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High Court to Revisit Federal Preemption

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This spring, the United States Supreme Court will hear *Cuomo v. The Clearing House Association, L.L.C. and Office of the Comptroller of the Currency* ("OCC").[1] The case addresses whether Section 484 of the National Bank Act ("NBA") and the OCC's regulations thereunder prohibit the New York State Attorney General ("NYAG") from examining national banks with respect to certain state laws that are not otherwise subject to federal preemption. Section 484 of the NBA provides the OCC with exclusive visitorial powers over national banks.[2] A Supreme Court ruling in favor of the NYAG could have a dramatic effect on both national banks and federal savings banks.[3] *Amici* briefs on this important case must be filed with the U.S. Supreme Court no later than March 25, 2009, under the current schedule.

We underscore the importance of this case. Preemption allows national banks (and federally chartered thrifts) to operate (with certain limited exceptions) under a single set of laws administered by a single regulator with substantial industry expertise. While many of us thought that the *Watters* case discussed below essentially put to rest issues of preemption, the granting of *certiorari* in *Cuomo* raises the prospect of a multitude of bodies administering a variety of laws in an inconsistent and inefficient fashion. The preemption doctrine substantially enhances the efficiencies of our national credit markets, a critically important benefit in our difficult economic environment.

The Supremacy Clause of the U.S. Constitution provides, "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."[4] In general, federal laws override state laws that conflict with a federally chartered bank's ability to exercise its banking powers, a concept reviewed most recently by the U.S. Supreme Court in *Watters v. Wachovia Bank, N.A.*[5] In 1999, the OCC adopted a regulation implementing Section 484 of the NBA, addressing visitorial powers and providing in sum that "[o]nly the OCC or an authorized representative of the OCC may exercise visitorial powers with respect to national banks."[6] The NYAG is now challenging whether Section 7.4000 of the OCC regulations should be entitled to judicial deference under the seminal federal deference case, *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[7] The NYAG is also asserting that Section 7.4000 should be deemed to be invalid because it is inconsistent with the authoritative construction of the NBA by the Supreme Court in *First National Bank in St. Louis v. Missouri*.[8]

Background of Dispute

Discrimination in the granting or extension of credit on the basis of race or national origin violates various federal and state laws, including

New York State's Human Rights Law.[9] In 2005, the NYAG initiated an investigation of the lending practices of various lenders, including national banks, based on Home Mortgage Disclosure Act ("HMDA") data indicating a disproportionately higher percentage of high-interest home mortgage loans issued to African-American and Hispanic borrowers than to white borrowers. Under the New York State's Human Rights Law, the NYAG sent letters of inquiry to lenders requesting their voluntary cooperation in the production of more information about their lending practices. Soon after, the OCC and Clearing House Association, L.L.C. ("Clearing House"), a consortium of national banks, filed separate actions in the U.S. District Court for the Southern District of New York, seeking to enjoin the NYAG's investigation and enforcement efforts involving national banks. The request for injunction asserted that the NYAG's efforts constituted an unlawful exercise of visitorial powers under the NBA.[10] Following a joint bench trial, the District Court granted an injunction against the NYAG concluding that the NYAG's actions constituted a form of visitorial authority prohibited by the NBA.[11]

Following appeal to the Second Circuit, a divided three-judge panel upheld the District Court's injunction on the ground that the OCC's interpretation of its scope of visitorial powers under the NBA was entitled to *Chevron* deference. Second Circuit Judge Richard J. Cardamone issued a separate opinion, concurring in part and dissenting in part. In dissent, Judge Cardamone opined the OCC was not entitled to *Chevron* deference in its interpretation of its visitorial powers. In particular, Judge Cardamone disagreed that the OCC's visitorial powers granted it exclusive enforcement authority over *all* applicable federal and state laws concerning banking activities. In support of his dissent, Judge Cardamone noted that, "[b]y limiting the power of the state to enforce applicable state law and vesting that authority in a federal agency under § 7.4000, the usual constitutional balance of power between the states and the federal government is heavily tilted towards the federal government, and the Tenth Amendment is put in peril."[12]

The *Cuomo* case is the first case involving issues of NBA federal preemption since the Supreme Court's 2007 decision in *Watters v. Wachovia Bank, N.A. Watters* upheld the OCC's exclusive visitorial powers over national banks, granted to the OCC under the NBA,[13] as applied to operating subsidiaries of national banks.[14] While both cases involve issues of federal preemption, *Watters* can be distinguished from *Cuomo.* In *Watters*, the question was whether the OCC's exclusive visitorial powers over national banks also extended to their operating subsidiaries, such that the state regulator's actions constituted an illegal exercise of visitorial powers. In *Cuomo*, the NYAG argues that his enforcement of a non-preempted state fair lending law is *not* an attempt to exercise visitorial powers over the national banks, but rather is an exercise of his authority under the state's police power to investigate civil rights violations allegedly committed against the people of New York.[15]

Cuomo challenges the validity of the OCC's interpretation on the scope of its visitorial powers under the NBA,[16] which the OCC interprets as the exclusive authority for "enforcing compliance with any applicable federal or state laws" concerning the activities authorized or permitted to national banks pursuant to federal banking law.[17] The OCC asserts that allowing state officials to enforce compliance with state laws would be duplicative of the OCC's ongoing efforts, and would defeat the purpose of a dual banking system by subjecting national banks to unduly burdensome regulation from states. According to the NYAG, this interpretation effectively deprives states of their basic sovereign powers to enforce non-preempted fair lending and other consumer protection laws against national banks.

Implications for Federally Chartered Banking Institutions

Federal preemption of state laws allows federally

chartered banking institutions to operate under a single set of regulations, enforced by one primary federal regulator. Allowing enforcement of state laws by state officials – rather than vesting such enforcement authority with a single primary federal regulator – would expose national banks and federal thrifts operating in various jurisdictions to multiple, and perhaps contradicting, sets of state laws, thereby increasing the cost of compliance (*e.g.*, for training and technology) and increasing the chance of administrative error or noncompliance. Section 7.4000 does not invalidate state laws, but, rather, designates the OCC as the exclusive enforcer of such provisions, for which it has significant discretion.

Summary

The pending case before the Supreme Court involves far-reaching and lasting consequences for all federally chartered banking institutions. A holding in favor of the NYAG, *i.e.*, allowing state officials to bring enforcement actions against federally chartered banking institutions based on state laws, would diminish a significant benefit of a federal banking charter for institutions that operate across multiple state jurisdictions. Granting enforcement powers to state officials would subject federally chartered banking institutions to the burden of compliance with multiple and competing authorities.

Given the significance of the *Cuomo* case on the operations of federally chartered banking institutions, affected institutions may wish to advise the Supreme Court of such implications through an *amicus* brief on the matter. Under the current schedule, *amici* briefs on this case are due no later than March 25, 2009. Members of Paul Hastings' appellate and banking practices are available to answer any additional questions you may have on the pending *Cuomo* case.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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[1] *The Clearing House Association, L.L.C. and Office of the Comptroller of the Currency v. Cuomo*, 510 F.3d 105 (2d Cir. 2007), *cert. granted*, 77 U.S.L.W. 3242 (U.S. Jan. 16, 2009) (No. 08-453).

[2] 12 U.S.C. § 484 (2001). "No national bank shall be subject to any visitorial powers except as authorized by Federal law . . ." Notwithstanding, "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."

[3] Federal savings banks must also be aware of the implications of this pending case because Section 13 of the Home Owners' Loan Act provides that Office of Thrift Supervision examiners are "subject to the same requirements, responsibilities and penalties as are applicable to examiners under the Federal Reserve Act [12 U.S.C. §§ 221 *et seq.*] and title LXII of the Revised Statutes" and "have, in the exercise of functions under this chapter, the same powers and privileges as are vested in such examiners by law." 12 U.S.C. § 1468b (2001). This cross-reference includes Section 484 of the U.S. Code, which was initially adopted as part of the National Bank Act in 1864 and later recodified by Section 21 of the Federal Reserve Act.

[4] U.S. Const., art. VI, cl. 2.

[5] *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 127 S. Ct. 1559 (2007).

[6] 12 C.F.R. § 7.4000(a)(1). *See* 64 FR 60100 (Nov. 4, 1999).

[7] In *Chevron*, the Supreme Court articulated the standard for judicial review of an agency's construction of a statute which it administers. Under the standard, the first question is "whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress . . . [I]f the statute is silent or ambiguous with respect to the specific issue, the [next] question for the court is whether the agency's answer is based on a permissible construction of the statute." 467 U.S. 837, 842-843 (1984).

[8] In *First National Bank in St. Louis*, the Supreme Court held that a state statute prohibiting branching did not "frustrate the purpose for which the bank was created or interfere with the discharge of its duties to the government or impair its efficiency as a federal agency." 263 U.S. 640, 659 (1924). "The state statute as applied to national banks is, therefore, valid, and the corollary that it is obligatory and enforceable necessarily results, unless some controlling reason forbids; and, since the sanction behind it is that of the state and not that of the national government, the power of enforcement must rest with the former and not with the latter." *Id.* at 659-660. "The state is neither seeking to enforce a law of the United States nor endeavoring to call the bank to account for an act in excess of its charter powers. What the state is seeking to do is to vindicate and enforce its own law, and the ultimate inquiry which it propounds is whether the bank is violating that law, not whether it is complying with the charter or law of its creation." *Id.* at 660.

[9] N.Y. Executive Law § 296-a.

[10] See 12 U.S.C. § 484 (2001).

[11] *The Clearing House Association, L.L.C. v. Spitzer*, 394 F. Supp. 2d 620, 631 (2005).

[12] *The Clearing House Association, L.L.C. and OCC v. Cuomo*, 510 F.3d 105, 130 (2007).

[13] 12 U.S.C. § 484(a) provides that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law . . ."

[14] *Watters*, 127 S. Ct. at 1570-1571.

[15] *See The Clearing House Association, L.L.C. and OCC v. Cuomo*, 510 F.3d at 128.

[16] 12 U.S.C. § 484 (2001).

[17] 12 C.F.R. § 7.4000(a)(2)(iv) (2008).