National Banks

Federal Preemption

The Future of Preemption Under the National Bank Act in the Wake of Dodd-Frank

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For years, national banks received the benefit of federal regulations granting them immunity from any “state laws that obstruct, impair, or condition a national bank’s ability to fully exercise its powers to conduct activities authorized under Federal law.”1 The passage of the Dodd-Frank Act has invalidated these regulations and cast the precise scope of the federal preemption of state banking laws into doubt.2

Preemption and the Dual Banking System

In 1864, Congress passed the National Bank Act (NBA) which established nationally chartered banks and gave them “all such incidental powers as shall be necessary to carry on the business of banking.”3 At the same time, Congress created the Office of the Comptroller of Currency (OCC) to oversee these new banks.4 The passage of the NBA and the creation of the OCC resulted in a “dual banking system,” in which federally-chartered banks operate in one system governed by one set of regulations at the national level and state-chartered banks operate in parallel systems subject to laws and regulations at the state level.

One feature of the dual banking system that has enabled it to function smoothly is that federal banking laws and regulations preempt state banking laws in many instances. Indeed, in the 150 years since the NBA was passed, the Supreme Court has “repeatedly made clear that federal control shields national banking from unduly burdensome and duplicative state regulation.”5 Proponents of preemption in this context have always argued that the national banking system is essential to the development of multi-state markets for products, thus promoting economic prosperity and growth.6 They contend that national banks would not be able to serve this goal if they were subjected to state-by-state regulation, especially given the extensive regulations established by the NBA and the OCC.7

The Barnett Bank Preemption Standard

Supreme Court case law generally recognizes three forms of preemption: express preemption, field preemption, and conflict preemption.8 Express preemption exists when there is “language in the federal statute that reveals an explicit congressional intent to pre-empt state law.”9 Field preemption exists when a federal statute creates “a scheme of federal regulation ‘so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.’”10 Conflict preemption exists when there is an “irreconcilable conflict” between federal and state law.11

In Barnett Bank of Marion County, N.A. v. Nelson, the Supreme Court determined that the third type of preemption just mentioned, conflict preemption, supplies the appropriate framework for evaluating the preemptive effect of federal laws...
and regulations on state banking laws and regulations. In Barnett Bank, Florida had passed legislation “prohibit[ing] certain banks from selling most kinds of insurance,” allowing only unaffiliated small town banks to sell insurance in small towns. After Barnett Bank bought an insurance agency licensed in Florida, the Florida State Insurance Commissioner attempted to prevent this agency from selling insurance in small towns, because Barnett Bank was not an unaffiliated small town bank. Barnett Bank filed suit, seeking declaratory and injunctive relief and claiming that the state statute was not applicable to it, as a national bank regulated by the NBA and the OCC. The District Court for the Middle District of Florida and the Eleventh Circuit Court of Appeals both rejected this argument and held that the Florida statute was not preempted.

The Supreme Court reversed, finding first that the NBA and the OCC’s subsequent interpretation of it “grant[ed] small town national banks authority to sell insurance, whether or not a State grants its own state banks or national banks similar state approval.” The Supreme Court then found that there was an “irreconcilable conflict” between this authority and the Florida statute, which explicitly forbid national banks, like Barnett Bank, from selling insurance in small towns. Thus, the Florida statute was preempted.

In reaching this decision, the Supreme Court utilized at least three different formulations to describe the type of “irreconcilable conflict” that triggers preemption. In one place, the Court noted that “the Federal Statute authorizes national banks to engage in activities [selling insurance in small towns] that the State Statute prohibits.” That formulation would suggest a fairly narrow scope for preemption under which state banking laws would be preempted only when the state law expressly prohibits a national bank from exercising a power granted to it under the NBA. However, elsewhere in the opinion the Court indicated that preemption of state banking laws was not limited to that narrow circumstance. Rather, the Court explained that its “cases take the view that normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted.” On this formulation, a state statute may be preempted not only when it prohibits a national bank from exercising one of its federally granted powers, but also when it “impairs” the exercise of that power “significantly.” Still elsewhere in its decision, the Court formulated the “irreconcilable conflict” standard in yet another way, stating that state banking laws and regulations are not preempted so long as they do not “prevent or significantly interfere with the national bank’s exercise of its powers.”

The OCC’s Preemption Regulations

In 2004, the OCC established its own regulations defining the scope of federal preemption of state banking laws and regulations. These regulations provided that “state laws that obstruct, impair, or condition a national bank’s ability to fully exercise its” federally authorized banking powers do “not apply to national banks.”

The preemptive effect of this provision was deemed to apply even to state tort and contract claims except “to the extent that they only incidentally affect the exercise of national bank powers.”

Arguably, the scope of preemption under the OCC’s regulations was broader than that articulated by the Court in Barnett Bank. To trigger preemption, in the OCC’s view, a state statute did not need to “forbid,” “prevent,” “impair significantly” or “significantly interfere” with “the exercise of a power that Congress explicitly granted.” Instead, under the OCC’s regulations, preemption would be triggered if a state law simply “obstruct[ed]” or “impair[ed],” or even merely “condition[ed],” a national bank’s ability to “fully exercise” its federally authorized powers.

Indeed, in the years following their adoption, many courts held these regulations to have a sweeping pre-emptive effect on state banking laws, consumer protection laws, and common-law causes of action.

Some commentators, including Americans for Financial Reform and its member organizations, have argued that broad preemption undermined consumer protection laws and played a significant role in the recent financial meltdown. They contend that states attempted to stop various practices which they claim contributed to the recession but these efforts were thwarted by the broad preemption established by the OCC’s regulations.

The drafters of the Dodd-Frank Act apparently held the same view point, because they included in the Act a provision specifically intended to invalidate the OCC’s preemption regulations.

The Dodd-Frank Act

In 2010, Congress passed comprehensive legislation, known as the Dodd-Frank Act, to address some of the perceived causes of the financial crisis. One of the stated goals of the Dodd-Frank Act is “to protect consumers from abusive financial services practices.”

Section 1044 of the Dodd-Frank Act states: “State consumer financial laws are preempted, only if . . . in 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 (1996), the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers . . . .” The exact meaning and effect of this provision has been hotly debated, both before and after the OCC adopted new regulations to implement it.

The OCC first proposed new regulations to implement the Dodd-Frank Act’s preemption provision in May 2011. In proposing those regulations, the OCC stated that its preemption formula—“obstruct, impair, or condition”—had “created ambiguities and misunderstandings” and would therefore be removed from the regulations. Nevertheless, the OCC concluded that its formula was “drawn from an amalgam of prior precedents relied upon” in Barnett Bank, and was therefore consistent with Barnett Bank itself. Because, in the OCC’s view, the Dodd-Frank Act merely “preserves the Barnett conflict preemption standard,” it does not
in fact invalidate the “obstruct, impair, or condition” formula, and thus “OCC's rules and existing precedents (including judicial decisions and interpretations) consistent with that analysis are also preserved.” The OCC further opined that while the Dodd-Frank Act had extracted from Barnett Bank a specific formulation of the conflict preemption standard—the “prevents or significantly interferes with” formulation discussed above—that is “not the only formulation” in Barnett Bank, and Barnett Bank did not “present it as a test different from” the other formulations in the opinion. Thus, the OCC chose not to incorporate the specific Barnett Bank formulation used in the Dodd-Frank Act's preemption provision into its new proposed regulations implementing that provision.

Treasury's Dispute with OCC

In response to these proposed changes to the OCC's regulations, the Treasury Department sent written comments to the OCC in which Treasury objected to the changes in two respects.

First, Treasury took issue with the OCC's decision not to incorporate the specific formulation of the Barnett Bank standard—“prevents or significantly interferes”—used in the Dodd-Frank Act. According to Treasury, the Dodd-Frank Act adopted “prevents or significantly interferes” as the standard for conflict preemption under the NBA, and the OCC's “avoidance of the specific standard is inconsistent with the plain language of the statute and its legislative history.”

Second, Treasury rejected the OCC's suggestion that its own prior “obstructs, impairs, or conditions” formulation, and precedents applying that standard, were consistent with Barnett Bank and the Dodd-Frank Act. Treasury stated that this suggestion “runs afoul of basic canons of statutory construction” and is inconsistent with the stated intent of the Dodd-Frank Act's drafters to revise the OCC's preemption standard.

Resolving the Dispute

It appears likely that Treasury's first objection is wrong but its second objection is correct.

With respect to its first objection, Treasury is probably focusing too narrowly on the “prevents or significantly interferes” language used in the Dodd-Frank Act, and not properly acknowledging the import of the Dodd-Frank Act's reference to the Barnett Bank decision itself. Indeed, courts applying the Dodd-Frank Act's preemption provision have concluded that it was included to make clear that conflict preemption is the applicable framework for evaluating the preemptive effect of federal banking laws and regulations, and Congress did not adopt the “prevents or significantly interferes” formulation to the exclusion of other formulations in Barnett Bank.

For example, in Baptista v. JPMorgan Chase Bank, the Eleventh Circuit held that the Dodd-Frank Act adopted the Barnett Bank preemption standard, and then formulated “the controlling question to be whether the state statute ‘forbid[s], or . . . impair[s] significantly, the exercise of a power that Congress explicitly granted.” Thus, the Baptista court did not utilize the “prevents or significantly interferes” preemption formulation that Treasury assumes was exclusively adopted by the Dodd-Frank Act.

With respect to its second objection, however, Treasury appears to be on firmer ground. On its face, the OCC's “obstructs, impairs, or conditions” standard simply is not equivalent to any of the formulations found in Barnett Bank, including the specific “prevents or significantly interferes” formulation used in the Dodd-Frank Act. Thus, it is not plausible to maintain, as the OCC did in its May 2011 proposal, that the “obstructs, impairs, or conditions” standard survives the Dodd-Frank Act. Likewise, preemption precedent based on that prior standard is called into doubt.

Indeed, even the OCC appears to have come to this conclusion. In its comments accompanying its adoption of its final rules implementing the Dodd-Frank Act in July 2011, the OCC stated that it “has reconsidered its position concerning precedent that relied on [the 'obstructs, impairs, or conditions'] standard.” The OCC stated that “[t]o the extent that an existing preemption precedent is exclusively reliant on the phrase ‘obstructs, impairs, or conditions’ as the basis for the preemption decision, we believe that validity of the precedent would need to be reexamined[.]” However, the OCC stated that it “has not identified any OCC-issued preemption precedent that rested only on the ‘obstruct, impair, or condition’ formulation.”

Conclusion

The OCC's concession that the “obstruct, impair, or condition” language in its prior regulations was not consistent with the conflict preemption standard established in Barnett Bank and the Dodd-Frank Act casts doubt on all of the preemption precedent applying that standard. While the OCC says that it has not identified “any OCC-issued preemption precedent” relying “only” on its prior standard, that statement does nothing to assure that the numerous court decisions holding state statutes and even state common law causes of action preempted under that standard are still viable. Thus, the argument will surely be made by states and private litigants seeking to overturn such precedent that these decisions were crucially based on this now-rejected standard. Whether this ultimately leads to courts overturning a significant number of preemption decisions based on the OCC's prior standard remains to be seen.

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