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Damning *Watters*: Channeling the Power of Federal Preemption of State Consumer Banking Laws

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DAMMING WATERS: CHANNELING THE POWER OF FEDERAL PREEMPTION OF STATE CONSUMER BANKING LAWS

ELIZABETH R. SCHILTZ*

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I. INTRODUCTION

In April 2007, while adjudicating a dispute between Wachovia Bank and Michigan's Commissioner of Insurance and Financial Services, the United States Supreme Court effectively reversed two presumptions about federal preemption of state law that historically have guided the delicate balance between state and federal authority over consumer protection in banking services.¹ The first presumption is that issues involving consumer protection are "quintessentially" matters of state (rather than federal) prerogative and are thus governed by state law unless specifically preempted by Congress.² The second presumption is that national banks are subject to "nondiscriminatory laws of general application" of the states where they are

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

2. *Id.* at 1581.

located, provided that those laws “do not ‘forbid’ or ‘impair significantly’ national bank activities.”³ In *Watters v. Wachovia*, the first presumption was entirely negated, and the second presumption was essentially reversed. After *Watters*, consumer protection in banking services can no longer be considered to be primarily the province of state legislatures. Furthermore, national banks can be presumed *not* to be subject to any state law that hinders the efficient exercise of any of the banks’ powers.

This development is a dramatic turning point in a persistent struggle between the federal and state authorities for control over consumer protection regulation in the banking industry. This struggle is a particularly complicated one because it plays out on two very different planes. On one level, the struggle is over who should determine the degree and content of legal protection afforded to individual consumers. Should the federal government establish a uniform level of consumer protection with regard to banking services? Or should individual states be permitted to establish nonuniform, state-specific levels of consumer protection for their own citizens? On another level, the struggle is over who should determine the degree and content of legal regulation applicable to the various kinds of banks operating within a particular state. A unique characteristic of the American banking industry is what is commonly referred to as the “dual banking system”—two parallel systems of banks operating side by side.⁴ One system is the state banking system, comprised of banks chartered and primarily regulated by state banking authorities.⁵ The other is the national banking system, comprised of banks chartered and primarily regulated by federal banking authorities.⁶ Over the years, state banks have become subject to increasing amounts of federal regulation, while national banks have become increasingly immune from state regulation. The reversal of presumptions about the applicability of state consumer credit laws has played a significant role in this growing imbalance.

With the recent public spotlight on abusive lending practices and their effect on consumers in both the home mortgage⁷ and credit card

3. *Id.* at 1574.

4. See generally Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 STAN. L. REV. 1 (1977) (classic article discussing the evolution and theoretical justifications for dual banking system).

5. *Id.* at 3.

6. *Id.*

7. Edmund L. Andrews, *In Reversal, Fed Acts to Tighten Mortgage Rules*, N.Y. TIMES, Dec. 19, 2007, at A1 (describing regulatory activity in the wake of the collapse of the subprime lending market in fall 2007); Stacy Kaper, *Benign? Many Say Schumer Bill Would Bring Drastic Changes*, AM. BANKER, May 8, 2007, at 1 (discussing legislation proposed by three Senate Banking Committee members to increase regulation of subprime mortgage lending); Stacy Kaper, *Schumer Fix in Subprime: Refi Fund, Tighter Regs*, AM. BANKER, May 4, 2007, at 1 (same); Stacy Kaper, *Trepidation All Around as Anti-Predator*

lending areas,⁸ the possibility of federal legislation addressing consumer credit issues is more realistic now than it has been for decades.⁹ After the *Watters* ruling, it is clear that the courts will not provide any adjustments or corrections to the current balance of power in this area. The current congressional focus on consumer credit issues thus presents a particularly timely opportunity for a principled consideration of the appropriate balance of state and federal power with respect to consumer banking services, taking into account the policy considerations relevant to both planes of activity—the protection of consumers of banking services and the continued vitality of the dual banking system. This Article will provide a framework for such a principled consideration, proposing a new paradigm for regulation of consumer banking services that uses the mechanism of preemption to protect consumers while respecting and preserving the vitality of the dual banking system.

A careful analysis of the evolution of the arguments for federal preemption of state banking laws supports this new perspective on preemption. This analysis reveals a need to rethink the relationships among three distinct developments in the market for consumer banking services over the past few decades. During this time, the enactment of significant federal consumer credit legislation and the increasingly aggressive preemption of state consumer regulation

Push Rolls On, AM. BANKER, Mar. 21, 2007, at 1 (discussing a growing sense in Congress that legislation is necessary to address the subprime market crisis).

8. Joe Adler, *Card Rules Have Fed, Lauvmakers Far Apart: Where Central Bank Would Boost Disclosure, Bills Seek Bans*, AM. BANKER, May 29, 2007, at 1 (summarizing seven bills pending in Congress to regulate credit card loans); Stacy Kaper, *Support for Credit Card Rulemaking Beyond Fed*, AM. BANKER, June 8, 2007, at 1 (describing House Financial Services Financial Institutions Subcommittee hearing on June 7, 2007 in which the possibility of substantive federal credit card regulation was considered).

9. Indeed, in a recent letter to the heads of the federal banking regulatory agencies, House Financial Services Committee Chairman Barney Frank and House Energy and Commerce Committee Chairman John Dingell cited, among other things, the *Watters* decision as one of the recent “developments bring[ing] into sharp relief an urgent need to rethink the way in which our financial regulators approach consumer protection.” Joe Adler, *In Brief: FTC to Gain More Authority?*, AM. BANKER, May 14, 2007, at 19; see also Stacy Kaper, *A Vote Without a Resolution: Provisions in Mortgage Bill Remain in the Air*, AM. BANKER, Nov. 7, 2007, at 1 (summarizing legislative proposals being considered in wake of the collapse of the subprime mortgage market in the fall of 2007). Proposals introduced in the 110th Congress include: Credit Card Reform Act of 2008, S. 2753, 110th Cong. (2008); Credit Card Minimum Payment Notification Act of 2008, S. 2542, 110th Cong. (2008); Stop Unfair Practices in Credit Cards Act of 2007, S. 1395, 110th Cong. (2007); Borrower’s Protection Act of 2007, S. 1299, 110th Cong. (2007); Stopping Mortgage Transactions Which Operate to Promote Fraud, Risk, Abuse, and Underdevelopment Act, S. 1222, 110th Cong. (2007); Fair and Justifiable Credit Card Interest Rate Act of 2008, H.R. 5988, 110th Cong. (2008); Credit Cardholders’ Bill of Rights Act of 2008, H.R. 5244, 110th Cong. (2008); Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. (2007); Universal Default Prohibition Act of 2007, H.R. 2146, 110th Cong. (2007); Credit Card Minimum Payment Warning Act of 2007, S. 1176, 110th Cong. (2007); Credit Card Accountability Responsibility and Disclosure Act of 2007, H.R. 1461, 110th Cong. (2007); Consumer Overdraft Protection Fair Practices Act, H.R. 946, 110th Cong. (2007).

through the operation of federal banking laws have increasingly federalized consumer protection laws related to banking services. Over this same time period, the content of most consumer credit regulation has shifted from substantive restrictions on particular credit terms to disclosure requirements. Also during the same time period, the consumer credit market has become an increasingly national rather than regional market. Although these three developments—federalization of consumer lending laws, substantive deregulation of consumer credit, and nationalization of the consumer lending market—certainly have had causal relationships with each other over the past decades, they are not necessarily linked. The critics of the expansion of federal preemption have not fully appreciated the varying effects of these three developments on the two concerns at issue—consumer protection and the dual banking system. A clearer understanding of the relationship among them, I argue, could open the door to innovative and effective approaches to consumer credit regulation within the framework of a strong dual banking system.

In Part II of this Article, I describe the historical evolution of consumer protection in the banking industry from primarily a matter of state law to primarily a matter of federal law. This evolution occurred in three stages. The first stage was a gradual expansion of the preemptive effect of a federal usury statute for national banks through a combination of actions by federal banking regulatory agencies and case law. The second stage was the development of a broad theoretical framework for federal preemption of state banking law based not on a particular federal statute, but rather on a theory of congressional intent to permit national banks to provide consistent banking services nationwide, without any interference from inconsistent state regulations. The third stage was the validation of that broad theory of federal preemption by the Supreme Court in *Watters*. After illustrating this historical evolution, I demonstrate how the reversal of the historic presumptions has recently played itself out in the context of the struggle between state and federal regulation of bank-issued gift cards, culminating in the first citation of *Watters* by a court.¹⁰

In Part III of this Article, I analyze the effects of the federalization of consumer protection law in the banking industry. I challenge the proposition reflected in recent scholarship in this area suggesting that federalization of consumer protection law always and necessarily entails *deregulation* of consumer protection law by unbundling the three trends in consumer credit regulation noted above—federalization of consumer lending laws, substantive deregulation of

10. See *SPGGC, LLC v. Ayotte*, 488 F.3d 525, 532 (1st Cir. 2007), *cert. denied*, 128 S. Ct. 1258 (2008).

consumer credit, and nationalization of the consumer lending market. Nevertheless, I argue that *Watters'* reversal of the presumption of preemption of state consumer protection laws will have significant adverse effects on the vitality of the dual banking system. I analyze a recent shift in the tenor of arguments for the preservation of the dual banking system. When bank powers were at stake, the argument most often asserted was one based on the effectiveness of competition to produce the best banking system; now that consumer protection laws are at stake, a different argument, based on the principle of subsidiarity, is increasingly being articulated. I argue that, while both of these arguments are valid, the subsidiarity-based argument asserted in the consumer protection context is likely to be more persuasive in convincing Congress to intervene to address the current imbalance between national and state banks that endangers the vitality of the dual banking system.

Finally, in Part IV, I suggest a practical way to preserve such a balance, inspired by a recent proposal before the primary federal regulator of state-chartered banks, the Federal Deposit Insurance Corporation (FDIC), to assert on behalf of state-chartered banks some of the same wide-ranging preemption powers currently being asserted by the primary regulator of nationally-chartered banks, the Office of the Comptroller of the Currency (OCC), on behalf of nationally-chartered banks.¹¹ Assertion of such powers on behalf of state banks is arguably necessary to maintain a healthy and vital dual banking system in the United States. However, it is not legally justifiable under current laws. Redress of this imbalance would require action by Congress, including a partial reversal of *Watters*. Congress might choose to harness the prodigious power of preemption by giving it some regulatory content at the federal level; or, it might achieve the same effect, and at the same time preserve the vitality of the dual banking system, by preserving a role for states in providing regulatory content to preemption by state banks.

II. THE REVERSAL OF HISTORICAL PREEMPTION PRESUMPTIONS FOR NATIONAL BANKS

A. *The First Stage: Preemption by Expansion of the Exportation Doctrine.*¹²

The gradual reversal of presumptions about federal versus state regulation of consumer banking issues tracks the development of in-

11. See *infra* notes 272-74 and accompanying text.

12. The following section summarizes and updates the more detailed account of the evolution of the OCC's preemption position with respect to the Exportation Doctrine set forth in Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518 (2004).

terstate banking in the United States. As long as banks limited their operations to the physical borders of the states in which they were headquartered, other states' laws were not important to them. However, as nationwide interstate banking developed, the inconsistency of various state regulatory schemes became more of an operational obstacle to national banks, leading to an almost total preemption of state laws for national banks.

The first stage in this process involved increasingly expansive interpretations by the courts and the OCC of one federal statute—section 85 of the National Bank Act.¹³ Section 85 gives a national bank the power to charge

interest at the rate allowed by the laws of the State [or] Territory . . . where the bank is located . . . and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for [national banks] organized or existing in any such State.¹⁴

The “Most Favored Lender Doctrine,” first articulated by the Supreme Court in *Tiffany v. National Bank of Missouri*,¹⁵ interpreted Section 85 to permit national banks to take advantage of the most favorable interest rates provided to *any* type of lender under the laws of the state where the bank was located.¹⁶ This doctrine was developed in a series of cases in which national banks successfully argued that they should be able to charge particularly favorable rates available to various types of lenders under state laws.¹⁷

However, as banks began to expand their operations across state lines, the power to *disregard* various state laws became a more significant advantage. The most significant such power for national banks was the power given to them under the “Exportation Doctrine” to export the interest rate permitted by the state in which they are located to other states. The Exportation Doctrine was articulated by the Supreme Court in *Marquette National Bank v. First of Omaha Service Corp.*¹⁸ In that case, a national bank located in Minnesota challenged the power of a national bank located in Nebraska to offer credit card loans to residents of Minnesota at interest rates permitted under Nebraska law, but usurious under Minnesota law.¹⁹ The

13. National Bank Act, ch. 106, § 30, 13 Stat. 99, 108 (1864) (codified as amended at 12 U.S.C. § 85 (2000)). Section 85 has been amended a number of times, as described in detail in William G. Bornstein, Comment, *Extension of the Most Favored Lender Doctrine Under Federal Usury Law: A Contrary View*, 27 VILL. L. REV. 1077, 1080-82 (1981-1982).

14. *Id.*

15. 85 U.S. (18 Wall.) 409 (1873).

16. *Id.* at 413.

17. See Schiltz, *supra* note 12, at 545 n.122 (listing cases in which the Most Favored Lender Doctrine was developed).

18. 439 U.S. 299 (1978).

19. *Id.* at 301-02.

Court interpreted Section 85 to permit the Nebraska bank to “export” the higher rates into Minnesota; Minnesota’s usury law was preempted by the federal law that allowed the Nebraska bank to charge rates legal in Nebraska.²⁰

A significant factor in the Court’s analysis was the fact that the Nebraska bank itself had no physical presence in Minnesota.²¹ Nebraska, the state of the bank’s charter address and the only state in which it had any offices or branches, was the only state in which the bank could be considered to be “located” for purposes of Section 85. The Nebraska bank was reaching borrowers in Minnesota by mail or through agents, rather than by branch activity.²² Indeed, at the time of the *Marquette* decision banks did not have the power to maintain branches in states other than the states in which they were headquartered. Not until the enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (“Riegle-Neal”)²³ sixteen years later did Congress give national banks the power to branch across state lines.

In those interim sixteen years, though, banks increasingly engaged in interstate banking by establishing physical presences that stopped short of meeting the statutory definition of branches.²⁴ During this period, the OCC promulgated a series of interpretations supporting the national banks’ position that their growing physical presence in the various states into which they were “exporting” interest rates did not mean the banks were “located” in those states.²⁵ The banks continued to be “located,” for purposes of Section 85, in the state listed as their charter headquarters. During this same time period, large credit card issuers began to realize the advantage of establishing “locations” for their credit card operations in banks chartered in states with generous usury laws (such as South Dakota, Delaware, and Utah),²⁶ allowing them to preempt the usury laws of all the other states in which they might solicit customers.

Riegle-Neal did not directly address how the presence of a legitimate branch in a state into which a bank wanted to export another state’s interest rate might affect the *Marquette* analysis. Instead,

20. *Id.* at 313.

21. Schiltz, *supra* note 12, at 546-47. Marquette Bank named as defendants in the litigation Omaha Service Corp., a subsidiary of the Nebraska Bank organized under the laws of Nebraska and qualified to do business in Minnesota, and the Credit Bureau of St. Paul, a corporation organized under the laws of Minnesota not related to the Omaha Bank. These two corporations apparently solicited the merchants and cardholders, respectively, for Omaha Bank’s credit card program in Minnesota. *Marquette*, 439 U.S. at 304-05.

22. *Marquette*, 439 U.S. at 311.

23. Pub. L. No. 103-328, 108 Stat. 2338 (1994) (codified at 12 U.S.C. § 1811 (2000)).

24. Schiltz, *supra* note 12, at 549-53.

25. *Id.* at 549-52.

26. *Id.* at 552-53.

Riegle-Neal states only that “[n]o provision of this title . . . shall be construed as affecting the applicability of [Section 85].”²⁷ The OCC promptly promulgated an Interpretative Letter, IL 822, in which it asserted that a bank’s power under *Marquette* to export its headquarter state’s interest rate laws “is not defeated simply because a bank has a branch in the state where the borrower resides.”²⁸ Furthermore, the OCC asserted that Riegle-Neal gave national banks the power to export the interest rate *either* of the state where the bank is headquartered *or* of the state where the bank has a branch, depending on how much of the lending activity is conducted in each location.²⁹

IL 822 thus represented a dramatic expansion of preemption power by the OCC. It went significantly further than the Supreme Court in *Marquette* by permitting a national bank to choose its “location” for purposes of Section 85 from among any of the states in which it has either a bank charter or a branch. Under *Marquette*, a national bank could preempt the laws of forty-nine states, but only through the application of the laws of one state—the state of its headquarters. Under IL 822, a national bank could theoretically establish branches in fifty different states and take advantage of particular advantageous laws for particular types of loans in each state to preempt the laws of forty-nine other states.

A 2006 Supreme Court decision concerning a national bank’s “location” for purposes of determining citizenship for federal court diversity jurisdiction purposes contains dicta supporting the OCC’s position. In *Wachovia Bank, N.A. v. Schmidt*,³⁰ the Court held that, for purposes of establishing federal court jurisdiction based on diversity of citizenship, a national bank was “located” in (and thus a citizen of) *only* the state designated in its charter as its headquarters location,

27. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, § 111, Pub. L. No. 103-328, 108 Stat. 2338 (1994) (codified at 12 U.S.C. § 1811 (2000)).

28. OCC Interpretative Letter No. 822, [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,265 (Feb. 17, 1998) [hereinafter IL 822].

29. Under IL 822, the location from which the loan is “made” determines which state’s laws can be exported. To determine where a loan is “made,” the OCC divided the lending process into two categories—ministerial functions and nonministerial functions. Ministerial functions—the strictly mechanical loan processing tasks such as providing applications or processing payments—were deemed to be irrelevant to the “making” of a loan. Three nonministerial functions—the decision to extend credit, the extension of credit itself, and the disbursement of the proceeds of a loan—were considered integral to the “making” of the loan. If all three of the nonministerial functions take place in the state where a bank has a branch, the loan is definitely “made” in that state. However, if fewer than all three of those functions are made in a state where a bank has a branch, the loan may be considered to have been “made” in the state where the bank is headquartered, rather than the branch state. IL 822, *supra* note 28, ¶ 90,261.

30. 546 U.S. 303 (2006).

rather than in every state where it had a branch.³¹ The Court first determined that “the term ‘located’ . . . has no fixed, plain meaning” under the National Bank Act.³² Indeed, the Court characterized the term as “a chameleon word; its meaning depends on the context in and purpose for which it is used.”³³ Focusing on the particular context and purpose for which this statute was being used, the Court reasoned that national banks should be treated analogously to corporate citizens conducting business in more than one state; they are not deemed to be citizens of every state in which they operate, but rather of their state of incorporation or principal place of business.³⁴ For a national bank, the determinative “location” was held to be the state of its charter address.³⁵

In determining that the term “located” is capable of having more than one meaning under the National Bank Act, the Court carefully examined the various provisions of the National Bank Act in which the term “located” is used and the meanings attached to it. The Court noted that in some provisions the term “unquestionably refers to a single place: the site of the banking association’s designated main office.”³⁶ In other provisions, the Court noted that term “apparently refers to or includes branch offices.”³⁷ Among the provisions singled out as supportive of the latter interpretation, the Court included Section 85, *specifically noting* the construction given to it by the OCC in IL 822.³⁸

Although it might be tempting to dismiss this as mere dicta, Supreme Court dicta is not easily dismissed. Lower federal courts generally accord substantial weight to Supreme Court dicta if it is “carefully considered.”³⁹ Since the OCC interpretation in IL 822 was specifically considered by the Supreme Court and identified as supporting the particular interpretations of banking law cited by the Court in its opinion, it was arguably “carefully considered.” At the very least, it will be accorded weight beyond that generally accorded to

31. *Id.* at 313. Additionally, 28 U.S.C. § 1348 (2000) provides that, for purposes of diversity jurisdiction, national banks are “deemed citizens of the States in which they are respectively located.”

32. *Schmidt*, 546 U.S. at 313.

33. *Id.* at 318.

34. *Id.* at 317.

35. *Id.* at 313.

36. *Id.* at 313 (citing 12 U.S.C. §§ 52, 55, 75, 182 (2000)).

37. *Id.* at 313-14 (citing 12 U.S.C. §§ 36(j), 85, 92 (2000)).

38. *Id.*

39. In *Wynne v. Town of Great Falls*, 376 F.3d 292, 298 n.3 (4th Cir. 2004), the Fourth Circuit Court of Appeals rejected a party’s dismissal of its opponent’s arguments based solely on its characterization as “dicta.” The court explained, “[A]s we and our sister circuits have frequently noted, with ‘inferior [c]ourt[s]’ . . . ‘that argument carries no weight since carefully considered language of the Supreme Court, even if technically dictum, generally must be treated as authoritative.’” *Id.* (alterations in original) (quoting *Sierra Club v. E.P.A.*, 322 F.3d 718, 724 (D.C. Cir. 2003)).

dicta by other federal courts. The OCC's broad interpretation of "located" for purposes of Section 85 preemption is thus likely to be upheld.

During the same time period that the Exportation Doctrine expanded in the geographic sense through the definition of "located," it also expanded along another dimension—the scope of the credit terms considered to be exportable as "interest" under Section 85. This expansion succeeded through generous OCC interpretations that were repeatedly challenged in courts across the country and repeatedly sanctioned by the courts, culminating in the Supreme Court's decision in *Smiley v. Citibank (South Dakota), N.A.*⁴⁰ The *Smiley* Court held that the OCC has the regulatory authority to define "interest" for purposes of Section 85.⁴¹ Applying the standard of deference to agency interpretations articulated in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,⁴² the Court upheld as "reasonable"⁴³ an OCC regulation that defined interest to include "among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees."⁴⁴ *Smiley's* endorsement of the OCC's definition of interest was another significant expansion of the preemption powers of national banks. It gave national banks the power to preempt numerous potentially significant consumer protection laws that might be on the books of states into which the bank was exporting interest rates.⁴⁵

Thus, through aggressively expansive interpretations of two words in one federal statute—"located" and "interest"—national banks acquired substantial immunity from an increasing number of state laws. At the time of its adoption, Section 85 *subjected* national banks to, rather than *excepted* national banks from, the most significant substantive form of consumer credit regulation that existed—a state's limit on how much interest could be charged for loans to that state's citizens. One hundred and fifty years later, Section 85 has become a national bank's most potent legal tool for *ignoring* not only state usury limits, but also laws limiting other significant credit terms such as annual fees, late fees, NSF fees, overlimit fees, cash

40. 517 U.S. 735 (1996).

41. *Id.* at 747.

42. 467 U.S. 837, 842-45 (1984).

43. *Smiley*, 517 U.S. at 745.

44. *Id.* at 740 (quoting 61 Fed. Reg. 4869 (Feb. 9, 1996) (to be codified at 12 C.F.R. § 7.4001(a) (2007))).

45. Indeed, the OCC has even argued that state *disclosure* laws could be covered by the preemptive reach of § 85 because complying with such laws could affect the interest rates charged. See Schiltz, *supra* note 12, 563-64 (discussing the use of this argument by the OCC in *American Bankers Ass'n v. Lockyer*, 239 F. Supp. 2d 1000 (E.D. Cal. 2002)).

advance fees, and even disclosure laws. This evolution took place through a process of aggressive agency interpretations of the federal law at issue, ratified by essentially unlimited judicial deference to those interpretations.

However, in developing its arguments during this stage, the OCC began to articulate a theory for national bank preemption of state laws that was even more robust than the theory underlying its expansion of Section 85. The OCC's expansion of the Exportation Doctrine was based primarily on its authority to interpret arguably ambiguous language in a specific federal law—Section 85—that has a preemptive effect. The Supreme Court in *Smiley* applied *Chevron* deference to the OCC's definition of interest only after concluding that “interest” was an ambiguous term in the National Bank Act (a federal statute that the OCC was specifically charged with administering) and that the OCC's interpretation was reasonable.⁴⁶ The more expansive, and exponentially more controversial, recent assertions of preemption power by the OCC were based on a different theory of preemption—a more general theory of “conflict preemption”—pursuant to which the OCC has asserted the authority to exempt national banks from the reach of virtually *all* regulation by states.

B. The Second Stage: Setting the Groundwork for Comprehensive Preemption of State Consumer Protection Laws

In January 2004, the OCC promulgated a set of regulations that it claimed clarified issues that had arisen regarding the applicability of state law to national banks (the “Preemption Regulations”). In these regulations, the OCC applied the same template of a preemption claim to four separate categories of powers given by statute to national banks: the power to take deposits,⁴⁷ the power to make loans secured by real estate,⁴⁸ the power to make loans *not* secured by real estate,⁴⁹ and the catch-all power to exercise all powers authorized under federal law as part of the “business of banking.”⁵⁰ In each case, the regulation declared, “[e]xcept where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank's exercise of [powers authorized by Federal law] are not applicable to national banks.”⁵¹ The Preemption Regulations identified particular state laws applicable to the particular powers that are explicitly pre-

46. *Smiley*, 517 U.S. at 739-45.

47. 12 C.F.R. § 7.4007 (2007).

48. *Id.* § 34.4.

49. *Id.* § 7.4008.

50. *Id.* § 7.4009.

51. *Id.* §§ 7.4007(b)(1), 7.4008(c)(1), 7.4009(b); *cf.* § 34.4(a) (worded slightly differently).

empted, such as disclosure requirements,⁵² the ability of the bank to require insurance for collateral,⁵³ and credit terms.⁵⁴ The Preemption Regulations also offered a list of state laws that were presumed *not* to be inconsistent with the powers of national banks and thus *applicable* to national banks, but *only* “to the extent that they only incidentally affect the exercise of national bank powers.”⁵⁵ These included laws governing contracts, torts, criminal law, homestead laws for real estate loans, rights to collect debts, acquisition and transfer of property, taxation, zoning, and “[a]ny other law the effect of which the OCC determines to be incidental to . . . or otherwise consistent with” the powers of national banks.⁵⁶

When the OCC first published the Preemption Regulations for public comment, it noted some confusion with respect to the basis of its authority to preempt state law. The Supreme Court has identified three general ways in which the Supremacy Clause of the Constitution⁵⁷ can operate to preempt state laws. The first is express preemption, which occurs when Congress expressly preempts state law in a federal statute.⁵⁸ The second is “field preemption,” which occurs when Congress adopts a comprehensive framework of regulations that pervasively occupies that entire field, leaving no opening for state regulation.⁵⁹ The third is “conflict preemption,” which occurs when federal law and state law conflict; conflict can be found either if it is physically impossible to comply with both laws⁶⁰ or if the state “law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”⁶¹ In proposing the Preemption Regulation, the OCC noted that “Our positions in some instances . . . have not clearly reflected whether we were employing an ‘occupation of the field’ or ‘conflicts’ approach, although our individual preemption decisions have more commonly reflected a ‘conflict’ type approach to preemption analysis.”⁶² The OCC suggested that the comprehensive federal system of laws governing the operations of na-

52. *Id.* §§ 7.4007(b)(2)(iii), 7.4008(d)(2)(viii), 34.4(a)(9).

53. *Id.* §§ 7.4008(d)(2)(ii), 34.4(a)(2).

54. *Id.* §§ 7.4008(d)(2)(iv), 34.4(a)(4).

55. *Id.* §§ 7.4007(c), 7.4008(e), 7.4009(c)(2), 34.4(b).

56. *Id.*

57. “This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.” U.S. CONST. art. VI, cl. 2.

58. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977).

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

60. *Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142 (1963).

61. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

62. Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 46,119, 46,123 (Aug. 5, 2003) (to be codified at 12 C.F.R. pts. 7 & 34) [hereinafter Preemption Proposal].

tional banks is similar to that governing federal savings associations and that the OCC might be justified in asserting the same type of “field preemption” accorded to federal thrifts.⁶³ Indeed, it specifically invited public comment on whether it should assert field preemption.

The invitation to comment on whether field preemption was appropriate was issued most particularly for the portion of the proposed regulation dealing with real estate lending by banks.⁶⁴ Indeed, most of the recent state legislative activity to combat predatory lending has focused on real estate secured lending, and thus most of the conflict has been between the states trying to enforce and the national banks trying to avoid such legislation.⁶⁵ The OCC proposed a particularly detailed set of arguments for its preemption authority with respect to real estate lending by national banks based on the language of 12 U.S.C. § 371, the federal statute that authorizes banks to make real estate loans.⁶⁶ By its terms, Section 371 authorizes national banks to make real estate loans “subject to . . . such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order”⁶⁷ and subject to another federal law requiring the federal banking agencies to adopt uniform regulations prescribing standards for real estate lending by financial institutions.⁶⁸ The OCC suggested that “this authority arguably enables the OCC to occupy the field of regulation of national banks’ real estate lending.”⁶⁹

However, when it issued the final Preemption Regulations, the OCC declined to assert field preemption, either for real estate lending or for any other portions of its regulation.⁷⁰ Instead, the OCC argued that the U.S. Supreme Court, in *Barnett Bank, N.A. v. Nelson*,⁷¹ had adopted conflict preemption as the appropriate standard for pre-

63. *Id.* at 46,129 n.91; *see also* Schiltz, *supra* note 12, at 604-17 (contrasting authority for field preemption asserted by the OTS with respect to federal savings associations with authority for field preemption asserted by the OCC with respect to national banks).

64. This invitation was specifically issued with respect to the real estate lending portion of the Preemption Regulation, Preemption Proposal, *supra* note 62, at 46,124, and was suggested with respect to the more general portions of the Preemption Regulation. *Id.* at 46,129 n.91.

65. *See, e.g.*, Preemption Determination and Order, 68 Fed. Reg. 46,264 (Aug. 5, 2003) (preempting Georgia Fair Lending Act, which restricted the ability of lenders to charge certain fees on various categories of home loans).

66. *Id.*

67. 12 U.S.C. § 371 (2000).

68. 12 U.S.C. § 1828(o), *amended by* Federal Deposit Insurance Reform Conforming Amendments Act of 2005, Pub.L. No. 109-173, § 8(a)(29), 119 Stat. 3601, 3615 (2006).

69. Preemption Proposal, *supra* note 62, at 46,125.

70. Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1910-11 (Jan. 13, 2004) (to be codified at 12 C.F.R. pts. 7 & 34) [hereinafter Final Preemption Rule].

71. 517 U.S. 25 (1996).

emption questions involving national banking laws.⁷² Quoting *Barnett*, the OCC explained that:

In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress explicitly granted. To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers.⁷³

The OCC argued that there was no single, settled formulation of this conflict standard in this particular context. It argued that its regulation, which preempted all state laws that “obstruct, impair, or condition” a national bank's ability to fully exercise its federally granted powers, was a justifiable articulation of this conflict standard for national banks—a “distillation of the various preemption constructs articulated by the Supreme Court.”⁷⁴ The formulation was aimed at conveying the following substantive point: “that state laws do not apply to national banks if they impermissibly contain a bank's exercise of a federally authorized power.”⁷⁵

The OCC's preemption argument is that Congress adopted a set of laws with the purpose of establishing a national banking system that would operate “distinctly and separately from the existing system of state banks,”⁷⁶ with long-range goals “including financing commerce, establishing private depositories, and generally supporting economic growth and development nationwide.”⁷⁷ To accomplish these goals, the OCC argued, Congress specifically granted national banks the flexible authority found in 12 U.S.C. § 24 (Seventh) “to exercise ‘all such incidental powers as shall be necessary to carry on the business of banking.’”⁷⁸ Congress also explicitly gave the OCC

the fundamental responsibility of ensuring that national banks operate on a safe and sound basis, and that they are able to do so, if they choose, to the full extent of their powers under Federal law. *This responsibility includes enabling the national banking system to operate as authorized by Congress, consistent with the essential character of a national banking system and without undue con-*

72. Final Preemption Rule, *supra* note 70, at 1910.

73. *Id.* (quoting *Barnett*, 517 U.S. at 33-34).

74. *Id.* The OCC cited specific Supreme Court opinions for each of the three terms used. *Id.* at 1910 nn.51-53.

75. *Id.* at 1910.

76. *Id.* at 1907 n.17.

77. *Id.* at 1907.

78. *Id.*

finement of their powers. Federal law gives the OCC broad rule-making authority in order to fulfill these responsibilities.⁷⁹

In essence, the OCC argued that Congress *specifically* gave national banks flexible powers, with statutory language permitting the evolution of powers to facilitate the natural evolution of a national financial services market; additionally, Congress *specifically* gave the OCC flexible authority to adopt whatever regulations might be necessary to ensure that national banks can exercise these flexible powers to the fullest extent possible.

The OCC noted that profound changes in the financial services marketplace over the past years have created a truly nationwide market for both consumer and commercial credit, for deposits, and for other financial services. The OCC highlighted three developments: (1) technological innovations, such as the Internet, that have expanded both the consumer's market for financial services providers and the banks' market for customers nationwide; (2) the erosion of legal barriers to interstate banking; and (3) the increasing mobility of society, leading to an expectation of portable and consistent financial relationships.⁸⁰ The OCC explained that

These developments highlight the significance of being able to conduct a banking business pursuant to consistent, national standards, regardless of the location of a customer when he or she first becomes a bank customer or the location to which the customer may move *after* becoming a bank customer. They also accentuate the costs and interference that diverse and potentially conflicting state and local laws have on the ability of national banks to operate under the powers of their Federal charter. *For national banks, moreover, the ability to operate under uniform standards of operation and supervision is fundamental to the character of their national charter.* When national banks are unable to operate under national standards, it also implicates the role and responsibilities of the OCC.⁸¹

In short, the OCC argued that Congress has, over the years, created a nationwide system of banking for national banks. The OCC has the authority to implement regulations to let them operate on a nationwide basis. Inconsistent state banking laws applicable in discrete geographic pockets within a bank's nationwide market interfere with the ability of national banks to fully exercise their authority to

79. *Id.* (emphasis added).

80. *Id.* at 1907-08.

81. *Id.* at 1908 (second emphasis added) (footnote omitted).

operate nationwide.⁸² Thus, under the conflict preemption standards articulated above, such laws “obstruct, impair, or condition” a national bank’s ability to fully exercise its federally granted powers uniformly throughout its national market and are thus preempted.

The OCC further asserted that its preemption arguments also apply to operating subsidiaries of national banks as well as to the national bank parent (even though the subsidiaries are state-chartered corporations) pursuant to a pre-existing regulation which provides: “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.”⁸³ The OCC justified the extension of the Preemption Regulations to operating subsidiaries of national banks on the grounds that operating subsidiaries are nothing more than incorporated departments of the national bank itself.⁸⁴ For purposes of accounting, regulatory reporting, and applying many federal statutory and regulatory limits, the subsidiaries are consolidated with the parent bank.⁸⁵ Thus, any power that the parent bank has to preempt state laws can be asserted by the bank through any of its operating subsidiaries.⁸⁶

As a companion to the Preemption Regulations, the OCC also promulgated a regulation asserting that only the OCC has the power to exercise visitorial powers with respect to national banks or their subsidiaries and that state officials have no authority to exercise any visitorial powers with respect to national banks or their subsidiaries (including conducting examinations, inspecting their records, or prosecuting enforcement actions), except where specifically authorized by federal law (the “Visitorial Regulation”).⁸⁷ The Visitorial Regulation was supported not directly with a preemption argument, but rather on the grounds that “[t]he OCC’s exclusive visitorial authority complements principles of Federal preemption.”⁸⁸ Indeed, the

82. The OCC explained:

When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, which negatively affects their safety and soundness. The application of multiple, often unpredictable, different state or local restrictions and requirements prevents them from operating in the manner authorized under Federal law, is costly and burdensome, interferes with their ability to plan their business and manage their risks, and subjects them to uncertain liabilities and potential exposure.

Id.

83. 12 C.F.R. § 7.4006 (2007).

84. Final Preemption Rule, *supra* note 70, at 1905.

85. *Id.*

86. *Id.*

87. 12 C.F.R. § 7.4000 (2007).

88. Rules, Policies, and Procedures for Corporate Activities; Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 6363, 6368 (Feb. 7, 2003) (to be codified at 12 C.F.R. pts. 3, 5, 6, 7, 9, 28 & 34).

OCC argued that the Visitorial Regulation “would not have the effect of preempting substantive state laws, but rather would clarify the appropriate agency for enforcing those state laws that are applicable to national banks.”⁸⁹ The OCC’s position was that its rule is an interpretation of the federal law providing that “[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law.”⁹⁰

With the Preemption and Visitorial Regulations, the OCC exponentially broadened the scope of a national bank’s immunity from state consumer protection laws in a number of significant ways. First, the OCC uncoupled the preemption argument from particularized statutory grants of power. The authority for preemption of state law by federal law is not based on judicial deference to an agency’s interpretation of a particular statute, such as Section 85 or Section 371. Instead, the authority for preemption of state law is based on the entirety of national banking laws, which evidence congressional intent to establish a national banking system within which national banks are granted a flexible set of incidental powers that evolve with the development of the banking industry. As a consequence of this uncoupling, the OCC could assert preemption for *all* banking powers, not merely for the lending activities governed by Section 85 or Section 371. Second, the OCC established the ability to operate uniformly throughout the nation, without interference by inconsistent state laws, as a fundamental characteristic of the national bank charter. Third, the OCC jettisoned the principle that consumer protection laws are quintessentially matters of state law. Despite the fact that Congress in Riegle-Neal identified consumer protection as one of four areas of particular interest to states,⁹¹ the only state laws the OCC recognized as being presumptively applicable to national banks are those governing contracts, torts, criminal law, homestead

89. Bank Activities and Operations, 69 Fed. Reg. 1895, 1896 (Jan. 13, 2004) (to be codified at 12 C.F.R. pt. 7).

90. *Id.* at 1895 (quoting 12 U.S.C. § 484 (2000)). The full text of this statute reads:

(a) No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

(b) Notwithstanding subsection (a) of this section, lawfully authorized State auditors and examiners may, at reasonable times and upon reasonable notice to a bank, review its records solely to ensure compliance with applicable State unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with such laws.

12 U.S.C. 484 (2000).

91. 12 U.S.C. § 43(a) (2000). The other three areas identified in Riegle-Neal as being of particular interest to states were community reinvestment, fair lending, and the establishment of intrastate branches.

law, rights to collect debts, acquisition and transfer of property, taxation, and zoning—and even those are only applicable to the extent they only incidentally affect the exercise of national bank powers.⁹²

As the icing on the cake, the OCC asserted that this aggressively expansive presumption position applies not only to nationally-chartered banks, but also to state-chartered corporations wholly-owned by these banks.⁹³ And, finally, the OCC claimed that even the state laws that *do* apply to national banks cannot be *enforced* by state regulators; only federal regulators have visitorial authority with respect to national banks or their subsidiaries.⁹⁴

C. *Watters v. Wachovia: Vindication of the OCC's Conflict Preemption Argument*

In the years leading up to and following the promulgation of the Preemption Regulations, commentators disagreeing with the OCC's aggressive preemption position have expressed increasing levels of frustration over the “phenomenal success” enjoyed by the OCC in judicial challenges to its incrementally more expansive assertions of immunity from state law for national banks.⁹⁵ In *Watters v. Wachovia Bank, N.A.*, the Supreme Court handed the OCC its most phenomenal success to date, ratifying essentially all of the OCC's broad conflict preemption argument as outlined in the preamble to the Preemption Regulations.⁹⁶

Watters involved a challenge to the OCC's assertion of federal preemption of a state law requiring the operating subsidiary of a national bank to comply with state mortgage licensing laws.⁹⁷ The subsidiary at issue was Wachovia Mortgage Corporation (“Wachovia

92. *Supra* note 56 and accompanying text.

93. *Supra* notes 83-86 and accompanying text.

94. *Supra* notes 87-90 and accompanying text.

95. Keith R. Fisher, *Towards a Basal Tenth Amendment: A Riposte to National Bank Preemption of State Consumer Protection Laws*, 29 HARV. J.L. & PUB. POL'Y 981, 996 (2006). Fisher identified four recent federal court decisions in which the OCC's assertion of preemption for national banks had been upheld: *Wells Fargo Bank of Texas, N.A. v. James*, 321 F.3d 488 (5th Cir. 2003); *Bank of Am. v. San Francisco*, 309 F.3d 551 (9th Cir. 2002); *Bank of Am., N.A. v. Sorrell*, 248 F. Supp. 2d 1196 (N.D. Ga. 2002); and *Am. Bankers Ass'n v. Lockyer*, 239 F. Supp. 2d 1000 (E.D. Cal. 2002), and four recent federal court decisions in which the OCC's assertion of preemption power for national bank operating subsidiaries or the exclusive visitorial position had been upheld: *Wachovia Bank, N.A. v. Watters*, 334 F. Supp. 2d 957 (W.D. Mich. 2004); *Wachovia Bank, N.A. v. Burke*, 319 F. Supp. 2d 275 (D. Conn. 2004), *aff'd on preemption issue*, 414 F.3d 305 (2d Cir. 2005), *cert. denied* 127 S. Ct. 2093 (2007); *Wells Fargo Bank, N.A. v. Boutris*, 265 F. Supp. 2d 1162 (E.D. Cal. 2003); *Nat'l City Bank v. Boutris*, No. Civ. S-03-0655 GEB J, 2003 WL 21536818 (E.D. Cal. July 2, 2003). More recently, *Office of Comptroller of Currency v. Spitzer* has added another jurisdiction to the list of those upholding the OCC's exclusive visitorial position. 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *aff'd*, *Clearing House Ass'n v. Cuomo*, 510 F. 3d 105 (2d Cir. 2007).

96. 127 S. Ct. 1559 (2006).

97. *Id.* at 1564-66.

Mortgage”), a corporation organized under the laws of North Carolina and operating as a mortgage lender in Michigan.⁹⁸ On January 1, 2003, the ownership of Wachovia Mortgage was transferred from Wachovia Bank’s parent holding company, a North Carolina corporation,⁹⁹ to Wachovia Bank, a nationally-chartered bank.¹⁰⁰ A few months later, Wachovia Mortgage informed the Michigan Office of Financial and Insurance Services (OFIS) that, as an operating subsidiary of a national bank, it was no longer subject to the provisions of Michigan law requiring non-bank operating subsidiaries of out-of-state national banks to register with OFIS.¹⁰¹ OFIS objected to Wachovia Mortgage’s surrender of its license, and Wachovia Mortgage and Wachovia Bank filed suit against the OFIS Commissioner, Linda Watters.¹⁰²

Both of the lower federal courts that heard this case upheld Wachovia’s position that federal banking law preempted Michigan’s registration requirements for operating subsidiaries of national banks.¹⁰³ Indeed, all of the circuit courts opining on this issue had reached the same conclusion.¹⁰⁴ Nevertheless, the Supreme Court granted certiorari to consider two questions: (1) whether the OCC’s regulation interpreting the National Bank Act’s limitation on visitorial powers over national banks to extend to operating subsidiaries of national banks was entitled to *Chevron* deference; and (2) whether the OCC’s equation of state-chartered operating subsidiaries of national banks with national banks themselves (for purposes of federal preemption) violated the Tenth Amendment to the U.S. Constitution.¹⁰⁵

This grant of certiorari was interpreted by many observers as a sign that the Court might be willing to impose some limits on the OCC’s aggressive preemption positions, particularly since there was no split in the circuits that needed to be resolved.¹⁰⁶ The facts of the

98. *Id.* at 1565.

99. WACHOVIA CORPORATION, RESTATED ARTICLES OF INCORPORATION (2002), available at <http://www.wachovia.com/file/CorpGovArticlesofIncorporation2001.pdf>.

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

101. *Id.*

102. *Id.*

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

104. *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305 (2d Cir. 2005), *cert. denied*, 127 S. Ct. 2093 (2007); *Wells Fargo Bank, N.A. v. Boutris*, 419 F.3d 949 (9th Cir. 2005).

105. Petition for Writ of Certiorari at i, *Watters v. Wachovia Bank, N.A.*, 127 S. Ct. 1559 (2007) (No. 05-1342); Order List Granting Certiorari, *Watters v. Wachovia Bank, N.A.*, 126 S. Ct. 2900 (June 19, 2006) (No. 05-1342) (mem.).

106. See Fried, Frank, Harris, Shriver & Jacobson LLP, *U.S. Supreme Court to Review State Regulation of National Bank Operating Subsidiaries*, 21ST CENTURY MONEY, BANKING & COMMERCE ALERT No. 06-06-21, June 21, 2006, at 2, available at <http://www.ffhsj.com/siteFiles/ffFiles/060621.pdf>; Todd Davenport, *Wachovia Preemption Suit: Gauging the Implications*, AM. BANKER, Dec. 4, 2006, at 4; Thomas P. Vartanian & Dominic A. Labitzky, *Viewpoint: Preparing Post-Watters ‘Op Sub’ Strategies*, AM. BANKER,

case present the underlying issues in starkly dramatic relief. The state-chartered corporation at issue obtained a national bank's immunity from state law simply because its ownership was transferred from the corporate parent in a holding company structure to a national bank subsidiary. Is federal preemption of state law as a result of such corporate restructuring justified in the absence of a specific federal law, based on the OCC's construction of a broad congressional grant of authority for national banks to provide consistent nationwide banking services?

However, rather than circumscribing the preemption powers of national banks, the Supreme Court decisively and dramatically validated the broad conflict preemption position underlying the OCC Preemption Regulations. A vigorous dissent¹⁰⁷ argued in vain for the preservation of the historic presumption against preemption of state law except where expressly preempted by Congress, reminding the majority "that because federal law is generally interstitial, national banks must comply with most of the same rules as their state counterparts," except where the state's "nondiscriminatory laws of general application" either "forbid" or "impair significantly" the national bank's exercise of its powers.¹⁰⁸ The dissent found it "especially troubling that the Court so blithely preempts Michigan laws designed to protect consumers. Consumer protection is quintessentially a 'field which the States have traditionally occupied.'"¹⁰⁹ The dissent argued that affirming those historic presumptions—and recognizing that Congress did not, in fact, expressly authorize preemption of state law with respect to operating subsidiaries of national banks—should have led the Court to the conclusion that the OCC had overstepped its authority in asserting preemption powers for operating subsidiaries.¹¹⁰ By definition, though, the dissent's arguments were not the ones that prevailed.

Mar. 2, 2007, at 11; *Viewpoint: Electoral Tide, a Warning on Preemption*, AM. BANKER, Dec. 15, 2006, at 11; Ben Winograd, *Briefs Filed in High Court Preemption Challenge*, AM. BANKER, Nov. 7, 2006, at 1.

107. *Watters*, 127 S. Ct. at 1573-86 (Stevens, J., dissenting). The dissenting opinion was written by Justice Stevens and joined by Chief Justice Roberts and Justice Scalia. For some interesting observations about the general positions of the various Justices on preemption issues (including the characterization of Justice Stevens as "the standard-bearer for voting against preemption"), see Samuel Issacharoff & Catherine M. Sharkey, *Backdoor Federalization*, 53 UCLA L. REV. 1353, 1366 n.42 (2006). However, Issacharoff and Sharkey characterize Justice Scalia as representing the *other* extreme, finding more readily *for* preemption, suggesting that the dissent in *Watters* presented a somewhat uncharacteristic alliance on these issues. *Id.* at 1367 n.42.

108. *Watters*, 127 S. Ct. at 1574.

109. *Id.* at 1581 (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)).

110. *Id.* at 1583-84.

The majority opinion¹¹¹ summarily rejected Watters' arguments on both of the questions on which certiorari had been granted. The Court ruled that "the level of deference owed to the [OCC's] regulation is an academic question" because the regulation merely clarifies and confirms preemption powers expressly conferred by federal statute.¹¹² The Court dismissed Watters' Tenth Amendment argument in four brief sentences, with the conclusion that "[r]egulation of national bank operations is a prerogative of Congress under the Commerce and Necessary and Proper Clauses" and is therefore not a power reserved to the states under the Tenth Amendment.¹¹³

The bulk of the Court's opinion fleshed out what can only be characterized as the broadest possible construction of the OCC's general conflict preemption argument. Even *before* the creation of the current national banking system with the promulgation of the National Bank Act (NBA), the Court claimed that it "held federal law supreme over state law with respect to national banking" in *McCulloch v. Maryland*.¹¹⁴ The enactment of the NBA in 1864 established "the system of national banking still in place today,"¹¹⁵ a system that the Court took pains to describe as one which Congress expressly intended to be largely free of state interference. Indeed, the Court enshrined "[s]ecurity against significant interference by state regulators [as] a characteristic condition of the 'business of banking' conducted by national banks."¹¹⁶ The Court characterized the national banking system that Congress intended to establish with the NBA as "a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the States."¹¹⁷ The Court's primary statutory support for this characterization was the section of the NBA reserving visitatorial powers over national banks to the OCC.¹¹⁸

Although the Court emphasized that the real estate lending activities at issue in this particular case are a category of the business of banking indisputably outside the jurisdiction of state regulation, it

111. The majority opinion was drafted by Justice Ginsburg and joined by Justices Kennedy, Souter, Breyer, and Alito. *Id.* at 1563 (majority opinion).

112. *Id.* at 1572.

113. *Id.* at 1573. The dissent also rejected the Tenth Amendment arguments. *Id.* at 1585 (Stevens, J., dissenting). For a defense of these Tenth Amendment arguments, see generally Fisher, *supra* note 95.

114. *Watters*, 127 S. Ct. at 1566 (majority opinion) (citing *McCulloch v. Maryland*, 4 Wheat. 316 (1819)).

115. *Id.*

116. *Id.* at 1571. This echoes the language in the OCC's preamble to the Preemption Regulations. See *supra* text accompanying note 81.

117. *Id.* at 1568 (citing *Easton v. Iowa*, 188 U.S. 220, 229 (1903)).

118. *Id.* (citing 12 U.S.C. § 484(a) (2000), which states that "[n]o national bank shall be subject to any visitatorial powers except as authorized by Federal law").

emphatically declined to limit the scope of its ruling to such activities: “Beyond genuine dispute, state law may not significantly burden a national bank’s own exercise of its real estate lending power, *just as it may not curtail or hinder a national bank’s efficient exercise of any other power, incidental or enumerated under the NBA.*”¹¹⁹

Although the Court did not expressly cite the OCC’s Preemption Regulation,¹²⁰ it adopted the Preemption Regulation’s articulation of the conflict preemption standard for national banks,¹²¹ ruling that

[s]tates are permitted to regulate the activities of national banks where doing so does not prevent or significantly interfere with the national bank’s or the national bank regulator’s exercise of its powers. But when state prescriptions significantly impair the exercise of authority, enumerated or incidental under the NBA, the State’s regulations must give way.¹²²

The Court, like the OCC, cited its *Barnett* decision in support of this proposition.¹²³

After thus affirming the broadest possible construction of the OCC’s general preemption theory for national banks, the Court then decisively rejected Watters’ arguments that these broad preemption powers should not be extended to operating subsidiaries of national banks.¹²⁴ The Court described how the OCC in 1966 recognized the authority of national banks to conduct any business authorized by the bank itself through operating subsidiaries.¹²⁵ For supervisory purposes, the OCC historically treated operating subsidiaries as a part of the parent national bank, rather than as separate corporate entities.¹²⁶ The Court concluded that Congress ratified the authority and regulatory treatment of operating subsidiaries with the enactment of the Gramm-Leach-Bliley Act of 1999 (GLBA).¹²⁷ GLBA authorized national banks under certain conditions to affiliate with nonbank corporate entities conducting certain financial activities *not* directly authorized for national banks.¹²⁸ GLBA distinguished these newly authorized affiliations from the affiliations traditionally au-

119. *Id.* at 1567-68 (emphasis added).

120. The Court did, however, cite the OCC Preemption Regulations preamble in arguing that national banks should not be subject to multiple enforcement regimes of the various states in which they operate. *Id.* at 1568 n.6.

121. See sources cited *supra* note 51.

122. *Watters*, 127 S. Ct. at 1567.

123. *Id.*

124. *Id.* at 1569.

125. *Id.* (citing 12 U.S.C. § 24 (Seventh)).

126. *Id.* at 1570 n.10.

127. *Id.* at 1570.

128. See generally PATRICIA A. MCCOY, BANKING LAW MANUAL § 4.03[3] (2003) (describing generally activities and regulatory limitations of financial subsidiaries).

thorized between banks and their operating subsidiaries engaged in traditional banking activities by exempting from the new regulatory scheme “a subsidiary that . . . engages solely in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks.”¹²⁹

After thus establishing a statutory foundation both for the authority to operate through operating subsidiaries and for the OCC’s regulatory treatment of such subsidiaries as indistinguishable from the operations of the bank itself, the Court then stated:

We have never held that the preemptive reach of the NBA extends only to a national bank itself. Rather, in analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of a national bank’s *powers*, not on its corporate structure. And we have treated operating subsidiaries as equivalent to national banks with respect to powers exercised under federal law (except where federal law provides otherwise).¹³⁰

The Court supported this claim with reference to two significant affirmations of the scope of national bank powers in which the entity conducting the activity was an operating subsidiary rather than the bank itself—the power to sell annuities¹³¹ and the power to offer discount brokerage services.¹³²

The Court rejected Watters’ argument that Congress’ failure to specifically include “operating subsidiaries” in the language of the statute denying states visitorial powers over national banks¹³³ meant that Congress intended operating subsidiaries to be subject to such power, for two reasons. First, operating subsidiaries were not authorized by the OCC until decades after that statutory provision was written, and while operating subsidiaries have since “emerged as important instrumentalities of national banks,” Congress has not objected to the OCC’s treatment of them as functionally equivalent to the banks.¹³⁴ Second, the Court again emphasized that GLBA’s distinction between the operating subsidiary, which is limited in operations to activities permitted to its parent bank, and all other affiliates is a ratification of the OCC’s conception of the operating subsidiary as equivalent to the bank for regulatory purposes.¹³⁵

129. 12 U.S.C. § 24a(g)(3)(A) (2000).

130. *Watters*, 127 S. Ct. at 1570-71 (internal citation omitted).

131. *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995).

132. *Clarke v. Sec. Indus. Ass’n*, 479 U.S. 388 (1987).

133. See *supra* note 118 and accompanying text.

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

135. *Id.*

Watters thus not only affirmed the substance of the Preemption Regulation, but it also unequivocally adopted the OCC's theoretical framework for the broadest possible preemption powers for national banks. The Court located the statutory authority for federal preemption not in any particular Congressional grants of power, but rather in the entirety of national banking laws. As a consequence, this preemption power could be asserted with respect to *all* national bank powers, whether incidental or enumerated. The Court identified the ability to operate uniformly across the nation without interference by state banking regulators as a characteristic of the national bank charter.¹³⁶ Furthermore, the Court did not even deem the fact that the state laws being preempted were consumer protection laws worthy of mention.

After *Watters*, it is no longer accurate to say that matters involving consumer protection in banking services are presumptively matters of state, rather than federal, authority. Furthermore, it is no longer accurate to say that national banks are presumed to be subject to state law unless specifically preempted by Congress; instead, national banks can be presumed to be exempt from any state law that infringes in any way on banks' ability to offer banking services nationwide on uniform terms. These two historical presumptions underlying the dual banking system have been reversed. The First Circuit Court of Appeals, the first court to cite *Watters*, in the context of state bank regulation of gift cards issued by national banks, made evident the dramatic consequences of this reversal.

D. Case Study: Gift Card Guidance and Litigation

In August 2006, the OCC issued guidelines to national banks selling gift cards, stressing the importance of "sound disclosure practices to help ensure that consumers understand the gift card products they are purchasing and using."¹³⁷ Three days later, the *American Banker*, the daily newspaper of the banking industry, published an analysis of the reaction to these guidelines.¹³⁸ The article reported that some in the banking industry opposed the new guidelines.¹³⁹ The American Bankers Association claimed "that the guidelines were overly restrictive and would hurt national banks."¹⁴⁰ However, most other banking industry groups, such as the Consumer Bankers Association, America's Community Bankers, and the Independent Community Bankers

136. *Id.* at 1562.

137. OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULLETIN 2006-34, GIFT CARD DISCLOSURES at 2 (2006) [hereinafter GIFT CARD GUIDELINES].

138. Stacey Kaper, *Is Gift Card Guidance Preemption Precursor?* AM. BANKER, Aug. 17, 2006, at 1.

139. *Id.*

140. *Id.*

of America, “welcomed the guidance” as helpful clarification in an area rendered confusing by litigation.¹⁴¹ Consumer advocates, on the other hand, claimed that the guidelines were not strong enough, characterizing them as “‘extremely weak’ . . . allow[ing] banks to do anything as long as they disclose it.”¹⁴²

More interesting than these fairly predictable alignments of arguments with respect to the content of the regulation, however, were the reactions of analysts to the strategic impact of this guidance. Most of the article focused on the effect this guidance would have on *state* laws governing gift cards, particularly state laws imposing more stringent restrictions on gift cards.¹⁴³ The analysts, whether they approved or disapproved of the move, came to the consensus that the OCC took this step to assure that all inconsistent state laws would be preempted for national banks. One analyst explained:

It’s very much analogous to what the OCC has done in all of its preemption decisions. . . . It defines a national standard that includes more consumer protection than the industry generally would like, but it is often less than is possible under certain state law and simultaneously creates a uniform framework¹⁴⁴

Or, in the words of a consumer advocate, “[t]he states were regulating this product. Now the OCC is virtually unregulating it.”¹⁴⁵

The Gift Card Guidelines¹⁴⁶ and their effect on litigation challenging federal preemption of state laws governing gift cards provide a paradigmatic example of the reversal of preemption presumptions in consumer protection regulation in the banking industry. They consist of federal regulation based on disclosure of terms rather than substantive regulation of terms. They involve a banking product other than a loan, representing an expansion of the preemption power beyond the lending context that served as the initial staging ground for preemption of state laws governing banking services. The preemptive authority of the Gift Card Guidelines is based on the broad conflict preemption argument laid out by the OCC in its Preemption Regulation. *SPGGC, LLC v. Ayotte*,¹⁴⁷ the first judicial opinion to cite *Watters*, confirmed this preemptive effect.

141. *Id.*

142. *Id.* (quoting Edmund Mierzwinski, Director of Consumer Programs at the U.S. Public Interest Research Group).

143. *See infra* note 155.

144. Kaper, *supra* note 138 (quoting Karen Shaw Petrou, Managing Partner of Federal Financial Analytics Inc).

145. *Id.* (quoting Edmund Mierzwinski, Director of Consumer Programs at the U.S. Public Interest Research Group).

146. GIFT CARD GUIDELINES, *supra* note 137.

147. 488 F.3d 525, 532 (1st Cir. 2007), *cert. denied*, 128 S. Ct. 1258 (2008).

The Gift Card Guidelines apply to bank-issued prepaid or stored value cards intended to be purchased by one consumer and given as a gift to another consumer.¹⁴⁸ In contrast to gift cards issued by retailers (which typically can be used only at those retailers and their affiliates), the bank-issued gift cards covered by these guidelines are associated with a card network like Visa, MasterCard, or American Express, and can be used at any merchant that accepts cards from that network.¹⁴⁹

The Gift Card Guidelines do not impose any substantive restrictions on the features of such cards. Instead, they set forth the types of disclosures that the OCC expects national bank gift card issuers to provide purchasers and users of such cards. Basic information considered to be essential to the card users' decisions about how to use the card should be put on the card itself, either directly or in the form of a sticker.¹⁵⁰ Such information should include: the card's expiration date; the amount or existence of any monthly maintenance, dormancy, or usage fee; and a toll-free phone number or website address for inquiries about the card.¹⁵¹ The issuer should also provide additional information in a form designed to be passed on to the ultimate user of the card, in promotional packaging, or in a sleeve containing the card itself.¹⁵² The exact content of such additional disclosures will depend on the particular card's features.¹⁵³ Finally, the Gift Card Guidelines warn national banks to avoid using misleading marketing or promotional practices in connection with the sale of gift cards.¹⁵⁴

This de minimus federal regulation of gift cards—requiring disclosure instead of imposing restrictions on fees or terms—contrasts with the more substantive regulation of the terms of gift cards enacted by a growing list of states over the past decades.¹⁵⁵ The states impose

148. GIFT CARD GUIDELINES, *supra* note 137, at 1.

149. *Id.*

150. *Id.* at 2.

151. *Id.*

152. *Id.*

153. The OCC suggests that the following types of information might be provided: the name of the bank issuing the card; other fees such as card replacement, balance inquiry, or cash redemption; whether and how consumers can obtain replacement cards; consumer liability for unauthorized use; whether and how the card can be used at merchants such as gas stations and restaurants that may seek payment authorization in amounts greater than the amount of the purchase; when the issuer may refuse to authorize transactions on the card; the importance of tracking the remaining balance on the card; whether and how the card can be used in conjunction with other forms of payment; the process for redeeming cash balances; how to resolve consumer problems; and, when applicable, the issuer's ability to revoke or change terms of the card. *Id.* at 2-3.

154. *Id.* at 3.

155. *See, e.g.*, ARIZ. REV. STAT. ANN. § 44-7402 (2007) (gift cards must conspicuously disclose expiration dates in a way that is clearly visible prior to purchase); CAL. CIV. CODE § 1749.5 (West 2008) (no expiration dates or fees, unless the balance of the card is \$5 or less, in which case a maximum \$1 per month fee is permitted so long as the card has not

varying types of substantive restrictions on gift cards. Some forbid or limit dormancy fees, other types of fees, or expiration dates. Others require specific formats and procedures for specific types of disclosures.¹⁵⁶

This pattern of substantive state consumer regulation contrasting with federal regulation limited to disclosure requirements is similar to the pattern observed in the regulation of consumer credit. And the pattern of judicial reaction to the states attempting to challenge the contrasting federal regulatory approaches is also similar, culminat-

been used for twenty-four months and is reloadable); CONN. GEN. STAT. ANN. § 3-65c (West 2007) (inactivity fees prohibited); CONN. GEN. STAT. ANN. § 42-460 (West 2007) (expiration dates prohibited); GA. CODE ANN. § 10-1-393 (West 2007) (must include the cards' terms in the packaging and conspicuously print dormancy fees or expiration dates on the card); HAW. REV. STAT. ANN. § 481B-13 (LexisNexis 2007) (cards may not expire within first two years of issue; service fees prohibited); 765 ILL. COMP. STAT. ANN. 1025/10.6 (West 2008) (cards that do not have an expiration date or any post-sale fees will not escheat); IOWA CODE ANN. § 556.9 (West 2007) (no fees unless there is a written contract between the card issuer and the card holder); LA. REV. STAT. ANN. § 51:1423 (2008) (no expiration dates shorter than five years and no service fees, except a one-time handling fee not to exceed \$1); MD. CODE ANN., COM. LAW § 14-1319 (West 2008) (no expiration dates or fees within the first four years; restriction does not apply to cards processed through national credit card or debit service); MASS. GEN. LAWS ANN. ch. 266, § 75C (West 2007) (no expiration for the first seven years); MONT. CODE ANN. § 30-14-108 (2007) (no expiration dates or fees; possessor can request cash for the remaining balance if it is under \$5 and the original value was more than \$5); NEV. REV. STAT. ANN. § 598.0921 (West 2007) (no fees for the first twelve months; after twelve months fees may not exceed \$1 per month); N.H. REV. STAT. ANN. § 358-A:2 (2007) (for gift cards over \$100, no expiration earlier than the date the funds escheat to the state; for those under \$100, no expiration date); N.J. STAT. ANN. § 56:8-110 (West 2007) (no expiration dates or fees within twenty-four months; after twenty-four months, no fee greater than \$2 per month; does not include prepaid bank cards); N.Y. GEN. BUS. LAW § 396-i (McKinney 2008) (no fees prior to the thirteenth month of dormancy); N.D. CENT. CODE § 51-29-02, 03 (2007) (no service or maintenance fees; no expiration date for six years); OHIO REV. CODE ANN. § 1349.61 (West 2008) (no expiration date or service fees for two years); OKLA. STAT. ANN. tit. 15, § 797 (West 2008) (no expiration date until five years after date of purchase and no service fees unless the remaining value is \$5 or less, the fee does not exceed \$1 per month, there has been no activity for twenty-four months, the holder may reload, and the fee is printed clearly); R.I. GEN. LAWS § 6-13-12 (2007) (no expiration dates or fees); S.C. CODE ANN. § 39-1-55 (2007) (no expiration date within the first year; fees permitted but must be disclosed on the certificate, envelope, covering, or receipt); TENN. CODE ANN. § 66-29-135 (West 2007) (issuer is exempt from turning unused funds over to the state if the card has no expiration date or dormancy fee); TEX. BUS. & COM. CODE ANN. § 35.42 (Vernon 2007) (expiration dates and fees must be clearly disclosed at the time of purchase; does not apply to financial institutions acting as financial agents for the United States or Texas); VT. STAT. ANN. tit. 8, § 2702 (2007) (no expiration dates for three years); VA. CODE ANN. § 59.1-531 (West 2007) (must disclose expiration date and fees or provide a phone number or Web site where the information can be obtained); WASH. REV. CODE ANN. §§ 19.240.020, 19.240.040, 19.240.100 (West 2007) (prohibits fees and expiration dates, except for a fee not to exceed \$1 per month when the balance is \$5 or less, the card has not been used in twenty-four months, the card is reloadable, and the fee is disclosed on the card; doesn't apply to gift cards issued to a financial institution or subsidiary if useable by multiple unaffiliated sellers of goods or services).

156. See sources cited *supra* note 155; see also Sarah Jane Hughes et al., *Developments in the Law Concerning Stored Value and Other Prepaid Payment Products*, 62 BUS. LAW. 229, 239-51 (2006) (summarizing the different ways states regulate gift cards).

ing in the first citation of *Watters* as support for preemption of a state's substantive regulation.¹⁵⁷

Beginning in 2004, the attorneys general of Connecticut,¹⁵⁸ Massachusetts,¹⁵⁹ New Hampshire,¹⁶⁰ and New York¹⁶¹ sued Simon Property Group ("Simon") for violating state law restrictions on gift cards in connection with gift card programs with two national banks and a federal thrift.¹⁶² Simon is a Delaware corporation that owns and operates shopping malls in thirty-six states across the United States.¹⁶³ In August 2001, Simon began selling Simon-branded Visa Giftcards ("Giftcards") issued through Bank of America ("BoA").¹⁶⁴ In 2005, Simon transferred its Giftcard program to U.S. Bank, N.A. ("USB").¹⁶⁵ The district courts that heard the two lawsuits brought by the attorneys general of New Hampshire and Connecticut reached different conclusions on whether the state consumer protection laws were preempted by federal banking law, based on differences in the particular legal entities involved in the litigation and the structure of the two Giftcard programs.

The Connecticut case was brought against Simon¹⁶⁶ in connection with the BoA Giftcard program. The Attorney General alleged that Simon violated provisions of Connecticut law prohibiting the imposition of expiration dates and dormancy or inactivity fees on gift cards.¹⁶⁷ The Connecticut District Court ruled that federal banking laws and regulations permitting national banks to issue stored value cards with expiration dates and to charge non-interest fees did *not* preempt Connecticut's laws in this case.¹⁶⁸ The court looked carefully at the particular contractual arrangement that Simon had with BoA,

157. See *SPGGC, LLC v. Ayotte*, 488 F.3d. 525, 532 (1st Cir. 2007).

158. Complaint, *State v. Simon Prop. Group, Inc.*, No. CV-04-4005355-S (Conn. Super. Ct. Nov. 15, 2004).

159. Complaint, *Commonwealth v. Simon Prop. Group, Inc.*, No. 04-4993 (Mass. Super. Ct. Nov. 15, 2004).

160. Petition for Preliminary Injunction, Permanent Injunction, Restitution and Civil Penalties, *Ayotte v. Simon Property Group, Inc.*, No. 04-E-431 (N.H. Super. Ct. Nov. 15, 2004) [hereinafter *Ayotte* Petition].

161. Verified Petition, *State v. Simon Prop. Group, Inc.*, No. 400425/05 (N.Y. Sup. Ct. Feb. 2, 2005).

162. The New York litigation settled, Hughes, Middlebrook & Peterson, *supra* note 156, at 247, and the Massachusetts proceeding appears to have stalled. Judith Rinearson and K. Richard Foster, *Prepaid Card Preemption Issue Under Scrutiny*, 2006 J. PAYMENT SYS. L. 9 (2006). However, the Connecticut and New Hampshire actions resulted in the litigation described in this section.

163. *Ayotte* Petition, *supra* note 160, ¶¶ 4 & 6.

164. *SPGGC, LLC v. Ayotte*, 443 F. Supp. 2d 197, 200 (D.N.H. 2006).

165. *Id.*

166. More accurately, against SPGGC, Inc., the corporate affiliate of Simon (organized in Virginia) that administers the operation of the Giftcard program. Complaint, *supra* note 158, ¶¶ 4 & 7.

167. *Id.* ¶ 28.

168. *SPGGC, Inc. v. Blumenthal*, 408 F. Supp. 2d 87, 95 (D. Conn. 2006).

noting that BoA's profit on the arrangement came solely from interchange fees from Visa in connection with each transaction conducted through a Giftcard.¹⁶⁹ Simon received all of the monthly maintenance fees charged on the card.¹⁷⁰ The Court reasoned that the plaintiff in this case, Simon, was not a national bank and did not acquire the status of a national bank merely by its close agency or business relationship with a national bank.¹⁷¹ Thus, Connecticut state law, as it applied to its Giftcard program, was not preempted by the NBA.¹⁷²

However, the Court emphasized that this reasoning would *not* apply if the plaintiff had been a national bank (in this case BoA), explaining:

the [Connecticut Gift Card Law ("CGCL")] is a consumer protection law that regulates the sale of gift cards. The CGCL does not purport to regulate the conduct of national banks; if it did, it might be preempted by the NBA. If the BOA was the plaintiff in this case, a different analysis might be required, but the BOA is not a plaintiff. As a result, the protections of the NBA simply do not apply to [Simon], and therefore the CGCL, as applied against [Simon], is not preempted by the NBA.¹⁷³

In contrast to the Connecticut case, in the New Hampshire Giftcard case, Simon's national bank partner, USB, was a party to the litigation.¹⁷⁴ The New Hampshire law also prohibited the imposition of expiration dates and dormancy or inactivity fees on gift cards.¹⁷⁵ The New Hampshire District Court, however, distinguished the program at issue in this case from the program at issue in Connecticut, describing as "a critical factual difference" the fact that the issuing banks, rather than Simon, impose the various fees and establish the expiration dates on the Giftcards.¹⁷⁶ In addition, the Court noted some other differences in the programs, including the fact that under the New Hampshire program Simon's involvement was strictly limited to sales and marketing functions, and Simon was compensated

169. *Id.* at 94.

170. *Id.*; see also *Ayotte*, 443 F. Supp. 2d at 200.

171. *Blumenthal*, 408 F. Supp. 2d at 94.

172. *Id.* at 95.

173. *Id.*

174. The Attorney General brought an enforcement action only against Simon, but U.S. Bank was permitted to intervene as a plaintiff in the declaratory judgment action brought by Simon. *Ayotte*, 443 F. Supp. 2d at 199. MetaBank, a federally-chartered thrift that issued gift cards sold over the Internet, was another institutional partner of Simon. The courts deciding these cases resolved the preemption questions for the thrift in the same manner as they had for the national bank, but under the slightly different statutory scheme applicable to federal thrifts. *Id.* at 206-07; *SPGGC, LLC v. Ayotte*, 488 F.3d 525, 534-36 (1st Cir. 2007). For a discussion of the relevant differences between bank and thrift regulation, see Schiltz, *supra* note 12, at 604-10.

175. *Ayotte*, 443 F. Supp. 2d at 201.

176. *Id.* at 205-06.

through a sales-based commission.¹⁷⁷ Furthermore, Simon lacked the “authority to alter the terms of the Giftcards, the associated fee schedule, the substantive terms of the disclosures provided to the purchaser, or the terms and conditions of the contractual relationship that arises between the consumer and the issuing bank.”¹⁷⁸

In light of these differences in the programs, the New Hampshire Court concluded that

the relationship between the issuing bank and the Giftcard consumer is substantial, the terms of which are established by the issuing bank. Simon’s involvement in the marketing and sale of those Giftcards on behalf of the issuing banks does not alter or even attenuate that relationship. . . . Consequently, the terms of the relationship between the Giftcard consumer and . . . U.S. Bank . . . (including the fee schedule and provisions regarding expiration dates) are governed by federal banking law. State law, to the extent it purports to regulate the terms or essential aspects of that relationship, is preempted.¹⁷⁹

The issue of extending national bank preemption privileges to third parties partnering with national banks exposed by the conflicting opinions of the New Hampshire and Connecticut district courts has significant ramifications for other types of bank partnerships with nonbanks, such as cobranded credit cards.¹⁸⁰ For purposes of our inquiry, however, the most interesting aspect of both opinions is the point on which they both agree. Both accepted the argument that the relevant state consumer protection laws *were* preempted by national banking law with respect to the national banks involved, and both supported their conclusions by reference to the OCC’s general articulation of its broad conflict preemption position: that state laws that obstruct in any way a bank’s ability to exercise powers granted under federal law are preempted.¹⁸¹ Indeed, the New Hampshire Court made it a point to quote the following passage from the Connecticut

177. *Id.* at 206.

178. *Id.*

179. *Id.* at 206-07 (citation omitted).

180. *See, e.g.*, Hughes, Middlebrook & Peterson, *supra* note 156, at 249 (speculating about differences between cobranded credit card programs and retailer gift card programs); Schiltz, *supra* note 12, at 575-82 (describing and speculating about the validity of expansion of scope of federal preemption of state consumer credit regulation to nonbank third parties).

181. *SPGGC, Inc. v. Blumenthal*, 408 F. Supp. 2d 87, 93 (D. Conn. 2006) (“[S]tate laws that obstruct, impair, or condition a bank’s ability to fully exercise its powers authorized under federal law do not apply to national banks.” (quoting 12 C.F.R. § 7.4009(b) (2004)); *Ayotte*, 443 F. Supp. 2d at 204 (“State laws that stand as an obstacle to the ability of national banks to exercise uniformly their Federally authorized powers through electronic means or facilities, are not applicable to national banks.” (quoting 12 C.F.R. § 7.5002 (c) (2006))).

court's opinion in support of this conclusion, despite the conflicting results of the two rulings:

Because the OCC explicitly authorizes national banks to charge [their] customers fees, any state law that impairs a national bank from exercising its federally authorized power to charge fees could arguably be preempted by the NBA. The rationale underlying that conclusion is that Congress has clearly expressed its intent for national banks to be regulated by federal authority. Complying with both laws could cause an irreconcilable conflict, because the OCC has ruled that, when it explicitly authorizes a national bank to exercise a power, a state may not infringe that authorization.¹⁸²

The judicial endorsement of these general articulations of the OCC's broad conflict preemption standards is particularly noteworthy because there is no specific federal law either authorizing or regulating national bank issuance of gift cards. This is not a situation in which the OCC can rely on *Chevron* deference being applied to its interpretation of arguably ambiguous language in a federal law, as it did in expanding the scope of the Exportation Doctrine.¹⁸³ National bank authority to issue gift cards is set forth in OCC regulations authorizing national banks to offer "electronic stored value systems."¹⁸⁴ Implicit in the authority to engage in this activity, according to both courts, was the "incidental" power to establish the terms and conditions of such cards, including the imposition of charges and fees.¹⁸⁵

Indeed, the New Hampshire court noted the absence of federal regulation of national banks' gift card authority: "If there are to be any restrictions on fees associated with the Giftcards, or limitations imposed on expiration dates, they must come either from Congress or the federal agencies empowered by Congress to oversee national banks" ¹⁸⁶ Against this background, it is perhaps easier to understand the reaction of the commentators¹⁸⁷ to the OCC's Gift Card Guidelines—released shortly *after* the two district court opinions were issued.¹⁸⁸ The OCC provided some specific federal regulation of

182. *Ayotte*, 443 F. Supp. 2d at 204 (alteration in original) (quoting *Blumenthal*, 408 F. Supp. 2d at 93-94).

183. See *supra* note 46 and accompanying text.

184. 12 C.F.R. § 7.5002(a)(3) (2007).

185. *Blumenthal*, 408 F. Supp. 2d at 93 (noting that "[a] national bank may charge its customers non-interest charges and fees" (citing 12 C.F.R. § 7.4002 (2001)); *Ayotte*, 443 F. Supp. 2d at 204.

186. *Ayotte*, 443 F. Supp. 2d at 207.

187. See *supra* notes 144-45 and accompanying text.

188. Between the time that the Connecticut court issued its opinion and the time the New Hampshire court issued its opinion, the federal regulator of thrifts, the Office of Thrift Supervision (OTS), issued an opinion declaring that OTS regulation preempts state gift card regulation with respect to federal thrifts. Letter from John E. Bowan, Chief Counsel, Office of Thrift Supervision (June 9, 2006), available at <http://www.ots.treas.gov/docs/5/56218.pdf>. A few months later, the OTS issued additional

gift cards issued by national banks, even if that regulation was limited to general disclosure guidelines. This more specific regulatory scheme bolstered the judicial inclination to defer to the OCC's general articulation of its broad conflict preemption powers evidenced by the two existing opinions.

Indeed, when the First Circuit Court of Appeals upheld the lower court's decision in the New Hampshire case a few years later in *SPGGC, LLC v. Ayotte*, both the Gift Card Guidelines and the *Watters* decision figured prominently in its analysis.¹⁸⁹ In a de novo review of the district court's preemption determination,¹⁹⁰ the First Circuit set out a two-step analysis. First, does a national bank have the power to issue stored-value gift cards with expiration dates and administrative fees and to market them through third parties?¹⁹¹ If so, does New Hampshire law limit a national bank's ability to exercise that power?¹⁹² The court found that there was "little dispute" over a national bank's power to issued stored value cards with expiration dates and administrative fees.¹⁹³ It based its decision on an OCC determination that the issuance and sale of electronic stored value systems, like gift cards, was "incidental to the business of banking."¹⁹⁴ The court cited the Gift Card Guidance's requirement that expiration dates and administrative fees in connection with such cards be disclosed as support for the fact that such features were authorized.¹⁹⁵ The power to engage third party agents to market and sell gift cards was found in explicit language from the NBA permitting a national bank to "use 'duly authorized officers or agents' to exercise its incidental powers."¹⁹⁶

Next, the court considered whether New Hampshire's law "frustrates the exercise" of the national bank's power to issue gift cards with expiration dates and administrative fees and to use third par-

guidance on gift card programs by federal thrifts, similar to the OCC's Gift Card Guide. Memorandum from Scott M. Polakoff, Deputy Director, Office of Thrift Supervision to Chief Executive Officers (Feb. 28, 2007), available at <http://www.ots.treas.gov/docs/2/25254.pdf>.

189. The Second Circuit Court of Appeals also upheld the lower court's decision in the Connecticut case, while at the same time citing *Watters* in reaffirming that the Connecticut law would be preempted if the plaintiff were either a national bank or the operating subsidiary of a national bank. *SPGGC, LLL V. Blumenthal*, 505 F.3d 183, 189-91 (2d Cir. 2007).

190. *SPGGC, LLC v. Ayotte*, 488 F.3d 525, 530 (1st Cir. 2007).

191. *Id.* at 531-32.

192. *Id.* at 532.

193. *Id.* at 531.

194. *Id.* at 531 (citing 12 C.F.R. § 7.5002(a)(3) (2006); OFFICE OF THE CURRENCY, OCC BULLETIN 98-31, GUIDANCE ON ELECTRONIC FINANCIAL SERVICES & CONSUMER COMPLIANCE 8 (1998)).

195. *Ayotte*, 488 F.3d at 531. The court also noted that the OCC's amicus brief suggested that expiration dates might be required as a matter of sound banking practice. *Id.* at 531-32.

196. *Id.* at 532 (quoting 12 U.S.C. § 24 (Seventh) (2000)).

ties to market and sell them.¹⁹⁷ The court rejected as “too formalistic” the argument that New Hampshire’s law does not conflict with any banking law because it regulates only Simon, a nonbank.¹⁹⁸ Citing *Watters*, the court held that the relevant focus should not be on the legal entity that New Hampshire is trying to regulate, but rather on the *activity* that is being regulated—and that activity is a national bank selling gift cards with features authorized for national banks through a third party agent.¹⁹⁹ Stressing that it is the bank, rather than Simon, that regulates the terms of the gift cards, the court concluded that the activity being regulated is the bank’s activity rather than Simon’s marketing activity:

Even if the [New Hampshire law] does not directly prohibit USB from engaging in such activity, it does so indirectly by prohibiting Simon from acting as USB’s agent. It would be contrary to the language and intent of the National Bank Act to allow states to avoid preemption of their statutes simply by enacting laws that prohibited non-bank firms from providing national banks with the resources to carry out their banking activities.²⁰⁰

The court also rejected the argument that, since the federal law does not *require* gift cards to have expiration dates or administrative fees, there is no direct conflict between New Hampshire law and federal law. The court did not cite *Watters*, but rather relied on the *Watters* standard for preemption: “Because the New Hampshire [law] ‘significantly interferes’ with USB’s statutory power, it is preempted by the National Bank Act.”²⁰¹

Ayotte vividly illustrates the dramatic reach of *Watters* and the effect of its reversal of the two basic historical preemption principles that have guided preemption decisions in banking until now. First, the opinion did not mention that consumer protection issues are presumptively a matter of state, rather than federal, law. Second, the opinion applied the reversed presumption of whether state or federal law governs the activities of the national bank. Because New Hampshire’s law was found to “significantly interfere” with a national bank’s exercise of an incidental banking power made specific only through OCC action, it was deemed to be preempted.²⁰² States have, in fact, lost their power to impose standards of consumer protection on banking services—not just lending products, but all banking services—that differ significantly from standards (or lack of standards)

197. *Id.*

198. *Id.*

199. *Id.*

200. *Id.* at 533.

201. *Id.*

202. *Id.*

imposed on national banks at the federal level.²⁰³ For national banks, at least, the efficient exercise of all of its powers on consistent, nationwide terms trumps individual conceptions by any state government of desirable levels of protection for its consumers.

III. ASSESSING THE CONSEQUENCES OF THE REVERSAL OF THE HISTORICAL PREEMPTION PRESUMPTIONS.

The logic of the OCC's broad conflict preemption position is compelling. Congress clearly did establish the national banking system as a distinct alternative to the state banking system, and Congress has given the OCC fairly comprehensive authority to administer this national banking system. Although some particular statutes do defer to state laws to provide content to the federal laws applicable to banks,²⁰⁴ for the most part, national banks operate under a comprehensive set of federal laws and statutes. Furthermore, Congress did, fairly recently, specifically authorize the evolution of this national banking system into a truly nationwide banking system with the enactment of Riegle-Neal. The reality is that we do have a national banking system for which state borders are operationally meaningless. There is a logical integrity to the argument that, since Congress has authorized such a system and has given the OCC the authority to administer this system, the OCC should have the power to ensure operational uniformity within that system. Although the logical integrity of this argument does *not* necessarily extend to operating subsidiaries, *Watters* has effectively ended debate on whether the state-issued corporate charters of operating subsidiaries exclude them from this congressionally-established national banking system. Thus, absent congressional action, the *Watters* decision signifies the complete preemption of state consumer protection laws for national banks and their subsidiaries.²⁰⁵

203. Subsequent decisions supporting this conclusion include *Rose v. Chase Bank USA, N.A.*, 513 F.3d 1032, 1036-38 (9th Cir. 2008) (citing *Watters* in holding that claims that disclosures on convenience checks issued to credit card holders violated California credit card disclosure requirements were preempted by the National Bank Act); *Martinez v. Wells Fargo Bank, N.A.*, No. C-06-03327 RMW, slip op. at 4-6 (N.D. Cal. July 31, 2007) (citing *Watters* in holding that a claim challenging servicing charges by a home mortgage lending subsidiary of a national bank under California's state unfair and deceptive practices act was preempted by the National Bank Act); and *Montgomery v. Bank of America Corp.*, 515 F. Supp. 2d 1106, 1113-14 (C.D. Cal. 2007) (holding that claims challenging inadequate disclosure of fees for nonsufficient funds and overdrafts in checking accounts under California's unfair competition laws were preempted by the National Bank Act).

204. See, e.g., 12 U.S.C. § 85 (2000) (allowing national banks to charge interest at rates permitted in the states in which the bank is located); 12 U.S.C. § 36(c) (2000) (allowing national banks to branch within a state to the extent permitted by state laws); 12 U.S.C. § 92a(a) (2000) (stating that fiduciary powers of national banks determined by state laws).

205. This logic appears to extend to the OCC's assertion of exclusive visitorial powers as well. See *Clearing House Ass'n, L.L.C. v. Cuomo*, 510 F.3d 105 (2d Cir. 2007) (upholding the OCC's Visitorial Regulation).

Should Congress take any action to address this situation? Opponents of the OCC's broad conflict preemption position assert two main policy arguments²⁰⁶ for why the uniformity argument underlying the OCC's position is not compelling enough to outweigh two competing values asserted by the states attempting to impose their own laws: providing effective protection to consumers within the state and preserving the vitality of the dual banking system. The weakness of the first argument and the strength of the second argument is made clear by assessing each argument against the backdrop of the evolution of the preemption position outlined above, paying particular attention to the interplay between the nationalization of federal banking markets, federalization of consumer banking law, and the deregulation of consumer credit laws.

A. *Consequences of Federal Preemption of State Consumer Banking Laws for Consumer Protection*

Opponents of the OCC's broad conflict preemption position present facially compelling arguments that preempting state laws will inevitably weaken the protections provided to consumers against abusive banking practices.²⁰⁷ These arguments take two different forms. One is the substantive argument that the content of consumer protection laws at the state level is more robust than the content at the federal level.²⁰⁸ The other is the procedural argument that the regulatory will to enforce existing laws is stronger at the state level than at the federal level.²⁰⁹ However, both arguments prove to have weaknesses when assessed in light of the three contemporaneous developments in banking services—development of national markets for banking services, federalization of banking regulation, and substantive deregulation.

The argument that federal consumer credit law is weaker consumer credit law assumes that federal law necessarily entails *deregulation*. But this is not a logical inevitability. As the historical narrative of the federalization of consumer banking law laid out in the preceding Section demonstrates, it is entirely plausible to conclude that the federalization was motivated as much by—if not more than—the desire to support the nationalization of the consumer

206. These arguments supplement the more specific statutory interpretation and federal agency authority arguments rejected time and time again by the courts, most dramatically by the Supreme Court in *Watters*. See *supra* Part II.C.

207. See, e.g., Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 68-72 (2005); Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225, 348-56 (2004).

208. See Fisher, *supra* note 95, at 991-93; Peterson, *supra* note 207, at 73.

209. See Fisher, *supra* note 95, at 993-94; Wilmarth, *supra* note 207, at 348-57.

banking market than by the desire to deregulate the consumer banking market. Indeed, the federalization through preemption of legal regimes historically reserved to the states is not unique to the banking market. Professors Issacharoff and Sharkey have documented a similar pattern of increased judicial deference to preemption arguments based on support for uniform national commercial markets in the area of product liability law. They have noted “that the U.S. Supreme Court has, in preemption . . . cases, attempted to capture the considerable benefits that flow from national regulatory uniformity and to protect an increasingly unified national . . . commercial market from the imposition of externalities by unfriendly state legislation.”²¹⁰

Indeed, while it may be true that, in the recent history of legislative assaults on particular predatory lending practices, states have been more aggressive than the federal government,²¹¹ that has not always been the case. One only has to look at the table of contents of three popular law school casebooks to note that the bulk of what is considered “consumer protection” law today is federal, rather than state, law.²¹² The federalization of consumer law may have been accompanied by an overall loosening of consumer protection law;²¹³ however, that is not primarily because federal laws have explicitly preempted *stronger* state consumer protection laws—rather, the federal laws that were actually implemented by Congress were passed *instead* of hypothetically stronger state consumer protection laws that were proposed, but failed, at the state level.

The Consumer Credit Protection Act of 1968,²¹⁴ the “first modern consumer protection statute,”²¹⁵ initially comprised only the Truth in Lending Act,²¹⁶ but was subsequently supplemented by the Fair Credit Reporting Act,²¹⁷ the Fair Credit Billing Act and the Equal Credit

210. Issacharoff & Sharkey, *supra* note 107, at 1356; *see also id.* at 1360-65. In another article, Professor Sharkey focuses on the role of federal agencies in this preemption. Catherine M. Sharkey, *Preemption by Preamble: Federal Agencies and the Federalization of Tort Reform*, 56 DEPAUL L. REV. 227 (2007).

211. Peterson, *supra* note 207, 61-68.

212. *See* MICHAEL M. GREENFIELD, CONSUMER TRANSACTIONS xxix-xxxiv (2d ed. 1991); JOHN A. SPANOGLE ET AL., CONSUMER LAW: CASES AND MATERIALS xv-xxvi (3d ed. 2007); DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW xi-xviii (4th ed. 2006).

213. Peterson, *supra* note 207, at 97.

214. 15 U.S.C. § 1601 (2000).

215. Edward L. Rubin, *Legislative Methodology: Some Lessons from the Truth-in-Lending Act*, 80 GEO. L.J. 233, 234 (1991).

216. 15 U.S.C. §§ 1601-1693r (2000).

217. Pub. L. No. 91-508, 84 Stat. 1114 (1970), *amended by* the Consumer Credit Reporting Reform Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009 (1996) (codified at 15 U.S.C. § 1681-1681t (2000)).

Opportunity Act,²¹⁸ and the Fair Debt Collection Practices Act.²¹⁹ Each of these federal laws sets up an enforcement mechanism that defers enforcement to the federal agency with primary enforcement responsibility for that type of lender and preempts inconsistent state laws.²²⁰ This model for consumer protection law at the federal level was enacted by Congress around the same time that the National Commissioners on Uniform State Laws was mounting one of its *least* successful uniform state law efforts—the Uniform Consumer Credit Code.²²¹ It is true that the federal law focused on disclosure rather than on substantive regulation of credit terms. It is also true that the Uniform Consumer Credit Code *would have* imposed substantive restrictions on credit terms. However, Congress enacted the federal law, while the Uniform Consumer Credit Code largely failed to become law, except for nonuniform variations in a handful of states.²²² The failure of the states to enact a strong uniform state consumer credit law paved the way for the federalization of consumer credit law.

The states' failure in 1968 to generate a stronger, coordinated defense of states as the most effective level at which to provide meaningful consumer credit protection law laid the foundation for the current environment, in which it is difficult to argue that the states should be accorded deference in conflicts between state and federal consumer protection laws on the basis that their laws are stronger than federal laws. It is simply no longer the case that consumer protection is the exclusive province of state legislatures; nor is it the case that consumers have always been better protected by state rather than federal legislatures. This reality no doubt lies behind the comfort that courts faced with recent preemption cases have felt with the position that “[c]onsumer protection is not reflected in the case law as an area in which states have traditionally been permitted to regulate national banks,”²²³ laying the groundwork for the reversal of the presumption *against* preemption of state laws dealing with consumer protection in banking services.²²⁴

The federalization of consumer protection law in banking services does not necessarily have to entail substantive deregulation. Allegations of predatory mortgage lending led Congress to enact the Home

218. Both of these laws were enacted as Pub. L. No. 93-495, 88 Stat. 1500 (1974). The Fair Credit Billing Act is codified at 15 U.S.C. §§ 1666-666j (2000), and the Equal Credit Opportunity Act is codified at 15 U.S.C. § 1691(a) (2000).

219. Pub. L. No. 95-109, 91 Stat. 874 (codified at 15 U.S.C. §§ 1692-692o (2000)).

220. Schiltz, *supra* note 12, at 535.

221. *See id.* at 528-33.

222. *See id.* at 529 n.38.

223. *Am. Bankers Ass'n v. Lockyer*, 239 F. Supp. 2d 1000, 1016 (E.D. Cal. 2002).

224. *Id.* (citing *Bank of Am. v. San Francisco*, 309 F.3d 551, 559 (9th Cir. 2002)).

Ownership and Equity Protection Act of 1994,²²⁵ which imposed greater disclosure *and* substantive limits on the terms of subprime mortgage loans.²²⁶ Indeed, the current Congress, in reaction to the recent turbulence in the mortgage market, is considering numerous proposals for substantive regulation of consumer credit markets.²²⁷ Thus, the argument that the content of consumer protection laws at the state level is *necessarily* more robust than consumer protection laws at the federal level is not compelling. Congress is fully capable of enacting more substantive consumer protection laws any time it chooses to do so.

The procedural argument that the regulatory will to enforce existing laws is more robust at the state level than at the federal level is subject to debate. The federal banking regulators argue that the strict oversight to which national banks are subject renders them significantly less prone to engaging in egregiously predatory banking practices than nonbanks engaged in consumer banking activities.²²⁸ Indeed, the Congressional Research Services recently released a study supporting this contention in the context of the mortgage banking crisis.²²⁹ The federal banking regulators also point to the escalating volume of enforcement actions for infractions of consumer law in the past.²³⁰ In fact, Congress has begun to respond to the OCC's petition for more legal authority to impose and enforce consumer protection regulations.²³¹ And at least one federal regulator, the Federal

225. Pub. L. No. 103-325, 108 Stat. 2160 (1994).

226. See ELIZABETH RENUART & KATHLEEN KEEST, *THE COST OF CREDIT*, § 12.2.2 (3d ed. 2005) (detailing coverage and content of the Home Ownership and Equity Protection Act of 1994).

227. See sources cited *supra* note 9.

228. *Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Financial Servs.*, 110th Cong. 14-16 (2007) (statement of John C. Dugan, Comptroller of the Currency) [hereinafter *Dugan Testimony*].

229. EDWARD V. MURPHY, CONGRESSIONAL RESEARCH SERV., CRS REPORT FOR CONGRESS: SECURITIZATION AND FEDERAL REGULATION OF MORTGAGES FOR SAFETY AND SOUNDNESS (2007), available at http://openocrs.com/rpts/RS22722_20070917.pdf.

230. *Recent Events in the Credit and Mortgage Markets: Hearing Before the H. Comm. on Financial Servs.*, 110th Cong. (2007) (testimony of John C. Dugan, Comptroller of the Currency); *Dugan Testimony*, *supra* note 228; *Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Financial Servs.*, 110th Cong. 16-17 (2007) (statement of Sheila C. Bair, Chairman, FDIC) [hereinafter *Bair Testimony*]. But see sources cited *supra* note 209 (arguing that federal regulators lack the will to strictly enforce consumer protection laws).

231. *Dugan Testimony*, *supra* note 228; see also *Bair Testimony*, *supra* note 230, at 7. House Financial Services Committee Chairman Barney Frank has stated: "We can't undo preemption—that is just . . . a practical fact. But what we have to do is make sure [the regulators] are able to carry out the consumer protection function that they have pre-empted from the states." Cheyenne Hopkins, *Democrats Eye Bill as High Court Backs OCC*, AM. BANKER, Apr. 18, 2007, at 1. The House Financial Services Committee approved H.R. 3526, a bill that would give the OCC and the FDIC rulemaking power under the Federal Trade Commission Act to identify and prohibit unfair or deceptive practices for the in-

Reserve Board of Governors, has recently responded to the reports of abusive lending practices surfacing in the wake of the collapse of the subprime mortgage market by proposing prohibitions on particularly abusive practices for mortgage loans²³² and credit card loans.²³³

However, even if Congress shared the critics' assessment of the federal banking agencies' will to enforce consumer protection laws, Congress could act to remedy the situation. Indeed, there is a historical precedent for such an action by Congress. In legislation passed by Congress in 1991 in the wake of the savings and loan crisis of the 1980s, Congress effectively legislated agency "will to enforce." The ultimate cost of the savings and loan crisis was exacerbated by regulatory agencies' reluctance to close down thrifts that were technically insolvent, largely due to political pressure to avoid the embarrassment of admitting their failures of oversight.²³⁴ In response, Congress enacted a specific, mandatory scheme of enforcement actions that federal regulators must take when capital levels of financial institutions fall below certain levels.²³⁵ If Congress were skeptical of the will of the federal agencies to enforce particular substantive federal consumer protection it might enact, it certainly has the power to draft laws bolstering the regulatory "will" to enforce such schemes.

In conclusion, the federal preemption of state consumer protection law in banking services is not inevitably deregulatory. The federalization of consumer banking law was arguably spurred more directly by a desire to facilitate the nationalization of markets for consumer banking services than by a conscious desire to deregulate, though the national banks benefitting from this deregulation no doubt appreciated both effects. Although the current paradigm for federal regulation of financial services is primarily one of disclosure rather than substantive regulation, that paradigm could change.

Congress could, if it chose to, impose substantive regulation of consumer banking services offered by all national banks and could enact measures ensuring robust enforcement of those regulations. Indeed, the current crisis in the mortgage banking markets and per-

stitutions under their jurisdiction. R. Christian Bruce, *House Financial Services Panel Clears Bill Giving FDIC, OCC Power to Write UDAP Rules*, 89 BANK. REP. 437 (2007).

232. Truth in Lending, 73 Fed. Reg. 1672 (proposed Jan. 9, 2008) (to be codified at 12 C.F.R. pt. 226).

233. Unfair or Deceptive Acts or Practices, 73 Fed. Reg. 28,904 (May 19, 2008) (to be codified at 12 C.F.R. pt. 535); Truth in Savings, 73 Fed. Reg. 28,739 (May 19, 2008) (to be codified at 12 C.F.R. pt. 230); Truth in Lending, 73 Fed. Reg. 28,866 (May 19, 2008) (to be codified at 12 C.F.R. pt. 226).

234. MCCOY, *supra* note 128, at § 15.02. For a concise history of the savings and loan crisis, see Jonathan R. Macey, *Commercial Banking and Democracy: The Illusive Quest for Deregulation*, 23 YALE J. REG. 1, 11-17 (2006).

235. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (1991) (codified at 12 U.S.C. § 1831o (2000)).

ception of unfairness in credit card terms might just provide Congress the impetus to do so. However, congressional reaction to particular financial crises once they begin to affect commercial securities markets is unlikely to afford consumers well-considered, effective schemes of protection in the long run. Moreover, the congressional inclination to regulate or deregulate industry groups is likely to be as strongly influenced by political considerations as by rational considerations of what level of regulation strikes the optimal balance between regulation or deregulation.²³⁶ A potential counterbalance to this political pressure can arguably be identified in the more competitive mechanism of the dual banking system, which might more effectively ensure, over the long run, an appropriate balance of regulation and deregulation in the banking services area.

B. Consequences of Federal Preemption of State Consumer Banking Laws for the Dual Banking System

On a practical level, there is no doubt that the power to preempt inconsistent state laws provides a significant advantage to the national bank charter. If similar power is not extended to state banks, the value of the state bank charter is clearly eroded. A significantly less attractive state banking charter poses a threat to the continued vitality of the dual banking system.²³⁷ Indeed, the dissenting justices in *Watters* specifically identify as the reason for their extensive dissent, “[t]he significant impact of the Court’s decision on the federal-state balance and the dual banking system.”²³⁸

However, preemption of state consumer banking laws is not the only reason for the decline of the value in the state bank charter. Far more significant has been the gradual regulatory homogenization of

236. Stacy Kaper, *Suddenly, Banks Seem to Like Data Bill Impasse*, AM. BANKER, Feb. 27, 2007, at 1 (noting apparent reversal in support of financial services lobbyists on a uniform federal data security standard that would preempt inconsistent state laws, based on concerns that Democratic control of Congress could “potentially produc[e] a bill with onerous elements”); Eric Lipton & Gardiner Harris, *In Turnaround, Industries Seek U.S. Regulation*, N.Y. TIMES, Sept. 26, 2007, at 11 (noting the general surge in industry-initiated requests for federal regulation in areas such as food and drug safety and product safety and speculating that a prime motivation is concern of growing Democratic Party control of federal government).

237. Cheyenne Hopkins, *Taylor, Going, Repeat Dual System Fears*, AM. BANKER, Mar. 9, 2007, at 1 (interview with Diana Taylor, outgoing superintendent of the New York State Banking Department, discussing charter migration from state to national system in New York as a result of preemption powers); see also Wilmarth, *supra* note 207, at 278-87 (documenting the decline of the state banking system and analogizing it to the decline of the state thrift system based on aggressive preemption of state laws).

238. *Watters v. Wachovia Bank, N.A.*, 127 S. Ct. 1559 1573 (2007) (Stevens, J., dissenting). The majority dismisses concerns about the effect of the decision on the dual banking system in a curt footnote that seems to reduce its significance to branching laws. *Id.* at 1569 n.7 (majority opinion).

all bank charters over the past few decades.²³⁹ Because of the increasing amounts of federal regulation to which state banks are subjected and the growing lack of any meaningful difference between the powers of state banks as opposed to national banks, there are fewer and fewer substantive distinctions between the two charters. As Professor Scott noted over thirty years ago (before the large-scale homogenization of bank powers), “[t]he very core of the dual banking system is the simultaneous existence of different regulatory options that are *not* alike in terms of statutory provisions, regulatory implementation and administrative policy.”²⁴⁰ The weaker the strength of that core principle, the weaker the resulting system. Extending even broader preemption powers to facilitate more comprehensively uniform interstate operations for national banks but not for state banks constitutes another significant blow to the continued vitality of an already seriously weakened dual banking system.²⁴¹

Is there any reason that Congress should be concerned with this particular blow—struck as it has been in the context of preemption of state consumer laws—when it has not been troubled by the more general homogenization of bank regulation and bank powers in the preceding decades? Rather than responding to this particular threat to the dual banking system, should Congress simply allow the system to continue on its path toward a “natural death” by attrition from the state banking system?²⁴² A careful look at the arguments presented generally for the preservation of the dual banking system reveals a recent shift in the tenor of these arguments. This shift can be tied to the different contexts in which the arguments are being made—the context of *restrictions* on bank powers imposed by state consumer protection laws, rather than the earlier context of *increasing* bank powers. The shift in focus arguably reveals an argument for preserving the dual banking system that is likely to have greater resonance with Congress than arguments made in the past.

The dual banking system is in one sense, as Professor Miller has noted, “highly anomalous.”²⁴³ He points out:

239. An excellent, if somewhat dated, account of this homogenization is found in Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 693-707 (1988). This account is updated in Robert C. Eager & C.F. Muckenfuss, III, *Federal Preemption and the Challenge to Maintain Balance in the Dual Banking System*, 8 N.C. BANKING INST. 21, 36-69 (2004); see also Hal S. Scott, *What Is the Proper Role of the States in Financial Regulation?*, available at <http://ssrn.com/abstract=922771> (forthcoming).

240. Scott, *supra* note 4, at 41.

241. Eager & Muckenfuss, *supra* note 239, at 22-23.

242. Scott, *supra* note 239, at 28.

243. Geoffrey P. Miller, *Banking Regulation: The Future of the Dual Banking System*, 53 BROOK. L. REV. 1, 12 (1987).

Virtually all private business enterprises, other than depository institutions, are chartered at the state level. Federal chartering is generally reserved for enterprises that are partially or wholly devoted to serving a governmental interest. Yet in banking we see a very different pattern, one of federal chartering of institutions that are both privately owned and devoted to the pursuit of profit for the owners.²⁴⁴

Adding to the anomaly of even *having* a federal system of chartering for private institutions, we also have the anomaly of preserving the arguably redundant parallel state system of chartering.

In another sense, though, the dual banking system is simply a specific manifestation of the fundamentally federalist sensibilities that underlie our nation. At the most basic level, our federalist system recognizes the value of state governments as a locus of authority that constrains the centralized power of the federal government. There are two arguments for why state governments are typically considered to operate to provide such constraints. The first argument is based on the advantages of competition—states can offer alternatives that, if proven superior, can serve to reform the federal model. Pursuant to this argument, states are often characterized as “laboratories of democracy,” where smaller-scale social experiments can be tested and incubated. If successful, the innovations bred at the state level can be adopted to reform the entire nation, either through federal action or through uniform state adoption.²⁴⁵ The second argument is based on the principle of subsidiarity.²⁴⁶ In its most general terms, “[s]ubsidiarity expresses a preference for governance at the most local level consistent with achieving government’s stated purposes.”²⁴⁷ This principle underlies the federalist structures of governance in place in the European Union as well as in the United States.²⁴⁸ It is the aspect of American federalism that holds that state governments, as decentralized units of governing that are closer to the people being governed, are considered to be more responsive and

244. *Id.* at 12-13.

245. This argument “is captured in Justice Brandeis’s famous invocation of the states as the laboratories of democracy in which ‘a single courageous State’ may blaze new paths by trying ‘novel social and economic experiments.’” Issacharoff & Sharkey, *supra* note 107, at 1354-55 (quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)).

246. Good descriptions of the roots of the principle of subsidiarity in the teachings of the Catholic Church and its application in other contexts can be found in Robert K. Vischer, *Subsidiarity as a Principle of Governance: Beyond Devolution*, 35 *IND. L. REV.* 103, 108-26 (2001), and Paolo G. Carozza, *Subsidiarity as a Structural Principle of International Human Rights Law*, 97 *AM. J. INT’L L.* 38, 40-68 (2003).

247. George A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 *COLUM. L. REV.* 331, 339 (1994).

248. *Id.* at 344-403.

accountable to their constituents, and thus governments in which “democratic ideals are more fully realized.”²⁴⁹

These same basic categories of arguments are applied in the banking area to justify maintaining the dual banking system. The generalized American mistrust of centralized power that motivates preserving some decentralized locus of power is typically expressed in the banking context as apprehension about the concentration of financial power in the hands of any one bank or even any one banking system.²⁵⁰

The most commonly articulated defense for maintaining the dual banking system as a mechanism for resisting total centralization is the competitive argument.²⁵¹ While there is significant debate over how well competition among the two regulatory schemes, as currently constituted, in fact *operates*,²⁵² commentators from all perspectives invariably agree that genuine regulatory competition in theory ought to produce the optimum scheme of banking regulation over time.²⁵³ The state banking system is often characterized as the locus of “laboratories of reform” in the banking area, leading to innovation

249. Issacharoff & Sharkey, *supra* note 107, at 1355. Subsidiarity has been described as “an aspect of the original theory of American federalism which held that state governments will be more responsive than the national government to the public will [and] better informed about local circumstances.” James L. Huffman, *The Impact of Regulation on Small and Emerging Businesses*, 4 J. SMALL & EMERGING BUS. L. 307, 316-17 (2000).

250. Tamar Frankel, *The Dual State-Federal Regulation of Financial Institutions—A Policy Proposal*, 53 BROOK. L. REV. 53, 54-55 (1987). Professor Scott argues that the dual banking system, with its dynamic competition between two regulatory systems, “prevents the formation of a single industry cartel policed through the rules and powers of a single government agency.” Scott, *supra* note 4, at 35.

251. Frankel, *supra* note 250, at 56; Scott, *supra* note 239, at 27-28; Scott, *supra* note 4, at 12-13; Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers, the Federal Response, and the Case for Preserving the Dual Banking System*, 58 FORDHAM L. REV. 1133, 1155-59 (1990).

252. Compare Butler & Macey, *supra* note 239, at 693-707 (arguing that the current system is not competitive), with Wilmarth, *supra* note 251, at 1250-55 (arguing that the current system is competitive).

253. Butler and Macey, for example, argue that “[t]he regulatory outcomes generated by the dual banking system appear to be cooperative rather than competitive, because Congress has divided up the regulatory turf of the relevant state and federal agencies in the way most beneficial to the groups that the system regulates.” Butler & Macey, *supra* note 239, at 679. However, they concede that real competition in banking regulatory schemes (which they argue should be provided by the various states) is preferable to centralizing banking regulation at the national level. They argue that

[i]n an industry already dominated by special interests and entrepreneurial legislators, a monopoly provider of banking powers would have no incentive to liberalize the restrictions on entry into the banking industry, to develop innovative ways to solve contracting problems banks face, or to respond rationally to technological changes. Instead, increasing centralization will likely lead only to continued stagnation of banking laws.

Id. at 713; see also Miller, *supra* note 243, at 14-15.

in banking services and forms of regulation.²⁵⁴ Examples of innovations in banking now common to national and state banks that originated as unique state powers include deposit insurance; automated teller machines (ATM); NOW accounts; interstate bank acquisitions; and securities, insurance, and real estate lending powers.²⁵⁵ While these arguments for the dual banking system based on the states' innovation have largely focused on providing banks with more powers, more recently these arguments have begun to focus on restricting bank powers through consumer protection regulations.²⁵⁶ Diana Taylor, who at the time was the New York Superintendent of Banks, recently testified before Congress on behalf of the Conference of State Bank Supervisors that

[t]he traditional dynamic of the dual banking system has been that the states experiment with new products and services that Congress later enacts on a nationwide basis. We generally discuss this history in terms of expanded powers, but the states have been innovators in the area of consumer protection as, well. . . . If you lose the states as a laboratory for consumer protections and other innovations you lose a great attribute of our federalist system—the ability to find out what does and doesn't work.²⁵⁷

Notably absent from most defenses of the dual banking system, until very recently, have been arguments based on the subsidiarity principle used to justify other manifestations of our federalist system. These would be the arguments based on the desire to preserve a locus of authority that is local for various related reasons, including: 1) that it is closer to the concerns of, and more directly accountable to, the citizens²⁵⁸ and 2) that local governments can be more responsive “to local conditions and local tastes.”²⁵⁹ More recently, however, such arguments have begun to find their way into the debate over preemption of state consumer protection laws.

For example, the Tenth Amendment arguments ultimately rejected by the Supreme Court in *Watters* focus not on the competitive rationale for the dual banking system, but rather on “preserving state sovereignty from excessive federal regulation.”²⁶⁰ Critics of pre-

254. See Frankel, *supra* note 250, at 56; Wilmarth, *supra* note 251, at 1157.

255. Wilmarth, *supra* note 251, at 1156-57.

256. See Peterson, *supra* note 207, at 67 (characterizing the spate of state laws regulating predatory real estate loans in the early 2000s as “a classic example of state governments acting as laboratories of our democracy”).

257. *Preemption of State Regulation of National Banks: Hearing on Congressional Review of OCC Preemption Before the Subcomm. on Oversight and Investigations, H. Comm. on Financial Servs.*, 109th Cong. 5-10 (2004) (statement of Diana L. Taylor, New York Superintendent of Banking, on behalf of the Conference of State Bank Supervisors).

258. See Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. CHI. L. REV. 1484, 1509 (1987).

259. See *id.* at 1493.

260. See Fisher, *supra* note 95, at 1016.

emption have begun to stress the subsidiarity argument more generally as well. Professor Peterson argued that the OCC's Preemption Regulations and Visitorial Regulation

are controversial, not merely because the recent rash of fraudulent, deceptive, and unconscionable lending has had a corrosive effect on minority communities, senior citizens, and the entire lower middle class. Rather, their controversy lies in the fact that democratically-elected state representatives all across the country responded to their constituents' demands by adopting such legislation, and no federal statute had ever explicitly authorized the unelected beltway banking custodians to dismiss these state consumer protection laws.²⁶¹

Touching on the democratic accountability aspect of the subsidiarity argument, Peterson in another article reminded readers that, "[t]he comptroller of the currency does not stand for election, lives in Washington, D.C., serves as a partisan appointment, and is closely tied to one of the most powerful industries in the country."²⁶²

Consumer protection regulation touches the heart of what is at stake in the subsidiarity argument in support of the dual banking system to a much greater degree than regulation of the types of services that banks can offer, the geographic reach of their operations, or safety and soundness regulations. Consumer protection regulations, by their very nature, protect *individual citizens* from otherwise unrestrained power of the corporate entities offering banking services. The consequences of the presence or absence of consumer protection regulations, whether good or bad, are more directly experienced by the citizenry than the consequences of the presence or absence of a particular bank power. The ability of that citizenry to accurately assess whether those consequences are good or bad in the long run is not the point here; the point is that the citizenry is more likely to be aware of, to care about, and to hold government responsible for the presence or absence of consumer protection regulations than regulations of bank powers, geographic restrictions, or safety and soundness regulations. Thus, it is not surprising that the subsidiarity argument for the preservation of the dual banking system is particularly resonant in the context of the consumer protection debate.

Moreover, the types of predatory practices that are the target of most significant consumer protection regulation in banking services

261. See Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents*, 56 AM. U. L. REV. 515, 516 (2007).

262. Peterson, *supra* note 207, at 73.

are often practices with unique local characteristics.²⁶³ States and local municipalities will often be in a better position to accurately assess how these local variations affect the appropriate balance between regulation and deregulation to protect consumers without restricting access to banking services. In the context of predatory lending, for example:

empirical evidence suggests that the predatory lending problem in urban areas with large minority communities is different than the problem that exists in areas where such communities do not exist. The predatory lending problem in urban, minority communities results from the higher rate of subprime lending that occurs in those areas. By contrast, the problem in Utah, for example, is much different. Although many borrowers in Utah are being saddled with loans they cannot handle—a common practice among predatory lenders—the fraud in that jurisdiction often includes participation by the borrowers themselves, who assist mortgage brokers in the inflation of incomes and other such practices in order to be approved for a home they could not otherwise afford. Problems faced in various jurisdictions require a distinct regulatory response.²⁶⁴

The subsidiarity argument that local authority should not be superseded by federal authority where the local solution is preferable is thus particularly compelling in this situation. There are many instances in which federal solutions (imposed through preemption) fail to address local variations in practices and needs of the community. For these reasons, it is not surprising that the subsidiarity argument for the preservation of the dual banking system should have a resonance in the context of the recent preemption of state consumer laws that is stronger than that experienced in prior preemption skirmishes involving bank powers or geographical expansion.

Most commentators debating the wisdom of maintaining the dual banking system have, until recently, tended to focus exclusively on different aspects of the competitive arguments. While coming to different conclusions about whether competition is, in fact, effectively creating the optimal system of banking regulation,²⁶⁵ most seem to concede that, politically, the dual banking system is remarkably durable. The dual banking system is characterized as “a sacred cow in the American political tradition,”²⁶⁶ “an object of almost universal ve-

263. DELVIN M. DAVIS & ELLEN SCHLOEMER, CTR. FOR RESPONSIBLE LENDING, CRL ISSUE PAPER NO. 10, STRONG COMPLIANCE SYSTEMS SUPPORT PROFITABLE LENDING WHILE REDUCING PREDATORY PRACTICES 4 (2005).

264. Christopher R. Childs, Comment, *So You've Been Preempted—What Are You Going to Do Now?: Solutions for States Following Federal Preemption of State Predatory Lending Statutes*, 2004 BYU L. REV. 701, 720-21 (footnotes omitted).

265. See *supra* note 252.

266. Miller, *supra* note 243, at 1.

neration,"²⁶⁷ and the object of "such widespread political support among regulators and politicians" that its premises are rarely questioned.²⁶⁸ What this focus on the competitive argument has perhaps obscured is that the reason for the political durability of the dual banking system lies in the subsidiarity rationale rather than the competitiveness rationale. Ultimately, for politicians who are regularly held accountable to their constituents in elections, the subsidiarity arguments might be more compelling than the competitive arguments. Since the subsidiarity arguments are more directly implicated in the consumer protection area, it is possible that they will obtain more purchase with Congress than the competitive arguments raised in past debates about the preservation of the dual banking system dealing with bank powers or other structural issues. It is also possible that the broadscale preemption of laws governing consumer banking services described earlier in this Article and ratified by the Supreme Court in *Watters* will prompt intervention by Congress to reassert the competitive equality between the federal and state banking systems.

IV. CHANNELING THE POWER OF PREEMPTION TO PROTECT CONSUMERS AND PRESERVE THE DUAL BANKING SYSTEM

The complete preemption of state consumer protection laws in banking services clearly constitutes a victory for those who believe that national banks should be permitted to offer their services on consistent terms throughout the country, regardless of where their customers happen to reside. It also constitutes a victory for those who favor a minimum of substantive regulation of the terms under which such services may be offered, since the current framework of federal regulation of banking services is largely one of regulation by disclosure, rather than substantive restrictions. At the same time, however, preemption constitutes a severe blow to the state banking system, and thus to the continued vitality of the dual banking system, since state banks are operating under the significant competitive disadvantage by *not* having the power to offer their services on the same consistent terms throughout the country.

Neither the current framework of federal regulation of banking services, nor the current state of disequilibrium in the dynamic of the dual banking system, are set in stone. As I have argued above, the preemption initiatives on behalf of national banks were arguably motivated as much, if not more, by a recognition of the nationalization of the markets for banking services than by the desire to deregulate. That nationalization applies equally to state banks. Therefore, it is

267. Scott, *supra* note 4, at 1.

268. Butler & Macey, *supra* note 239, at 678.

arguable that, in the spirit of the competitive equality dynamic of innovation historically displayed in the dual banking system,²⁶⁹ this same preemption power ought to be extended to state banks, in recognition of the nationalization of the markets for banking services, rather than out of a desire to deregulate.

In reaction to the current mortgage crisis and perceived abuses in terms offered by credit card companies, Congress currently is evidencing some inclination to explore whether more substantive consumer credit regulation is appropriate at the federal level.²⁷⁰ I believe that Congress should take the opportunity to consider more broadly whether the current approach to consumer protection in banking services generally presents the best mechanism for ensuring the proper mix of regulation and deregulation, particularly in light of *Watters'* upheaval of the historic presumptions guiding this area.

A possible starting point for such a deliberation could be a recent proposal of the Federal Deposit Insurance Corporation (FDIC). The FDIC is the primary federal regulator of most state banks as a consequence of its authority over the federal deposit insurance fund to which all state banks must belong.²⁷¹ Shortly after the promulgation of the Preemption Regulations, the FDIC, acting on a petition from the Financial Services Roundtable, proposed for comment a regulation codifying for state banks preemption powers analogous to those granted national banks.²⁷² The rule published for comment by the FDIC would do two things. First, it would codify its more informal positions that grant state banks interest rate exportation powers co-extensive with those granted to national banks under Section 85 of the NBA and subsequent OCC regulations.²⁷³ Second, it would interpret provisions of Riegle-Neal that give interstate branches of state banks the power to preempt host state laws in such a way as to quite specifically piggyback (albeit not fully) on analogous preemption powers extended by the OCC to national banks branching across state lines.²⁷⁴ This part of the proposal provides:

A host state law does not apply to an activity conducted at a branch in the host State of an out-of-State, State bank to the same extent that a Federal court or the Office of the Comptroller of the

269. Competitive equality is the dynamic that has operated historically to maintain the vitality of the dual banking system, pursuant to which regulatory innovations giving one of the two systems a competitive advantage are typically eventually extended to the other system. See Schiltz, *supra* note 12, at 565. But see Scott, *supra* note 4, at 41-42 (criticizing the notion of competitive equality).

270. See sources cited *supra* note 9.

271. See *infra* note 281 and accompanying text.

272. Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 60,019 (Oct. 14, 2005) (to be codified at C.F.R. pts. 331 & 362).

273. *Id.* at 60,030.

274. *Id.* at 60,031.

Currency has determined in writing that the particular host State law does not apply to an activity conducted at a branch in the host State of an out-of-State, national bank.²⁷⁵

The proposal defines activities conducted at a branch quite generously to include any “activity of, by, through, in, from, or substantially involving, a branch.”²⁷⁶

The FDIC’s proposal was open for public comment from October through December 2005.²⁷⁷ It generated a flurry of comments but has not been acted on, either to withdraw it or to move forward on it, since it was promulgated.²⁷⁸ Although the lack of activity may reflect the diversion of the FDIC’s attention to other higher-profile issues (such as the mortgage crisis and Wal-Mart’s application for federal deposit insurance for a Utah industrial loan corporation²⁷⁹), it is likely that it also reflects the fact that the proposal was intended to provoke discussion about the growing imbalance in the preemption powers of national banks as opposed to state banks, particularly in light of the OCC Preemption Regulation.

It is not likely that the FDIC believes it has the statutory authority to assert the broad preemption power that this proposal would grant to state banks without some congressional action. In contrast to the OCC’s preemption rule, the FDIC’s rule, if promulgated, has no chance of withstanding judicial challenge for many reasons. First, the FDIC’s backup supervisory role as the insurer of state-chartered banks is in no way analogous to the OCC’s role as the charterer and supervisor of national banks. State banks are chartered and primarily supervised by their individual state’s banking supervisor.²⁸⁰ When a state bank applies for federal deposit insurance (as required by most states), the FDIC acquires some authority as *federal* supervisor of that bank, but that authority is essentially a backup, rather than primary, supervisory authority over that bank.²⁸¹ In contrast to the

275. *Id.*

276. *Id.*

277. *Id.* at 60,019.

278. See Joe Adler, *State-Bank Preemption: 2nd Look at a Long Shot*, AM. BANKER, May 1, 2007, at 1.

279. Wal-Mart’s application to enter into the federally-insured depository institution market through a Utah-chartered industrial loan corporation in July 2005 generated reams of newspaper coverage, numerous regulatory and Congressional hearings, and undoubtedly absorbed significant amounts of the FDIC’s institutional resources until Wal-Mart withdrew the application in March 2007. Press Release, FDIC, Statement of FDIC Chairman, Sheila C. Bair on the Decision of Wal-Mart to Withdraw Bank Application (Mar. 16, 2007), available at <http://www.fdic.gov/news/news/press/2007/pr07023.html>. For a description of the legal, political, and policy issues raised by this application, see Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539 (2007).

280. MCCOY, *supra* note 128, § 3.02[1].

281. As primary federal supervisor, the FDIC typically trades off annual examinations of state banks with the state chartering authority on an annual basis. *Id.* §12.04[1][a]. If a

OCC, Congress has never charged the FDIC with the authority for creating a uniform nationwide banking system in which state banks can operate efficiently.

This distinction between the roles of these two regulators is reflected in the complete lack of anything close to the case law history of *Chevron* deference that the courts have extended to the OCC's interpretations of the NBA. Indeed, the Supreme Court denied certiorari in a First Circuit decision upholding the FDIC's authority to adopt a definition of "interest" as expansive as the OCC's definition upheld in *Smiley*,²⁸² even though that authority was arguably based on the FDIC's authority to interpret the definition of the term "interest" in the federal statute giving state banks the authority to export interest rates in the same manner as national banks.²⁸³

Furthermore, the FDIC's attempt to expand the preemption powers of state banks does not have the same constitutional authority as the OCC's efforts. The OCC is effecting preemption of state laws by federal laws, under the operation of the Supremacy Clause of the Constitution.²⁸⁴ Although the content of the federal law creating the preemption is sometimes provided by the law of the state where the national bank is located, federal law is preempting state law. In contrast, under the FDIC's proposal, state banking laws of one state would be preempting state consumer laws of another state. There is no authority under the Constitution for sister-state preemption. Of course, if Congress were to enact a federal law that gave state banks broader preemption rights as a matter of federal law, the Supremacy Clause arguments would be available to support the constitutionality of that preemption, even if the content of the preempting law might be furnished by state law.²⁸⁵ In other words, Congress has the power to do what the FDIC is attempting to do by regulation.

If Congress does, for the reasons outlined above, want to maintain a vital dual banking system, it is usually presented as having two basic choices—to take some preemption power away from the national banks or to give the same preemption power to the state

state-chartered bank chooses to become a member of the Federal Reserve System, the Federal Reserve Bank becomes the primary federal backup regulator of that bank rather than the FDIC. *Id.* However, even in that case, the FDIC retains some regulatory authority over that bank in its capacity as insurer of the bank. For example, the FDIC retains the authority to determine whether proposed activities of that bank, even if permitted under the bank's state law, are prohibited as posing too great a risk to the federal deposit insurance fund. 12 U.S.C. §§ 1831e(a)-(b) (2000).

282. *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st. Cir. 1992); *see also* Schiltz, *supra* note 12, at 565-68 (providing a more detailed discussion of this issue).

283. 12 U.S.C. § 1831d(a).

284. *See supra* note 12 and accompanying text.

285. Indeed, this is precisely what Congress did in extending Exportation Authority to state banks. *See infra* note 292 and accompanying text.

banks. The first option will certainly be opposed by the national banks, and the second option is opposed equally as forcefully by about half of the state attorneys general who have commented on the FDIC's proposal (including the attorneys general of California, Connecticut, Illinois, Iowa, New Mexico, New York, North Carolina, and Vermont)²⁸⁶ as well as the Banking Commissioners of Connecticut, Delaware, Maine, Massachusetts, New Jersey, Rhode Island, and Vermont.²⁸⁷ The opponents articulate sound reasons for their opposition, including concerns about the "race to the regulatory bottom" by states seeking charters,²⁸⁸ the inability of states to protect their citizens from unscrupulous out-of-state banks,²⁸⁹ and the unmanageable confusion confronting consumers faced with financial service providers exporting potentially fifty different sets of laws into any one state.²⁹⁰

However, I think that these opponents of state bank preemption powers need to consider the consequence of *not* extending the same sort of preemption power to state banks—the inability of their state-chartered institutions to compete on a nationwide basis in the provision of banking services. The potentially devastating consequences of this to the continued vitality of the state banking system need to be taken seriously. I think it is time to consider the possibility of channeling the power of preemption for state as well as federal banks, in recognition of the reality that geographic limitations are no longer meaningful in the provision of banking services. However, if this channeling of the power of preemption to state banks is to also preserve the vitality of the competitive dynamic of the dual banking system, it will be crucial to recognize that preemption need not necessarily entail deregulation.

The preemption of state interest rate regulation by the expansion of the Exportation Doctrine described above²⁹¹ was extended to state banks by congressional fiat.²⁹² This simple extension of preemption

286. Letter from Eliot Spitzer, Attorney Gen. of NY, to Robert E. Feldman, Executive Sec'y, FDIC (May 16, 2005), *available at* <http://www.fdic.gov/regulations/laws/federal/2005/05c6petition.pdf> [hereinafter NY AG Letter]; Letter from Bill Lockyer, Attorney Gen. of Cal., to Robert E. Feldman, Executive Sec'y, FDIC (May 18, 2005), *available at* <http://www.fdic.gov/regulations/laws/federal/2005/05c13petition.html>.

287. Letter from John P. Burke et al., Banking Regulators, to Robert E. Feldman, Executive Sec'y, FDIC (Dec. 13, 2005), *available at* <http://www.fdic.gov/regulations/laws/federal/2005/05c9petition.pdf> [hereinafter Bank Regulators Letter].

288. *See* NY AG Letter, *supra* note 286, at 7; Bank Regulators Letter, *supra* note 287, at 2.

289. *See* NY AG Letter, *supra* note 286, at 7-8; Bank Regulators Letter, *supra* note 287, at 2.

290. *See* NY AG Letter, *supra* note 286, at 8-9.

291. *See supra* Part II.A.

292. 12 U.S.C. § 1831d(a) (2000); Depository Institutions Deregulation and Monetary Control Act of 1980, § 521, Pub. L. No. 96-221; *see also* Schiltz, *supra* note 12, at 565-67.

power to state banks without any limitations did, indeed, contribute to the well-documented “race to the bottom” in state regulation of interest rates,²⁹³ as states competed to attract banks desiring to export the *lack* of regulation. This pattern is *not*, however, inevitable.

A possible variation on this pattern could be effected if Congress were to consciously decouple preemption from deregulation by conditioning broad exportation and preemption powers by national banks on some basic threshold of consumer protection requirements and by extending analogous exportation and preemption powers to state banks chartered in jurisdictions meeting or exceeding those same consumer protection thresholds. The basic threshold of federal consumer protection laws could remain focused on disclosure or could include some substantive restrictions. More important for purposes of this proposal is that Congress preserve the right of state banks to offer an alternative to the federal level of consumer protection in banking services.

To do this, Congress would have to partially reverse *Watters*. Congress would have to reassert its mandate in Riegle-Neal that consumer protection laws be recognized as being of particular interest to state governments.²⁹⁴ It would do so not by subjecting national banks to state consumer banking laws, but by preserving the possibility that state banks subject to a different, state-determined set of consumer protection laws can compete on a nationwide basis with national banks. Preserving this regulatory power for the states, while at the same time extending the preemption power to state banks whose states chose to offer a distinct approach to consumer banking services, would present a possible bulwark against the complete homogenization of the federal and state banking systems. A national banking system could compete nationwide with a state banking system, and both could offer different levels of consumer protection.

Whether this possibility would, indeed, revitalize the dual banking system would depend largely on whether the states in fact resisted the race to the bottom by consciously *competing* with national banks by enacting and aggressively promoting the advantages of banking services coming from consumer-friendly regulatory regimes. As geographic location continues its slide into irrelevance in the choice of providers of banking services, the niche of customers willing to choose banking service providers based on a state “seal,” as it were, of consumer protection could be cultivated.

Recent studies of behavioral economists and others are beginning to suggest, at the very least, strong consumer reactions to particular

293. Schiltz, *supra* note 12, at 568, 619-20.

294. See *supra* note 91 and accompanying text.

types of credit terms,²⁹⁵ sales pitches,²⁹⁶ and perceptions of the safety of particular products.²⁹⁷ These studies indicate that consumers are sensitive to credit terms in addition to rates; features seen as enhancing the safety of a product might be more important to some consumers than the rate alone. For example, in one recent study of low-income credit card users, they were found to be willing to accept high interest rates in order to preserve access to credit, but would prefer credit cards with terms such as low but inviolable credit limits or options to convert credit card debt into installment debt.²⁹⁸ These studies suggest that a market in *regulated* consumer services might realistically compete with a market in *unregulated* or *minimally-regulated* consumer banking services. If the only market that exists is a uniform, national, unregulated market, consumers will never have the opportunity to demonstrate such a preference. With some congressional support in giving state banks the power to compete nationally, and with the conscious rejection of preemption as always entailing *deregulation*, the states could continue serving as the laboratories of reform and the responsive units of democratic accountability that underlie the vision of a robust dual banking system.

295. See Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1395-1408 (2004); Angela Littwin, *Beyond Usury: A Study of Credit Card Use and Preference Among Low-Income Consumers*, TEX. L. REV. (forthcoming 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968330.

296. See Patricia A. McCoy, *A Behavioral Analysis of Predatory Lending*, 38 AKRON L. REV. 725 (2005).

297. Bar-Gill, *supra* note 295, at 1395-1408; Littwin, *supra* note 295, at 20-25.

298. Littwin, *supra* note 295, at 13-25.

