MEMORANDUM OF LAW

DATE: January 6, 2000

TO: Honorable Mayor and Members of the City Council

FROM: City Attorney

SUBJECT: Local Authority to Prohibit ATM Fees

INTRODUCTION

Recently, the cities of Santa Monica and San Francisco [Cities] passed ordinances prohibiting financial institutions from imposing a surcharge, or "convenience fee," on noncustomers who use the banks' automated teller machines [ATMs] to access their own bank accounts. Santa Monica passed the ordinance by Council action; San Francisco by popular vote on an initiative. Bank of America, N.T. & S.A. [BofA], Wells Fargo, N.A. [Wells Fargo] [collectively, Banks], and the California Bankers Association filed suit in the United States District Court for the Northern District of California seeking to permanently enjoin the enforcement of both the Cities' ordinances, on the grounds they are preempted by federal banking law. On November 15, 1999, the District Court granted the Banks' motion for preliminary injunction.

In a memorandum dated October 18, 1999, Deputy Mayor Byron Wear asked whether the City of San Diego can and should pass a similar ordinance.

QUESTION PRESENTED

May the City of San Diego pass and enforce an ordinance prohibiting financial institutions within the city from charging an ATM usage surcharge on noncustomers who use the banks' ATMs to access their own bank accounts?

SHORT ANSWER

A local ordinance prohibiting such surcharges on ATM usage is probably preempted by both state and federal law. With respect to federal preemption, the courts in this state will likely

follow the lead of the recent decision from the United States District Court for the Northern District of California. That district court held that as to federally chartered banks, such local measures are preempted. Further, provisions of the California Financial Code, principles of statutory construction and legislative history make a strong case for finding that such a local ordinance would not be allowed as to state-chartered banks, because of a statewide interest in the uniform regulation of such institutions.

DISCUSSION

A. The Arguments of the Parties

The principal adversaries in this debate thus far, at least in California, have been the Cities, favoring such ordinances, and the Banks, who are opposed to such local measures. Because both Banks are federally chartered, their focus has been on the preemption of local regulation by federal law, specifically, the National Bank Act and regulations promulgated thereunder. However, authority also exists under state law for an implied preemption argument.

B._____Federal Preemption

The Banks, joined by the federal Office of the Comptroller of the Currency [OCC], argue first that the National Bank Act [NBA], and regulations promulgated under the NBA, give federally chartered banks the right to impose the challenged surcharges (or "convenience fees," in the Banks' parlance). Second, they claim that this grant of authority preempts any state (or local) effort to prevent the imposition of these surcharges. They refer specifically to 12 U.S.C. 24, which provides that a national bank may exercise "all such incidental powers as shall be necessary to carry on the business of banking," and 12 C.F.R. 7.4002, which allows national banks to charge fees for any such services provided. The OCC has opined that the ability to operate ATMs and to charge fees for that service are incidental powers essential to the business of banking. The OCC concludes, therefore, that states may not regulate these aspects of a federally chartered bank's operations. The Eighth Circuit Court of Appeals recently agreed with the Banks and the OCC, ruling that an Iowa statute prohibiting national banks from operating ATMs in that state without an in-state office was preempted by the NBA. *Bank One, Utah v. Guttau*, 190 F.3d 844, 846 (8th Cir. 1999). The underlying principle is that, unless Congress allows for state regulation of a particular aspect of national banks' operation, any such regulation is preempted by federal law.

The Cities argued in court that the Electronic Funds Transfer Act, 15 U.S.C. 1693-1693r [EFTA], provides such explicit authority for state regulation. In Section 1693q, Congress provided that this regulatory framework for certain aspects of ATM operations "does not annul, alter, or affect the laws of any State relating to electronic fund transfers, except to the extent that those laws are inconsistent with the provisions of this subchapter, and then only to the extent of the inconsistency." This section also provides that a state ATM law is not inconsistent with the EFTA "if the protection such law affords any consumer is greater than the protection afforded by this chapter." These provisions, argued the Cities, explicitly allow states to regulate ATMs, including the fees they charge. Essentially, the Cities dismissed the general provisions of the NBA and OCC regulation, cited by the Banks and OCC, and argued that the

more specific provisions of the EFTA control; because the EFTA allows additional state regulation, the Cities argued, the ordinances are not preempted.

The District Court disagreed with the Cities' arguments and adopted the reasoning of the Banks and OCC. The OCC's determination, that local ordinances prohibiting ATM surcharges are preempted by federal law and regulation, was accorded great weight by the district court.[1] Despite the fact that ATMs are not expressly enumerated in these laws, the District Court found that the operation of ATMs generally, and the charging of fees therefor, is central to the Banks' operation and is covered by the general laws of the NBA, and OCC regulation.

Addressing the Cities' arguments concerning the EFTA, the District Court agreed with the Eighth Circuit in *Guttau* that "the antipreemption provision of the EFTA is specifically limited to the provisions of the EFTA [and] does not extend to any other federal statute and does not grant the states or municipalities any additional authority that the states would not otherwise possess." *Bank of America*, Transcript of Proceedings, at 69-70. The court then found that ATM *fee* regulation is not included in the scope of the EFTA:

The kind of consumer protection measures that the EFTA appears to contemplate for the states and localities relate to ATM user safety, such as location, installation and lighting of ATM[s] and, possibly, disclosure of fees and other terms and conditions of electronic transfers. ATM fee regulation goes to the ability of a national bank to install and operate ATMs and cannot under any reasonable stretch be considered a measure necessary to protect consumers.

Bank of America, Transcript of Proceedings, at 70. In short, the court found that the general powers of national banks to operate ATMs, provided by the NBA and OCC regulation, include the right to charge fees for that operation, and that this grant of power preempts the states' ability to regulate such operations. The regulation of ATMs by the EFTA (which would allow some state regulation) covers only certain types of consumer protection regulation, *not* the charging of fees for ATM services.

C. State Preemption

In deciding whether a local ordinance prohibiting such surcharges would withstand judicial challenge, the first question to address is whether a city would be preempted by state law from enacting such a local ordinance.[2] The city attorneys for the Cities have taken the position that such local regulation is not preempted by state law. For the reasons expressed below, we cannot agree with their rationale. State law expressly allows financial institutions to charge fees for a variety of services. We believe this express authorization extends to fees for ATM services, and that a contrary local ordinance would be preempted. Moreover, the legislature has acknowledged in other contexts that there is a statewide interest in uniformity of bank regulation; thus, state law allowing the Banks to charge such fees preempts any local measures to the contrary, even by charter cities such as San Diego.

1. Charter Cities and the Preemption Doctrine

Pursuant to Article XI, section 5, subdivision (a) of the California Constitution, a charter

city such as the City of San Diego operates under the "home rule" doctrine, which gives the City supreme authority over all matters which are deemed to be "municipal affairs."

> In such cases, the city charter supersedes conflicting state law. If the statute in question addresses an area of "statewide concern," however, then it is deemed applicable to charter cities. [Citations]. In deciding whether a matter is a municipal affair or of statewide concern, the Legislature's declared intent to preempt all local law is important but not determinative."

DeVita v. County of Napa, 9 Cal. 4th 763, 783 (1995). As to matters of statewide concern, home rule charter cities remain subject to and controlled by applicable state laws, regardless of their charter provisions, if it is the intent and purpose of such general laws to occupy the field to the exclusion of municipal regulation (the preemption doctrine). *Bishop v. City of San Jose*, 1 Cal. 3d 56, 61-62 (1969).

In sum, a charter city may legislate on "municipal affairs," even if the local legislation conflicts with state law. On matters of "statewide concern," however, a charter city may not enact legislation that conflicts with state law. A conflict exists if the local legislation prohibits an act that the state law expressly authorizes, or authorizes an act that the state law expressly prohibits. *Sherwin-Williams Company v. City of Los Angeles*, 4 Cal. 4th 893, 902 (1993). In each case where a conflict exists, it ultimately becomes necessary for the courts to decide whether the subject matter under discussion is of municipal or statewide concern. *Bishop*, 1 Cal. 3d at 62. The courts will give "great weight" to the legislature's stated intent, but it is not controlling; rather, the courts must look at each factual situation on its own and "allocate the governmental powers under consideration in the most sensible and appropriate fashion as between local and state legislative bodies." *Johnson v. Bradley*, 4 Cal. 4th 389, 399-400 (1992).

In this situation, the court would first consider whether an ordinance prohibiting ATM surcharges conflicts with state law. If a conflict were found, the court would then look to the intent of the legislature as well as the practical considerations of allowing individual cities to regulate the business of banking, to determine whether the matter was one of statewide concern, preempting local legislation, or a municipal affair that may be regulated at the local level.

2. Conflicts Between State Law and Local Legislation Regarding ATM Surcharges

The California Bankers' Association has identified California Financial Code section 778 as a state law that expressly allows banks to impose ATM surcharges. That section provides:

(a) A commercial bank may provide electronic data-processing services and may charge a fee therefor.

(b) As used in this section, "electronic data-processing" means the process that encompasses all computerized and auxiliary automated information handling, including systems analysis and design, conversion of data, computer

> programming, information storage and retrieval, data transmission, requisite system controls, simulation, and all the related operator-machine interaction.

This section does not enumerate ATM fees (or any other type of fee, for that matter), but it is located in that part of the Financial Code that sets forth the laws generally applicable to commercial banks. The question presented is thus whether ATM services fall within the definition of services, set forth in Section 778(b), for which fees are expressly authorized. We believe they do.

> There is no single definition of "ATM" in the Financial Code, but the various provisions defining it are substantively the same. Under Financial Code section 550, for example, ATMs are defined as "any electronic information processing device used by a financial institution and its customers for the primary purpose of executing transactions solely between the financial institution and its customers . . . ." Financial Code section 13020 defines ATMs as "any electronic information processing device located in California which accepts or dispenses cash in connection with a credit, deposit, or convenience account." Matching these definitions with that provided in section 778, we conclude that ATM services are included in the scope of section 778, and accordingly that fees for ATM services are expressly authorized by state law.

Acknowledging that a conflict with section 778 would render its local ordinance preempted, the city attorney for Santa Monica has opined that section 778 does not apply to ATM fees. He first notes that section 778 is general in nature, then turns to more specific statutes pertaining to ATMs (such as Financial Code section 13080, which prescribes the manner in which banks must disclose ATM fees). Pointing out that these specific ATM-focused statutes do not expressly preempt local regulation of ATM fees, he concludes that there is nothing in state law which prevents a local government from prohibiting ATM fees.[3] Mirroring the Cities' arguments in the district court based on the EFTA, he argues that because these specific ATM laws contain no express preemption of local regulation, none can be read into the more general provisions of the Financial Code. Indeed, he concludes that "it is both a logical and linguistic stretch to argue that automated teller machines constitute 'information handling' within the meaning of section 778."

We disagree. As set forth above, the legislature has defined ATMs variously as "any *electronic information processing device* used by a financial institution and its customers for the primary purpose of executing transactions solely between the financial institution and its customers," and "any *electronic information processing device* located in California which accepts or dispenses cash in connection with a credit, deposit or convenience account." It seems a longer stretch to find that such an "electronic information processing device" is not included in the definition of "electronic data-processing . . . [including] all computerized and auxiliary automated information handling" for which a fee is expressly authorized by section 778. We believe a court would likely find that "electronic information processing" and "electronic information handling" are the same, and that as such section 778 expressly authorizes banks to impose the challenged ATM fee. A municipal ordinance prohibiting ATM fees would therefore be contrary to state law. If the court then found that the regulation of banking is a matter of statewide concern, local legislation to the contrary would be preempted.

Our analysis of these Financial Code sections tracks the district court's analysis of the relationship between the consumer protection provisions of the EFTA, and the general provisions of the NBA: the permissive nature of ATM statutes related to disclosure of fees does not extend to the broad commercial banking sections of the Financial Code, including section 778, governing general bank operations.

3. Legislative Intent Regarding the Regulation of Banking

The legislature and courts in California have not expressly stated that the regulation of basic banking operations (which, as the *Bank of America* judge found, includes the operation of ATMs and the charging of fees therefor) is a matter of statewide concern that would preclude contrary local regulation. But other acts and statements of the legislature establish a statewide interest that we believe would preempt local regulation. For example:

(1) In 1996, the legislature enacted AB 3351, consolidating into a single regulatory agency the four state offices which had previously regulated various forms of banking. In so doing, the legislature expressly found that

> Consolidating the regulation of depository corporations and other providers of financial services presently regulated by the State Banking Department in a single department is in the public interest . . . the regulation of all four categories of depository corporations by a single department is expected and intended to be more efficient and cost-effective than regulation by multiple departments.

1996 Cal. Legis. Serv. Ch 1064 (A.B. 3351 Weggeland), section 1(c),(d). The legislature's stated interest in a single source for banking regulation, and in the benefits to be derived thereby, would be defeated if individual cities in California could operate as localized regulatory agencies.

(2) In 1979, the legislature amended Revenue and Taxation Code section 23182 to confirm that the state’s imposition of certain taxes on financial institutions was "in lieu of" and therefore preempted certain local taxes on financial institutions. The legislature based this action on, among other things, its finding "that divergent and competing local tax measures imposed on financial corporations impair the *uniform statewide regulation of banks and financial corporations*." [emphasis added]. This finding confirms that the uniform regulation of banks is a matter of statewide interest. Local regulation of ATM operations and fees would impair the same statewide interest.

Twice in recent years, state legislators have tried to pass bills that would prohibit the same fees prohibited by the San Francisco and Santa Monica ordinances. In 1996, A.B. 46 (Sweeney) would have amended Financial Code section 13080 – the statute that presently requires disclosure of surcharges – to prohibit such surcharges altogether except in specific circumstances. SB 270 (Karnette), introduced in 1999, was nearly identical. The Sweeney bill failed; the Karnette bill did not pass last year but is still pending at the committee level.

CONCLUSION

Federally chartered banks have a strong argument, adopted by the federal courts in the Eighth Circuit, and in the Northern District of California, that federal law allowing national banks to impose a surcharge for the use of their ATMs preempts state or local action to prohibit such charges. The federal preemption principle would not apply to state-chartered banks; however, courts would likely find that the regulation of banking operations and fees is a matter of statewide concern, and thus preempts local legislation that is contrary to state law. Financial Code section 778 allows state banks to charge fees for a variety of electronic data processing services. The definition of "electronic data processing services" is sufficiently broad to include ATM surcharges. Local ordinances to the contrary would be preempted.

The Cities in the *Bank of America* case have appealed the district court's ruling to the Ninth Circuit Court of Appeals, and the Ninth Circuit has set an expedited schedule for the briefing and hearing of the case. The Ninth Circuit's decision will give all cities in California greater guidance on the federal preemption issue as it relates to federally chartered banks. Since many of the largest banks in San Diego (Bank of America, Wells Fargo and Union Bank, for example) are all national banks, the Ninth Circuit's decision in this case will be significant as you decide how to handle this issue. We will continue to monitor the law as it develops in the courts of this and other states, and will keep you advised of anything that either changes or reinforces the opinions stated in this memorandum.

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