Financial Services Litigation: 2023 Hot Topics & Recent Updates

MAY 22, 2023

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Today's Focus

- Overview of Key Cases and Trends
- Agency Rule-Making and Strategy Going Forward
- ESG Developments
- Recent DOJ Guidance on Corporate Crime
- Mass Arbitration Developments and Strategies

Overview of Key Cases and 2023 Trends

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Ponzi Schemes and Expanding Theories

- Surge in Ponzi scheme cases – US and Worldwide
- New focus on "willful blindness" and "conscious avoidance" – not just "actual knowledge"
- Need for continuing development of standing and other defenses in receivership/trustee cases
- Work to stop "collective knowledge" and other theories

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Ponzi Schemes: Key Cases

- *Kelly v. BMO*, Case No. 19-cv-1756 (D. Minn) ($500M+ verdict) (experts barred from testifying regarding state of mind/willful blindness)
- *Isaiah v. JPMorgan*, 960 F.3d 1296 (11th Cir.) (dismissed) (Receiver of Ponzi scheme entity lacks standing to sue for common law claims)
- *ORC Sen. Secured Ltd. v. Deutsche Bank*, Case No. 1:21-cv-22437 (S.D. Fla.) ($95M verdict) (court granted motion in limine preventing bank from arguing that it is not charged with the cumulative knowledge of its employees)
- *Telefax Sec. Litig.*, 4:14-md-02566 (D. Mass.) (court finds "reg flags" alone to be insufficient for actual knowledge, but a bank's reaction to those "red flags" can show knowledge of fraud)
- *Gunthrie Abbott v. Trustmark National Bank*, Case No. 4:22-cv-00800 (S.D. Tex.) ($1.6B and $157M settlements) (where Ponzi scheme involved sale of securities, a bank's repeated failure to scrutinize customer's activity could expose it to liability)

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Off-Channel Communications Risks

- Regulator's continued focus on unrecorded business communications
  - There is almost a "presumption" that various encrypted apps are only used for nefarious reasons
  - While it is impossible to curb the personal use of Threema, Signal, etc, companies need very clear guidance prohibiting these apps for business communications
- Issues at all seniority levels – this does not simply apply to traders and customer facing employees
- A company's management of electronic communications is becoming a key part of effective compliance

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Off-Channel Comms: Key Cases in 2023

- The SEC continues its industrywide investigation:
  - Fifth Third
  - BNY Mellon
  - Blackrock
  - Wells Fargo (SEC/CFTC)
  - Societe Generale

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Growth in AML Cases and Impact

- Increasing scrutiny on AML programs and detection
- Spike in cases and regulatory action
- Impact of AML issues also leading to rise in derivative actions, class cases, DPA issues, blocking acquisitions, and other matters

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AML: Key Cases

- *U.S. v. Danske Bank A/S*, 1:22-cr-00679 (S.D.N.Y) ($2B+) (plea agreement relating to Estonian business unit and allegations regarding the state of its anti-money laundering program)
- *In re Coinbase* (NYDFS) ($100M) (consent order with NYDFS relating to alleged failures with anti-money laundering program including in relation to backlog of unreviewed alerted activity)
- *In re USAA Fed. Savings Bank*, Case No. 2022-01 ($140M) (consent order relating to alleged failures with anti-money laundering program including inadequate staffing and training)
- *TD/First Horizon Deal* (regulatory scrutiny of TD's anti-money laundering practices involved with issues leading to termination of First Horizon acquisition)
- *In re Wells Fargo Securities Litigation*, No. 20 Civ. 4494 (S.D.N.Y.) (derivative suit asserting claims relating to issues regarding compliance program and statements relating to thereto)

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Shifts in Payment Fraud/Zelle

- Surge in cases continues
- Changing theories being used to avoid settled law
- No longer focusing on “actual knowledge,” time of transaction, or limited duties owed
- Continuing attempt to erode concept of “authorization”

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Payment Fraud: Key Cases

- *Wilkins v. Navy Fed. Credit Union*, 2:22:cv-0219 (D. N.J.) (transaction was not "unauthorized" or the result of "fraudulent use of the customer account" where the plaintiff initiated the transactions to an impostor)
- *Tristan v. Bank of America*, Case No. 8:22-cv-01183-DOC-ADS (C.D. Cal.) (claims asserted for consumer fraud based on allegedly deceptive marketing, breach of contract, and violations of EFTA)
- *Stock v. Wells Fargo*, Case No. 8:22-cv-00763 (C.D. Cal.) (motion to compel arbitration)
- *Berry v. TD Bank, N.A.*, Docket No. 0:22-cv-60826 (S.D. Fla. Apr 28, 2022) (same)
- CFPB, Electronic Fund Transfers FAQs (December 13, 2021) (EFTA guidance including in relation to unauthorized transactions)

Agency Rule-Making, Key Cases, and Strategy Going Forward

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Axon Enterprise, Inc. v. FTC
SEC v. Cochran

- Both suits challenged the constitutionality of agency ALJs
  - Axon also challenged combination of prosecutorial and adjudicatory functions in same agency
- But rather than raise constitutional challenges before the agencies themselves, Axon/Cochran brought suit in district court

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Axon & Cochran, Cont'd

- Issue: must challenges to constitutionality be presented to the agency, or do courts have jurisdiction?
- Held: neither the Securities Act nor the FTC Act demonstrates a congressional intent to exclude normal 1331 jurisdiction.
  - *Thunder Basin* factors
  - No effective judicial review because injury is being subjected to unconstitutional process

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CFPB v. Consumer Fin. Servs. Assn.

- CFPB rule prohibited payday lenders from making more than two attempts to withdraw funds from borrowers' accounts if declined for insufficient funds
- Lender challenged rule on several grounds
- Issue: whether the CFPB funding scheme is constitutional

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CFPB, Cont'd

- CFPB funded directly from Federal Reserve, outside appropriations process
  - Art. I, § 9: "No money shall be drawn from the Treasury, but in Consequence of Appropriations made by law."
  - Is congressional adoption of alternative funding scheme a valid appropriation?

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Key Rulemakings

- CFPB proposed rules include:
  - Limitations on credit card late fees (2/1/23)
  - Non-bank registries
    - Those using certain covered terms & conditions (1/11/23)
    - Those subject to agency/court orders (12/12/22)
- Post-SVB & Signature regulatory reform

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Key CFPB Enforcement Issues

- Junk fees
- Overdraft fees
- Anti-discrimination
- Payments / Reg. E
- Mortgage servicing, auto repossessions and credit reporting


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ESG Developments and What to Think About

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ESG Developments

- SEC Climate Change Disclosure Rule
  - Final Rule expected soon
  - Disclosure of Climate-Related Impacts and Events on Business Strategy, Outlook, and Financial Statements
  - Disclosure of Greenhouse Gas Emission Metrics (Scope 1, 2, and 3)
  - Disclosure of Management Oversight and Governance of Climate-Related Risks
- Greenwashing Rules & Initiatives
  - SEC Proposed Names Rule (80%) & Proposed ESG Investment Practices Disclosure Rule (Consistent Metrics)

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ESG Developments

- Greenwashing Investigations
  - German authorities and SEC investigating DWS for greenwashing after former ESG director accused the firm of overstating its green credentials
  - SEC fined major banks, finding they did not properly weigh ESG factors in investment products
- NYS Department of Financial Services Banking Climate Guidance
  - Rules would require NY state-chartered banks and foreign branches in NY to integrate climate change considerations into risk management framework and strategic planning
  - Comment period has ended; rules likely formalized this fall
  - Already enacted by DFS in insurance field and DFS has raised compliance with climate guidance in examinations
- 2023 in ESG – More in the Pipeline
  - Corporate Board Diversity Disclosure
  - Human Capital Management Disclosure

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ESG Developments Cont'd.

- Executive Compensation + ESG
  - Harvard study found that more than 73% of Fortune 500 companies are tying executive compensation to some form of ESG performance
  - Most significant increase is in connection with diversity, equity, and inclusion
  - Carbon reduction goals also increasingly tied to compensation

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ESG Backlash

- Rise in state-level anti-ESG measures
  - 18 states have passed or have proposed legislation restricting states from doing business with companies that practice ESG
  - Florida ESG resolution = “pecuniary factors only rule”
  - LA, WV, and FL all pulled $$ from BlackRock;
  - Market + shareholders push for ESG is in tension with some states’ anti-ESG measures

Impact of Recent DOJ Guidance on Corporate Crime Policies and Application

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Updates to Corporate Enforcement Policy

- Unveiled at the ABA White Collar conference in March
- Focus on corporate compliance and recidivism
- DOJ has now provided a roadmap for obtaining deferred prosecution agreements:
  - Voluntary Disclosure
  - Cooperation
  - Remediating Misconduct
- New: Pilot Program on Compensation Incentives and Clawbacks
- New: Focus on Ephemeral Messaging

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Pilot Program on Compensation Incentives and Clawbacks

- The Pilot Program will last three years and the decision to enter the program rests with the company.
- Goal is to shift burden of corporate financial penalties to those responsible for misconduct – those with "skin in the game."
- Any corporate resolution must require compliance-promoting criteria in compensation and bonus system. Bottom line: if you fail compliance, you don't get paid.
- Directs prosecutors to reduce fines levied on companies by the amount of compensation a company recoups during the resolution period (such as a deferred prosecution agreement) from employees engaged in wrongdoing.
- Fine reduction for "good faith effort" to clawback; fine reductions up to 75% under the Sentencing Guidelines if successful and up to 25% if unsuccessful.
- No express statutory authority for policies – companies must rely on state remedies, which may be difficult and costly.

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Use of Ephemeral/Encrypted Messaging Applications

- In evaluating corporate compliance programs, DOJ will now focus on the corporation's approach to the use of personal devices and ephemeral/encrypted messaging platforms.
- DOJ prosecutors will consider a company's use of ephemeral and encrypted applications, whether the company preserved those communications, and if those messages are accessible for the investigation, as well as company policies governing such apps.
- Companies must have policies governing employee use of personal devices and third-party messaging apps such as Signal, Telegram, WhatsApp, etc., training about these policies, and enforcement mechanisms for these policies.
- If companies do not turn over these communications, prosecutors will "not accept that at face value."

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Case Study: Danske Bank

- Danske Bank defrauded U.S. banks regarding Danske Bank Estonia's customers and anti-money laundering controls to facilitate access to the U.S. financial system for its high-risk customers who resided outside of Estonia – including in Russia.
- December 13, 2022, guilty plea.
- Plea agreement required Danske to implement certain compliance-related criteria into their executive review and bonus systems. With new policy, we expect more widespread use of these requirements.
    - "The Bank will implement evaluation criteria related to compliance in its executive review and bonus system so that each Bank executive is evaluated on what the executive has done to ensure that the executive's business or department is in compliance with the Compliance Programs and applicable laws and regulations. A failing score in compliance will make the executive ineligible for any bonus for that year. The Bank will include in its evaluation criteria and bonus system provisions that allow the Bank to implement measures to incentivize future compliant behavior and discipline executives for conduct occurring after the filing of the Agreement that is later determined to have contributed to future compliance failures, subject to applicable law."
    - New policy represents a formalization of the practice: DOJ has been using this clause in AML related cases for a long time (e.g., Western Union (2017) and MoneyGram (2012) DPAs).
- On the flip side, in issuing a declination in the Safran case, DOJ specifically cited as an example of full remediation the company's withholding of deferred compensation from a former employee involved in the misconduct.

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Case Study: Corsa Coal

- Assistant Attorney General Kenneth Polite mentioned this March 2023 declination as illustrative of how a company should cooperate.
  - "[I]f companies voluntarily self-disclose, fully cooperate with our investigations, and timely and fully remediate, they can rely on a ***presumption*** of a declination."
- Scheme to bribe Egyptian government officials to obtain and retain lucrative contracts to supply coal to an Egyptian state-owned and -controlled company.
- Bad actors relied on encrypted and ephemeral messaging.
- Factors contributing to declination:
  - Timely voluntary self-disclosure
  - "Full cooperation"
  - Full remediation, including termination of wrongdoers
  - Employees charged

Mass Arbitration Developments and Strategies

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What's Going On?

- Mass-arbitration plaintiff lawyers simultaneously file thousands of largely identical arbitration demands
- The filings trigger massive up-front cost in the form of arbitration fees to the designated arbitral forum, with some bills reaching more than $100,000,000
- Even if the claims are frivolous, the business is pressured to settle, abandon arbitration altogether, or pay the huge fee just to defend itself
- Began with tech companies but focus turning to financial services

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Initial Defense Reaction

- *Abernathy v. Doordash*, 438 F Supp 3d 1062, 1067-68 (ND Cal 2020):
- "For decades, the employer-side bar and their employer clients have forced arbitration clauses upon workers, thus taking away their right to go to court, and forced class-action waivers upon them too, thus taking away their ability to join collectively to vindicate common rights.
- The employer here, DoorDash, faced with having to actually honor its side of the bargain, now blanches at the cost of the filing fees it agreed to pay in the arbitration clause.
- [I]n irony upon irony, DoorDash now wishes to resort to a class-wide lawsuit, the very device it denied to the workers, to avoid its duty to arbitrate. This hypocrisy will not be blessed, at least by this order."

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Other Strategic Options

- Dropping arbitration
- New/different arbitration providers
- Bellwether procedures/staging
- Fee shifting
- Small claims option
- *Also note: impact on class certification*

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Beware – Unconscionability Part 2

Maclelland v. CellCo, 21-cv-08592-EMC (N.D. Cal. Jul. 1, 2022):

- Mass arbitration provision setting cap on number of arbitrations that may proceed at one time substantively unconscionable due to length of delay, and because "provision is pregnant with the risk that claims will be effectively barred when coupled with the statute of limitations"

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Beware – Unconscionability Part 2

Bielski v. Coinbase, 21-07478 WHA (N.D. Cal. Apr. 8, 2022):

- Delegation clause that included pre-filing complaint and dispute resolution process substantively unconscionable because it lacked mutuality and "only delegates questions from the user agreement's tripartite dispute-resolution procedure, not arbitration-generally" and therefore "imposes an onerous, unfair burden beyond that of a typical delegation clause"

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Case Examples

- Samsung/BIPA
- Wells Fargo/Reg E

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Presenters

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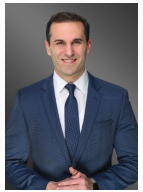

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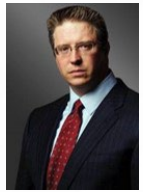

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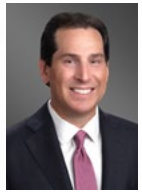

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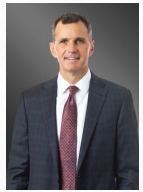

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Thank You