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Can a Bank Have its Cake and Eat it Too?: Why *Watters v. Wachovia* Wrongly Infers Preemption of State Consumer Protection Laws

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CAN A BANK HAVE ITS CAKE AND EAT IT TOO?: WHY *WATTERS V. WACHOVIA* WRONGLY INFERS PREEMPTION OF STATE CONSUMER PROTECTION LAWS

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This Note is dedicated to my family.

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I. INTRODUCTION[1]

The murky worlds of federalism, administrative law, and banking regulation collide in *Watters v. Wachovia*.[2] When the Supreme Court granted certiorari, the acceptance was seen as a move designed to halt what scholars have termed "preemption creep." Such preemption creep stemmed from the heightened deference the Court has given in recent years to administrative agency interpretations of federal statutory law under the *Chevron* system of analysis.[3] This, in turn, seems to have emboldened federal agencies to take the unprecedented step of issuing banking regulations solely for the purpose of preempting state oversight and consumer protection law.

At the district and circuit court level, Wachovia successfully argued that such administrative action was permissible under the *Chevron* scheme, and put a stop to nearly all alleged "visitorial" power that states could use to exert influence over consumer lending practices.[4] Curiously, since the Court could easily have let such a lower court ruling stand without granting certiorari, one would imagine that there were a number of Justices inclined to vote against the Bank's position. Ultimately, however, a majority of the Court not only affirmed the lower court's ruling, but further expanded the ability of the federal agencies to deny states the capacity to regulate banking activity within their borders in any meaningful way.[5] Unfortunately, the majority's reasoning was not only unsound; it avoided the most important issue raised by the case: the role of administrative agencies to preempt state law.

This Note asserts that state consumer protection laws are not preempted by the National Banking Act (NBA) in light of both sound canons of statutory construction and principles of federalism. Part II briefly recounts the conflicting interpretive norms of preemption law and administrative law. Part III examines the NBA and its progeny, as well as key cases interpreting its role in the "dual banking system." Part IV details the factual context and procedural background of *Watters*. Part V critiques the majority opinion and explains why the dissenting view is both constitutionally sound and better protects consumers from predatory lending practices, many of which

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1 *Watters* is also the answer to a potential trivia question suitable for use at cocktail parties among Supreme Court aficionados: What 2007 case united Justice Stevens and Scalia in dissent against a majority bloc that included Justices Alito and Ginsburg?

2 127 S. Ct. 1559 (2007).

3 *See generally* Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984) (establishing the basic framework of analysis in state law preemption cases).

4 *See generally* Wachovia Bank, N.A. v. Watters, 334 F. Supp. 2d 957 (W.D. Mich. 2004).

5 *See generally Watters*, 127 S. Ct. at 1572-73.

contributed to the current subprime mortgage crisis. Part VI summarizes and responds to one scholar's assertion that the opinion was policy-driven. Finally, this Note concludes that the Court should have utilized the *Barnett* test, and required greater accountability by the federal government for its role in banking regulation.

II. PREEMPTION AND THE ROLE OF FEDERALISM

The battle over the dual banking system is really a conflict over preemption and statutory interpretation of the NBA. Therefore, an overview of preemption law is warranted.

The Supremacy Clause authorizes Congress to preempt state law if it chooses.[6] Statutory preemption is divided into three categories.[7] Under express preemption, Congress explicitly states its intention to overrule state law.[8] Under implied conflict preemption, congressional intent is inferred when compliance with both state and federal law is impossible or impractical.[9] Similarly, implied conflict exists when state law is a legitimate obstacle to the full accomplishment of Congress's goals and purposes.[10] The broadest form is field preemption.[11] To establish this, a litigant must demonstrate that a high degree of federal regulation shows a congressional intent to occupy the field and preempt the states entirely from regulating in that area.[12] It is important to note that for all of these categories, congressional intent is the lodestone from which all analysis must spring.[13]

Generally, courts have applied a presumption against preemption.[14] A court starts with the assumption that the historic police powers of the states are not superseded by a federal law unless supported by the clear and manifest purpose of Congress.[15] On a broad level, this idea is rooted in principles of federalism, and courts will generally refer to the long-standing constitutional ideal of a government of limited powers. One interesting interpretation of Supreme Court precedent notes that the presumption against preemption began to appear at the same time the New Deal Court was expanding congressional power under a broad interpretation of the

6 U.S. CONST. art. VI, cl. 2.

7 Nina A. Mendelson, *Chevron and Preemption*, 102 MICH. L. REV. 737, 752 (2004).

8 *Id.*

9 *Id.*

10 *Id.* at 752-53.

11 *Id.* at 753.

12 *Id.* at 753-55.

13 *Id.*

14 *See, e.g.*, Rice v. Santa Fe Elevator Corp. 331 U.S. 218 (1947).

15 *See, e.g.*, Medtronic, Inc. v. Lohr, 518 U.S. 470 (1996) citing *Rice*, 331 U.S. at 218.

Commerce Clause.[16] Thus, the anti-preemption presumption may have been created as a new check to balance the increased Federal Commerce Clause power.[17] Even if such a balance of power motivated the Court at the time, it does not necessarily justify its continued use today.[18]

Still, there are powerful arguments in its favor. According to one legal scholar, a presumption against preemption "effectively make[s] congressional deliberation a prerequisite to preemption."[19] There are several systemic advantages of such a presumption. First, by lowering the amount of preemption, it rewards state lawmakers for initiative and creation of a legislative "laboratory." Second, it creates accountability for Congress by forcing them to indicate that they are taking both control and consequent responsibility for their actions. Third, it places those who may be adversely affected by the preemption of state law on notice to allow them to lobby against the Act if they choose.[20] Justice Stevens was particularly concerned that states be placed on notice of a threat to their legislative scheme, calling the anti-preemption presumption a "structural safeguard[] inherent in the normal operation of the legislative process . . . to defend state interests from undue infringement."[21]

At the same time, the anti-preemption presumption is not without its detractors. Congress may not always be aware of statutory schemes in all fifty states, so the presumption places a high burden on drafters to anticipate possible conflicts. One commentator has noted that the choice to place states on notice through explicit indication by Congress is an arbitrary rather than a necessary option.[22] For example, if the presumption were made in favor of preemption, states would then be aware of the need to lobby federal legislators to explicitly affirm a congressional desire to avoid preemption in any legislation that affects their interests. Thus, the current presumption is really a normative choice to place the burden on private actors rather than states to lobby Congress to be more explicit.

Various scholars have reached different conclusions about the merits of such a choice. The argument to place the burden on private actors may have been made best by Professor Roderick Hills. He argues that the presumption

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16 *See generally* Mendelson, *supra* note 7.

17 *See id.*

18 *See id.*

19 *Id.* at 753.

20 *Id.*

21 Geier v. American Honda Motor Co., 529 U.S. 861, 907 (2000) (Stevens, J., dissenting) (citing Garcia v. San Antonio Metro. Transit Auth, 469 U.S. 528, 552 (1985)).

22 *See* Note, *New Evidence on the Presumption Against Preemption: An Empirical Study of Congressional Responses to Supreme Court Preemption Decisions*, 120 HARV. L. REV. 1604, n.10 (2007).

against preemption should be a "preference-eliciting statutory default rule."[23] From his standpoint, powerful business interests generally have great incentives to be pro-preemption, due to the desire for a single set of regulatory requirements and fewer regulatory bodies to appease. These actors will generally put Congress on notice of their desire to preempt and therefore influence drafters to express such a preference explicitly.

By contrast, state and consumer groups form a less organized, more diverse lobbying group. Thus, when opposing certain state interests, Congress is less likely to insert statutory language that expresses a lack of a desire to preempt various state schemes. Other scholars take issue with this premise and argue, although not as effectively as Professor Hills, that states are powerful actors with direct access to congressmen who could implement the states' interest in legislation.[24] Under this view, the preference-eliciting default rule would favor no presumption against preemption.

Professor Hills' position seems to better reflect the relative influence of typical pro-preemption and anti-preemption forces.[25] Just as a contract is often interpreted against the drafter, legislation can be most fairly interpreted against the most powerful lobbying groups, as long as an ambiguity exists.[26] In light of the extensive deregulation of the banking industry over the past twenty-five years, few would question the legislative influence of the banking lobby.

A. *Administrative Law Analysis*

Although preemption case law generally presumes that state and federal law can coexist, courts deal with an entirely different set of presumptions in the complex field of administrative law. In its 1984 opinion in *Chevron*

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23 *Id.* at 1610.

24 *Id.* at 1610-11. For example, Professor Goldsmith argues:

> States are among the most influential of interest groups in the federal legislative process, and thus are relatively well suited to convince Congress to revise unwanted judicial interpretations. Erroneous judicial preemptions (which adversely affect states) are thus more likely, on balance, to be corrected than erroneous judicial non-preemptions (which adversely affect groups that are in general less influential in Congress than states).
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> . . . .
>
> Professor Alan Schwartz makes a similar argument, attempting to prove by a mathematical model that, at least in the product liability context, 'it is harder for Congress to correct an erroneous judicial interpretation [finding non-preemption] than it is for Congress to correct an erroneous judicial interpretation [finding preemption].

Id.

25 *Id.* at 1610.

26 *See generally id.*

U.S.A., Inc. v. National Resources Defense Council, Inc.,[27] the Supreme Court implemented a new framework for determining the appropriate occasion for courts to defer to the statutory interpretation by an administrative agency.[28] *Chevron* concerned the Environmental Protection Agency's (EPA) interpretation of the Clean Air Act that entails an emissions limitation, via the EPA, of all "stationary sources."[29] The EPA read the statutory term "stationary source" to encompass an entire plant, instead of confining their interpretation to a sole combustion apparatus.[30] As discussed in detail in Section IV, *Watters* involved a similarly arguable interpretation of a federal statutory mandate.

Chevron requires federal courts to defer to any reasonable interpretation by an agency responsible for the administration of a statute.[31] Such deference is only due, however, if Congress has not clearly specified its intent regarding the matter at hand. In establishing the desired scope of judicial review of agency interpretation, the *Chevron* Court devised what has become known as the "*Chevron* two-step."[32] The first step of the analyses calls on the court to decipher "whether Congress has directly spoken to the precise question at issue,"[33] and if so, "the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[34] If the court determines that "Congress has not directly addressed the precise question at issue,"[35] the court must desist from statutory interpretation of its own devise and merely decide "whether the agency's answer is based on a permissible construction of the statute."[36] Said differently, the court first determines if the statute resolves the specific issue or is silent or ambiguous with regard to the issue.[37] If the court determines that the statute is silent or ambiguous, the court then

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27 Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).

28 Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 YALE L. J. 969 (1992).

29 Richard J. Pierce, Jr., Chevron *and its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions*, 41 VAND. L. REV. 301 (1988).

30 *Id.* ("That statutory interpretation was adopted as part of the EPA's 'bubble concept,' which is based on the EPA's belief that it can simultaneously further the inherently conflicting goals of the Clean Air Act—improved air quality and continued economic growth—most effectively by imposing emissions limitations on an entire plant, and by conferring upon the owner of the plant both the obligation and discretion to determine the means by which to reduce emissions.").

31 *Id.* at 302.

32 *Id.* at 301.

33 *Id.* at 301-302.

34 *Id.* at 302.

35 *Id.*

36 *Id.*

37 *See id.*

affirms the agency's interpretation of the statute, assuming that the interpretation is reasonable.[38]

B. *Rationales for the* Chevron *Presumption*:

Chevron deference or the "two-step" formulation is a focal point for vast scholarly attention.[39] Scholars, however, generally fall within two distinct factions. One faction argues that *Chevron*'s purpose is to prevent the courts from interfering with duties allocated to the legislature delegated to the executive branch; a separation of powers argument.[40] This position emphasizes that courts should "abide by and police congressional intent."[41] The other faction subscribes to the notion that *Chevron* deference is motivated by an alleged superior competence and expertise that agencies have relative to courts in interpreting the statutes that agencies are charged with implementing.[42]

The contours of *Chevron* step-one, ambiguity about congressional intent, exists mainly in the eye of the beholder. Justice Scalia wrote:

> Where one stands on this last point-- how clear is clear--may have much to do with where one stands on . . .what *Chevron* means . . . [O]ne who finds more often (as I do) that the meaning of a statute is apparent from its text and from the relationship with other laws, thereby finds [clear congressional intent] . . .Contrariwise, one who abhors the "plain meaning" rule, and is willing to permit the

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38 *Id.*

39 Note, *The Two Faces of* Chevron, 120 HARV. L. REV. 1562, 1562 (2007) [hereinafter *Two Faces*].

40 *See id.* at n.3 (citing Stephen Breyer, *Judicial Review of Questions of Law and Policy*, 38 ADMIN. L. REV. 363, 389–90 (1986); David M. Hasen, *The Ambiguous Basis of Judicial Deference to Administrative Rules*, 17 YALE J. ON REG. 327, 329–30 (2000); Michael Herz, *Imposing Unified Executive Branch Statutory Interpretation*, 15 CARDOZO L. REV. 219, 260 (1993); Ronald J. Krotoszynski, Jr., *Why Deference?: Implied Delegations, Agency Expertise, and the Misplaced Legacy of Skidmore*, 54 ADMIN. L. REV. 735, 739 (2002); Ronald M. Levin, *Identifying Questions of Law in Administrative Law*, 74 GEO. L.J. 1, 4 (1985); Richard J. Pierce, Jr., Chevron *and Its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions*, 41 VAND. L. REV. 301, 305 (1988); Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511, 514 (1989)).

41 *See Two Faces*, *supra* note 39, at 1562.

42 *Id. See, e.g.*, Pierce Jr., *supra* note 29. Note that additional views have been expressed. Some of these views encompass a mixture of each faction illustrated above discussed *supra*. This segment of the note, however, will focus only on the two prevailing views concerning *Chevron* deference.

> apparent meaning of a statute to be impeached by legislative history, will more frequently find agency liberating ambiguity. . . .[43]

Often the thorniest issue for a court to determine is whether Congress intended to set a "ceiling," "floor," or both in terms of the federal law. A federal auto safety law, for example, may require seat belt installation, but a state may require additional safety features, like airbags, unless congressional intent to make this a "ceiling" can be logically implied.[44] While silence may sometimes be golden, it can lead to a variety of conflicting interpretations of congressional intent in the preemption arena. As detailed in Section IV(d), *infra*, the National Banking Act was a statute that launched no less than four different judicial resolutions based on *Chevron*'s framework. This division stems in part from the somewhat convoluted history of federal banking regulation.

III. NATIONAL BANK ACT, ITS PROGENY AND *BARNETT*: THE DUAL BANKING SYSTEM

On a narrow level, the decision in *Watters* turned on the proper interpretation of a statute passed over 140 years ago, which, itself was rooted in issues that trace back to the founding of the United States. In pertinent part, the National Banking Act grants nationally chartered banks both enumerated powers and "all such incidental powers as shall be necessary to carry on the business of banking."[45] In addition, as a means of limiting duplicative or conflicting state regulation, the Act requires that: "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law . . . ."[46]

A. *A Chronological Elaboration of the United States National Banking System*

To effectively analyze the congressional intent behind the drafting of the NBA, an understanding of the historical context in which the NBA was passed is germane.

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43 Scalia, *supra* note 40, at 520.

44 *See* Mendelson, *supra* note 7, at 752-53.

45 12 U.S.C. § 24(Seventh) (2006).

46 *Id.* at § 484(a).

Prior to 1791, the United States lacked a discernible banking system.[47] In 1787, the drafters of the Constitution sought to remedy this predicament by incorporating provisions within the document empowering the federal government to "coin money and regulate the value thereof."[48] As a result, states were stripped of the very same powers. The federal government, however, was not explicitly granted the power to charter or establish a national bank.[49]

Treasury Secretary Alexander Hamilton, in a 1790 proposal, sought to establish a privately owned Bank of the United States, which would provide public functions vital to the developing economy.[50] After intense debate, the Bank of the United States opened in 1791 in Philadelphia.[51] In 1811, political opponents rallied to close the institution, and it remained closed for the next five years.[52] Subsequently, a second national charter lasted from 1816 through 1836.[53] President Andrew Jackson then vetoed a renewal of this charter, initiating what came to be known as the "free banking era."[54]

The free banking era was a consequence of the failure of the national banking system.[55] States were left to regulate their own banking systems, creating instability, not only in the national currency, but widespread failure in the banking system in general.[56] Subsequent to the initiation of the Civil War, numerous flaws in the banking and monetary system became evident. For example:

> The federal government needed to borrow money from northern banks in order to fund the war. Because it could not legally obtain these funds in bank credit, the federal government was forced to

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47 Andrew T. Reardon, *An Examination of Recent Preemption Issues in Banking Law*, 90 IOWA L. REV. 347, 350 (2004).

48 *Id.*

49 *See generally* JONATHAN R. MACEY ET AL., BANKING LAW AND REGULATION 2-4 (3d ed. 2001).

50 Reardon, *supra* note 47, at 351. James Madison, however, argued that Hamilton's proposal was unconstitutional because the Constitution does not contain an express grant for the establishment of a national bank by the federal government. *Id.*

51 *Id.* (citing Acts to Charter the Bank of the United States, chs. X-XI, 1 Stat. 191, 196 (1791)).

52 *See* Reardon, *supra* note 47, at 351.

53 *Id.*

54 *Id.*

55 *See id.* at 352. The free banking era derived its name from the ease of creation of new banks under state law. *Id.* at 351.

56 *Id.* at 351-52.

demand payment in specie (gold or silver), creating a tight money supply and prompting the hoarding of gold.[57]

The National Banking Act sought to remedy the failures illustrated above.

In 1864, the NBA was enacted to advance the development of a national banking structure.[58] The NBA's original provisions granted plentiful powers to national banks, such as "incidental powers . . . necessary to carry on the business of banking," and a bar against subjection of national banks to "visitorial powers," meaning any form of direct state regulation, absent those permitted under federal law.[59]

Congress provided no indication that the express grant of powers derived from the NBA could be exercised by any entity other than a national bank, such as a bank subsidiary.[60] In fact, at the time the Act was passed, national banks were not authorized to own subsidiaries that carried on banking activity, so the original intent of the visitorial powers rule could not have been designed to include such parties.

Subsequently, the status of federal banking remained unchanged for approximately 100 years after the enactment of the NBA.[61] Only national banks exercised the "incidental powers" granted by the statute.[62]

In the 1990s, deregulation transformed the banking industry. Significantly, the Gramm-Leach-Bliley Act of 1999 amended the NBA to allow banks to extend their business into a broader range of services. It also placed restrictions on bank subsidiaries, in that they could "engage only in activities national banks may engage in directly, 'subject to the same terms and conditions that govern the conduct of such activities by national banks.'"[63] Whether this language demonstrated congressional intent to become the *exclusive* regulators of bank subsidiaries is a question that ultimately divided the Court.

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57 *Id.* at 352.

58 Christopher R.J. Pace, *Supremacy Clause Limitations on Federal Regulatory Preemption*, 11 TEX. REV. L. & POL. 157, 159 (2006).

59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.*

63 12 U.S.C. § 24a(a)(2)(A)(ii) (2006).

B. *The Distinguishing Characteristic Between the State and Federal Banking Regulatory Systems*

The primary regulatory distinction between the state and national banking systems is located in their respective charters.[64] National banks are chartered under the NBA, while state banks are chartered pursuant to state law.[65] This is not an immaterial distinction. National banks chartering and regulatory body is the Office of the Comptroller of the Currency (OCC).[66] But state banks are chartered by regulatory bodies of a particular state.[67]

National and state banks objected to the growing ossification of regulatory controls. For example, all banks which are members of the Federal Reserve System fall within the regulatory power of the Federal Reserve Board.[68] The Federal Deposit Insurance Corporation (FDIC) is another body with regulatory control over state and national banks.[69] State banks are also subject to regulators that govern their respective state banking systems.[70]

In addition to regulatory bodies that govern depository institutions directly, numerous organizations exercise regulatory control over depository institutions in an indirect manner.[71] Bank merger-applications, for example, are evaluated by the Department of Justice under federal antitrust laws.[72] Banks that engage in specific security activities find themselves subject to the regulation of the Securities and Exchange Commission.[73] Additionally, state insurance boards potentially have regulatory power to shape bank activity

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64 Reardon, *supra* note 47, at 353.

65 *Id.*

66 *Id.*

67 *Id.*

68 *Id.*

69 *Id.* at 353-54. FDIC membership is advertised by banks to demonstrate to potential customers the safety of their deposit in the event of a bank failure. *Id.* at 354.

70 *Id.* The Office of Thrift Supervision ("OTS") adds to the complexity of the banking regulatory structure. Federal savings and loan associations ("S&L's") fall within the ambit of the OTS's regulatory control. *Id.* Although S&L's are not banks, the distinctions are diminutive to those foreign to banking law. *Id.* In addition to S&L's, another non-banking institution akin to a bank is a credit union. *Id.* Credit unions are governed by the regulatory body known as the National Credit Union Administration ("NCUA"). *Id.* Regulations governing federal and state credit unions, are administered via the NCUA, and pertain to banks whose shares are federally insured. *Id.* State regulatory bodies of the various states also govern state non-bank depository institutions. *Id.*

71 *Id.* at 355.

72 *Id.*

73 *Id.*

within the ambit of the insurance industry.[74] Banks, in their capacity as a corporation, may find themselves subject to state oversight by the state of incorporation.[75] Amid the morass of regulatory bodies, both state and federal, *Barnett Bank of Marion County, N.A. v. Nelson*,[76] established a preemption standard to limit a state's ability to exercise control over national banks within its jurisdiction.[77]

C. Barnett *and its Progeny*

The Supreme Court clarified the standard for preemption of state banking law in *Barnett*.[78] The *Barnett* Court, in an opinion authored by Justice Breyer, decided whether a federal statute permitting national banks to sell insurance in small towns preempts a state statute that forbids such action.[79] The Court held that the McCarran-Ferguson Act,[80] which permitted banks in small towns to sell insurance, preempted a Florida statute that barred most banks from selling insurance.[81]

The Court recapitulated the rule it had developed for when a federal banking statute preempted state law.[82] The Court observed, "[our] cases take the view that normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted [to national banks]."[83] *Barnett* can be characterized as an expression of the Court's reluctance to interpret federal banking regulation as a "floor" rather than a "ceiling." At the same time, the scope of the holding was misinterpreted by the majority in *Watters*. Unlike the way it is used in that decision, *Barnett* seems to stand only for the proposition that an explicit grant from Congress of national bank power should not be significantly obstructed. The use of the word "explicit" suggests that a congressional grant of a particular

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74 *Id.*

75 *Id.*

76 517 U.S. 25 (1996).

77 *See id.*

78 *See generally* Howard N. Cayne & Nancy L. Perkins, *Point-Counterpoint: Federal Preemption: National Bank Act Preemption: The OCC's New Rules Do Not Pose A Threat to Consumer Protection or the Dual Banking System*, 23 ANN. REV. BANKING & FIN. L. 365, 368-91 (2004).

79 *Barnett*, 517 U.S. at 27.

80 15 U.S.C. § 1012 (2006).

81 *Barnett*, 517 U.S. at 42.

82 *Id.*

83 *Id.* at 33. Three years later, Congress passed the Gramm-Leach-Bliley Act. Section 104(d)(2) of the Act codified and clarified the *Barnett* standard for preemption of state laws regulating banks' sale of insurance as to any state law passed before September 3, 1998 (the date on which the provisions of section 104(d)(2) were first introduced in Congress). *Barnett*, however, was partially overridden by Section 104(e) of the Gramm-Leach-Bliley Act.

national bank power should be fairly clear before the court moves to an analysis of whether state regulation significantly impairs the exercise of that power. Furthermore, it is unclear whether *Barnett's* rule applies when an administrative agency has taken an expansive view of the scope of national bank powers. This set the stage for the battle in *Watters*.

IV. WATTERS:

A. *Michigan's Regulation of a Wholly-Owned Subsidiary: A Mountain or a Molehill?*

To understand the *Watters* case, it is important to distinguish between two entities that sound similar but are in legal terms, quite distinct: Wachovia Bank and Wachovia Mortgage. Wachovia Bank, a national banking association, is chartered by the OCC.[84] Wachovia Mortgage was a North Carolina corporation that conducted real estate lending in Michigan and throughout the nation. Although Michigan's statutory regime exempts national banks from state mortgage lending regulation, it compels mortgage brokers, lenders, and servicers that are subsidiaries of national banks to register with the State's Office of Insurance and Financial Services (OIFS) and submit to state supervision.[85]

From 1997 until 2003, Wachovia Mortgage was registered with OIFS to conduct mortgage lending.[86] During that time, Wachovia Mortgage, as a registrant, was required to pay an annual operating fee, file an annual report, and could have been required to open its books and records to scrutiny by OIFS employees.[87] Wachovia Mortgage does not appear to have alleged that such regulations were particularly burdensome during this time.

In January 2003, Wachovia Mortgage became a wholly-owned operating subsidiary of Wachovia Bank.[88] The reasons for this shift in corporate form are murky and ambiguous. Counsel for Wachovia suggested, in oral argument before the Supreme Court, that such a shift was based on managerial efficiency.[89] Several Justices were skeptical.[90]

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84 Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1565 (2007).

85 *Id.*

86 *Id.*

87 *Id.*

88 *Id.*

89 Transcript of Oral Argument at 23, Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559 (2006) (No. 05-1342) [hereinafter Transcript].

90 *Id.*

The most obvious benefit for the adoption of an independent corporation was to shield both Wachovia Mortgage and Wachovia Bank from liability should there be a major lawsuit or financial crisis. While it would be unusual for a wholly-owned bank subsidiary to become insolvent, such a possibility is heightened by the increased risk associated with greater speculation in the lending market. Another possible explanation was to free the subsidiary from state regulation, thus giving the entity a potential advantage over state competitors. At the same time, Wachovia contended that state competitors are not subject to national bank regulation, so such a move would merely level the playing field unless there was a significant difference between national and state regulation.[91] Still, several Justices raised the idea that Wachovia was attempting to "have its cake and eat it too" by accepting the liability benefits of a state corporate form, but claiming freedom from state regulatory requirements.[92]

Whatever the reasons for assuming the new corporate form, Wachovia Mortgage notified the State of Michigan that it was surrendering its mortgage lending registration.[93] Wachovia Mortgage asserted that, because it had become an operating subsidiary of a national bank, Michigan's registration and inspection requirements were preempted.[94] Wachovia contended that a wholly-owned subsidiary was essentially a part of a national bank, and the corporate form should not interfere with the traditional freedom from state regulation enjoyed by national banks.[95] The OCC agreed, finding that wholly-owned subsidiaries of national banks were to be treated as free from state regulations unless specifically exempted by the NBA.[96]

Linda Watters, the commissioner of OIFS, administered Michigan's lending laws. As commissioner, she exercised "general supervision and control" over registered lenders.[97] Moreover, Watters possessed the authority to carry out examinations and investigations as well as enforce requirements

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91 *See Watters*, 127 S. Ct. at 1565-66.

92 Transcript, *supra* note 89, at 26-27.

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

94 *Id.*

95 *See id.* at 1565-66.

96 *See id.* at 1566.

97 MICH. COMP. LAWS ANN. § 445.1661(1) (West 2008). In particular, Wachovia Mortgage and Wachovia Bank challenged certain provisions of two Michigan statutes as preempted, the Mortgage Brokers, Lenders, and Services Licensing Act and the Secondary Mortgage Loan Act. The segments of the challenged provisions (1) require mortgage lenders to register and pay fees to the State before they may conduct banking activities in Michigan, and authorize the commissioner to deny or revoke registrations; (2) require submission of annual financial statements to the commissioner and retention of certain documents in a particular format; (3) grant the commissioner inspection and enforcement authority over registrants; and (4) authorize the commissioner to take regulatory or enforcement actions against covered lenders. *Id.*

against registrants.[98] The investigation of consumer complaints and enforcement action also falls within the ambit of her authority. This power is significantly restricted, however, because it is only triggered if Watters finds that a complaint is not "being adequately pursued by the appropriate federal regulatory authority."[99] In response to Wachovia's assertion of freedom from state regulation, Watters issued a letter advising Wachovia Mortgage that it would no longer be authorized to conduct mortgage-lending activities in Michigan.[100]

After receipt of Watters' letter, Wachovia Mortgage and Wachovia Bank filed suit in the United States District Court for the Western District of Michigan against Watters seeking declaratory and injunctive relief.[101] Such relief would prohibit Watters from enforcing Michigan's registration prescriptions against Wachovia Mortgage, and from interfering with OCC's exclusive visitorial authority. Wachovia argued that the NBA and its related regulations, vest supervisory authority in the OCC to preempt the application of the Michigan's law to its wholly-owned state subsidiaries.[102]

B. *A* Chevron *Approach to* Watters

Both the district court and the circuit court utilized the *Chevron* test to interpret the validity of OCC regulation 12 C.F.R. § 7.4006.[103] As discussed above, this regulation by the OCC barred state control over wholly-owned subsidiaries of national banks even if they used a state corporate form.

Since the *Chevron* test generally favors federal agencies, Watters made a creative, yet unsuccessful argument, which would avoid *Chevron* entirely. In what some legal scholars term "*Chevron* step-zero," the court must examine whether a particular agency has the authority to issue a regulation at all for certain subject matter based on the underlying organic act.[104] Watters argued that no agency has the power to preempt state law through a regulation unless Congress explicitly authorizes such authority.[105] Both the district and

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98 *Id.* at §445.1665.

99 *Id.* at § 445.1663(2).

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

101 *Id.*

102 *Id.*

103 *See* Wachovia Bank, N.A. v. Watters, 334 F. Supp. 2d 957 (W.D. Mich. 2004); *see* Wachovia Bank, N.A. v. Watters, 431 F.3d 556 (6th Cir. 2005).

104 United States v. Mead Corp., 533 U.S. 218 (2001); *see also* Jacob E. Gersen & Adrian Vermeule, Chevron *as a Voting Rule*, 116 YALE L.J. 676, 714-15 (2007); Cass R. Sunstein, Chevron *Step Zero*, 92 VA. L. REV. 187 (2006).

105 *Watters*, 127 S. Ct. at 1571.

circuit court rejected this argument.[106] They correctly held that a congressional grant of authority to interpret a federal statute includes, at least some authority to overrule conflicting state law.[107]

Both courts applied *Chevron* step-one, whether Congress has spoken directly to the issue, to interpret 484(a) of the NBA.[108] The district court did not address step-one directly because Watters and Wachovia stipulated that the statutory language was silent concerning wholly owned bank subsidiaries.[109] Thus, strangely, Wachovia conceded at the district court level the argument that would ultimately prevail at the U.S. Supreme Court, whose majority held otherwise.[110] The circuit court, however, addressed *Chevron* step-one in more detail.

The circuit court began its analysis of *Chevron* step-one with the highly dubious proposition that OCC regulations "do not expand the definition of 'national bank' as Congress used it in [NBA] section 484 to include an 'operating subsidiary,' such as Wachovia Mortgage."[111] Rather, the court concluded that the regulations interpret an entirely different statutory provision, that of a national bank's "incidental powers" under Gramm-Leach-Bliley. This statute authorized national banks to conduct business through an operating subsidiary.[112]

With this move, the circuit court completely sidesteps the issue at hand.[113] The federal statute referred to, Gramm-Leach-Bliley, and subsequent regulations merely confirmed the power of national banks to own an "operating subsidiary."[114] The OCC also staked its claim to interpret various incidental powers beyond those specifically enumerated in the statute.[115] That a national bank has the power to own a subsidiary, however, does not mean that such a subsidiary now falls within the meaning of the phrase "national bank" for purposes of the NBA.

It is true that a regulation interpreting Gramm-Leach-Bliley provides that "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."[116] But this regulation

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106 *See Wachovia Bank*, 334 F. Supp. 2d 957; *see Wachovia Bank*, 431 F.3d 556.

107 *Watters*, 127 S. Ct. at 1573.

108 *Wachovia Bank*, 334 F. Supp. 2d. at 963; *Wachovia Bank*, 431 F.3d at 560-561.

109 *Wachovia Bank*, 334 F. Supp. 2d. at 963.

110 *See id.* at 961-62.

111 *Wachovia Bank*, 431 F.3d at 561.

112 12 U.S.C. § 24(Seventh) (2000).

113 *Wachovia Bank*, 431 F.3d at 561.

114 *See id.*

115 *Id.*

116 12 C.F.R. § 5.34(e)(3) (2006).

does not address the issue of whether Congress has spoken about national bank subsidiaries in section 484(a).

Having found that Congress was silent about whether the OCC had the ability to preempt state laws despite section 484(a)'s exclusive reference to national banks, the circuit court moved to step-two.[117] The application of *Chevron* step-two seeks to determine whether the regulations are a reasonable construction of the statutory scheme.[118] In rejecting Watters' argument, the circuit court concluded that the Comptroller's regulations were a reasonable construction of the NBA.[119] The circuit court reasoned that the regulations simply recognize the reality that national banks have been conducting business vis-à-vis operating subsidiaries for decades. The circuit court went further in its pursuit to meet *Chevron* step-two's reasonableness criteria by rationalizing that the regulation "simply reflect[s] the eminently reasonable conclusion that when a bank chooses to utilize the authority it is granted under federal law, it ought not be hindered by conflicting state regulations."[120]

The court deferred to the OCC's determination that an operating subsidiary is subject to state regulation only to the extent that the parent bank would be if it performed the same functions.[121] Furthermore, the court rejected Watters' Tenth Amendment argument. The Sixth Circuit affirmed on similar grounds.[122] Subsequently, the Supreme Court granted certiorari.[123]

C. *The Practical Implications of* Watters: *To Catch a Financial Predator*[124]

While there are interesting constitutional complexities to *Watters*, it is significant to note why Michigan was willing to fight so vigorously for the right to exercise its regulatory power, and why Wachovia fought so hard against it.

The need for state oversight of mortgage lending practices is exemplified by the experience of Prospero Torralba. A thirty-six year old construction worker, he purchased a modest home in May 2006.[125] Shortly thereafter, he received notice from a lender that he owed $679 per month, in addition to his regular mortgage payment, in exchange for a $74,000 "down payment

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117 *Wachovia Bank*, 431 F.3d at 562.

118 *Id.*

119 *Id.*

120 *Id.*

121 *Id.*

122 *Id.*

123 Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1566 (2007).

124 Vikas Bajaj & Miguel Helft, *The Loan That Keeps on Taking*, N.Y. TIMES, Sept, 25, 2007, at C1.

125 *Id.*

assistance" loan.[126] The problem was that Mr. Torralba was not aware that he had incurred such a loan, since it had not been disclosed to him in his native language of Spanish, and was omitted from several key documents.[127] Federal law requires that real estate mortgage documents be drafted and signed in English.[128] California state law, however, requires that the documents be translated into Spanish if the primary negotiations were conducted in Spanish, as was the case with Mr. Torralba.[129] Mr. Torralba is now suing the creditor, who was not involved in the initial negotiations.[130] Consequently, the creditor is suing the originator of the loan. The originator claims that she is immune from suit due to the statute of limitations. The end result? Although the suit is still ongoing, Mr. Torralba notes, "with so much sacrifice, we tried to get ahead, all for the possibility of this man to come and take the house . . . it was no[t] fair."[131]

Mr. Torralba's story demonstrates why state law is often better equipped to address predatory lending practices. Federal legislation mandating translation of documents might seem inefficient or unnecessary in some states, but if California recognized a problem of predatory lending practices targeting non-English speakers, their state law seems to be an appropriate response. The Michigan statute at issue in *Watters* was a similar attempt by a state government to fill in a gap left by the federal regulatory scheme because Michigan officials apparently viewed the system as open to abuse by unscrupulous mortgage lenders. Michigan's objective, as well as similar ones in twenty-nine other states, was to discourage predatory lending practices, particularly where it seemed that federal regulations offer weak or inefficient assurances of consumer protection.

Consumer protection is quintessentially a "field which the states have traditionally occupied."[132] This law was seen as an important role in the fight against predatory lending, bearing in mind that it may be difficult for the federal government to give appropriate attention to individual consumer complaints.[133]

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126 *Id.*

127 *Id.*

128 *Id.*

129 Bajaj, *supra* note 124 at C1. It is unclear whether compliance with federal law alone is sufficient or what documents must be translated. *Id.*

130 *Id.*

131 *Id.*

132 Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

133 *See* CTR. FOR RESPONSIBLE LENDING, Federal Preemption Favors Predatory Lending: States Have an Edge in Protecting Homeowners, *available at* http://www.responsiblelending.org/pdfs/ib010-Fed_Preemption_Favors_PL-0604.pdf [hereinafter Federal Preemption].

Predatory lending is distinct from subprime lending. Subprime lending typically involves a loan where the credit risk of the consumer is greater than that needed to qualify for the prime rate, and thus interest rates are higher to accommodate the lender's additional risk.[134] Predatory loans, while always subprime, are ones in which lenders charge more than needed to cover their additional risks often through deceptive practices or plain fraud.[135] Victims of these loans are typically elderly or minority consumers, since the lenders target those with a low or fixed income but with high equity in their homes.[136] When a consumer has trouble making payments, they are often encouraged to refinance with high or exorbitant points and fees.[137] Even refinancing with an honest lender may bring profit to the predatory lender who can charge the consumer for early termination of the loan.[138]

Predatory lenders can also take advantage of a holder-due course doctrine. This doctrine prevents the maker of a note from raising personal defenses, such as fraud or breach of warranty, against a value-giving assignee of the note who takes in good faith without notice of such defenses.[139] This rule can force the borrower to continue paying a predatory loan to an assignee to avoid foreclosure, while having sole recourse against an unscrupulous originator who may no longer be in business or who may be judgment proof. A number of state regulations have placed limits on the liability of an assignee to claim holder in due course protection in the consumer mortgage context.[140] Although the federal government also passed legislation in 1994 designed to curb this practice and similar ones, the number of predatory loans has actually risen since that time.[141]

If the federal government's efforts are lacking, do the benefits of allowing states to fill in the enforcement gap outweigh the costs of additional regulations on banks? The banking industry lobbied extensively that such state enforcement is unduly burdensome, emphasizing that many predatory

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134 Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1311 (2006). Subprime loans are graded "A" through "D" to acknowledge the degree of risk. *Id.*

135 *See* CTR. FOR RESPONSIBLE LENDING, Borrowers in Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans, *available at* http://www.responsiblelending.org/ (search for "Borrowers in Higher Minority"; then follow "Borrowers in Higher Minority . . ." hyperlink; then follow "View this Document (PDF)" hyperlink).

136 *Id.*

137 *Id.*

138 *Id.*

139 Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending By Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 AM. U. L. REV. 515, n.140 (2007).

140 *See id.*

141 *See generally* Forrester, *supra* note 134, at 1303.

loans come not from banks, but from used car dealers and payroll lenders. Accordingly, there is a bill pending in Congress that would preempt all state regulation of predatory lending practices.[142]

Michigan's attempt to regulate was more modest. The State acknowledged that it could not regulate predatory lending practices by national banks due to the dual banking system and the NBA.[143] But Michigan drew the line when it came to subsidiaries of banks taking advantage of state corporate form without subjecting themselves to state compliance.

Certainly, some might be initially skeptical about whether national banks were involved in predatory lending practices, either directly or through their affiliates. OCC officials suggest that states have just made a mountain out of a molehill and that such practice by national banks is rare.[144]

While far from common, a number of commentators have suggested that the OCC is incorrect in its assumption.[145] Citibank settled a multi-million dollar lawsuit for steering its customers to subprime loans when they qualified for more favorable ones.[146] With the commoditization of the loan market, many national banks often serve as "enablers" of predatory practices by financing or purchasing loans with originators who violate federal law. If federal regulators were investigating such practices vigorously, it seems unlikely that the Michigan legislature would have bothered to insert an enforcement provision triggered whenever a complaint is not "being adequately pursued by the appropriate federal regulatory authority."[147]

If *Watters* was a simple preemption case, the *Rice* presumption against federal displacement of at least arguably complementary state consumer protection law would have made a strong case for Michigan. But the *Rice* presumption was countered by a competing presumption: deference to a federal agency's interpretation of a federal law under *Chevron*. As discussed above, *Chevron* deference is anchored in the idea that federal agencies have a particular expertise in the area of law covered by the statute.[148]

"Shouldn't it be the Congress of the United States that would preempt something by statute . . . rather than a regulatory body . . . such as the OCC?" asked the Chairman of the Senate Banking Committee during hearings on

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142 *Id.*

143 *See* Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1565 (2007).

144 *See* Patterson, *supra* note 134, at 1350.

145 *See id.* at 1350-52.

146 *See id.* at 1350.

147 MICH. COMP. LAWS ANN. § 445.1663(2) (West 2008).

148 *See supra* Part IV. B. (discussing *Chevron* deference).

the subject.[149] This was also the question faced by the district court in *Watters*.

D. *Four Possible Interpretations of Section 484(a)*

A single sentence in the NBA became a hall of mirrors in which a judge's interpretation revealed a lot about their view of the role of the federal government in banking regulation. The relevant statutory text is "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law . . . ."[150]

Interpretation #1: *Congress unambiguously indicated its intent to preempt regulation of both national banks and their wholly owned state subsidiaries.*

This essentially is the flawed position taken by a majority of the Supreme Court opinion.[151] This loose interpretation did not refer much to the explicit statutory language. Instead, it "was salted" with other somewhat related congressional statutes that vaguely hinted that national bank subsidiaries were to be treated as national banks, as well as the general policy of the NBA to avoid duplicative regulation.

Interpretation #2: *Congress was silent on whether section 484(a) applied to wholly owned state subsidiaries but the OCC reasonably interpreted the statute and its interpretation is entitled to deference.*

The Sixth Circuit and the federal district court adopted this view.[152] The courts correctly recognized that "national bank" cannot unambiguously express the inclusion of subsidiaries. The courts then applied *Chevron*'s deference to federal administrative interpretation in light of agency expertise, and refused to alter the presumption based on preemption concerns.[153]

Interpretation #3: *Congress was silent as to whether section 484(a) applied to subsidiaries but the OCC's interpretation was unreasonable, and is therefore not entitled to deference.*

The *Watters* dissent took this position.[154] When choosing between the *Chevron* presumption, and the *Rice* anti-preemption presumption, this view appropriately emphasizes federalism and efficiency concerns over the blind

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149 Recent Case, *Federal Preemption* - Chevron *Deference - Second Circuit Finds National Bank Operating Subsidiary Exempted from State Law.* - Wachovia Bank v. Burke, 414 F.3d 305 (2d Cir. 2005), 119 HARV. L. REV. 1598, 1598 (2006).

150 12 U.S.C. § 484(a) (2006).

151 Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1564-73 (2007).

152 *See generally* Wachovia Bank, N.A., v. Watters, 334 F. Supp. 2d 957 (W.D. Mich. 2004); *see generally* Wachovia Bank, N.A., v. Watters, 431 F.3d 556 (6th Cir. 2005).

153 *See generally Wachovia Bank*, 334 F. Supp. 2d 957; *see generally Wachovia Bank*, 431 F.3d 556.

154 *See Watters*, 127 S. Ct. at 1573-81 (Stevens, J., dissenting).

deference of *Chevron* to a federal agency with little incentive to take federalism into account.[155]

Interpretation #4: *Congress unambiguously expressed its intent to apply 484(a) to national banks only, and not their wholly owned subsidiaries.*

The *Watters* dissent also expresses some support for this position. Under this perspective, the plain statutory text of section 484(a) only refers explicitly to "national banks" and therefore must be amended before wholly owned subsidiaries could reasonably be brought within its ambit.[156]

E. *The Majority's Overly Broad View of Congressional Intent About Visitorial Power*

The majority, in an opinion authored by Justice Ginsburg, strangely chose to avoid the somewhat firmer ground of the lower court's use of interpretation #2 (*Chevron* deference) in favor of a rather strained version of interpretation #1 (direct interpretation of the underlying statute).[157] With only a cursory mention of *Chevron*, the majority concludes that the underlying statutory language itself preempts state regulation over any operating subsidiaries, and that the subsequent OCC regulation merely "clarifies and confirms" the majority's extremely broad interpretation of the language.[158] The Court's reasoning, however, is highly questionable and, if taken literally, has broad implications for the future of any meaningful state consumer protection law in the mortgage industry.

The Michigan statute, in an attempt to minimize the burden on national banks, only authorized state oversight if the relevant federal agency "inadequately" addressed the consumer complaint. Justice Ginsburg took particular issue with this section in oral argument. Calling it a "reverse supremacy," she questioned whether states should have the "last word."[159] In response, Justices Roberts and Scalia suggested it was not unique for a state regulatory scheme to complement a federal one, such as a situation where a federal prosection for manslaughter does not prevent a state from pursuit of a murder charge; or where a victim of a civil rights violation may sue in state court regardless of whether the federal government has pursued a civil penalty.[160]

155 *Id.*

156 *See id.*

157 *See id.* at 1564-73 (majority opinion).

158 *Id.* at 1572.

159 Transcript, *supra* note 89, at 16.

160 *Id.* at 17-18.

In this debate, Justices Roberts and Scalia seem to have the upper hand, when the facts of the case are seen as a coherent whole. In addition, federal laws such as the Fair Housing Act and the Equal Credit Opportunity Act regulate the real estate finance market without displacement of comparable state regulations.[161] This is not a case, as Justice Ginsburg implies, where states are preventing Congress from accomplishing a goal that empowers the individual in the wake of influential business interests. Instead, the roles are reversed: Congress, through the NBA, wants to empower national banks through deregulation and economic efficiency. At the same time, such deregulation creates a risk of abuse. In this scenario, the Court should not be so quick to presume that Congress intended to prevent States from adding additional layers of protection for less empowered interests.

Michigan, as well as Justice Stevens' dissent, point out that the language of section 484 of the NBA provides that "[n]o *national* bank shall be subject to any visitorial powers except as authorized by Federal law."[162] The majority opinion, however, reads this to encompass congressional intent that "national bank" be read as "national bank, as well as any state entity through which the national bank exercises its powers."

Justice Ginsburg writes that the Court has "interpreted 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."[163] It is true that Congress granted national banks the power to enter the mortgage business. A national bank that issues a mortgage therefore is not subject to any state regulation that significantly impairs this power. But if Congress intended such a power to extend to wholly-owned state subsidiaries, it could easily have amended section 484 to reflect this.

Does that reasonably lead to the interpretation that Congress intended to avoid a state regulation of subsidiaries? Justice Ginsburg answers in the affirmative when she writes that ". . . 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."[164] *Barnett*, the authority cited for this proposition, does, in fact, mention powers of a national bank.[165] But the reference is somewhat deceptive because the statute in *Barnett* explicitly referred to *powers* of a national bank.[166] In *Watters*,

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161 Federal Preemption, *supra* note 133.

162 *Watters*, 127 S. Ct. at 1578 (Stevens, J., dissenting) (emphasis added).

163 *Id.* at 1567 (majority opinion) (citing Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 32 (1996)).

164 *Id.* at 1570 (citing *Barnett Bank*, 517 U.S. at 32).

165 *Barnett Bank*, 517 U.S. at 32 (citing 12 U.S.C. § 92).

166 *Id.*

the statute in question (section 484) makes no mention of the powers of a national bank. It merely states that national banks are free from certain restrictions; this is not a power, but rather freedom from the power of another.[167]

Justice Ginsburg takes her biggest leap in logic when she asserts that Congress unambiguously expressed its intent regarding section 484(a) through other related statutes and the 1999 amendment.[168] She initially seems to make the dissent's case when she discusses that the 1864 statute and 1933 revision could not have included wholly-owned subsidiaries within section 484(a) because such subsidiaries were unlawful under federal law at the time.[169]

Without any citation for support, she then writes that "[o]ver 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."[170] The internal quotation is a reference to the Gramm-Leach-Bliley Act, a federal statute which allows banks to own subsidiaries as long as those subsidiaries are subject to the same limitations as national banks.[171] Under the majority's reasoning, this was a grant of a national bank "power" that could not be significantly impaired by any state visitorial "power."

The majority seems to misinterpret the textual language of section 484(a). The only powers referred to by the statute itself are state visitorial powers; the statute's provisions only explicitly apply to national banks. As the dissent points out, the majority's interpretation reduces section 484(a) to mere surplusage, implying that, once national banks became authorized to own subsidiaries in 1966, all such subsidiaries were free of state regulation.[172]

Essentially, the Court appears to be bending over backwards to favor national banks in this specific instance but avoids the pressing constitutional and administrative law questions. As Justice Ginsburg confirms in a footnote, "[b]ecause we hold that the NBA itself—independent of OCC's regulation—preempts the application of the pertinent Michigan laws to national bank operating subsidiaries, we need not consider the dissent's

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167 *See* 12 U.S.C. § 484 (2006).

168 *Watters*, 127 S. Ct. at 1572.

169 *Id.* at 1571.

170 *Id.*

171 Gramm-Leach-Bliley Act, 113 Stat. 1378 (codified as amended at 12 U.S.C. § 24a (2006)).

172 *Watters*, 127 S. Ct. at 1579 (Stevens, J., dissenting).

lengthy discourse on the dangers of vesting preemptive authority in administrative agencies."[173]

A phrase that rose repeatedly in oral arguments was "to have [one's cake] and eat it too."[174] The bench used the phrase to refer to Wachovia's attempt to take advantage of the benefits of a state corporate form, but avoid the state regulations and costs that come with it.[175] But, the phrase applies equally well to the majority opinion. Through a strained interpretation of legislative intent, the majority reached the result it sought (a single set of regulations for wholly owned bank subsidiaries) but refused to acknowledge, as both the district court and circuit court had, that this case set a precedent for the ability of an administrative agency to preempt state law.

V. AN UNLIKELY ALLIANCE: WHY STEVENS, SCALIA, AND ROBERTS GOT IT RIGHT

It is said that the first step in recovery is acknowledgment of the problem. The most important aspect of Stevens' dissent is its avoidance of denial about a disturbing trend of undue deference to federal power, particularly unelected federal officials.[176] While the problem was on a vastly greater scale, the Supreme Court's excessive deference to a military officer's discretion enabled a compliant Congress and President to avoid accountability for one of the United States' most shameful episodes in *Korematsu v. United States*.[177] In *Watters*, Justice Stevens' dissent at least takes the small step of placing restrictions on the unelected (and generally unaccountable) branch of government when it attempts to encroach on the power of a democratically elected, accountable state legislature.

First, Justice Stevens succinctly explains why the Court's combination of statutes fails to express an unambiguous intent to preempt state law.[178] Noting the "vast and obvious difference between rules authorizing or regulating conduct and rules granting immunity from regulation," he shows that Congress' grant of authority to the OCC to authorize subsidiaries to perform various business functions is a "lesser power."[179] The greater power, unauthorized by Congress, is the ability to immunize these actors from state

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173 *Id.* at 1572 n.13.

174 Transcript, *supra* note 89, *passim*.

175 *Id.* at 26-27.

176 *See Watters*, 127 S. Ct. at 1582-83 (Stevens, J., dissenting).

177 *See generally* 323 U.S. 214 (1944). For an enlightening discussion on how the decision to create Japanese internment camps stemmed from unquestioning deference of both the President and Congress to an unelected official, see Patrick O. Gudridge, *Remember Endo?*, 116 HARV. L. REV. 1933 (2003).

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

179 *Id.* at 1583.

law that prohibits certain conduct by those with equal status under state corporate law.

Chevron deference is unwise in this area. Preemption doctrine requires application of complex legal rules, in which a court's expertise is significant. In addition, preemption of state law raises sensitive questions of federalism, and agencies are ill-equipped to resolve the appropriate balance of power between federal and state actors. The federal agency, in effect, is forced to become an arbiter of its own power, a calculus sure to favor expansive administrative power. Justice Stevens correctly points out that no matter what the Court states, this is a case about whether administrative agencies can pass a rule purely to preempt state law.[180]

VI. THE MERITS OF STATE REGULATION: A RESPONSE TO THE COLE ANALYSIS

As evidenced by the discussion above, defining congressional intent from statutory language is a highly subjective exercise.[181] Should we force a national bank to choose between asset protection (i.e., "the cake") and deregulation ("eating it too")? It seems like it should be Congress itself who should make such a choice. But when Congress, whether through intent or happenstance, does not make such a choice it forces the Court into the awkward position of deciding the implications of ducking the question. Professor G. Marcus Cole[182] offers a compelling interpretation of the Court's divisions when he suggests that the difference between the majority and the dissent was ultimately a policy choice disguised as a doctrinal choice.[183]

The Court purports to use primarily doctrinal reasoning. Justice Stevens, for example, vigorously asserts that "competitive equities" and federalism require deference to state regulatory schemes.[184] Through the majority's doctrinal lens, Justice Ginsburg interprets the statutory language broadly (and far more expansively than the district and circuit court opinions) to infer deference to federal control over bank subsidiaries.

Such reasoning, however, may well have been motivated by the Justices' underlying instinctive views on the significance and effectiveness of state

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180 *Id.* at 1582.

181 *See* Part VI. *supra* (discussing congressional intent).

182 Cole is a professor of law and former Associate Dean of Stanford Law School. Curriculum vitae of G. Marcus Cole, http://www.law.stanford.edu/ (then follow "Directory" hyperlink at the top of the screen; then follow "G. Marcus Cole" hyperlink in the faculty directory) (last visited Mar. 7, 2008).

183 G. Marcus Cole, *Markets and the Law: Protecting Consumers From Consumer Protection:* Watters v. Wachovia Bank, 2006-07 CATO SUP. CT. REV. 251, 253 (2006).

184 *Id.* at 262.

consumer protection law in the mortgage context. The majority opinion makes no reference to state consumer protection law, and the dissent only does so briefly. But as a matter of policy, a decision in favor of Wachovia allows national banks to lend to higher risk consumers with less oversight, where the contrary outcome would have restricted lending to high risk customers for fear of being labeled "predatory."

While the term "consumer protection" suggests a laudable goal, the merits of state regulatory schemes that purport to do so are a matter of debate. Professor Cole argues, somewhat persuasively, that state-consumer-protection-law often hurts consumers more than it helps them.[185]

To illustrate, Professor Cole uses as an example a 2004 Illinois law that required mandatory credit counseling, paid for by the lender, in several "high risk" zip codes.[186] The law was intended to protect consumers from predatory lending and reduce foreclosures, but Professor Cole suggests it had the unintended consequence of "protecting" high risk consumers from receiving a loan in the first place. By adding a $500 to $700 cost to the loan, most lenders either raised interest rates or refused to lend in those areas. Home sales dropped by 45% in those zip codes the moth after the bill took effect. At the same time, the law did lead to a drop in foreclosures.[187]

Professor Cole essentially argues that the *Watters* majority reached the right result because he sees NBA preemption as a means of liberating high-risk consumers from oppressive state limits of high-risk credit. In *Marquette National Bank v. First Omaha Serv. Corp.*,[188] the Court held that the NBA preempted most state credit card interest rate ceilings.[189] Professor Cole believes that such ceilings can make it more difficult for high-risk consumers to receive credit and may drive them to illegal loan sharks or similar sources.[190]

But Professor Cole emphasizes all the benefits of free market access to credit without giving much credence to the costs. In light of the current mortgage "bubble" bust, it is certainly arguable that somewhat greater governmental oversight of extension of credit may have averted a rash of foreclosures, but still struck a balance between economic efficiency and consumer protection. Furthermore, national banks still have a choice to enter the mortgage market free of any state regulation, rather than operate through a wholly-owned subsidiary. If state banks feel the regulations are

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185 *See id.* at 264-75.

186 *Id.* at 265.

187 *Id.* at 266.

188 439 U.S. 299 (1978).

189 Cole, *supra* note 183, at 271.

190 *See id.*

unduly burdensome they may lobby the state legislature with empirical evidence (for example, by comparing their foreclosure rate with those of national, less regulated, lenders), or even merge with a national bank to gain a competitive advantage.

The other major flaw in Professor Cole's position is that, while he discusses the burdens of state oversight in great detail, he never adequately justifies the need for asset protection through the state corporate form. After all, Wachovia could have easily avoided the Michigan controversy altogether by making Wachovia Mortgage a division of its national entity. There is always the risk of a debilitating lawsuit, but even Wachovia seemed to downplay this risk. In oral argument, an exchange between Justice Stevens and the attorney for Wachovia is revealing:

> JUSTICE STEVENS: [Branches of national banks] are not separate corporate subsidiaries.
> MR. LONG: That — that —
> JUSTICE STEVENS: Why is that, that the best bank decided to use the subsidiary approach for this business, rather than the more traditional banking approach.
> MR. LONG: Well, of course, anything that a bank does through an operating subsidiary it could do through the bank. It can always do it through the bank. But there are many reasons why a bank may choose an operating subsidiary. They can be managerial reasons; it's —just sometimes works better as matter of business management.
> JUSTICE STEVENS: It protects from liability, too.
> MR. LONG: Well, that is one of the reasons. Although—
> JUSTICE STEVENS: —in the district.
> MR. LONG: I will say, Justice Stevens, I have not been able to find examples of national bank operating subsidiaries that have become insolvent. They are regulated very heavily by the Comptroller and so they don't.[191]

There is nothing wrong with Congress making a policy choice to free national banks from regulation. If state regulation, however, is considered burdensome by a national bank, there seems to be little disincentive to folding them into the national bank itself. If the bank fears unprecedented tort litigation that might endanger its assets, perhaps it should reexamine its lending policies to at least somewhat lessen this risk.

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191 Transcript, *supra* note 89, at 23-24.

Professor Cole is correct, however, that *Watters* created "strange bedfellows" because it divides the conservatives from the libertarians, revealing the nuances of the Justices' judicial philosophy. Justices Alito and Kennedy, one imagines, would fall into the "libertarian" camp: Such a position views *Watters* as an opportunity to facilitate a lesser degree of regulation of a private entity, especially if one disagrees with the merits of state regulation, even as it seems to disfavor federalism.[192] Justices Ginsburg, Breyer, and Souter, the remaining justices in the majority, likely saw the case from a structural perspective: a chance to defer to the policy choice of Congress in an area of traditional economic regulation with little or no implications for civil liberties.

Justices Scalia and Roberts would take the "conservative" position: Even if state regulation may create burdens on a private actor, they reason, the Court cannot abandon its commitment to the role of state actors even when it disagrees with the state's position. Justice Steven takes a different kind of democratic accountability/structuralist perspective: he saw *Watters* as primarily a chance to limit the power of an aggressive position by an unelected administrative entity.

While each of the Justices' views have some validity (which is what makes the case so fascinating), Justice Stevens' position addresses the most pressing need. With the growth of expansive administrative action, the Court should take care to ensure that the "fourth branch" of government does not overtake democratically accountable state actors in the constitutional hierarchy unless Congress has clearly authorized such a position.

VII. CONCLUSION

While the Court mentioned it in passing, the *Watters* opinion could have been better reasoned if it had focused more precisely on the *Barnett* standard. The *Barnett* test was a reasonably coherent attempt to strike a balance between state innovation and consumer protection and the bank's desire for uniformity in the regulatory context. Remember, *Barnett* held that, when interpreting the NBA, "normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted."[193]

There are two reasons why this test could have been used to apply the Michigan statute to wholly owned subsidiaries. First, a plausible reading of the NBA is that the power to run a state subsidiary wholly free of state

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192 *See generally id.*

193 Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 33 (1996).

regulation is not a power that Congress has "explicitly granted." Since such a power is nowhere in the text of the NBA, it should not be viewed as explicit, and thus it would not be subject to deference under *Barnett*. Second, even assuming *arguendo* that such a power could be incorporated through Gramm-Leach-Bliley or historical context, the statutes in Michigan do not "significantly impair" a national bank's powers. Since Wachovia Mortgage lived with state regulations apparently without incident from 1997 to 2003, one can infer that there was little impairment during that time. Furthermore, the intrusion by the state is minimal, and the possibility of opening up one's records in response to a consumer complaint seems to be relatively nonintrusive. The Michigan statute here was far less burdensome on lenders that the Illinois act discussed above. The Michigan statute, triggered by consumer complaints, merely created an additional watchdog for predatory practices, thus easing the burden on federal regulators. Perhaps a relatively narrow interpretation of when a federal agency "inadequately" responds could help ease the potential burden on these wholly owned subsidiaries.[194] But better use of the "significant impairment" test could allow states to participate in the dual regulatory system, as long as they are careful not to go too far.

In light of the *Watters* holding, consumers can only place their trust in the federal government and hope for the best. Michigan Commissioner Watters expressed such a sentiment shortly after the case when she said, "[a]s a commissioner of Michigan, I certainly want to see them perform . . . and perform at a very high level to protect consumers."[195]

Even federal legislators are concerned that the *Watters* holding may result in the spread of predatory lending practices to national banks and their units. Consequently, in May, the Chairmen of both the House Financial Services Committee and the House Energy and Commerce Committee sent a letter to multiple federal agencies, urging them to strengthen their rules to protect consumers against unfair and deceptive practices in the financial services industry. Neil Milner, Conference of State Bank Supervisors President, said states will need to push U.S. lawmakers to see if "a federal system is going to . . . have that same kind of responsiveness to the individual customers as what

[194] The plaintiff in an upcoming Supreme Court case advanced the same interpretation in their brief, arguing that state regulation of debt collection by banks did not significantly impair the bank's powers under *Barnett*. Brief of Respondent and Cross-Appellant at 34-35, Miller v. Bank of America, NT & SA, No. S149178 (Cal. Jun. 1, 2007), 2006 CA S. Ct. Briefs 447917.

[195] John Poirier, *States Urge Feds to Step Up Consumer Protection*, REUTERS, May 30, 2007, http://www.reuters.com (search for "States Urge Feds"; then follow "States urge feds to step up consumer protection" hyperlink).

thousands of people at the state level do for consumers."[196] A bill is currently before Congress that would effectively overrule *Watters* but has yet to pass.[197]

Thus, while *Watters* was a step forward for deregulation and broad access to credit, it was two-steps backward for a true dual banking system that gives state actors the ability to protect their citizens from unfair and deceptive lending practices.

[196] *Id.* For an interesting discussion on accountability for the subprime crisis see Kristofor W. Nelson, *Rough Waters for the Ratings Companies: Should the Securities Ratings Companies Be Held Liable for Investors' Reliance in the Wake of the Real Estate Meltdown of 2007-2008?*, 63 U. MIAMI L. REV. (forthcoming Oct. 2008).

[197] Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. (1st Sess. 2007). While the bill passed the House, one can be sure that the banking lobby will fight vigorously to prevent the bills ultimate passage in the Senate and approval by the President.