The Scope of State Power

Supreme Court rules that national banks are subject to enforcement of state laws.

By John F. Cooney and Brock R. Landry

In *Cuomo v. Clearing House Association* decided in late June, the Supreme Court rejected the position of the Comptroller of the Currency that the states are pre-empted from enforcing their fair lending laws against national banks. This decision gives state attorneys general some as-yet-undefined degree of authority to bring enforcement actions against national banks under many types of consumer protection laws. Many practical questions remain about the scope of state power over federally chartered institutions, especially whether the states can enforce laws that are more restrictive than the counterpart federal rule. Congress ultimately will have the last word on this vital issue.

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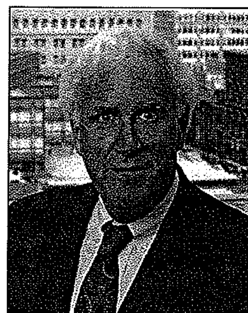

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The Supreme Court Decision

The question in *Cuomo* was whether the National Bank Act, which provides that "[n]o national bank shall be subject to any visitorial powers except as authorized by federal law," absolutely prohibits a state from enforcing its fair lending laws against national banks. The OCC and the banks argued that this provision broadly preempted the states from enforcing compliance with any local laws concerning activities authorized or permitted by federal law.

In response, New York noted that there was no actual conflict between the federal and state laws at issue because New York's fair lending law was identical to the federal statute. Having taken the possible concern with "conflict pre-emption" out of the case, New York argued that in adopting the term "visitorial power" in 1864, Congress did not explicitly prohibit the states from enforcing their laws of general applicability against national banks. The OCC conceded that some state laws were applicable to national banks, such as contract, property, zoning and tax statutes. The question for the Supreme Court was where and how to draw the line that defined when state enforcement is permissible.

At oral argument, the justices wrestled with how to distinguish between safety and soundness regulation, on the one hand, and enforcement of a general state law, on the other, because of the substantial overlap between the two functions. The court ultimately was unable to draw a functional line between the two but instead adopted a procedural distinction.

The five justices in the majority distinguished between the "sovereign-as-supervisor," where the government may, without obtaining a court order, inspect a bank's books and records and compel it to take remedial actions, and the "sovereign-as-law-enforcer," where the government acts through formal court procedures to demand compliance with its laws. Applying

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this template, the majority held that in its capacity as "sovereign-as-law-enforcer," New York could enforce its fair lending laws against a national bank through a lawsuit filed in court, where the bank's rights would be protected by a judge. It ruled, however, that a state may not enforce its laws in the manner attempted by the New York attorney general, by issuance of an executive subpoena on his own authority.

Implications of *Cuomo*

Several conclusions can be drawn from the *Cuomo* decision.

1. This case fundamentally changed the rules governing state regulation of national banks. By adopting a narrow definition of "visitorial powers," the court limited the category of action reserved to the federal government and absolutely forbidden to the states. State attorneys general now possess some degree of independent enforcement authority, subject to the requirement that they proceed through civil litigation rather than by executive subpoena. The logic of the court's decision is not limited to fair lending laws. It justifies state enforcement of a broad array of consumer protection laws against national banks in such areas as credit card, auto, education and second mortgage loans.

2. The requirement that state attorneys general may enforce their laws against national banks only through formal judicial proceedings will make it more expensive and time-consuming for them to investigate and bring an individual case. Like other prosecutors, however, the attorneys general have many tools at their disposal with which to persuade national banks to cooperate with investigations conducted through less formal procedures. The bottom line is that as a result of *Cuomo* and the green light for independent enforcement that the Supreme Court has now given the states, federally chartered depository institutions will be subject to more enforcement actions than in the past.

3. The *Cuomo* decision resolved only the threshold question of whether a state is absolutely prohibited from enforcing its consumer protection laws against a national bank. It did not address the critical conflict pre-emption question – whether the particular law a state seeks to enforce is unconstitutional because it is more restrictive than the counterpart federal provision and would interfere with the carrying out of the federal purpose.

> Many **practical questions** remain about the **scope** of state power over federally chartered institutions.

The conflict pre-emption issue will take center stage when the first state seeks to implement its distinct consumer protection laws against a national bank. In many instances, state laws are more restrictive than federal rules. As matters now stand, if a state attempts to implement a more stringent aspect of its law, the national bank will immediately move to dismiss the enforcement action based on conflict pre-emption grounds. Whether this defense continues to remain available and to provide effective protection to federally chartered institutions will depend importantly on what Congress decides in the coming months.

Congressional Proposals on Pre-emption

Shortly after *Cuomo* was decided, the Obama Administration and House Financial Services Committee Chairman Barney Frank introduced bills to create a federal Consumer Financial Protection Agency. Both bills have similar provisions concerning pre-emption of state consumer protection laws. They provide that nondiscriminatory state laws would apply to federally chartered institutions (including, specifically, national banks and thrifts), and a law would not be pre-empted as inconsistent with federal law on the ground that "the protection it affords consumers is greater than the protection provided under federal law."

This proposal is consistent with Obama Administration policy. On May 20, the president instructed the heads of all executive agencies that "pre-emption of state law... should be undertaken only with full consideration of the legitimate prerogatives of the states." He specifically directed that his appointees "should not include pre-emption provisions in codified regulations" without sufficient legal authority and required them to review all pre-emption rules issued in the past 10 years to determine if they are lawful.

Federally chartered institutions with operations in multiple states have generally opposed these bills, based in part on concern that if the doctrine of conflict pre-emption is eliminated or restricted, they would become subject to the potentially conflicting laws of 51 different jurisdictions and would face significant difficulties in their efforts to offer consumer products nationwide. This promises to be a difficult fight.

As a result of *Cuomo*, the status quo now protects state authority, and a major assault on the critical defense of conflict pre-emption is now underway in Congress. This is a fundamental reversal of position that will have practical consequences for federally chartered depository institutions for years to come.

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