Key Preemption Ruling Gives States More Power Over National Banks

Scalia Joins Liberal Majority

By John Cooney

In June 2009, the Supreme Court invalidated, by a vote of 5 to 4, a regulation issued by the Office of the Comptroller of the Currency that preempted the states from enforcing their fair lending laws against national banks.

The case, which concerned a New York law, was *Cuomo v Clearing House*. Under the broad language of the majority opinion, the states now implicitly have the authority to enforce other consumer protection laws against national banks.

The issue of the scope of preemption and appropriate limits on state enforcement with respect to national banks ultimately will be decided by Congress. The burden of inertia to overcome the status quo and obtain a new statute now lies on the OCC and the national banks, who must make their case to Congress.

But passage of such legislation may be difficult in this Congress, especially given that Chairman Frank of the House Financial Services Committee participated in the Cuomo case in support of New York's position.

Justice Scalia, joined by the four members of the Supreme Court's liberal block, held that the language of the National Bank Act — that "[n]o national bank shall be subject to any visitorial powers except as authorized by federal law" — did not constitute an absolute prohibition against the states from enforcing their fair lending laws against national banks. The majority accordingly overruled a regulation issued by the OCC that had invoked the term "visitorial powers" to preempt the states from "[e]nforcing compliance with any applicable… state laws" concerning activities authorized or permitted by federal banking law.

OPINION SKIRTS PREEMPTION

In issuing the rule, the OCC conceded that some state laws were applicable to national banks, such as contract, property, zoning, and tax statutes. The question for the majority thus was where to draw the line. Justice Scalia distinguished between the "sovereign-as-supervisor," in which the government exercises administrative powers that allow it to inspect the books and records of a bank on demand, through informal means; and the "sovereign-as-law-enforcer," in which the government acts through formal procedures in its courts to require compliance with its laws of general applicability.

Based on this distinction, the majority held that New York could not lawfully seek to enforce its laws against national banks by the process threatened by its Attorney General, through issuance of an administrative subpoena on his own authority that would compel the institution to produce an enormous volume of documents.

The Court ruled, however, that the state in its capacity as "sovereign-as-law-enforcer" could enforce its laws through a judicial action filed in court. In such

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a lawsuit, compulsory process would be issued only pursuant to the normal discovery rules of the state trial court, and the bank would have recourse to the trial judge to protect its due process rights.

In its briefs and at oral argument, New York emphasized that the substantive provisions of its fair lending statute are exactly the same as the provisions of the federal law. The state thereby eliminated from the case one of the two critical preemption issues involved in bank regulation — whether a state can enforce against federally-chartered institutions a state law that is more restrictive than the counterpart federal statute.

Surprisingly, the opinions in the case do not even mention this issue, but silently preserved this issue for resolution at a later time. The decision addressed only the threshold question whether in passing the National Bank Act in 1864, Congress had explicitly granted the OCC discretionary authority to preempt state laws as they might apply to national banks. The five person majority concluded that the OCC lacked this authority.

Nothing in the logic of Justice Scalia's opinion restricts its scope to the fair lending/racial discrimination area. The decision, therefore, will support state efforts to enforce consumer protection laws against national banks in other areas such as credit card, auto, education and second mortgage loans.

However, the requirement that the states must proceed through formal litigation will make it more expensive and time consuming for the attorneys general to investigate and prepare enforcement cases. Time will reveal the extent to which this requirement will impede state enforcement, because the attorneys general have tools in their arsenals that will allow them to try to pursue enforcement against a national bank without service of compulsory process.

What is clear is that the status quo has changed overnight. Yesterday, the states were precluded from bringing enforcement actions against national banks in a broad variety of areas. Today, the states possess that authority, subject only to the requirement that they pursue their remedies through civil litigation rather preemptory administrative subpoenas.

The Cuomo case only establishes the fact that Congress did not grant the OCC categorical authority to prevent the states from enforcing their laws against national banks in any and all situations. As the states start bringing litigation against national banks in their capacity as "sovereign-as-law-enforcer," a major legal issue will be joined immediately: whether a particular state law that is more restrictive than its federal counterpart is unconstitutional under the doctrine of conflict preemption.

Under that doctrine, a state law may be held unconstitutional if its substantive requirements are: (a) inconsistent with the governing federal law and agency regulations, and (b) might stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in adopting the federal statute.

In many cases, state consumer protection laws are indeed more restrictive than applicable federal laws. If and when a state seeks to enforce such non-identical laws, there will be a subsequent wave of litigation in which national banks will file motions to dismiss enforcement lawsuits on the ground that the state law is preempted to an extent that differs from, and is more onerous than, federal law.

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The Cuomo decision is hardly the last word about the proper scope of federal preemption of state consumer protection laws. This dispute ultimately will be resolved by Congress.

What the litigation has done is determine which side in this battle is protected by the status quo and which side has the burden of trying to persuade Congress to change the existing state of affairs. As a result of the Supreme Court's decision, the burden of inertia has shifted, the states are now protected by the status quo, and the OCC and the national banks will have to take the initiative to change the law. Stopping new legislation from passing is far simpler than persuading both houses of Congress and the White House to adopt a law.

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The effort to persuade Congress to modify the law may be especially difficult in the current Congress. First, national banks may start at a disadvantage because of the adverse publicity surrounding large financial institutions during the recession. Second, the Chairman of the House Financial Services Committee, the Chairman of the House Judiciary Committee, and the Chair of the Joint Economic Committee filed a brief amicus curiae in the Cuomo case that supported New York's position. Third, the Chairman of the House Financial Services Committee has discussed publicly his desire to "un-preempt" the states from some of the rules previously adopted by the OCC.

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