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Federal Court Finds Dodd-Frank Does Not Change Preemption Standard for National Banks*

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A little noticed decision late last year, the Federal District Court for the Central District of California held that the Dodd-Frank Act did not change the preemption standard for national banks. This opinion is consistent with some of the scholarship on the issue,[1] but contrary to the views of many consumer groups and State bank advocates.

In Lusnak v. Bank of America, (C.D. Ca. No CV 14-1885-GHK), decided October 29, 2014, the court dismissed a class action suit brought by a mortgagor who sought damages against Bank of America. The suit was premised on the fact that Bank of America failed to comply with a California law requiring financial institutions to pay at least 2 percent interest on escrow funds held in connection with residential mortgage loans. The bank argued that this California law was preempted by the National Bank Act, and OCC regulations and opinions authorizing national banks to make mortgage loans and hold escrow accounts.

The court determined that the applicable preemption standard is found in the Dodd-Frank Act, and, in particular, the provision that declares that a State consumer financial law is preempted if:

> "[I]n accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in *Barnett Bank of Marion County, N. A. v. Nelson, Florida Insurance Commissioner, et al., 517 U.S. 25, 116 S. Ct. 1103, 134 L. Ed. 2d 237 (1996)*, the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers; and any preemption determination under this subparagraph may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law..."

The court reasoned that the Barnett Bank v. Nelson preemption standard was the pre-existing rule prior to Dodd-Frank, and therefore the statute simply codified existing law, rather than change the applicable test for preemption.

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[1] See, e.g., Raymond Natter and Katie Wechsler, *Dodd-Frank Act and National Bank Preemption: Much Ado About Nothing*, 7 Va. L. & Bus. Rev. 303 (2012).

The court went on to explain that under the Barnett Bank v. Nelson standard, a State law is preempted when the State law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Further, quoting the Barnett decision, the court noted that "normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted," and therefore, "grants of both enumerated and incidental powers to national banks ... ordinarily preempt contrary State law."

The court examined the National Bank Act, as well as regulations and opinions issued by the Comptroller of the Currency, and determined that national banks have the power to make mortgage loans and to hold escrow accounts in connection with these loans. The court then concluded that imposing a mandatory 2 percent minimum interest payment for these accounts "constitutes a significant interference" with a national bank power. The court reasoned that this State law imposes costly operational and administrative burdens on national banks. In addition, since a rigid 2 percent requirement does not take into consideration changing prevailing interest rates, it would interfere with a national bank's ability to make loans given evolving and potentially fluid market conditions. The court also stated that if a national bank had to comply with State escrow interest rate requirements it would be subject to potentially different requirements in the 49 other states. The court concluded by quoting the Supreme Court decision in Watters v. Wachovia that "Diverse and duplicative superintendence of national banks' engagement in the business of banking" is exactly what "the NBA was designed to prevent."

In short, this case is significant in that the Federal District Court determined that it would apply the traditional and long-standing preemption principles in determining the legal status of the California law at issue. The court determined that the Dodd-Frank Act merely codified existing preemption standards rather than create a new standard. If this reasoning is accepted by the other courts, the preemption cases decided prior to the Dodd-Frank Act will continue to be binding precedents within their respective jurisdictions, or in the case of Supreme Court decisions, throughout the United States.

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