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


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(a): 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.”


   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 . . . .”


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.”


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. Under one of the Michigan statutes at issue, the State’s banking commissioner has general authority to conduct examinations of and bring enforcement actions against national bank operating subsidiaries. Under the other Michigan statute at issue, the Commissioner has “back-up” authority to act on consumer complaints against national bank operating subsidiaries if she deems the OCC’s response inadequate, and general regulatory authority in the absence of a complaint.

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

c) The States concede that Section 24 Seventh authorizes national banks to engage in banking activities through operating subsidiaries, but deny that it supports preemption of state laws that regulate operating subsidiaries.

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. (The States argue that the “same terms and conditions” language should not be understood as preempting state laws that apply to operating subsidiaries.)


   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 371(a). (The States deny that the OCC’s rulemaking authority is this broad.)

4. *Judicial Deference to the OCC.* The OCC’s interpretation of the National Bank Act is entitled to *Chevron* deference.

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.

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 OCC’s regulations are inconsistent with federal statutory provisions, in excess of congressionally-delegated authority, and contrary to corporate law principles.

1. The Commissioner urges 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. “[A] federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority.” *Louisiana Public Serv. Comm’n v. FCC*, 476 U.S. 355, 374 (1986). *See also Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*, 474 U.S. 361 (1986) (rejecting federal agency’s definition of “bank” because it conflicted with clear statutory language). The OCC’s regulation exceed its congressionally delegated authority because they are inconsistent with 12 U.S.C. § 484, which refers to national banks but not to their operating subsidiaries.

   a) Section 484 limits state visitorial authority over national banks, but imposes no such limitation with respect to operating subsidiaries of national banks.

   b) Federal banking law defines an “affiliate” of a national bank to include any company controlled by a national bank. 12 U.S.C. § 221a(b). Thus, a national bank operating subsidiary is an “affiliate” of a national bank rather than a “national bank.” Section 484 does not refer to “affiliates” of national banks.
c) In 12 U.S.C. § 481, Congress gave the OCC authority to examine “affiliates” of national banks. “It is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another.” *Chicago v. Env’l Defense Fund*, 511 U.S. 328, 338 (1994) (internal quotation and citation omitted).

d) Wachovia and the U.S. argue that the language of § 484 does not address operating subsidiaries. This is not surprising since Section 484 was enacted in the 1860s, long before operating subsidiaries were authorized. Moreover, an operating subsidiary is a particular type of national bank affiliate, so it would not have been appropriate to insert the broad term “affiliate” in 12 U.S.C. § 484. Thus, the absence of a specific reference to affiliates or operating subsidiaries in § 484 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.

3. “No principle of corporate law and practice is more firmly established than a State’s authority to regulate domestic corporations.” *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987). The Commissioner argues that this principle supports the conclusion that States have authority to regulate national bank operating subsidiaries, which are state-chartered corporations. (Wachovia and the U.S. argue that Wachovia’s operating subsidiary was chartered by the State of North Carolina, not the State of Michigan. In addition, the OCC seeks to regulate only its federally-authorized banking activities, not matters of corporate formation, dissolution, or governance.)

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. (The Commissioner argues that the OCC’s statement that it does not regulate corporate existence or governance is not supported by the text of the OCC’s regulations.)
V. Litigation in the Lower Courts

A. The preemption issue has been litigated in four cases:


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.