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OVERVIEW OF *WATTERS* v. *WACHOVIA BANK, N.A.*

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I. Questions Presented

- A. Whether mortgage lending activities conducted through an operating subsidiary of a national bank are subject to exclusive supervision and regulation by the federal Office of the Comptroller of the Currency (OCC), such that state laws providing for supervision and regulation of those activities by state banking officials are preempted by federal law.
- B. Whether the OCC's exclusive supervision and regulation of mortgage lending activities conducted through national bank operating subsidiaries violates the Tenth Amendment to the U.S. Constitution.

II. Statutory and Regulatory Background

- A. Federal Statutory Provisions
 - 1. Powers of National Banks:
 - a) 12 U.S.C. § 24 Seventh: National banks have "all such incidental powers as shall be necessary to carry on the business of banking." The OCC interprets national banks' "incidental powers" to include the power to engage in banking activities, such as mortgage lending, through an operating subsidiary.
 - b) 12 U.S.C. § 371: National banks may make real estate loans subject to "such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."
 - 2. "Functionally Regulated Subsidiary" Provisions of the Gramm-Leach-Bliley Act (GLBA):
 - a) National banks are authorized to own and operate "financial subsidiaries," which are defined as national bank subsidiaries other

than subsidiaries engaged “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 activity by national banks.” 12 U.S.C. § 24a(g)(3)(A). (In other words, “financial subsidiaries” are defined as national bank subsidiaries other than operating subsidiaries.)

- b) Financial subsidiaries are authorized to engage in certain financial activities that a national bank may not conduct directly. In addition, financial subsidiaries (like operating subsidiaries) are authorized to engage in activities that the bank could conduct directly, “subject to the same terms and conditions that govern the conduct of the activities by a national bank.” 12 U.S.C. § 24a(2)(A)(ii).
 - c) Certain specified activities are expressly subject to state regulation: “Securities activities” and “insurance agency and brokerage activities and activities as principal,” when “conducted in a functionally regulated subsidiary of a depository institution,” are subject to regulation by state authorities “to the same extent as if they were conducted in a nondepository institution subsidiary of a bank holding company.” 12 U.S.C. § 1844(c)(4)(A), (B).
3. Limitation on Exercise of Visitorial Authority, 12 U.S.C. § 484: “No national bank shall be subject to any visitorial powers except as authorized by Federal law”

B. Federal Regulatory Provisions

1. Op. Sub. Regulation, 12 C.F.R. § 5.34: “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 An 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.”
2. Op. Sub. Preemption Regulation, 12 C.F.R. § 7.4006: “Unless 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.”
3. Real Estate Lending Regulations: “This part [12 C.F.R. Part 34] applies to national banks and their operating subsidiaries.” 12 C.F.R. § 34.1. “Except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank’s ability to fully exercise its Federally authorized real estate lending powers do not apply to national banks. Specifically, a national bank may make real estate loans under 12 U.S.C.

371 and § 34.3, without regard to state law limitations concerning . . . [l]icensing, registration (except for purposes of service of process), filings, or reports by creditors.” 12 C.F.R. § 34.4.

4. Visitorial Powers Regulation, 12 C.F.R. § 7.4000: “[V]isitorial powers include: (i) Examination of a bank; (ii) Inspection of a bank’s books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) Enforcing compliance with any applicable federal or state laws concerning those activities.”

C. State Statutory Provisions

1. Michigan statutes generally require national bank operating subsidiaries to register and pay fees to the State in order to conduct banking activities in Michigan. National bank operating subsidiaries are required to submit financial reports to the State and to maintain documents in a specified format. Michigan’s banking commissioner is authorized to conduct examinations of and bring enforcement actions against national bank operating subsidiaries.
2. Operating subsidiaries are exempt from these requirements if the parent national bank has a branch in Michigan.

III. Overview of the Preemption Issue

A. *Arguments of Wachovia and the United States:* Wachovia and the United States argue that Michigan’s laws providing for state supervision and regulation of national bank operating subsidiaries are preempted for several reasons:

1. *Incidental Powers of National Banks.* A national bank’s “incidental powers” under 12 U.S.C. § 24 Seventh include the power to conduct banking activities such as mortgage lending through an operating subsidiary.
 - a) The Supreme Court “interprets grants of both enumerated and incidental ‘powers’ to national banks as grants of authority not normally limited by, but rather ordinarily preempting, contrary state law.” “[W]here Congress has not expressly conditioned the grant of ‘power’ upon a grant of state permission, the Court has ordinarily found that no such condition applies.” *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 32, 34 (1996).
 - b) For example, national banks’ incidental power to advertise preempts state law prohibiting banks from using the word “savings” in their advertising. *Franklin Nat’l Bank of Franklin Square v. New York*, 347 U.S. 373 (1954).

2. *Statutory Language.* GLBA's "same terms and conditions" language provides that mortgage lending is subject to the same regulatory terms and conditions, whether conducted by a national bank directly or through an operating subsidiary. GLBA's express provisions for state regulation of specified insurance and securities activities supports this interpretation of the "same terms and conditions" language.
3. *OCC Regulations.* The OCC's regulations clearly provide for exclusive federal supervision and regulation of the banking activities of op. subs. "Federal regulations have no less preemptive effect than statutes." *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982).
 - a) A federal regulation may preempt state law without any "express congressional authorization to displace state law." *Id.* at 154. Here, Congress *has* expressly recognized the OCC's authority to preempt state law. See 12 U.S.C. § 43(a) (requiring the OCC to follow notice and comment procedures before determining "that Federal law preempts the application to any national bank or any State law regarding community reinvestment, consumer protection, fair lending or . . . interstate branches.>").
 - b) The OCC's regulations are within its rulemaking authority under 12 U.S.C. §§ 93a and 371a.
4. *Judicial Deference to the OCC.* The OCC's interpretation of the National Bank Act is entitled to *Chevron* deference.
 - a) The OCC's interpretations of the National Bank Act receive *Chevron* deference. *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995). The Court has deferred to the OCC's interpretations even in the absence of notice-and-comment rulemaking. *United States v. Mead Corp.*, 533 U.S. 218, 231 & n.13 (2001). Here, the OCC's interpretations are embodied in notice-and-comment rules.
 - b) The Court has distinguished between the substantive meaning of a statute and whether the statute is preemptive. *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 744 (1996). In *Smiley*, the Court deferred to the OCC on the first question, and found it unnecessary to decide whether to defer on the second question (because it was clear that there was a conflict between state law and federal law as reasonably interpreted by the OCC). The same analysis applies here.
 - c) The Court should defer to the OCC on the question whether federal banking law is preemptive. "[T]he 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.” *Medtronic v. Lohr*, 518 U.S. 470, 496 (1996) (citation and internal quotation omitted). “The agency is likely to have a thorough understanding of its own regulation and its objectives and is ‘uniquely qualified’ to comprehend the likely impact of state requirements.” *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 883 (2000).

B. *Arguments of Commissioner Watters*: Commissioner Watters argues that the Court should apply a presumption against preemption, and that the OCC’s regulations are inconsistent with 12 U.S.C. § 484.

1. The States urge the Court to apply a “presumption against preemption.” (Wachovia and the U.S. argue that no such presumption applies to state laws limiting national bank powers. *See Barnett Bank*.)
2. The States argue that the OCC’s regulation are inconsistent with 12 U.S.C. § 484, which refers to national banks but not to their operating subsidiaries. The States note that federal banking law defines an “affiliate” of a national bank, and that an operating subsidiary is an “affiliate” of a national bank and not a “national bank.” (Wachovia and the U.S. argue that the language of § 484 does not address operating subsidiaries, and thus does not foreclose the conclusion – based on 12 U.S.C. § 24 Seventh and “same terms and conditions” language of GLBA – that the OCC exercises exclusive visitorial authority over banking activities of national bank operating subsidiaries).

IV. Overview of the Tenth Amendment Issue

- A. Michigan argues that the OCC’s regulations effectively “federalize” state-chartered corporations, in violation of the Tenth Amendment as interpreted by the Supreme Court in *Hopkins Fed. Sav. & Loan Ass’n v. Cleary*, 296 U.S. 315 (1935).
- B. Wachovia and the U.S. argue that the OCC’s regulations apply only to federally-authorized banking activities of operating subsidiaries, and that exclusive federal regulation of specified corporate activities is neither unusual nor unconstitutional. The OCC does not regulate the existence or corporate governance of operating subsidiaries. This case thus differs from *Hopkins*, in which a federal law allowed state-chartered corporations to be converted to federally-chartered corporations without the state’s permission.

V. Litigation in the Lower Courts

- A. The preemption issue has been litigated in four cases:
1. California: *Wells Fargo Bank, N.A. v. Boutrous*, 265 F. Supp. 2d 1162 (E.D. Cal. 2003), *affirmed*, 419 F.3d 949 (9th Cir. 2005).
 2. Connecticut: *Wachovia Bank, N.A. v. Burke*, 319 F. Supp. 2d 275 (D. Conn. 2004), *affirmed*, 414 F.3d 305 (2d Cir. 2005).
 3. Michigan: *Wachovia Bank, N.A. v. Watters*, 334 F. Supp. 2d 957 (W.D. Mich. 2004), *affirmed*, 431 F.3d 556 (6th Cir. 2005).
 4. Maryland: *National City Bank of Indiana v. Turnbaugh*, 367 F. Supp. 2d 805 (D. Md. 2005), *affirmed*, 463 F.3d 325 (4th Cir. 2006).
- B. In each case, the district court and the court of appeals upheld the OCC's regulations, and held that the state laws at issue are preempted to the extent they provide for state supervision and regulation of the mortgage lending activities of national bank operating subsidiaries.

VI. Litigation In The Supreme Court

- A. Connecticut, Michigan, and Maryland filed petitions for certiorari; California chose not to file a petition for certiorari.
- B. In December 2005, the Court invited the Solicitor General to file a brief expressing the views of the United States in the Connecticut case. (*Wachovia v. Burke*). The Solicitor General filed a brief recommending that the petition be denied because there is no conflict in the circuits and the decisions of the lower courts are correct. The SG's brief also questioned whether the *Chevron* issue presented by the petition was properly raised in the lower courts.
- C. In June 2006, the Court granted the petition for certiorari in the Michigan case (*Wachovia v. Watters*). The Court did not explain why it granted review in *Watters* rather than *Burke*. It may have had doubts about whether the *Chevron* issue was properly preserved in *Burke*, or it may have been interested in the Tenth Amendment issue, which is presented in *Watters* but not in *Burke*.
- D. Briefing of the *Watters* case was completed on November 6. In addition to the briefs of the parties, briefs were filed by *amici curiae* supporting one side or the other.
1. *Amici* supporting Wachovia: the United States; the American Bankers Association and other banking associations; the Clearing House Association; the U.S. Chamber of Commerce; National City Bank; Economists and Scholars; Administrative Law Professors.

2. *Amici* supporting Commissioner Watters: 49 States, the District of Columbia, and Puerto Rico; National Conference of State Legislatures and other associations; Maryland Commissioner of Financial Regulation; National Association of Realtors; AARP and other associations; Center for State Enforcement of Antitrust and Consumer Protection Laws.
- E. The Court heard oral argument on November 29. The Court is expected to issue a decision by the end of June 2007.