 3, of its Reply Brief, Quality alleged that “[p]rior to Cavett establishing a checking account with Quality Bank, Quality Bank provided Cavett with a brochure entitled “Fees and Service Charges.”” To document this allegation, the Quality Brief referred to its Appendix 11, which in turn referred to Exhibit F, Quality’s Fees and Service Charges brochure, Quality Bank App. 74. This brochure states that the fees it imposed are effective as of May 1, 2004. According to monthly statements provided by Quality, the Cavett account at issue was established on October 2, 2003. Quality App. 79. Yet the brochure of bank fees to which Quality refers is dated to be effective May 1, 2004. Quality could not have provided Cavett with a document of overdraft fees on October 2, 2003, that did not exist and was not in effective prior to May 1, 2004.
4. Quality did not provide the Trial Court a copy of any agreement between Cavett and Quality as to overdraft fees as of October 2, 2003, when the Cavett checking account was established, nor has Quality set forth what its *overdraft charges* and *daily overdraft fees* were when Cavett established her account. Quality App. 84 shows that on November 12, 2003, Quality charged Cavett an “overdraft charge” of \$5, and on November 13 a similar fee of \$6. There is no provision for a \$5 or \$6 overdraft fee on the May 1, 2004, fee schedule. Therefore the May 1, 2004, fee schedule could not have been in existence when Cavett initially established her account. Furthermore, an examination of the Cavett statements before May 1,

2004, Quality App. 87-92, reveals that for overdrafts up to \$5,000, Quality was charging a fee of \$15, and for overdrafts over \$5,000 the fee was \$25. These fees are less than the fee schedule of May 1, 2004, which Quality claims was in effect when Cavett established her account on October 2, 2003. Quality's assertions to the Trial Court and to the Supreme Court that Cavett agreed to the Quality fee schedule of May 1, 2004, when she established her account in October 2, 2003, were in error. Therefore, the Quality argument that Cavett agreed to the overdraft fees that Quality charged must be disregarded.

5. In Paragraph 26, page 10 of its Brief, Quality alleged that from January 1, 2004, to June 2, 2008, Cavett paid Quality 842 overdraft fees. A perusal of the monthly statements attached at App. 82 – 181 reveals that many, but not all, of the 842 overdraft fees were for \$100. Had all 842 fees been for \$100, the sum would be \$84,200, plus the \$11,776 of overdraft fees that Cavett paid from June 3, 2008 through November 21, 2008, for a total of \$95,976. The actual total of the fees that Cavett contests will be somewhat less, because not all the fees were for \$100, and Cavett concedes that a small component of the fees were administrative costs and reasonable interest for the money advanced. Nonetheless, the fees Cavett paid were a very substantial sum for a one-person hog farm. Quality wrote in Paragraph 26 of its Brief: "Cavett is not contesting the 842 overdraft fees she paid Quality Bank." This is incorrect; Cavett is contesting the unconscionable portion of all of the 842 fees.
6. In Paragraph 57, Page 23 of its Brief, Quality conceded that "[o]verdrafts are considered to be loan granted by the bank, resulting in customers having an

obligation to repay their loans to the bank.” In North Dakota, any compensation for use of money (a loan) is referred to as ‘interest.’ “Interest is the compensation allowed for the use, ... of money” N.D.C.C. § 47-14-04. When Quality honored her overdraft checks, Quality made a loan to Cavett, which Cavett was obligated to repay, and did repay. Quality was entitled to reasonable compensation for use of its money by Cavett. Quality was paid for Cavett’s use of its money, under the guise of “fees,” but the amount was not reasonable. Regardless of what word Quality used to denote its compensation for use of its money, N.D.C.C. § 47-14-04 refers to the compensation as “interest.” In Paragraph 68, page 29, of its Brief, Quality alleged: “Overdraft fees are not interest.” By N.D.C.C. § 47-14-04 that statement is incorrect. Charges against the Cavett account which Quality entitled ‘fees’ were, in fact, the compensation that Quality received by Cavett for Cavett’s use of Quality money. By law, those ‘fees’ are interest.

7. In Paragraph 69, page 30, of its Brief, Quality stated, “Cavett asserts that Quality Bank’s overdraft fees were usurious.” This is incorrect. Cavett has never asserted that Quality’s overdraft fees were usurious. In Paragraph 15 of her Brief, Cavett acknowledged: “Overdraft fees charged by [Quality] Bank were not usurious under North Dakota law, as “usury” has a statutory definition and in general does not apply to banks.
8. In Paragraph 70, page 30, of its Brief, Quality claimed: “Quality Bank’s fees are not interest and cannot be deemed to be interest by law. *See, e.g.*, N.D.C.C. § 13-08-12(2).” The statute to which Quality referred pertains only to licensing and regulating Deferred Presentment Service Providers, who make what is commonly

known as Pay Day Loans. N.D.C.C. Chapter 13-08 is narrowly drawn for a very specific industry. It does not apply to Quality. In Paragraph 70 of its Brief, Quality asserted that the effective interest rate on payday loans may be as high as 520% annually. Quality also asserted that the overdraft fee it charged Cavett during the month examined, May 25, 2004 through June 24, 2004, “is not unconscionable since the converted fee into annual interest rate is 300% less than legislatively approved payday loan fees.” This argument has no merit, because payday loan dealers and state chartered banks are different types of entities, regulated under different laws, with much different functions.

9. In Paragraph 71, page 31, of its Brief, Quality implicitly acknowledged that in order to determine if they were unconscionable, the overdraft fees it charged Cavett should be analyzed as though they were interest on an annual basis. Quality then examined certain arbitrarily selected time periods in the Cavett account history and argued that the annual interest rate for those time periods was not excessive. The effective interest rate that Quality charged Cavett via overdraft fees did vary from time to time, depending on the fluctuating overdrawn balance of Cavett’s account. However, Quality cannot deny that its overdraft policy permitted it to charge \$100 per day for an account overdrawn by over \$10,000, even if there were no new overdrafts or activity in the account. A fee of \$100 per day amounts to \$36,400 per year. If an account were overdrawn by \$10,001 for a year, Quality’s policy allows it to collect over 360% interest per year on money it had advanced to cover the overdrawn account.

**QUALITY'S OVERDRAFT FEE SCHEDULE IN GENERAL
AND THE ACTUAL FEES IMPOSED BY QUALITY AGAINST
THE CAVETT ACCOUNT ARE FAR IN EXCESS OF THE
COMMERCIAL RISKS AND EXPENSES INCURRED BY
QUALITY IN COVERING CAVETT'S OVERDRAFTS.**

10. In Paragraph 14, page 5, of its Brief, Quality acknowledged that on several occasions from 2004 through 2008 Cavett paid in full all overdrafts and fees and made her account balance positive. In Paragraph 8, page 3, Quality acknowledged that it has been paid in full for all overdrafts and fees. Paragraph 5 in this Brief shows Quality earned a great deal of money from the Cavett overdraft fees. The fact that the Cavett account was brought into positive balance on several occasions and was eventually paid in full, indicates that even during the months when the account became substantially negative, Quality's risks of not being repaid the money it loaned to Cavett were low.
11. Quality was not obligated to cover any of Cavett's overdrafts, but rather made a shrewd business decision to do so.

When a bank honors a customer's overdraft, it makes an unsecured loan to that customer, and thus, absent an agreement to the contrary, a bank need not honor a customer's overdrafts even if it has previously done so. [citations deleted] A bank's decision to honor or dishonor a check creating an overdraft but otherwise properly payable is a business decision turning on factors such as the size of the overdraft and the bank's view of its customer. [citations deleted]

Thiele v. Security State Bank of New Salem, 396 N.W.2d 295, 298, 3 UCC Rep.Serv.2d 686 (N.D. 1986).

12. With fees of \$100 per day, even if no checks were presented against the Cavett account when it was overdrawn over \$10,000, Quality was potentially earning up to

360% annual interest on money it had advanced to the Cavett account. This was 20 times the interest rate Quality could earn on a risky loan, such a credit card to a poor credit risk customer, which may carry an 18% rate. It was 30 times the interest Quality could earn on a typical medium risk loan that may pay 12% annual interest. It was over 40 times the interest Quality could earn on a good credit risk, such as an 8% loan secured by a mortgage.

13. The facts that Cavett periodically brought her account current, and owned substantial real estate, indicates she was not a poor credit risk. Thus Quality was earning from 30 to 40 times as much interest on the Cavett overdrafts as it would have on a loan to Cavett. That is an astounding differential. There was a tremendous profit incentive for Quality to permit, even encourage the Cavett overdrafts, because the overdrafts were potentially 30 to 40 times more profitable than if the money advanced to cover overdrafts would have been disbursed as a loan to Cavett or to anyone else.
14. Quality asserted because payday loans may carry a higher effective interest rate than do its overdraft fees, its fees are not unconscionable. Quality ignores North Dakota legislative (N.D.C.C. § 41-02-19) and judicial limits on unconscionable agreements. To determine substantive unconscionability, whether an agreement is so outrageously unfair as to shock the judicial conscience, a court should consider “the commercial reasonableness of the contract terms, the purpose, and effect of the terms, the allocation of the risks between the parties, and similar public policy concerns.” Jenkins v. First Am. Cash Advance of Ga., LLC, 400 F.3d 868, 876 (11th Cir.2005).

15. By charging Cavett interest (designated as “fees”) 20, 30 or 40 times higher than was commercially justified by the risk it was taking by loaning money to Cavett to cover her overdrafts, the amount of money that Quality collected from Cavett during the 5 years she had an account with Quality so exceeded what was commercially reasonable as to shock the conscience of any Court. The effective interest rates charged by payday loan dealers to desperate wage earners for loans under \$500 pending their next pay check is not an appropriate standard for North Dakota state chartered banks in their commercial lending.

**WHERE DOCUMENTS SUBMITTED BY A PARTY MOVING
FOR SUMMARY JUDGMENT SHOW SUMMARY
JUDGMENT IS NOT WARRANTED, THE OPPOSING PARTY
NEED NOT SUBMIT AN AFFIDAVIT**

16. In its Motion for Summary Judgment, Quality submitted its Schedule of Overdraft Fees and all monthly statements of the Cavett account, which showed the fees Quality actually collected from Cavett. Those documents were sufficient to show that Quality could impose fees equal to 360% annual interest; in the month examined, May 25 – June 24, 2004, imposed fees equal to an annual interest rate of 169%; and over five years charged Cavett many tens of thousand dollars in fees. These documents on their face showed unconscionable behavior by Quality sufficient to deny its own motion. “Failure of the adverse party in a summary judgment proceeding to respond by filing affidavits or other proof as required by Rule 56(e), N.D.R.Civ.P., does not authorize the entry of summary judgment against him when the proof submitted in support of the motion by the moving party

indicates the presence of a genuine issue of material fact.” Luthle v. Taverna, 214 N.W.2d 117, 124, (N.D. 1973).

CONCLUSION

17. In determining the unconscionability of an agreement, a court is essentially acting as the spokesperson for the conscience of the society. Contrary to Quality’s arguments, payday loans should not be, and are not, representative of bank lending in North Dakota. Ms. Cavett was unable to comprehend the magnitude of her overdraft fees for over 5 years. Quality Bank took advantage of her inattention to collect from her 20 to 40 times as much as was commercially justified by the risk Quality was taking by loaning her money. Summary judgment must be denied and the matter remanded with instructions to the Trial Court to determine the portion of the overdraft fees that were unconscionable.

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Dated this 11th day of May, 2010.

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IN THE SUPREME COURT

STATE OF NORTH DAKOTA

**Supreme Court Case No.: 20100024
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The following document was electronically served on this date to Brad Sinclair at bsinclair@serklandlaw.com, and Fallon M. Kelly at fkelly@drtel.net.

APPELLANT'S REPLY BRIEF

Dated this 11th day of May, 2010.

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