2 Rulings Serve As Conversion Fee Warnings For Banks

By **Timothy Ofak, Brian Serafin and Greyson Brown** (July 18, 2024)

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Private litigants, along with regulators like the Consumer Financial Protection Bureau, continue to target ancillary fees and charges in the financial services sector — often referred to disparagingly as "junk fees" — with a current area of focus being the currency conversion or foreign exchange rates applied to international payment transactions.

There is typically a spread between the rates at which an entity buys versus sells a foreign currency, which can add expense to an international transaction regardless of which direction the conversion goes.

Two decisions — Wright v. Capital One Bank NA in the U.S. District Court for the Eastern District of Virginia in March and Guerrero v. Bank of America NA in the U.S. District Court for the Western District of North Carolina in March 2023 — demonstrate the importance of carefully crafting contractual provisions with consumers governing foreign transactions, including for third-party charges by payment card processors.

For both cases, the plaintiffs alleged that the foreign exchange rates used by the processors exceeded the rates permitted under their cardholder agreements, which in turn caused the consumer to pay more than they should have for the foreign transactions.

In Guerrero, the bank was unable to obtain dismissal of the class action where the processor allegedly failed to use either of the two rates specified in the agreement.

In contrast, the bank in Wright defeated a class action where the relevant customer agreement gave the bank's third-party card processors significant discretion in setting the currency conversion rates.

These different outcomes highlight how banks must be careful in describing how fees and charges are determined in their customer agreements, as well as the need to monitor whether third parties act in the same manner that the bank represents to its customers.

Guerrero v. Bank of America

In Guerrero, the earlier of the two decisions, cardholders brought a putative class action alleging that the bank charged inflated currency exchange rates that were higher than those permitted in the cardholders' agreements with the bank.

The plaintiffs brought claims for breach of contract, breach of the implied covenant of good faith and fair dealing, unjust enrichment, and violations of state consumer protection statutes.

In a motion to dismiss, the bank denied responsibility for the foreign exchange rates charged. According to the agreement between the parties, foreign currency "will be converted by [the third party card processors used by the bank]," and "the currency conversion rate to be used is either (1) a wholesale market rate or (2) a government-mandated rate."

The bank took the position that this description of which currency conversion rates might be used was merely "explanatory language" that did "not contain a legally enforceable obligation owed by [the bank] with respect to the conversion of currency."

The court, however, was unconvinced. The reference to the card processors as the determiners of the exchange rate did not negate the fact that the bank told its customers how these conversions would work.

In turn, the language in the cardholder agreement could plausibly be construed as imposing an obligation on the bank toward its customers with respect to which foreign exchange rates the processors used.

Additionally, while unjust enrichment claims usually fail in the face of an express contract provision governing the conduct at issue, the bank undermined its position by asserting that the foreign exchange provisions in the agreement were only explanatory and did not create a contractual obligation.

The court found that even if the bank was correct on this point, then the unjust enrichment claim could survive as an alternative theory of liability.

Wright v. Capital One Bank

Wright involved similar claims for breach of contract, breach of the implied covenant of good faith and fair dealing, unjust enrichment, and violation of state consumer protection statutes in connection with the rates used for foreign currency transactions.

The relevant agreement between the bank and the cardholders provided:

> If you make a transaction in a foreign currency, the [processor] will use its own currency conversion procedures. The conversion rate in effect on the processing date may differ from the rate in effect on the transaction date that appears on your Statement. We do not adjust the currency exchange rate or charge any currency conversion fees.

Separate from that agreement, the processors had promulgated their own rules stating that the rates for foreign transactions would be either wholesale foreign exchange market rates or government-mandated rates.

The plaintiffs claimed that instead of using either of these two types of rates, the processors created fictional off-market currency conversion rates that did not come from any single moment in time in the wholesale currency market.

The plaintiffs alleged that the provision in the cardholder agreement effectively incorporated the processors' separate rules on which currency conversion rates would be applied, and that the processors were effectively acting as the bank's agents when selecting and charging the foreign exchange rates.

Further, by subsequently billing cardholders based on the alleged off-market rates, the bank was allegedly consenting to the processors acting as the bank's agents and was independently ratifying rates charged by the processors.

In turn, the cardholders asserted that the bank violated its agreement with the cardholders that the processors would use their own currency conversion procedures, since the processors had in fact violated their own internal rules on which exchange rate to use.

The district court rejected this theory. According to its plain meaning, the language in the agreement between the bank and the cardholders did not identify the specific procedures or rules that the processors would use to set currency conversion rates, and in turn did not include a specific promise on which rates would ultimately be charged to their cardholders.

The court also found that the cardholder agreement did not incorporate by reference the processors' internal rules on what rates to use. Incorporation by reference requires that the underlying contract makes a clear reference to a separate document whose identity may be ascertained.

However, the bare reference in the cardholder agreement to the processors' "own currency conversion procedures" was not clear enough to ascertain the identity of any specific document to be incorporated.

The processors' rules — including the reference to use of wholesale foreign exchange market rates or government-mandated rates — was therefore not a part of the contract at issue.

Additionally, the court in Wright found that the plaintiffs did not plausibly allege that the processors were the bank's agents. The cardholder agreement stated that the processors would use their own procedures, and there was no indication that the rates were subject to the bank's control.

Quite to the contrary, the agreement instead stated that the bank does "not adjust the currency exchange rate or charge any currency conversion fees." The fact that the bank passed on the processors' currency exchange rates to its customers did not mean that the bank controlled or ratified them.

Implications for Customer Agreements and the Roles of Third Parties

Notable differences existed between the agreement at issue in Guerrero versus that in Wright.

The latter clearly explained that the processor would set the currency conversion rates, disclaimed any role by the bank in setting the exchange rate or any currency conversion fees, and did not provide an explicit reference to any particular currency conversion rates that would be applied.

In contrast, the agreement in Guerrero seemingly represented to customers that specific currency conversion rates would be used and could therefore be read as a promise by the bank to limit the foreign exchange charges to only the specified rates.

Institutions drafting customer agreement provisions governing exchange rates or any currency conversion fees should therefore carefully consider how to describe and explain these fees in the cardholder agreement.

In a related vein, these two cases also highlight the need to monitor and oversee the work of any third-party service providers that help an institution implement the features of a financial product or service.

The opinions in these two cases do not delve into the extent to which the banks were aware of whether and to what extent their processors were charging currency conversion fees that were potentially different from what was described in either the bank's cardholder agreement or the processors' own internal rules.

Even if the processor's alleged failure in Wright to follow its own internal rules did trigger a valid civil claim against the bank, the possibility that a third-party service provider is not following its own internal policies and procedures should still be a source of concern for entities that use that third-party's services.

This can indicate the risk that the service provider is not following its own internal policies and procedures in other areas of its operations and can also suggest that the service provider lacks sufficient internal controls or compliance monitoring to detect and address these types of issues.

Careful consideration of the specific terms and conditions in customer agreements, and the extent to which institutions delegate and oversee authority granted to third-party service providers, are perennial issues facing the financial services industry and are critical components of legal compliance.

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