Preemption and Federalism Developments: *Watters* Under the Bridge

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Introduction

The United States Supreme Court's anticipated decision in *Watters v. Wachovia Bank, N.A.*,[1] dominated discussions of federalism and preemption issues over the past year. In May 2007, the Court ruled in *Watters* that state laws apply to national bank operating subsidiaries to the same extent as such laws apply to national banks.[2]

The Court's opinion in *Watters* was not the only significant development regarding preemption. Other rulings examined National Bank Act ("NBA")[3] preemption of state laws regulating gift cards and refund anticipation loan programs,[4] the limits of complete preemption,[5] the extent of the Office of the Comptroller of the Currency's ("OCC") exclusivity as to national bank visitorial powers,[6] and

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Summaries of leading cases, regulations, interpretive letters, and other information on preemption and federalism issues, including recent developments and links to public copies of preemption and federalism materials discussed in this Survey, are available on the American Bar Association's Preemption Task Force web page at http://www.abanet.org/buslaw/committees/CL230044pub/links.shtml.

1. 127 S. Ct. 1559 (2007), *aff'g* Wachovia Bank, N.A. v. Watters, 431 F.3d 556 (6th Cir. 2006).

2. *Watters*, 127 S. Ct. at 1572 (citing 12 C.F.R. § 7.4006 (2007)).

3. Act of June 3, 1864, ch. 106, 13 Stat. 99 (codified as amended in Title 12, U.S.C.).

4. *See* SPGGC, LLC v. Ayotte, 488 F.3d 525, 530 (1st Cir. 2007) (gift cards); Hood v. Santa Barbara Bank & Trust, 49 Cal. Rptr. 3d 369, 377 (Cal. Ct. App. 2006), *cert. denied*, 127 S. Ct. 2916 (2007) (refund anticipation loan programs); Pac. Capital Bank, N.A. v. Connecticut, No. 3:06-CV-28 (PCD), 2006 WL 2331075, at *5–6 (D. Conn. Aug. 10, 2006) (refund anticipation loan programs). *See also* Roberta G. Torian, Russell W. Schrader, Oliver I. Ireland & Ryan S. Stinneford, *Developments in Electronic Banking and Payment Systems*, 63 Bus. Law. ___ (2008) (in this *Annual Survey*).

5. Fornshell v. FirstMerit Corp., No. 1:06-cv-1505, 2006 WL 3545134, at *2 (N.D. Ohio Dec. 8, 2006); Patterson v. Regions Bank, No. 06-CV-469-DRH, 2006 WL 3407852, at *4 (S.D. Ill. Nov. 27, 2006).

6. Bank of Am., N.A. (USA) v. Miller, No. CIV. S-06-1971 LKK/KJM, 2007 WL 184804, at *2 (E.D. Cal. Jan. 19, 2007).

NBA preemption of state law due-on-sale clause limitations.[7] Additionally, the OCC entered into several agreements to share consumer complaint information with state banking regulators.[8]

Further, courts held that the Home Owners' Loan Act ("HOLA")[9] does not provide complete preemption for federal savings banks[10] and took the opportunity to clarify the scope of HOLA preemption concerning state fraud and consumer protection claims.[11] The Office of Thrift Supervision ("OTS"), as did the OCC, entered into agreements with state banking regulators to share consumer complaint information.[12]

Finally, the U.S. Court of Appeals for the Fourth Circuit upheld complete preemption with regard to federally insured, state-chartered banks,[13] and state law was determined to preempt local "predatory lending" ordinances in Maryland.[14]

Supreme Court Rules in Favor of Bank in *Watters*

The Ruling

In a five-to-three decision,[15] the Supreme Court ruled in favor of the national bank in *Watters*.[16] The case was originally brought by Wachovia Bank, N.A. ("Wachovia Bank"), a national bank, and Wachovia Mortgage Company ("Wachovia Mortgage"), a wholly owned operating subsidiary of Wachovia Bank (collectively "Wachovia").[17] Prior to becoming a wholly owned operating subsidiary of Wachovia Bank, Wachovia Mortgage was registered with the Michigan Office of Financial and Insurance Services ("OFIS") and submitted to state supervision.[18] Three months after its acquisition by Wachovia Bank, Wachovia Mortgage

7. Levine v. First Nat'l Bank of Commerce, 948 So. 2d 1051, 1059 (La. 2006).

8. Press Release, Office of the Comptroller of the Currency & Conference of State Bank Supervisors, OCC, CSBS Agree on Consumer Complaint Information-Sharing Plan, NR 2006-126 (Nov. 20, 2006), http://www.occ.treas.gov/toolkit/newsrelease.aspx?Doc=D39TFJ65.xml&JNR=1; Press Release, Office of the Comptroller of the Currency & Office of the Comm'r of Fin. Insts., Commonwealth of P.R., OCC and Puerto Rico Agree To Share Consumer Complaints, Bringing Total of Such Agreements to Twenty, NR 2007-69 (July 10, 2007), http://www.occ.treas.gov/ftp/release/2007-69.htm.

9. Home Owners' Loan Act, ch. 64, 48 Stat. 128 (1933) (codified as amended at 12 U.S.C.A. §§ 1461–1470 (West 2001 & Supp. 2007)).

10. King v. HomeSide Lending, Inc., No. 2:03-2134, 2007 WL 1009383, at *7 (S.D. W. Va. Mar. 30, 2007).

11. *See generally* Weiss v. Wash. Mut. Bank, 53 Cal. Rptr. 3d 782 (Cal. Ct. App. 2007); McKell v. Wash. Mut., Inc., 49 Cal. Rptr. 3d 227 (Cal. Ct. App. 2006); Binetti v. Wash. Mut. Bank, 446 F. Supp. 2d 217 (S.D.N.Y. 2006).

12. *See* Press Release, Office of Thrift Supervision, OTS Enters into Complaint Sharing Agreement with CSBS, OTS 07-043 (June 14, 2007), http://www.ots.treas.gov/docs/7/777043.html.

13. Discover Bank v. Vaden, 489 F.3d 594, 606 (4th Cir. 2007).

14. Am. Fin. Servs. Ass'n v. Montgomery County, No. 269105 (Md. Cir. Ct. Nov. 30, 2006).

15. Justice Thomas recused himself from the case, reportedly because his son was employed by Wachovia Securities at its headquarters in Richmond, Virginia. *See* Linda Greenhouse, *Ruling Limits State Control of Big Banks*, N.Y. Times, Apr. 18, 2007, at C2, *available at* http://www.nytimes.com/2007/04/18/business/18scotus.html?_r=1&oref=slogin.

16. *Watters*, 127 S. Ct. 1559.

17. *Id.* at 1565.

18. *Id.*

advised the Commissioner of the OFIS ("Commissioner") that Wachovia Mortgage was surrendering its mortgage lending registration because as an operating subsidiary of a national bank, the company believed that Michigan's registration and inspection requirements were preempted by the OCC's operating subsidiary regulation.[19] The Commissioner replied that because Wachovia Mortgage was surrendering its mortgage lending registration, the company would no longer be authorized to conduct mortgage lending activities in Michigan.[20]

Wachovia sought declaratory and injunctive relief in light of the Commissioner's attempt to prevent Wachovia Mortgage from conducting mortgage lending activities in Michigan.[21] The Commissioner responded by arguing, among other things, that the OCC exceeded its authority in promulgating the operating subsidiary regulation, contending that the regulation impermissibly expanded the definition of "national bank."[22]

The Majority Opinion

Justice Ginsburg wrote the opinion for the majority, in which Justices Kennedy, Souter, Breyer, and Alito joined.[23] The opinion was grounded in the notion that national banks are federal instrumentalities, and the Court proceeded from a presumption in favor of preemption and from a concern for protecting national banks from a multiplicity of state laws and from state regulatory interference.[24] The majority reviewed existing precedent regarding the NBA and concluded that in light of the powers granted explicitly by the NBA itself, the State of Michigan cannot confer on its Commissioner any examination or enforcement authority over mortgage lending or any other banking business conducted by national banks.[25] The Court also recognized the ability of national banks to do business through operating subsidiaries and explained that operating subsidiaries are to be treated as equivalent to national banks with respect to powers exercised or limited

19. *See id. See also* 12 C.F.R. § 7.4006 (2007) (limiting the application of state laws to national bank operating subsidiaries to the same extent as they apply to national banks).

20. *Watters*, 127 S. Ct. at 1565.

21. *Id.*

22. *Id*. at 1566. The federal circuit courts that addressed the operating subsidiary issue previously unanimously held that a national bank's mortgage business, whether conducted by the bank itself or through an operating subsidiary, is subject to OCC superintendence and not to the various licensing, reporting, and visitorial regimes of the states in which the bank or its operating subsidiaries conduct business. *See* Nat'l City Bank of Ind. v. Turnbaugh, 463 F.3d 325, 328 (4th Cir. 2006), *cert. denied*, 127 S. Ct. 2096 (2007); Wachovia Bank, N.A. v. Watters, 431 F.3d 556, 558 (6th Cir. 2005), *cert. denied*, 126 S. Ct. 2900 (2006); Wachovia Bank, N.A. v. Burke, 414 F.3d 305, 309 (2d Cir. 2005), *cert. denied*, 127 S. Ct. 2093 (2007); Wells Fargo Bank N.A. v. Boutris, 419 F.3d 949, 954 (9th Cir. 2005). These decisions were based primarily on an analysis of OCC regulations and upon the application of so-called "*Chevron*" deference to the OCC's administrative determinations as articulated in *Chevron U.S.A. Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 843 (1984) (holding that where a statute is silent or unclear on a given subject, courts are required to defer to an authorized administrative agency's reasonable interpretation of that statute). *See id.*

23. *Watters*, 127 S. Ct. at 1563.

24. *See id.* at 1571.

25. *Id.* at 1571–72.

under federal law.[26] The Court stated that it has never held that the preemptive reach of the NBA extends only to a national bank itself.[27]

The Court rejected the Commissioner's argument that if Congress had intended to deny states visitorial powers over national bank operating subsidiaries, "it would have written the [NBA] ban on state inspection to apply not only to national banks but also to their affiliates," and that 12 U.S.C. section 481,[28] which authorizes the OCC to examine "affiliates" of national banks, does not preempt state visitorial powers.[29] The Court held that Congress and the OCC have indicated without doubt that operating subsidiaries are "subject to the same terms and conditions" as their parent national banks and distinguished Congress's use of similar language authorizing affiliates to engage in nonbanking activities.[30]

The Court also rejected the argument that the OCC lacked authority to issue its operating subsidiary regulation,[31] holding that the regulation merely clarified and confirmed what the NBA already conveys: "[a] national bank has the power to engage in real estate lending through an operating subsidiary, subject to the same terms and conditions that govern the national bank itself."[32] The Court concluded that such power cannot be significantly impaired or impeded by state law, and state regulators cannot interfere with the "'business of banking' by subjecting national banks or their OCC-licensed operating subsidiaries to multiple audits and surveillance under rival oversight regimes."[33]

Finally, the Court rejected the Commissioner's Tenth Amendment argument, finding that "[r]egulation of national bank operations is a prerogative of Congress under the Commerce and Necessary and Proper Clauses" of the United States Constitution.[34]

The Dissent

Justice Stevens wrote the dissenting opinion, which was longer than the majority opinion and in which Justices Roberts and Scalia joined.[35] The dissent proceeded both from a presumption against federal preemption of state law and a concern for the potential impact of the majority's decision on competitive equality between state and federal institutions.[36] The dissent found that "Congress has enacted no legislation immunizing national bank subsidiaries from compliance with non-discriminatory state laws regulating the business activities of

26. *Id.* at 1571.
27. *Id.* at 1570.
28. 12 U.S.C. § 481 (2000).
29. *Watters*, 127 S. Ct. at 1572.
30. *Id.*
31. 12 C.F.R. § 7.4006 (2007).
32. *Watters*, 127 S. Ct. at 1572.
33. *Id.* at 1573.
34. *Id.*
35. *Id.* (Stevens, J., dissenting).
36. *Id.* at 1573–74.

mortgage brokers and lenders."[37] The dissent also pointed out that there was no evidence "that compliance with the Michigan statutes imposed any special burdens on Wachovia Mortgage's activities" or anything that would indicate Wachovia Mortgage was required to make any changes in its methods of doing business when it became an operating subsidiary of Wachovia Bank.[38]

The dissenting justices opined that "the primary advantage of maintaining an operating subsidiary as a separate corporation is that it shields the national bank from the" liabilities of operating subsidiaries.[39] The dissent noted that the majority allows operating subsidiaries, as state corporations, to avoid complying with state regulations while at the same time taking advantage of the state laws insulating its owners from liability.[40]

Significant Points in the Opinion and Issues for the Future

Although it was a split decision, a majority of the Court upheld NBA preemption.[41] The Court did not rely on broad *Chevron* deference in upholding the OCC's operating subsidiary regulation. Rather, the court found preemption based on the scope of the national bank "powers" expressly granted or implied under the NBA.[42] This rationale leaves uncertain the precise scope of federal regulators' authority to issue preemption regulations not based on specific statutory authority and all but assures further, extensive litigation in the future to resolve the parameters of permissible preemption. Moreover, the Court's rationale could lead to additional preemption based solely on the language of the NBA, without reliance on OCC-issued regulations.

The Court seemed to endorse a lower threshold and a broader preemption test than the Court previously set forth in *Barnett Bank of Marion County, N.A. v. Nelson*[43] (preempting state regulation of a bank activity that is "significantly impaired or impeded by state law"),[44] using language in *Watters* that cited a need "to protect from state hindrance . . . a national bank's engagement in the business of banking"[45] and to provide "[s]ecurity against significant interference by state regulators [as] a characteristic condition of the 'business of banking' conducted by national banks."[46] This apparently lower and broader (even if somewhat ambiguous) preemption standard could impact future preemption decisions in lower courts by possibly eliminating, for example, the need for a national bank and its operating subsidiaries to demonstrate any economic or other impact of the challenged state law or regulation.

37. *Id.* at 1573.
38. *Id.* at 1580.
39. *Id.* at 1585.
40. See *id.*
41. *Id.* at 1571 (majority opinion).
42. *Id.* at 1564.
43. 517 U.S. 25 (1996).
44. *Watters,* 127 S. Ct. at 1572 (citing *Barnett Bank of Marion County, N.A.*, 517 U.S. at 33–34).
45. *Id.*
46. *Id.* at 1571.

The Court in *Watters* also stated that "[w]e have never held that the preemptive reach of the NBA extends only to a national bank itself."[47] This open-ended statement broadly suggests that NBA preemption might extend to all of a national bank's exclusive agents and others, and at least one panel of the U.S. Court of Appeals has already held this to be the case.[48]

In a footnote, the *Watters* Court rejected the concept of total equality between national banks and state-chartered banks.[49] The Court's discussion of the "dual banking system" may potentially encourage state banks to seek more aggressive preemption authority in an attempt to achieve competitive equality or spur the Federal Deposit Insurance Corporation ("FDIC") to proceed with or expand upon its proposed preemption regulations.[50]

Whether Congress will take any direct action in response to *Watters* remains an open issue. Congress could amend the federal consumer protection statutes to establish national standards affecting all financial services providers, including national banks. However, these statutes are inherently interstitial, built on the foundation of a comprehensive state law system that would not be easy to replace or replicate. Congressional leaders have called upon federal banking agencies such as the Federal Reserve Board ("FRB") to use existing rulemaking authority to establish banking rules regulating credit practices or else risk removal of the barrier to Federal Trade Commission action against banks under the Federal Trade Commission Act.[51]

State Attorneys General

Watters may not deter state attorneys general from bringing actions against national banks based on general state statutes such as unfair and deceptive trade practices statutes. But the New York Attorney General's appeal to the U.S. Court

47. *Id.* at 1570.

48. *See* SPGGC, LLC v. Ayotte, 488 F.3d 525, 532 (1st Cir. 2007) (stating that "the question here is not *whom* the New Hampshire statute regulates, but rather, against *what activity* it regulates" (emphasis in original) (citing *Watters*, 127 S. Ct. at 1570)).

49. *Watters*, 127 S. Ct. at 1569 n.7.

50. *See* Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 60019 (proposed Oct. 14, 2005) (to be codified at 12 C.F.R. pts. 331 & 362). The proposed FDIC preemption regulations are relatively narrow, are based in part on branching provisions in 12 U.S.C. § 1831a(j) (2000), and deal with preemption with regard to activities conducted at a branch. They currently require specific written authority (whether by the OCC or a court) on national bank preemption regarding particular state laws. *See*, *e.g.*, Michael C. Tomkies, Ralph T. Wutscher, Elizabeth L. Anstaett & Keefe E. Roberts, *Mired in the Process?: The Future of State Bank Preemption*, 62 Bus. Law. 713, 717–22 (2007) (2007 *Annual Survey*).

51. Letter from Barney Frank, Chairman, House Comm. on Fin. Servs., & John Dingell, House Comm. on Energy and Commerce, to Hon. Ben S. Bernanke, Chairman, Fed. Res. Bd., Hon. John C. Dugan, Comptroller, Office of the Comptroller of the Currency, Hon. John M. Reich, Dir., Office of Thrift Supervision, Hon. Sheila Bair, Chairman, Fed. Deposit Ins. Corp., Hon. Deborah Platt Majores, Chairman, Fed. Trade Comm'n (May 11, 2007).

of Appeals for the Second Circuit in *Clearing House Association, L.L.C. v. Cuomo*[52] failed in light of *Watters*.

Other Preemption Developments Affecting National Banks

First Circuit Affirms Preemption of State Gift Card Law

In the first appellate court decision about banking preemption rendered after *Watters*, the U.S. Court of Appeals for the First Circuit, citing *Watters,* affirmed a grant of summary judgment in favor of SPGGC, LLC ("Simon"), a mall owner selling bank-issued gift cards, U.S. Bank, N.A. ("U.S. Bank"), a national bank that issues Simon-branded gift cards sold at Simon malls, and MetaBank, a federal savings association that issues Simon-branded gift cards sold over the Internet, against Kelly A. Ayotte, Attorney General of New Hampshire.[53] The court held that: (i) federal banking laws authorize federally chartered banks and thrifts to sell gift cards as a banking product; (ii) the New Hampshire law substantially frustrates the ability of MetaBank and U.S. Bank to sell gift cards in New Hampshire; and (iii) the NBA and HOLA preempt New Hampshire law with respect to products issued by federally chartered banks and thrifts—including provisions of New Hampshire law that would prohibit Simon from selling (as an agent of such institutions) gift cards issued by those institutions with expiration dates and administrative fees.[54] Thus, according to the First Circuit, states do not have the power to regulate the sale of national bank and federal thrift products by third-party agents.

In its discussion of NBA preemption, the First Circuit noted that section 24 (Seventh) of Title 12[55] grants to national banks the power to exercise activities necessary to carry on the business of banking through their duly authorized officers or agents, a grant of authority that ordinarily preempts contrary state law.[56] Following the Supreme Court's powers-based analysis in *Watters*, the First Circuit opined that NBA preemption protection extends to third-party agents of national banks. The First Circuit focused not on "*whom*" the law regulates but on "*what activity* it regulates."[57]

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52. *See* ___F.3d___, Nos. 05-5996-cv (L), 05-6001-cv (CON), 2007 WL 4233358, at *7–8 (2d Cir. Dec. 4, 2007), *aff'g sub nom.* OCC v. Spitzer, 396 F. Supp. 2d 383, 407–08 (S.D.N.Y. 2005) (permanently enjoining the New York Attorney General from enforcing the state's fair lending laws against national banks and their operating subsidiaries based on the OCC's visitorial powers regulation). For a discussion of this case, see generally John L. Ropiequet, Nathan O. Lundby, Kenneth J. Rojc & Sara B. Robertson, *Update on ECOA and Fair Lending Developments*, 63 Bus. Law. ___ (2008) (in this *Annual Survey*).

53. *See* SPGGC, LLC v. Ayotte, 488 F.3d 525, 532, 536 (1st Cir. 2007) (citing Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1570 (2007)); *see also* State Farm Bank, F.S.B. v. Burke, 445 F. Supp. 2d 207, 221 (D. Conn. 2006) (holding that HOLA preemption extends to exclusive thrift agents).

54. *See SPGGC, LLC*, 488 F.3d at 530; *see also generally* Torian, Shrader, Ireland & Stinneford, *supra* note 4.

55. 12 U.S.C. § 24 (Seventh) (2000).

56. *See SPGGC, LLC*, 488 F.3d at 531; *see also* 12 U.S.C. § 92a(b) (2000); Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 32 (1996).

57. *SPGGC, LLC*, 488 F.3d at 532 (italics in original).

In the First Circuit's analysis, the New Hampshire law focused not on Simon's activity, which is limited to how and where the gift cards are marketed, but rather on the sale of certain gift cards through a third-party agent, which is the activity of U.S. Bank, a national bank.[58] Thus, the court held that the state law would significantly interfere with U.S. Bank's statutory power and is preempted.[59]

However, the court distinguished the gift card program between Simon and its former national bank partner, Bank of America, N.A. ("BoA"), declining to decide whether the NBA would have preempted state regulation of the BoA program.[60] The court noted that, unlike the BoA program, the U.S. Bank and MetaBank programs in *SPGGC, L.L.C.* provided that: (i) U.S. Bank and MetaBank received the proceeds of the gift card sales; (ii) U.S. Bank and MetaBank paid Simon a commission per card sold; (iii) U.S. Bank and MetaBank were responsible for setting and collecting gift card fees pursuant to the card agreements between the banks and consumers; and (iv) U.S. Bank and MetaBank retained responsibility for servicing the gift cards.[61] Thus, in *SPGGC, LLC,* Simon merely acted as, and was accordingly paid to be, the marketing agent of the banks with respect to the banks' gift card product.

Mixed Rulings on Preemption Affecting Refund Anticipation Loans

National banks and their operating subsidiaries were not always victorious in their assertions of NBA preemption in the past year. In a challenge to state-law limitations on refund anticipation loans ("RALs") under the NBA, a California appellate court held that the plaintiffs' claims brought under various state consumer protection statutes against a national bank were not preempted by the NBA.[62] The court held that: (i) California's debt collection law, the Rosenthal Fair Debt Collection Practices Act ("RFDCPA"), does not have more than an incidental effect on the bank, and claims for relief under state debt collection law are not preempted by federal law; (ii) state laws redressing violations of federal laws are also not preempted even where those laws offer additional remedies; and (iii) the plaintiffs' California Consumer Legal Remedies Act ("CLRA"), California Unfair Competition Law ("UCL"), and RFDCPA causes of action were not preempted because they do not impose any substantial limitations upon or "obstruct, impair, or condition" the bank's actions.[63] Additionally, the court noted that the consumer plaintiffs did not receive loans from the bank, and therefore the OCC's non-real estate lending preemption regulation did not apply.[64]

58. *See id.* at 533.
59. *Id.*
60. *Id.* at 534.
61. *Id.*
62. Hood v. Santa Barbara Bank & Trust, 49 Cal. Rptr. 3d 369, 377 (Cal. Ct. App. 2006), *cert. denied*, 127 S. Ct. 2916 (2007).
63. *Id.* at 384.
64. *Id.* at 385–86.

In another case involving a RAL program, the United States District Court for the District of Connecticut held that: (i) the state's requirement that non-bank "facilitators" of RALs provide a particular disclosure to the borrower was not preempted under the NBA; (ii) the state's prohibition on making RALs at any location other than a location at which the principal business is tax preparation was preempted as to national banks; and (iii) the state's limitation on interest for RALs would not apply to RALs extended by national banks, whether from their own branch or from the offices of a "facilitator" partner of the national bank.[65]

Limits on Complete Preemption

Two federal district courts rejected defendants' attempts to remove cases to federal court on the basis of complete preemption under the NBA and remanded the actions back to state court. The United States District Court for the Northern District of Ohio found that preemption under section 85 of the NBA does not apply to state law claims regarding fraud, corrupt activities, aiding and abetting fraud, and conspiracy relating to an alleged "Ponzi Scheme."[66] Similarly, the United States District Court for the Southern District of Illinois found that fraud allegations relating to the interest rate, costs, and method of computing interest were not preempted by section 85 of the NBA.[67]

Limits on Visitorial Powers Preemption

The United States District Court for the Eastern District of California rejected a national bank's attempt to enjoin a consumer group's lawsuit alleging violations of state laws prohibiting the assessment of penalties on credit card payments received immediately after a holiday due date.[68] The national bank argued that the consumer group's attempt to enforce state laws as a private attorney general against the national bank interfered with the OCC's exclusive "visitorial" powers over the national bank.[69] The court rejected the national bank's argument, holding that the exclusivity of visitorial authority preempts only the enforcement of state visitation laws by state officials and not by private citizens.[70]

65. Pac. Capital Bank, N.A. v. Connecticut, No. 3:06-CV-28 (PCD), 2006 WL 2331075, at *8–11 (D. Conn. Aug. 10, 2006).

66. Fornshell v. FirstMerit Corp., No. 1:06-cv-1505, 2006 WL 3545134, at *4 (N.D. Ohio Dec. 8, 2006).

67. Patterson v. Regions Bank, No. 06-CV-469-DRH, 2006 WL 3407852, at *5 (S.D. Ill. Nov. 27, 2006). The court explained that the crux of the plaintiffs' injury centered around a per annum interest rate on the note at a rate other than what the defendant allegedly represented it would be, and that the plaintiffs did not appear to be alleging that the challenged interest rate was illegal. *Id.* Therefore, the court found that the consumer plaintiffs did not allege usury claims, but rather that they alleged that the defendant violated the Illinois Consumer Fraud and Deceptive Business Practices Act. *Id.*

68. Bank of Am., N.A. (USA) v. Miller, No. CIV S-06-1971 LKK/KJM, 2007 WL 184804, at *1 (E.D. Cal. Jan. 19, 2007).

69. *Id.* at *2.

70. *Id.* at *3.

Preemption of Due-on-Sale Clause Limitations Upheld

The Supreme Court of Louisiana held that federal law explicitly preempts state law regarding the effect of a bond for deed on a due-on-sale clause in a mortgage.[71] The court cited the OCC regulation providing that national banks are authorized to make or acquire loans secured by liens on real estate which contain a due-on-sale clause, and that national banks are authorized to enforce such clauses notwithstanding any state law limitations to the contrary.[72]

OCC to Share Consumer Complaints with States

On November 20, 2006, the OCC and Conference of State Bank Supervisors ("CSBS") announced they had reached a Memorandum of Understanding ("MOU") regarding procedures for the exchange of consumer complaint information between state banking departments and the OCC.[73] The MOU was a model for the subsequent agreements executed by state banking departments and the OCC on a state-by-state basis and provided for the sharing of consumer complaints and information on how complaints are resolved.[74] By July 20, 2007, twenty states and Puerto Rico had entered into versions of the MOU with the OCC.[75]

Developments as to Federal Savings Banks

Federal District Court Holds That Complete Preemption Is Not Available

The United States District Court for the Southern District of West Virginia held that the HOLA and related OTS regulations do not "completely preempt" state law claims as HOLA and the OTS regulations do not provide an exclusive cause of action or remedy against federal savings banks and thrifts.[76] The court relied on the ruling of the United States Court of Appeals for the Fourth Circuit in *Pinney v. Nokia, Inc.*[77] The court in *Pinney* held that in order to show complete preemption a defendant must establish that the plaintiff has a discernible federal claim, and that Congress intended the federal claim to be the exclusive remedy for the alleged wrong.[78] The West Virginia federal court in *King* also rejected the defendant's

71. Levine v. First Nat'l Bank of Commerce, 948 So. 2d 1051, 1059 (La. 2006).
72. *See id.* at 1061–62. *See* 12 C.F.R. §§ 34.4(a)(13), 34.5 (2007).
73. Press Release, Office of the Comptroller of the Currency & Conference of State Bank Supervisors, OCC, CSBS Agree on Consumer Complaint Information-Sharing Plan, NR 2006-126 (Nov. 20, 2006), http://www.occ.treas.gov/toolkit/newsrelease.aspx?Doc=D39TFJ65.xml&JNR=1.
74. *See* Press Release, Office of the Comptroller of the Currency & Office of the Comm'r of Fin. Insts., Commonwealth of P.R., OCC and Puerto Rico Agree To Share Consumer Complaints, Bringing Total of Such Agreements to Twenty, NR 2007-69 (July 10, 2007), http://www.occ.treas.gov/ftp/release/2007-69.htm.
75. *Id.*
76. King v. HomeSide Lending, Inc., No. 2:03-2134, 2007 WL 1009383, at *7 (S.D. W. Va. Mar. 30, 2007).
77. *King*, 2007 WL 100983, at *5–6 (citing Pinney v. Nokia, Inc., 402 F.3d 430 (4th Cir. 2005)).
78. *Pinney*, 402 F.3d at 449.

argument that HOLA preemption raises a "substantial question of federal law" sufficient to warrant removal.[79]

HOLA Preemption of State-Law Fraud and UDAP Claims

Courts differed last year with respect to whether HOLA and the related OTS regulations preempt state-law fraud and Unfair and Deceptive Acts and Practices claims. A California appellate court held that a state-law challenge to a federal savings and loan association's prepayment penalty formula was preempted by HOLA and the OTS regulations.[80] In so ruling, the court held that the borrower's related fraud claim against the federal savings bank was also preempted.[81] Although 12 C.F.R. section 560.2(c) exempts state tort laws that only incidentally affect the lending operations of federally regulated institutions, the court held that the "incidentally affect" analysis is triggered only when dealing with an activity that is not listed in 12 C.F.R. section 560.2(b).[82] Because the borrower's fraud claim involved a matter included among the illustrative examples of preempted state laws in section 560.2(b) (specifically, a challenge to the prepayment penalty), the court held that the analysis ends there and the state law is preempted.[83] In addition, the court further held that the claims against the federal savings bank's employee were also preempted.[84]

However, the same California appellate court held that the borrowers' attempt to sue a federal savings bank under California's Unfair Competition Law ("UCL") for alleged violation of the federal Real Estate Settlement Procedures Act ("RESPA") [85] was not preempted.[86] The plaintiff borrowers claimed that several federal savings bank defendants "overcharged" them or "marked up" their underwriting, tax services, and wire transfer fees, respectively, in connection with their home mortgage loans and argued that those alleged overcharges violated RESPA, the UCL, state common law, and other state laws.[87] The state appellate court held that because the plaintiff borrowers were using a state law to enforce the requirements of a federal law governing the operation of federal savings associations, the state law was not preempted.[88]

Moreover, the United States District Court for the Southern District of New York held that a borrower's cause of action under New York's consumer fraud statute,[89] in which the borrower alleged that the defendant charged interest beyond

79. *King*, 2007 WL 100983, at *7–9.
80. Weiss v. Wash. Mut. Bank, 53 Cal. Rptr. 3d 782, 784 (Cal. Ct. App. 2007).
81. *Id.*
82. *Id.* at 785.
83. *Id.*
84. *Id.*
85. Pub. L. No. 93-533, 88 Stat. 1724 (1974) (codified as amended at 12 U.S.C. §§ 2601–17 (2000)).
86. McKell v. Wash. Mut., Inc., 49 Cal. Rptr. 3d 227, 250–51 (Cal. Ct. App. 2006).
87. *Id.* at 234.
88. *Id.* at 250–51.
89. N.Y. Gen. Bus. Law § 349 (McKinney 2004).

the termination date of her mortgage loan, was not preempted under the HOLA and OTS's implementing regulations.[90] The court concluded that "the question is whether any impact on lending operations is incidental to the statute's primary purpose not whether the impact of the statute on a bank's lending operation is 'incidental,'" and that the New York limitation on charging interest after the loan payoff had no more than a *de minimis* impact on the defendant's lending operations.[91]

In addition, the OTS issued an advance notice of proposed rulemaking seeking input on new OTS regulations relating to unfair or deceptive acts and practices.[92]

OTS to Share Consumer Complaints with States

On June 14, 2007, the OTS and the CSBS announced a MOU that will function as a model for state-by-state consumer complaint-sharing agreements between the OTS and state banking regulators.[93] The anticipated agreements between the OTS and particular states executed pursuant to the MOU are intended, among other things, to ensure that consumer complaints are routed to the proper regulatory authority so as to allow a timely response.[94] The MOU also calls for periodic reports on the number of complaints forwarded to the states or the OTS, the disposition of such complaints, and other summary information.[95] The MOU is reportedly similar to a model agreement that the OTS and the National Association of Insurance Commissioners signed several years ago and the MOU reached by the OCC and CSBS in late 2006.[96]

Developments Affecting Federally Insured State Banks

Complete Preemption Upheld When Bank Is the Lender

The U.S. Court of Appeals for the Fourth Circuit has held that section 27 of the Federal Deposit Insurance Act ("FDIA")[97] completely preempts state law usury claims against state-chartered, federally insured banks.[98] In so ruling, the Fourth Circuit noted with approval that the U.S. Court of Appeals for the Third Circuit had reached the same conclusion.[99] In support of its ruling, the court referenced

90. Binetti v. Wash. Mut. Bank, 446 F. Supp. 2d 217, 221 (S.D.N.Y. 2006).
91. *Id.*
92. Unfair or Deceptive Acts or Practices, 72 Fed. Reg. 43570 (proposed Aug. 6, 2007) (to be codified at 12 C.F.R. pt. 535).
93. Press Release, Office of Thrift Supervision, OTS Enters into Complaint Sharing Agreement with CSBS, OTS 07-043 (June 14, 2007), http://www.ots.treas.gov/docs/7/777043.html.
94. *Id.*
95. *Id.*
96. *Id.*
97. This section is codified at 12 U.S.C. § 1831d (2000).
98. Discover Bank v. Vaden, 489 F.3d 594, 603–06 (4th Cir. 2007).
99. *Id.* at 604–05.

other appellate decisions as well as interpretive rulings discussed in the FDIC *amicus* brief—all that uniformly construed section 27 of the FDIA *in pari materia* with sections 85 and 86 of the NBA.[100]

Importantly, the Fourth Circuit limited its holding to situations in which the federally insured state bank is the lender and real party in interest.[101] The court concluded that the bank in that case was the lender and real party in interest but only after analyzing (i) the cardmember agreements issued to the plaintiff, which demonstrated that the bank and not its servicing affiliate was the entity that extended the credit and set the interest and fees at issue; (ii) the agreement between the bank and its servicing affiliate, which demonstrated that the servicing affiliate performed marketing and collection services for the bank but did not set the terms and conditions of lending money through the bank's credit cards; (iii) the monthly billing statements mailed to the plaintiff, which did not identify or suggest that the servicing agent was the lender; and (iv) the bank's financial statement and prospectuses for the sale of interests in credit card receivables through securitizations, which confirmed the roles of the bank and its servicing affiliate.[102]

Other Developments

Maryland Predatory Lending Ordinance Struck Down

A Maryland trial court struck down a Montgomery County bill prohibiting predatory lending practices and authorizing up to $500,000 in damages to Montgomery County citizens who suffered "humiliation and embarrassment" as a result of predatory lending.[103] While the court agreed that the Montgomery County Council was entitled to enact local laws confined in substance and subject matter to the territorial limits of the county, the court held that the predatory lending ordinance could not be reasonably read to apply only to discriminatory acts occurring in Montgomery County and was therefore not a "local law."[104] The court declared that the Montgomery County bill was unconstitutional and unenforceable because the Montgomery County Council exceeded its authority in enacting a general law, as distinct from local law, in violation of the Maryland Constitution.[105]

Conclusion

Many observers expected a seismic shift in preemption analyses following issuance of the Supreme Court's *Watters* opinion. To this extent, partisans on both sides of the issue are likely disappointed. The *Watters* Court decided only a narrow

100. *Id.* at 605–06.
101. *Id.* at 607.
102. *Id.* at 601–04.
103. Am. Fin. Servs. Ass'n v. Montgomery County, No. 269105, slip op. at 6 (Md. Cir. Ct. Nov. 30, 2006).
104. *Id.* at 23.
105. *Id.* at 24–25.

issue and even on that issue reflected a sharply divided Court that disagrees on fundamental issues. Moreover, *Watters* follows a line of authority that couches discussions about the scope of federal preemption in the most ambiguous of terms. This guarantees a future of extended litigation on preemption.

Meanwhile, the spotlight has clearly shifted to Congress and the federal banking agencies. Their action (or inaction) will shape the next stages of the continuing debate. But regardless of the outcome, extensive further litigation seems inevitable as the nation revisits the basic relation between state and federal law and the role of federalism in our constitutional system.