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**IN THE UNITED STATES DISTRICT COURT FOR THE  
EASTERN DISTRICT OF CALIFORNIA**

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AMERICAN BANKERS ASSOCIATION, a national  
trade association; AMERICA'S COMMUNITY  
BANKERS, a national trade association; CHASE  
MANHATTAN BANK USA, N.A., a national  
banking association; CITIBANK (SOUTH  
DAKOTA), N.A., a national banking association;  
CONSUMER BANKERS ASSOCIATION, a national  
trade association; FIRST USA BANK, N.A., a  
national banking association; HOUSEHOLD BANK  
(SB), N.A., a national banking association;  
INDEPENDENTCOMMUNITY BANKERS OF  
AMERICA, a national trade association; MBNA  
AMERICA BANK, N.A., a national banking  
association; NATIONAL ASSOCIATION OF  
FEDERAL CREDIT UNIONS, a national trade  
association,

Plaintiffs,

v.

BILL LOCKYER, in his official capacity  
as Attorney General of the State of California,  
KATHLEEN HAMILTON, Director of the California  
Department of Consumer Affairs, DOES 1-25,

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No. CIV.S-02-1138 FCD  
(JFM)

Date: June 28, 2002  
Time: 10:00 A.M.  
Courtroom: 2

**MEMORANDUM  
*AMICUS CURIAE* OF  
THE OFFICE OF THE  
COMPTROLLER OF  
THE CURRENCY IN  
SUPPORT OF  
NATIONAL BANK  
PLAINTIFFS'  
APPLICATION FOR  
PRELIMINARY  
INJUNCTION**

**MEMORANDUM *AMICUS CURIAE* OF THE OFFICE OF THE  
COMPTROLLER OF THE CURRENCY  
IN SUPPORT OF NATIONAL BANK PLAINTIFFS’  
APPLICATION FOR PRELIMINARY INJUNCTION**

The Office of the Comptroller of the Currency (“OCC”) respectfully submits this brief *amicus curiae* in support of the preemption element of the national bank plaintiffs’ motion for preliminary equitable relief. As the federal agency responsible for interpreting the National Bank Act and administering the national bank charter, including determining the scope of permissible national bank activities and assessing the burden placed on those activities by state restrictions, the OCC has a particular interest and expertise concerning the preemption issues raised by the litigation.

To the extent that the California statute at issue seeks to promote financial literacy among credit card accountholders, its goal is salutary. Cardholders who maintain balances on their accounts should be aware that a decision to make smaller rather than larger payments on credit balances will result in a relatively longer time until the credit is repaid, and in higher total interest costs. There are various ways in which states may play a constructive role in promoting such consumer awareness. But the measures imposed by the California statute at issue are ill-matched to that goal and an impermissible means of achieving it, in that they would interfere with the exercise of the national bank powers to lend, to determine the terms and conditions under which credit will be offered, to manage credit accounts, and to advertise.

The effect of the maze of alternatives imposed by the statute is to require that national banks: 1) forbear from charging interest; 2) require that their cardholders repay a minimum of

10% of the outstanding balance on their accounts each month; or 3) comply with some combination of required warnings and estimates to borrowers of the length of time necessary to pay off their balance and the total cost of the credit if only the required minimum is repaid each month. Because such estimates cannot take account of a variety of variables that depend upon future events unknowable at the time of the estimate, the estimates will be inherently inaccurate, and potentially misleading.

None of these alternate requirements is consistent with federal law. The state is without power to constrain national bank operations by prohibiting the charging of interest or by dictating a required credit repayment schedule. The minimum payment warning regime, reflecting in part an attempt to graft a mechanism adapted to a closed-end credit account to the very different characteristics of open-end credit, would impose substantial added direct and indirect costs on credit card lending operations. In some ways, the warning regime provides banks with insufficient guidance as to the actions necessary to achieve compliance, threatening national banks with unavoidable civil liability. The statute would also require extensive customization of bank operations specific to California, rendering uniform nationwide national bank operations impossible. Each of these alternative requirements therefore would stand as an obstacle to the exercise of the national bank power to extend credit, and the statute is preempted by operation of the Supremacy Clause. Plaintiffs are therefore likely to succeed on the merits of their preemption claim.

## **STATEMENT OF**

### **THE CASE**

#### **A. OCC Authority**

The OCC is a bureau within the Treasury Department charged with the administration of the National Bank Act, 12 U.S.C. §§ 1-216d. The OCC has broad authority over the chartering, supervision, and regulation of virtually every aspect of banks organized under the National Bank Act, including the authority to determine whether a bank's activities are permissible. Five of the plaintiffs here, Chase Manhattan Bank, Citibank, First USA Bank, Household Bank, and MBNA America Bank, are national banks, subject to the OCC's regulatory and supervisory authority. Plaintiffs American Bankers Association, Consumer Bankers Association, and Independent Community Bankers of America are trade associations that include national banks among their members.

**B. National Bank Powers To Extend Credit**

The statutory authority for national banks to conduct business comes largely from the National Bank Act, enacted in 1864. In addition to setting forth the framework for the creation, regulation, and operation of national banks, the National Bank Act governs the scope of "banking powers" – *i.e.*, statutorily-authorized banking-related activities. Those powers include the authority: "To exercise \* \* \* all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; \* \* \* by loaning money on personal security." 12 U.S.C. § 24(Seventh). Accordingly, the national bank power to engage in the business of extending credit is textually explicit.

The National Bank Act also provides that national banks may charge interest for their extensions of credit, at the rate permitted by the state where the bank is located, or a rate one percent above the Federal Reserve discount rate, whichever is higher. 12 U.S.C. § 85.

### **C. Recent Caselaw Invalidating State and Local Restrictions on National Banks.**

This case follows upon a series of recent cases invalidating state and local restrictions upon national bank business practices authorized under federal law, including the charging of service fees. In each case, the court determined that the state or local restriction acted as an obstacle to the exercise of an authorized national bank power and therefore was preempted by operation of the Supremacy Clause.

Ordinances passed by four municipalities in California and New Jersey specifically to prohibit ATM access fees were promptly enjoined by district court order on grounds that included National Bank Act preemption. In California, the district court entered a preliminary injunction against the fee prohibition ordinances adopted by San Francisco and Santa Monica, the Ninth Circuit affirmed, and the district court on remand entered a permanent injunction against the ordinances, which is currently pending on appeal. *Bank of America, N.A. v. City and County of San Francisco*, 2000 WL 33376673 (N.D. Cal. June 30, 2000) *on appeal*, (9<sup>th</sup> Cir. Nos. 00-16994 & 00-16355, *argued* Jan. 17, 2002). Similarly, a federal district court in New Jersey entered temporary restraining orders blocking the effectiveness of fee prohibition ordinances adopted by Newark and Woodbridge. The combined case was ultimately settled by each city's consent to a permanent injunction against its ordinance.

*Township of Woodbridge, New Jersey Bankers Ass'n v. City of Newark*, No. CV-00-702 (JAG)(D.N.J. Nov. 8, 2000). A federal district court in Des Moines declared a longstanding Iowa prohibition on ATM access fees to be in conflict with national bank powers and therefore

preempted. *Metrobank v. Foster*, 193 F. Supp. 2d 1156 (S.D. Iowa 2002).<sup>1</sup> For similar reasons, a federal district court in Austin declared that a Texas statute that prohibited the charging of fees for cashing checks drawn upon accounts at the payor bank to be displaced by federal law. *Wells Fargo Bank Texas, N.A. v. James*, 184 F.Supp.2d 588 (W.D.Tex. 2001), *appeal pending*, No. 01-51298 (5th Cir. *filed* Dec. 20, 2001).

Restrictions on national bank activities other than fees have also been held preempted. Deferring to the OCC's interpretations of the National Bank Act, the Eighth Circuit held that federal law preempted Iowa restrictions on ATM location, operation, and advertising as applied to national banks. *Bank One, Utah v. Guttau*, 190 F.3d 844 (8<sup>th</sup> Cir. 1999), *cert. denied sub nom. Foster v. Bank One, Utah*, 529 U.S. 1087 (2000).

#### **D. California Civil Code Section 1748.13**

The alternate requirements imposed upon lenders by California Civil Code Section 1748.13 are set forth in the form of a minimum payment warning regime, with the proviso that

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<sup>1/</sup> In Connecticut, a state administrative determination that existing state law prohibited ATM fees was ultimately invalidated on state law grounds, so that the state court did not reach the alternative National Bank Act preemption argument. *Burke v. Fleet Nat'l Bank*, 742 A.2d 293 (Conn. 1999). In addition, while the state proceeding was pending, a federal district court determined that Connecticut's attempt to subject national banks to the state administrative scheme was precluded by the National Bank Act's reservation to the OCC of exclusive visitorial authority over national banks under 12 U.S.C. § 484(a). *First Union Nat'l Bank v. Burke*, 48 F. Supp. 2d 132 (D. Conn. 1999).

the regime does not apply at all if lenders conduct their lending operations in certain ways. The warning regime does not apply in two instances: 1) any billing cycle in which the account agreement requires a minimum payment of at least 10 percent of the outstanding balance; and 2) any billing cycle in which finance charges are not imposed. Sec. 1748.13(c). The minimum payment warning regime comprises a combination of different requirements which distill to two primary multipart alternatives, except in certain circumstances when only one of those alternatives may be used.

The warnings required must be made “on the front of the first page of the billing statement,” in type that is at least 8 points in size. Sec. 1748.13(a). A requirement common to both alternatives within the disclosure regime is the statement required in every case: “Minimum Payment Warning: Making only the minimum payment will increase the interest<sup>2</sup> you pay and the time it takes to repay your balance.” 1748.13(a)(1). (The “Basic Warning”). Next, the statute requires either of two sets of warnings, on top of the Basic Warning, either: 1) an illustrative, relatively generic “three line statement,” with four variations<sup>3</sup> PLUS establishment of

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<sup>2/</sup> Because the term “interest” can readily be read by a cardholder as “  
than as “total cumulative interest cost” as was probably intended, this statement has great  
potential to **cause** consumer confusion.

<sup>3/</sup> For non-retail credit cards, the statute provides two options: examples for three  
different loan amounts illustrating the length of time to pay off a balance and the total cost of the  
loan based on specified assumed interest rates and minimum payments; or 2) the same  
illustrative examples based on the interest rate and minimum payment schedule actually

a phone bank to provide “custom” information; or 2) a) a “written statement providing individualized information indicating an estimate” of the time necessary to pay off the balance and the approximate “total cost” if the cardholder were to pay only the minimum amount due on the account each billing cycle (the “Custom Estimate”)<sup>4</sup> PLUS information referring the cardholder to credit counseling services. The “illustrative warning” alternative is not available, under one reading of the statute, for any cardholder who has made only the minimum payment

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applicable to that cardholder’s account. A different illustrative statement requirement is applicable to retail credit card issuers, who must, if a cardholder has a balance that is \$500 or more, provide illustrative elapsed times and total interest payable either assuming specified interest rates and repayment schedules or the rates and schedules applicable to that cardholder’s account. Sec. 1748.13(a)(2)(A)(i, ii).

<sup>4/</sup> The custom estimates requirement appears to be modeled upon disclosures that are required under federal law for certain kinds of closed end credit, where the total amount of credit extended, and the repayment schedule, is fixed, even if the interest rate is variable. Problems arise in applying that mechanism to open end extensions of credit, however, because so many variables are unknowable as of the time of the estimate: e.g., whether more credit will be extended on the account; interest rates; time of repayment within the billing cycle. These variables could easily combine to render the estimate totally divorced from the reality of what will actually happen with the repayment of the account. That disparity is virtually certain to be a source of consumer confusion.

for six consecutive billing cycles. In such cases, the lender must employ the custom estimates and credit counseling requirements.<sup>5</sup>

In all cases where the lender has not provided the “custom” estimates and credit counseling referrals, the lender is required to establish a phone bank accessible by toll free numbers, open “between the hours of 8 a.m. and 9 p.m., Pacific standard time,<sup>6</sup> seven days a week,” that will provide consumers “with the opportunity to speak with a person rather than a

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<sup>5/</sup> The literal meaning of the text of the six-month provision differs widely from the way in which it has been construed. The text provides: “The creditor is required to provide, or continue to provide, the [customized warning and credit referral information] **only** if the cardholder has not paid more than the minimum payment for six consecutive months . . .”. Sec. 1748.13(a)(2)(B)(emphasis added). The placement of the textual term “only” is most naturally read as a limitation upon the custom warning requirement, *i.e.*, that custom estimates need be given “only” in the case of six-month-minimum payment cardholders. Because that would mean that custom estimates would be required for a much smaller universe of cardholders, the custom estimates route might be more attractive to lenders than the other options available. But we understand that the State construes the statute in a way that departs from its literal meaning – that the “only” alternative available to a bank for six-month-minimum-payers is the custom estimate route.

<sup>6/</sup> There is no apparent reason why the statute does not provide for Pacific Daylight Savings Time, but rather specifies Pacific Standard Time.

recording,” who will provide the cardholder with a custom estimate for that cardholder of elapsed time to pay off the balance and total amount of those payments if only the minimum payment is made.<sup>7</sup> Sec. 1748.13(a)(3)(B). The statute directs the California Department of Financial Institutions to establish a detailed table that a lender may use to make custom estimates for different levels of account balances and interest rates, using certain specified assumptions. Sec. 1748.13(a)(3)(C).

The statute is enforceable under the California Business and Professions Code Provisions that provide for civil penalties and civil liability for unlawful or unfair business practices. Cal. Bus. & Prof. Code section 17200-17210.<sup>8</sup>

Thus, in summary, it appears that the effect of the warning regime and exceptions is to impose four nominally alternative requirements on credit card lenders:

- 1) not to charge interest on the account balance (the “no-interest” alternative);
- 2) to require a minimum ten percent repayment of the outstanding balance each cycle (the “10% repayment” alternative);

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<sup>7/</sup> The written custom estimate is to be provided with the billing statement, and thus need be updated only once a billing cycle. As to custom estimates given over the phone, however, the statute does not specify how frequently the estimates must be updated. This vagueness puts national banks at risk of civil liability because they must guess at what is necessary to comply with the statute.

<sup>8/</sup> Federal law prohibits the State from taking enforcement actions against national banks, 12 U.S.C. § 484, but does not preclude civil liability.

- 3) to give the basic warning, PLUS an illustrative warning, PLUS establish a phone bank capable of giving custom estimates (the “illustrative warning” alternative);
- 4) to give the basic warning, PLUS written custom estimates, PLUS referring cardholders to credit counseling services (the “custom estimate” alternative).

In practice, the number of alternatives is reduced. The waiving of interest payments is not consistent with safe and sound bank operations and therefore not a true option; and the “illustrative warnings” alternative is taken off the table as to any cardholder who has made only the minimum payment for six months. For this class of cardholders, the only available alternatives are the 10 % repayment or the customized estimates.

## **ARGUMENT**

### **THE NATIONAL BANK ACT AUTHORIZES NATIONAL BANKS TO CONDUCT ACTIVITIES IN CONNECTION WITH THE EXTENSION OF CREDIT, DISPLACING CONTRARY STATE LAW**

#### **I. THE NATIONAL BANK ACT AUTHORIZES NATIONAL BANKS TO LEND, TO DETERMINE CREDIT REPAYMENT SCHEDULES, TO ADVERTISE, TO MANAGE CREDIT ACCOUNTS AND TO CONDUCT NATIONAL BANK OPERATIONS NATIONWIDE**

National banks are private, for-profit entities authorized by federal law to engage in the business of banking. The authority to lend money is fundamental to the operation of that business. The National Bank Act expressly authorizes national banks: “To exercise \* \* \* all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; \* \* \* **by loaning money on personal security.**” 12 U.S.C. § 24(Seventh)(emphasis added). That authority extends to credit card operations.

Within a legal framework formed by the National Bank Act and other federal laws, national banks are authorized to set the terms and conditions under which they offer extensions

of credit.<sup>9</sup> As part of that framework, the National Bank Act applies state interest rate ceilings to national banks (12 U.S.C. § 85). The OCC enforces against national banks extensive federal consumer protection laws and regulations that govern lending procedures. *See, e.g.*, the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*; 12 C.F.R. Part 226 (Regulation Z). The OCC supervises all national bank lending activity to ensure that it is consistent with safe and sound banking practices, including the creditworthiness of borrowers.

Within the scope of these limitations, national banks are responsible for managing the components of their lending to produce a business return. Within the limits imposed by law, banks are free to compete on interest rates, on the amount of credit extended, and on the timetable under which that credit must be repaid. A necessary aspect of those lending operations is the ability to communicate with customers about repayments and to monitor delinquencies. Bank management is accountable to the OCC, as well as to the marketplace, for ensuring the efficient bank operation that is fundamental to bank safety and soundness. Thus, the terms and conditions of extensions of credit, and the lender's management of credit accounts, are at the heart of the National Bank Act power to lend money.

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<sup>9/</sup> The OCC's determinations as to the scope of national bank powers under the National Bank Act are entitled to *Chevron* deference. *NationsBank of North Carolina, N.A., v. Variable Life Ins. Co.*, 513 U.S. 251, 256-257 (1995). The skepticism that may attach to agency litigating positions unsupported by administrative determinations does not apply to *amicus* briefs where there "is simply no reason to suspect that the interpretation does not reflect the agency's fair and considered judgment on the matter in question." *Auer v. Robbins*, 519 U.S. 452, 461 (1997).

Among the other powers vested in national banks is the authority to advertise their services without state restrictions. *Franklin Nat'l Bank v. New York*, 347 U.S. 373, 377-78 (1954)(national bank power to advertise savings accounts not subject to state restriction). Similarly, the national bank power to advertise the availability of ATM services displaced an Iowa prohibition on the placing of bank logos on ATMs. *Bank One v. Guttau*, 190 F.3d at 850. Credit card issuers' common practice of using the monthly billing statement to advertise banking and other services thus represents the exercise of a recognized national bank power.

An additional dimension to national bank lending powers, as with all national bank powers, is the authority conveyed by the national charter to conduct operations nationwide under federal standards supervised by the OCC. *See* 67 Fed. Reg. at 34996-34997(May 17, 2002) (preamble to OCC regulation regarding electronic banking). The creation of the national bank charter reflected a Congressional purpose that, except where specifically provided by federal law, national banks would not be subject to a patchwork quilt of varying state restrictions. The Supreme Court has consistently recognized that subjecting national banks' exercise of their Federally authorized powers to state regulation or supervision would be inconsistent with that purpose. *See, e.g., Easton v. Iowa*, 188 U.S. 220, 229 (1903)(National Bank Act contemplates "a system extending throughout the country, and independent, so far as the powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the States."); *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314-315 ("Congress intended to facilitate a 'national banking system.'). The increasingly interstate character of national bank operations over recent decades has rested upon these principles. If any single state could require that national banks

tailor their operations to that state's dictates, any other state could do the same. The federal purpose underlying the national bank charter is fundamentally at odds with forced state-by-state customization of national bank operations. The authority to conduct interstate operations efficiently under federally prescribed standards, except where otherwise provided by federal law, is thus inherent in the exercise of all national bank powers.

**II. THE CALIFORNIA MINIMUM PAYMENTS WARNING STATUTE STANDS AS AN OBSTACLE TO THE EXERCISE OF NATIONAL BANKS' LENDING POWERS AND IS THEREFORE PREEMPTED BY FEDERAL LAW**

The California statute at issue conflicts with national banks' exercise of a range of federally authorized powers connected to the lending function and is therefore preempted by operation of the Supremacy Clause. For that reason, the national bank plaintiffs are likely to succeed on the merits of their preemption claim.

Under the Constitution's Supremacy Clause, when the federal government acts within the sphere of its authority, federal law is paramount over, and preempts, inconsistent state law. *See, e.g., McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316 (1819). The nature and degree of disharmony between state and federal law that will trigger preemption has been expressed in a variety of formulations,<sup>10</sup> but has been summarized by the question whether, under the

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<sup>10/</sup> "This Court, in considering the validity of state laws in the light of treaties or federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

circumstances of a particular case, the state law may “stan[d] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” *Barnett Bank v. Nelson*, 517 U.S. 25, 31 (1996), quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).<sup>11</sup> Those principles have repeatedly been applied to invalidate state authority that would pose obstacles to the exercise of national bank powers.<sup>12</sup> The Court has observed that the history of Supremacy

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<sup>11/</sup> In the context of national bank preemption, the Supreme Court has applied a host of different formulations for the applicable principle of preemption, often within the same case, without indicating a substantive difference among them. In *Anderson Nat’l Bank v. Lockett*, 321 U.S. 233 (1944) the Court used the formulations “infringe the national banking laws or impose an undue burden on the performance of the banks’ functions” (at 248); state statute “obnoxious to the federal banking laws”( *id.*); “infringe or interfere with any authorized function of the *id.* at 249); “forbidden encroachment upon the privileges of a national bank” (*id.*). In *McClellan v. Chipman Traders Nat’l Bank*, 164 U.S. 347 (1896), the court used the formulations: function of national banks “destroyed or hampered”( *id.* at 358); “impairs the efficiency of national banks or frustrates the purpose for which they were created” (*id.*) state laws “repugnant to” federal law ( *id.* at 360); or conflict “with the letter or the object and purposes of” federal law ( *id.* at 361). In *National Bank v. Commonwealth*, 76 U.S. 353 (1869), the Court used the formulation “interfere with or impair their efficiency in performing the functions by which they are designed to serve” federal purposes ( *id.* at 362).

<sup>12/</sup> See, e.g., *Farmers’ & Merchants’ Nat’l Bank v. Dearing*, 91 U.S. 29, 33-35 (1875); *First Nat’l Bank of Logan v. Walker Bank & Trust Co.*, 385 U.S. 252, 256 (1966) (observing that

Clause litigation of national bank authority is “one of interpreting grants of both enumerated and incidental ‘powers’ to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting contrary state law.” *Barnett*, 517 U.S. at 27.<sup>13</sup>

The Supreme Court has long recognized that national banks are private enterprises that are entitled to exercise National Bank Act powers inherent in the operation of the business of banking. In holding that the National Bank Act preempted a state restriction on national bank advertising, the Court stated: “Modern competition for business finds advertising one of the most usual and useful of weapons.\* \* \* It would require some affirmative indication to justify an interpretation that would permit a national bank to engage in a business but gave no right to let the public know about it.” *Franklin Nat’l Bank v. New York*, 347 U.S. 373, 377-78 (1954); *see Guttau*, 190 F.3d at 850. Thus, the national bank power to offer savings accounts preempted a state restriction that burdened banking operations by depriving national banks of a “usual and

. In two cases involving state escheat statutes, the Court focused on the perceived effect of each statute on the conduct of national bank business in upholding one statute

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“[t]he paramount power of the Congress over national banks has \* \* \* been settled for almost a century and a half”). *See generally Barnett* (federal statute preempts state statute restricting bank sales of insurance); *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 283 (1896).

<sup>13/</sup> It is immaterial to the application of this principle whether the federal power is explicit or implicit in the National Bank Act. *Barnett*, 517 U.S. at 31; *see Franklin Nat’l Bank v. New York*, 347 U.S. at 375-79 & n.7. In any event, as discussed above, the power to “loan money on personal security” at issue here is explicitly authorized by the National Bank Act.

and declaring the other preempted. In *Anderson Nat'l Bank v. Luccett*, 321 U.S. 233, 236 (1944), the Court concluded that the escheat scheme at issue was not as “harsh” as the preempted state escheat scheme at issue in the earlier case of *First National Bank of San Jose v. California*, 262 U.S. 366 (1923), and therefore “We cannot say that the protective custody of long inactive bank accounts \* \* \* will deter [depositors] from placing their funds in national banks in that state.” 321 U.S. at 252. Thus, in each case, the Court looked to the burden imposed by state restrictions on national bank operations to determine preemption.

Here, each of the alternate requirements that California purports to impose would impair the efficiency of national bank credit card lending and the statute is therefore preempted by the National Bank Act. The statute contemplates four options, two of which consist of warning regimes, and two of which would directly restrict the power of national banks to manage their lending operations:

- 1) forbearing from charging interest on the account balance;
- 2) requiring a minimum 10% repayment of the outstanding balance each cycle;
- 3) giving the basic warning, PLUS a three-line statement, PLUS establish a phone bank capable of giving custom estimates [not an option for cardholders who have not made more than the minimum payment for six consecutive months];  
or
- 4) giving the basic warning, PLUS custom estimates in writing, PLUS referring cardholders to credit counseling services.

Of the four alternate requirements, one – forbearing from charging interest – is not a realistic option. And for cardholders who do not make more than the minimum payment for six consecutive months, the statute makes only two options available, the required 10% repayment or the custom estimates plus credit counseling. These nominal alternatives do nothing to redeem

the statute from preemption because each option is in itself onerous. The statute leaves no easy way out – a point illustrated by the different alternatives that national banks have chosen in their attempts to comply with the statute. Because these alternate requirements, separately and in the aggregate, stand as obstacles to the exercise of the national bank power to lend, the statute is preempted by federal law.<sup>14</sup>

### **1. The No-Interest Alternative Requirement.**

The California statute creates an exception from the application of any of its provisions for any billing cycle in which a national bank does not charge interest. By its nature, this is not an option that any lender can sustain consistent with safety and soundness for any borrower carrying a credit balance,<sup>15</sup> and thus it is not a realistic ongoing option for national banks.

Nevertheless, the creation of that exception is illustrative of California's overreaching in attempting to regulate the terms and conditions of national bank lending. The interest rates that national banks may charge are regulated by federal law, 12 U.S.C. § 85, which empowers national banks to charge interest with respect to state law or the Federal Reserve discount rate

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<sup>14/</sup> The OCC's expertise in the operation of national banks enables it to identify the nature and degree of the conflict between federal powers and state laws, and thus is entitled to persuasive weight on that aspect of the preemption analysis. *See Geier v. American Honda Motor Co.*, 529 U.S. 861, 882 (2000).

<sup>15/</sup> Presumably, the exception was intended to relieve lenders of the requirement of making the warnings for customers who do not carry balances.

plus 1 percent, whichever is higher. Accordingly, California may not forbid a national bank to charge interest for extending credit, nor coerce that result.

## **2. The Ten Percent Minimum Repayment Alternative Requirement.**

To the extent that the statute causes national banks to alter their lending operations by requiring higher minimum payments, it is preempted because it would encroach directly upon the national bank power to determine the terms and conditions of offers of credit. As the Supreme Court stated long ago, “the states can exercise no control over [national banks], nor in any way affect their operation, except in so far as Congress may see proper to permit.” *Farmers’ & Merchants’ Nat’l Bank v. Dearing*, 91 U.S. 29, 33-35 (1875). Because Congress has not empowered California to “affect” national bank lending decisions, this requirement is nullified by operation of the Supremacy Clause.

As discussed above, national banks are authorized to offer credit subject to terms and conditions that they may set in their business judgment. Some national banks routinely choose to require a 10 percent minimum repayment each month. Other national banks choose to compete for business by offering credit that requires a lesser monthly repayment, and therefore offers borrowers more flexibility, at the cost of greater total interest payments. The OCC, which supervises all aspects of national bank lending activity, does not prescribe that bank management require any particular rate of minimum repayment. These are business decisions that the National Bank Act authorizes national bank management to make, and California lacks authority to dictate or coerce a different result.

Plaintiffs’ declarations confirm that the statute would indeed have the effect of coercing national banks into changing their lending practices. In light of the apparent burdens imposed by

the warning regime, some national banks have apparently made the business decision to acquiesce in an impermissible state interference in the lending function. *See* Dugan Decl. (bank has given notice to cardholders that it will require a minimum ten percent repayment as of the effective date of the California statute). That result is inconsistent with the National Bank Act, and highlights the degree of burden imposed by the warning regime.

**3. The Basic Warning PLUS Illustrative Warnings PLUS Phone Bank Giving Custom Estimates Alternative Requirement.**

The illustrative-warning alternative route stands as an obstacle to the exercise of national bank powers because it intrudes, massively, upon the front page of the credit card billing statement, a crucial component of credit card lending operations, and because it mandates costly phone banks operated to California specifications. Neither requirement is consistent with federal law.

As set forth in detail in the declarations supporting plaintiffs' motion, the front page of the billing statement performs a wide variety of functions.<sup>16</sup> First, it contains disclosures required under federal law, many of which are also fundamental to account management.<sup>17</sup> Furthermore, there is no place in the billing statement that can be as effective a place for communication with the cardholder, whether that communication be for the purposes of marketing<sup>18</sup> or for alerting a cardholder to a problem with the account, such as delinquency.<sup>19</sup>

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<sup>16/</sup> *See, e.g.*, Stork Decl. ¶ 6.

<sup>17/</sup> *See, e.g.*, Christie Decl. ¶ 9; Fimby-Dukart Decl. ¶ 4; Kietz Decl. ¶ 14.

<sup>18/</sup> *See, e.g.*, Kietz Decl. ¶ 18; Weber Decl. ¶ 14.

Additionally, postage costs impose an overall constraint upon the overall space for communication within the billing statement; any enclosures that raise the total weight of the statement above one ounce drive up the postage costs to the bank by an increment large enough to cause changes in operations.

The nominal “three line” illustrative statement, which must be placed on the front of the first page of the billing statement, would have the effect of displacing much of the space on the billing statement available for communication. The space crunch created by the requirement is illustrated by the example attached to the Christie Declaration. There, the illustrative “three-line” warning, in the type size required by the statute and in the statement format dictated by weight and postal rates, takes up **ten** lines, exclusive of the additional three lines that the bank felt necessary to explain the nature of the warning. One effect would be to push information about delinquent accounts to a less conspicuous position lower on the page. To the extent that the illustrative warnings left no capacity under the one-ounce threshold, banks would also be required to forego marketing material,<sup>20</sup> on behalf of themselves and others, or to pay higher postage costs. At the margin, the warnings would combine with information that must be included, such as transaction details, to raise the weight over the one-ounce threshold, and thus cause significant increased postage costs.<sup>21</sup> Compliance with the illustrative warning conditions

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<sup>19/</sup> See, e.g., Kietz Decl. ¶ 16; Weber Decl. ¶ 14.

<sup>20/</sup> See, e.g., Weber Decl. ¶ 11; Walden Decl. ¶ 7.

<sup>21/</sup> See, e.g., Fimby-Dukart Decl. ¶ 10; Willis Decl. ¶ 8.

would also require that national banks extensively tailor their operations specifically to deal with California requirements, in conflict with the authority of national banks to structure their interstate operations efficiently.<sup>22</sup>

The OCC has previously opined that a nominal disclosure requirement is preempted where it interacts with space limitations to create an obstacle to the exercise of national bank powers. The OCC determined that the national bank power to advertise displaced a Colorado restriction that permitted a bank to display its own name on an ATM only so long as the names of all other banks whose customers could use the ATM were displayed with “equal prominence.”

-6.5-104(III) (1987); OCC Interpretive Letter 789 [1997 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 81-216 at 90,244 (June 27, 1997). Because the space required to list all such other names exceeded the available space on the ATM, a national bank was effectively precluded under Colorado law from using its name or logo on its own off-premises ATMs. IL 789 at 7. The OCC concluded that: “This prohibition of a very basic type of advertising is, in our opinion, a significant burden on a national bank’s right to engage in the business of banking by means of an ATM, as authorized by the National Bank Act.” *Id.* The Eighth Circuit relied in part on Interpretive Letter 789 in striking down Iowa’s prohibition on advertising on ATMs. *Guttau*, 190 F.3d at 850. Here, the illustrative warning would similarly crowd out advertising, and would otherwise impinge upon communications fundamental to the operation of lending through credit card accounts.

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<sup>22/</sup> See Stork Decl. ¶ 5; Morrison Decl. ¶ 5.

The burden created by the required illustrative warnings is compounded by the requirement that a phone bank be maintained to give custom estimates to cardholders, an obviously onerous imposition on the operation of national banks. For those national banks that do not now maintain phone banks, the costs of establishing them, training personnel, and operating them on California time would create burdensome costs that could make the “warning regime” options impracticable for those banks. Even for those banks that now operate customer phone banks, the California specifications would significantly drive up costs<sup>23</sup> and intrude upon bank operations in a way incompatible with federal law. *See* 12 C.F.R. § 7.3000. “A national bank’s board of directors should review its banking hours, and independently of any other bank, take appropriate action to establish a schedule of banking hours.” Because federal directors, the state is without power to set those decisions aside.

In addition, the statute requires that the phone banks have the capacity to give customized estimates. In addition to the inherent costs and inaccuracies that accompany the customized estimate requirement, the phone bank estimates add another uncertainty-of-compliance cost because the statute does not specify whether the estimates given over the phone must be the same as those given with the monthly statement or whether they must be based upon the customer’s account as of the time of the call. Where a bank cannot ascertain precisely what is necessary to comply with a statute, on pain of potential civil liability, that uncertainty in itself imposes costs weighing upon national banks’ ability to conduct credit card operations in California.

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<sup>23/</sup> *See, e.g.,* Walden Decl. ¶ 10; Stork Decl. ¶ 12.

**4. Basic Warning PLUS Customized Estimate Warnings PLUS Required Referrals to Credit Counseling Option.**

The customized estimates requirement stands as an obstacle to the exercise of national bank lending powers because it imposes significant costs on national bank lending, and because it requires that banks provide consumers with necessarily inaccurate projections. Those flawed projections will produce customer confusion and drive up the cost of maintaining cardholder relationships through means such as phone banks. They might also form the basis for civil liability. It is a measure of the degree of burden imposed by the customized estimates that many banks appear to be preparing to conform to the illustrative warning alternative, with its manifest burdens, so long as that option is available.

The customized estimate disclosure is burdensome, first, because the maintenance of various necessary additional fields of information would drive up data processing costs. In addition to the basic estimates on time and cost of paying down the balance, banks would be required to cross-index cardholders by California address and by payment history<sup>24</sup> in an attempt to identify the state requirements for that particular cardholder, a task compounded by cardholder migrations in and out of California during the six-month period. While the statute contemplated that the California Department of Financial Institutions would create a set of tables to assist in providing the custom estimates, those tables did not take into account a number of variable

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<sup>24/</sup> See, e.g., Christie Decl. ¶ 15; Weber Decl. ¶ 12;

factors inherent in national bank's existing credit card operations, and therefore were ineffective in alleviating the custom estimate burden.<sup>25</sup>

Furthermore, the statute imposes severe costs in the form of uncertainty as to what would be necessary for a national bank to comply with the necessary estimates so as to avoid civil liability. The estimates that can be produced in response to the statute cannot help but be inaccurate to some extent. The calculations depend upon unknowable variables such as compounding, timing of payments, grace periods, multiple and variable rates.<sup>26</sup> Thus, the year-and-month warnings, and the total cost warnings will be inaccurate, perhaps widely so, because of the cumulative effect of those variables. That disparity is likely to generate cardholder confusion, thus driving up usage of existing mechanisms for answering consumer questions, a direct cost to banks.<sup>27</sup> The difficulty of identifying exactly what must be done to comply with

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<sup>25/</sup> See, e.g., Fimby-Dukart Decl. ¶ 7 (array of different terms and conditions, including fixed and variable rates, expiration dates, and allocation of payments by different terms and conditions); Christie Decl. ¶ 8 (DFI tables did not take account of different rates for limited-time promotions and different rates for purchase and cash advance transactions).

<sup>26/</sup> See, e.g., Kietz Decl. ¶ 13

<sup>27/</sup> See, e.g., Kietz Decl. ¶17.

the statute creates a potential for unavoidable civil liability and thus business uncertainty that is antithetical to the exercise of the national bank power to lend.<sup>28</sup>

### CONCLUSION

For all of the foregoing reasons, Section 1748.13 of the California Civil Code conflicts with federal law and is therefore null and void as applied to national banks. The national bank plaintiffs are therefore likely to succeed on the merits of their preemption claim.

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<sup>28/</sup> In addition, the requirement that national banks distribute to their borrowers referrals to credit counseling centers has the potential to interfere with existing national bank collection programs that, in some cases, employ referrals to credit counselors, but generally at a later stage in the workout process than California would require. *See, e.g.*, Weber Decl. ¶¶ 17- 20; Kietz Decl. ¶ 20; Walden Decl. ¶ 12.

JUNE 2002

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