LOOKING AHEAD AFTER *WATTERS V. WACHOVIA BANK*: CHALLENGES FOR LOWER COURTS, CONGRESS, AND THE COMPTROLLER OF THE CURRENCY

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Introduction

The Supreme Court's recent decision in *Watters v. Wachovia Bank*[2] dealt a major blow to consumers by shielding operating subsidiaries of national banks from the reach of state banking

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[2] 127 S. Ct. 1559 (2007).

officials, despite the states' demonstrated vigilance and success in consumer protection.[3] The ruling prevents the Commissioner of the Michigan Office of Insurance and Financial Services from enforcing the state's licensing, registration, and inspection laws against Wachovia Mortgage Corporation, a state-chartered operating subsidiary of Wachovia Bank.[4] Absent congressional intervention, hundreds of national bank operating subsidiaries that engage in mortgage lending and a wide range of other activities will be regulated almost exclusively by the Office of the Comptroller of the Currency ("OCC"), a federal agency that in recent years has sought to expand its own authority while showing little zeal in enforcing consumer protection laws.

The ultimate effect of this troubling decision will depend on how the lower courts and Congress respond. Although the result of the case is itself highly damaging, lower courts should note that the Supreme Court's reasoning was limited in several key respects. The primary question on which the Court granted certiorari was whether it should defer to a federal agency's interpretation of that agency's own preemptive authority—an issue of major significance due to the Bush Administration's unprecedented efforts to preempt a wide variety of state laws through rulemaking.[5] As Section II.A below explains, the majority's surprising evasion of this issue, combined with language from the dissent and earlier Court opinions, suggests that the current Court would not defer to an agency's assessment of its own preemptive authority under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[6] As Section II.B below explains, the majority also stopped short of expressly rejecting the applicability of the historic presumption against preemption to the banking context, despite invitations from Wachovia and its *amici* to do so.

In interpreting the National Bank Act, the Court also left undecided a number of key statutory questions that have arisen in recent years as the OCC has sought to preempt state laws and expand

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[3] *Id.* at 1564-65.

[4] *Id.*

[5] *See, e.g.,* Stephen Labaton, *'Silent Tort Reform' Is Overriding States' Powers*, N.Y. TIMES, Mar. 10, 2006, at C5; Caroline E. Mayer, *Rules Would Limit Lawsuits: U.S. Agencies Seek to Preempt States*, WASH. POST, Feb. 16, 2006, at D1.

[6] 467 U.S. 837 (1984).

its exclusive "visitorial" or supervisory powers. Section II.C below discusses three primary sets of issues that have surfaced under the National Bank Act: (1) whether entities beyond national banks can assert preemption under the Act or invoke the Act's "visitorial powers" provision; (2) what substantive laws are preempted under the Act; and (3) what constitutes a prohibited exercise of "visitorial powers" under the Act, including whether enforcement activities by officials other than state banking officials are included.

Watters explicitly answers part of the first question in the OCC's favor, holding that operating subsidiaries of national banks may use the National Bank Act to shield themselves from state visitorial laws.[7] Although some have read the decision to support extending immunity more broadly, the Court's emphasis on certain unique features of operating subsidiaries suggests that lower courts should not allow other entities, such as third parties and agents of national banks, to invoke the Act's protections.

As to the substantive laws that are preempted under the National Bank Act, despite some broad preliminary language in the majority opinion, both the majority and the dissent reiterated the well-established standards that the Court has traditionally applied in analyzing preemption issues in the banking context rather than embracing a more expansive test. Because the only defendant in the case was a financial regulator and no one questioned that the statutes at issue were "visitorial" in nature, *Watters* left for another day a determination of what types of activities are prohibited visitations and whether non-banking officials such as state attorneys general can enforce state laws that are not preempted.

While *Watters* thus left a number of preemption and visitation issues open for the lower courts and even signaled a reluctance to embrace some of the OCC's positions, there are damaging aspects of the decision and of the OCC's campaign to augment its own authority that lower courts cannot or will not fix and that cry out for congressional attention. As explained in section III below, Congress should send a clear message to the courts and the OCC about the need for states to continue to play their historic consumer protection role and the importance of competitive equality in our dual banking system.

Finally, no discussion of *Watters* or the OCC's preemption efforts would be complete without noting the gargantuan task that

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[7] *Watters*, 127 S. Ct. at 1564-65.

now exclusively rests, at least temporarily, in the OCC's hands. Having successfully ousted state financial regulators from virtually any role in overseeing national bank operating subsidiaries, the OCC has an obligation to deliver on its promises by greatly increasing its efforts to protect consumers, as discussed in section IV below.

I. Background on the Watters *Case*

A. 12 U.S.C. § 484(a) and the OCC's Preemption and Visitation Regulations

12 U.S.C. § 484(a) provides: "No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or . . . exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized."[8] This provision generally protects national banks from "visitation," which the Supreme Court has defined as "the act of a superior or superintending officer, who visits a corporation to examine into its manner to conducting business, and enforce an observance of its laws and regulations."[9] The core issue in *Watters* was whether operating subsidiaries of national banks can assert a similar immunity from oversight by state banking officials even though section 484(a) refers only to national banks.[10]

Before the case arose, the OCC had answered this question in the affirmative through rulemaking. In 2001, the OCC promulgated an operating subsidiary rule in 12 C.F.R. § 7.4006 providing that "[u]nless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank."[11] In justifying its rule, the OCC asserted that operating subsidiaries had "been authorized . . . for decades" as "an embodiment of the incidental powers of their parent bank" under 12 U.S.C. § 24 (Seventh) and "often have been described as the equivalent of a

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[8] 12 U.S.C. § 484(a).

[9] Guthrie v. Harkness, 199 U.S. 148, 158 (1905) (internal quotation marks omitted), *quoted in Watters*, 127 S. Ct. at 1568.

[10] *Watters*, 127 S. Ct. at 1564.

[11] 12 C.F.R. § 7.4006.

department or division of their parent bank."[12] The OCC also pointed to language added by the Gramm-Leach-Bliley Act that, in defining a "financial subsidiary," limits operating subsidiaries to "'activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks.'"[13]

In 2004, the OCC further expanded its own authority at the states' expense by issuing a revised "visitorial powers" rule in 12 C.F.R. § 7.4000 and a series of preemption rules now found in 12 C.F.R. § 7.4007 (deposit-taking), § 7.4008 (non-real estate lending), § 7.4009 (incidental powers regarding other national bank operations), and § 34.4 (real estate lending).[14] In the revisions to its "visitorial powers" rule, the OCC asserted exclusive visitorial authority over the "content and conduct of [any] activities authorized for national banks under Federal law" and took the position that the "vested in the courts of justice" exception in section 484(a) does not provide any authority for state attorneys general or other governmental entities "to inspect, superintend, direct, regulate or compel compliance by a national bank with respect to any law, regarding the content or conduct of activities authorized for national banks under Federal law."[15] In the four new preemption rules, the OCC set up a general principle that state laws do *not* apply to national banks unless the laws no more than "incidentally affect" the national bank's

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[12] Investment Securities; Bank Activities and Operations; Leasing, 66 Fed. Reg. 8178, 8181 (Jan. 30, 2001) (codified at 12 C.F.R. § 7.4006).

[13] *Id.* at 8181 (quoting Gramm-Leach-Bliley Act, Pub. L. 106-102, § 121, 113 Stat. 1338, 1378 (codified at 12 U.S.C. § 24a(g)(3))).

[14] 69 Fed. Reg. 1895 (Jan. 13, 2004) (codified at 12 C.F.R. § 7.4000); 69 Fed. Reg. 1904 (Jan. 13, 2004) (codified at 12 C.F.R. § 7.4007, § 7.4008, § 7.4009, and § 34.4); *see also* Clearing House Ass'n, L.L.C. v. Cuomo, 510 F.3d 105, 119 (2d Cir. 2007) ("[The OCC] accretes a great deal of regulatory authority to itself [in its 2004 visitorial powers regulation] at the expense of the states through rulemaking lacking any real intellectual rigor or depth.").

[15] 69 Fed. Reg. at 1895, 1904 (codified at 12 C.F.R. § 7.4000); *see also Clearing House Ass'n*, 510 F.3d at 111 ("The revised rule added 'prosecuting enforcement actions' against [national] banks as an example of prohibited state visitorial powers."); *infra* Section II.c.iii.

exercise of its powers.[16] These new rules preempt state laws that "obstruct," "impair," or even merely "condition" the exercise of a national bank's powers.[17] As explained in Section II.C.ii below, the rules reflect a significant departure from prior caselaw, which had found state laws to be preempted only if they "prevent or significantly interfere with" the exercise of a national bank's powers.[18] In preambles to the rules, the OCC took the position that 12 U.S.C. § 484(a) and the 2004 rules apply to national bank operating subsidiaries to the same extent as to their parent national banks under 12 C.F.R. § 7.4006 and the OCC regulation that parroted the "terms and conditions" language from the Gramm-Leach-Bliley Act, 12 C.F.R. § 5.34(e)(3).[19]

B. The *Watters* Dispute and Ruling

The dispute in *Watters* was about whether several Michigan mortgage laws apply to national bank operating subsidiaries. As the Court explained:

> The challenged provisions [of two Michigan statutes —the Mortgage Brokers, Lenders, and Services Licensing Act[20] and the Secondary Mortgage Loan Act[21]] (1) require mortgage lenders—including national bank operating subsidiaries but not national banks themselves—to register and pay fees to the State before they may conduct banking activities in Michigan, and authorize the commissioner to deny

[16] 69 Fed. Reg. at 1913, 1916-17 (codified at 12 C.F.R. § 7.4007, § 7.4008, § 7.4009, and § 34.4).

[17] 69 Fed. Reg. At 1910, 1916-17 (codified at 12 C.F.R. § 7.4007, § 7.4008, § 7.4009, and § 34.4).

[18] Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33 (1996); *see also* Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225, 237-52 (2004).

[19] 69 Fed. Reg. at 1913; 69 Fed. Reg. at 1900-01 & n.48.

[20] MICH. COMP. LAWS § 445.1651 et seq.

[21] MICH. COMP. LAWS § 493.51 et seq.

> or revoke registrations; (2) require submission of annual financial statements to the commissioner and retention of certain documents in a particular format; (3) grant the commissioner inspection and enforcement authority over registrants; and (4) authorize the commissioner to take regulatory or enforcement actions against covered lenders.[22]

Wachovia Mortgage, a North Carolina corporation that engages in mortgage lending in Michigan and other states, registered under these Michigan statutes from 1997 to 2003 and apparently had no particular difficulty complying with their requirements.[23] In 2003, Wachovia Mortgage became a wholly-owned operating subsidiary of Wachovia Bank, a national bank chartered by the OCC.[24] Wachovia Mortgage then informed the State of Michigan that it was surrendering its registration on the ground that the Michigan statutes requiring registration were preempted.[25] Michigan's Commissioner of Insurance and Financial Services advised Wachovia Mortgage that the company could not conduct mortgage lending activities in Michigan without registering and complying with applicable Michigan laws.[26] In response, Wachovia Mortgage and Wachovia Bank filed suit against the Commissioner in her official capacity, seeking declaratory and injunctive relief prohibiting the Commissioner from enforcing the requirements that they maintained were preempted.[27]

The U.S. District Court for the Western District of Michigan and the Sixth Circuit ruled in Wachovia's favor, concluding that the OCC's position on preemption was entitled to *Chevron* deference

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[22] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1565-66 (2007) (citations omitted).

[23] *Id.* at 1565; *see also id.* at 1580 (Stevens, J., dissenting) ("There is no evidence, and no reason to believe, that compliance with the Michigan statutes imposed any special burdens on Wachovia Mortgage's activities, or that the transfer in 2003 of its ownership from the holding company to the Bank required it to make any changes whatsoever in its methods of doing business.").

[24] *Id.* at 1565.

[25] *Id.*

[26] *Id.*

[27] *Id.*

and that the Michigan statutes therefore did not apply to Wachovia Mortgage.[28] Other federal appellate courts also extended *Chevron* deference to the OCC in cases involving the applicability of state law to national bank operating subsidiaries.[29] After granting certiorari in *Watters*, the Supreme Court held that "Wachovia's mortgage business, whether conducted by the bank itself or through the bank's operating subsidiary," is not subject to the "licensing, reporting, and visitorial regimes of the several States in which the subsidiary operates" and falls "outside the governance of state licensing and auditing agencies."[30] Unlike the lower courts, the Court based its holding on the National Bank Act itself, rather than on the OCC's regulations.[31]

C. The Effect of the Ruling on Consumers

The practical effect of the *Watters* decision is to shield a large number of institutions that engage in a broad range of activities from the oversight of state regulators who have shown much more interest in consumer protection than the OCC has. As of the end of 2006, the OCC had identified more than 400 national bank operating subsidiaries doing business directly with consumers.[32] These institutions include major players in the mortgage and student loan

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[28] Wachovia Bank v. Watters, 334 F. Supp. 2d 957, 963-65 (W.D. Mich. 2004), *aff'd*, 431 F.3d 556 (6th Cir. 2005).

[29] Nat'l City Bank of Indiana v. Turnbaugh, 463 F.3d 325, 330 (4th Cir. 2006), *cert. denied*, 127 S. Ct. 2096 (2007); Wells Fargo Bank v. Boutris, 419 F.3d 949, 957-67 (9th Cir. 2005); Wachovia Bank v. Burke, 414 F.3d 305, 309, 318-21 (2d Cir. 2005), *cert. denied,* 127 S. Ct. 2093 (2007); *see also Burke*, 414 F.3d at 315 n.6 (noting that some "courts addressing [National Bank Act] preemption issues have not applied *Chevron* but have adopted a similar approach requiring deference to a reasonable regulation issued within the OCC's authority").

[30] *Watters*, 127 S. Ct. at 1564-65.

[31] *Id.* at 1572 & n.13.

[32] *See* OCC, NATIONAL BANK OPERATING SUBSIDIARIES DOING BUSINESS WITH CONSUMERS, AS OF 12/31/2006 (2007), http://www.occ.gov/consumer/Report_May07%20-%202006.xls.

markets.[33] In 2005, just one operating subsidiary of National City Bank of Indiana, First Franklin Financial, originated over $29 billion in mortgages, composing 4.4% of the subprime market share that year.[34] Like national banks, operating subsidiaries are permitted to engage in a wide range of activities that extend well beyond lending, such as acting as a finder for used car sales or counseling clients on Medicare and Medicaid.[35]

Watters leaves these entities and their various activities under the almost exclusive oversight of the OCC, which has a weak record of consumer protection enforcement and lacks expertise beyond the banking context. Although the OCC has had authority to address unfair and deceptive practices under section 5 of the Federal Trade Commission Act ("FTC Act") since at least the 1970s, it stayed its hand for more than a quarter century before bringing its first such action in 2000.[36] Even as of June 2007, in the midst of

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[33] *Id.* (listing, *inter alia*, Chase Home Finance LLC, HSBC Mortgage Corporation (USA), and The Student Loan Corporation as national bank operating subsidiaries).

[34] 1 INSIDE MORTGAGE FINANCE, THE 2006 MORTGAGE MARKET STATISTICAL ANNUAL 187 (2006); OCC, NATIONAL BANK OPERATING SUBSIDIARIES DOING BUSINESS WITH CONSUMERS AS OF 12/31/2005 TO BE UPDATED ANNUALLY (2005), http://www.occ.treas.gov/consumer/Report%20-%202006%20for%20Op%20Sub%20pdf.pdf. Because National City Bank sold First Franklin Financial to Merrill Lynch in December 2006, First Franklin Financial is no longer a national bank operating subsidiary. *In Brief: Nat City Sells First Franklin*, AM. BANKER, Jan. 3, 2007, at 20.

[35] *See* OCC, ACTIVITIES PERMISSIBLE FOR A NATIONAL BANK, CUMULATIVE 2006, at 4, 12-13 (2007), *available at* http://www.occ.treas.gov/corpapps/BankAct.pdf (listing permissible activities for national banks and their operating subsidiaries, including "Medicare and Medicaid counseling" and finder activities); OCC Corporate Decision No. 97-60 (July 1, 1997), *available at* http://www.occ.treas.gov/interp/jul97/cd97-60.pdf (approving an application to expand an operating subsidiary's activities to include acting as a "finder" for used car sales and taking a fee for referring customers to "national auto service companies, such as Firestone, Jiffy Lube and other appropriate parties"); PATRICIA A. MCCOY, BANKING LAW MANUAL § 5.02 (2d ed. 2003).

[36] *See* Julie L. Williams & Michael S. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 BUS. LAW. 1243, 1244, 1246 & n.25, 1253 (2003) (citing authority from the early 1970s indicating that the OCC

serious problems in the mortgage market, the OCC had brought only two cases under the FTC Act against abusive mortgage lending practices.[37]

Under other federal consumer protection and fair lending laws,[38] the OCC's record of enforcement is also thin. During the

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had the authority to bring such actions under Section 8 of the Federal Deposit Insurance Act and recognizing that "[a]n obvious question is why it took the federal banking agencies more than twenty-five years to reach consensus on their authority to enforce the FTC Act"); *cf.* Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMPLE L. REV. 1, 72-73 (2005); Wilmarth, *supra* note 18, at 352-56 ("[T]he OCC's record in protecting consumers is not impressive. . . . To date the OCC has not issued a single public enforcement order against any of the largest national banks or their subsidiaries for abusive or predatory lending, even though allegations of misconduct were filed against several of them."). The action that the OCC brought in 2000 only came after more than a decade in which the target bank "had been well known in the . . . industry as the poster child of abusive consumer practices" and after a "California state prosecutor . . . embarrassed the OCC into taking action." Duncan A. MacDonald, Letter to the Editor, *Comptroller Has Duty to Clean Up Card Pricing Mess*, AM. BANKER, Nov. 21, 2003, at 17 (author is former General Counsel of Citigroup Inc.'s Europe and North American card businesses); *see also Frontline: Secret History of the Credit Card* (PBS television broadcast Nov. 23, 2004) (transcript available at http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/script.html) (discussing the OCC's response to complaints about the business practices of Providian Financial, a credit card company).

[37] *See Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 18 (2007) (statement of John C. Dugan, Comptroller of the Currency) [hereinafter *Dugan Testimony*], *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htdugan061307.pdf; *cf. Credit Card Practices: Current Consumer and Regulatory Issues: Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the H. Comm. on Fin. Servs.*, 110th Cong. 14-15, 18 (2007) (statement of Arthur E. Wilmarth, Jr., Professor of Law, George Washington Univ. Law School) [hereinafter *Wilmarth Testimony*], *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htwilmarth042607.pdf (discussing the OCC's enforcement record and remarking that most OCC actions against violations of consumer lending laws have targeted small national banks, even though "ten large banks accounted for four-fifths of all complaints received by the" OCC's Customer Assistance Group in 2004).

twenty-year period from 1987 to 2006, the OCC brought only four formal enforcement actions pursuant to its authority under the Equal Credit Opportunity Act[39] and/or the act's implementing Regulation B,[40] and from 1999 to 2006, the OCC made only six fair lending referrals to the U.S. Department of Justice.[41] For the years 1997 to 2006, the Federal Reserve Board reported only nine formal enforcement actions by the OCC under the Truth in Lending Act's Regulation Z.[42] No matter what steps the OCC may be taking behind the scenes, such limited public enforcement is inadequate.[43]

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[38] Federal consumer protection and fair lending laws give the OCC enforcement authority over national banks independent of the National Bank Act. *E.g.,* 15 U.S.C. § 1691c(a)(1)(A); 15 U.S.C. § 1607(a)(1)(A).

[39] 15 U.S.C. § 1691 et seq.

[40] 12 C.F.R. pt. 202.

[41] This information is contained in annual reports that the Federal Reserve Board and U.S. Attorney General must provide to Congress. *See* 2006 FED. RESERVE BD. ANN. REP. 103-07; 2005 FED. RESERVE BD. ANN. REP. 98-103; 2004 FED. RESERVE BD. ANN. REP. 69-73; 2003 FED. RESERVE BD. ANN. REP. 67-71; 2002 FED. RESERVE BD. ANN. REP. 75-79; 2001 FED. RESERVE BD. ANN. REP. 134-37; 2000 FED. RESERVE BD. ANN. REP. 104-08; 1999 FED. RESERVE BD. ANN. REP. 106-11; 1998 FED. RESERVE BD. ANN. REP. 220-24; 1997 FED. RESERVE BD. ANN. REP. 192-95; 1996 FED. RESERVE BD. ANN. REP. 199-203; 1995 FED. RESERVE BD. ANN. REP. 211-15; 1994 FED. RESERVE BD. ANN. REP. 224-28; 1993 FED. RESERVE BD. ANN. REP. 210-15; 1992 FED. RESERVE BD. ANN. REP. 196-201; 1991 FED. RESERVE BD. ANN. REP. 180-84; 1990 FED. RESERVE BD. ANN. REP. 166-69; 1989 FED. RESERVE BD. ANN. REP. 146-49; 1988 FED. RESERVE BD. ANN. REP. 149-51; 1987 FED. RESERVE BD. ANN. REP. 157-60; *see also* 15 U.S.C. §§ 1613, 1691f (requiring that each such annual report of the Federal Reserve Board shall include an "assessment of the extent to which compliance . . . is being achieved, and a summary of the enforcement actions taken by each of the agencies assigned administrative enforcement responsibilities"). The U.S. Attorney General's Reports to Congress for 1999 to 2006 are available online. U.S. DEP'T OF JUSTICE, CIVIL RIGHTS DIVISION, HOUSING AND CIVIL ENFORCEMENT SECTION, SPECIAL TOPICS RELATING TO OUR ENFORCEMENT PROGRAM (2007), http://www.usdoj.gov/crt/housing/housing_special.htm.

[42] *See* 1997-2006 FEDERAL RESERVE BOARD ANNUAL REPORTS, *supra* note 41.

[43] In congressional testimony in June 2007, the OCC claimed to have taken over 100 formal enforcement actions relating to various consumer protec-

While the OCC has suggested that national banks and their operating subsidiaries do not engage in significant consumer abuses,[44] ample evidence suggests otherwise. National banks or their operating subsidiaries have been defendants in a host of cases involving allegations of predatory lending.[45] Indeed, the OCC's Customer Assistance Group receives roughly 70,000 complaints and inquiries each year on consumer issues.[46] The agency has been criticized by consumer advocates as slow to respond to subprime mortgage lending and credit card abuses, despite the substantial role played by national banks in those markets.[47]

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tion issues since 2002. *Dugan Testimony*, *supra* note 37, at 17. This total is miniscule compared with the total of over 1,700 enforcement actions that the OCC brought against banks and institution-affiliated parties in fiscal years 2003 to 2006, suggesting that the agency has been much less aggressive with banks on consumer protection issues than on other matters. *See* 2006 OCC ANN. REP. 15, *available at* http://www.occ.treas.gov/annrpt/annual.htm; 2005 OCC ANN. REP. 21; 2004 OCC ANN. REP. 15; 2003 OCC ANN. REP. 16.

[44] In its brief in *Watters*, the United States reiterated the OCC's position that "the Comptroller has found 'no reason to believe that [abusive] practices are occurring in the national banking system to any significant degree.'" Brief for the United States as Amicus Curiae Supporting Respondents at 26, Watters v. Wachovia Bank, 127 S. Ct. 1559 (2007) (No. 05-1342), *available at* http://www.occ.treas.gov/law/sg_wattersvwachovia_1106.pdf [hereinafter United States Amicus Brief] (quoting 69 Fed. Reg. 1904, 1914).

[45] *See, e.g.,* Comments from National Consumer Law Center et al. to OCC, Banking Activities and Operations; Real Estate Lending and Appraisals, Docket No. 03-16 (Oct. 6, 2003), *available at* http://www.nclc.org/initiatives/test_and_comm/10_6_occ.shtml (listing examples of cases alleging violations of law and/or predatory lending by national banks or their operating subsidiaries).

[46] *Dugan Testimony*, *supra* note 37, at 20.

[47] *See Improving Federal Consumer Protection in Financial Services—Consumer and Industry Perspectives; Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 5-6, 9, 19 (2007) (statement of Travis B. Plunkett, Legislative Dir., Consumer Fed'n of Am., On Behalf of Consumer Action, Consumer Fed'n of Am., Consumers Union, Ctr. for Responsible Lending, Nat'l Consumer Law Ctr., and the U.S. Pub. Interest Research Group) [hereinafter *Plunkett Testimony*], *available at* http://www.consumerfed.org/pdfs/Financial_Services_Regulation_House_Testimony_072507.pdf; *Improving Credit Card Consumer Protection: Recent Industry and*

Rather than vigilantly and publicly enforcing consumer protection laws, the OCC has in recent years frequently intervened on the side of national banks or their operating subsidiaries against the consumer.[48] For example, the OCC filed suit simultaneously with a banking trade association to enjoin the Attorney General of New York from even investigating mortgage discrimination by national banks and their operating subsidiaries.[49] The OCC has also filed *amicus* briefs in a host of cases supporting banks or operating subsidiaries against their customers, including one in which it unsuccessfully challenged the State of Minnesota's right to enforce the Telemarketing Sales Rule[50] against an operating subsidiary.[51]

Regulatory Initiatives: Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the Fin. Servs. Comm., 110th Cong. 5 (2007) (statement of Edmund Mierzwinski, Consumer Program Dir., U.S. Pub. Interest Research Group) ("[T]o our knowledge, the OCC has not imposed public penalties or sanctions on any of the nine of the current 'Top Ten' banks under its regulation, even though most advocates believe the sharp practices are endemic to the industry, including its largest players.") (footnote omitted), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htmierzwinski060707.pdf; *Wilmarth Testimony*, *supra* note 37, at 2 (noting that four of the top five credit card issuers are national banks, and seven of the top twenty subprime mortgage lenders are national banks or federally-chartered thrifts); Greg Ip & Damian Paletta, *Lending Oversight: Regulators Scrutinized in Mortgage Meltdown—States, Federal Agencies Clashed on Subprimes as Market Ballooned*, WALL ST. J., Mar. 22, 2007, at A1 (reporting that 23% of subprime lenders in 2005 were federally regulated banks or thrifts).

[48] *See, e.g.,* Jess Bravin & Paul Beckett, *Friendly Watchdog: Federal Regulator Often Helps Banks Fighting Consumers*, WALL ST. J., Jan. 28, 2002, at A1.

[49] Clearing House Ass'n, L.L.C. v. Spitzer, 394 F. Supp. 2d 620, 622 (S.D.N.Y. 2005) & OCC v. Spitzer, 396 F. Supp. 2d 383, 387-88 (S.D.N.Y. 2005), *aff'd in part, vacated in part sub nom.* Clearing House Ass'n, L.L.C. v. Cuomo, 510 F.3d 105 (2d Cir. 2007).

[50] 16 C.F.R. §§ 310.1-.7.

[51] *E.g.*, Minnesota ex rel. Hatch v. Fleet Mortgage Corp., 181 F. Supp. 2d 995, 997, 999-1001 (D. Minn. 2001) (denying a motion to dismiss and finding that "[t]he OCC's insistence that it must have exclusive jurisdiction over subsidiaries in order to avoid having its authority 'restricted' is not persuasive"); Charter One Mortgage Co. v. Condra, 847 N.E.2d 207 (Ind.

That the OCC sides with banks rather than consumers when their interests conflict is not wholly surprising given its own institutional interests. At bottom, the agency's institutional focus is on ensuring the safety and soundness of national banks, a goal that is not always aligned with the goal of protecting consumers.[52] Furthermore, depository institutions may choose not only between state and federal regulators, but also *among* federal regulators, leading to "charter competition" in banking.[53] The OCC has a financial stake in attracting financial institutions to its charter because it is funded by assessments from the banks it regulates, rather than by Congressional appropriations.[54] Roughly 97% of the OCC's operating budget comes from semi-annual assessments on national banks.[55]

The OCC has not been shy about using preemption to encourage institutions to adopt its charter. A former comptroller, John D. Hawke, Jr., described the OCC's use of its power to override state laws protecting consumers as "one of the advantages of a national charter," and asserted that he was "not the least bit ashamed

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Ct. App. 2006) (rejecting the argument of an operating subsidiary and the OCC as *amicus* that the challenged state law was preempted).

[52] *See* Peterson, *supra* note 36, at 73 (observing that the OCC's "primary mission and long-standing cultural focus," like that of other federal depository regulators, "has been monitoring the safety and soundness of their institutions, rather than consumer protection").

[53] *See* Christine E. Blair & Rose M. Kushmeider, *Challenges to the Dual Banking System: The Funding of Bank Supervision*, 18 FDIC BANKING REV. 1, 14 (2006); John A. Weinberg, *Competition Among Bank Regulators*, 88 FED. RES. BANK OF RICHMOND ECON. Q. 19, 19 (2002).

[54] 2006 OCC ANN. REP., *supra* note 43, at 7.

[55] *Id.* Large banks account for almost 70% of total OCC assessment revenue. *Id.* at 48. The agency's revenues can therefore be heavily dependent upon a few large players. *See Wilmarth Testimony*, *supra* note 37, at 17 ("During 2004-05, the OCC's assessment revenues rose by 15%, primarily due to the transfer of $1 trillion of banking assets into the OCC's jurisdiction by virtue of the charter conversions of JP Morgan Chase, HSBC and Bank of Montreal."). The Bank of America's $40 million annual assessment, for example, was reportedly 10% of the OCC's annual budget in one recent year. Bravin & Beckett, *supra* note 48.

to promote it."[56] This charter competition and funding mechanism create conditions ripe for regulatory capture.[57]

The contrast between the OCC's enforcement record and that of the states is stark. According to one congressional report, "[i]n the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions."[58] In the wake of *Watters*, the experience and resources of these state regulators will no longer be available to monitor the myriad interactions between national bank operating subsidiaries and consumers.

II. Issues Remaining for the Lower Courts After Watters

A. Deference to Administrative Agencies' Preemption Determinations

Although *Watters* concluded that operating subsidiaries are entitled to the same immunity from regulation and supervision under the Michigan laws at issue as their parent national banks, it left for another day a number of other disputes that have arisen in recent

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[56] Bravin & Beckett, *supra* note 48, at A1.

[57] "Regulatory capture" occurs when an agency becomes unduly influenced or controlled by the industry it regulates. *Cf.* Nicholas Bagley, Note, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y.U. L. REV. 2274, 2295 (2004) (describing "two well-documented institutional pathologies: regulatory capture . . . . [and] self-aggrandizing administrators," which "could manifest themselves in particularly pernicious ways if agencies were given an effective *carte blanche* to override the laws of duly elected state legislatures") (footnotes omitted).

[58] COMM. ON FIN. SERVS., 108TH CONG., VIEWS AND ESTIMATES ON MATTERS TO BE SET FORTH IN THE CONCURRENT RES. ON THE BUDGET FOR FISCAL YEAR 2005, at 16 (Comm. Print 2004), *cited in* Wilmarth, *supra* note 18, at 316 & n.359; *see also Improving Federal Consumer Protection in Financial Services*: *Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 13 (2007) (statement of Steven L. Antonakes, Massachusetts Commissioner of Banks, on Behalf of the Conference of State Bank Supervisors) [hereinafter *Antonakes Testimony*] ("In 2006 alone, states took 3,694 enforcement actions against mortgage lenders and brokers."), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htantonakes061307.pdf.

years involving the OCC. One such issue is whether a federal agency's interpretation that its regulation preempts a state law is entitled to *Chevron* deference.[59] This issue will continue to come up due to the Bush Administration's aggressive efforts to preempt state law through rulemaking in areas ranging from highway safety to drug labeling.[60] When ruling on such disputes, courts should take note of the *Watters* majority's telling silence as to deference, Justice Stevens' strong dissent, and earlier Supreme Court decisions casting doubt on the propriety of deferring in this context.

At the time when the Supreme Court agreed to hear *Watters*, the three circuits that had considered whether national bank operating subsidiaries could assert preemption had deferred to the OCC's views and ruled in the subsidiaries' favor.[61] However, decisions in other contexts suggested that deference should not be accorded to agencies' preemption determinations or, alternatively, that agency preemption determinations might only be entitled to weight to the extent they have the power to persuade.[62] In *Colorado Public*

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[59] *See* Supreme Court, Watters v. Wachovia Bank, 126 S. Ct. 2900 (June 19, 2006) (No. 05-1342) (Questions Presented), *available at* http://www.supremecourtus.gov/qp/05-01342qp.pdf. The second question presented in *Watters* was whether the OCC's rules violate the Tenth Amendment by effectively converting a state-chartered corporation into a federal instrumentality in violation of the laws of the state of its creation. *Id.* This issue was given very short shrift by both the Sixth Circuit and the Supreme Court. Watters v. Wachovia Bank, 431 F.3d 556, 563 (6th Cir. 2005), *aff'd*, 127 S. Ct. 1559, 1573 (2007).

[60] *See infra* notes 92-96.

[61] *Watters*, 431 F.3d at 562-63; Wells Fargo Bank v. Boutris, 419 F.3d 949, 957-67 (9th Cir. 2005); Wachovia Bank v. Burke, 414 F.3d 305, 318-21 (2d Cir. 2005), *cert. denied*, 127 S. Ct. 2093 (2007).

[62] *E.g.,* Colo. Pub. Utils. Comm'n v. Harmon, 951 F.2d 1571 (10th Cir. 1991) (deferring to determinations by the U.S. Department of Transportation that its regulations overlapped with Colorado regulations, but independently reviewing the question of preemption); *see also* Brief of the Center for State Enforcement of Antitrust and Consumer Protection Laws, Inc., as Amicus Curiae Supporting Petitioner, Watters v. Wachovia Bank, 127 S. Ct. 1559 (2007) (No. 05-1342) [hereinafter Center for State Enforcement Amicus Brief] (arguing that agency views about the displacement of state law should be reviewed under the standard set forth in *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944), rather than *Chevron*); *cf.* Nat'l Mining Ass'n v. Sec'y of Labor, 153 F.3d 1264, 1267 (11th Cir. 1998) ("An

Utilities Commission v. Harmon,[63] the Tenth Circuit explained that "courts should defer to the judgment of an administrative agency with reference to topics within the agency area of expertise. . . . However, a preemption determination involves matters of law—an area more within the expertise of the courts than within the expertise of the [administrative agency]."[64] Commissioner Watters highlighted the tension between the Sixth Circuit's decision and *Colorado Public Utilities* in her petition for certiorari.[65] Defending the Sixth Circuit's decision, Wachovia and the Solicitor General maintained that *Chevron* deference was appropriate.[66] Commentators speculated that the Court had granted certiorari to resolve this question, which had spawned considerable discussion in law review articles.[67]

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agency's interpretation of its governing statute is often given significant deference. But, when applying *Chevron*'s first step, we do not need to defer when the issue is a 'pure question of statutory construction.' Likewise, we need not defer to issues beyond the agency's expertise.") (citations omitted). In a decision that was slated to be reheard en banc but was ultimately vacated as moot, an Eleventh Circuit panel refused to defer to a preemption determination by the Federal Deposit Insurance Corporation, explaining: "Because 'a preemption determination involves matters . . . more within the expertise of the courts than within the expertise of' an administrative agency, we need not defer to an agency's opinion regarding preemption." Bankwest, Inc. v. Baker, 411 F.3d 1289, 1301 (11th Cir. 2005) (quoting *Colo. Pub. Utils. Comm'n*, 951 F.2d at 1579), *vacated and reh'g granted en banc*, 433 F.3d 1344 (11th Cir. 2005), *vacated and remanded*, 2006 WL 1329700 (11th Cir. Apr. 27, 2006) (en banc), *vacated as moot*, 446 F.3d 1358 (11th Cir. 2006) (per curiam); *see also* Hood v. Santa Barbara Bank & Trust Co., 49 Cal. Rptr. 3d 369, 386 (Cal. Ct. App. 2006) ("Although respondents urge this court to give deference to the OCC regulations concerning the preemption of state law, respondents have not cited any controlling authority requiring a court to defer to an agency's regulations concerning preemption."), *cert. denied*, 127 S. Ct. 2916 (2007).

[63] 951 F.2d 1571 (10th Cir. 1991).

[64] *Id.* at 1579 (internal quotation marks and citations omitted).

[65] Petition for Writ of Certiorari at 22, Watters v. Wachovia Bank, 127 S. Ct. 1559 (2007) (No. 05-1342).

[66] United States Amicus Brief, *supra* note 44, at 9-22, 23-26; Brief for the Respondents at 39-44, Watters v. Wachovia Bank, 127 S. Ct. 1559 (2007) (No. 05-1342).

[67] *See, e.g.,* Bagley, *supra* note 57, at 2286-97; Christopher R.J. Pace, *Supremacy Clause Limitations on Federal Regulatory Preemption*, 11 TEX.

The *Watters* majority, however, studiously avoided addressing deference to an agency's own preemption views, instead reaching the improbable conclusion that the National Bank Act itself preempts the Michigan laws at issue.[68] As the dissent noted, not one of the circuits that had previously considered preemption claims by national bank operating subsidiaries had taken the Court's approach.[69] Indeed, in briefs in *Watters* and another operating subsidiary case, the Solicitor General asserted that Congress had *not* spoken directly to the question of the extent to which state laws are applicable to an operating subsidiary's activities.[70] This position should have foreclosed the operating subsidiaries' claim that the National Bank Act itself is preemptive given the long line of cases establishing an "assumption [in preemption cases] that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."[71]

REV. L. & POL. 158 (2006); Damien J. Marshall, Note, *The Application of* Chevron *Deference in Regulatory Preemption Cases*, 87 GEO. L.J. 263 (1998).

[68] *See Watters,* 127 S. Ct. at 1572 & n.13 ("Because we hold that the [National Bank Act] itself—independent of OCC's regulation—preempts the application of the pertinent Michigan laws to national bank operating subsidiaries, we need not consider the dissent's lengthy discourse on the dangers of vesting preemptive authority in administrative agencies.").

[69] *Id.* at 1579 & n.16 (Stevens, J., dissenting). As Justice Stevens explained, the majority's analysis indicates that operating subsidiaries have been exempt since 1966, begging the question why operating subsidiary preemption cases only surfaced *after* the OCC issued its recent regulations. *Id.* at 1579 ("Stranger still, the Court's reasoning would suggest that operating subsidiaries have been exempted from state visitorial authority from the moment the OCC first authorized them in 1966. Yet if that were true, surely at some point over the last 40 years some national bank would have gone to court to spare its subsidiaries from the yoke of state regulation; national banks are neither heedless of their rights nor shy of litigation. But respondents point us to no such cases that predate the OCC's preemption regulations.") (citation omitted).

[70] *See, e.g.,* Brief of the United States as Amicus Curiae on Petition for a Writ of Certiorari at 12, Burke v. Wachovia Bank, 127 S. Ct. 2093 (2007) (No. 05-431), *available at* http://www.usdoj.gov/osg/briefs/2005/2pet/6invit/2005-0431.pet.ami.inv.pdf; United States Amicus Brief, *supra* note 44, at 16.

[71] *Watters*, 127 S. Ct. at 1578 (Stevens, J., dissenting) (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) (quoting Rice v. Santa Fe Elevator

Writing for the *Watters* majority, Justice Ginsburg nevertheless concluded that the National Bank Act as a whole preempted the Michigan laws at issue.[72] Justice Ginsburg discussed various National Bank Act provisions but did not specify which provision gives rise to preemption. References to section 484(a) appear throughout her opinion,[73] although that section by its terms clearly applies only to "national banks."[74] The majority also relied heavily on the portion of the Gramm-Leach-Bliley Act that defines "financial subsidiary" (and, by exclusion and implication, "operating subsidiary"),[75] but denied that it was imputing a preemptive effect to that provision.[76] The majority also cited 12 U.S.C. § 24 (Seventh) and § 371(a), which establish national banks' authority "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking" and to engage in real estate lending.[77] But the mere fact that national banks have the power to make real estate loans and to do business through operating subsidiaries (a power that itself is implied as "incidental" because it does not appear anywhere in the text of the National Bank Act) does not mean that operating subsidiaries are entitled to invoke section 484(a) or other preemptive

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Corp., 331 U.S. 218, 230 (1947))); *infra* Section II.B (discussing the presumption against preemption). As noted below, the United States maintained that the presumption against preemption does not apply in the national bank context and that both the National Bank Act and the OCC's regulations preempted the Michigan laws. United States Amicus Brief, *supra* note 44, at 11-12, 22-23, 27-29.

[72] *Watters*, 127 S. Ct. at 1572-73.

[73] *E.g., id.* at 1568-69, 1571, 1572.

[74] 12 U.S.C. § 484(a).

[75] Gramm-Leach-Bliley Act, 12 U.S.C. § 24a(g)(3)(A), *cited in Watters,* 127 S. Ct. at 1570-72.

[76] *See Watters,* 127 S. Ct. at 1572 n.12 ("The dissent protests that the GLBA does not itself preempt the Michigan provisions at issue. We express no opinion on that matter. Our point is more modest: The GLBA simply demonstrates Congress' formal recognition that national banks have incidental power to do business through operating subsidiaries.") (internal citations omitted).

[77] *Id.* at 1564-67, 1569, 1571-72.

provisions of the Act for their activities.[78] That the Court was willing to make this logical leap in interpreting the National Bank Act suggests that it could not marshal a majority in favor of deferring to the OCC's views and wished to evade the issue.

By contrast, Justice Stevens—the author of the Court's original unanimous *Chevron* opinion—addressed the deference question head-on in a dissent joined by the Chief Justice and Justice Scalia. Without denying that "a properly promulgated agency regulation can have a preemptive *effect* should it conflict with state law," Justice Stevens unequivocally asserted that it would not be appropriate to accord *Chevron* deference to "agency regulations (like the one at issue here) that 'purpor[t] to settle the scope of federal preemption' and 'reflec[t] an agency's effort to transform the preemption question from a judicial inquiry into an administrative *fait accompli*.'"[79] As he explained:

> No case from this Court has ever applied such a deferential standard to an agency decision that could so easily disrupt the federal-state balance. . . . [W]hen an agency purports to decide the scope of federal preemption, a healthy respect for state sovereignty calls for something less than *Chevron* deference.[80]

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[78] *See* Brief for the Petitioner at 21-22, Watters v. Wachovia Bank, 127 S. Ct. 1559 (2007) (No. 05-1342), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/06-07/05-1342_Petitioner.pdf ("A national bank's 'incidental powers' cannot reasonably be understood to include the power to obliterate the distinction between 'national banks' and their affiliates.").

[79] *Watters,* 127 S. Ct. at 1583 n.24 (Stevens, J., dissenting) (quoting Bagley, *supra* note 57, at 2289).

[80] *Id.* at 1584 ("[E]xpert agency opinions as to which state laws conflict with a federal statute may be entitled to 'some weight,' especially when 'the subject matter is technical' and 'the relevant history and background are complex and extensive.' But '[u]nlike Congress, administrative agencies are clearly not designed to represent the interests of States, yet with relative ease they can promulgate comprehensive and detailed regulations that have broad preemption ramifications for state law.'") (citation omitted).

In its *amicus* brief, the United States distinguished "an agency's assessment of whether a *statute* gives rise to preemption" from "a preemptive *regulation* adopted in an exercise of delegated authority," arguing that deference should apply in the latter situation even if there is a question about its applicability to the former.[81] However, Justice Stevens made it clear that the dissenters would not accord *Chevron* deference even if Congress had delegated preemptive authority and the OCC had exercised it.[82] The dissent also went on to identify other reasons for not deferring to the OCC's views in the case at bar, finding that there was no applicable congressional delegation of authority, that the OCC had expressly indicated that it was *not* preempting state law in its rulemaking, and that the justifications offered by the OCC were inadequate for *Chevron* purposes.[83]

The dissent's resounding rejection of the OCC's claim for *Chevron* deference appears particularly significant when considered with prior opinions from the Court relating to deference on preemption issues. This is admittedly not an area where the Court has spoken clearly,[84] but recent Court opinions have questioned whether *Chevron* deference applies to agency preemption decisions and have recognized that federal agencies are not well-equipped to evaluate federalism concerns. In *Smiley v. Citibank (South Dakota)*,[85] for example, a unanimous Court assumed, without deciding, that no deference is due to an agency in determining whether a

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[81] United States Amicus Brief, *supra* note 44, at 24 n.8.

[82] *Watters,* 127 S. Ct. at 1582-84 (Stevens, J., dissenting); *see also* Gonzales v. Oregon, 126 S. Ct. 904, 916, 919, 921 (2006) (citing Adams Fruit Co. v. Barrett, 494 U.S. 638, 649-50 (1990)); New York v. Fed. Energy Regulatory Comm'n, 535 U.S. 1, 18 (2002) ("'[A]n agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it.'") (quoting Louisiana Public Service Comm'n v. Federal Commc'n Comm'n, 476 U.S. 355, 374 (1986)).

[83] *Watters,* 127 S. Ct. at 1582-84 (Stevens, J., dissenting).

[84] *See generally* Center for State Enforcement Amicus Brief, *supra* note 62, at 21-25.

[85] 517 U.S. 735 (1996).

statute is preemptive.[86] In *Medtronic, Inc. v. Lohr*,[87] Justice O'Connor filed a separate opinion concurring in part and dissenting in part, in which she expressed skepticism about any claim for deference to a regulation defining the preemptive reach of a statute.[88] On behalf of Chief Justice Rehnquist, Justice Scalia, and Justice Thomas, she wrote:

> Apparently recognizing that *Chevron* deference is unwarranted here, the Court does not admit to deferring to these regulations, but merely permits them to "infor[m]" the Court's interpretation. It is not certain that an agency regulation determining the pre-emptive effect of *any* federal statute is entitled to deference, *cf. Smiley v. Citibank (South Dakota), N. A.*, 517 U. S. 735, 743-744 (1996), but one pertaining to the clear statute at issue here is surely not.[89]

In a dissent joined by Justices Souter, Thomas, and Ginsburg in *Geier v. American Honda Motor Co.*,[90] Justice Stevens noted the serious federalism concerns raised by regulatory preemption. As he explained, "[u]nlike Congress, administrative agencies are clearly not designed to represent the interests of States, yet with relative ease they can promulgate comprehensive and detailed regulations that have broad pre-emption ramifications for state law."[91] With *Watters*

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[86] *Id.* at 744 ("This argument confuses the question of the substantive (as opposed to pre-emptive) *meaning* of a statute with the question of *whether* a statute is pre-emptive. We may assume (without deciding) that the latter question must always be decided *de novo* by the courts.").

[87] 518 U.S. 470 (1996).

[88] *Id.* at 511-12 (O'Connor, J., concurring in part and dissenting in part); *see also* Center for State Enforcement Amicus Brief, *supra* note 62, at 15 (arguing that the Sixth Circuit should have applied the standard of *Skidmore v. Swift & Co*., 323 U.S. 134 (1944), rather than *Chevron*).

[89] *Medtronic,* 518 U.S. at 512 (first citation omitted).

[90] 529 U.S. 861 (2000).

[91] *Id.* at 886, 908 (Stevens, J., dissenting), *quoted in Watters*, 127 S. Ct. at 1584 (Stevens, J., dissenting); *see also Watters*, 127 S. Ct. at 1584 n.25

added to this mix, a majority of justices on the Court have rejected the applicability of *Chevron* deference to preemption determinations (Chief Justice Roberts and Justices Stevens and Scalia in *Watters*) or at least expressed skepticism or concerns about deferring in such circumstances.

Watters thus bodes poorly for recent efforts by a range of federal agencies to preempt state law—including tort law—by administrative fiat.[92] For example, the National Highway Traffic Safety Administration ("NHTSA") asserted in a preamble to its new fuel economy rule for light trucks that states cannot regulate motor vehicle carbon dioxide emissions.[93] NHTSA has also taken the position that its proposed new "roof crush" standards for motor vehicles would preempt differing state standards, including state common law requirements.[94] The Consumer Product Safety Commission issued a mattress regulation that the agency claims will preempt "all non-identical state requirements which seek to reduce the risk of death or injury from mattress fires," whether imposed by

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(Stevens, J., dissenting) (citing Nina Mendelson, Chevron *and Preemption*, 102 MICH. L. REV. 737, 779-790 (2004)).

[92] For background and discussion of these recent preemption efforts, *see generally* Catherine M. Sharkey, *Preemption by Preamble: Federal Agencies and the Federalization of Tort Law*, 56 DEPAUL L. REV. 227 (2007); Labaton, *supra* note 5; Mayer, *supra* note 5.

[93] Average Fuel Economy Standards for Light Trucks Model Years 2008-2011, 71 Fed. Reg. 17,566, 17,654-70 (Apr. 6, 2006) (codified at 49 C.F.R. pts. 523, 533 and 537).

[94] Federal Motor Vehicle Safety Standards; Roof Crush Resistance, 70 Fed. Reg. 49,223, 49,245-46 (proposed Aug. 23, 2005) (to be codified at 49 C.F.R. pt. 571) ("[I]f the proposal were adopted as a final rule, it would preempt all conflicting State common law requirements, including rules of tort law" and "all differing state statutes and regulations would be preempted . . . ."); Karen Barth Menzies, *Focus on Facts to Defeat Preemption*, 43 TRIAL 44, 51 (Mar. 2007) ("[A]fter NHTSA issued its proposed rule on roof crush resistance for vehicles, both the chairman and the ranking Democrat of the Senate Judiciary Committee—Sens. Arlen Specter (R-Pa.) and Patrick Leahy (D-Vt.)—wrote to NHTSA [to request] an explanation of 'how NHTSA concluded that preemption of state law was the intent of Congress.'") (quoting Ralph Lindeman, *Federalism: Agencies Move to Override State Law as Part of Federal Rulemaking Process,* 66 Daily Rep. for Execs. (BNA) C-1 (Apr. 6, 2006)).

statute or common law.[95] After filing various *amicus* briefs supporting the industry, the Food and Drug Administration aggressively asserted in the preamble to its January 2006 labeling regulations that "under existing preemption principles, FDA approval of labeling under the act . . . preempts conflicting or contrary State law."[96] Industry officials have argued that courts should defer to these agencies' assessments of their own preemptive authority.[97] Consumer advocates have already identified a host of reasons why such deference is inappropriate, such as the lack of formality, consistency, thoroughness, and persuasiveness of the agencies' views.[98] The strong dissent in *Watters* and the majority's unexpected silence provide yet another reason why lower courts should not accord *Chevron* deference.

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[95] Standard for the Flammability (Open Flame) of Mattress Sets, 71 Fed. Reg. 13,472, 13,496-97 (Mar. 15, 2006) (codified at 16 C.F.R. pt. 1633) ("The Commission intends and expects that the new mattress flammability standard will preempt inconsistent state standards and requirements, whether in the form of positive enactments or court created requirements."); *see also* Labaton, *supra* note 5 (noting that the Consumer Product Safety Commission had never before voted to limit consumers' ability to bring cases in state courts), *cited in* Sharkey*, supra* note 92, at 233 & n.29.

[96] Requirements on Content and Format of Labeling for Human Prescription Drug and Biological Products, 71 Fed. Reg. 3922, 3934 (Jan. 24, 2006) (codified at 21 C.F.R. pts. 201, 314 and 601); *see generally* Allison M. Zieve & Brian Wolfman, *The FDA's Argument for Eradicating State Tort Law: Why It Is Wrong and Warrants No Deference*, 21 TOXICS LAW REP. 516 (2006), *available at* http://www.citizen.org/documents/PDFArtic.pdf. The preemptive language in the preamble came after the FDA had indicated in commentary to its proposed rule that the rule would *not* preempt state law. *See* Requirements on Content and Format of Labeling for Human Prescription Drugs and Biologics; Requirements for Prescription Drug Product Labels, 65 Fed. Reg. 81,082, 81,103 (proposed Dec. 22, 2000) (to be codified at 21 C.F.R. pt. 201) ("[T]his proposed rule does not contain policies that have federalism implications or that preempt State law."); *see also* Daniel R. Cahoy, *Medical Product Information Incentives and the Transparency Paradox*, 82 IND. L.J. 623, 662 & n.199 (2007).

[97] *See* Zieve & Wolfman, *supra* note 96, at 6 & n.56.

[98] *See, e.g., id.* at 8.

B. The Presumption Against Preemption

Another issue raised by the parties in *Watters* that the majority did not expressly address is the presumption against preemption. In preemption cases, as noted above, it is well established that the Court "'start[s] with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.'"[99] This presumption is particularly strong in fields that the states have traditionally regulated, such as consumer protection.[100] As Justice Stevens explained in his dissent, the Court should have read section 484(a) against the backdrop of this presumption against preemption.[101]

In their respective briefs, Wachovia and the United States argued that the presumption against preemption should not apply based, in part, on language from the Supreme Court's decision in *United States v. Locke*,[102] a case involving oil tanker operations and designs.[103] There, the Court stated that an "'assumption' of nonpreemption is not triggered when the States regulate in an area in which there has been a history of significant federal presence."[104] *Locke* is inapposite, however, because it dealt with an area of law—maritime commerce—where Congress has sought to establish "a uniformity of regulation" and "has legislated . . . from the earliest days of the Republic, creating an extensive federal statutory and regulatory

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[99] Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

[100] *Medtronic,* 518 U.S. at 485; General Motors Corp. v. Abrams, 897 F.2d 34, 41 (2d Cir. 1990), *cited in* Watters v. Wachovia Bank, 127 S. Ct. 1559, 1581 n.19 (2007) (Stevens, J., dissenting).

[101] *Watters,* 127 S. Ct. at 1578 (Stevens, J., dissenting).

[102] 529 U.S. 89, 108 (2000).

[103] *See* Brief for the Respondents, *supra* note 66, at 23; United States Amicus Brief, *supra* note 44, at 22-23; *see also* Bank Activities and Operations, 69 Fed. Reg. 1895, 1896-97 & n.10 (Jan. 13, 2004) (citing *Locke*, 529 U.S. at 108, and asserting that "there is no presumption against preemption in the national bank context").

[104] *Locke*, 529 U.S. at 108, *quoted in* United States Amicus Brief, *supra* note 44, at 22, and *quoted in* Brief for the Respondents, *supra* note 66, at 23.

scheme."[105] With regard to national and international maritime commerce, the *Locke* Court found no basis for "a beginning assumption that concurrent regulation by the State is a valid exercise of its police powers."[106] By contrast, Congress has allowed national banks to be "governed in their daily course of business far more by the laws of the State than of the nation" for over a hundred years.[107]

In arguing that the presumption against preemption should not apply, Wachovia and its *amici* also quoted language from *Barnett Bank of Marion County v. Nelson*[108] stating that the Court had "interpret[ed] 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."[109] However, the *Barnett Bank* Court was not discussing the presumption against preemption in the cited passage and, in fact, did not mention the presumption anywhere in its opinion. Instead, as Commissioner Watters explained in her reply brief, the Court was simply "restat[ing] basic principles of conflict preemption, making clear that the National Bank Act preempts State law that is contrary to—that is, irreconcilably conflicts with—federal law because it forbids or significantly impairs the exercise of a power Congress granted."[110]

As in *Barnett Bank*, the majority in *Watters* did not refer to the historic presumption against preemption at all.[111] Justice Ginsburg did quote the language mentioned above from *Barnett Bank*, but she did so in the context of discussing conflict preemption standards.[112] Significantly, the Court did not invoke *Locke* and did not hold, as the Ninth Circuit has, that "the usual presumption against federal preemption of state law is inapplicable to federal banking

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[105] *Locke,* 529 U.S. at 108; *see also* Wilmarth, *supra* note 18, at 288-89.

[106] *Locke,* 529 U.S. at 108.

[107] Nat'l Bank v. Commonwealth, 76 U.S. (9 Wall.) 353, 362 (1869), *quoted in* Atherton v. Fed. Deposit Ins. Corp., 519 U.S. 213, 222-23 (1997).

[108] 517 U.S. 25 (1996).

[109] *Id.* at 32, *quoted in* Brief for the Respondents, *supra* note 66, at 23, and *quoted in* United States Amicus Brief, *supra* note 44, at 23.

[110] Reply Brief for the Petitioner at 8, Watters v. Wachovia Bank, 127 S. Ct. 1559 (2007) (No. 05-1342); *see also* Wilmarth, *supra* note 18, at 247 n.79.

[111] *See Watters*, 127 S. Ct. at 1564-73.

[112] *Id.* at 1567.

regulation."[113] Although the Court should have invoked the presumption against preemption, it at least did not expressly reject it—leaving intact a long line of precedents on this point.[114]

C. Preemption and Visitation Under the National Bank Act

In *Watters*, the Supreme Court was asked to consider one of many questions that have surfaced regarding the meaning of the

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[113] Wells Fargo Bank v. Boutris, 419 F.3d 949, 956 (9th Cir. 2005) (citing Bank of America v. City & County of San Francisco, 309 F.3d 551, 558-59 (9th Cir. 2002)); *see also* Nat'l City Bank of Indiana v. Turnbaugh, 463 F.3d 325, 330-31 (4th Cir. 2006) (finding the presumption against preemption inapplicable to a case involving national bank operating subsidiaries), *cert. denied*, 127 S. Ct. 2096 (2007). *But see, e.g.*, Hood v. Santa Barbara Bank & Trust Co., 143 Cal. App. 4th 526, 537, 49 Cal. Rptr. 3d 369 (Cal. App. 2d Dist. 2006) (applying a presumption against preemption and "narrowly constru[ing]" OCC regulations in analyzing preemption question), *cert. denied*, 127 S. Ct. 2916 (2007). Despite its earlier holding in *Bank of America*, the Ninth Circuit "beg[a]n with the presumption that Congress did not intend the National Bank Act [to be] preempt[ive]" when it analyzed a claim that a National Bank Act provision granting national banks the power to dismiss bank officers "at pleasure" preempted application of an age discrimination statute to a national bank in a subsequent case. Kroske v. US Bank Corp., 432 F.3d 976, 979, 981-82 (9th Cir. 2005) (citing, *inter alia*, Fla. E. Coast Ry. Co. v. City of W. Palm Beach, 266 F.3d 1324, 1328-29 (11th Cir. 2001)), *cert. denied*, 127 S. Ct. 157 (2006). The *Kroske* court explained that the state law at issue "was enacted pursuant to the State's historic police powers to prohibit discrimination on specified grounds." *Id.* at 981.

[114] *See, e.g.,* Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996); *see also Watters,* 127 S. Ct. at 1579 (Stevens, J., dissenting) ("Consistent with our presumption against preemption—a presumption I do not understand the Court to reject—I would read § 484(a) to reflect Congress' considered judgment not to preempt the application of state visitorial laws to national bank 'affiliates.'"). The Court also did not take up the government's invitation to find a "presumption in *favor* of preemption," United States Amicus Brief, *supra* note 44, at 23, although some bank representatives have argued that it did, *see, e.g.,* Appellant's Answer Brief on the Merits at 33, Miller v. Bank of America, No. S149178 (Cal. Sept. 13, 2007) (asserting that *Watters*, 127 S. Ct. at 1566, recognized a strong presumption in favor of preemption in the banking context).

National Bank Act's preemption and "visitorial powers" provisions —*i.e.,* whether operating subsidiaries can invoke the protections of section 484(a) to the same extent as national banks. In the wake of *Watters*, a host of related issues remain for lower courts' consideration—including additional questions about what entities can shield themselves using the National Bank Act, questions about what substantive laws are preempted, and disputes about what constitutes a prohibited exercise of "visitorial powers" by state officials.

1. Who can use the National Bank Act as a shield?

Watters held that operating subsidiaries are immune from the Michigan laws at issue to the same extent as their parent national banks, begging the question whether any other entities can invoke the same protection from state laws. The majority's emphasis on certain distinctive features of operating subsidiaries—combined with strong policy reasons—suggests that other entities, such as agents or third-party contractors of national banks, should not be able to invoke the National Bank Act's provisions.

Over the past several years, banks have increasingly used third parties as contractors or agents and have sought to shield these third parties from the reach of state laws designed to protect consumers.[115] Courts considering these relationships prior to *Watters* reached different conclusions, with a number holding that the National Bank Act is not preemptive with respect to non-bank third parties.[116]

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[115] *See* Christopher L. Peterson, *Preemption, Agency Cost Theory and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 AM. U. L. REV. 515, 527-29 (2007).

[116] *Compare* Fleming v. Dollar Tree Stores, Inc., No. C06-03409, 2006 WL 2975581, *3 (N.D. Cal. Sept. 15, 2006) ("An entity that is neither a national bank, nor a wholly-owned subsidiary of a national bank may not claim preemption under the [National Bank Act]."), *and* SPGGC, Inc. v. Blumenthal, 408 F. Supp. 2d 87, 95 (D. Conn. 2006) ("[P]reemption by the [National Bank Act] does not apply to a non-bank entity, even if it has an agency or business relationship with a national bank."), *vacated in part*, 505 F.3d 183 (2d Cir. 2007), *and* Carson v. H & R Block, Inc., 250 F. Supp. 2d 669, 674-75 (S.D. Miss. 2003), *and* Colorado *ex rel.* Salazar v. ACE Cash Express, Inc., 188 F. Supp. 2d 1282, 1285 (D. Colo. 2002) (holding that a

The OCC for its part took the view that the National Bank Act can preempt state law as applied to third parties that are not operating subsidiaries, most notably in a 2001 preemption determination.[117] At issue in the determination were agreements between national banks headquartered in Ohio and some Michigan car dealerships, in which the dealerships agreed to perform services including soliciting loans, preparing loan documents, and obtaining buyer signatures as agents for the banks.[118] Although the banks

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check cashing business serving as an agent for a national bank was not covered by the National Bank Act because it was not a bank), *and* Goldman v. Simon Property Group, Inc., 31 A.D.3d 382, 818 N.Y.S.2d 245 (N.Y. App. Div. 2d Dept. 2006) (reversing dismissal on preemption grounds of claims against a non-bank that promoted and sold gift cards issued by a national bank), *with* Pacific Capital Bank v. Conn., Civil No. 3:06-CV-28 (PCD), 2006 WL 2331075 (D. Conn. Aug. 10, 2006) (holding that Connecticut could not impose statutory rate limits on a non-bank tax preparation service that markets tax refund anticipation loans for a national bank), *appeal pending*, No. 06-4149cv (2d Cir. argued Dec. 4, 2007). In a decision that was slated to be reheard en banc but was ultimately vacated as moot, an Eleventh Circuit panel addressed a closely analogous issue under the Federal Deposit Insurance Act and initially concluded that the Act did not preempt the Georgia payday loan law, which regulated certain non-bank payday lenders acting as agents for banks. Bankwest, Inc. v. Baker, 411 F.3d 1289, 1301-09 (11th Cir. 2005), *vacated and reh'g en banc granted*, 433 F.3d 1344 (11th Cir. 2005), *vacated and remanded*, 2006 WL 1329700 (11th Cir. Apr. 27, 2006) (en banc), *vacated as moot*, 446 F.3d 1358 (11th Cir. 2006) (per curiam). *But cf.* State Farm Bank, F.S.B. v. Burke, 445 F. Supp. 2d 207 (D. Conn. 2006) (finding preemption under the Home Owners' Loan Act, 12 U.S.C. § 1461 et seq., in a case involving an exclusive third-party agent for a federal savings association).

[117] OCC Preemption Determination, 66 Fed. Reg. 28,593 (May 23, 2001). The Office of Thrift Supervision also issued a permissive letter in 2004 finding preemption under the Home Owners' Loan Act of certain state laws as applied to third parties performing marketing, solicitation, and customer services activities as exclusive agents for a federal savings association. *See* Letter from Office of Thrift Supervision Chief Counsel re Authority of a Federal Savings Association to Perform Banking Activities through Agents Without Regard to State Licensing Requirements, P-2004-7 (Oct. 25, 2004), *available at* http://www.ots.treas.gov/docs/5/560404.pdf. Both agencies' preemption determinations are discussed at length in Peterson, *supra* note 115, at 529-34.

[118] 66 Fed. Reg. at 28,593-94.

retained the authority to approve and prescribe the terms for each loan, the contracts permitted the dealers to set rates up to six percent higher than the rates required by the banks' underwriters and to pocket the difference (the "yield-spread differential") as part of their commissions from the banks.[119] One of the banks initially asked the Michigan State Financial Institutions Bureau for a declaratory ruling that the Michigan Motor Vehicle Sales Finance Act would not apply to the dealership in such a transaction.[120] When the Michigan Bureau reached the opposite conclusion, the banks obtained a determination from the OCC that the National Bank Act preempts application of the Michigan law to the Michigan dealerships.[121] The OCC argued that preemption as to the third-party dealership was appropriate because national banks are permitted to: (1) make loans, (2) use the services of third parties in doing so, and (3) charge interest rates that would be permitted in the banks' home state even when making loans to borrowers residing in other states.[122]

Although *Watters* did not address this issue explicitly, the Court's reasoning appears to undermine this 2001 preemption determination and other decisions extending immunity to third parties that are not operating subsidiaries because the majority relied on several rationales that are unique to operating subsidiaries.[123] Since the *Watters* ruling, much emphasis has been placed on a passage from

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[119] State of Michigan, Department of Consumer and Industry Services, Financial Institutions Bureau, In the Matter of Request by Rodney D. Martin on Behalf of National City Bank for a Declaratory Ruling on the Applicability of the Motor Vehicle Sales Finance Act to Certain Transactions (Jan. 1, 2000), *available at* http://www.michigan.gov/cis/0,1607,7-154-10555_20594_20597-51126--,00.html.

[120] *See* 66 Fed. Reg. at 28,594.

[121] *Id.* at 28,593.

[122] *Id.* at 28,595-96; *see also* Peterson, *supra* note 115, at 534 (referring to the OCC's conclusion as a "grating non sequitur").

[123] *See generally* Elizabeth Renuart, *Elizabeth Renuart on Line-Drawing and the Practical Effects of Watters v. Wachovia*, CONSUMER LAW & POLICY BLOG, Apr. 17, 2007, http://pubcit.typepad.com/clpblog/2007/04/elizabeth_renua.html ("The majority focuses on the legal relationship between operating subsidiaries and the banks, the OCC's position that it oversees both entities in a similar fashion, and the added 'support' it found in the Gramm-Leach-Bliley Act for Congressional recognition of these closely related companies.").

the majority opinion in which Justice Ginsburg asserted: "We have never held that the preemptive reach of the [National Bank Act] 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."[124] However, this statement must be read in the context of the language immediately following it and throughout the opinion that emphasizes three factors that distinguish operating subsidiaries from other third parties: (1) the limitations imposed on operating subsidiaries by the Gramm-Leach-Bliley Act, (2) the manner in which the OCC supervises operating subsidiaries, and (3) precedents that specifically address operating subsidiaries.

In promulgating and defending its operating subsidiary rule, 12 C.F.R. § 7.4006, the OCC cited the Gramm-Leach-Bliley Act's requirement that operating subsidiaries conduct their activities "subject to the same terms and conditions that govern the conduct of such activities by national banks" and noted that operating subsidiaries—unlike financial subsidiaries—can engage only in activities "that national banks are permitted to engage in directly."[125] The *Watters* majority latched on to the same language, repeatedly noting that operating subsidiaries are subject to the "same terms and conditions" as their parent national bank, that their "authority to carry on the business coincides completely with that of the bank," and that they are "empowered to do only what the bank itself could do."[126] The majority also took pains to distinguish operating subsidiaries from financial subsidiaries and other affiliates.[127] Although the majority stopped short of calling the Gramm-Leach-Bliley Act preemptive, it nevertheless placed great emphasis on the statute, asserting that it "demonstrates Congress' formal recognition that national banks have

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[124] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1570 (2007) (citing Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 32 (1996)), *cited in* SPGGC, LLC v. Ayotte, 488 F.3d 525, 532 (1st Cir. 2007), *petition for cert. filed*, 76 U.S.L.W. 3324 (U.S. Dec. 11, 2007) (No. 07-797), and *cited in* SPGGC, LLC v. Blumenthal, 505 F.3d 183, 190 (2d Cir. 2007).

[125] 66 Fed. Reg. at 34,788 (quoting 12 U.S.C. § 24a(g)(3)(A)); United States Amicus Brief, *supra* note 44, at 11, 20-21.

[126] *Watters*, 127 S. Ct. at 1564, 1570 & n.10, 1571-72.

[127] *See id.* at 1570 n.10, 1571-72 (discussing the "distinctions Congress recognized among 'affiliates'").

incidental power to do business through operating subsidiaries."[128] The fact that the Gramm-Leach-Bliley Act language emphasized by the Court does not extend to third-party contractors or agents that are not operating subsidiaries severely undermines any claim such entities might have to preemption under the National Bank Act.

The majority also emphasized the distinctive licensing and supervision that the OCC applies to operating subsidiaries. The majority asserted, for example, that the "OCC licenses and oversees national bank operating subsidiaries just as it does national banks."[129] The majority also went on to state that: "[f]or supervisory purposes, OCC treats national banks and their operating subsidiaries as a single economic enterprise. OCC oversees both entities by reference to 'business line,' applying the same controls whether banking 'activities are conducted directly or through an operating subsidiary.'"[130] As an example, the majority pointed out that although a national bank is not allowed to consolidate the assets and liabilities of a financial subsidiary with its own, "for accounting and regulatory reporting purposes, . . . assets and liabilities of [the operating subsidiary] are combined" with that of its parent.[131] Whatever monitoring the OCC may do of third-party contractors and agents, it seems highly unlikely that such oversight would rise to the level that the Court assumed that operating subsidiaries receive from the OCC.

Finally, the distinctive situation of operating subsidiaries is evident from the Court's reliance on a line of its own precedents in

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[128] *Id.* at 1572 n.12 (declining to express an opinion on whether the Gramm-Leach-Bliley Act preempts the Michigan laws at issue).

[129] *Id.* at 1569-70 (citing 12 C.F.R. § 5.34(e)(3) and OCC, RELATED ORGANIZATIONS: COMPTROLLER'S HANDBOOK 53 (Aug. 2004), and noting that Commissioner Watters did not "dispute OCC's authority to supervise and regulate operating subsidiaries in the same manner as national banks"); *see also id.* at 1570 n.10 ("On becoming Wachovia's operating subsidiary, Wachovia Mortgage became subject to the same terms and conditions as national banks, including the full supervisory authority of OCC. This change exposed the company to significantly more federal oversight than it experienced as a state nondepository institution.").

[130] *Id.* at 1570 (citations omitted).

[131] *Id.* at 1570 n.10 ("'[F]or purposes of applying statutory or regulatory limits,' . . . '[t]he results of operations of operating subsidiaries are consolidated with those of its parent.'") (quoting OCC, RELATED ORGANIZATIONS: COMPTROLLER'S HANDBOOK 53, 64 (Aug. 2004)).

which, it said, it had "treated operating subsidiaries as equivalent to national banks with respect to powers exercised under federal law (except where federal law provides otherwise)."[132] The OCC in its rulemaking had emphasized the same purported "equivalen[ce]" of an operating subsidiary to a department or division of the parent national bank.[133] While this characterization appears a stretch for operating subsidiaries (since banks often use operating subsidiaries precisely because such subsidiaries are separate and may shield the bank from liability), agents or third-party contractors that are not operating subsidiaries do not fall within the line of cases cited by the Court and are even less "equivalent" to a national bank than an operating subsidiary—providing yet another reason why they should *not* be allowed to invoke the same protections as national banks and operating subsidiaries under *Watters*.

Extending preemption to other entities that are not national banks would also raise serious policy concerns. As Professor Christopher Peterson explained in a recent article, "bank agents are likely to be less averse to predatory lending than the banks they represent" because they are "relatively less concerned about damage to their reputation," "have less assets exposed to liability than depository institutions," face "less scrutiny than depository institutions," "may be more difficult to supervise," and face more incentives to fraud, deception, and other illegal activity.[134] One example of the abuses that can arise in banks' dealings with third parties occurred when several national banks rented out their charters to payday lenders charging extremely high interest rates in order to help the payday lenders evade state usury laws and other regulation.[135] Although the OCC eventually took a stand against this particular abuse,[136] the OCC does not—and cannot—adequately

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[132] *Id.* at 1570-71.

[133] *See* Investment Securities; Bank Activities and Operations; Leasing, 66 Fed. Reg. 34,784, 34,788 (July 2, 2001) (codified at 12 C.F.R. pts. 1, 7, 23).

[134] Peterson, *supra* note 115, at 542-49 (discussing advisability of federal preemption of state regulation of agents of depository institutions).

[135] *See id.* at 524-25 ("For years, bank regulators facilitated predatory payday lending by allowing both state and federal banks to make predatory payday loans out of fringe lending company store fronts.").

[136] Joint Statement by John D. Hawke, Comptroller of the Currency, and Ellen Seidman, Director, Office of Thrift Supervision (Nov. 27, 2000) (recognizing that non-bank vendors such as payday lenders "seek out

supervise against all of the abuses that can arise in such third-party relationships. Consider, for example, the car loan origination activities at issue in the 2001 preemption letter described above—an area often fraught with deceptive and abusive practices.[137] It is highly improbable that the OCC could—or would—adequately supervise a car dealership's loan origination practices, despite the fact that the OCC found preemption of Michigan laws specifically aimed at curbing abuses by car dealerships.

In light of *Watters*'s reliance on the distinctive features of operating subsidiaries and the public policy concerns raised by Professor Peterson, the First Circuit's recent decision in *SPGGC, LLC v. Ayotte*[138] appears misguided. The First Circuit found that the National Bank Act and the Home Owners' Loan Act and their implementing regulations preempted a New Hampshire statute that prohibited a third-party retailer from selling stored-value gift cards issued by national banks and national thrifts with expiration dates and administrative fees. In considering the National Bank Act issues in the case, the First Circuit cited *Watters* to support its assertion that "the question . . . is not *whom* the New Hampshire statute regulates,

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national banks and thrifts as participants in the marketing of their products in an effort to avoid the application of state and local consumer protection laws that would restrict the ways in which these products are offered," that "[i]n many cases, the national bank or thrift is not significantly involved in the marketing of the product and may have a relatively insignificant economic interest in the business," and "that such situations may represent an abusive use of the benefits of the national bank and thrift charters"), *available at* http://www.ots.treas.gov/docs/4/48594.pdf; *see also* In re Eagle Nat'l Bank, OCC No. 2001-104 (Dec. 18, 2001) (consent order), *available at* www.occ.treas.gov/ftp/eas/ea2001-104.pdf; In re Goleta Nat'l Bank, OCC No. 2002-93 (Oct. 25, 2002) (consent order), *available at* www.occ.treas.gov/ftp/eas/ea2002-93.pdf; In re Peoples Nat'l Bank, OCC No. 2003-2 (Jan. 30, 2003) (consent order), *available at* www.occ.treas.gov/ftp/eas/ea2003-2.pdf; In re First Nat'l Bank in Brookings, OCC No. 2003-1 (Jan. 17, 2003) (consent order), *available at* www.occ.treas.gov/ftp/eas/ea2003-1.pdf.

[137] *See* OCC Preemption Determination, 66 Fed. Reg. 28,593 (May 23, 2001); *supra* text accompanying notes 117 to 122; *see generally* NATIONAL CONSUMER LAW CENTER, THE COST OF CREDIT: REGULATION, PREEMPTION, AND INDUSTRY ABUSES ch. 11.6 (3d ed. 2005) (discussing used car loan abuses).

[138] 488 F.3d 525 (1st Cir. 2007).

but rather, against *what activity* it regulates."[139] However, it clearly mattered to the *Watters* Court whom the Michigan laws regulated, since the majority took great pains to distinguish operating subsidiaries from other entities at various points throughout its decision.[140] The logical conclusion from the majority's reasoning in *Watters*—and from the prudential considerations outlined by Professor Peterson—is that the National Bank Act's protections should not extend beyond operating subsidiaries.

2. What substantive laws are preempted?

Another major dispute between the OCC and the states has been over what substantive laws are preempted through conflict preemption principles under the National Bank Act. Although it is difficult to understand how the Court found a conflict sufficient to preempt the innocuous Michigan laws at issue in *Watters*,[141] the

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[139] *Id.* at 532 (citing Watters v. Wachovia Bank, 127 S. Ct. 1559, 1570 (2007)). The First Circuit also relied on the fact that the New Hampshire statute focused on the terms and conditions of the gift cards, over which it found the third party had no control, rather than issues within the third party's control, such as how and where the gift cards are marketed. *Id.* at 533; *see also id.* at 534 (describing how bank's involvement was more limited in *SPGGC, Inc. v. Blumenthal*, 408 F. Supp. 2d 87 (D. Conn. 2006), *affirmed in part, vacated in part*, 505 F.3d 183 (2d Cir. 2007)). The Court was also careful to distinguish the facts before it from those at issue in an earlier OCC letter provided to the Massachusetts Attorney General and in other cases, such as *Carson v. H & R Block, Inc.*, 250 F. Supp. 2d 669 (S.D. Miss. 2003), which involved a prohibition on an agent misrepresenting bank products it was selling. *See SPGGC*, 488 F.3d at 534 & n.6.

[140] *Watters*, 127 S. Ct. at 1570 & n.10, 1571-72; *cf.* State Farm Bank v. Reardon, 512 F. Supp. 2d 1107, 1121-22 (S.D. Ohio 2007) (finding *Watters* not to be controlling in a case involving the Office of Thrift Supervision's authority to extend federal preemption to agents of federal depository institutions because "[t]he *Watters* holding did not address federal agency preemption of state laws impacting wholly independent third-party contractors in which a federal financial institution has no ownership interest or direct operational control"); *id.* at 1126-28 (rejecting an effort to analogize third-party contractors to operating subsidiaries of savings associations).

[141] *Id.* at 1580 (Stevens, J., dissenting) ("There is no evidence, and no reason to believe, that compliance with the Michigan statutes imposed any special burdens on Wachovia Mortgage's activities, or that the transfer in 2003 of

majority's repeated references to section 484(a) suggest that its conclusion relied in large part on section 484(a)'s fairly categorical prohibition of visitation by state officials.[142] Since Michigan did not dispute that the challenged statutes were visitorial in nature, *Watters* should be read to have extended the preemptive scope of the National Bank Act to include laws applied to operating subsidiaries if, but only if, the laws are clearly visitorial. More generally, it is important to note that the *Watters* majority did not alter the conflict preemption standards that have traditionally applied in the national banking context and did not endorse the OCC's efforts to preempt a host of other consumer protection statutes that do not "prevent or significantly interfere with" the exercise of a national bank's powers.[143]

Shortly after the National Bank Act was enacted, the Supreme Court recognized in *National Bank v. Commonwealth*,[144] that "[i]t is only when the State law *incapacitates* the banks from discharging their duties to the government that it becomes unconstitutional."[145] More than a century later in *Barnett Bank*, the Court was careful not to upend this well-established standard, pointing out that it was "not . . . depriv[ing] States of the power to regulate national banks, where (unlike here) doing so does not *prevent or significantly interfere* with the national bank's exercise of its powers."[146] Although the *Watters* Court emphasized the preemptive

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its ownership from the holding company to the Bank required it to make any changes whatsoever in its methods of doing business."); *see also* Brief for the Petitioner, *supra* note 78, at 6 (explaining that "[s]tate authority over nonbank operating subsidiaries of national banks is specifically limited" under the Michigan laws at issue in *Watters* and noting, *inter alia*, that the Michigan laws exempt registrants from complaint investigations "unless the complaint is not being adequately pursued by the appropriate federal regulatory authority").

[142] *Watters*, 127 S. Ct. at 1568-69, 1571, 1572.

[143] *Id.* at 1567.

[144] 76 U.S. (9 Wall.) 353 (1869).

[145] *Id.* at 362 (emphasis added).

[146] Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33 (1996) (emphasis added).

effect of the National Bank Act,[147] the majority also once again reaffirmed the standard established by this long line of cases, stating:

> States are permitted to regulate the activities of national banks where doing so does not prevent or significantly interfere with the national bank's or the national bank regulator's exercise of its powers. But when state prescriptions significantly impair the exercise of authority, enumerated or incidental under the [National Bank Act], the State's regulations must give way.[148]

This reaffirmation is important because the OCC had advanced a broader standard in its 2004 preemption rules and over the last few years has zealously sought to preempt state laws that would not qualify for preemption under the test established by the Court's precedents. The OCC's 2004 rules provide that state laws generally do not apply to national banks to the extent that they more than "incidentally affect" the exercise of a national bank's powers.[149] The rules also purport as a general matter to preempt state laws that "obstruct, impair, *or condition*" a national bank's ability to fully exercise its federally-authorized powers.[150] Although the OCC maintains that the 2004 rules merely "distill[ed]" prior Supreme

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[147] *See, e.g.*, *Watters*, 127 S. Ct. at 1566-67 ("[W]e have repeatedly made clear that federal control shields national banking from unduly burdensome and duplicative state regulation."); *id.* at 1567 ("'[T]he states can exercise no control over [national banks], nor in any wise affect their operation, except in so far as Congress may see proper to permit.'") (quoting Farmers' and Mechanics' Nat'l Bank v. Dearing, 91 U.S. 29, 34 (1875)); *id.* at 1567-68 ("Beyond genuine dispute, state law may not significantly burden a national bank's own exercise of its real estate lending power, just as it may not curtail or hinder a national bank's efficient exercise of any other power, incidental or enumerated under the [National Bank Act].").

[148] *Id.* at 1567.

[149] Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1913, 1916-17 (Jan. 13, 2004) (codified at 12 C.F.R. §§ 7.4007(c), 7.4008(e), 7.4009(c)(2), 34.4(b)).

[150] 69 Fed. Reg. at 1904, 1910, 1912, 1916-17 (emphasis added) (codified at 12 C.F.R. §§ 7.4007(b), 7.4008(d)(1), 7.4009(b), 34.4(a)).

Court precedents, they in fact departed significantly from the established "prevent or significantly interfere" test.[151]

When asked to rule on conflict preemption issues in the banking context, it is important that lower courts follow this line of Supreme Court precedents and recognize that only those statutes that actually "prevent or significantly interfere with" a national bank's exercise of its powers are preempted. As the *Watters* dissent recognized, "because federal law is generally interstitial, national banks must comply with most of the same rules as their state counterparts," especially in the consumer protection arena, the "quintessential[]" example of a field that the states have traditionally regulated.[152]

The OCC and the entities it regulates have nevertheless sought to use the OCC's 2004 preemption rules to preempt a wide swath of state consumer protection laws, including state laws that supplement or complement federal laws in ways that Congress intended. One example is state anti-predatory lending laws that supplement the federal Home Ownership and Equity Protection Act of 1994 ("HOEPA").[153] Congress enacted HOEPA in 1994 in response to abuses in the subprime or high-cost mortgage market. The legislative history of HOEPA makes it clear that the "Conferees intend[ed] to allow states to enact more protective provisions than

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[151] 69 Fed. Reg. at 1910 & n.53 (citing Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 34 (1996), although the case does not support the proposition that state laws that only "condition" the exercise of national bank powers are preempted); Wilmarth, *supra* note 18, at 237-52.

[152] *Watters*, 127 S. Ct. at 1574, 1581 n.19 (Stevens, J., dissenting); *cf.* In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig., No. 06-3132, 2007 WL 1791004, at *3-*6, *7, *8 (7th Cir. June 22, 2007) (holding that, even under Office of Thrift Supervision regulations that purport to occupy the field, breach of contract claims in servicing are not preempted merely because they occur during servicing and that the Office of Thrift Supervision's "assertion of plenary regulatory authority does not deprive persons harmed by the wrongful acts of savings and loan associations of their basic state common-law-type remedies" or of all claims under state statutes).

[153] Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, §§ 151-158, 108 Stat. 2160 (1994) (codified primarily at 15 U.S.C. § 1639).

those in [HOEPA]."[154] Although HOEPA accomplished many of its objectives, market abuses that exploited its weaknesses continue to this day. To bolster the federal law, states including North Carolina, Georgia, New York, Illinois, and Massachusetts enacted their own statutes providing greater protections with private rights of action.[155] At the request of two national banks and their operating subsidiaries, the OCC pronounced the Georgia law preempted in its entirety with respect to national banks and their operating subsidiaries.[156] The OCC has cited its preemption of the Georgia law as an example of how it will apply the 2004 preemption rule standards,[157] suggesting that it will take the position that other state anti-predatory lending laws are preempted as well.[158] Particularly in light of HOEPA's

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[154] H.R. REP. NO. 103-652 (1994) (Conf. Rep.), *reprinted in* 1994 U.S.C.C.A.N. 1977, 1992; *see also* 15 U.S.C. § 1610(b).

[155] N.C. GEN. STAT. §§ 24-1.1A, -1.1E, -2.5, -8, -9, -10.2; GA. CODE ANN. §§ 7-6A-1 to -13; N.Y. BANKING LAW § 6-*l*; N.Y. GEN. BUS. § 771-a; N.Y. REAL PROP. ACTS. § 1302; 815 ILL. COMP. STAT. 137/1 to 137/175; MASS. GEN. LAWS ch. 183C §§ 1-19; *see also* Peterson, *supra* note 115, at 516 n.3 (identifying state laws and local ordinances addressing predatory mortgage lending).

[156] OCC Preemption Order and Determination, 68 Fed. Reg. 46,264, 46,264 (Aug. 5, 2003); Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 46,119 (Aug. 5, 2003). For thoughtful academic criticisms of the OCC's preemption of state anti-predatory lending laws and other consumer protection laws, *see generally* Baher Azmy*, Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 382-83, 385-88 (2005); Bagley, *supra* note 57; Peterson, *supra* note 115; Wilmarth, *supra* note 18; Vincent Di Lorenzo, *Federalism, Consumer Protection and Preemption: A Case for Heightened Judicial Review*, St. John's Legal Studies Research Paper #09-0026 (2005), *available at* http://ssrn.com/abstract=796147.

[157] *See* Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1911-12 nn.57, 59 (Jan. 13, 2004).

[158] An OCC official testified to Congress that, despite a Congressional request for delay, the OCC proceeded with the final preemption rules due to continuing initiatives from states on anti-predatory lending laws. *Cong. Review of OCC Preemption: Hearing Before the Subcomm. on Oversight & Investigations of the House Fin. Servs. Comm.*, 108th Cong. 30-31 (2004) (testimony of Julie Williams, OCC First Senior Deputy Comptroller and Chief Counsel), *available at* http://commdocs.house.gov/committees/bank/

legislative history, such sweeping preemption is not warranted under the traditional conflict preemption test because the state laws generally do not "prevent or significantly interfere" with any bank powers.

The OCC and banks have also been extremely aggressive in using the agency's preemption rules in other ways—such as selectively invoking the rules when they favor banks but arguing that the rules do not apply when they might assist consumers. For example, the OCC recognizes in its rules that state law governing the "[r]ights to collect debts" is generally not preempted due to Supreme Court precedents, and banks often rely on state law in collecting debts from consumers.[159] However, when consumers have sued banks using state debt collection law, banks and the OCC have vociferously argued that the "[r]ight[] to collect debts" is not at issue. An example of this occurred in a California appeal from a $1.5 billion trial verdict in favor of Social Security recipients whose directly-deposited exempt benefits had been taken from their accounts by Bank of America to collect overdrafts and related fees.[160] In an effort to establish preemption, the defendant bank and the United States as *amicus* characterized the bank's practice of allowing overdrafts on its customers' accounts, charging overdraft fees, and then collecting the overdrafts and related fees from the accounts as account-balancing, rather than debt collection.[161] After the

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hba93717.000/hba93717_0f.htm; *cf.* Bagley, *supra* note 57, at 2284 (asserting that the rules would preempt all state predatory lending laws).

[159] *See* 12 C.F.R. §§ 7.4007(c)(4), 7.4008(e)(4), 7.4009(c)(2)(iv), 34.4(b)(5); 69 Fed. Reg. at 1912 & n.60.

[160] *See* A.E. Wilmarth, Jr., *Viewpoint: The OCC's Twisted Logic on Overdrafts*, AM. BANKER, Aug. 10, 2007, at 11.

[161] *See* Miller v. Bank of America N.T. & S.A., No. CGC-99-301917, 2004 WL 3153009 (Cal. App. Super. Dec. 30, 2004), *rev'd*, 144 Cal. App. 4th 1301, 51 Cal. Rptr. 3d 223 (Cal. Ct. App. 1st Dist., Div. 3 2006), *depublished and review granted*, 56 Cal. Rptr. 3d 471, 154 P.3d 997 (Cal. 2007); *Amicus Curiae* Brief for the United States in support of Appellants/Cross-Appellants at 19-20, 22-23 & n.9, 28, Miller v. Bank of America, 144 Cal. App. 4th 1301 (No. A110137); Appellant's Answer Brief on the Merits at 1-2, 40, Miller v. Bank of America, No. S149178 (Cal. Sept. 13, 2007); *see also* Wilmarth, *supra* note 160 ("In the OCC's legal universe, debts become nondebts, noncustomers become customers, and conditions become nonconditions—whatever is necessary to advance the interests of the constituents who pay the agency's bills.").

California Supreme Court agreed to review the case, the OCC issued an interpretive letter to bolster national banks' argument for preemption, asserting that the bank at issue in the letter "is not exercising its right to collect a debt" when it "processes an overdraft item and recovers a fee for doing so."[162] In considering aggressive preemption claims of this nature by the OCC and the entities it regulates, lower courts should keep in mind that the *Watters* majority did not invoke the broader preemption standards articulated in the OCC's rules, but instead reiterated the same basic standard the Court has used since the early days of the National Bank Act: state laws are preempted only if they "prevent or significantly interfere with" the national bank's exercise of its powers.[163]

3. What constitutes prohibited "visitorial powers"?

A third area of conflict between the states and the OCC that *Watters* did not resolve relates to what the terms "visitorial powers" and "vested in the courts of justice" mean in section 484(a), which provides that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or . . . exercised or directed by Congress."[164] The revised visitation rule that the OCC promulgated in 2004 broadly defines "visitorial powers" to include "(i) Examination of a bank; (ii) Inspection of a bank's books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) Enforcing compliance with any applicable federal or state laws concerning those activities."[165] The revised rule also asserts that the exception in section 484(a) for powers "vested in the courts of justice" exception "does not grant state or other governmental authorities any right to inspect, superintend, direct, regulate or compel compliance by a national bank with respect to any law, regarding the content or conduct of activities authorized for

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[162] OCC Interpretive Letter No. 1082 (May 17, 2007), *available at* http://www.occ.treas.gov/interp/jun07/int1082.pdf, at 6; *see also* Wilmarth, *supra* note 160.

[163] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1567 (2007).

[164] 12 U.S.C. § 484(a).

[165] 12 C.F.R. § 7.4000(a)(2).

national banks under Federal law."[166] Relying on the revised rule, the OCC has tried to stop state attorneys general from investigating possible discrimination and other misconduct by national banks and their operating subsidiaries on the ground that such investigations are prohibited exercises of "visitorial powers."[167] In the wake of *Watters*, one bone of contention is how the Supreme Court's decision bears on the meaning of "visitorial powers" and "vested in the courts of justice."

Citing *Watters*, a divided Second Circuit panel in December 2007 upheld an injunction prohibiting the New York State Attorney General from investigating possible violations of state fair lending laws by national banks and their operating subsidiaries.[168] While acknowledging that "*Watters* does not directly address the questions at issue here," the panel argued that "the [*Watters*] Court implied that investigation and enforcement by state officials are just as much aspects of visitorial authority as registration and other forms of administrative supervision, and that the OCC was not clearly wrong to include in its definition of visitorial powers '[e]nforcing compliance with any applicable federal or state laws concerning' a national bank's authorized banking activities."[169]

Watters, however, cannot bear the weight that this line of argument places on it because the exact contours of what constitutes a "visitorial" law were not at issue before the Court. Although the

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[166] 12 C.F.R. § 7.4000(b)(2).

[167] *See* Arthur E. Wilmarth, Jr., OCC v. Spitzer: *An Erroneous Application of* Chevron *That Should Be Reversed*, 86 Banking Rep. (BNA) No. 8, at 379-94 (Feb. 20, 2006); Comments of the Attorneys General of 50 States and the Virgin Islands and the D.C. Office of Corporation Counsel, Docket No. 03-16, at 7-9 (Oct. 6, 2003) (describing OCC actions interfering with state consumer protection enforcement actions).

[168] Clearing House Ass'n, L.L.C. v. Cuomo, 510 F.3d 105 (2d Cir. 2007). The Second Circuit vacated the district court's judgment to the extent that it enjoined the Attorney General from enforcing the Fair Housing Act on the ground that the district court lacked jurisdiction to decide the Fair Housing Act claim. *Id.* at 110, 121-26. In doing so, the court of appeals commented that "the question of whether the [National Bank Act] precludes state attorneys general from seeking to enforce the FHA against national banks is significantly more complicated than the district court's analysis suggests." *Id.* at 125.

[169] *Id.* at 116.

Watters majority quoted a definition of visitation from *Guthrie v. Harkness*[170] and cited the OCC's "visitorial powers" rule in passing,[171] the petitioner in *Watters* did not dispute that the challenged state statutes were "visitorial" in nature and could not have been extended to a national bank.[172] Because the only defendant named in the case was the Commissioner of Insurance and Financial Services, the authority of the state attorneys general was also not at stake. The parties in *Watters* also did not brief the meaning of the exception in section 484(a) that permits the exercise of visitorial power "vested in the courts of justice." The *Watters* Court therefore was not called upon to determine exactly what actions constitute forbidden exercises of "visitorial powers" or whether the OCC had overreached in promulgating its revised visitation rule.

Although the *Watters* Court did not address these issues, a review of precedents—including the *Guthrie* decision cited in *Watters*—suggests that the OCC and the Second Circuit have read the OCC's exclusive "visitorial powers" too broadly and that section 484(a) should not preclude a state attorney general's enforcement of generally applicable consumer protection and civil rights laws.[173]

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[170] 199 U.S. 148 (1905).

[171] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1568-69 (2007) (quoting Guthrie v. Harkness, 199 U.S. 148 (1905)) (citing 12 C.F.R. § 7.4000(a)(2)); *see also id.* at 1564 (citing 12 C.F.R. § 7.4000).

[172] *See Watters*, 127 S. Ct. at 1569 (stating that Petitioner "conced[ed] that Michigan's licensing, registration, and inspection requirements cannot be applied to national banks") (citing Brief for the Petitioner, *supra* note 78, at 10, 12); *see also id.* at 1568 ("[A]s the parties recognize, the [National Bank Act] . . . would spare a national bank from state controls of the kind here involved.") (citing, *inter alia*, Brief for the Petitioner*, supra* note 78, at 12); *Clearing House Ass'n*, 510 F.3d at 134 (Cardamone, J., dissenting in part) (explaining that "*Watters* had no occasion to address directly" whether the OCC has the authority to stop a state attorney general from enforcing a valid state law against a national bank). In fact, the Michigan Mortgage Brokers, Lenders, and Servicers Licensing Act expressly exempts depository financial institutions such as national banks. MICH. COMP. LAWS § 445.1675(a).

[173] *See, e.g.,* cases cited *infra* notes 174-185. *But see Clearing House Ass'n*, 510 F.3d at 115-17 (concluding that while *Watters* "does not directly address the question[]" it "casts . . . doubt" on the New York State Attorney General's argument that his investigation of possible discrimination by

Guthrie upheld the common law right of a shareholder to inspect a national bank's books notwithstanding the bank's effort to shield itself with the National Bank Act.[174] The definition of visitation from *Guthrie* that the *Watters* majority quoted—the "act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting business, and enforce an observance of its laws and regulations"[175]—suggests that visitation is limited to acts of regulators who oversee the industry ("superior or superintending officer[s]"), rather than general law enforcement officials such as an attorney general. The definition also suggests that visitation embraces only acts that enforce industry-specific provisions ("its laws and regulations"), rather than more generally applicable laws such as anti-discrimination statutes.

The narrow view of section 484(a)'s "courts of justice" exception advanced by the OCC and embraced by the Second Circuit[176] also cannot be reconciled with *Guthrie*. *Guthrie* held that Congress "did not intend, in withholding visitorial powers, to take away the right to proceed in courts of justice to enforce such recognized rights as are here involved."[177] Although the *Guthrie* Court was addressing civil actions by private parties, its reasoning that the courts of justice exception is designed to permit courts to vindicate longstanding rights should extend to the well-established right of state officials to enforce applicable laws in court.[178]

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national banks does not constitute a prohibited exercise of "visitorial powers").

[174] Guthrie v. Harkness, 199 U.S. 148, 159 (1905).

[175] *Watters*, 127 S. Ct. at 1568 (quoting *Guthrie,* 199 U.S. at 158); *see also Clearing House Ass'n*, 510 F.3d at 128 (Cardamone, J., dissenting in part) (explaining that "[e]arly interpretations of the term emphasized the supervisory nature of visitorial authority").

[176] *Clearing House Ass'n*, 510 F.3d at 111-12, 117.

[177] *Guthrie*, 199 U.S. at 159.

[178] *See* Bowles v. Shawano Nat'l Bank, 151 F.2d 749 (7th Cir. 1945) (upholding the right of the Office of Price Administration to require a national bank representative to testify and produce certain records over the bank's objections under § 484, after finding all of § 484's statutory exceptions applicable). *But see Clearing House Ass'n*, 510 F.3d at 117 ("If a state official could sidestep the Act's restriction on the exercise of visitorial powers simply by filing a lawsuit, the exception would swallow the rule.").

The Supreme Court's subsequent decision in *First National Bank in St. Louis v. Missouri*[179] also undermines the OCC's claims regarding the breadth of its exclusive "visitorial powers." There, the Supreme Court upheld a state's right to enforce applicable state law against the argument of the bank and the United States as *amicus* that the visitation provisions of the National Bank Act precluded that.[180] Although the Court's opinion did not mention "visitorial powers" by name,[181] it decisively rejected this argument, stating:

> To demonstrate the binding quality of a statute but deny the power of enforcement involves a fallacy made apparent by the mere statement of the proposition, for such power is essentially inherent in the very conception of law . . . . What the state is seeking to do is to vindicate and enforce its own law, and the ultimate inquiry which it propounds is whether the bank is violating that law, not whether it is complying with the charter or law of its creation.[182]

Consistent with *Guthrie* and *First National Bank in St. Louis*, enforcement of consumer protection laws by state attorneys general—even when related to activities authorized for national banks—continued largely without question from either banks or the OCC until very recently.[183] For example, the state of Michigan sued

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[179] 263 U.S. 640 (1924).

[180] *Id.* at 642-43, 645-48.

[181] The U.S. reporter's summary of argument indicates that both the bank and the United States argued that the state's action constituted an improper exercise of "visitatorial power" and specifically cites § 484(a)'s predecessor, § 5241, in summarizing the bank's argument. *Id.* at 643, 645.

[182] *Id.* at 660; *see also Clearing House Ass'n*, 510 F.3d at 129, 132 (Cardamone, J., dissenting in part) (discussing *First Nat'l Bank in St. Louis*).

[183] *See, e.g.,* Comments & Recommendations of the Attorneys General of 47 States and the D.C. Corporation Counsel to the OCC 7 & n.29 (Apr. 8, 2003) (citing cases); *see also Clearing House Ass'n*, 510 F.3d at 129 (Cardamone, J., dissenting in part) ("Considerable authority supports the proposition that states have the authority to enforce [nonpreempted state] laws against national banks.").

a national bank in 1980 over its mortgage escrow practices—though mortgage lending is an expressly authorized banking activity.[184] Similarly, the West Virginia Attorney General brought an action against Citizens National Bank of St. Albans in 1990 asserting that the bank, which had acted as the financer of a dealer's extended warranty purchases, was liable because it had collected fees for services never received.[185] When lower courts confront questions about the meaning of "visitorial powers" and "vested in the courts of justice" in the future, they should recognize that *Watters* left these issues unresolved and that *Guthrie*, *First National Bank in St. Louis*, and the long history of enforcement by state attorneys general belie the broad reading that the OCC and the Second Circuit have given to the agency's exclusive "visitorial powers."

III. The Need for Congressional Intervention

As scholars and courts have recognized, administrative agencies do not represent states' interests and are not as attuned to federalism concerns as Congress is.[186] Congress is much better positioned than the OCC to appreciate the critical role that states have played in consumer protection initiatives. Congress has also used state legislation as a model for many important federal consumer protection efforts—such as the Truth in Lending Act—reaping the benefits that the states can provide as laboratories of

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[184] Attorney Gen. v. Mich. Nat'l Bank, 312 N.W.2d 405, 407 (Mich. Ct. App. 1981) (holding that it was improper to dispose of the Attorney General's complaint by summary judgment in action filed against a national banking association), *rev'd in part and remanded on other grounds*, 325 N.W.2d 777 (Mich. 1982).

[185] West Virginia v. Scott Runyan Pontiac-Buick, Inc., 461 S.E.2d 516, 520-21 (W. Va. 1995).

[186] *See, e.g.,* Watters v. Wachovia Bank, 127 S. Ct. 1559, 1584 (2007) (Stevens, J., dissenting); Geier v. American Honda Motor Co., 529 U.S. 861, 908 (2000) (Stevens, J., dissenting); Nina A. Mendelson, Chevron *and Preemption*, 102 MICH. L. REV. 737, 779, 799 (2004) (arguing that "the relative institutional competence of agencies in considering federalism values weighs against deferring to agency interpretations on preemption questions" and that agencies "generally lack expertise in questions of the overall balance of government authority," which if "intrinsic to a preemption determination, . . . weighs strongly against Chevron deference").

experimentation on consumer protection issues.[187] Historically, Congress has also been sensitive to the importance of competitive equality in our dual banking system.[188]

In response to the *Watters* decision and the OCC's recent efforts to undermine state authority, Congress needs to send a clear message reaffirming the states' authority and emphasizing the importance of consumer protection initiatives at both the state and federal level. A number of consumer groups have expressed their support for legislation based on "The Preservation of Federalism in Banking Act" introduced by Representative Luis Gutiérrez.[189] The bill would rein in both the OCC and the Office of Thrift Supervision and restore state regulators' authority over operating subsidiaries.[190] It would also expressly permit states to enforce their consumer laws of general application and would clarify that the National Bank Act does not bar a state from enacting legislation that builds on existing federal laws that Congress intended to serve as a floor not a ceiling.[191] The bill would clarify that neither the visitorial powers

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[187] *See Plunkett Testimony*, *supra* note 47, at 3 n.8 (citing as examples the Truth in Lending Act and provisions of the Fair and Accurate Credit Transactions Act); *Antonakes Testimony*, *supra* note 58, at 6 ("Nearly every consumer protection regulation that exists at the federal level, or that Congress is currently contemplating, has its roots at the state level. For example, the states were the first to enact fair lending statutes, and are now leading the way on predatory lending, mortgage supervision, data security, and credit card disclosures.").

[188] *See generally* Wilmarth, *supra* note 18, at 253-73 (detailing the history of congressional efforts to maintain a competitive equilibrium in the dual banking system).

[189] Preservation of Federalism in Banking Act, H.R. 1996, 110th Cong. (2007); *see also Plunkett Testimony*, *supra* note 47, at 20-21.

[190] H.R. 1996, at § 103 ("No provision of [Title 12 U.S.C.] shall be construed as preempting the applicability of State law to any State-chartered nondepository institution, subsidiary, other affiliate, or agent of a national bank."); *id.* at § 203 ("No provision of [the Home Owners' Loan Act] shall be construed as preempting the applicability of State law to any State-chartered nondepository institution, subsidiary, other affiliate, or agent of a Federal savings association."). Title I of the bill addresses national banks, while Title II of the bill addresses savings associations. *See* H.R. 1996.

[191] *Id.* at § 101(a) ("Notwithstanding any other provision of Federal law, any consumer protection in State consumer law of general application . . . shall

provision of the National Bank Act nor the Home Owners' Loan Act limits the historic enforcement authority of the state attorneys general.[192]

As consumer groups have explained, Congress should also unequivocally grant state officials concurrent authority to enforce federal lending laws and the Federal Trade Commission Act's prohibition on unfair and deceptive practices against national banks and thrifts and their operating subsidiaries.[193] Congress should also reconsider how the OCC and other federal banking agencies are funded to ensure that the funding mechanisms do not encourage lax regulation.[194] Federal regulators should be required to conduct periodic reviews of all consumer protection rules and enforcement efforts to determine their effectiveness and to make recommendations to Congress for changes.[195] These steps by Congress would begin to undo the damage wrought by the *Watters* decision and the federal regulators' efforts to sideline the states.

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apply to any national bank[,]" and, with limited exceptions, "any State law that— (A) is applicable to State banks; and (B) was enacted pursuant to or in accordance with, and is not inconsistent with, an Act of Congress . . . that explicitly or by implication, permits States to exceed or supplement the requirements of any comparable Federal law, shall apply to any national bank."); *see also id.* at § 201(a) (amending the Home Owners' Loan Act to clarify state law preemption standards for federal savings associations and affiliates).

[192] *Id.* at § 102 ("No provision of [Title 12 U.S.C.] which relates to visitorial powers or otherwise limits or restricts the supervisory, examination, or regulatory authority to which any national bank is subject shall be construed as limiting or restricting the authority of any attorney general . . . of any State to bring any action in any court of appropriate jurisdiction—(1) to enforce any applicable Federal or State law, as authorized by such law; or (2) on behalf of residents of such State, to enforce any applicable provision of any Federal or State law against a national bank, as authorized by such law, or to seek relief and recover damages for such residents from any violation of any such law by any national bank."); *see also id.* at § 202 (amending the Home Owners' Loan Act regarding visitorial standards).

[193] *See Plunkett Testimony*, *supra* note 47, at 21 & nn.38-39 (citing, as models, the Telemarketing Sales Act, 15 U.S.C. § 6103, and the Credit Repair Organizations Act, 15 U.S.C. § 1679h).

[194] *See id.* at 22.

[195] *See id.*; *see also* H.R. 1996, at § 204 (requiring some data collection and reporting).

IV. Challenges for the OCC

No matter what Congress and the lower courts do in response to *Watters*, the OCC now faces the enormous task of fulfilling the promises it has made to the Court, Congress, and the public. The OCC has repeatedly represented that it "'has ample legal authority and resources to ensure that consumers are adequately protected.'"[196] In reaching its decision in *Watters*, the Court evidently relied on the OCC's assertions that it vigorously supervises operating subsidiaries and may well have been swayed by the agency's broader representations about its ability to protect consumers.[197]

Unfortunately, as explained in Section I.C above, the evidence does not bear out the OCC's assessments of its own efforts, and post-*Watters* initiatives by the OCC have not alleviated concerns about the agency's commitment to consumer protection. In May 2007, for example, the OCC issued the interpretive letter described above that includes a suspect interpretation of the term "[r]ight[] to collect debts" designed to help a national bank avoid a landmark judgment in a consumer case.[198] The interpretive letter also permits national banks to process their customers' bank transactions in an order that increases the likelihood of overdrafts and maximizes overdraft-related fees that consumers must pay.[199]

A new website for consumers that the OCC launched in the summer of 2007 at http://www.helpwithmybank.gov has also met

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[196] United States Amicus Brief, *supra* note 44, at 26 (quoting 69 Fed. Reg. 1904, 1915).

[197] *See, e.g.,* Watters v. Wachovia Bank, 127 S. Ct. 1559, 1569-70 (2007); *see also supra* text accompanying notes 129 to 131.

[198] *See* OCC Interpretive Letter No. 1082, *supra* note 162, at 6 ("[T]he processing of an overdraft and recovery of an overdraft fee by balancing debits and credits on a deposit account are activities directly connected with the maintenance of a deposit account. Fundamentally, the Bank is not creating a 'debt' that it then 'collects' by recovering the overdraft and the overdraft fee from the account.").

[199] *See id.* at 4 & n.10; Wilmarth, *supra* note 160 ("[T]he OCC allows national banks to process overdraft items using an unfair method that maximizes their overdraft fees."); *see also Plunkett Testimony*, *supra* note 47, at 9-10.

with fierce criticism.[200] After a careful review of the website, a representative of six public interest organizations testified before Congress that "it is possible that the site itself may actually discourage consumers from making complaints."[201] Although the Comptroller has touted the assistance that the agency offers to consumers who complain about national banks,[202] the website advises consumers that the OCC "cannot release any information relating to any supervisory actions or regarding whether a violation of law or regulation occurred in connection with your complaint."[203]

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[200] *See Plunkett Testimony*, *supra* note 47, at 12-15 ("Overall, the message from the OCC to consumers seems to be, 'you're on your own.'").

[201] *Id.* at 12.

[202] *See, e.g., Dugan Testimony*, *supra* note 37, at 19-20. *But see, e.g., Wilmarth Testimony*, *supra* note 37, at 17 (testifying that the OCC's Customer Assistance Group accounted for "less than two percent of the OCC's total workforce" and "just over one percent of the OCC's operating budget" in 2005).

[203] OCC, Answers & Solutions for Customers of National Banks, http://www.helpwithmybank.gov/faqs/other_occ_help.html#drop02 (last visited Sept. 4, 2007) ("Can the OCC help me find out if a bank has been cited for a violation of a regulation or law? According to Federal law, results of examinations are considered confidential. The OCC cannot release any information relating to any supervisory actions or regarding whether a violation of law or regulation occurred in connection with your complaint."); *see also Plunkett Testimony*, *supra* note 47, at 14; Greg Ip & Damian Paletta, *Lending Oversight: Regulators Scrutinized In Mortgage Meltdown—States, Federal Agencies Clashed on Subprimes As Market Ballooned*, WALL ST. J., Mar. 22, 2007, at A1 (describing borrower Dorothy Smith's unsuccessful efforts to obtain assistance from the OCC regarding an abusive subprime loan from a national bank). In other contexts, the OCC has indicated that examination reports are covered by the bank examination privilege, a privilege that belongs to the agency and that the agency has the power to waive. *See, e.g.,* OCC Interpretive Letter No. 972 (Aug. 12, 2003) (explaining that "examination reports prepared by OCC examiners on national banks are . . . privileged under the bank examination privilege," that "[t]he bank examination privilege belongs to the OCC," and that the OCC had not waived the privileged in the litigation at issue). The OCC's regulations expressly reserve to the agency discretion to release non-public OCC information, despite a general policy of confidentiality. 12 C.F.R. § 4.32(b), § 4.36.

This lack of transparency combined with the OCC's failure to bring many formal enforcement actions is simply unacceptable. Consumers should be informed when they have been victims of illegal conduct and should know what entities engage in illegal conduct, so they can decide which businesses to avoid and which to patronize. Transparency is also necessary for the deterrent function of law enforcement to work. Secret enforcement, at whatever level, fails in some of the most essential purposes of law enforcement in the marketplace. To effectively protect consumers from abuses by national banks and their operating subsidiaries, the OCC must allow light to shine on bank practices and substantially increase its enforcement efforts.

For its consumer protection efforts to succeed, the agency will also have to work with the states, making good on the Comptroller's recent statement to Congress that "there is much promise for enhanced federal/state cooperation and corresponding improvements in consumer protection."[204] The OCC can find models of successful intergovernmental collaboration in other agencies' efforts, including, for example, the Federal Trade Commission's cooperation with the states in achieving a $60 million settlement in the First Alliance Mortgage Company predatory mortgage lending case.[205] It is high time for the OCC to shift the energy that it has expended on helping national banks and their operating subsidiaries preempt state laws to collaborating with the states in a joint effort to ensure that the marketplace is fair to consumers.

V. Conclusion

Watters represents a major setback for consumers because it puts hundreds of state-chartered national bank operating subsidiaries out of state financial regulators' reach. Lower courts must take care, though, not to read more into the decision than it held or to overlook the majority's silence on key matters, such as deference to agency

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[204] *Dugan Testimony*, *supra* note 37, at 27.

[205] Bill Brubaker, *Mortgage Lender, FTC Agree To Settle; First Alliance May Pay $60 Million in Suit*, WASH. POST, Mar. 22, 2002, at E01; *see also Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 6 (2007) (statement of Thomas J. Miller, Attorney General of Iowa), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htmiller061307.pdf.

preemption determinations and the OCC's formulation for its preemption test.

Preemption determinations are best made by Congress, which has never signaled an intent to preempt many of the state consumer protection measures that the OCC has challenged in recent years. Instead, Congress has historically recognized the important role that states play as laboratories of experimentation and the tremendous resources and expertise that states bring to bear in areas ranging from mortgage lending to used car sales to telemarketing. That Congress has not mandated complete uniformity for the national banking system makes sense for a host of reasons—including the historic leadership role played by the states in consumer protection and the resource limitations, narrow focus, and conflicted incentives of federal banking regulators. In the wake of *Watters*, Congress should pass legislation reaffirming its commitment to consumer protection efforts at all levels of government. Such action is necessary to correct the damage from *Watters* and to roll back more generally the federal banking regulators' unprecedented preemption efforts. Whether or not the OCC ultimately retains visitorial authority over operating subsidiaries under *Watters*, the agency needs to do vastly more to help consumers, including stepping up its enforcement, lifting the veil of secrecy that shrouds banks' behavior, and collaborating more with the states.