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LEGAL ISSUES BULLETIN

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New Independent Contractor Laws in California … Again?

On January 1, 2020, California's AB5 went into effect, making sweeping changes in how workers are classified. What resulted was a growing number of questions from employers concerning the use of independent contractors. On September 4, 2020, the Governor signed AB2257 with immediate effect in an attempt to "clean up" AB5.

While AB2257 leaves many questions unanswered, it does expand on the exemptions to the law (bringing the total exemptions to over 100). Of importance, AB2257, among other changes/requirements, eases the "business-to-business" exception by:

1. allowing the business service provider (i.e., the contractor) to use their residence as the required separate business location;
2. changing the requirement under AB5 that a business service provider "actually" contract with other businesses to provide the same or similar services to "can" contract with other businesses; and
3. qualifying the prohibition of a business service provider from providing services directly to the contracting businesses customers.

With the ever-changing landscape of worker classifications in California, financial institutions should review any workers classified as independent contractors in accordance with the new law.

A Reminder of California Credit Union Charge-off Obligations

The country continues to face a significant economic downturn as a result of shutdowns of non-essential businesses during the COVID-19 pandemic. To alleviate the financial stress of borrowers, on March 22, 2020, federal regulators released a statement which encouraged lenders to provide short term modifications of up to six months. However, as members continue to request assistance past 180 days, California credit unions should be mindful of charge-off obligations in California Code of Regulations, Title 10 § 30.402.

Section 30.402 provides that charge-offs are mandatory at specific time thresholds. Most relevant is the obligation to charge off at 180 days without reducing the principal balance, or sooner if the Board determines the obligation to be uncollectable. However, a failure to reduce the principal balance may not require a charge-off under § 30.402(D) if the contract creating the obligation does not require a reduction in the principal balance of the obligation but provides for the principal balance to be paid off at the time the obligation matures. This can be an important exception in the current environment.

During the last economic downturn, the DBO scrutinized loan deferrals on a case-by-case basis in light of § 30.402. To avoid potential violations, California credit unions must ensure that any payment arrangements which may be extended up to or beyond 180 days are reflected in a contractual agreement which complies with § 30.402(D) and requires the principal balance to be paid at maturity. Alternatively, credit unions should ensure that a borrower make at least one payment which reduces principal before the 180-day period expires and before entering into a further forbearance agreement. Credit unions must maintain documentation to establish compliance for its modification agreements.

CFPB Enforcement Action Against Nissan

On October 13, 2020, the CFPB found that Nissan Motor Acceptance Corporation: (1) wrongfully repossessed vehicles despite having agreements in place with consumers to prevent repossession; (2) kept personal property in consumers' repossessed vehicles until consumers paid a storage fee for said personal property; (3) deprived consumers making auto-loan payments by phone of the ability to select a payment option with a significantly lower fee than the one they were charged; and (4) made a deceptive statement in its agreements to extend consumers' auto loans that appeared to limit consumers' bankruptcy protections. The CFPB found that these actions violated the Consumer Financial Protection Act's (CFPA) prohibition against unfair and deceptive acts and practices.

The Consent Order serves as an important reminder that a contractual agreement cannot limit a consumer's right to file bankruptcy. An agreement to waive an individual's right to file for bankruptcy is void as against public policy and will also be deemed to be a deceptive act in violation of the CFPA.

Additionally, financial institutions should ensure that they (and their agents) are adhering to their written agreements and are in full compliance with all vehicle repossession and related consumer protection laws, rules and regulations as these appear to be ripe for enforcement actions, especially given a pending Supreme Court case (*City of Chicago v. Fulton*). The Supreme Court will likely address a circuit split and decide whether a bankruptcy automatic stay requires a creditor to turn over repossessed property immediately after the debtor files a Chapter 13 petition.

Also, financial institutions should ensure that they are fully disclosing all payment options as well as the corresponding difference in fees related to each payment option. Although the Nissan Consent Order dealt exclusively with auto loans and payments by phone, the premise is generally applicable to other financial services—the failure to fully disclose any and all fees associated with available payment options will likely be considered an unfair practice.

Bank of America ATM Fee Class Action Lawsuit

Schertzer v. Bank of America is a class action against Bank of America and three ATM services companies (the ATM Defendants). The plaintiffs allege that (1) the ATM Defendants profited off misleading representations on the screens and on signs at ATMs they operated, which led cardholders to unknowingly incur balance inquiry charges for out of network ATMs; and (2) BofA charged its customers unwarranted fees for out of network ATM balance inquiries.

Recently, the plaintiffs defeated BofA's motion to dismiss on certain claims, while BofA was successful in other areas.

Regarding the plaintiffs' breach of contract claim, the *Schertzer* court dismissed the claim reasoning that regardless of the advertising on the outside of the ATM by the ATM Defendants, plaintiffs and BofA had a valid and enforceable agreement that provided for the charging of the balance inquiry fees. Next, the court dismissed the plaintiffs' unjust enrichment claim against BofA, noting that as a matter of law, an unjust enrichment claim does not work where the parties have an enforceable express contract.

However, the court was unwilling to dismiss the plaintiffs' claim for breach of the covenant of good faith and fair dealing. The court held that to while the disputed fee may not have been a breach of contract, the plaintiffs may be able to show that BofA's conduct was nevertheless contrary to the contract's purposes and the parties' legitimate expectations.

The key takeaway from *Schertzer* for financial institutions is the importance of having a valid and up-to-date account agreement that specifically addresses ATM fees and how those fees are being charged. Without such an agreement, BofA would not have been able to get these wins this early in litigation. As for the plaintiffs' claim for breach of the covenant of good faith and fair dealing, having clear and detailed disclosures in place regarding ATM fees (and strictly adhering to them) would mitigate compliance risks.

California Homestead Exemption to Increase Significantly on January 1, 2021

Under California law, a judgment debtor is entitled to "exempt" (*i.e.*, protect from collection activity) certain assets in certain amounts. Among other things, a judgment debtor may potentially exempt a certain amount of equity in the debtor's residence—the "homestead exemption." On September 15, 2020, California's Governor signed AB1885, which increases the amount of equity in a homestead that a homeowner can exempt. Prior to AB1885, a homeowner could exempt a maximum of $75,000, $100,000, or $175,000, depending on a variety of factors, such as the age or family status of the homeowner. This tiered system has now been eliminated, replaced with an increase to the homestead exemption for every homeowner to a minimum of $300,000. The amount of the exemption can increase up to a maximum of $600,000 based on housing value factors and adjusted annually for inflation.

Since many homeowners who might otherwise qualify for a Chapter 7 case file Chapter 13 cases in order to avoid having a Chapter 7 trustee sell a home with equity in excess of the homestead exemption, financial institutions are likely to see an uptick in Chapter 7 filings (relative to Chapter 13 filings). While this is unlikely to significantly impact secured lenders, the assets available for unsecured creditors (by, for example, the Chapter 7 trustee selling the debtor's home and distributing the excess proceeds) will decrease, meaning that the percentage repayment on credit card and other unsecured debt will see a reduction. This change may impact the collectability, and value, of certain debt, and may become a factor in collectability of all debt for homeowners in California, particularly in bankruptcy.

Don't Forget about State Servicemember Protections

Most of you are very familiar with the federal laws that provide protections for the brave men and women (and their families) that serve in our armed forces. The Servicemember Civil Relief Act, among other things, provides an interest rate cap for loans entered into before the servicemember's call to active duty; the Military Lending Act generally requires various protections for "covered borrowers" that enter into certain consumer credit related transactions. However, it is also important for financial institutions to remember that California and other states offer additional protections to servicemembers that extend beyond these federal laws. For example, under the California Military & Veterans Code, a "reservist," defined as a member of the state militia or a member of a reserve unit of the United States Armed Forces that is called to active duty, can request deferrals of up to a maximum of 180 days on mortgage, credit card, or vehicle loan payments. Each of these laws should be included in lending and collections procedures. We are also hearing that some examiners are recommending that lending policies address California law in addition to the SCRA and MLA.