

Litigation Update

APRIL 2006

PROPOSITION 65 WARNINGS

There has been recent activity by some plaintiffs' attorneys regarding efforts to enforce Proposition 65. Proposition 65 is known as the Safe Drinking Water and Toxic Enforcement Act, passed by initiative in 1986. The main provision financial institutions are being charged with violating prohibits any person engaged in business from knowingly and intentionally exposing any individual to a chemical known to the State to cause cancer without first giving clear and reasonable warning to such individual.

The situation has arisen with respect to secondhand tobacco smoke at or near outdoor ATM machines. Tobacco and tobacco smoke are listed by the State as chemicals causing cancer, so the issue is presented as to whether warnings must be posted at or near ATM machines where the bank may "expose" a customer to secondhand smoke.

Proposition 65 provides a civil penalty not to exceed \$2,500 per day for each violation.

Prior to bringing a lawsuit for Prop 65 violations, a private party must serve a 60-day notice of an alleged violation on the California Attorney General's office, as well as the alleged violator. The firm is aware of over 30 California financial institutions which have received such notices from a party calling itself Consumer Defense Group Action ("Consumer Defense").

In a separate but related matter, California court of appeals' decision on March 28, 2006 delivered a major blow to Consumer Defense, overturning a trial court's approval of a settlement agreement entered between a group of apartment owners and Consumer Defense. Instead of receiving an agreed-upon \$500,000 in attorneys fees, the appellate court stated that the legal work "merited an award closer to a dollar ninety-eight." *Consumer Defense Group v. Rental Housing Industry Members*, 2006

DJDAR 3584. The court dismissed the lawsuits filed by Consumer Defense on the grounds that the 60-day notices were insufficient. The opinion clearly demonstrates the court's dissatisfaction with the attorneys for Consumer Defense. The court likened their conduct to that of a "bounty hunter" in pursuing these types of claims. The court did not, however, decide the underlying issue of whether a Proposition 65 warning must be posted at ATM machines to warn customers using the machines.

If you need any assistance or advice on handling this issue, please contact Alan White, head of the firm's Litigation practice group, to discuss the alternatives your institution will want to consider.

CALIFORNIA COURTS UNDERMINE FEDERAL PREEMPTION

It is no secret that California state courts are unenthusiastic about federal preemption of state laws. A case decided in late 2005 took another bite out of the preemption of state laws which the OCC probably intended to confer on national banks. *Smith v. Wells Fargo Bank, NA*, 135 Cal. App. 4th 1463 (2005). There is little doubt that the holding of the case will extend to federal savings associations as well.

Consumer Defense in the *Smith* case filed a class action against Wells Fargo Bank for failing to adequately disclose an expansion in the Bank's overdraft protection program to cover check card and POS transactions (the concern apparently being the fees Wells imposed for permitting the transactions to go through). After some procedural wrangling, Consumer Defense amended the complaint to bring claims under the Truth in Savings Act and Regulation DD. BCG members will note that there is no civil liability for violations of Regulation DD itself (or the Truth in Savings Act) but Consumer Defense wrapped the complaint in the blanket of California's infamous Unfair Competition Law (Business & Professions Code Section 17200 *et seq.* (UCL) and the Consumer Legal

Remedies Act (Civil Code Section 1750) (CLRA). These state laws do provide for civil liability for damages, attorneys fees and everything else a plaintiffs' lawyer could wish for.

Wells argued that the UCL and CLRA claims were preempted by the OCC's regulations which expressly preempt state laws regarding deposit taking and "disclosure requirements" as to deposit taking by national banks. 12 CFR 7.4007. Since Consumer Defense's claim was that Wells didn't adequately disclose the changed overdraft protection policy, the preemption argument seemed pretty strong.

Wells Fargo won at the trial level but lost on appeal. The state appeals court took the position that a UCL (state law) cause of action is not preempted when it is based on the "predicate act" of a national bank's alleged violations of federal law, even when the federal law itself does not provide for civil liability. The state lawsuit merely serves to enforce the requirements imposed by the federal law, according to the court.

The *Smith* decision is not the first time that California state courts have used the infinitely flexible UCL to effectively gut federal preemption. Some years ago a similar theory was used to allow a consumer plaintiff to work around the OTS preemption rules regarding lending activities. *Gibson v. World Savings & Loan Association*, 103 Cal. App. 4th 1291 (2002).

The message to financial institutions doing business in California, even those with federal charters, is that the threat of consumer class-action litigation in state courts remains real. All a plaintiffs' lawyer needs to do is crack open a book of federal banking laws, find a provision he or she thinks an institution did not comply with in full, and then file a lawsuit in state court alleging a claim under the UCL or CLRA. A second point is that a strong and effective compliance program can help protect an institution against civil liability as well as regulatory criticism.

SUPREME COURT RULES ON ADJUDICATION OF NATIONAL BANK CASES

In a unanimous decision, the U.S. Supreme Court has reversed a Fourth Circuit Court of Appeals ruling that a

national bank is "located" in, and therefore a citizen of, any state in which it has a branch. *Wachovia Bank, NA v. Schmidt*, 126 S. Ct. 941 (2006). The high court ruling helps ensure that national banks will have access to a federal forum for diversity-jurisdiction purposes.

The plaintiff sued Wachovia in a South Carolina state court for fraudulently inducing them to participate in an illegitimate tax shelter. Wachovia then filed a petition in federal district court seeking to compel arbitration of the dispute. In seeking federal court jurisdiction, Wachovia relied solely on the parties' *diverse citizenship*. Federal courts have "diversity jurisdiction" over cases between citizens of different states, even if the underlying dispute is based entirely on state law. Wachovia is headquartered in North Carolina and argued it was not "located" in South Carolina, even though it has branches there. Ultimately, the outcome hinged upon the definition of the term "location."

The Supreme Court opinion stresses that "venue and subject-matter jurisdiction are not concepts of the same order Subject matter jurisdiction . . . concerns a court's competence to adjudicate a particular category of cases; a matter far weightier than venue." In evaluating congressional intent, the Court noted that when the governing statutes were enacted, national banks could not even operate a branch outside their home state, and that the terms "located" and "established" were used somewhat interchangeably in the law. The term "located" does not have a fixed, plain meaning in the National Bank Act. In some provisions of the related statutes, "located" refers to a bank's main office, but in others it includes branch offices. At the end of the day, the analysis likened national banks to corporations which are considered citizens only of states in which they are incorporated or maintain their principal place of business. To do otherwise, the court stated, would unduly restrict national banks' access to diversity jurisdiction relative to the access granted to other comparable corporations.

This case preserves the federal courts as the "go to" jurisdiction for federally-chartered financial institutions, which are generally seen as more favorable to corporate interests.

FOR ADDITIONAL INFORMATION...

If you have questions, please contact Alan White, Timothy Lambirth or Keith Forrester of Aldrich & Bonnefin.