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U.S. Supreme Court Maintains Absence of Bright-Line Standards in National Bank Act Preemption

U.S. Supreme Court Affirms that Lower Courts Should Determine Whether a State Law is Preempted Based on a Practical Assessment Grounded in Prior Court Decisions

SUMMARY

On May 30, 2024, in a unanimous opinion authored by Justice Kavanaugh, the U.S. Supreme Court issued its first decision on National Bank Act ("NBA") preemption of state law since the codification of the *Barnett Bank* decision in Dodd-Frank in 2010. The Court directed lower courts to reach preemption decisions based on a "practical assessment" of whether the state law "prevents or significantly interferes with" a national bank's power.[1] The Supreme Court instructed lower courts to make this determination by comparing the state laws at issue to those the Court had analyzed in previous preemption decisions. The Supreme Court rejected the parties' proposals for more "bright line" tests, or even additional guidance, for ascertaining the meaning of "prevents or significantly interferes" because Congress declined to establish such a bright-line test in Dodd-Frank.[2] The Court noted, but did not address, the role of the Office of the Comptroller of the Currency ("OCC") in making determinations about whether a state law regulating a national bank is preempted.

As a result of the Court's decision, national banks arguing that state laws are preempted must continue litigating on a case-by-case basis. The Supreme Court's instruction to use its prior preemption determinations—in which the Court has often preempted state laws based on relatively low levels of interference with national bank powers—should continue to give preemption arguments significant force. Moreover, by rejecting the calls by the petitioners and the Solicitor General for a preemption standard that turns on the economic magnitude of a state law's effects on national bank powers—which may have

required extensive, bank-specific evidence and litigation—the Supreme Court helped maintain a reasonable burden on banks in most such cases. Nevertheless, the lower courts have sometimes come to different views on whether similar laws are preempted under this *status quo* standard, indicating that lower courts may continue to struggle with this issue after the Court's decision. Indeed, even the Court's own prior split on two "seemingly similar" state escheatment statutes (in 1923 and 1944) illustrates the absence of clarity.[3] The case-by-case nature of the analysis and differing views of lower courts will frequently cause uncertainty as to whether, absent a final judicial ruling, a state law is preempted. The absence of further Supreme Court guidance may be particularly problematic as national banks face increased state legislation seeking to regulate their activities and terms of service.

BACKGROUND

In the wake of the 2008 financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which had a number of consumer-related provisions including a statement as to the legal standard for federal preemption of state consumer financial laws with respect to national banks. Dodd-Frank provided that the NBA preempts a state consumer financial law if the state law (i) discriminates against national banks as compared to state-chartered banks, or (ii) in accordance with the legal standard set forth in the Supreme Court's decision in *Barnett Bank of Marion County, N.A.* v. *Nelson, Florida Insurance Commissioner, et al.*, 517 U.S. 25 (1996), "prevents or significantly interferes with the exercise by the national bank of its powers."[4] With respect to state laws that do not discriminate against national banks, the *Barnett Bank* court did not offer a clear test for determining when a state law's interference with a national bank's power amounts to "significant[] interfer[ence]." Moreover, the *Barnett Bank* decision inherently creates confusion as to the term's meaning because the Florida statute in question directly "prevent[ed]" the national bank power in question (selling insurance), so the degree of interference was not truly relevant to the decision.[5]

In the years since Dodd-Frank, courts have disagreed over the meaning of "significant interference" with national banking powers. In *Lusnak* v. *Bank of America, N.A.*, 883 F.3d 1185 (9th Cir. 2018), and in *Kivett* v. *Flagstar Bank, FSB*, 2022 WL 1553266 (9th Cir. May 17, 2022), the U.S. Court of Appeals for the Ninth Circuit held that the NBA did not preempt a California law requiring banks to pay a minimum rate of interest on money placed into borrowers' mortgage escrow accounts (to cover expenses on the property, such as taxes and insurance). In reaching these decisions, the Ninth Circuit considered the *magnitude* of the state law's interference with national banking powers, concluding that the 2% minimum interest rates on mortgage escrow accounts required by the California law was not a "punitively high" amount and thus did not amount to "significant interference" in accordance with *Barnett Bank*.[6] Those courts, however, provided no economic analysis of why 2% was not punitively high as compared to prevailing interest rates at the time.

The U.S. Court of Appeals for the Second Circuit reached the opposite conclusion. In an opinion issued in the combined cases of *Cantero* v. *Bank of America, N.A.* and *Hymes* v. *Bank of America, N.A.*, the Second Circuit held that a New York law very similar to the California law at issue in *Lusnak* and *Flagstar*, requiring mortgage lenders to pay 2% interest to borrowers on money placed into mortgage escrow accounts, was preempted as to national banks.[7] The Second Circuit explained that the New York law was preempted under the "ordinary legal principles of pre-emption" set forth in *Barnett Bank*, and as codified by Dodd-Frank.[8] According to the Second Circuit, under these principles, "[t]o determine whether the NBA conflicts with a state law, we ask whether enforcement of the law at issue would *exert control* over a banking power—and thus, if taken to its extreme, threaten to 'destroy' the grant made by the federal government."[9] The court reasoned that national banks have the granted power to make real estate mortgage loans, and the New York law was preempted because it would "exert control over" the undisputed incidental power of national banks under the NBA "to create and fund escrow accounts" in connection with those loans.[10] The court expressly addressed and rejected the Ninth Circuit's NBA preemption analysis, stating that "[i]t is the *nature* of an invasion into a national bank's operations—not the magnitude of its effects—that determines whether a state law purports to exercise control over a federally granted banking power [and the powers incidental thereto] and is thus preempted."[11] The Second Circuit further noted that courts would be poorly equipped to assess the magnitude of a state law's interference with national banking powers, particularly in cases where specific interest rates were mandated.[12]

In light of the circuit split, the defendant bank in *Flagstar* and the plaintiffs in *Cantero* both filed petitions for a writ of certiorari. The U.S. Supreme Court granted review in *Cantero*. (It is not clear why the Court chose *Cantero* rather than *Flagstar*, or did not consider them together.) In the merits briefs, Petitioners advocated for a bank-specific factual inquiry into the practical effects of a particular state law on national banks to determine whether the level of interference caused by a particular state law could be deemed "significant" under *Barnett Bank*, while Respondents supported the so-called "control test" articulation of the *Barnett Bank* standard by the Second Circuit.

THE SUPREME COURT'S DECISION

The U.S. Supreme Court vacated the Second Circuit's decision in *Cantero*, holding that the standard for NBA preemption set forth in *Barnett Bank* and codified by Dodd-Frank "did not purport to establish a clear line to demarcate when a state law 'significantly interfere[s] with the national bank's exercise of its powers.'"[13] Rather, the *Barnett Bank* court "looked to prior cases of [the Supreme Court] where the state law was preempted, as well as several cases where the state law was not preempted."[14] The Court found that such precedents "furnish content to *Barnett Bank*'s significant-interference test—and therefore also to Dodd-Frank's preemption standard incorporating *Barnett Bank*."[15] Accordingly, courts deciding NBA preemption must "likewise take account of those prior decisions of [the Supreme Court] and similar precedents."[16] The Court rejected both the position of the Second Circuit and Plaintiffs as two extremes.

The Second Circuit opinion was categorized as a "categorical test that would preempt virtually all state laws," while the plaintiffs' position "would yank the preemption standard to the opposite extreme and would preempt virtually no non-discriminatory state laws."[17]

The Court walked through its prior opinions on NBA preemption that preceded the *Barnett Bank* holding, and noted that in each of those cases the Court decided whether the state law should be preempted based on a combination of the "nature *and* degree of the state law's alleged interference with the national banks' exercise of their powers."[18] The determination was guided by "the text and structure of the laws, comparison to other precedents, and common sense."[19] For example, the Court cited *Franklin National Bank of Franklin Square* v. *New York*, 347 U.S. 373 (1954), as a "paradigmatic example of significant interference identified by *Barnett Bank*."[20] *Franklin* involved a New York law prohibiting banks from using the word "savings" in their advertisements.[21] The Court found this state law was preempted as to national banks because it significantly interfered with national banks' ability to "efficiently" and "effectively" describe their activities in advertisements.[22] Whereas in *Anderson National Bank* v. *Luckett*, 321 U.S. 233 (1944), the Court held that a Kentucky law requiring banks to turn over abandoned deposits to the state was not preempted because it did not alter national banks' "'obligation to pay' the deposits 'to the persons entitled to demand payment according to the law of the state where it does business.'"[23]

Thus, to assess the significance of a state law's interference, *Cantero* instructs the courts to compare the interference caused by the state law at issue to the state laws considered in prior cases, and make a "practical assessment of the nature and degree of the interference caused by [the] state law."[24] The Court stated that, "if the state law's interference with national bank powers is more akin to interference in cases like *Franklin*, *Fidelity* [*Federal Savings & Loan Association* v. *De la Cuesta*, 458 U.S. 141 (1982)], *First National Bank of San Jose* [v. *California*, 262 U.S. 266 (1923)], and *Barnett Bank* itself, then the state law is preempted. If the state law's interference with national bank powers is more akin to the interference in cases like *Anderson*, *National Bank* v. *Commonwealth*, [9 Wall. 353 (1870),] and *McClellan* [v. *Chipman*, 164 U.S. 347 (1896)], then the state law is not preempted."[25] Because the Second Circuit did not conduct such a "nuanced comparative analysis" of the prior cases, and instead "distilled a categorical test that would preempt virtually all state laws that regulate national banks . . . other than generally applicable state laws such as contract or property laws," the Court rejected its holding.[26]

The Court acknowledged "the desire by both parties for a clearer preemption line one way or the other," but nevertheless found that Congress "expressly incorporated *Barnett Bank* into the U.S. Code," and "*Barnett Bank* did not draw a bright line."[27]

The Court also noted, but did not address, the role of the OCC in making NBA preemption determinations under Dodd-Frank.[28] As relevant to this case, in 2004, the OCC issued a final rule finding that state laws regulating mortgage escrow accounts are preempted as to national banks.[29] When promulgating the rule, the OCC made clear that its preemption determinations were made in accordance with the standard for

NBA preemption set forth in *Barnett Bank*.[30] Petitioners claimed—and Respondents disputed—that this OCC rule was overruled by Dodd-Frank.

IMPLICATIONS

Although, at first glance, the Supreme Court's decision to vacate the Second Circuit's decision in *Cantero* is a rejection of the Second Circuit's "control test," which the Court regarded as too sweeping and extreme, the Court also explicitly did not endorse Petitioners' interpretation of *Barnett Bank*, which primarily looked to the economic magnitude of a state law's effects on national banks. Indeed, as mentioned, the Court stated that such an approach would "yank the preemption standard to the opposite extreme, and would preempt virtually no non-discriminatory state laws that apply to both state and national banks."[31]

By deciding not to distill a categorical approach for determining the meaning of *Barnett Bank's* "significant interference," or even provide further guidance beyond citation to its precedential decisions, the Supreme Court's decision has, in effect, left the *status quo* and uncertainty prior to *Lusnak*, *Flagstar*, and *Cantero* in place. Parties must continue to carefully review the Supreme Court's precedents and consider ways to analogize the facts of those cases to the existing state law, as they have done for decades. Moreover, the Court's instruction to rely on cases such as *Franklin*, in which the Court preempted a state law that imposed a relatively low degree of interference by banning the use of the term "savings" in advertisements, is informative and suggests that the general threshold for "significant interference" has not shifted. The Court does appear to suggest that the test had both qualitative and quantitative elements, as it instructs courts to assess the "nature *and* degree" of interference.[32]

The Court also left open two issues raised over the course of the litigation that the Second Circuit "may address as appropriate on remand," which may become more prominent issues in future NBA preemption litigation.[33]

First, the Second Circuit may consider the significance, if any, of the OCC rules on NBA preemption.[34] If found valid, the 2004 OCC rules may be considered an alternative basis for federal preemption of state laws.

Second, the Second Circuit may consider the relevance, if any, of the Dodd-Frank provision preempting state consumer financial laws if a federal law "other than title 62 of the Revised Statutes preempts the state law."[35] Although Title 62 includes much of the NBA, it does not cover the provision authorizing national banks to make real estate loans, codified at 12 U.S.C. § 371. Accordingly, the Second Circuit and future litigants may consider whether Section 371 independently preempts state laws regulating mortgage escrow accounts.

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ENDNOTES

1 *Cantero* v. *Bank of Am., N.A.*, No. 22-529, slip op. at 12 (U.S. May 30, 2024).

2 *Id.* at 13.

3 *See id.* at 9-10 (discussing *Anderson Nat'l Bank* v. *Luckett*, 321 U.S. 233 (1944), and *First Nat'l Bank of San Jose* v. *California*, 262 U.S. 366 (1923)).

4 12 U.S.C. § 25b(b)(1).

5 *Barnett Bank*, 517 U.S. at 27-28.

6 *Lusnak*, 883 F.3d at 1194-95, n.7.

7 *Cantero*, 49 F.4th 121 (2d Cir. 2022).

8 *Id.* at 130.

9 *Id.* at 132 (emphasis added).

10 *Id.* at 134.

11 *Id.* at 131 (emphasis added).

12 *Id.* at 134, n.8.

13 *Cantero*, slip op. at 7.

14 *Id.* at 8.

15 *Id.* at 12.

16 *Id.* at 8.

17 *Id.* at 13.

18 *Id.* at 12, n. 3 (emphasis added).

19 *Id.*

20 *Id.* at 8.

21 *Id.*

22 *Id.*

23 *Id.* at 10 (internal citations omitted).

24 *Id.* at 12.

25 *Id.*

26 *Id.* at 13.

27 *Id.*

28 *Id.* at 14, n. 4.

29 12 C.F.R. § 34.4(a).

30 OCC, *Bank Activities and Operations; Real Estate Lending and Appraisals*, 69 Fed. Reg. 1904, 1910 (Jan. 13, 2004).

31 *Cantero*, slip op. at 13.

32 *Id.* at 12.

33 *Id.* at 14 n. 4.

34 *Id.*

35 *Cantero*, slip op. at 14 n.4 (citing 12 U.S.C. § 25b(b)(1)(C)).

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