BURR ARTICLE

PREEMPTION OF STATE CONSUMER PROTECTION LAWS UNDER THE DODD-FRANK ACT

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The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or the "Act"), signed into law in 2010, contains a series of regulatory reforms aimed in part to combat what was perceived as lax financial regulation that led to the recession of the late 2000's.[1] One way the Dodd-Frank Act seeks to tighten the reins on national banking institutions is by strengthening the legal standards for the preemption of state laws, thereby making it harder for banks to avoid liability under state law. Whereas prior to Dodd-Frank's enactment, national banking institutions enjoyed heavy deference in the area of preemption of state laws, Dodd-Frank curbs this deference by requiring a case by case determination of preemption and requiring that a state consumer financial services law conflict with the exercise of a national bank's powers before the state law can be preempted. Further, the Dodd-Frank Act strips subsidiaries of national banks of the same preemption protection enjoyed by national banks and subjects federally-chartered savings banks and federally-regulated savings associations to the same preemption standards as those applicable to national banks. The mandated "case by case" determination standard injects much uncertainty into the preemption analysis and ensures much preemption litigation for years to come.

A. BACKGROUND

In 1996, the Supreme Court set a conflict preemption standard for national banks in the case of *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner*.[2] In *Barnett*, the Court ruled that a state insurance law which prohibited national banks from selling insurance in certain towns in Florida was preempted by a 1916 federal law which authorized such actions because the state insurance law stood as an "obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[3] *Barnett* was interpreted by the OCC to provide for preemption of state consumer protection statutes on a case by case basis under the standard of conflict preemption, where a state law is enforceable so long as it does not "prevent or significantly interfere with the national bank's exercise of its powers." [4]

In 2004, the OCC codified the conflict preemption standard of *Barnett* in various preemption regulations, under which all state laws that obstructed or impaired the ability of a national bank to fully exercise its federally granted powers were preempted.[5] Under the rules, national banks were exempt from

[1] Louise Story, "Dodd-Frank Rekindles Age-Old Debate," New York Times, June 28, 2011.

[2] 517 U.S. 25 (1996).

[3] *Id.* at 31.

[4] Matthew Dyckman, *Financial Regulatory Reform – The Dodd-Frank Act Rolls Back Federal Preemption*, 64 Consumer Fin. L.Q. Rep. 129 (2010); *Barnett*, 517 U.S. at 33.

[5] 12 C.F.R. pts. 7 & 34; Dyckman, *supra* note 4, at 158.

complying with certain state laws, including those related to licensing, credit terms, and loan disclosures, without regard to whether the state law conflicts or significantly interferes with the exercise of the national bank's powers.[6]

In 2007, the Supreme Court decided *Watters v. Wachovia Bank, N.A.*, in which the Court held that the same preemption principles that applied to national banks also applied to their subsidiaries, rendering banks' subsidiaries largely immune from state regulation.[7] In *Watters*, the Court upheld an OCC regulation which preempts state regulation of any banking activity that a national bank conducts through an operating subsidiary. The Court reasoned that the National Bank Act was designed to prevent "unduly burdensome and duplicative state regulation" of national banks.[8]

B. DODD-FRANK REIGNS IN PREEMPTION STANDARDS FOR NATIONAL BANKS

The Dodd-Frank Act restored the conflict preemption standard of *Barnett* by requiring that (1) a state consumer financial law "prevents or significantly interferes with" the exercise of a national bank's powers before it will be preempted, and (2) any finding of preemption must be made on a case by case basis, rather than by a blanket rule.[9] The Act also permits preemption if application of the state law "would have a discriminatory effect on national banks, in comparison with the effect of the law on a bank chartered by that state," or if the state law is otherwise preempted by federal law.[10]

The Act defines "case by case basis" as a determination pursuant to this section made by the Comptroller concerning the impact of a particular State consumer financial law on any national bank that is subject to that law, or the law of any other State with substantively equivalent terms."[11] The Act also requires that, when making a case-by-case basis determination that a state law of another state has "substantively equivalent" terms as one that the Comptroller is preempting, the Comptroller must consult with the Bureau of Consumer Financial Protection and must take the views of the Bureau into account when making a decision.[12]

The Act further requires that, before a regulation or order of the OCC may be interpreted so as to invalidate a provision of a state consumer financial law as to a national bank, there must be "substantial evidence" to support the finding of preemption in accordance with *Barnett*.[13] The OCC is also required to conduct a review of each preemption determination every five years.[14]

Of particular importance is the Act's reversal of course with respect to the protection from state consumer financial laws that had been granted to subsidiaries of national banks under *Watters*. The Act

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[6] *See* 12 C.F.R. pt. 34.4.; Dyckman, *supra* note 4.

[7] 550 U.S. 1 (2007); Linda Greenhouse, "Ruling Limits State Control of Big Banks," New York Times, Apr. 18, 2007.

[8] 550 U.S. at 11.

[9] Dyckman, *supra* note 4; 12 U.S.C.A. § 25b(b)(1)(B). The Dodd-Frank Act defines a "state consumer financial law" as one that "does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer." 12 U.S.C.A. § 25b(a)(2).

[10] 12 U.S.C.A. § 25b(b)(1).

[11] *Id.* § 25b(b)(3)(A).

[12] *Id.* § 25b(b)(3)(B).

[13] *Id.* § 25b(c).

[14] *Id.* § 25b(d).

provides that subsidiaries and affiliates of national banks are not entitled to the same preemptive rights of national banks.[15] The Act also scales back the preemption enjoyed by federally chartered savings banks and federally chartered savings associations that, under the Home Owners' Loan Act, had enjoyed explicit field preemption. The Act amends the Home Owners Loan Act ("HOLA") to require the OTS and the OCC to make preemption determinations under the same standards applicable to national banks with respect to preemption of state law.[16] Further, the Dodd-Frank Act explicitly states that the HOLA does not occupy the field "in any area of State law," nullifying an explicit field preemption provision in the statute and its regulations.[17]

C. COURTS STRUGGLE WITH ANALYZING PREEMPTION UNDER DODD-FRANK

Federal courts have begun applying the new federal preemption regime of the Dodd-Frank Act to claims of preemption with regard to various state consumer protection laws. In doing so, courts have recognized that the Dodd-Frank Act has considerably reduced federal preemption of state law. If a court finds that the Dodd-Frank Act does not apply retroactively, the court will likely reach a finding that the state law is preempted under the more lenient pre-Dodd-Frank preemption standards. However, state laws analyzed under the more strict preemption standards of Dodd-Frank are less likely to be found preempted.

1. Non-Retroactive Application of Dodd-Frank and Application of Pre-Dodd-Frank Preemption Rules

The Dodd-Frank Act provides that it is not mean to "alter or affect the applicability of any regulation, order, guidance, or interpretation prescribed" by the OCC or the OTS regarding the applicability of state law under federal banking law "to any contract entered into on or before July 21, 2010" by federally regulated national banks, savings associations, or their subsidiaries.[18]

In accordance with this non-retroactivity provision, courts have applied pre-Dodd-Frank preemption standards to contracts entered into before July 21, 2010. *See Molosky v. Washington Mutual, Inc.*, 664 F.3d 109 (6th Cir. 2011) (while recognizing that the Dodd-Frank Act has changed the type of preemption available under HOLA, applying HOLA field preemption standards to bar plaintiffs' claim of usurious prepayment fees because Dodd-Frank Act was not intended to be retroactive); *Nicol v. Wells Fargo Bank, N.A.*, 857 F. Supp. 2d 1067 (D. Or. 2012) (applying HOLA field preemption analysis to hold that claims under Oregon's Unfair Trade Practices Act were preempted by HOLA because contract at issue was entered into before July 21, 2010); *Brown v. Wells Fargo*, 869 F. Supp. 2d 51 (D.D.C. 2012) (while noting that preemption landscape with respect to federal savings banks was "altered significantly" by Dodd-Frank, holding that the new preemption standards did not apply because the Act was passed after plaintiff received the loan at issue, and, therefore, several of borrower's claims under DC Consumer Protection Procedures Act were preempted by HOLA, 12 C.F.R. § 560.2); *Sovereign Bank v. Sturgis*, 863 F. Supp. 2d 75, 92 (D. Mass. 2012) (because Dodd-Frank Act does not apply retroactively, claims against federally chartered bank for failure to provide proper disclosures under state law held preempted by HOLA, 12 C.F.R. § 560.2(b)); *Benford v. CitiMortgage, Inc.*, No. 11-12200, 2011 WL 5525942 (E.D. Mich. 2011) (dismissing claim against subsidiary of national bank as preempted under rule of *Watters v. Wachovia*

[15] *Id.* § 25b(e).

[16] *See* 12 U.S.C.A. § 1465.

[17] *Id.* § 25b(b)(4); 12 C.F.R. pt. 560.2(a).

[18] 12 U.S.C.A. § 5553; 12 C.F.R. pt. 560.2(a).

Bank; Dodd-Frank's change to preemption rules of subsidiaries did not go into effect until after events of the case).

Under the pre-Dodd-Frank preemption rules of HOLA, under which HOLA was meant to occupy the field with respect to regulations of federal savings banks, a court must first ask whether the type of law is one listed in 12 C.F.R. § 560.2(b). *Sovereign Bank v. Sturgis*, 863 F. Supp. 2d 75, 92 (D. Mass. 2012). If so, then the law is preempted. *Id.* The types of laws listed under 560.2(b) include laws affecting disclosure and advertising; usury and interest rate ceilings; use of credit reports; and processing, origination, and servicing of mortgages. *Id.*; 12 C.F.R. § 560.2(b). If the state law at issue does not correlate to a type listed under § 560.2(b), then the court must ask whether the law in question affects lending. If it does affect lending, a presumption arises that the law is preempted by HOLA. 863 F. Supp. 2d at 92. The presumption can be rebutted if the law is a type listed in § 560.2(c) (such as contract, commercial law, real property law, tort, and criminal law) and if the law only incidentally affects the lending operations of a federal savings association. *Id.*; 12 C.F.R. § 560.2(c).

For instance, in *Sovereign Bank v. Sturgis*, the court found that the plaintiffs' credit disclosure claims were preempted because they arose under a type of law described in 12 C.F.R. § 560.2(b). 863 F. Supp. 2d at 92. However, the court found that the plaintiffs' contract claims were not preempted. *Id.* at 94. Because the contract law at issue is being used to impose requirements on the national bank's collection of its loans, the court found that a presumption of preemption arose because the law affects lending. *Id.* However, the court found that the law at issue had only an incidental effect on lending, and, therefore, the law was not preempted. *Id.*

Other courts have reached similar conclusions in finding no preemption where the law at issue was not directed towards the regulation of lending. *See Poindexter v. Wachovia Mortg. Corp.*, 851 F. Supp. 2d 121 (D.D.C. Mar. 30, 2012) (Indiana deceptive acts and practices statute not preempted by HOLA because the statute affected lending only incidentally and was aimed generally towards regulating the ethical practices of all businesses in Indiana); *Cuomo v. First American Corp.*, 18 N.Y. 3d 173 (N.Y. Ct. App. 2011) (attorney general's action for violations of state laws governing real estate appraisals was not preempted by HOLA because the state law only incidentally affected lending).

Courts have also distinguished between the conflict preemption standard of the National Bank Act ("NBA") and the pre-Dodd-Frank field preemption standard of HOLA. In *Tamburri v. SunTrust Mortgage*, the defendant bank moved to dismiss the plaintiff's foreclosure claims on the basis of NBA preemption. 875 F. Supp. 2d 1009 (N.D. Cal. 2012). The court held that the NBA utilizes a conflict preemption analysis and doesn't preempt state laws that only incidentally affect the exercise of a national bank's powers. The court noted that, while HOLA includes a field preemption clause, the OCC was not granted similar field preemption authority with respect to the NBA. The court found that the foreclosure laws were not preempted under the NBA, and also noted that, under Dodd-Frank, HOLA would be subject to the conflict preemption analysis of the NBA.

2. Application of Dodd-Frank Preemption

Other courts have found that Dodd-Frank does apply retroactively under certain circumstances. In *Meluzio v. Capital One*, the district court reversed a bankruptcy court's holding that the West Virginia Consumer Credit and Protection Act ("WVCCPA") was preempted by the National Bank Act. 469 B.R. 250 (N.D. W. Va. 2012). The court applied the new preemption rules of the NBA as articulated by Dodd-Frank, finding that, because the new Dodd-Frank preemption rules merely clarified existing law, and did not increase the bank's liability or impose new duties upon it, the preemption rules could be applied

retroactively. *Id.* at 256. The court then found that the WVCCPA did not directly or indirectly discriminate against national banks, because it applies generally to debt collectors, regardless of whether they are national banks. *Id.* The court then held that the section at issue of the WVCCPA was intended to protect state residents from abusive debt collection practices, and was not aimed to regulate financial transactions or accounts. *Id.* Accordingly, the court found that the state law was not preempted by the NBA because it was not a "consumer financial law" as defined by the statute. *Id.*

Similarly, the court in *Moore v. Wells Fargo Bank* also determined that the Dodd-Frank Act applied retroactively because it was a clarification of existing law, rather than a substantive change thereto. 470 B.R. 390, 394-95 (Bankr. S.D. W. Va. 2012) Therefore, it could be applied to a cause of action brought prior to the Act's effective date. *Id.* at 395. Because there was no allegation that the law discriminated against national banks, the court found that the "dispositive question regarding preemption is whether West Virginia's unconscionability laws interfere with the exercise of Wells Fargo's powers under the *Barnett* standard." *Id.* The court then found that the claims of unconscionability arising from the bank's alleged falsification of income did not stand as an obstacle to the accomplishment of the full purposes of Congress because falsifying income on a loan application is not an incidental power that is necessary to carry on the business of banking. *Id.* at 396. Also, the law did not conflict with any federal law, because the court was not aware of a federal law that authorized banks to falsify information on a loan application. *Id.* Accordingly, the claims were not preempted. *Id.*

Even under the standard of *Barnett*, however, some claims will continue to be preempted. For instance, in *Parks v. MBNA America Bank*, the court applied the *Barnett* standard to hold that a California statute that required certain credit disclosures was preempted by the NBA. 54 Cal. 4th 376 (Cal. 2012). The court applied *Barnett*'s obstacle preemption analysis under which there is no preemption absent a significant impairment of a bank's exercise of its congressionally authorized powers. The court found that the state law was preempted because it imposed a condition on the power of national banks to loan money that exceeded federal obligations.

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