Consumer Finance Monitor (Season 7, Episode 18): The U.S. Supreme Court's Pending Ruling on National Bank Preemption: A Discussion of Cantero v. Bank of America, N.A.

Speakers: Alan Kaplinsky, Jonathan Ellis, William Jay, Matthew Schwartz, and Arthur Wilmarth

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'll be moderating today's program.

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Also, please let us know if you have other ideas for other topics that we should consider covering or speakers that we should consider as guests for our show. And I'm very pleased to tell our listeners that our podcast show was ranked not so long ago by Good2bSocial as the very best law firm podcast show in the US, devoted exclusively to consumer financial services. Good2bSocial is a prominent law firm consulting firm that is owned by a company called Best Lawyers that I'm sure many of you are familiar with. We're very gratified by this recognition from one of the country's leading social media consultants for law firms. So today, our podcast show is a webinar round table and it's a repurposing of a webinar round table that we conducted on April 3rd of this year entitled Who Will Win Cantero v. Bank of America and What Does It Mean For You?

So on February 27th of this year, the Supreme Court heard oral argument in this case and it involves the effect of the Dodd-Frank Act on the scope of preemption under the National Banking Act, which a lot of us will refer to from now on as the NBA. The specific question before the Court is whether after the enactment of Dodd-Frank in 2010, whether the NBA preempts a New York statute requiring banks to pay interest on mortgage escrow accounts. The decision, however, could have ramifications and actually, I think, will have ramifications to go well beyond the issue, the specific issue that the Court will be dealing with in this case.

Just a tiny bit of history to give you the appropriate perspective on how important this case is. To date, national banks have as a practical matter, largely relied on regulations promulgated by the OCC after the enactment of Dodd-Frank, as well as prior US Supreme Court opinions concerning the NBA. And they've done that from the perspective of deciding what state laws they have to adhere to, either in the state where they're located or in various states in which they are extending credit or accepting deposits from. A ruling by the Supreme Court in Cantero that the NBA does not preempt the New York law could implicitly call into question the validity of the OCC's regulations in their entirety.

When the OCC adopted their regulations shortly after the enactment of Dodd-Frank, it was quite controversial. The Treasury department wrote a letter to the then comptroller of the currency saying he disagreed with these regulations, that he didn't believe that they properly reflected what Congress was trying to accomplish when it included in the Dodd-Frank Act a section dealing with National Bank Act preemption. And even after they were officially promulgated, a lot of people such as one of our guests today, Professor Wilmarth, had questioned the validity of those OCC regulations.

And basically just to put it very succinctly, the OCC didn't really make any changes as a result of the enactment of Dodd-Frank. The regulations that existed prior to the enactment were largely the same as the regulations issued after the enactment

of Dodd-Frank. And what they did was what I'll call a categorical preemption. In other words, in their regulation there is a laundry list of types of state laws that are deemed to be preempted by the OCC. Frankly, it's surprising to me that it took almost a decade before people started challenging what the OCC had done here, but it did. It took a while. And finally the challenges that have occurred have occurred within this whether or not interest has to be paid on mortgage escrow accounts.

Now, I am absolutely thrilled to have join me today four absolutely outstanding presenters. All of these speakers that will be on the program today have submitted amicus briefs in connection with the Cantero case. So they are very steeped in this subject of NBA preemption. Let me introduce to you each of our presenters.

So first of all, Jonathan Ellis. Jonathan's a partner at McGuireWoods. He's co-chair of the firm's Appeals and Issues team. Before joining McGuireWoods, Jonathan served as an assistant to the Solicitor General in the office of the Solicitor General in the Department of Justice. And following law school, Jonathan served as a law clerk to Justice Roberts, of course, Chief Justice Roberts. He's argued nine cases before the US Supreme Court, filed more than 150 briefs before that Court either at the certiorari stage or at the merit stage. It's particularly relevant here.

Jonathan is counsel of record for Flagstar Bank in connection with Flagstar's cert petition that's currently... Well, Flagstar's cert petition is not currently pending before the Supreme Court, but they did file an earlier cert petition at a time when there was no conflict in the circuits, and Jonathan was involved in that cert position. And that case presents the same identical issue as the issue in Cantero, except there you're dealing with the California state law rather than in New York state law. In the Cantero case, he's filed an amicus brief on behalf of Flagstar.

William Jay or Willie Jay is a partner in Goodwin Procter's Appellate and Supreme Court practice, which he previously chaired for 10 years. He's argued 17 cases before the Supreme Court, delivered more than 80 appellate oral arguments in state and federal courts throughout the country. He was co-counsel to Flagstar Bank, its petition for certiorari on the same issue, and has filed a grief in Cantero representing the former Comptrollers of the Currency and other former senior OCC officials. Now that's really important, very important here because there is a difference of opinion between two federal agencies. The Comptroller of the Currency filed a brief in the Second Circuit Court of Appeals supporting Bank of America.

At the Supreme Court level, Solicitor General of Department of Justice took over for the Comptroller of the Currency. The Comptroller of the Currency could not represent the United States before the Supreme Court, unless the Department of Justice agreed to that. And I don't know if a request was made or not.But suffice it to say that the brief filed by the DOJ and the Solicitor General in the US Supreme Court is markedly different than what the Comptroller of the Currency filed in the Second Circuit Court of Appeals.

Now, Matthew Schwartz, he's a partner in Sullivan & Cromwell's litigation group. His practice includes the involvement in complex litigation, appeals, government investigations. He's represented some of the world's largest corporations, financial institutions. He was council of record on the amicus brief submitted in Cantero by all the leading bank trade associations. Matthew clerked for Justice Samuel Alito during the Supreme Court's 2006 term.

And finally, the last but not least is Arthur Wilmarth. Arthur was a member of the faculty of George Washington University Law School from 1986 to 2020. I've known Arthur mostly because of his representation of the Conference of State Bank Supervisors. And not surprisingly, even though Professor Wilmarth is no longer teaching at GW, the Conference reached out to him to get involved in the amicus brief, which they filed. And the amicus brief, not surprisingly, supports the plaintiff in the case, not the industry. And you're going to be hearing a lot more from Arthur very soon.

So here's our agenda. I'm going to begin just giving you a very brief history, procedural history of this Cantero case. Then we are going to go to different presenters, one after the other, and we will end with what I'll call the roundtable portion of our discussion where we get the views of each of our presenters on what happened at the oral argument and who do they think might prevail. We're not going to be commenting at all on the individuals who argued the case. All of them did a terrific job with oral argument. We're going to be focusing a lot more on what the justices had to say.

So let me begin with this procedural history. So this began as a punitive class action filed in a federal district court in New York, where Bank of America was sued by the named plaintiffs for breach of contract, unjust enrichment and other related claims. There are actually two punitive class actions in the Eastern District of New York. The breach of contract claim is the only claim that cause of action is on appeal, and it turns whether Bank of America was required to pay a minimum 2% interest rate to the plaintiffs on their mortgage escrow accounts as is required by a provision of New York law, or it's actually by

statute. B of A moved to dismiss in the district court on the ground that the statute was preempted. The district court, relying on RESPA and relying on certain Truth in Lending Act amendments were made to Section 1639 D, concluded that there was no preemption.

The court also rejected any arguments that were made at that time by B of A relative to the preemptive effect of the regulations under the Dodd-Frank Act. The argument with respect to the regulations and reliance on the regulations basically became a non-issue, I would say during the case, in that nobody after the initial argument based on the regulations which the court didn't rely upon but implicitly rejected, I would say, based on its decision. That was the only thing that the court... The court actually had nothing to say about the regulations. And finally, the court, in considering the National Bank Act itself, it read the Supreme Court opinion in Barnett Bank along with prior Supreme Court case law, including the Franklin National Bank case to require a finding of no preemption. It concluded that the degree of interference with the mortgage escrow law was very minimal and it was not a practical abrogation of the banking power at issue.

And the court went on to say that the amendment to TILA shows a policy judgment that there is little incompatibility between requiring mortgage lenders to maintain escrow accounts, and requiring them to pay a reasonable rate of interest on the escrow accounts. District court also very closely tracked the reasoning of the Ninth Circuit Court of Appeals in the similar case that I referred to earlier, involving a California interest on escrow account, a Lusnak versus Bank of America.

After the district court denied Bank of America's motion to dismiss, B of A moved to certify the preemption issue for interlocutory appeal. The district court agreed there's a substantial ground for difference of opinion and it granted BOA's motion. The Second Circuit granted leave to appeal. Second Circuit reversed the district court, agreed with BOA that the National Bank Act preempts the New York statute. And in that second bullet point, I emphasized what I think is the key reasoning of the Second Circuit by requiring a bank to pay its customers in order to exercise a banking power granted by the federal government, the power being to create and fund escrow accounts. The law would exert control over banks' exercise of that power, that is by requiring them to pay interest.

Now I'm going to go back to the agenda, and I'm going to let that stay on your... That will be the slide that you'll be looking at because that's where we're going to go from here. And so first, we're going to go to a brief discussion of the Flagstar Bank case and the amicus curiae brief that was filed in the Cantero case on behalf of Flagstar Bank.

And so for that, if I could turn it over to Jonathan. Jonathan, why don't you take it from there?

Jonathan Ellis:

Happy to, Alan. Thanks very much for having me today and thanks everyone who's joined this webinar for being here. So Flagstar v Kivett is a case that I thought it might be helpful for the audience to have a little background on as we discuss the Cantero argument and the Justice's reaction to it. The Flagstar case is, its interpretation is still pending before the Supreme Court. The Lusnak, which I'll talk about in a moment, was filed previously and was just denied. But the Flagstar petition is still pending. That is a case coming out of the Ninth Circuit, and as Alan noted, is like Cantero is a class action for failing to pay interest on mortgage escrow accounts in conformance with state law. In that case, the California's IOE statute, which similar to the New York statute, requires a minimum of 2% interest be paid on mortgage escrow accounts for certain residential loans made in California.

So I think that the background is important though. Before the Kivett case was filed against Flagstar, the Ninth Circuit had decided this case Lusnak v Bank of America, which concerned the same question. In Lusnak, the Ninth Circuit held that the California IOE law was not preempted under the National Bank Act and under Dodd-Frank. Now, the Ninth Circuit's decision in Lusnak relied in large part on a provision of TILA that Alan mentioned. The Section 1639 D, a provision that played a big role in the cases in the lower courts in Cantero and Flagstar, but has played a diminished role before the Supreme Court. That provision 1639 D requires, arguably at least, banks to pay interest on escrow accounts, certain escrow accounts that are required by TILA for higher priced mortgages in conformance with any applicable state or federal law.

The loans in Lusnak, Flagstar, and Cantero are not subject to the TILA provision. They're not mandatory escrow accounts. But the court, the Ninth Circuit, in Lusnak, reasoned that Congress's requirement for national banks to pay interest on escrow accounts for certain accounts indicated that as a general matter, those sorts of laws did not significantly interfere with the national bank's exercise of its federal powers. And therefore, they concluded that requiring national banks to follow and

comply with state IOE laws would not cause that even if the TILA provision did not apply. So in Flagstar, with that precedent as the backdrop in our case, the strategy was to try to distinguish Lusnak. Lusnak was decided on a motion to dismiss. And so Flagstar built a factual record of the [inaudible 00:20:42] interference that the California IOE law would cause on their operations. But the district court refused to consider that evidence, decided that Lusnak was a categorical decision that the California IOE law was not preempted, and the Ninth Circuit affirmed with similar reasoning.

The Ninth Circuit's decision in Flagstar was issued in May of 2022, about four months before the Second Circuit decided issued Cantero in which the Second Circuit expressly disagreed with the Lusnak decision. So we had both cases being decided in relatively short order. The bank, Flagstar, filed a cert petition coming out of the decision from the Ninth Circuit in which Flag's counsel of record and Willie is co-counsel and about the same time as the plaintiffs in Cantero filed their cert petition to review the Second Circuit's decision. The court initially called for the views of the Solicitor General of the United States in which it filed a brief disavowing the OCC's long-held position on the question presented, urging the court to deny cert. The court ultimately granted cert course in Cantero and is holding the Flagstar petition while it decides the Cantero case. And that's where we are on that case.

Now Flagstar, as Alan mentioned, filed an amicus brief in Cantero case that obviously it's going to affect, likely affect how the Flagstar case is decided. And our amicus brief did a couple of things. First, it just made clear to the court about sort of how these mortgage escrow accounts work, the benefits they provide to consumers and to banks, the harm that would be brought about to consumers if national banks were required to pay and comply with interest on escrow laws, both as I say to the banks and the consumers. And then importantly responding to the suggestion by the plaintiffs in Flagstar as amicus in Cantero. That the Flagstar case was really an example of how the plaintiff's sort of practical effects test, which we'll get into, and the factual basis test could be applied. Just pointing out that, as I said, the district court and the Ninth Circuit didn't engage in any sort of analysis of the record in Flagstar, but instead decided on a categorical basis.

Alan Kaplinsky:

Okay. Well, thank you, Jonathan. Let's go now to Willie Jay, who submitted the amicus brief on behalf of the former comptrollers of the currency and other senior OCC officials.

William Jay:

Right. Well, thank you, Alan. It's good to be with all of you. When the brief that Jonathan referred to, the first brief in which the Solicitor General recommended that the court not hear the issue and that the Second Circuit, taking the position that the Second Circuit had gotten it wrong and that the OCC indeed had gotten it wrong in its amicus brief filed in the Second Circuit, that drew a lot of attention because the government was taking a position very different from the one taken by OCC, not just in amicus briefs in Lusnak and in Cantero, but in its overall approach to this issue since not just before Dodd-Frank, but in the wake of Dodd-Frank and its interpretation of Dodd-Frank in the rulemaking that followed immediately afterward. And partly for that reason, the sort of abrupt change of position on the part of the government and the lack of any indication on the government's brief that the OCC itself had changed its mind.

So in a departure from long-standing practice, no one from the OCC signed the Solicitor General's brief either at the cert stage or at the merit stage. So that was the impetus for a number of alumni of the office of the Comptroller of the Currency to file an advocacy brief, really underscoring a couple of points that the approach to preemption has not been a partisan issue on which administrations of one party sort of tack one way and administrations of the other party tack the other way, or where one administration writes, the next tears up and rewrites. There's been a lot of continuity really since the 1990s. And the approach to Dodd-Frank was not one that was put into place by some crazed pro-business administration, but by the OCC under President Obama. So we were privileged to have a distinguished and broad-based group of amici file this brief. So I'll tell you a little bit about who they were and then a little bit about what they said.

Basically every living former comptroller of the currency, but one since 1985 signed the brief. There's one former comptroller who's retired and joined. We also had a number of former acting comptrollers, chief councils, and deputy chief councils. Basically the people who approved, wrote, and signed the relevant rulemakings, briefs and rule preambles for 30 plus years. And this includes, for example, Julie Williams, who was chief counsel of the OCC from 1994 until I think 2005 or beyond that. So the group of signatories to this brief wanted to make two points. One is that this has not been an issue on which the

OCC has been inconsistent. To the contrary, OCC has approached real estate lending in particular and preemption more generally with a very consistent eye ever since before Dodd-Frank. And in particular, the substantive point the brief made was that the government's brief took the statute as if it was sort of a brand new form of words and parsed, for example, the word significant very heavily. We're going to come back to that as we get into the various briefing and the oral argument shortly.

But the Dodd-Frank Act, as I think Alan said, adopted a standard set out by the Supreme Court in Barnett Bank. And the OCC, likewise, has taken Barnett bank as the touchstone of its own preemption position for many, many years. And so that's the substantive point of this brief, that the amici urged the court to see the case as not an opportunity to make a clean break, but as a case where the court should be recognizing that Congress wanted continuity rather than change. In the legislative history, two of the key sponsors of the relevant language, it basically said we want Barnett Bank referred to specifically in this legislation. And so our amicus brief provides some of the context around that why the Barnett Bank standard rather than some new standard of significant interference wound up being codified by Congress and why OCC took that as a signal that while it should prune back some of the language in its regulations from before Dodd-Frank, its overall approach wasn't thrown out by Congress. It was ratified.

Alan Kaplinsky:

Okay. Well, thank you, Willie. Now, I suspect that we're going to hear a contrary view because we're going to go to Art Wilmarth, who I said earlier filed an amicus brief on behalf of the Conference of State Bank Supervisors. And so Art, take it away.

Arthur Wilmarth:

Thanks for allowing me to be part of this discussion, and welcome to those who are listening. So as Alan said, yes, the Con of State Bank Supervisors did file an amicus brief and we advanced three major points. First was to say that the Second Circuit's decision, which largely echoed the OCC's positions that it took when it adopted, it's what I would call blanket preemption rules in 2004 and largely reaffirmed them in 2011, that the Second Circuit's position would essentially sweep aside huge categories of state law affecting many, many areas of consumer protection. So the OCC's real estate regulation, as adopted and reaffirmed, essentially preempts 14 categories of state law. And if you add the similar preemptions in its general lending and other activities regulations, it's up to over 30 categories of state laws. So as Alan said, this case goes well beyond simply deciding whether the states can require the payment of some minimum rate of interest on mortgage escrow laws.

If the Second Circuit decision were upheld, at least in accordance with its terms, one would have to say that the effect on preempting state law would be enormous. We pointed out in our brief that at the current time, state licensed non-bank mortgage lenders control close to half and perhaps more than half of the mortgage servicing market, which obviously includes things like mortgage escrows, and that it would be very likely that many of those state lenders would either be sold to national banks or would leave the field if this broad-scale preemption took place. And in fact, that's what happened during the early 2000s and the years leading up to the global financial crisis that the OCC's sweeping preemption rules in 2004 convinced three very large national, I'm sorry, three very large state chartered banks with over a trillion dollars of assets to convert to national charters. And many state licensed lenders at the time essentially sold themselves to national charters. So the impact on the landscape of the mortgage lending market was immense.

The second point we made was that the OCC's 2011 rules, which essentially came shortly after the enactment of Dodd-Frank, violated both the procedural and substantive requirements of Dodd-Frank. As we'll discuss I think a bit more, the Dodd-Frank Act said that if the OCC wants to issue preemption determinations, it must act on a case-by-case basis, which takes account of the impact of state law on national banks. It may not conclude that the laws of more than one state that are similar are preempted, unless it consults with the consumer Consumer Financial Protection Bureau. Its decisions must be supported by substantial evidence made on the record of the proceeding. And also important that Dodd-Frank Act made clear that OCC preemption determinations would no longer receive Chevron deference, but would only receive the lower degree of deference under the so-called Skidmore v. Swift & Company doctrine.

So Congress did a number of things to indicate its extreme displeasure with what the OCC had done in 2004. It said, we don't want you to act on a categorical basis any longer. You have to act on a case-by-case basis, and you have to act with substantial evidence supporting you. The OCC's 2004 rules were largely devoid of any supporting evidence. Now, notwithstanding those

provisions of the Dodd-Frank Act, the OCC as has been indicated, largely reaffirmed the same regulations of 2011 with some small word changes, but basically preempted the same 30 plus categories of state law, didn't act on a case-by-case basis, did not act, I'm sorry, did not base their decisions on substantial evidence made on the record of the proceeding, and did not consult with the CFPB. And when the OCC was challenged on this by many people, myself included, when the proposed rules came out, their response was, we don't need to do this because we're simply reaffirming what we did before the Dodd-Frank Act was passed.

And our response was, you can't do that. Section 55, 53 of the Dodd-Frank Act provides that OCC regulations that were in place prior to the Dodd-Frank Act will continue to be effective for transactions that were completed before July 21, 2010. Congress obviously would not have included that grandfather savings provision, unless it expected fully that the OCC would adopt any regulations after 2010 in full compliance with the Dodd-Frank Act, which the OCC did not do. The OCC then added insult to injury by saying, we recognize that Barnett Bank provides the governing preemption standard, but we do not recognize the language "prevents or significantly interferes", which appears not only once but effectively twice in Barnett Bank. Barnett Bank said normally Congress would not want the states to forbid or impair significantly a power that Congress expressly granted. And then the very next sentence says, but this does not limit the ability of the states to regulate the activities of national banks where doing so does not prevent or significantly interfere with the exercise of their power.

So Congress used the same formulation twice, forbid or significantly impair, prevent or significantly interfere. And the OCC essentially said, we don't recognize that standard. We don't apply it. It's not a standalone standard. We take a broad view of Barnett. And their broad view of Barnett is basically to say that essentially everything that affects the power of a national bank is preempted. So that's what was the second part of our brief. The third part was to say that, in fact, the second Circuit's decision in Cantero is squarely contrary to Barnett Bank and other precedents including Atherton versus FDIC, Anderson National Bank versus Luckett, the most recent preemption case, Cuomo versus Clearinghouse and others.

And essentially, the Second Circuit tried to go back to McCullough versus Maryland and say that McCullough was the touchstone of its decision. And in our brief we said, you can't understand McCullough that way. That the next decision involving the Second Bank of the United States, Osborn versus Bank of the United States, Chief Justice Marshall explained what he had done in McCullough and he basically said, we accept that if the Second Bank of the United States were carrying on a private banking business, and that was what it was doing, and it wouldn't matter whether it had a federal charter, it would be subject to state regulation and state taxation. But the Second Bank of the United States is not carrying on simply a private banking business, it's carrying on a public business as the fiscal agent and monetary agent for the federal government. And its private banking business is essential to those public activities. And it's on that basis, on that basis that this is a public institution carrying on direct activities for the federal government that we uphold the preemption.

So at that point we argue that the Second Circuit's decision was wrong in simply saying McCullough means essentially cross the board preemption for almost anything touching a national bank. As we'll discuss when you get to the argument, the Supreme Court I think primarily focused on this precise language that Dodd-Frank expressly quoted from Barnett Bank, which is that a consumer financial law is preempted only if it prevents or significantly interferes with the exercise of a national bank's powers. So the court, I think, is really grappling with that language and I don't think the court doesn't appear to be persuaded by the OCC's view that prevents or significantly interferes is really not important language. I mean, that took up most of the argument. What does it mean to say that something prevents or significantly interferes with the exercise of the national bank's power?

Alan Kaplinsky:

Okay. Art, thank you very much. And now we're going to go to Matthew Schwartz, who submitted an amicus brief on behalf of a consortium of bank trade associations. Matthew.

Matthew Schwartz:

All right, Alan, thank you very much. So we submitted an amicus brief on behalf of the Bank Policy Institute, the American Bankers Association, the Consumer Bankers Association, the Mortgage Bankers Association, and the Mid-Size Bank Coalition of America. So basically all the major trades that represent national banks. And we thought there were some very important points to make both legal and practical for the court to consider. And the first one, and this actually did come up at oral

argument, was the question about whether Dodd-Frank adopted the entire preemption standard as set at Barnett and the hundreds of years of history on national bank preemption that the Supreme Court has written about, or if it just took an out of context phrase "prevents or significantly interferes" and use that as the standard. We thought it was very important that the Supreme Court recognized that Congress made clear in Dodd-Frank, at least when they were talking about the OCC, that they were adopting the entire Barnett Bank standard.

And the fact that they didn't specifically reference the entire Barnett Bank standard when they're talking about what the court should do didn't mean that they wanted to create some sort of free-floating and undefined term "prevents or significantly interferes". And for that we cited not just the text as I described, but also the drafting history, which obviously a lot of the national bank trade associations had been involved with along with a letter from the senators who were the primary authors of those provisions to the OCC and the Treasury explaining that they were adopting the entirety of the Barnett Bank standard and not just that particular foreword phrase. And once you get past that and you recognize that adopting what the Supreme Court has been saying for over a century about national bank preemption, we thought a lot of things started to fall in place. So for example, the Supreme Court has repeatedly recognized that national banks are instrumentalities of the federal government.

And though there was some argument in a lot of the briefing about how much of a national government role do national banks play, that language has never been changed by the Supreme Court, never been challenged by Congress. And in general, states do not have the authority to regulate the national government or its instrumentalities. And we didn't make the world's biggest deal of it, but we thought it was an important starting point, especially for some of the justices who previously have cited that in national bank cases like Justice Thomas. And Barnett was very clear when it said that enumerated and incidental powers of the National Bank Act ordinarily preempt state law. So if you read Barnett Bank and you read the entire context of it, there's a baseline assumption that if there is either an enumerated or an incidental National Bank Act power, that that would ordinarily preempt state law.

And of course, you look to the OCC guidelines before that, though I think the professor just did a very good job explaining why relying too heavily on the OCC guidelines in this case might be a little bit difficult. And then if you look a little bit at the history which we next went into about the cases that Barnett cited, we thought again, it's a very low level of state interference that gets automatically preempted by the National Bank Act. And state laws that are directed at the national bank powers we believe are inherently prevented, because a national bank has either the enumerated or the implicit authority to set rates on its product. And when you come in and you say what the rate a national bank can set on its product is, you are preventing the national bank from using its full discretion to exercise that power.

So that's not even an issue of significant interference. That's an issue of actually preventing the bank from setting where exactly it thinks its rates should be and extends beyond rates to other inherent products as well. And then our view when you look through all the case law is that significant interference refers to laws of general applicability that a state might have that could impact a national bank in such a way that it would interfere with its ability to do business. So for example, if a state said in order to enter into any kind of financial contract you must be at least 50 years old, that's not a direct attack on the powers of a national bank. It applies to all companies throughout the state. But it's a situation where that general rule would be a significant interference to the ability of a national bank to carry out its powers.

And we thought that of all the cases that Barnett cited, that the Franklin case was the most important because basically what the Franklin case did was, it said that a state law that said you can't use the word "savings" in a particular advertisement was preempted. That's very low. There were a lot of other words that could be used that wouldn't have stopped the ability of the bank to actually advertise its product or to offer that product. The Supreme Court didn't ask for any consumer surveys, didn't ask for any evidence as to whether or not this would actually harm the ability of the bank to undertake its advertising and its savings account powers. It just said this is preempted, straight up. And when you looked through the history of many of the cases that were cited in Barnett Bank, that's the way the Supreme Court did.

In fact, we couldn't find a single situation in which the Supreme Court ever looked at underlying technical factual issues in order to figure out whether or not something was a state law was a significant interference. And so we thought based on that, that under Barnett, the New York law was clearly preempted because it sought to regulate the price of a national bank's product. And again, we thought that the enumerated or incidental power that was at issue here is the power of a national bank to set the price of its product wherever that national bank feels is appropriate to do so.

And then finally, and I think this may have been sort of the most unique part of our brief because it really kind of comes from the perspective of how this is going to work, and this is something that all of these trade associations have been talking about for several years in a lot of other National Bank Act preemption cases is that the plaintiff's standard and the standard that the Solicitor General offered for how courts are supposed to go about deciding whether or not a state law is preempted, is utterly unworkable and completely contrary to history.

So what the plaintiff said is that the state law needs to make it practically infeasible for the national bank to exercise its power. And I think I just discussed that is a almost 180 degrees away from what Barnett Bank said, which is that National Bank Act powers whether enumerated or incidental, normally preempt state law. So that's just 180 degrees. And then the question, and this was a big issue at oral argument, is how in the world are district court and court of appeals and Supreme Court justices supposed to figure out on these kind of technical bases whether or not a state law is a significant interference? And we thought that this New York state law was a particularly good example. So it required 2% interest on mortgage escrow accounts. And the district court here, just as the court in Lusnak did, just basically said, hey, 2%, that's not that much. Maybe if it were 10% or 20% or 50% or something like that, that would be a significant interference.

And with respect to all these federal judges, they're relatively illiterate when it comes to these types of things and they didn't take in any expert testimony, nor do I think that they would really be able to, even with expert testimony, figure that out. So for example, 2% doesn't seem like a lot, but at the time the federal funds rates were significantly below that. All right. So if the bank has to pay out 2% on these, but it can only borrow at 1 or whatever it is, that's actually a significant loss for the banks on the interest that it's paying out on these mortgage escrow accounts. And there can be many, many different state laws that go after national bank powers that are even much more technical and much more difficult. That's the first thing.

Then second of all, you can have a patchwork of 50 different state regulations, which is one of the purposes of the National Bank Act is to not have that, is to allow certain banks to be able to practice with uniform policies across state lines. And then finally, and this was something that was very, very concerning, is under the plaintiff and the SG's view, you could have state laws preempted as to certain banks in certain situations in certain years, but not as to other banks in other situations in other years. So 2%, for example, the court said, well, 2% isn't enough to preempt this law. Well, what if the Fed funds rate were negative in 2026? Would that change their analysis? And then the Fed funds rate went back up in 2027. Is this going to be a year-to-year thing? If Bank of America's at different position than JP Morgan or Citibank or another large national bank, is that going to be different rules for different banks? Is it going to be different if the business climate in New York is different than the business climate in California, yet they both have a 2% rate?

None of this was answered by the plaintiff standard, and so we wanted to point out to the court that this was unworkable, that adopting the plaintiff or the Solicitor General standard would upend settled expectations, would upend what the industry has been doing and would just generate a tremendous number of lawsuits, that whether or not state laws are preempted that are going to be lasting for the next 15 years.

Alan Kaplinsky:

Okay. Thank you very much, Matthew. I'm going to exercise the chair's prerogative right now because I want to make sure we have ample time to focus on the oral argument and the comments of the justices and what the four of you were able to glean from that. So I'm going to go right to that final bullet point on the agenda and I'm going to first call on Jonathan, and we will go around the horn and see what people think and hopefully answer the question of who's going to win, how is the court going to rule?

Jonathan Ellis:

Happy to start us off here. Unfortunately, I don't think I'm going to be able to tell you who's going to win. I'm curious if the other members of the roundtable have a firm view. I think that the argument was one where you came out really, really hard to tell, hard to predict what the outcome might be. Certain justices certainly expressed a view of skepticism of one side or the other, but I think not enough for anyone to confidently count to five from this argument. I thought particular Justice Alito and Justice Kavanaugh seemed very skeptical of the petitioner's view of preemption here, in particular, the sort of fact-based practical effects test that they were proposing, expressing a lot of the concerns that Matt was just talking about. About how

does the district court build this record? What is the consequence of having a record-based approach? Is it going to change over time?

Is it going to change from state to state? What happens if one case builds one record and that the court doesn't think it's substantial enough to show a significant interference, but another set of another case builds a different record about even the same law? How does that work out in practice and where else do we, of course, look at this very fact-based fact-intensive analysis to decide preemption justice? Justice Kavanaugh, in particular, focused heavily on the Franklin decision that Matt has also mentioned. He called it the North Star here in his analysis of the case and indicated that in his view anyways, that the IOE laws here that affected exactly the pricing of a national bank's product seemed to be a more direct interference with the exercise of the national bank's powers than the regulation of advertisements for savings accounts that was at issue and found to be preempted in Franklin without any sort of indication that the court was looking to a factual record of interference.

Justice Kagan similarly expressed some skepticism of the sort of fact-based analysis, although she was a little bit harder to read as to where that left her and where she was going to come down. She also seemed to be somewhat skeptical of the control test adopted by the Second Circuit and really was struggling to find out, figure out where the line might be, I think, as I heard her questions. On the flip side of that, Justice Jackson and Justice Sotomayor and Justice Gorsuch all seemed to be attracted to the petitioners' position here, the plaintiffs' position, were skeptical of the banks. Justice Sotomayor asked a question that you love to get, if you're a petitioner, would you like us to vacate or reverse, which is usually a good sign.

Justice Jackson repeatedly came back to the petitioners' counsel and was giving her opportunities to address what she'd say were her colleagues' concerns about the case-by-case analysis, and expressing a view that this wasn't so unusual for preemption contrary to some of the other questions that were asked, and that even if it were expressing the view that this was in her view, the statute required and so the court would have to follow it. Then that kind of leaves the three justices in the middle there, or at least up for grabs. Justice Barrett, Justice Thomas and the Chief Justice, in my view anyways, none of them expressed their questions suggested a firm view on one side or the other. I think the chief asked one question throughout the entire argument by... I looked if I'm... I studied the transcript again today correctly, and it really didn't indicate one way or the other how he was approaching the case.

Justice Thomas and Justice Barrett both asked some questions sort of exploring a difference, a potential difference between expressed powers and incidental powers, but again, didn't give a lot of indication as to where they were coming down. I will say, Justice Barrett at one point suggested she didn't read Barnett Bank to impose a fact-specific standard, but I think it'd be hard to read into much for questions about where she's going to come out. So at the end of the day, I think this case could go either way in my view, and I think it's going to be difficult to predict that in the front end.

Alan Kaplinsky:

Before I get to our colleagues to get their views, assuming that there is a reversal, do you think, Jonathan, that there'll be a remand back to the Second Circuit? In other words that the court will develop some kind of a new standard that the Second Circuit obviously didn't apply and that there'll be a need to send it back?

Jonathan Ellis:

Yeah, I think if it's not going to be an affirmance, I think a vacatur and remand is likely here. I do think that if you were to take the petitioner's position, the plaintiff's position here and adopt fact-based analysis, perhaps that could lead you to a reversal entirely not to end the case, but to send it back because this was a motion to dismiss. And there's no fact-based, there's no record to really evaluate here, but I think the more likely result as a victory with an articulation of what the correct rule is in the court's view and a remand at the Second Circuit to tackle that in the first instance, if it's not an affirmance.

Alan Kaplinsky:

Okay. Art, what's your reading of the oral argument?

Arthur Wilmarth:

So I agree with I think a lot of Jonathan's impressions of the questions of the justices of where that might be leading them. I think in the petitioner counsel's argument, he tried to point out that to read prevent or significantly interfere as applying only to laws of general applicability would essentially destroy the statute that Congress wrote because the statute doesn't apply directly to general laws, it applies to state consumer financial laws. And state consumer financial laws are specifically defined as laws that govern the terms and conditions manner and method of conducting a financial transaction with a consumer. And these are financial transactions that national banks are authorized to engage in under their powers, including deposits and loans and mortgage escrows. And the statute says state consumer laws are preempted only if, right? They either discriminate against national banks in favor of state banks or they prevent or significantly interfere.

So the petitioners' counsel, I think, made the point that to apply this control test is to essentially destroy what Congress did, and that both the Senate committee report and the House conference report both said, we intend this prevent or significantly interfere standard to be the codified standard. And the house committee report, sorry, the Senate committee report specifically said it's undoing what the OCC did in 2004. Now I agree that there was a lot of discussion, but how do you apply this prevent or significantly interfere standard and what kind of factual record is required? The petitioner counsel repeatedly cited the fact that the OCC has to act on substantial evidence, which is a well-established Administrative Procedure Act standard, and although it doesn't directly apply to courts, it would suggest that the courts might do something very similar. So that is there enough evidence in the record to give you a reason basis for what you're deciding?

I was a little surprised that the court didn't spend more time. What does this term substantial evidence mean? It certainly indicates that this is not a decision made in the absence of a record, in the absence of substantial evidence. I agree with Jonathan that Justice Kavanaugh and Justice Alito strongly seem to adopt the view taken by the national banks, that essentially any attempt to do factual findings and individual decisions would be unworkable. I didn't see any other justice take that position so clearly. One might suspect that Justice Thomas might be inclined in that direction based upon his dissenting opinion in the Cuomo case, which was the most recent preemption case 15 years ago. But Justice Thomas is not always so easily predicted as to where he might go. I agree that Justice Kagan seemed to be quite divided, on the one hand, exploring how the preventer significantly interferes standard might be applied.

On the other hand, I think troubled by the fact that as she said, the control test adopted by the Second Circuit would basically preempt everything with regard to state consumer financial laws. So I think Justice Kagan is very hard to predict. Justice Roberts, I agree, also said so little, that it's a bit hard to predict where he might go. I tend to think his view of McCullough may have some impact since it had some impact on him in Waters. I think I agree with Johnathan that three justices, Justice Jackson, Justice Sotomayor and Justice Gorsuch clearly seemed to be on the side of the petitioners and I think took the language of the statute quite seriously. The statute says case-by-case, I wish they had said a little bit more about the statute says substantial evidence. Congress has told us what to do, we don't have the ability to rewrite what Congress said. I would say there are three solid votes either for vacating or reversing.

Justice Barrett was interesting because I thought that she asked some very tough questions to petitioners' counsel, but in her colloquy with the attorney for the Solicitor General, she seemed to be much more focused on what the statute said and to be more comfortable. She said, well, it's case-by-case what courts do. And counsel said, yes, that's exactly what courts do. These are Article III courts. Certainly Justice Jackson pointed out that there are many economic regulatory statutes, some of which petitioner counsel referred to such as the Airline Deregulation Act and ERISA, where you look at practical impact and you look at the degree of interference and it's not certainly unknown for preemption cases to fall on issues of degree and issues of economic impact.

Finally, I would agree that much of the discussion focused around Franklin and Anderson National Bank, which were the two decisions probably that Barnett most referred to. So Franklin, I think petitioner counsel did a good job of showing that if you look at the trial record, there was a lot of evidence in the trial record in Franklin that the prohibition on the use of the word savings in advertising and soliciting and offering savings accounts had a very negative impact on consumers in terms of they didn't want accounts that didn't say savings accounts. They didn't know what those accounts meant. And certainly the Supreme Court focused on the fact that at that time, the Federal Reserve Act gave national banks the explicit power to offer savings deposits so that the New York statute not only discriminated against national banks by only allowing state savings

banks to offer these things, but it also prohibited national banks from using the word savings, thereby directly conflicting with an expressed power that was then granted to them in the statute.

Anderson National Bank is worth a few words, which is that was a case where the state basically said presumptively abandoned accounts have to be transferred to the state auditor essentially, and then the state auditor will engage in notice and opportunity for hearing to decide. If they've been abandoned, it should be SG to the state. So saying that the national bank has to transfer the deposits to the state authority and they're frozen and the national bank no longer has the ability to earn any float on them is certainly a pretty significant issue. What the Supreme Court said was SG laws, abandoned deposit laws are well-recognized. The states have sovereign authority to enact those laws. It was a nondiscriminatory statute unlike Franklin, and it wasn't a statute like the California one in the San Jose case, which allowed the state to take deposits if they were just dormant and didn't require any proof of abandonment or any notice or opportunity for hearing.

And the court said in San Jose, that is such an unusual statute taking deposits because they're dormant, giving the depositor no chance to come in and say, "Hey, I'm still here. I still own these things." They said that was so onerous that it would deter depositors from putting their money in national banks and that would be a very bad thing. So this idea of looking at the practical impact of state laws and how severe are they and how much damage does the national bank suffer? This is not an unusual or unknown approach. I mean, so this idea that the National Bank Act has this long tradition of just knocking out state laws without looking at their impact, that's not what the case law shows.

In my view, the OCC has picked and chosen case law and has ignored those that don't agree with it. I took Barrett's question to the counsel for SG as somewhat indicating that she's open to the petitioners' case. So I would say three strong votes for reversal, two strong votes for affirmance. Thomas, I would say you would think would be leaning in favor of affirmance. Roberts, I could not tell. Kagan, I really could not tell. Barrett, I would put as a qualified vote for reversal, but again, not a strong vote for reversal.

Alan Kaplinsky:

Okay. Well, Art, thank you. Let's go to Willie and then I will finally hear from Matthew.

William Jay:

So just to elaborate on a couple of things that the other panelists have said, just note that Justice Kagan in the course of questioning the government lawyer about the significance test. As an aside, she mentioned it might be that you have text on your side, which was an interesting nod to where she might've started out. And she also had a long colloquy with the counsel for Bank of America about fair lending laws and how that might intersect with the bank's proposed test for analyzing this.

I agree with the other panelists that it was not 100% clear where she was going to come out. It seemed like she had some issues with both sides of the case or with aspects of both sides' position. I took the Justice Barrett colloquy a little differently than Art did, because I took kind of the upshot of it to be essentially saying all of the stuff in the statute about how OCC makes preemption determinations applies to OCC and not to the courts, which do case-by-case stuff anyway. And so it might, who knows, but it may just have been getting the government lawyer to acknowledge that all of that stuff in the statute regulates the OCC but does not speak directly to how a court should answer the question. So I thought that was sort of the likeliest reading of her questions, but I'm not sure.

And then as a couple of people have noted, Justice Thomas seemed interested in this possible distinction between expressed powers and implicit powers. And government lawyer pretty forthrightly said that's not a distinction that we're making here. And the government lawyer is always very candid, and it could well be that that concession could show up in a concurrence or a separate opinion in which Justice Thomas talks about why. Although he's often skeptical of preemption, he doesn't have a problem with it here.

Alan Kaplinsky:

Thank you, Willie. Matthew?

Matthew Schwartz:

I agree with everybody that this is a very hard case to read based on oral argument. I don't remember hearing such a fractured oral argument across ideological lines and two or three camps on a non sort of very politically charged issue in a long time. From the perspective of the bank industry, I'm cautiously optimistic that the court, regardless of what test it comes up with, is going to say that state regulation of the way a bank prices its products is inherently preventing or significantly interfering with a bank's national bank powers. I think what they do in terms of what tests they come up with to get there, that's a very open question. It seems like they would've a very hard time coming up with five votes for a straight-up affirmance and embrace of the Second Circuit's control test. But I also think they're going to have a very hard time coming up with five votes to say that every single state law in order to be deemed preempted, needs to be challenged by a national bank in a federal district court with evidence and experts and have the system work like that.

The only solution between those sort of Scylla and Charybdis type situations for the court was I think Justice Kavanaugh's suggestion that yes, you do look at whether or not something significantly interferes as opposed to controls, but you look at Franklin as the North Star. And I think the way he was thinking about Franklin was basically from the Supreme Court level, not from the district court level, where the Supreme Court kind of eyeballs something and says if this is impinging in any kind of either qualitative or quantitative way on a national bank power, it's going to be a pretty low standard because Franklin was pretty low. That would be my best guess, but I wouldn't put any money on it because I thought the oral argument was so difficult to read.

Alan Kaplinsky:

Yeah. Let me ask one of you to clarify something. Is it clear one way or the other that the mortgages that are at issue here where the escrow counts were maintained, that they were mortgages originated prior to the enactment of Dodd-Frank or after the enactment of Dodd-Frank, or they're mortgages on both sides?

Arthur Wilmarth:

There was one each. I believe that Cantero's mortgage was issued before Dodd-Frank, but the Heim's mortgage was issued after. So essentially, you have both types of mortgages at issue here.

Alan Kaplinsky:

Yeah. When do we expect the Supreme Court to rule? Somebody want to take a run at that?

Matthew Schwartz:

Yeah, sure. It's Matt. Supreme Court will issue all of its decisions from this term by the end of June. Given how fractured oral argument was, I would expect that this is going to take a while for the Court to come up with its opinion. So I would expect this to come in June and potentially be buried amongst an avalanche of other important decisions that the Court will be issuing in June as well, like, whether or not Chevron deference is still good and maybe some of the President Trump cases as well.

Alan Kaplinsky:

Do any of you think that the decision of the court in the Chevron deference cases will have any impact here or will it be irrelevant?

Arthur Wilmarth:

I think it would be irrelevant because of the special provision and Dodd-Frank saying that the Supreme, I'm sorry, the OCC doesn't get Chevron deference on preemption determinations. The only way they could get around that would be somehow to say that the 2004 regs are still in effect effectively, but I wouldn't expect them to touch Chevron in this case.

Alan Kaplinsky:

Right. With that-

William Jay:

This is the only case-

Jonathan Ellis:

I mean, I think-

William Jay:

... in which the Solicitor General benefits from not claiming deference because after all, they disagree with their [inaudible 01:08:47].

Alan Kaplinsky:

Right. I guess, one thing I want to... I had meant to mention this upfront, but I don't think that the decision in this case will have any impact on the preemptive scope of Section 85 for the National Bank Act. That is the provision that, what I call the interest rate provision that says the national bank may charge interest at the rate allowed by the laws of the state where it's located. This is dealing with a different provision of the National Bank Act Section 24, 7. Are we all in agreement on that?

Arthur Wilmarth:

Yes. Dodd-Frank actually has an express savings provision saying that nothing in Dodd-Frank affects what happens under 85, again, which to me, suggests that they meant to change everything that didn't affect 85. But that's my view.

Alan Kaplinsky:

Well, we come to the end of our webinar roundtable, and I want to extend my thanks to our very special guests today, Jonathan Ellis, William Jay, Matthew Schwartz, and Arthur Wilmarth.

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