WATTERS V. WACHOVIA: A FUNCTIONAL APPROACH TO FEDERAL BANKING LAW PREEMPTION

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Introduction

The United States Supreme Court recently held that the National Bank Act ("NBA")[2] preempts state licensing and registration requirements as applied to operating subsidiaries of national banks.[3] In *Watters v. Wachovia Bank*,[4] the Court, by a 5-3 margin, determined that such national bank subsidiaries may not be hindered by state licensing, registration, and other attendant requirements in the exercise of banking-related activities on behalf of their national bank parents, even though they were chartered under state law.[5]

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[2] 12 U.S.C. §§ 21-43 (2000).

[3] An "operating subsidiary" of a national bank is a subsidiary of the bank that "engages solely in 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." 12 U.S.C. § 24a(g)(3)(A) (describing operating subsidiaries as subsidiaries that are not "financial subsidiaries," but without express mention); 12 C.F.R. § 5.34(e)("A national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking . . . .").

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

[5] *Id.* at 1572-73 (finding that "a national bank's engagement in the 'business of banking' whether conducted by the bank itself or by an operating subsidiary" is protected from state hindrance).

According to Justice Ruth Bader Ginsburg's majority opinion, any such state-imposed hindrance would conflict with Congress's intent that national banks have the freedom to exercise their federally granted powers without state interference, including through operating subsidiaries.[6] Thus, as the Court held, such subsidiaries enjoy federal preemption of state law to the same extent as national banks themselves.[7]

The *Watters* decision was hailed by the banking industry as confirmation of longstanding principles which are critical to the efficient operation of federally chartered financial institutions. The President and Chief Executive Officer of the American Bankers Association ("ABA"), Edward L. Yingling, said "[t]he Court's decision reaffirms that, for national banks, the business of banking—whether through the bank itself or an operating subsidiary—is regulated by the OCC."[8] For national banks, the ruling gives assurance that they may continue, without state interference, to use operating subsidiaries as a means of segregating and concentrating particular portions of their banking and banking-related activities within a separate corporate structure. Such segregation and concentration have numerous benefits, including efficiency of management, oversight, accounting, and legal compliance.[9] Thus, it was a great relief to national banks (as well as other federally chartered banks) that the Court ruled for Wachovia regarding the preemption issue in the *Watters* case.

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[6] *Id*. at 1572.

[7] *Id.*

[8] News Release, Edward L. Yingling, President and CEO, American Bankers Association, ABA Statement on Supreme Court Decision on Watters v. Wachovia (Apr. 17, 2007), http://www.aba.com/Press+Room/041707SupremeDecision.htm. America's Community Bankers, another leading bank trade association, said the ruling "reaffirms a long line of cases that support federal preemption for national banks and their operating subsidiaries." R. Christian Bruce, *Financial Institutions: U.S. Supreme Court Rules for Bankers, Says Bank Subs Shielded From State Law*, 74 Daily Rep. for Executives (BNA) A-42 (Apr. 18, 2007).

[9] Yingling, *supra* note 8 ("Avoiding a patchwork of duplicative and conflicting federal and state regulation makes it easier for national banks to grant credit to customers across state lines and preserves our industry's competitive structure.").

For Michigan, whose laws were held preempted in *Watters*, however, the Court's decision was a major blow. Neil Milner, president of the Conference of State Bank Supervisors, said the decision "does irreparable harm to the states' historical role in advancing consumer protection and ability to respond to local issues."[10] Pat Vredevoogd Combs, 2007 president of the National Association of Realtors, similarly complained that the Court's ruling "gives a tremendous competitive advantage to federally chartered banks over financial and non-financial competitors, increasing the value of the federal charter at the expense of state licensing, marketplace competition and potentially even consumer protection measures."[11] And certain Members of Congress immediately vowed to take action to undo the decision. Representative Luis Gutierrez (D-IL) said the Court's ruling "drastically undermines consumers' interests and state sovereignty," and that it "flies in the face of clear congressional intent and weakens the dual charter system for banks"; he promised to introduce legislation to "correct" the ruling.[12]

Such heated reactions demonstrate the continuing tension between the interests of the federal banking regulators and the institutions they charter on the one hand, and state governments, state-chartered entities, and certain consumer advocates, on the other, regarding the jurisdictional boundaries for bank regulation. This tension has long historical roots dating back to the creation of the first Bank of the United States.[13]

The *Watters* decision raises a variety of questions about the balance of regulatory authority between the federal and state governments. Did the Court alter the parameters for federal banking law preemption, or did it merely confirm preexisting boundaries?

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[10] Bruce, *supra* note 8.

[11] Press Release, Pat Vredevoogd Combs, Statement by NAR President on Supreme Court Ruling on Preemption of State Banking Laws (Apr. 17, 2007), http://www.realtor.org/press_room/news_releases/2007/statement_on_preemption_banking_laws.html.

[12] Cheyenne Hopkins, *Democrats Eye Bill as High Court Backs OCC: Split vote in Wachovia preemption case; Roberts joins dissent*, AM. BANKER, Apr. 18, 2007, at 1.

[13] CONG. GLOBE, 38th Cong., 1st Sess. 1893 (1864) (statement of Sen. Sumner) (describing the tension inherent in state efforts to retain bank regulatory authority and the establishment of national banks).

What are the implications of the Court's ruling for entities other than operating subsidiaries with respect to activities they may undertake for national banks and other federally chartered institutions? What does the Court's decision suggest about judicial deference to federal agency regulations and opinions that declare preemption of state law? This article explores these questions in an effort to probe the *Watters* decision's significance and legal underpinnings.

Part I of the article provides general background on the case, both as to its facts and relevant law. Part II summarizes the key arguments the parties presented to the Court. Part III discusses the Court's majority and dissenting opinions. Part IV explores the legal implications of the majority's decision from a jurisprudential standpoint as well as for practical purposes of bank operations. Part V, focusing on the issue the dissent found most critical, discusses when courts should defer to determinations by administrative agencies such as the Office of the Comptroller of the Currency ("OCC") that federal law preempts state law. Finally, the article concludes with some predictions regarding possible legislative and regulatory actions designed to further refine—if not curtail—the banking preemption principles articulated in *Watters*.

I. The Proceedings Below

Watters commenced as a challenge to certain Michigan laws as applied to Wachovia Mortgage Corporation ("Wachovia Mortgage"), a North-Carolina nonbank corporation engaged in mortgage lending in Michigan and elsewhere. Prior to becoming a national bank operating subsidiary in 2003, Wachovia Mortgage had complied with Michigan's requirements that nonbank mortgage lending institutions register with state authorities, submit fees, reports, and financial statements to these authorities, and be subject to potential investigatory and enforcement proceedings under Michigan state law.[14] In January 2003, however, when Wachovia Mortgage became a wholly-owned operating subsidiary of *Wachovia Bank* ("Wachovia Bank"), it informed the Michigan authorities that it

[14] *See* Mortgage Brokers, Lenders, and Services Licensing Act, MICH. COMP. LAWS ANN. §§ 445.1651-.1684 (West 2002) (setting forth requirements for registration, investigation, enforcement, etc.); Secondary Mortgage Loan Act, *id.* §§ 493.51-.81 (West 2002) (providing for registration, fees, investigation, etc.).

was surrendering its mortgage lending registration, on the understanding that such registration requirements are preempted as applied to national bank operating subsidiaries. Linda Watters, the Commissioner of the Michigan Office of Insurance and Financial Services, responded by advising Wachovia Mortgage that it no longer was authorized to engage in mortgage lending in the State.[15]

Wachovia Mortgage, together with Wachovia Bank, filed suit in the U.S. District Court for the Western District of Michigan seeking declaratory relief and an injunction to prohibit Watters from enforcing Michigan's mortgage lending registration and related requirements against Wachovia Mortgage. The plaintiffs claimed that such enforcement was preempted by 12 C.F.R. § 7.4006 ("Section 7.4006"), the OCC's regulation stating 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."[16] In other words, state law is preempted for operating subsidiaries to the same extent that it is for national banks. Under 12 U.S.C. § 484 ("Section 484"), the OCC has the exclusive right, with limited exceptions, to exercise visitorial powers over national banks.[17] "Visitorial powers" include, *inter alia*, "[e]nforcing compliance with any applicable federal or state laws concerning those activities."[18]

The district court granted summary judgment for the plaintiffs, finding that Section 7.4006 was entitled to deference under *Chevron USA, Inc. v. Natural Resources Defense Council*.[19] Under

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[15] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1565 (2007).

[16] 12 C.F.R. § 7.4006.

[17] Section 484, which dates back to the original enactment of the NBA in 1864, provides that "No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized." 12 U.S.C. § 484(a).

[18] 12 C.F.R. § 7.4000(a)(2)(iv).

[19] Wachovia Bank v. Watters, 334 F. Supp. 2d 957, 963-66 (W.D. Mich. 2004) (holding that "EPA's interpretation of the statute was a permissible construction and entitled to deference, where the legislative history of the statute was silent as to the instant issue") (applying Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984)).

Chevron, deference is due to an agency's interpretation of a statute the agency is charged to administer if (1) Congress has left ambiguous its intent with respect to the precise issue in question and (2) the agency's interpretation is based on a reasonable (or "permissible") construction of the statute.[20] In that regard, the district court found that Congress had not addressed the precise issue of NBA preemption with respect to operating subsidiaries, that Congress had granted the OCC "broad and pervasive" authority to regulate national banks and their subsidiaries, and, thus, deference was due to the Comptroller's interpretation of Section 4.7006.[21] The district court also held, in response to arguments put forth by Watters, that the Tenth Amendment to the Constitution[22] was "not implicated" in the case, because Congress has the power to regulate national banks (and thus their activities through operating subsidiaries) under the Constitution's Commerce Clause.[23]

A unanimous panel of the Sixth Circuit Court of Appeals affirmed.[24] It held that "section 7.4006 makes clear that states cannot obstruct a national bank's power . . . to conduct 'the business of banking' through the use of operating subsidiaries, by imposing state laws and regulations on the subsidiaries that could not be imposed on the parent."[25] The Court of Appeals opined that under 12 U.S.C. § 24(Seventh) ("Section 24(Seventh)"), national banks are imbued not only with certain specifically identified banking powers, but also with "all such incidental powers as shall be necessary to carry on the business of banking."[26] The court found that "[t]he Comptroller has

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[20] *See Chevron*, 467 U.S. at 843-44 (holding that "[i]f Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation.").

[21] *Watters*, 334 F. Supp. 2d at 964 ("The OCC holds broad and pervasive authority to regulate national banking associations.").

[22] U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.").

[23] *Watters*, 334 F. Supp. 2d at 963-66.

[24] Wachovia Bank v. Watters, 431 F.3d 556, 558 (6th Cir. 2005).

[25] *Id.* at 561.

[26] *Id*. at 559.

the authority to define a national bank's 'incidental powers' to include conducting the business of banking through an operating subsidiary"[27] and that "the OCC further has the authority to preempt state law concerning operating subsidiaries to the same extent that those laws would be preempted with respect to the parent national bank."[28] The appellate court also affirmed the district court's holding that Section 7.4006 raised no Tenth Amendment concerns.[29]

Both the district court and the appellate court rulings in *Watters* were consistent with the decisions of all of the other courts that had addressed the national bank operating subsidiary preemption issue by the time it was considered by the Supreme Court.[30]

II. The Arguments Presented to the Court

A. Petitioner's Arguments

In presenting her case to the Supreme Court, Watters argued: (1) the NBA provides no basis for believing that Congress intended the statute to preempt state law with respect to operating subsidiaries; (2) Section 7.4006 should not be accorded judicial deference; and (3) the Tenth Amendment bars the OCC from usurping regulatory authority over state-chartered entities from the states.[31]

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[27] *Id.* at 561-62.

[28] *Id.* (quoting Wachovia Bank v. Burke, 414 F.3d 305, 318 (2d Cir. 2005)) (internal quotations omitted).

[29] *Id.* at 563.

[30] See Nat'l City Bank of Ind. v. Turnbaugh, 463 F.3d 325 (4th Cir. 2006), *aff'g* 367 F. Supp. 2d 805 (D. Md. 2005); Wachovia Bank v. Burke, 414 F.3d 305 (2d Cir. 2005), *aff'g* in part and *rev'g* in part 319 F. Supp. 2d 275 (D. Conn. 2004); Wells Fargo Bank v. Boutris, 419 F.3d 949 (9th Cir. 2005), *aff'g* 265 F. Supp. 2d 1162 (E.D. Cal. 2003).

[31] *See* Brief for the Petitioner at i, Watters v. Wachovia, 127 S. Ct. 1559 (2006) (No. 05-1342), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/06-07/05-1342_Petitioner.pdf [hereinafter *Pet. Br.*].

1. Statutory Construction and Congressional Intent

Relying on principles of statutory construction, Watters argued that neither the NBA nor any other statute suggests Congress's intent to preempt state law. The analysis first focused on the plain language of Section 484, which says that "no national bank shall be subject to any visitorial powers except as authorized by federal law."[32] Watters argued that the reference to "national banks" should be interpreted narrowly to include only national banks and not their affiliates.[33] She bolstered this argument by pointing out the NBA's separate definitions for "national bank" and "affiliate."[34] Given the separate definitions and the absence of any reference to "affiliates" in Section 484, Watters argued, Congress must not have intended "to extend the preemptive scope of that statute to reach nonbank operating subsidiaries."[35]

Watters then focused on Section 24(Seventh), which provides that a national bank may "exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking."[36] While conceding that this language implicitly authorizes national banks to use nonbank operating subsidiaries to conduct the business of banking, she argued that "a national bank's 'incidental powers' cannot reasonably be understood to include the power to obliterate the distinction between 'national banks' and their 'affiliates,'"[37] which Congress expressly defined and otherwise treated differently.[38]

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[32] 12 U.S.C. § 484(a).

[33] Pet. Br., *supra* note 31, at 13 ("By its express terms, 12 USC § 484(a) applies only to 'national banks.'").

[34] *See* 12 U.S.C. §§ 21-24, 221 ("national bank"); *id*. § 221a(b) ("affiliate").

[35] *Id.* at 13-14 (citing Keene Corp. v. United States, 508 U.S. 200, 208 (1993)).

[36] 12 U.S.C. § 24(Seventh).

[37] Pet. Br., *supra* note 31, at 21 (internal quotations omitted).

[38] *Id.* at 22 ("Congress has carefully separated national banks from their affiliates, including operating subsidiaries.").

2. Judicial Deference to Section 7.4006

Using her "plain language" argument as a springboard, Watters went on to argue that there was no basis for deference to Section 7.4006 because the NBA itself is "clear and unambiguous."[39] Moreover, even if Section 484 were ambiguous, Watters contended that still would not justify deference to Section 7.4006 because "an agency's rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute," and "Congress could not have intended to delegate a decision of such economic and political significance to an agency in so cryptic a fashion."[40]

Watters also argued that, as a general matter, "[a]gency rules purporting to preempt state law are not worthy of *Chevron* deference."[41] Though she conceded that certain administrative agencies, by statutory grant, do have authority to issue regulations that preempt state law, she posited the OCC was no such agency.[42] Watters argued that Congress's grant to the OCC of authority "to prescribe rules and regulations to carry out the responsibilities of the office"[43] empowers the OCC to promulgate "*standards*," but does not give it "the authority to decide the pre-emptive scope of the federal statute."[44] In essence, Watters's position was that the OCC could issue prescriptive rules either permitting or limiting the activities of national banks and their operating subsidiaries, which might preempt state law in the event of a conflict therewith, but that the OCC could not *declare* preemption of state law as a general matter with respect to operating subsidiaries.

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[39] *Id.* at 28-30 ("If the law passed by Congress is clear and unambiguous, it must be applied as written.").

[40] *Id.* at 30-31 (internal quotation marks and citations omitted).

[41] *Id*. at 31.

[42] *Id.* at 33-35 ("[A]gency regulations are generally not entitled to deference when they preempt State laws [except] where Congress specifically delegates to an agency the authority to make preemptive determinations that have force of law. The OCC, however, has not been specifically delegated the authority to expand the preemptive reach of the National Bank Act.").

[43] 12 U.S.C. § 93a (2000).

[44] Pet. Br., *supra* note 31, at 34 (quoting Gonzales v. Oregon, 126 S. Ct. 904, 919 (2006)) (internal quotations omitted).

3. The Tenth Amendment

With respect to the Tenth Amendment, Watters contended that it was abridged by Section 7.4006 because, in effect, the regulation "transform[s] State-chartered operating subsidiaries into 'creatures of the federal government' without the permission of the chartering States and put them beyond the reach of those States in which the corporation does business."[45] She criticized the Sixth Circuit for having reasoned "simplistically and erroneously" that Congress's authority to regulate national banks under the Commerce Clause means the Tenth Amendment cannot be a bar to an OCC regulation.[46] "At the very least," Watters concluded, "the seriousness of the constitutional question warrants application of the constitutional doubt doctrine and rejection of the OCC's radical expansion of its regulatory authority under the National Bank Act."[47]

B. Respondents' Arguments

In response to Watters, Wachovia Bank and Wachovia Mortgage (collectively, "Wachovia") argued that, because national banks indisputably have the power to conduct banking through operating subsidiaries, and because operating subsidiaries are subject to the same "terms and conditions" of law as national banks, the OCC was fully justified in concluding that the same preemption applicable with respect to national banks applies with respect to those banks' operating subsidiaries.[48] That conclusion merited judicial deference, Wachovia argued, because it was a reasonable interpre-

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[45] *Id.* at 43 (quoting Hopkins Fed. Sav. & Loan Ass'n v. Cleary, 296 U.S. 315, 335 (1935)).

[46] *Id*. at 39.

[47] *Id*. at 44.

[48] *See* Brief for the Respondents at 18-20, 33, Watters v. Wachovia Bank, 127 S. Ct. 1559 (2006) (No. 05-1342), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/06-07/05-1342_Respondent.pdf [hereinafter "Res. Br."].

tation of an issue the NBA left ambiguous.[49] The Tenth Amendment, Wachovia argued, posed no barrier to such a conclusion.[50]

1. Statutory Construction

Wachovia's argument that the "same terms and conditions" apply to operating subsidiaries as apply to national banks was based on a provision enacted as part of the Gramm-Leach-Bliley Act ("GLBA")[51] referring to operating subsidiaries of national banks as subsidiaries that engage "solely in 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."[52] In promulgating Section 7.4006, the OCC emphasized that this GLBA provision—as well as the OCC's own regulation to the same effect[53]—reasonably means that state laws apply to operating subsidiaries to the same extent as they apply to the parent national bank.[54] Thus, "unless otherwise provided by Federal law or OCC regulation, State laws, such as licensing requirements,

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[49] *Id.* at 40 (citing 12 U.S.C. § 24a(g)(3)(A) as the basis for a reasonable interpretation by the OCC regarding its regulatory scope over operating subsidiaries of national banks, and invoking *Chevron*'s mandate of judicial deference to an agency's reasonable interpretation of an ambiguous statute it is charged to administer).

[50] *Id.* at 46-50 ("[E]xclusive federal regulation of activities of state-chartered corporations is well established. Such regulation is entirely consonant with the design of our federal system. . . . Accordingly, there is no Tenth Amendment violation.").

[51] Pub. L. No. 106-102, 113 Stat. 1338 (1999).

[52] 12 U.S.C. § 24a(g)(3)(A) (2000) (emphasis added).

[53] 12 C.F.R. §§ 5.34(e)(1), (3) (2007) ("A national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly," and "[a]n operating subsidiary conducts activities authorized under this section pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank.").

[54] Applicability of State Law to National Bank Subsidiaries, 66 Fed. Reg. 34,784, 34,788 (July 2, 2001) (codified at 12 C.F.R. § 7.4006) ("A fundamental component of . . . the characteristics of operating subsidiaries in GLBA and the OCC's rule is that state laws apply to operating subsidiaries to the same extent as they apply to the parent national bank.").

are applicable to a national bank operating subsidiary only to the extent that they are applicable to national banks."[55]

With respect to Section 484 and the NBA provisions defining and regulating national bank "affiliates," Wachovia argued that no conclusions could be drawn from them about preemption of state law for operating subsidiaries, as they were enacted well before national banks were authorized to maintain operating subsidiaries.[56]

2. Deference to the OCC

On the issue of deference, Wachovia pointed out that the Court has repeatedly held that the OCC's interpretations of the NBA merit deference under *Chevron*, stating that the OCC "is charged with the enforcement of banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws."[57] In response to Watters's argument that declarations of preemption—as opposed to substantive regulations that have the effect of preempting inconsistent state law—are beyond the scope of agency authority, Wachovia argued that the OCC's regulation merited deference because, as the Court has recognized, an agency with expertise in administering a statute "is uniquely qualified to determine whether a particular form of state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[58]

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[55] *Id*.

[56] Res. Br., *supra* note 48, at 29 ("[N]either the 1864 Congress . . . nor the 1933 Congress . . . can be assumed to have any intention as to applicability of [their banking regulation laws] to operating subsidiaries, which were not authorized until 1966.").

[57] *Id.* at 39 (quoting NationsBank of N.C. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 256-57 (1995) (internal quotation marks and citations omitted)).

[58] *Id.* at 42 (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 496 (1996) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)) (internal quotation marks and citations omitted)).

3. Tenth Amendment

In addressing Watters's argument that, in promulgating Section 7.4006, the OCC had "federalized" a state corporation and thereby violated the Tenth Amendment, Wachovia pointed out that the OCC's regulations clearly disclaim any federal authority with respect to the formation, dissolution, and corporate governance of operating subsidiaries and that it is only the *banking activities* of operating subsidiaries over which the OCC claims exclusive regulatory authority, because those are activities that a national bank could do itself but has chosen instead, in its discretion, to delegate to its operating subsidiaries.[59] Arguing that "[t]he Court has upheld federal banking laws that have a far more intrusive effect on the States than the laws at issue in this case,"[60] Wachovia concluded that "there is no question, let alone a 'serious' question, that federal regulation of mortgage lending activities is permissible under the Tenth Amendment."[61]

III. The Court's Decision

A. The Majority Opinion

Justice Ginsburg's opinion for the majority approached the issue of preemption through a different lens than any of the courts below. Rather than focusing on Section 7.4006 and the OCC's authority to promulgate it, the Court focused on the NBA's preemptive scope with respect to the exercise of banking powers by national banks. The Court found that operating subsidiaries, by performing banking functions for their bank parents, are acting in fulfillment of Congress's intent with respect to national banks as

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[59] *Id.* at 47-48 ("[T]he OCC expressly disclaims authority to regulate the formation, dissolution, and corporate governance of operating subsidiaries, [and] only federally-authorized *banking activities* that national banks conduct through their operating subsidiaries are regulated by the OCC.").

[60] *Id.* at 49 n.28 (citing Missouri ex rel. Burnes Nat'l Bank of St. Joseph v. Duncan, 265 U.S. 17, 23 (1924); Van Reed v. People's Nat'l Bank of Lebanon, 198 U.S. 554, 557 (1905)).

[61] *Id*. at 49-50.

created by the federal government.[62] It followed naturally then that state law should not obstruct the banking activities of operating subsidiaries any more than it should obstruct those activities if undertaken by national banks themselves. Any other conclusion, the Court reasoned, would undermine the congressional objective for the efficient nationwide exercise by national banks of the powers granted to them under the NBA.[63]

1. Statutory Construction and Congressional Intent

The Court began with the NBA provisions that specifically authorize national banks to engage in real estate lending[64] and, more broadly, give them authority "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking."[65] As the Court emphasized, the parties did not dispute that, under these provisions, national banks have authority to engage in real estate lending through operating subsidiaries.[66] The only issue in dispute was whether the preemptive scope of the NBA, including its

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[62] *See* Watters v. Wachovia Bank, 127 S. Ct. 1559, 1570-71 (2007) ("Over the past four decades, during which operating subsidiaries have emerged as important instrumentalities of national banks, Congress and OCC have indicated no doubt that such subsidiaries are 'subject to the same terms and conditions' as national banks themselves.").

[63] *See id.* at 1567-68, 1572-73 ("[S]tate 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 NBA.").

[64] 12 U.S.C. § 371 (2000) ("Any national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to section 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.").

[65] 12 U.S.C. § 24(Seventh) (2000).

[66] *Watters*, 127 S. Ct. at 1564 (citing 12 U.S.C. § 24a(g)(3)(A); 12 C.F.R. § 5.34(e) (2007)) ("It is uncontested in this suit that Wachovia's real estate business, if conducted by the national bank itself, would be subject to the OCC's superintendence, to the exclusion of state registration requirements and visitorial authority.").

preemption of state authority to exercise "visitorial powers" extended to operating subsidiaries engaged in real estate lending.

To answer that question, the Court looked to the long history of its interpretations of the NBA in relation to state law. That jurisprudence, "ma[kes] clear that federal control shields national banking from unduly burdensome and duplicative state regulation."[67] Quoting its seminal opinion in *Barnett Bank of Marion County, N.A. v. Nelson*,[68] the Court observed that it has "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."[69] More specifically, "when state prescriptions significantly impair the exercise of authority, enumerated or incidental under the NBA, the State's regulations must give way."[70]

Given the congressional purposes underlying the NBA and express statutory authority for national banks to engage in real estate lending, it is "[b]eyond genuine dispute [that] state law may not significantly burden a national bank's own exercise of its real estate lending power."[71] Preemption accordingly must extend to any state law with such an effect, including those of Michigan, because national banks would otherwise be subjected to the varying regulatory and enforcement regimes imposed by all the states in which they operate."[72]

The Court emphasized that Section 484 is a direct and explicit expression of Congress's intent to prevent any such interference with respect to any authorized business of a national

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[67] *Id.* at 1566-67 (citing Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 10 (2003)).

[68] 517 U.S. 25 (1996).

[69] *Watters*, 127 S. Ct. at 1567 (quoting *Barnett Bank*, 517 U.S. at 32) (internal quotations omitted).

[70] *Id.* (citing *Barnett Bank*, 517 U.S., at 32-34; Franklin Nat'l Bank v. New York, 347 U.S. 373, 377-79 (1954)).

[71] *Id*. at 1568.

[72] *Id.* ("State laws that conditioned national banks' real estate lending on registration with the State, and subjected such lending to the State's investigative and enforcement machinery would surely interfere with the banks' federally authorized business: National banks would be subject to registration, inspection, and enforcement regimes imposed not just by Michigan, but by all States in which the banks operate.").

bank. In providing in Section 484 that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law,"[73] Congress dictated that the states, including Michigan, cannot exercise examination and enforcement authority over the banking business done by national banks.[74]

Watters conceded this. But, as discussed above, she contended that the NBA's preemption—and in particular the preemption of state "visitations" under Section 484—could not extend to state-chartered nonbank operating subsidiaries, which are one type of "affiliate" of national banks and cannot be equated with national banks themselves. The Court, however, was not persuaded.

First, the Court rejected Watters's argument that Section 484 must not cover operating subsidiaries because it does not mention them specifically. As the Court reasoned, the absence of such a reference suggests no clear congressional intent because operating subsidiaries did not exist when Congress enacted Section 484.[75] Second, the Court found that Congress's identification of an "operating subsidiary" as distinct from another type of "affiliate" of a national bank confirms the special relationship between national banks and their operating subsidiaries. Specifically, in identifying a national bank operating subsidiary as a subsidiary that "engages solely in 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,"[76] Congress subjected national bank operating subsidiaries to the *same* regulatory regime, including the exclusive visitorial authority of the OCC, as applies to national banks themselves.[77]

The Court found that nothing in the NBA suggested that banking activities permissibly undertaken by national banks through their operating subsidiaries—including real estate lending—should be any more subject to state law than the same activities undertaken by national banks directly.[78] Nor do the facts that an operating

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[73] 12 U.S.C. § 484(a).

[74] *Watters*, 127 S. Ct. at 1569.

[75] *Id*. at 1571 ("[O]perating subsidiaries were not authorized until 1966.").

[76] 12 U.S.C. § 24a(g)(3)(A) (2000).

[77] *See Watters*, 127 S. Ct. at 1571-72 (citing 12 U.S.C. § 24a(g)(3)(A) (2000)).

[78] *Id*. at 1571.

subsidiary is incorporated under state law and is not a bank affect the determination of which laws should apply to the exercise of a national bank's *banking* activities through such a subsidiary. As the Court emphasized: "[w]e have never held that the preemptive reach of the NBA extends only to a national bank itself. Rather, in analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of a national bank's *powers*, not on its corporate structure."[79]

Thus, as the Court noted, in prior cases concerning the authority of national banks to undertake certain activities, it made no difference to the analysis of the existence of such authority that the activities were conducted by an operating subsidiary rather than by the national bank itself.[80] A national bank is equally fettered in the exercise of its powers by state encroachments on its authorized banking activities when those activities are conducted directly by the national bank and when they are conducted indirectly through an operating subsidiary. Accordingly, the Court found that, just as national banks must be afforded security against interference by state regulators, so too should that security adhere "whether the business is conducted by the bank itself or is assigned to an operating subsidiary."[81]

In conclusion, the Court held: "The NBA is thus properly read by OCC to protect from state hindrance a national bank's engagement in the 'business of banking' whether conducted by the bank itself or by an operating subsidiary, empowered to do only what the bank itself could do."[82]

Despite its finding that "the NBA is . . . properly read by OCC" with respect to the preemption question at issue,[83] the Court explicitly emphasized that its holding was not based on deference to Section 7.4006. The Court explained that, "under our interpretation of the statute, the level of deference owed to the regulation is an

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[79] *Id.* at 1570.

[80] *See id.* at 1571 (discussing NationsBank of N.C. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 256-61 (1995)).

[81] *Id.* (citations omitted).

[82] *Id*. at 1572.

[83] *Id*.

academic question. Section 7.4006 merely clarifies and confirms what the NBA already conveys . . . ."[84]

2. The Tenth Amendment

The Court devoted a single short paragraph to Watters's contention that Section 7.4006 violates the Tenth Amendment. Reiterating its previous holding that "'[i]f a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States,'"[85] and the well-established understanding that Congress has authority to regulate national bank operations under the Commerce Clause and the Necessary and Proper Clause,[86] the Court concluded (as had the courts below) that the Tenth Amendment "is not implicated here."[87]

B. The Dissenting Opinion

Justice Stevens' dissenting opinion, joined by Chief Justice Roberts and by Justice Scalia, reflects a pronounced disagreement among the justices in the NBA context with respect to principles of federalism, statutory interpretation, and the role of administrative agencies in defining the scope of federal preemption. Justice Stevens' decision highlights the uncertainty that currently prevails concerning the standards for judicial deference to agency determinations regarding preemption of state law. Although an in-depth analysis of that issue—which has been the subject of considerable scholarly commentary[88]—is beyond the scope of this article, its

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[84] *Id*.

[85] *Id.* at 1573 (quoting New York v. United States, 505 U.S. 144, 156 (1992)).

[86] *Id.* ("Regulation of national bank operations is a prerogative of Congress under the Commerce and Necessary and Proper Clauses.") (citing Citizens Bank v. Alafabco, Inc., 539 U.S. 52, 58 (2003) (per curiam)).

[87] *Id*.

[88] *See, e.g.*, Nina A. Mendelson, *Chevron and Preemption*, 102 MICH. L. REV. 737 (2004); Jack W. Campbell IV, *Regulatory Preemption in the Garcia/Chevron Era*, 59 U. PITT. L. REV. 805 (1998); Howard P. Walthall, Jr., *Chevron v. Federalism: A Reassessment of Deference to Administrative Preemption*, 28 CUMB. L. REV. 715 (1997-98).

implications for OCC preemption determinations specifically are explored in Part VI below.

1. Statutory Construction and Congressional Intent

Justice Stevens commenced his dissent in *Watters* with the sharply critical contention that the Court's ruling disrupts the federal-state balance in regulation of the "dual" banking system in the United States.[89] According to Justice Stevens, the majority's decision "threatens the vitality of most state laws as applied to national banks—a result at odds with the long and unbroken history of dual state and federal authority over national banks . . . ."[90]

To demonstrate this perceived impact, Justice Stevens provided a detailed discussion of the history of bank regulation in the United States, including Congress's grant of specific powers to national banks, such as the power to engage in real estate lending and to affiliate with nonbank entities.[91] Justice Stevens opined that "Congress has consistently recognized that state law must usually govern the activities of both national and state banks for the dual banking system to operate effectively." He acknowledged that the Court has in some cases held state laws to be preempted because they "impair significantly" the exercise of core banking powers by national banks,[92] but distinguished those cases on the ground that the Michigan laws in question did not apply to national banks and, moreover, that there was no indication that those laws imposed any "special burdens" on Wachovia Mortgage's activities.[93]

In any event, Justice Stevens argued, it is irrelevant whether the Court believes that Michigan's laws hamper national banks' ability to carry out their banking functions through operating subsidiaries, because "[i]t is Congress' judgment that matters here,

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[89] *Watters*, 127 S. Ct. at 1573-78 (Stevens, J., dissenting).

[90] *Id*. at 1581.

[91] *Id.* at 1573-78.

[92] Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33 (1996) ("[T]hese cases take the view that normally Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress explicitly granted.").

[93] *Watters*, 127 S. Ct. at 1580 (Stevens, J., dissenting).

and Congress has in the NBA preempted only those laws purporting to lodge with state authorities visitorial power over *national banks*."[94] Congress, Justice Stevens asserted, has enacted no legislation "immunizing" national bank subsidiaries from state laws regulating real estate lending, nor has it authorized an administrative agency to preempt such state laws.[95] Section 484, which explicitly precludes state visitations of national banks, makes no mention of operating subsidiaries or of "affiliates"—despite the fact that Congress "lavished . . . attention on national bank affiliates" in other provisions of the NBA.[96] Justice Stevens thus reasoned that Section 484 "reflect[s] Congress' considered judgment *not* to preempt the application of state visitorial laws to national bank 'affiliates.'"[97]

The absence of any reference to "affiliates" in Section 484, and the absence of any express mention of "operating subsidiaries" either in Section 484 or elsewhere in the NBA, led to the dissent's conclusion that Congress did not intend the preemption urged by Wachovia. While acknowledging that the GLBA does refer to operating subsidiaries in defining "financial subsidiaries" as subsidiaries whose activities are subject to the "same terms and conditions" as national banks, the dissent found that "slanting reference" immaterial.[98] "The 'same terms and conditions' language at most reflects an uncontroversial acknowledgment that operating subsidiaries of national banks are subject to the same federal oversight as their national bank parents. It has nothing to do with preemption."[99]

In sum, from the dissent's perspective, the Court's opinion "infus[es] congressional silence with preemptive force."[100] This was "especially troubling" because, in the dissent's view, the Michigan

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[94] *Id.* at 1580-81 (emphasis added) (citing 12 U.S.C. § 484(a) (2000)).

[95] *Id*. at 1573 (Stevens, J., dissenting).

[96] *Id.* at 1579.

[97] *Id*.

[98] *Id*. at 1581.

[99] *Id.* (footnote omitted). In fact, as the majority explained in response: "[The Court's ruling] express[es] no opinion on that matter. [Its] point is more modest: The GLBA simply demonstrates Congress' formal recognition that national banks have incidental power to do business through operating subsidiaries." *Id*. at 1572 n.12 (majority opinion).

[100] *Id.* at 1581 (Stevens, J., dissenting).

laws at issue were "designed to protect consumers."[101] Because "[c]onsumer protection is quintessentially a 'field which the States have traditionally occupied,'"[102] the dissent lamented, "the Court should . . . have been all the more reluctant to conclude that the 'clear and manifest purpose of Congress' was to set aside the laws of a sovereign State."[103]

2. Deference to the OCC

Directly contrary to the majority's view that, in light of the NBA's preemptive effect, deference to the OCC was "beside the point,"[104] Justice Stevens argued that the most "pressing questions" in the case were whether Congress delegated to the OCC the authority to preempt state laws as applied "to operating subsidiaries, and if so, whether that authority was properly exercised here."[105] On both questions, he and his dissenting colleagues found the answer to be no.

With respect to delegation of authority, Justice Stevens drew a sharp distinction between agency authority to issue (1) regulations that *authorize or regulate conduct* (such as an OCC rule approving a national bank's use of an operating subsidiary as an exercise of the bank's "incidental powers" under Section 24(Seventh) and (2) rules "granting immunity from regulation."[106] Issuance of regulations governing conduct is well within the scope of the OCC's authority, and such regulations may preempt state law to the extent of any

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[101] *Id*.

[102] *Id.* (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

[103] *Id.* (quoting *Rice*, 331 U.S. at 230).

[104] *Id*. at 1572.

[105] *Id.* at 1582. *See also id*. at 1585 ("Whatever the Court says, this is a case about an administrative agency's power to preempt state laws.").

[106] *Id.* at 1583 ("[T]here is a vast and obvious difference between rules authorizing or regulating conduct and rules granting immunity from regulation. The Comptroller may well have the authority to decide whether the activities . . . should be characterized as 'incidental' to banking, and to approve a bank's entry into those businesses, either directly or through its subsidiaries. But that lesser power does not imply the far greater power to immunize banks or their subsidiaries from state laws regulating the conduct of their competitors.").

conflict therewith.[107] But that does not mean, Stevens opined, that the OCC has the "far greater power" simply to declare preemption of an entire body of state law, either with respect to national banks themselves or regarding operating subsidiaries.[108] Stevens opined that such administrative declarations, through which an agency "purports to decide the scope of federal preemption, are entitled to something less than *Chevron* deference."[109]

The dissent parsed carefully the possible statutory bases for OCC authority to preempt. It noted that, in promulgating its most recent regulations concerning NBA preemption in 2004, the OCC had cited as the source of its preemptive authority both 12 U.S.C. § 93a ("Section 93a"), which provides that "the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office," and 12 U.S.C. § 371(a), which authorizes national banks to make real estate loans "subject to . . . such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."[110] But neither of these provisions, the dissent protested, "says a word about preemption."[111] Similarly, the dissent observed, the GLBA's "same terms and conditions" provision,[112] which the OCC had cited as authority for promulgating Section 7.4006, "says nothing about preemption."[113]

Absent any clear statutory expression of congressional intent to delegate preemptive authority to the OCC, the dissent concluded, there is no basis for according *Chevron* deference to Section

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[107] *See id.* (citing Nations Bank of N.C. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 256-57 (1995)); *id.* at 1583 n.24 ("This conclusion does not touch our cases holding that a properly promulgated agency regulation can have a preemptive *effect* should it conflict with state law.").

[108] *See id*.

[109] *Id*. at 1584 (citations omitted).

[110] *Id.* at 1583 n.23.

[111] *Id.*.

[112] 12 U.S.C. § 24a(g)(3) (2000).

[113] Watters, 127 S. Ct. at 1584 (Stevens, J., dissenting) (citing *id*. at 1581-82).

7.4006.[114] And, while agreeing with the Court that the Tenth Amendment does not preclude the exercise of an administrative agency's power to preempt state laws, Justice Stevens counseled that the reasons for adopting that amendment, which "undergird the well-established presumption against preemption,"[115] should inform the Court's decisions, including with respect to agency authority to preempt. In the dissent's view, the Court's failure to properly apply such a presumption in *Watters* led to an unprecedented result: "Never before have we endorsed administrative action whose sole purpose was to preempt state law rather than to implement a statutory command."[116]

IV. Beyond Operating Subsidiaries: What Does Watters *Imply for Preemption With Respect to Other Non-Bank Third Parties?*

The dire predictions of Justice Stevens and his dissenting colleagues about the impact of the *Watters* decision suggests that the Court has effected a radical change in the balance of regulatory authority between the federal and state governments over the dual banking system. Properly understood, however, the Court's opinion merely confirms that national banks may continue to respond to an evolving financial services marketplace by developing new means of effectively servicing their customers on a nationwide basis, including through the use of third parties. Merely because an operating subsidiary is a separate corporation (as opposed to, for example, an automated teller machine),[117] and is chartered under state law, does not mean that its use by a national bank to conduct banking activities makes those activities any less an exercise by the *national bank* of *its* banking powers.

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[114] *See id*. at 1584 ("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.").

[115] *Id.* at 1585.

[116] *Id*. at 1586.

[117] *See*, *e.g.*, Bank One v. Guttau, 190 F.3d 844 (8th Cir. 1999), *cert. denied*, 529 U.S. 1087 (2000) (finding the NBA to preempt state law restricting a national bank's use of ATMs).

The dissent in *Watters* apparently perceived the case to be all about whose law should govern which *corporate entities*. But the majority properly focused on whose law should govern the *banking activities* at issue. As the majority recognized, Congress did not intend the NBA to preempt state law to protect national banks as corporations per se, but rather to protect the beneficial *functions* of national banks from being encumbered by state law.[118] This intent was well articulated by the Court in the late 1800s when it declared that the activities of national banks are "necessarily subject to the paramount authority of the United States."[119] Given the federal interest in the efficient nationwide operations of national banks,

> [A]n attempt by a state to define [national banks'] *duties* or control the *conduct of their affairs* is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or *impairs the efficiency of these agencies of the federal government to discharge the duties for the performance of which they were created*.[120]

Whether a national bank conducts its affairs within its own corporate form or instead delegates them to a third party, including an operating subsidiary, does not alter the need for preemption to ensure that state law will not "impair[] the efficiency" of the bank in exercising its authorized powers.[121] Thus, the fact that a national

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[118] *See Watters*, 127 S. Ct. at 1567 (explaining that states are permitted to regulate activities of national banks to the extent there is no interference with a national bank's exercise of its powers).

[119] Davis v. Elmira Sav. Bank, 161 U.S. 275, 283 (1896); *see also* Farmers' & Mechs.' Nat'l Bank v. Dearing, 91 U.S. 29, 34 (1875) ("The principle announced in the authorities cited [(freedom from state regulation)] is indispensable to the efficiency, the independence, and indeed to the beneficial existence, of the General Government.").

[120] *Davis*, 161 U.S. at 283 (emphasis added).

[121] *Id.* National banks may improve their efficiency in numerous ways by using third parties to assist with their banking activities. For example, national banks may use third parties to originate loans, 12 C.F.R. § 7.1004(a) (2007); to deliver loan proceeds to a borrower, *id.* § 7.1003(b); to

bank chooses to use a third party to assist in its banking operations should not deprive it of the protection afforded to its own conduct of those operations by preemption of "hostile" state law.[122] The majority's recognition of this in *Watters* should provide valuable clarity and guidance in future cases involving the application of state law to nonbank entities whose regulation by the states may infringe on the exercise of banking powers by national banks.[123]

Several cases highlight the importance of this issue, including four that were advancing through the lower courts during the time when *Watters* was decided. As these cases demonstrate, it is not enough to look solely to the form or type of entity directly subject to state law to adhere to congressional intent. Rather, as the majority perceived in *Watters*, to reach a correct conclusion concerning NBA preemption of state law it is necessary to examine the *effect* of such state law on the *exercise of banking powers by the national bank*.

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serve designated bonding agents to sell its money orders at nonbanking outlets, *id.* § 7.1014; among other things. In this context, the OCC has provided national banks with careful guidance to ensure that their use of third parties involves no risk to their safe and sound operation, consistent with congressional objectives. *See, e.g.*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, ADM'R OF NAT'L BANKS, OCC BULL. 2001-47: THIRD PARTY RELATIONSHIPS: RISK MANAGEMENT PRINCIPLES (2001) (detailing guidance given to national banks to manage risks arising from their relationships with third parties), *available at* http://www.OCC.treas.gov/ftp/bulletin/2001-47.doc; OFFICE OF THE COMPTROLLER OF THE CURRENCY, ADM'R OF NAT'L BANKS, ADVISORY LETTER 2000-9: THIRD-PARTY RISK (2000) (alerting national bank managements and executives of potential credit risk implications from third party dealings), *available at* http://www.occ.treas.gov/ftp/advisory/2000-9.doc).

[122] CONG. GLOBE, 38th Cong., 1st Sess. 1893 (1864) (remarks of Sen. Sumner) (stressing that Congress must not, in establishing a new national banking system pursuant to the NBA, "leave its most delicate nerves exposed to hostile influences" from the states).

[123] *See Watters*, 127 S. Ct. at 1559.

A. The SPGGC Cases: Use of Agents With Respect to Gift Cards

In two similar cases, the lower courts have grappled with determining the NBA's preemptive scope in relation to the same nonbank entity, SPGGC, LLC ("SPGGC"), a subsidiary of Simon Property Group, which manages the Simon chain of shopping malls. In 2001, SPGGC entered into a contract with Bank of America ("BoA"), a national bank, to sell Simon-branded stored value gift cards[124] issued by BoA.[125] That contract terminated in September 2005, at which point SPGGC entered into contracts for sale of the cards to be issued by another national bank, U.S. Bank, and by Metabank, a federally chartered savings bank ("federal thrift").[126] Among the states in which SPGGC marketed and sold the Simon gift cards were New Hampshire and Connecticut, both of which purport to prohibit the sale of gift cards that are subject to expiration dates or the imposition of dormancy, inactivity or other administrative fees or service charges.[127]

In November 2004, the Attorneys General of New Hampshire and Connecticut informed SPGGC of their intentions to bring enforcement proceedings against it because the bank-issued Simon gift cards were subject to expiration dates and fees in alleged violation of the states' respective laws. SPGGC responded by filing federal court actions in both states, claiming federal preemption of

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[124] A gift card "is a type of prepaid or stored value card that is designed to be purchased by one consumer (purchaser) and presented as a gift to a second consumer (recipient)." OFFICE OF THE COMPTROLLER OF THE CURRENCY, ADM'R OF NAT'L BANKS, OCC BULL. 2006-34: GIFT CARD DISCLOSURES (2006), *available at* http://www.occ.treas.gov/ftp/bulletin/2006-34.doc. National banks are authorized to issue gift cards as a form of stored-value system. 12 C.F.R. 7.5002(a)(3) (2007) (authorizing national banks to offer "electronic stored value systems").

[125] SPGGC, LLC v. Ayotte, 488 F.3d 525, 528 (1st Cir. 2007).

[126] *Id*. Both U.S. Bank and Metabank joined Simon as plaintiffs in the New Hampshire case. *Id*. at 527.

[127] New Hampshire Consumer Protection Act, N.H. REV. STAT. § 358-A:2 (prohibition on expiration dates applicable to cards with a face value of $100 or less); CONN. GEN. STAT. ANN. §§ 3-65c, 42-460(a).

the state law restrictions based on its relationship with the federally chartered issuing banks.[128] In both cases, SPGGC sought declaratory and injunctive relief from enforcement of the state restrictions based on the claim that, as applied to it, those restrictions infringed on the federally authorized lending activities of the issuing banks. Relying on the authority of a national bank or federal thrift to issue gift cards as an exercise of its banking powers,[129] and the authority of national banks and federal thrifts to exercise their banking powers free from state interference,[130] SPGGC claimed that it would violate the NBA and the Home Owners' Loan Act ("HOLA"),[131] as well the regulations issued thereunder, for the states to enforce their gift card restrictions against SPGGC.

Neither of the defendant Attorneys General contested the proposition that the state law restrictions at issue were preempted as applied to the federally chartered banks issuing the Simon gift cards. However, they vehemently contested the notion that the state laws were preempted as applied to SPGGC.[132] Thus, at the crux of both cases was the question whether state law provisions, even if they are not applied to any federally chartered bank (or any subsidiary or other affiliate thereof), may nevertheless be preempted by federal banking law.[133] In both cases, the district courts issued their

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[128] SPGGC v. Ayotte, 443 F. Supp. 2d 197 (D. N.H. 2006), *aff'd*, 488 F.3d 525 (1st Cir. 2007); SPGGC v. Blumenthal, 408 F. Supp. 2d 87 (D. Conn. 2006), *aff'd in part, vacated in part, remanded by* SPGGC, Inc. v. Blumenthal, 505 F.3d 183 (2d Cir. 2007).

[129] *See* 12 C.F.R. § 7.5002(a)(3) (2007) (authorizing national banks to offer "electronic stored value systems"); 12 C.F.R. 555.200(a) (2007) (authorizing federal thrifts to use "electronic means or facilities to perform any function" of such a thrift).

[130] *See* Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33 (1996) ("To say this is not to deprive 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 power."); 12 C.F.R. § 545.2 (preempting "any state law purporting to address the subject of the operations of a Federal savings association").

[131] 12 U.S.C. § 1461 *et seq*. The HOLA was at issue only in the New Hampshire case.

[132] *See Ayotte*, 488 F.3d at 532-534; *Blumenthal*, 505 F.3d at 188-89.

[133] As the court noted in the New Hampshire action, there had been no challenge by the state to the sale of stored value cards by either U.S. Bank

decisions prior to the Supreme Court's ruling in *Watters*, whereas the appellate courts—the First and Second Circuits—ruled thereafter.

1. *SPGGC v. Ayotte*

In SPGGC's action in New Hampshire, *SPGGC v. Ayotte*, the district court reasoned that, as the state restrictions at issue regulated a particular product (gift cards), whether those restrictions were preempted would depend on how closely the product was tied to the banking operations of the two federally chartered banks that issued the cards.[134] Specifically, the court posited that the question for resolution was whether SPGGC's involvement in the Simon gift card program "is so substantial and its relationship with Giftcard consumers so close that it renders the banks' involvement too remote to properly consider the Giftcard a national bank product."[135]

As the record showed, under the contracts between SPGGC and the two banks, SPGGC's role with respect to the bank-issued gift cards was limited to their marketing and sale. When SPGGC sold a gift card to a consumer, it would collect the consumer's payment, but would not retain any of that payment nor collect fees imposed on the consumer pursuant to the consumer's agreement with the issuing bank. Rather, SPGGC received commissions from the banks at the end of each quarter. SPGGC had no involvement in establishing the terms of the cardholder agreement with the banks, including the provisions for fees and the expiration date.[136]

The district court found that, under these circumstances, SPGGC's role in promoting and selling gift cards "[did] not alter the fact that the Giftcards are federal banking products."[137] The relationship between the bank and the consumer was "substantial," and SPGGC's involvement in the marketing and sale of the gift cards did "not alter or even attenuate that relationship."[138] Given those

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or Metabank directly to consumers, which both banks apparently did through the Internet. *Ayotte*, 443 F. Supp. 2d at 203.

[134] *Ayotte*, 443 F. Supp. 2d at 205.

[135] *Id*.

[136] *Id*. at 201, 206.

[137] *Id*. at 207.

[138] *Id*.

facts, the court found, "the terms of the relationship between the Giftcard consumer and either U.S. Bank or Metabank (including the fee schedule and provisions regarding expiration dates) are governed by federal banking law."[139]

Although the New Hampshire Attorney General argued that federal law was not implicated, because the state had no intention of enforcing its gift card restrictions against U.S. Bank or Metabank,[140] the district court disagreed. The court reasoned that, if the state were able to enforce its restrictions against SPGGC, the banks would either have to stop all sales of Simon giftcards in New Hampshire or, alternatively, change the terms and conditions of their contracts with purchasers of the giftcards.[141] But, the district court found: "Given that the Giftcards are banking products issued by federally chartered and federally regulated banks, the State cannot force those banks to elect between those options."[142]

Relying on *Watters*, the First Circuit affirmed.[143] Echoing *Watters*'s elucidation that there is no basis for believing that "the preemptive reach of the [NBA] extends only to a national bank itself,"[144] the First Circuit rejected the New Hampshire Attorney General's contention that the state restrictions were not preempted because they "regulate only Simon, a company that is not a bank."[145] The court found that such an analysis "is too formalistic: the question here is not *whom* the New Hampshire statute regulates, but rather, against *what activity* it regulates . . . ."[146] It was evident to the court that the state statute did not purport to regulate SPGGC's activities, which were "limited to how and where the giftcards are

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[139] *Id*. at 206.

[140] *Id.* (quoting Reply Brief for State's reply brief at 6, *id*.).

[141] *Id.*

[142] *Id*. And as the court further found: "If there are to be any restrictions on fees associated with the Giftcards, or limitations imposed on expiration dates, they must come either from Congress or the federal agencies empowered by Congress to oversee national banks and federal savings associations." *Id*.

[143] SPGGC, LLC v. Ayotte, 488 F.3d 525 (1st Cir. 2007).

[144] *Id*. at 532.

[145] *Id.*

[146] *Id.* (citing Watters v. Wachovia Bank, 127 S. Ct. 1559, 1570 (2007)).

marketed," but rather purported to regulate "the sale of certain giftcards through a third party agent, which is the activity of [U.S. Bank and Metabank], a national bank" and federal thrift, respectively.[147] Because the NBA and the HOLA granted U.S. Bank and Metabank, respectively, the power to issue the Simon gift cards and to sell them through a third-party agent such as SPGGC, the restrictions imposed by the New Hampshire law were in "'irreconcilable conflict'" with federal banking law and, therefore, were preempted as applied to SPGGC's sale of the gift cards at issue.[148]

2. *SPGGC v. Blumenthal*

The parallel Connecticut case, *SPGGC v. Blumenthal,* involved SPGGC's marketing and sale of Simon gift cards under the pre-2005 agreement with BoA. In *Blumenthal*, however, the outcome differed at both the district court and the appellate court levels. The district court, ruling prior to the Supreme Court's decision in *Watters*, rejected the contention that the Connecticut laws at issue,[149] as applied to SPGGC, could be preempted by the NBA.[150]

In reaching this conclusion, the district court contrasted the facts in *Blumenthal* from those in *Wachovia v. Burke*,[151] in which the Second Circuit upheld preemption with respect to national bank operating subsidiaries. The district court reasoned that "[a]n entity that is neither a national bank, nor a wholly-owned subsidiary of a national bank may not claim preemption based on the NBA, and the fact that a non-bank entity claims to have an agency or business relationship with a national bank does not give that entity the right to claim preemption based on the NBA."[152]

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[147] *Id*. at 533.

[148] *Id*. at 536 (quoting Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 31 (1996)).

[149] CONN. GEN. STAT. ANN. §§ 3-65c, 42-460(a).

[150] SPGGC v. Blumenthal, 408 F. Supp. 2d 87 (D. Conn. 2006).

[151] Wachovia Bank v. Burke, 414 F.3d 305 (2d Cir. 2005).

[152] *Blumenthal*, 408 F. Supp. 2d at 94.

With *Watters* as its guidance, the Second Circuit reversed in part, affirmed in part, and remanded the case to the district court.[153] Based on *Watters* and informed by an *amicus* brief submitted by the OCC, the Second Circuit rejected the district court's categorical conclusion that, because SPGGC was neither a national bank nor an operating subsidiary thereof, the NBA could not preempt state law as applied to SPGGC. Consistent with the First Circuit in *Ayotte*, the Second Circuit recognized that "a national bank's decision to carry out its business through an unaffiliated third party such as SPGGC might constitute an exercise of the bank's incidental powers under the NBA."[154] The Second Circuit observed, however, that "it does not follow that a state's attempt to regulate the *third party*'s conduct is *necessarily* preempted as it would be if directed toward the bank itself or toward an operating subsidiary."[155] The court reasoned that ascertaining whether and to what extent such preemption does exist requires discerning whether the state regulation at issue actually affects the exercise of any national bank powers or, rather, whether it simply limits the activities of a third party otherwise subject to state control.[156]

The Second Circuit found that, with respect to Connecticut's prohibition on gift card expiration dates, BoA's right to issue gift cards might be affected, because it appeared that BoA needed to impose expiration dates on the cards so that it could use the Visa card network for card payments.[157] But the court found insufficient facts in the record to resolve the issue, and so remanded to the district court for reconsideration the portion of the judgment relating to preemption of the state's ban on gift card expiration dates.[158]

With respect to the state's prohibition on dormancy and other fees on gift card-holding consumers, however, the Second Circuit affirmed the district court's ruling that there was no preemption.[159] Unlike in *Ayotte*, SPGGC collected and retained all the fees

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[153] SPGGC, LLC v. Blumenthal, 505 F.3d 183 (2d Cir. 2007).

[154] *Id.* at 190 (citing 12 U.S.C. § 24 (Seventh)).

[155] *Id*. (second emphasis added).

[156] *Id*.

[157] *Id*. at 191-92.

[158] *Id.* at 192.

[159] *Id.* at 191.

associated with the cards issued by BoA, and SPGGC—not BoA—had the power to establish the terms and conditions for those fees.[160] The Second Circuit found that, therefore, the enforcement of the Connecticut prohibition on gift card fees "affects only the conduct of SPGGC, which is neither protected under federal law nor subject to the OCC's exclusive oversight."[161] Accordingly, there was no basis for SPGGC's claim of preemption of the state's prohibition on gift card fees with respect to the BoA-issued cards.[162]

Both *Blumenthal* and *Ayotte* confirm that, following *Watters*, there is no basis for a categorical conclusion that an entity that is not a national bank may not claim preemption based on the NBA.[163] At the same time, *Blumenthal* suggests the possible limits of *Watters* with respect to such a claim. Other cases, as discussed below, similarly suggest such limits in the context of particular facts.

B. The Pacific Capital Bank Case: Use of Tax Preparers to Market Refund Anticipation Loans

Pacific Capital Bank, N.A. v. Connecticut ("*Pacific*")[164] (which, as of the date of publication of this article, is pending before the Second Circuit) parallels *Ayotte* and *Blumenthal* in that it involves a preemption challenge to state law as applied to third parties engaged in marketing a national bank's product. At issue in

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[160] *Id*.

[161] *Id*.

[162] *Id.* The court noted, however, that a different conclusion might be called for were the fees in question established and collected by the bank, as were the fees in *Ayotte*. *See id*. at 101 & n.1 (citing SPGGC, LLC v. Ayotte, 488 F.3d 525, 533 (1st Cir. 2007), and observing that both the First Circuit in *Ayotte* and the OCC in its *amicus* brief on appeal in *Blumenthal*, drew the same distinctions between SPGGC's relationship with the issuing banks in Ayotte, on the one hand, and SPGGC's relationship with BoA in *Blumenthal*, on the other).

[163] *Cf*. Goleta Nat'l Bank v. O'Donnell, 239 F. Supp. 2d 745, 752 (S.D. Ohio 2002) (finding that a national bank lacked standing to challenge the application to its nonbank agent of certain Ohio interest rate limitations on loans where the agent apparently was the "true lender").

[164] Pacific Capital Bank v. Connecticut, No. 3:06-CV-28 (PCD), 2006 WL 2331075 (Aug. 10, 2006), *appeal pending*, No. 06-4149-CV (2d Cir. 2007).

Pacific is a Connecticut statute that purports to regulate the interest rates charged on refund anticipation loans ("RALs"),[165] which are short-term loans that are repaid with the refunds from the borrower's tax return. As a practical matter, almost all RALs are obtained through tax preparers and, under the Connecticut statute, this practicality is made a requirement: All RALs in Connecticut *must* be made at "a location in which the principal business is tax preparation."[166] The statute defines a tax preparer who offers RALs as a "facilitator," and explicitly excludes from the definition of "facilitator" any bank, including a national bank.[167]

Pacific Capital Bank ("Pacific"), a national bank located in California and not having any branch or office in Connecticut, challenged the Connecticut statute on NBA preemption grounds, arguing that the statute impermissibly regulated the interest rates charged on Pacific's RALs.[168] Because the NBA expressly permits a national bank to make loans at the rate of interest set by its "home" state (in Pacific's case, California), and because (as was undisputed) the NBA gives Pacific the right to market its loans through third parties—including tax preparers—Pacific claimed that the Connecticut statute was in conflict with federal law and was, therefore, preempted.[169]

In response, Connecticut argued that Pacific had no grounds for challenging the state statute, because, properly construed, the law did not apply to Pacific, but rather only to "facilitators" of the

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[165] CONN. GEN. STAT. § 42-480(d) (2006).

[166] *Id*. § 42-480(c).

[167] *Id*. § 42-480(a)(2).

[168] *Pacific*, 2006 WL 2331075, at *4. *Pacific* did not challenge the disclosure requirements in the Connecticut statute, CONN. GEN. STAT. § 42-480(b), but, particularly in light of *Watters*, a national bank would have grounds to challenge them based on the OCC's preemption regulation governing non-real estate lending. *See* 12 C.F.R. § 7.4008(d)(2)(viii) (preempting state laws concerning "[d]isclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations . . . or other credit-related documents").

[169] *See Pacific*, 2006 WL 2331075, at *7-9.

loans.[170] The State asserted that the Connecticut Legislature, recognizing that the State could not regulate national banks' interest rates, deliberately focused the statute's mandates and prohibitions *exclusively on facilitators* (excluding national banks.).[171] According to Connecticut, because "a law which does *not* regulate national banks cannot be preempted under the NBA," Pacific had no NBA cause of action.[172]

That argument, which echoed the arguments of Connecticut and New Hampshire in the *SPGGC* cases, proved only partially persuasive. The court found that "[t]he fact that a statute regulates non-bank entities and not national banks is a *sign* that the statute will likely not be a burden to national banks, but it does not end the inquiry."[173] For example, the court reasoned, "a state statute forbidding citizens from becoming customers at a bank which lends at high interest rates would clearly and significantly interfere with the bank's right under the NBA, even though it does not regulate banks at all."[174] The Connecticut statute, by regulating facilitators, likewise adversely *affects* national banks that make RALs because "[t]he services of a tax preparer are clearly essential to the efficient operation of RALs."[175] And although it would theoretically be possible, as defendants had argued, for Pacific to avoid the Connecticut statute's limitations by opening branches in Connecticut and offering RALs through such branches rather than through tax preparers, the efficiency of Pacific's RAL lending would thereby plainly be compromised. Thus, the court concluded, the Connecticut statute "stands as an obstacle to the exercise of [Pacific]'s rights under the NBA."[176]

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[170] *Id.* at *5 ("Defendants argue that § 42-480 does not actually apply to Plaintiff . . . .").

[171] *Id.* at *8.

[172] *Id*.

[173] *Id.* (emphasis added).

[174] *Id*.

[175] *Id.* at *7. Indeed, as the record showed, all 8,313 of the RALs Pacific made in Connecticut in 2004 were originated through tax preparers. *Id*. at *8 (citing to record).

[176] *Id.*

Despite this conclusion, the district court in *Pacific* did not go on to hold that the statute was preempted. Rather, at the defendants' urging, the court sought to fashion an interpretation of the Connecticut statute that would avoid such a holding, citing the principle that "courts should construe statutes to avoid constitutional problems if possible."[177] The court constructed a theoretical basis on which to "uphold" the Connecticut statute as "constitutional," by reasoning that the Connecticut Legislature must not have intended it to apply to any RALs offered by national banks.[178]

Although reaching the correct result with respect to Pacific, the district court's analytical approach was unnecessary and risks a potentially unwarranted intrusion of the judiciary into the legislative purview. A federal preemption challenge to a state statute, whether under the NBA or other federal law, does not involve a claim that state law is "unconstitutional"—*i.e.*, inconsistent with the *Constitution*—rather presents a claim that the state law is inconsistent with the intent of *Congress* (or of a federal agency acting by delegation of congressional authority).[179] Thus, contrary to the *Pacific* court's characterization, federal preemption is not a "constitutional problem[]" at all.[180] Rather, preemption is an ordinary and necessary result of Congress's determination that federal law should operate without obstruction by inconsistent state dictates. Indeed, the benefits of preemption (including the reliability, predictability, and efficiency of operating nationwide under a single set of uniform rules) are continually and appropriately recognized by Congress as it goes about its daily business of creating federal legislation.

In enacting the NBA, Congress made eminently clear that state law obstructing the banking operations of national banks would

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[177] *Id*. at *11 (citing Jones v. United States, 529 U.S. 848, 857 (2000) and United States ex rel. Attorney General v. Delaware & Hudson Co., 213 U.S. 366, 408 (1909)).

[178] *See id.*

[179] *See* Swift & Co. v. Wickham, 382 U.S. 111, 125 (1965) ("'The declaration of the supremacy clause gives superiority to valid federal acts over conflicting state statutes but this superiority for present purposes involves merely the construction of an act of Congress, not the constitutionality of the state enactment.'") (quoting Ex parte Bransford, 310 U.S. 354, 358-59 (1940)).

[180] *Pacific*, 2006 WL 2331075, at *11.

be inconsistent with the NBA.[181] Thus, a finding of NBA preemption is not something that courts have any reason to seek to avoid. The Second Circuit, in ruling in *Pacific* on appeal, could appropriately affirm the judgment of the district court on straightforward preemption grounds, and simply hold that the statute is preempted to the extent that it purports to regulate RALs made by national banks, whether through "facilitators" or otherwise.

C. The State Farm Bank Cases: Use of Exclusive Agents to Market Loans

In both the SPGGC cases and in Pacific, the state law restrictions at issue regulated the terms and conditions under which particular banking products (gift cards in SPGGC cases; RALs in Pacific) could be offered to consumers in the state. The Michigan mortgage lender registration and related requirements challenged in *Watters* were different, in that they provided for broad regulatory oversight and enforcement authority over certain *entities*. It remains to be seen whether *Watters* will serve to justify preemption of the latter type of laws with respect to nonbank entities other than operating subsidiaries. A case decided prior to *Watters*, however, *State Farm Bank, F.S.B. v. Burke*,[182] strongly suggests that the rationale for preemption articulated in *Watters* properly extends beyond the operating subsidiary context to circumstances where another type of nonbank entity performs functions for a federally chartered financial institution subject to federal regulatory oversight and control.

In *State Farm Bank*, State Farm Bank, F.S.B., together with one of its exclusive agents,[183] sued the Banking Commissioner of

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[181] As one Senator explained during the debates over enactment of the NBA: "'[I]t is of the very essence of supremacy to remove all obstacles to its action within its own sphere,'" and accordingly, a bank created by the federal government "must not be subjected to any local government, State or municipal; it must be kept absolutely and exclusively under that Government from which it derives its functions." CONG. GLOBE, 38th Cong., 1st Sess. 1893 (1864) (statement of Sen. Sumner) (quoting McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 427 (1819)).

[182] 445 F. Supp. 2d 207 (D. Conn. 2006).

[183] Complaint at ¶ 20, State Farm Bank v. Burke, 445 F. Supp. 2d 207 (D. Conn. 2006) (No. 3:05CV808), 2005 WL 1539054.

Connecticut for injunctive and declaratory relief to prevent the enforcement against the exclusive agents of the bank (the "Agents") of Connecticut's mortgage broker licensing and registration laws and also certain state securities dealer registration laws. The Agents, who also act as agents of State Farm Bank's parent company, State Farm Mutual Automobile Insurance Company ("State Farm"), are "exclusive" to State Farm Bank in that they perform banking-related services only for State Farm Bank.[184] State Farm Bank, which does not maintain any branches or offices open to the public, uses its Agents to perform the bank's marketing and customer service activities (but not its lending activities), primarily because the Agents already maintain well-established marketing channels due to their agency relationships with State Farm's affiliated insurance companies.[185]

In challenging the application of Connecticut's licensing and registration requirements to the Agents, State Farm Bank claimed that the laws were preempted because they interfered with the bank's right to engage in banking-related activities through the most efficient means available to State Farm Bank.[186] In support of this claim, State Farm Bank submitted an opinion issued to it by the OTS (the "OTS Opinion"), in which the OTS had found that, under the HOLA and the OTS implementing regulations, state mortgage broker licensing and securities dealer registration laws such as those of Connecticut indeed were preempted as applied to the agents of State Farm Bank.[187] As the OTS Opinion emphasizes, State Farm Bank

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[184] *See State Farm Bank*, 445 F. Supp. 2d at 209-10, 212-13.

[185] Complaint, *supra* note 183, at ¶ 19.

[186] *Id.* ¶ 6, 31-33.

[187] Authority of a Federal Savings Association to Perform Banking Activities through Agents Without Regard to State Licensing Requirements, P-2004-7 OTS L. Op. 13 (Oct. 25, 2004), *available at* http://www.ots.treas.gov/docs/5/560404.pdf [hereinafter OTS Op.]. The OTS reached this conclusion in part by analogizing the Agents to operating subsidiaries, which, under the OTS's regulation paralleling Section 7.4006, 12 C.F.R. § 559.3(n)(1), are not subject to state licensing and registration requirements that are preempted for their federal thrift parent. *Id.* ("Where an association exercises sufficient control over an agent's performance of authorized banking activities, the agent . . . will be subject to OTS regulation and supervision, and federal preemption of state license and registration

"should not be hamstrung in the exercise of its authorized powers merely because it chooses to market its products and services using agents whose activities the association closely monitors and controls."[188]

The district court agreed. The court found a "functional" similarity between the State Farm Bank agents and operating subsidiaries,[189] and concluded that, just as OTS regulations preempt state licensing and registration requirements are preempted for operating subsidiaries of federal thrifts, so too "the OTS regulations preempt the Connecticut statutes as applied to the lending and deposit-related activities of State Farm [Bank]'s exclusive agents."[190]

Underlying the court's decision in *State Farm Bank* was the recognition, much like that expressed by the Court in *Watters* as well as by the courts in the *SPGGC* and *Pacific* cases, that the *effect* of the state requirements at issue, as applied to the agents of State Farm Bank, was to burden impermissibly the authorized banking activities of the bank itself. As stated in the OTS Opinion upon which the court relied: "Subjecting the *Association*, through its Agents, to state licensing and registration requirements impermissibly interferes with and burdens the *Association*'s deposit and lending operations."[191]

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requirements applies to the agent, just as it would apply to an operating subsidiary.").

[188] *Id*. at 11.

[189] *State Farm Bank*, 445 F. Supp. 2d at 219 ("[T]he record . . . demonstrates substantial functional similarity between the activities of operating subsidiaries and State Farm's exclusive agents."). Note the connection between the term "functional" in this context and the Court's emphasis on the exercise of national bank "powers" in *Watters*. Watters v. Wachovia Bank, 127 S. Ct. 1559, 1570 (2007) ("[I]n 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.").

[190] *Id*. at 220-21. In a subsequent decision in a parallel action, State Farm Bank v. Reardon, 512 F. Supp. 2d 1107 (S.D. Ohio 2007), the District Court for the Southern District of Ohio reached a different conclusion based on the theory that the OTS Opinion should have been subject to notice-and-comment rulemaking procedures under the Administrative Procedure Act. That decision is on appeal. State Farm Bank v. Reardon, 512 F. Supp. 2d 1107 (S.D. Ohio 2007), *appeal docketed*, No. 07-4260 ((6th Cir.).

[191] OTS Op., *supra* note 187, at 12 (emphasis added).

The application of such state laws to the agents "would operate so as to indirectly apply state licensing or registration requirements to the *Association* as a precondition to exercising powers granted under federal law."[192] Because such state requirements, as applied either to State Farm Bank or its agents, "are inconsistent with the authority of the Association to exercise its deposit and lending powers and with the OTS's exclusive regulatory authority," they are preempted from application either "to the Association *or its* Agents."[193]

D. Implications: The Limits of *State Farm Bank*

The decision in *State Farm Bank* (from which the defendant Connecticut officials did not appeal) raises the question of whether a wide range of agents of both federal thrifts and national banks might qualify for preemptive protection from state licensing and registration requirements and the "visitations" attendant thereto. In considering this question, several aspects of the case merit particular attention. First, the relationship between State Farm Bank and its Agents is unique. As the OTS Opinion emphasizes, unless a federal savings association can demonstrate that it, like State Farm Bank, maintains a level of supervision and control over its agents' banking-related activities that is comparable to that maintained over an operating subsidiary, preemption of state law would not necessarily apply with respect to the association's agents.[194] Second, even if such a demonstration could be made, agents who do not exclusively act on behalf of federally chartered financial institutions could enjoy preemption of state regulatory requirements (including licensing) only to the extent of their activities for those federally chartered institutions. Third, *State Farm Bank* turned on deference to the OTS Opinion, and there is no comparable opinion from the OCC.[195]

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[192] *Id.* at 14 (emphasis added).

[193] *Id.* at 14-15 (emphasis added).

[194] *See id.* at App. A (listing the conditions that, as a minimum requirement, other federal savings associations must comply with if they seek to use agents to perform activities related to the association's authorized banking products or services).

[195] In an opinion issued in 2001, the OCC found that certain Michigan law provisions, including licensing requirements, were preempted with respect to motor vehicle sales financing activities conducted by two national banks through motor vehicle dealers who (much like the Agents of State Farm

Fourth, the OTS Opinion itself relied on preemption regulations not challenged by the defendant state authorities[196] and, even after *Watters*, state authorities might challenge the OCC's separate preemption regulations.[197] As discussed above, the Court in *Watters* left open the question whether the OCC's preemption regulations merit deference.[198]

Thus, in the context of entities that act on behalf of national banks but are not operating subsidiaries thereof, the boundaries of state law preemption remain subject to definition. The OCC may well, as did the OTS in its opinion to *State Farm Bank*, take steps to delineate those boundaries on a case-by-case basis. But the states' vigorous arguments in *Watters* indicate that deferring to an OCC interpretation, as the court deferred to the OTS Opinion in *State Farm Bank*, could be highly controversial.

The next section, Part V, *infra*, addresses the issue of deference to agency decisions regarding preemption, and specifically, the deference due to OCC preemption determinations. It argues that the position taken by the *Watters* dissent fails adequately to recognize the scope of authority delegated to the OCC to make such determinations. This authority, coupled with the OCC's unique experience and expertise, provides ample basis for judicial deference to OCC opinions on whether the NBA preempts state law.

Bank) "acted as the Banks' agents for the purpose of soliciting . . . loans, taking applications for the . . . loans, preparing the loan documentation, and obtaining the buyers' signatures on all required documents." OCC Preemption Determination No. 01-10, 66 Fed. Reg. 28,593, 28,594 (May 23, 2001). The OCC found that the Michigan provisions at issue impermissibly "prohibit[ed] the Banks from originating loans at an automobile dealership in Michigan." *Id*. Although the OCC did not explicitly state that the state *licensing* requirements were preempted with respect to the motor vehicle dealer agents as well as with respect to the Banks, its opinion suggests that the agency would reach that conclusion today under the "functional" analysis set forth in *Watters*. *See id*. at 28,595-96.

[196] *E.g.* 12 C.F.R. §§ 545.2, 557.11, 557.12, 560.2.

[197] *E.g.*, 12 C.F.R. §§ 7.4006-7.4009, 34.4.

[198] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1572 (2007) ("Under our interpretation of the statute, the level of deference owed to the regulation is an academic question.").

V. The Question Watters *Left Open: Do OCC Preemption Determinations Merit Judicial Deference?*

As observed above, the dissenting justices in *Watters* argued that "[w]hatever the Court says, this is a case about an administrative agency's power to preempt state laws."[199] The case had been decided as such in the lower courts, and Watters articulated her first question presented as a challenge to the Sixth Circuit's decision that Section 7.4006 merited *Chevron* deference.[200] Further, the Circuit Courts of Appeals in all three of the other cases raising the same issues also reached their conclusions by granting deference to Section 7.4006.[201] Although the *Watters* majority correctly found that, in light of the NBA itself, there was no need to reach the deference issue, that determination left open important questions that will continue to arise in other NBA cases. A review of the Court's prior jurisprudence concerning deference to agency preemption determinations is instructive as a framework for approaching such future cases.

A. The Court's Prior Jurisprudence on Deference to Agency Preemption Regulations

The Court's deference jurisprudence largely centers on its landmark decision in *Chevron*, in which the Court held that judicial deference is due to agency regulations interpreting a statute the agency is charged with administering if (1) Congress has left ambiguous its intent with respect to the precise issue in question and

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[199] *Id.* at 1585.

[200] *See* Pet. Br., *supra* note 31, at Part II.A.

[201] *See* Nat'l City Bank v. Turnbaugh, 463 F.3d 325, 332 (4th Cir. 2006) (finding that because Section 7.4006 is "reasonable" and "within the OCC's delegated authority" it is "entitled to *Chevron* deference"); Wachovia v. Burke, 414 F.3d 305, 319 (2d Cir. 2005) (finding that the OCC promulgated Section 7.4006 to codify its belief that state law should be preempted when it would cause a subsidiary to be subject to different rules than its national parent bank, and that this "policy judgment is reasonable and entitled to deference"); Wells Fargo v. Boutris, 419 F.3d 949, 958 (9th Cir. 2005) (finding that the OCC's interpretation of ambiguous language in the NBA, "as manifested in § 7.4006 . . . . is entitled to deference under the two-step framework of *Chevron* . . .").

(2) the agency's interpretation is based on a reasonable construction of the statute.[202] *Chevron*, however, did not involve an agency's interpretation of the *preemptive* effect of a statute. Thus, although most of the lower courts in *Watters* analyzed deference through the *Chevron* framework, it is not clear that the Supreme Court deems *Chevron* applicable to such agency interpretations regarding preemption. Indeed, the Court has explicitly distinguished (without determining the import of the distinction) agency interpretations of the "*meaning* of a statute" from agency determinations of "*whether* a statute is preemptive."[203] The Court has yet to directly opine on the extent to which administrative agencies may authoritatively answer the latter question—*i.e.*, *whether* a statute that does not itself speak to preemption has preemptive effect—and some Justices apparently may believe that question "must always be decided by the courts."[204]

Cases decided prior to *Chevron* and cited in it, however, reveal that there is an analytical basis for concluding that at least certain agencies, including the OCC, *should* be accorded deference with respect to their preemption determinations. In three particularly notable prior cases, *United States v. Shimer*,[205] *Fidelity Federal*

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[202] Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843-44 (1984) ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. [And] if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.").

[203] Smiley v. Citibank, 517 U.S. 735, 744 (1996) (upholding the OCC's definition of "interest" as used in 12 U.S.C. § 85 because the OCC's interpretation is entitled to deference, and it is reasonable).

[204] *Id.* ("We may assume (without deciding) that the latter question must always be decided *de novo* by the courts. That is *not* the question at issue here; there is no doubt that *§ 85* pre-empts state law."); *see also* Medtronic v. Lohr, 518 U.S. 470, 512 (1996) (O'Connor, J., joined by Rehnquist, C.J., and Scalia and Thomas, J.J., concurring in part and dissenting in part) ("It is not certain that an agency regulation determining the pre-emptive effect of *any* federal statute is entitled to deference.").

[205] 367 U.S. 374 (1961) (holding that the Servicemen's Readjustment Act authorized the Veterans' Administration to displace state law by regulation, and that the regulation in the instant case was a valid exercise of authority).

Savings & Loan Ass'n v. de la Cuesta,[206] and *Capital Cities Cable, Inc. v. Crisp*,[207] the Court laid the groundwork for principles of deference that have continued to be applied both by it and by lower courts, even after *Chevron*. Both *Shimer* and *de la Cuesta* are routinely cited for the proposition that courts must defer to agency decisions on preemption, irrespective of any indication of clear congressional intent to preempt, where Congress has delegated sufficient regulatory authority to the agency to make decisions of policy.

In *Shimer*, which involved a conflict between certain Pennsylvania law and regulations issued by the Veterans' Administration ("VA"), the Court did not even mention congressional intent. Instead, it considered two questions: (1) did the VA intend its regulations to preempt state law, and (2) if so, did the VA have authority to issue those regulations?[208] If the answer to those two questions was affirmative, the Court reasoned, the regulations would preempt state law, because "'where Congress has committed to the head of a department certain duties requiring the exercise of judgment and discretion, his action thereon . . . will not be reviewed by the courts unless he has exceeded his authority or . . . his action was clearly wrong.'"[209] Put slightly differently: "[I]f [the agency's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."[210]

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[206] 458 U.S. 141 (1982) (holding that the Home Owners' Loan Act empowered the Federal Home Loan Bank Board to issue regulations regarding certain clauses in deeds for the sale of real estate which preempted California state law).

[207] 467 U.S. 691 (1984) (holding that an Oklahoma state ban on alcohol advertisements conflicted with and was preempted by the Federal Communications Commission's regulations that required that out-of-state television signals which are imported be retransmitted to subscribers without deletion or alteration).

[208] *See Shimer*, 367 U.S. at 381.

[209] *Id.* at 381-82 (quoting Bates & Guild Co. v. Payne, 194 U.S. 106, 108-09 (1904)) (emphasis added).

[210] *Id.* at 383.

The foregoing language, quoted by the Court in *Chevron*,[211] set the stage for a focus in subsequent cases concerning agency preemption on (1) the extent of *delegation of policymaking authority* to the agency involved and (2) the agency's intent to preempt, as opposed to inquiries into *congressional* intent to preempt. For example, in *de la Cuesta*, the Court applied this analysis with respect to a regulation issued by the Federal Home Loan Bank Board (the "Board") (the predecessor to the current Office of Thrift Supervision) that permitted federal thrifts to use "due-on-sale" clauses in mortgage contracts, despite a California law to the contrary.[212] The Court emphasized that "[a] pre-emptive regulation's force does not depend on express congressional authorization to displace state law."[213] Rather, the questions upon which the case turned were "whether the Board meant to pre-empt California's due-on-sale law, and, if so, whether that action is within the scope of the Board's delegated authority."[214]

Finding it quite clear that the Board intended its regulation to preempt state restrictions on due-on-sale clauses for federal thrifts, the Court then examined the statutory source of authority for the Board's regulation. It found that the HOLA, which authorized the Board to "provide [via rules and regulations] for the organization, incorporation, examination, operation, and regulation of . . . 'Federal Savings and Loan Associations,'"[215] delegated "ample authority" to the Board to preempt state law.[216] Indeed, the Court found, the HOLA delegation language "express[ed] no limits on the Board's

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[211] Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 845 (1984).

[212] *See* 44 Fed. Reg. 39108, 39149 (1979) (describing due-on-sale clauses) (codified at 12 C.F.R. § 545.8-3(f) (1982).

[213] Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982).

[214] *Id.*

[215] 12 U.S.C. § 1464(a) (Supp. IV 1978) (current version at 12 U.S.C. § 1464(a) (2000)).

[216] *de la Cuesta*, 458 U.S. at 159-60 ("The language and history of the HOLA convince us that Congress delegated to the Board ample authority to regulate the lending practices of federal savings and loans.").

authority to regulate . . . . 'It would have been difficult for Congress to give the Bank Board a broader mandate.'"[217]

Crisp reflects an extension of the same line of reasoning. In *Crisp*, the Court found that a regulation of the Federal Communications Commission ("FCC") preempted an Oklahoma constitutional prohibition on alcohol advertising because (1) the FCC had indicated its intent to that effect and (2) the Federal Communications Act of 1934, as the Court had previously found, gave the FCC "broad responsibilities" to regulate "all aspects" of interstate wire or radio communication.[218] The Court repeated the deference formulation of *Shimer* and *De la Cuesta*, stating that "if the FCC has resolved to pre-empt an area of cable television regulation and if this determination 'represents a reasonable accommodation of conflicting policies' that are within the agency's domain, we must conclude that all conflicting state regulations have been precluded."[219]

Enter *Chevron*: "We have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations."[220] Citing *Shimer* and

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[217] *Id.* at 161 (alteration in original) (quoting Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 910 (C.D. Cal. 1978)).

[218] Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 700 (1984) (citing United States v. Southwestern Cable Co., 392 U.S. 157, 177-78 (1968) (holding that the FCC "had been given 'broad responsibilities' to regulate all aspects of interstate communication by wire or radio by virtue of § 2(a) of the Communications Act of 1934, 47 U. S. C. § 152(a), and that this comprehensive authority included power to regulate cable communications systems"); Communications Act of 1934, 47 U.S.C. § 152(a) (2000) ("The provisions of this Act shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; . . . . The provisions of this Act shall apply with respect to cable service, to all persons engaged within the United States in providing such service, and to the facilities of cable operators which relate to such service . . . . ").

[219] *Crisp*, 467 U.S. at 700 (quoting United States v. Shimer, 367 U.S. 374, 383 (1961)).

[220] Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984).

Crisp, the Court explained that, in accordance with this well-established principle, if an agency's determination "represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."[221]

Although *Chevron* itself involved an agency's interpretation of a particular statutory term and did not involve the issue of preemption, there is no inconsistency between the analytical basis for deference in that context and the basis for deference to an agency's determination that state law should be preempted in a particular area. The fundamental reasoning is the same: If Congress delegates to an agency authority to administer a statute, the agency may—and should—exercise that authority to implement the statute using its particular expertise and policymaking judgment, consistent with the statute's underlying objectives.[222] The agency may apply that expertise to interpret particular statutory terms or phrases that Congress left ambiguous, or, as in *Shimer* and *de la Cuesta*, it may do so to declare state law preempted where Congress did not speak directly to preemption.[223] Thus, as a unanimous Court emphasized in *City of New York v. FCC* ("*NYC v. FCC*"),[224] federal agencies properly effectuate preemption of state law not only because "[t]he statutorily authorized regulations of an agency will pre-empt any state or local law that conflicts with such regulations or frustrates the purposes thereof," but also because, "[b]eyond that, in proper circumstances,

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[221] *Id*. at 845 (citing *Shimer*, 367 U.S. at 382-83; *Crisp*, 467 U.S. at 699-700).

[222] *See* Geier v. Am. Honda Motor Co., Inc., 529 U.S. 861, 883 ("Congress has delegated to [the federal agency] authority to implement the statute; the subject matter is technical; and the relevant history and background are complex and extensive. The agency is likely to have a thorough understanding of its own regulation and objectives and is 'uniquely qualified' to comprehend the likely impact of state requirements." (quoting Medtronic, Inc. v Lohr, 518 U.S. 470, 496 (1996) (Breyer, J., concurring)).

[223] *See de la Cuesta*, 458 U.S. at 154 ("If [the agency's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.").

[224] 486 U.S. 57 (1988).

the agency may determine that its authority is exclusive and pre-empts any state efforts to regulate in [a particular] area."[225]

In *Watters*, Justice Stevens cited both *NYC v. FCC* and *de la Cuesta* in his dissent, but he did so to support the proposition that "a properly promulgated regulation can have preemptive effect should it *conflict* with state law."[226] Justice Stevens specifically distinguished such a regulation from "agency regulations . . . that 'purport 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*.'"[227] In so doing, he cast doubt on whether he still agrees with *NYC v. FCC.* Indeed, Justice Stevens and the other dissenting Justices in *Watters* seem to suggest that an agency determination "that its authority is exclusive and pre-empts any state efforts to regulate in [a particular] area"[228] can *never* merit deference unless *that determination* is explicitly compelled by specific statutory language (or possibly legislative history).

But such a position undercuts the value of administrative agencies and does not appear necessary to ensure that preemption of state law occurs in accordance with congressional intent. An insistence on explicit statutory authority to preempt effectively requires either (1) that Congress foresee (or return to address on a case-by-case basis) every instance in which its underlying legislative intent would be frustrated by the application of state law or (2) that preemption questions be resolved through litigation in the courts. But, as discussed below, when Congress delegates broad authority to an agency to construe and implement a statute, as Congress did in the NBA with respect to the OCC, that agency is uniquely well-positioned to ascertain whether a particular state law (or type of state law) is in conflict with the statute's underlying objectives. Thus, although the existence of preemption may in the abstract appear to be a quintessentially "legal" issue to be resolved by the courts, in

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[225] *Id.* at 64 (citing *Crisp*, 467 U.S. at 700).

[226] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1583 n.24 (2007) (Stevens, J., dissenting) (emphasis added).

[227] *Id.* (quoting Nicholas Bagley, Note, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y.U. L. REV. 2274, 2289 (2004)).

[228] *City of New York v. FCC*, 486 U.S. at 64 (citing Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 700 (1984)).

practice, at least with respect to preemption under the NBA, the agency's views should be granted substantial deference.[229]

B. The Authority of the OCC to Make Preemption Determinations

The OCC's authority under the NBA is extremely broad. The NBA grants the OCC plenary power to regulate national banks, including their organization,[230] incorporation,[231] examination,[232] operation,[233] regulation,[234] and dissolution.[235] Notably, these powers parallel those granted to the OTS under the HOLA, which, as mentioned above, authorizes the OTS (formerly the Home Loan

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[229] The deference due to agency opinions regarding the existence of preemption does not raise the same concerns as an agency's opinion regarding the scope of the agency's own jurisdiction. *See, e.g.*, Miss. Power & Light Co. v. Mississippi, 487 U.S. 357, 386-89 (1988) (Brennan, J., dissenting) (criticizing Justice Scalia's "conclusion that courts must defer to an agency's statutory construction even where . . . the statute is designed to confine the scope of the agency's jurisdiction"). A federal agency may not have expertise superior to the courts to determine the boundaries set by Congress on the agency's own jurisdiction, but, where an agency does have jurisdiction to administer a statute, it generally does have superior expertise with respect to determining the extent to which state law interferes with the proper administration of that statute and, thus, the extent to which state law is preempted by the statute and the agency's implementing regulations.

[230] 12 U.S.C. §§ 21, 26 (2000) ("[After receiving a certificate of incorporation by a bank applicant,] the Comptroller shall examine into the condition of such association. . . to determine whether the association is lawfully entitled to commence the business of banking.").

[231] *Id.* (outlining the process of forming a "national bank" through an association with documentation submitted to the OCC).

[232] *Id.* § 481 (giving the OCC power to appoint, control and regulate banks through bank examiners).

[233] *E.g.*, *id.* §§ 81-92a (setting limits on lending, interest rates, and other operational aspects of banking).

[234] *Id.* §§ 93a, 371(a) ("[T]he Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office.").

[235] *E.g.*, *id.* §§ 181-200 (describing, *inter alia*, the dissolution process, receivership possibilities and distribution of assets).

Bank Board), "under such rules and regulations as [it] may prescribe . . . to provide for the organization, incorporation, examination, operation, and regulation of . . . Federal savings associations . . . , giving primary consideration of the best practices of local mutual thrift and home financing institutions in the United States."[236]

In *de la Cuesta*, the Court found that the above-quoted HOLA language "suggests that Congress expressly contemplated, and approved, the [OTS]'s promulgation of regulations superseding state law."[237] In particular, the Court found that, by directing the OTS to consider the "best practices" of thrift institutions, "Congress plainly envisioned that federal savings and loan[] [associations] would be governed by what the [OTS]—not any particular State—deemed to be the "best practices."[238] It was this language, together with the delegation of broad rulemaking authority to the agency, that led the Court to conclude that Congress intended to authorize the OTS to issue regulations aimed at preempting state law, and that obviated the need to look for specific *congressional* intent to preempt.[239]

The NBA provides at least as much evidence of a congressional grant of authority to the OCC for determinations of preemption. The near-exclusive visitorial authority over national banks granted to the OCC in Section 484 clearly evinces Congress's intent that the OCC exclusively be responsible for ensuring national banks employ "best practices" in connection with their exercise of banking powers granted under the NBA.[240] Indeed, the NBA's legislative history is replete with statements of intent to oust the states from any type of supervisory role over the exercise of the banking powers granted by the federal government to national

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[236] 12 U.S.C. § 1464(a) (2000).

[237] Fidelity Fed. Sav. & Loan Ass'n. v. de la Cuesta, 458 U.S. 141, 162 (1982).

[238] *Id*. at 161.

[239] *See id*.

[240] Section 484 was designed "to take from the States . . . all authority whatsoever over . . . [national] banks, and to vest that authority here in Washington, in the . . . Secretary of the Treasury." CONG. GLOBE, 38th Cong., 1st Sess. 1267 (1864) (statement of Rep. Brooks).

banks.[241] It would defy that intent for the OCC to regulate national banks without considering the possible ways in which state regulation might impair the exercise of their banking powers, and a failure to respect the OCC's policy determinations based on such considerations would be contrary to the fundamental purposes and scheme of the NBA.[242]

Congress, in fact, underscored this point when it enacted the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal").[243] Riegle-Neal specifically recognizes the OCC's authority to "conclude that Federal law preempts the application to a national bank of any State law."[244] It provides that, when reaching any such conclusion with respect to certain types of state laws, the OCC must follow public notice-and-comment

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[241] As one Senator reminded his colleagues during the debates leading to enactment of the NBA, a bank created by the federal government "must not be subjected to any local government, State or municipal; it must be kept absolutely and exclusively under that Government from which it derives its functions." CONG. GLOBE, 38th Cong., 1st Sess. 1893 (1864) (statement of Sen. Sumner) (quoting McCulloch v. Maryland, 17 U.S. (4. Wheat.) at 427); *see also* CONG. GLOBE, 37th Cong., 3d Sess. 1115 (1863) ("[The NBA would establish a banking system] made to operate directly upon the people independently of State boundaries or State sovereignty, . . . wholly independent of State authority.") (statement of Rep. Spaulding); CONG. GLOBE, 38th Cong., 1st Sess. 1413 (1864) ("[T]he whole purpose and object and scope and tendency of the bill is to prostrate State power and put it at the control of the great centralized power to be established here.") (statement of Rep. Mallory).

[242] Indeed, even critics of OCC preemption concede that the agency's expertise is uniquely important to determining when certain state laws frustrate the purpose of the NBA. *See, e.g.,* Bagley, *supra* note 227, at 2287, 2295 ("Federal agencies, particularly in highly technical fields (like banking) have the expertise and the institutional capacity to make refined judgments about whether state laws will in fact conflict with congressional purposes . . . [and thus will] sometimes understand far better than courts the complex interactions between state laws and complicated federal regulatory regimes.").

[243] Pub. L. No. 103-328, 108 Stat. 2338 (1994) (codified as 12 U.S.C. § 43 (2000)).

[244] 12 U.S.C. § 43 (2000).

procedures.[245] As Congress explained, the purpose of that procedural requirement is "to help focus any administrative preemption analysis and to help ensure that an agency only makes a preemption determination when the legal basis is compelling and the Federal policy interest is clear."[246] Thus, through Riegle-Neal, "Congress has expressly recognized the OCC's power to preempt particular state laws by issuing opinion letters and interpretive rulings, subject to certain notice-and-comment procedures."[247]

The dissent in *Watters* acknowledged Riegle-Neal's express congressional confirmation of the OCC's preemptive authority, but brushed it aside, stating that, "[b]y its own terms . . . this provision *granted* no preemption authority to the OCC."[248] That is hardly a basis to refute that such OCC authority exists; obviously, Congress could not put procedural constraints on the OCC's exercise of an authority Congress did not believe the OCC has. The Riegle-Neal provisions, therefore, belie the insistence of the *Watters*'s dissent that, because Sections 93a and 371 of the NBA (granting rulemaking authority to the OCC)[249] do not "say[] a word about preemption," there is "no textual foundation for the OCC's preemption authority."[250]

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[245] The notice-and-comment requirement applies to determinations of preemption with respect to state law in the areas of community reinvestment, consumer protection, fair lending, and the establishment of interstate branches. *Id.* § 43(a) (spelling out the notice-and-comment requirements used whenever the OCC decides it has the authority to preempt state law).

[246] H.R. REP. NO. 103-651, at 53 (1994) (Conf. Rep.), *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074.

[247] Wachovia v. Burke, 414 F.3d 305, 314 (2d Cir. 2005); *see also* Wells Fargo Bank v. Boutris, 419 F.3d 949, 962 (9th Cir. 2005) ("12 U.S.C. § 43 specifically contemplates that the OCC . . . has authority to preempt state laws . . . .").

[248] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1583 n.22 (2007) (Stevens, J., dissenting).

[249] 12 U.S.C. §§ 93a, 371. Section 93a indicates that "the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office . . . ." *Id.* § 93a. Section 371gives the OCC the power to prescribe restrictions and requirements on national banks ability to make real estate loans. *Id.* § 371.

[250] *Watters*, 127 S. Ct. at 1583 n.23 (Stevens, J., dissenting) (citing 12 U.S.C. §§ 93a, 371).

Indeed, it is interesting to note that the unanimous Court in *NYC v. FCC*, including Justices Stevens and Scalia, were satisfied with *implicit* indications of congressional intent to imbue the FCC with authority to determine preemption of certain local standards under the Cable Communications Policy Act of 1984 ("Cable Act"), despite that statute's lack of "'express congressional authorization to displace state law.'"[251] The Court in *NYC v. FCC* found it sufficient that "nothing in the Cable Act or its legislative history indicates that Congress explicitly *disapproved* of the Commission's pre-emption of local technical standards," indicating an *acknowledgment* of the FCC's power to declare such preemption.[252] Riegle-Neal, which *expressly* speaks to the OCC's authority to make preemption determinations, is at least as clear evidence of Congress's endorsement of an agency's preemptive authority as the legislative history the Court relied on in *NYC v. FCC*.

C. Deference Due to the OCC's Preemption Determinations

Even in the absence of Riegle-Neal's express acknowledgment of the OCC's authority to make preemption determinations, there would be ample grounds for concluding that deference is due to such determinations. When Congress vests full responsibility in an agency for administering a statute, "[t]hat responsibility means informed agency involvement and, therefore, special understanding of the likely impact of both state and federal requirements, as well as

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[251] City of New York v. FCC, 486 U.S. 57, 64 (1988) ("[I]n a situation where state law is claimed to be pre-empted by federal regulation 'a narrow focus on Congress' intent to supersede state law [is] misdirected,' for 'a pre-emptive regulation's force does not depend on express congressional authorization to displace state law.'" (quoting Fidelity Federal Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982))).

[252] *Id.* at 68-69 (emphasis added) ("It is also quite significant that nothing in the Cable Act or its legislative history indicates that Congress explicitly disapproved of the Commissions' pre-emption of local technical standards. Given the difficulties the Commission had experienced in that area, which had caused it to reverse its ground in 1974 after two years of unhappy experience with the practical consequences of inconsistent technical standards imposed by various localities, we doubt that Congress intended to overturn the Commissions decade-old policy without discussion or even any suggestion that it was doing so.").

an understanding of whether (or the extent to which) state requirements may interfere with federal objectives."[253] It is the recognition of just such understanding that underlies the principle of deference articulated in *Chevron*.[254] And although *Chevron* did not involve an agency's decision concerning preemption, it has properly served in many cases as the analytical basis for testing whether a preemption decision merits judicial deference. Indeed, all of the Circuit Courts that decided the operating subsidiary preemption question posed in *Watters* found that the OCC's declaration of preemption in 7.4006 met the *Chevron* deference test.[255]

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[253] Medtronic, Inc. v Lohr, 518 U.S. 470, 506 (1996) (Breyer, J., concurring).

[254] Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 865-66 (1984) ("[A]n agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely on the incumbent administration's views of wise policy to inform its judgments . . . [I]t is entirely appropriate for [the executive branch] to make such policy choices—resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities. When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail.").

[255] *See* Nat'l City Bank v. Turnbaugh, 463 F.3d 325, 330 (4th Cir. 2006) ("The district court found that a presumption against preemption does not exist, the Maryland statutes conflict with federal law, and the regulations are entitled to *Chevron* deference. The district court accordingly found that federal law preempts the Maryland statute. We agree."); Wachovia v. Burke, 414 F.3d 305, 314-15 (2d Cir. 2005) ("Given these principles, the Commissioner incorrectly attempts to frame the issue as whether Congress has expressly and clearly manifested an intent to preempt state visitorial power over operating subsidiaries. The focus, rather, is on the reasonableness of the OCC's exercise of its regulatory authority. The District Court properly approached the issue through the framework of *Chevron* . . . ."); Wells Fargo v. Boutris, 419 F.3d 949, 958 (9th Cir. 2005) ("Given this rulemaking authority, the OCC's interpretation of ambiguous language in the Bank Act is entitled to deference under the two-step framework of *Chevron*); Wachovia v. Watters, 431 F.3d 556, 560 (6th Cir. 2005) ("We therefore decline Michigan's invitation to frame the issue as whether Congress has expressly manifested its intent to preempt state laws such as Michigan's and instead focus on whether the Comptroller has exceeded its

In any event, as the Second Circuit aptly pointed out in *Wachovia v. Burke*, "the analysis would be the same even if [the court] did not apply *Chevron* itself."[256] Following the *Shimer*, *Crisp*, and *de la Cuesta* line of decisions, the Second Circuit reasoned, the judiciary's task in reviewing OCC preemption regulations is "'only to determine whether [the agency] has exceeded [its] statutory authority or acted arbitrarily,'" and the regulations must be enforced "'unless they are unreasonable or inconsistent with the statutory scheme.'"[257]

The Second Circuit's observation is eminently reasonable and consistent with pertinent Supreme Court precedent. As the Court underscored in *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, the OCC is responsible for the "surveillance of 'the business of banking' authorized by [the NBA]."[258] The OCC's experience and expertise in supervising, examining, and regulating that business imbues it with unique capability to make policy judgments about the impact of state law on the exercise of the banking powers of national banks. "Because the [OCC] is the federal agency to which Congress has delegated its authority to implement the provisions of the [NBA], the agency is uniquely qualified to determine whether a particular form of state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' and, therefore, whether it should be pre-empted."[259]

In dissenting in *Watters*, Justice Stevens suggested that Section 7.4006 embodied no such uniquely qualified determination because the OCC had stated, in its economic impact assessment upon promulgating the regulation, that the preemption declared therein "'reflects the conclusion [the OCC] believe[s] a Federal court would

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authority or acted arbitrarily. We do so through the framework established by *Chevron* . . . . .").

[256] *Burke*, 414 F.3d at 315 n.6.

[257] *Id.* (quoting Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982)).

[258] NationsBank of N.C. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 256 (1995).

[259] Medtronic Inc. v. Lohr, 518 U.S. 470, 495 (1996) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)) (footnote omitted).

reach, even in the absence of the regulation.'"[260] But the fact that the OCC has taken judicial precedent into account (among other factors) in determining the scope of federal preemption, and believes its policy conclusions are in accord with likely court judgments, in no way indicates the agency did not employ its unique experience and expertise regarding banking operations to reach those conclusions. To the contrary: the rulemaking notice issued by the OCC upon promulgating Section 7.4006 plainly shows that the agency made "explicit findings, based on considerable experience in th[e] area [of national banks' banking powers], that complementary or additional . . . standards set by state and local authorities . . . conflict with the basic objectives of federal policy" underlying Section 484.[261]

For example, the OCC observed that "[f]or decades national banks have been authorized to use the operating subsidiary as a convenient and useful corporate form for conducting activities that the parent bank could conduct directly."[262] Both from "a consumer protection [and] a safety and soundness standpoint," the OCC found, consistent regulation of operating subsidiaries and national banks is the appropriate policy approach.[263] "The OCC considers the overall risk exposure of a national bank as part of its supervisory processes, including safety and soundness and compliance risk originating in, or resulting from, the bank's operating subsidiaries."[264] Thus, under the OCC's operating subsidiary regulation, "an operating subsidiary conducts its activities subject to the same authorization, terms, and conditions that apply to the conduct of those activities by its parent bank."[265] These circumstances justify the OCC's policy conclusion that "state laws apply to operating subsidiaries to the same extent as they apply to the parent national bank. Thus, unless otherwise provided by Federal law or OCC regulation, State laws, such as

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[260] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1583-84 (Stevens, J., dissenting) (quoting Investment Securities; Bank Activities and Operations; Leasing, 66 Fed. Reg. 34,784, 34,790 (July 2, 2001) (to be codified at 12 C.F.R. pts. 1, 7, 23)).

[261] City of New York v. FCC, 486 U.S. 57, 69 (1988).

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

[263] *Id.* at 34,789.

[264] *Id*.

[265] *Id*. at 34,788.

licensing requirements, are applicable to a national bank operating subsidiary only to the extent that they are applicable to national banks."[266]

The OCC similarly applied its experience and expertise in promulgating its more general preemption regulations in 2004.[267] By following the *standards* for NBA preemption set forth in cases such as *Barnett Bank*,[268] the OCC reached *policy conclusions* as to which types of state laws, due to their effect on the exercise of national bank powers, are preempted, and which generally are not.[269] Observing that several factors, including technological innovations, the erosion of legal barriers, and an increasingly mobile society, have "affected both the type of products that may be offered and the geographic region in which banks—large and small—may conduct business," the OCC found a heightened need to ensure that the exercise of national bank powers not be obstructed by "the costs and interference [imposed by] diverse and potentially conflicting state and local laws."[270] Not only is the application of "multiple, often unpredictable, different state or local restrictions and requirements . . . costly and burdensome," the OCC found, but it also interferes with the ability of national banks to "plan their business and manage their risks, and subjects them to uncertain liabilities and potential exposure. In some cases, this deters them from making certain products available in certain jurisdictions."[271]

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[266] *Id*.

[267] The 2004 preemption regulations are codified at 12 C.F.R. §§ 7.4007, 7.4008, 7.4009, and 34.4(a) (2004).

[268] Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33-34 (1996) (finding that state law is preempted if it would "interfere with," "encroac[h]" upon, or "hampe[r]" the exercise of a power authorized under the NBA).

[269] *See* Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (codified at 12 C.F.R. pts. 7 & 34) [hereinafter 2004 Preemption Rule Notice] (explaining that the list of state laws that are preempted "reflects judicial precedents *and* OCC interpretations concerning the types of state laws that can obstruct the exercise of national banks' deposit-taking and non-real estate lending powers") (emphasis added).

[270] *Id.* at 1907-08.

[271] *Id.* at 1908.

Both Section 7.4006 and the OCC's 2004 preemption rules plainly embody policy judgments made by the agency in accordance with its interpretation of Supreme Court precedent. By issuing rules delineating the circumstances in which state laws are preempted with respect to national banks' banking operations, the OCC "translate[d] [its] understandings [of such precedent] into particularized pre-emptive intentions."[272] Under *Chevron* as well the Court's other deference-related opinions, the OCC's preemption regulations merit substantial deference from the courts.

VI. Conclusion

The practical result of the Court's ruling in *Watters* is to confirm the preemption already declared by the OCC in Section 7.4006. By ruling that state laws apply to national bank operating subsidiaries only to the extent they apply to national banks themselves, the Court did not effect a radical change in the national bank preemption landscape, contrary to dissent's suggestions. It may be true that the ruling could, in Justice Stevens' words, "drive companies seeking refuge from state regulation into the arms of federal parents."[273] But such an outcome does not mean that the preemption found in *Watters* "threatens both the dual banking system and the principle of competitive equality that is its cornerstone."[274]

Indeed, there is no reason to believe that *Watters* will have a greater impact on competition between national banks and their state-chartered counterparts than many of the other determinations regarding national bank powers that have been made over the past 150 years. The states have proven highly resilient in responding to such determinations, including by enhancing the authority of state-chartered banks (and their operating subsidiaries) to compete with

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[272] Medtronic, Inc. v. Lohr, 518 U.S. 470, 506 (1996) (Breyer, J., concurring) (citing Hillsborough County v. Automated Medical Labs., Inc., 471 U.S. 707, 718-21 (1985)).

[273] Watters v. Wachovia Bank, 127 S. Ct. 1559, 1585 (2007) (Stevens, J., dissenting).

[274] *Id*.

national banks pursuant to so-called "parity" statutes (also often referred to as "wild card" statutes).[275]

Typically, a state parity statute grants a state bank the authority to engage in activities permissibly undertaken by national banks (or other federally chartered financial institutions). For example, under the California's State Bank Parity Act,[276] the California Department of Financial Institutions ("DFI") may authorize state banks to exercise the powers of national banks, if the California Financial Code would not otherwise authorize the exercise of such powers.[277] As described by its sponsor, the California law "provides competitive parity for state-chartered commercial banks vis-à-vis national banks headquartered in California" by allowing the DFI to "adopt regulations giving California state-chartered banks or trust companies parity with national banks whenever Congress or federal agencies extend by statute or regulation to national banks any right, power or privilege that is not authorized to state banks or trust companies."[278] Other states' bank parity statutes employ slightly different means to achieve similar goals.[279]

The states' interest in consumer protection also is not threatened by the *Watters* decision, contrary to intimations by the dissent and certain members of Congress.[280] As Comptroller of the

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[275] *See, e.g.*, Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 363-67 (1995).

[276] CAL. FIN. CODE § 753 (1995).

[277] The statute provides that "if the commissioner [of the DFI] finds that any provision of federal law applicable to national banking associations doing business in this state is substantively different from the provisions of this code applicable to banks organized under the laws of this state, the commissioner may by regulation make that provision of federal law applicable to banks organized under the laws of this state. *Id*. § 753(b)(1).

[278] Letter from Gregory O. Wilhelm, California Bankers Ass'n, Sponsor, to S. Fin., Inv. & Int'l Trade Comm. (Apr. 7, 1995) (Leg. Hist. at 7).

[279] *See*, *e.g.*, CONN. GEN. STAT. § 36a-250(a)(41); ME. REV. STAT. ANN. tit. 9-B, § 416; MASS. GEN. LAWS ch. 167F, § 2(31); N.H. REV. STAT. ANN. § 394.

[280] *See* Watters v. Wachovia Bank, 127 S. Ct. 1559, 1581 (2007) (Stevens, J., dissenting) ("It is especially troubling that the Court so blithely preempts Michigan laws designed to protect consumers."); *see also* Bill Swindell, *Frank Likely to Move Measure to Give OCC More Power*, CONG. DAILY,

Currency John C. Dugan testified before Congress shortly after the ruling in *Watters* was announced: "[The OCC] believe[s] that there is much promise for enhanced federal/state cooperation and corresponding improvements in consumer protection, and that the recent decision of the Supreme Court in *Watters v. Wachovia Bank* does not undermine those opportunities."[281] Comptroller Dugan explained that, although federal and state standards may differ in certain respects with respect to consumer protection, that does not mean there is "gap" in consumer protection for customers of national banks."[282] Such regulatory differences reflect "the essence of our dual banking system and federalism, where individual states can take different approaches to a particular issue affecting state banks," and are "the inherent and essential result of the different approaches possible—and encouraged—in our dual system of national and state banks."[283] Accepting those differences, there are important steps toward cooperation and collaboration between federal and state regulators that will serve to strengthen consumer protection.

One example of such cooperation is the model Memorandum of Understanding agreed to by the OCC and the Conference of State Bank Supervisors ("CSBS") in late 2006, which is designed to facilitate the referral of complaints, and the sharing of information about the disposition of complaints, between the OCC and the individual states.[284] The OCC has executed agreements with as many as 20 states based on the model Memorandum of Understanding, and

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Apr. 18, 2007 (quoting House Financial Services Chairman Barney Frank's statement that "[i]t is now the law of the land that the great majority of state consumer protection laws that were particularly aimed at banks and thrift institutions have been pre-empted").

[281] *Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 120, 147 (2007) (statement John C. Dugan, Comptroller of the Currency) [hereinafter *Dugan Testimony*] (statement John C. Dugan, Comptroller of the Currency), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htdugan061307.pdf.

[282] *Id*. at 149.

[283] *Id.*

[284] *Id*. at 142, 150.

more are likely in the future.[285] The OCC also is developing a web-based technology platform to expedite complaint information sharing called the "Complaint Referral Express" ("CRE").[286] Once operational, the CRE will facilitate the transfer of misdirected complaints and referrals between the OCC and other federal and state banking agencies, and enable the agency with jurisdiction over a particular complaint to retrieve the consumer's complaint information in a digital format and incorporate that information into the agency's own case management system. In addition, like the information-sharing agreements based on the Memorandum of Understanding with the CSBS, the CRE will provide access to reports on the status and disposition of complaints referred to the OCC by the states.[287]

The jurisdictional boundaries confirmed in *Watters* are not, therefore, impediments to a competitive dual banking system or to consumer protection. *Watters* confirms and clarifies the fundamental principles of preemption that guarantee national banks the right to experiment with and expand on the channels through which they exercise their federally granted banking powers nationwide. Banking is a dynamic process, and the preemption analysis applied in *Watters* properly recognizes this, by eschewing a narrow and formalistic approach in favor of a flexible, functional test for determining when state regulatory authority impinges on a national bank's ability to conduct its banking operations most efficiently and effectively across state lines.

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[285] *See* News Release No. 2007-69, OCC, OCC and Puerto Rico Agree to Share Consumer Complaints, Bringing Total of Such Agreements to Twenty (July 10, 2007), *available at* http://www.occ.treas.gov/ftp/release/2007-69.htm.

[286] *Dugan Testimony*, *supra* note 281, at 143.

[287] *Id*.