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Jaworski on the SPGGC Decisions: May Third Party Agents Take Advantage of a National Bank's Federal Preemptive Authority?

In [Watters v. Wachovia Bank, N.A., 27 S. Ct. 1559, 167 L. Ed. 2d 389 \(2007\)](#), decided on April 17, 2007, the Supreme Court of the United States held that national banks have the power to engage in lending activities through operating subsidiaries ("Op Subs") subject to the same terms and conditions that govern the bank itself, and that this power may not be significantly impaired or impeded by state law. States are thus permitted to regulate the activities of national banks or their Op Subs only "where doing so does not prevent or significantly interfere with the national bank's or the national bank regulator's exercise of its powers." [[Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1567, 167 L.Ed. 2d 389, 400 \(2007\)](#)]

Two recent Circuit court decisions, [SPGGC, LLC v. Ayotte, 88 F.3d 525 \(1st Cir. 2007\)](#), and [SPGGC, LLC v. Blumenthal, 505 F.3d 183 \(2d Cir. 2007\)](#), explore whether the rationale expressed by the Supreme Court in *Watters* can be extended to cover the activities of third-party agents of a national bank. Although these two decisions arrive at seemingly opposite conclusions, it appears that they can be harmonized and may therefore be useful in attempting to determine how other courts may analyze similar situations.

The Watters Rationale. The Supreme Court found that a national bank's authority to preempt state law derives from three specific sections of the National Bank Act (the "NBA") [[12 U.S.C. § 21](#) *et seq.*], itself:

[§ 371](#) – which authorizes national banks to engage in mortgage lending subject to regulation by the Office of the Comptroller of the Currency (the "OCC");

[§ 484\(A\)](#) – which says that "[n]o national bank shall be subject to any visitatorial powers except as authorized by federal law"; and

[§ 24](#) (Seventh) - which gives national banks the power "to exercise ... all such incidental powers as shall be necessary to carry on the business of banking."

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The Supreme Court also found that (i) among the incidental powers granted to national banks by [§ 24](#) (Seventh), as recognized by the OCC as early as 1966, is the power to do business through Op-Subs, and (ii) this power was confirmed by Congress in the Gramm-Leach-Bliley Act, which distinguished between national bank “financial subsidiaries” (that can engage in certain activities in which the parent bank is not permitted to engage) and national bank Op-Subs (that may engage “only in activities national banks may engage in directly, subject to the same terms and conditions that govern the conduct of such activities by national banks”). [113 Stat. 1378 (codified at [12 U.S.C. § 24a\(g\)\(3\)\(A\)](#))] The phrase “subject to the same terms and conditions,” the Supreme Court concluded, incorporates the notion that “state laws apply to [Op-Subs] to the same extent as they apply to the parent national bank.” [[Watters v. Wachovia, N.A., 127 S. Ct. 1559, 1572, 167 L. Ed. 2d 389, 406 \(2007\)](#)]

Responding to Michigan's argument that the NBA does not indicate in any of the cited sections that the preemptive authority of a national bank extends to an Op-Sub (which can only be organized pursuant to state law), the Supreme Court pointed out:

We have never held that the preemptive reach of the NBA extends only to a national bank itself. Rather, in analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of a national bank's powers, not on its corporate structure.

[[Watters v. Wachovia, N.A., 127 S. Ct. 1559, 1570, 167 L. Ed. 2d 389, 404 \(2007\)](#) (italics in original)] It is this last point that gives support to the notion that a third-party that is engaging in activities on behalf of and as agent for a national bank — activities in which the national bank is empowered by the NBA to engage — may also do so “subject to the same terms and conditions” that govern the national bank itself, including principles of preemption.

SPGGC v. Ayotte. In this case, the First Circuit Court of Appeals examined a New Hampshire statute (the “NH Act”) [[N.H. Rev. Stat. Ann. § 358-A:2](#)] that makes it illegal for anyone to sell “gift certificates” that “expire” on or after a certain date or on which administrative fees may be imposed. The specific question that the First Circuit addressed was whether a mall owner, SPGGC, LLC (“Simon NH”), could market and sell gift cards (meeting the definition of “gift certificates” under the NH Act) that contained expiration dates and/or imposed administrative fees, as agent for the national bank that issued the cards, notwithstanding the prohibition in the NH Act.

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The court answered this question in the affirmative, finding that: (1) the NBA gave the national bank the power to issue gift cards with expiration dates and administrative fees, as well as the power to engage third party agents to market and sell the gift cards; and (2) the NH Act necessarily frustrates the national bank's exercise of one or the other of these two powers. That Simon NH was merely an agent of the bank was not seen by the Court as disqualifying Simon NH from taking advantage of the preemption afforded national banks and federal thrifts. In this regard, the court quoted the statement in *Watters* that: "We have never held that the preemptive reach of the [NBA] extends only to the national bank itself. Rather, in analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of a national bank's powers..." [[SPGGC, LLC v. Ayotte, 88 F.3d 525, 532 \(1st Cir. 2007\)](#)]

The deciding factor for the Court appears to have been that, if the NH Act were not preempted and the national bank wanted to sell gift cards in New Hampshire that had expiration dates and imposed administrative fees, it would not be able to exercise its authority to engage third-party agents to market and sell the cards in New Hampshire. Alternatively, if the NH Act was not preempted and the national bank wanted to use third-party agents to sell the cards in New Hampshire, it would not be able to exercise its authority to include expiration dates or administrative fees as features of those cards. In either case, the result would be a direct infringement on the national bank's powers — either the power to use third-party agents to sell its gift cards in New Hampshire or the power to include expiration dates and/or administrative fees as features of the gift cards it wishes to sell in New Hampshire.

SPGGC v. Blumenthal. This case involved a third party agent ("Simon CT") engaged by a national bank to market gift cards on its behalf in Connecticut that carried expiration dates and inactivity fees. Similar to the NH Act, a Connecticut law prohibited the in-state sale of gift cards with inactivity fees and expiration dates (the "CT Act"). [[Conn. Gen. Stat. § 3-65c](#), 42-460 (2007)] Under its contract with the national bank, however, Simon CT, rather than being paid a commission by the bank for its services as was Simon NH, was given the right to collect and retain any administrative fees associated with the card, including upfront handling and loading fees, and potentially applicable maintenance, replacement, and call center fees (including inactivity fees). The national bank, which was a member of VISA payment network, earned its compensation in connection with the gift card in the form of an interchange fee for each transaction executed on the network.

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On these facts, the Second Circuit concluded that the Connecticut law prohibiting inactivity fees may be enforced against Simon CT. It found *Watters* not controlling since Simon CT was not an Op-Sub of the national bank. With respect to expiration dates, however, the Court found that the Connecticut law prohibiting expiration dates on gift cards may be found preempted. The court reasoned that, since the expiration dates were fraud prevention measures insisted upon by the VISA payment network, enforcement of the CT Act against Simon CT could have a direct impact upon the national bank by disqualifying it from using the VISA network and thus from earning interchange fees. The Second Circuit therefore refused to dismiss this part of the national bank's complaint and remanded it to the district court for trial.

Can These Decisions Be Harmonized? *SPGGC v. Ayotte* and *SPGGC v. Blumenthal* appear to be consistent in the sense that both courts refused to apply state law if the state law *directly infringed* upon the *national bank's* power to issue gift cards with permitted features or upon its power to sell them using third-party agents. In *Blumenthal*, however, the Second Circuit permitted the state law to be enforced against the third-party agent where such enforcement directly infringed only *the third-party agent's ability* to collect the inactivity fees on its own behalf. Any impact on the national bank itself, the Court felt, was indirect and not significant.

Are These Decisions Consistent With Respect to Future Efforts to Extend Federal Preemption to National Bank Agents? The answer to this question may well be yes. Rather than trying to shoehorn a third-party agent of a national bank into the Op-Sub mold and thereby allow the agent to take advantage of federal preemption to the same extent as the national bank, it seems likely that courts will look to see whether and to what extent the state law directly infringes on the powers of the national bank in deciding whether or not state law should be deemed preempted with respect to the third-party agent.

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