Banks Beware - Does Dodd-Frank Erode Preemption of State Banking Laws?

By Deborah S. Lapin

The Ninth Circuit Court of Appeals recently issued a ruling that refuted a national bank's claim that a state banking law was preempted by the National Bank Act. In *Donald Lusak v. Bank of America*, N.A., the plaintiff, on behalf of a putative class, alleged that Bank of America violated California's escrow interest law by failing to pay its borrowers interest on the positive balance in their accounts. California's interest law requires that financial institutions pay borrowers up to 2% interest on funds in borrowers' escrow accounts. Bank of America argued that the National Bank Act preempted California's escrow interest law. The National Bank Act, enacted in 1864, provides national banks with "all incidental powers as shall be necessary to carry on the business of banking."

The district court agreed with Bank of America, concluding that California's escrow interest law "prevents or significantly interferes with" banking powers and is preempted by the National Bank Act. The Ninth Circuit, however, noted that Titles X and XIV of the Dodd-Frank Act were structured to address preemption determinations under the National Bank Act. While the Ninth Circuit recognized that the preemption standard codified in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996), i.e., that state consumer financial laws are preempted only if they prevent or significantly interfere with a national bank's exercise of powers, it determined that Bank of America failed to affirmatively demonstrate that Congress intended to preclude states from enacting escrow interest laws. The panel noted the absence of legal authority for the proposition that state escrow interest laws prevent or significantly interfere with the exercise of national bank powers, especially because 13 states have laws similar to California's. The Court further suggested that the enactment of Dodd-Frank reflected Congress' belief that escrow interest laws do not prevent or significantly interfere with the exercise of national bank powers.

On April 13, 2018, Bank of America filed a Petition for Hearing En Banc, asserting that the panel's decision conflicts with U.S. Supreme Court precedent as well as

prior Ninth Circuit and other court rulings. Bank of America points out that the decision does not consider 12 C.F.R. § 34.4 (a regulation of the Office of the Comptroller of the Currency) which provides that states' limitations on national bank loan terms and mortgage escrow accounts significantly interfere with the powers of national banks. Bank of America further suggests that the decision will create confusion regarding which state laws apply to national banks.

This is definitely a case to monitor going forward. The decision does not affirmatively hold that a state escrow interest law is never subject to preemption. For instance, it identifies that a state law setting high rates that banks must pay on escrow interest accounts could prevent or significantly interfere with a bank's ability to conduct business. As it stands, however, the decision reflects the impact of Dodd-Frank on the issue of preemption and suggests that courts may be less inclined to rule in favor of national banks and more in favor of consumers.

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