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GUEST COMMENTARY

NATIONAL ASSOCIATIONS *ARE* SUBJECT TO DUTIES AND LIABILITY UNDER CALIFORNIA'S EJL

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Is a bank chartered as a national association, an entity organized and existing under federal law, subject to duties and potential liability arising out of a state's statutory regime for enforcement of judgments? In *Grayson Services, Inc. v. Wells Fargo Bank*, No. F059773, 2011 WL 4436470 (Cal. Ct. App. 09/26/11), a case of first impression in California, the California Court of Appeal answered in the affirmative. The appellate panel concluded that a national banking association is a person under California's Enforcement of Judgments Law and is subject to the duties and liabilities imposed on third persons by the EJL.

At first blush, to the extent banks chartered as national associations already strive to comply with state regulations, *Grayson* appears to present a non-issue. However, placed against the backdrop of recently promulgated federal regulations, the California Court of Appeal's decision underscores an ongoing tension between state law and federal oversight.

FEDERAL REGULATIONS RESTRICT GARNISHMENT

Federal oversight of bank activities has been steadily on the rise. One recent step in this progression was the U.S. Department of the Treasury's publication of the interim final rule, 31 C.F.R. § 212, in February of this year. 31C.F.R. § 212, which went into effect on May 1, 2011, imposes requirements on financial institutions to change the way they process and respond to garnishments of accounts containing federal benefits. Among other requirements, the regulation outlines specific timelines and processes that financial institutions must follow:

- *Within two days of receipt of the garnishment order*, determine whether there is a Notice of Right to Garnish Federal Benefits (§ 212.4).

- *No later than two business days following receipt of the garnishment order* or other information sufficient to determine whether the debtor is an account holder, perform an account review (§ 212.5(a)).
- *Prior to taking any other actions related to the garnishment*, perform an account review (§ 212.5(e)) and calculate, protect and ensure access to the protected amount (§ 212.6).
- *Within three business days of the account review*, provide notice to the account holder of the garnishment order, the protected amount, and a listing of Federal benefit payments subject to protection, and the account holder's rights to assert further exemptions and seek legal advice (§ 212.7).

The intent of § 212 is to ensure that, in complying with state regulations governing garnishments of deposit accounts, banks do not inadvertently violate federal laws. For example, a state regulation may require a bank to freeze a judgment debtor's account immediately upon receipt of a garnishment order. However, if federal benefits have been deposited into the debtor's account, freezing the account would conflict with federal law that safeguards from garnishment benefit payments from the Social Security Administration, Veterans Administration, Railroad Retirement Board and the Office of Personnel Management. The procedures set forth in § 212 are aimed to prevent this conflict from occurring.

To protect its intended impact, and in recognition of potential conflicts with state law, § 212 expressly preempts conflicting state laws. Specifically, § 212.9(a) provides preemption of "[a]ny State or local government law or regulation … if it requires a financial institution to take actions or make disclosures that contradict or conflict with the requirements of this part or if a financial institution cannot comply with the State law or regulation without violating this part."

NATIONAL ASSOCIATIONS BOUND BY CALIFORNIA EJL

Enter *Grayson Services, Inc. v. Wells Fargo Bank*. In *Grayson*, which issued on Sept. 26, 2011, the California Court of Appeal firmly establishes that banks chartered as national associations may not escape application of California's EJL, codified at Cal. Civ. Proc. Code § 680.010 *et seq*., by simply asserting that they fall outside the definition of "third persons" under the EJL. Whether intended or not, the effect of this decision is to prevent a national bank caught between federal and state regulations from resolving the tension by disregarding the latter.

In *Grayson*, a judgment creditor brought a claim against Wells Fargo Bank for, *inter alia*, noncompliance with a writ of execution and levy. Under the EJL at § 701.020(a)(1)-(2), "third persons" who fail or refuse to comply with a levy are liable for the lesser of either "[t]he value of the judgment debtor's interest in the property or the amount of the payments required to be made" or "[t]he amount required to satisfy the judgment pursuant to which the levy is made." If the third person's liability is established, the court additionally has discretion under § 701.020(c) to award the judgment creditor costs and reasonable attorney fees.

The trial court eliminated Grayson's claim at the pleading stage. It reasoned that a claim for violation of duties the EJL imposed on "third persons" could not lie against Wells because, as a "financial institution," it was not a "person" for purposes of the EJL. The California Court of Appeal disagreed. In its strikingly detailed analysis, the court explained that a bank chartered as a national association *is* a "person" as defined in § 680.280 and, accordingly, is subject to the duties and liabilities imposed on "third persons" by California's EJL.

The Court of Appeal based its holding on two main findings. First, the court rejected the trial court's reasoning that the EJL's definitions for "person" and "financial institution" are mutually exclusive. Following general principles of statutory construction, the court noted that neither the definition of "person" (which "includes a natural person, a corporation, a partnership or other unincorporated association, a general partner of a partnership, a limited liability company, and a public entity") nor the definition of "financial institution" (which includes "a state or national bank, state or federal savings and loan association or credit union, or like organization, and includes a corporation engaged in a safe deposit business") contain no words of exclusion. To the contrary, the words of the definitions demonstrate that those definitions overlap. As such, the fact that a bank chartered as a national association is a "financial institution" does not preclude a finding that it is also a "person" for purposes of the EJL.

Second, the Court determined that a bank chartered as a national association is a "person" under the EJL because it is *either* a corporation *or* an unincorporated association. The court began by noting that, to the extent an entity might be called an "incorporated association," it would be regarded as a corporation and therefore a person for purposes of the EJL. Next, the court established the "usual, ordinary meaning" of "unincorporated association" to be "a group or organizations of two or more people or entities that is not incorporated."

Then the court explained that a national banking association is either a corporation or an unincorporated association. On the one hand, the court observed, a bank chartered as a national association is a federally chartered entity labeled an "association" by federal law. Thus, strictly adhering to the federal label, a national

banking association would be classified as an "unincorporated association" for purposes of the EJL. On the other hand, a national banking association is a federally chartered entity with the organizational characteristics of a corporation, such as "a body corporate" with power to elect or appoint a board of directors and prescribe bylaws, and a requirement to file articles of association with the Office of the Comptroller of the Currency. The court went on to note that no statutory purpose is frustrated by its interpretation, and that other portions of the statutory scheme assume that a financial institution is a "third person" under the EJL.

Finally, the court stated that its finding was consistent with other published cases. *Grayson* cites two cases in support of this assertion, *Grover v. Bay View Bank*, 87 Cal.App.4th 452 (2001) and *Da-Green Electronics, Ltd. v. Bank of Yorba Linda*, 891 F.2d 1396 (9th Cir.1989). The applicability of *Grover* and *Da-Green* to *Grayson* seems clear: In both of these cases, a judgment creditor brought claims under the EJL for noncompliance with a writ of execution and levy; and, in both cases the court presupposed that the banks faced potential liability under the EJL.

Yet neither *Da-Green* nor *Grover* contains any analysis of whether a bank chartered as a national association is a "person" subject to liability under the EJL. Indeed, neither even discusses whether the respective defendant banks were chartered as national associations. Moreover, the *Da-Green* defendant is named as "Bank of Yorba Linda, a California Corporation," indicating that it in fact is *not* a national association. As such, *Da-Green* and *Grover* to a certain extent appear inapposite to *Grayson*'s finding that a bank chartered as a national association is a "person" under the EJL. Nonetheless, *Grayson*'s citation to these cases signals that the court interprets the EJL to apply equally to all banks, regardless of whether they are chartered as national associations.

GRAYSON PREVIEWS RESPONSE TO FEDERAL -STATE TENSION

What is most remarkable about the Court of Appeal's decision in *Grayson* is not the conclusion that California's EJL applies to national associations. After all, banks chartered as national associations already expend significant resources to ensure compliance with state garnishment laws.

Rather, what is noteworthy is the Court of Appeal's attention to the issue. The appellee barely addressed the matter in its responding brief, and the court noted that Wells actually "conceded that the EJL applied to Wells" at oral argument. Yet, the court devotes nearly one-third of the opinion — the only published portion — to the question.

Seemingly, the Court of Appeal believed it worth the effort to ensure that banks chartered as national associations understand that they are to be treated no differently than other financial institutions for purposes of the EJL. Given the increase of federal oversight and broadening regulatory authority over financial institutions in recent years, *Grayson*'s exhaustive analysis may be the Court of Appeal's way of reasserting California state law over financial institutions that choose to do business in California.

Regardless of the court's intent, *Grayson* reinforces one of the many complications that a national association must navigate between state and federal laws. As litigation over federal preemption of state law continues to mount, *Grayson* may be an indication of how California courts will react to arguments over more subtle distinctions that would deny application of state law.