November 21, 2018

United States Supreme Court Denies *Certiorari* in *Bank of America, N.A.* v. *Lusnak*

U.S. Supreme Court Declines Review of Ninth Circuit's Holding That the National Bank Act Does Not Preempt California Law Requiring Banks to Pay Interest on Mortgage Escrow Accounts

SUMMARY

On Monday of this week, the U.S. Supreme Court denied Bank of America's petition for *certiorari* to review the decision of the U.S. Court of Appeals for the Ninth Circuit that the National Bank Act ("NBA") does not preempt a California law requiring lenders to pay a minimum 2% interest rate on mortgage escrow accounts. The Ninth Circuit held that the California law was not preempted under the NBA, because the law did not "significantly interfere" with Bank of America's exercise of its banking powers. The Ninth Circuit rejected the contrary position of the Office of the Comptroller of the Currency ("OCC"), holding that the OCC's position was entitled to little, if any, weight. The Supreme Court still has not addressed the issue of national bank preemption since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[1] which included a specific provision relating to national bank preemption.

The Ninth Circuit's decision could have significant implications for national banks. Beyond the exposure of national banks to non-uniform state requirements relating to mortgage escrow accounts, the decision could create a significantly higher standard for national banks to invoke preemption of certain state laws.

BACKGROUND

In 1864, Congress passed the NBA to create a "system of national banking."[2] Under that system, Congress established that national banks would operate under the "paramount authority" of the federal

government[3] and be supervised by the Office of the Comptroller of the Currency[4]. In *Barnett Bank of Marion Cty. N.A.* v. *Nelson*, the Supreme Court held that any state regulation that "prevent[s] or significantly interfere[s] with [a] national bank's exercise of its powers" is preempted by the NBA.[5] The *Barnett* standard was explicitly codified in the Dodd-Frank Act.[6]

On March 12, 2014, Donald Lusnak filed a case on behalf of himself and a putative class of similarly situated Bank of America customers alleging, among other claims, that Bank of America violated a California law "by failing to pay interest on his escrow account funds."[7] That California law—California Civil Code Section 2954.8(a)—mandates that "[e]very financial institution" pay a minimum 2% interest rate on mortgage escrow accounts. Bank of America moved to dismiss the case on the ground that the NBA preempted that California law under the U.S. Supreme Court's *Barnett* standard. The district court agreed with Bank of America, holding that "California's escrow interest law 'prevents or significantly interferes with' banking powers and therefore is preempted by the NBA."[8] In so holding, the district court found persuasive "the OCC's interpretation that escrow accounts fall within the scope of a national bank's powers."[9] The district court also found that "Section 2954.8(a) constitutes a significant interference" with those powers because, among other things, "[r]equiring [Bank of America] to pay all of its borrowers 2 percent interest would allow a state to impose costly operational and administrative burdens on national banks' lending activities and would jeopardize a helpful (and free) service that [Bank of America] provides its real estate borrowers."[10]

On March 2, 2018, the U.S. Court of Appeals for the Ninth Circuit issued a 3-0 decision, reversing the district court and holding that "the NBA does not preempt California Civil Code § 2954.8(a)," in part because "no legal authority establishes that state escrow interest laws prevent or significantly interfere with the exercise of national bank powers."[11] The Ninth Circuit did not cite relevant case law holding that States may not interfere with the pricing of a national bank's product or service,[12] discuss the importance of mortgage escrow accounts to the overall mortgage lending industry, or analyze how a 2% rate of interest would affect the ability of Bank of America to offer escrow accounts or price mortgages.[13] Moreover, in reaching its holding, the Ninth Circuit rejected the regulation previously issued by the OCC that the NBA preempted state laws that interfere with a national bank's real estate lending powers, including state escrow laws. The Ninth Circuit contended that the OCC's regulation did not accurately adopt the *Barnett* standard, and, thus "the OCC's conclusions are entitled to little, if any, deference."[14] Accordingly, the Ninth Circuit remanded the case, noting that "Lusnak may proceed with his . . . claims against Bank of America."[15] With the support of the OCC as an *amicus*, Bank of America sought reconsideration of that decision in its petition for rehearing *en banc.* However, in May 2018, the Ninth Circuit denied that petition.

On November 19, 2018, the U.S. Supreme Court denied Bank of America's petition for *certiorari*.

IMPLICATIONS

The Ninth Circuit's decision could have significant implications for national banks, as it represents a departure from decades of precedent establishing that States cannot regulate a national bank's ability to set the prices, terms, or conditions of its products and services. As an initial matter, the Ninth Circuit's decision exposes national banks to a patchwork of state laws on the payment of interest on mortgage escrow accounts. For example, Minnesota requires that banks pay a minimum 3% interest rate on mortgage escrow accounts.[16] The holding in *Lusnak* could have ramifications far beyond mortgage escrow accounts, however, and expose national banks, particularly in the Ninth Circuit, to both limits and requirements on a wide variety of products and services.

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ENDNOTES

1 *See* Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The U.S. Supreme Court has also denied *certiorari* in other recent NBA-related cases since the passage of the Dodd-Frank Act. *See*, *e.g.*, *Madden* v. *Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016). Prior to that, the Court did grant *certiorari* in a number of NBA-related cases. *See*, *e.g.*, *Cuomo* v. *Clearing House Ass'n, L.L.C.*, 557 U.S. 519 (2009); *Wachovia Bank* v. *Schmidt*, 546 U.S. 303 (2006).

2 *Watters* v. *Wachovia Bank, N.A.*, 550 U.S. 1, 10 (2007).

3 *Davis* v. *Elmira Sav. Bank*, 161 U.S. 275, 283 (1896).

4 *See* Act of June 3, 1864, § 8, 13 Stat. 99, 101 (1864).

5 517 U.S. 25, 33 (1996).

6 *See* 12 U.S.C. § 25b(b)(1)(B).

7 *Lusnak* v. *Bank of America, N.A.*, 883 F.3d 1185, 1190 (9th Cir. 2018).

8 *Id*.

9 *Lusnak* v. *Bank of Am., N.A.*, 2014 WL 6779131, at *7 (C.D. Cal. Oct. 29, 2014), *rev'd*, 883 F.3d 1185 (9th Cir. 2018).

10 *Id.* (internal quotation marks omitted).

11 *Lusnak*, 883 F.3d at 1196-97.

12 *See*, *e.g.*, *Franklin Nat'l Bank of Franklin Square* v. *New York*, 347 U.S. 373 (1954) (holding state law limiting how a particular national bank power could be advertised preempted); *Baptista* v. *JPMorgan Chase Bank, N.A.*, 640 F.3d 1194 (11th Cir. 2011) (state statute regulating national banks' ability to charge non-account holder check cashing fees preempted by NBA).

13 The Ninth Circuit did note that "a state law setting punitively high rates banks must pay on escrow balances may prevent or significantly interfere with a bank's ability to engage in the business of banking." *Lusnak*, 883 F.3d at 1195 n.7.

14 *Id.* at 1193-94.

15 *Id.* at 1188.

16 Minn. Stat. § 47.20, subd. 9.

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