

FPB Blog Entry on *Watters v. Wachovia Bank*

It's no secret that many of the most generous contributors to the President are energetically calling for major "tort reforms" – measures to eliminate or reduce the liabilities corporations face for various harm that they cause to others.

It's also a matter of public record that these corporations have not as of yet been able to get Congress to pass the vast majority of the items on their wish list. While corporations have received some Christmas gifts from the Congress (most importantly, the euphemistically named Class Action Fairness Act and the Bankruptcy Reform Act), most corporations do not yet enjoy the kind of sweeping immunity from any liability for which they've been hoping.

While the White House cannot quite dictate its will unfettered to the legislative branch, it does have complete control over the administrative agencies of the executive branch. It is through this control of administrative agencies that the Administration has principally attempted to immunize powerful corporations from legal liability, by means of administrative regulations that attempt to expand the scope of federal preemption of state consumer protection laws.

It is widely recognized that in many areas of the law, state laws provide individual consumers with far better and more generous remedies and rights than federal law. Nonetheless, the Supremacy Clause of the U.S. Constitution provides that federal law trumps state law when the two clash. Accordingly, one of the most common arguments that corporations make when they are caught violating state consumer protection laws or state tort laws is that those laws are supposedly preempted by federal law. In case after case, corporations have vehemently argued that they are exempt from most or all state laws, on the grounds that the only standards they must meet are those contained in weaker, toothless or even non-existent federal laws. The pitch is

reminiscent of the old B’rer Rabbit story: corporations want to be excused from the “clutches” of those who would actually hold them accountable, and instead to be thrown into the briar patch of federal law.

Accordingly, a series of federal administrative agencies have recently adopted regulations that attempt to free corporations from state laws. For example, the National Highway Safety Transportation Administration has tried to immunize auto manufacturers from liability if they defectively design car roofs in ways that kill drivers or passengers in accidents. Similarly, the Food and Drug Administration is trying to exempt drug manufacturers for liability if defective medicines kill or injure American citizens.

This fall, the U.S. Supreme Court will hear arguments in a case that tests the outer limits of this multi-faceted Administration effort to use federal agency rules to strip Americans of their legal protections under state law. This case, *Watters v. Wachovia Bank*, challenges a federal agency’s attempt to re-write a statute to give itself far more power and to wipe away a long-standing regime of state law.

The federal agency at issue in *Watters* is the Office of Comptroller of Currency (“OCC”). If there were ever to be a contest to name “The Most Co-Opted Federal Agency,” a great many consumer lawyers and consumer advocates would vote for the OCC, because of its huge incentive to please the banks it regulates and a pattern of behavior where it has acted on that incentive. Under our current, odd system, banks have great control over who will regulate them, as they may choose to be state regulated banks, federally regulated thrifts, or national banks that are regulated by the OCC. The OCC wants and needs for as many banks as possible (and especially as many wealthy banks as possible) to choose it for their regulator, because it depends

heavily upon industry user fees for its budget. As just one illustration of this phenomenon, approximately 10% of the OCC's annual budget comes from Bank of America alone!

The conduct of the OCC at issue in *Watters* concerns OCC's attempt to expand its federal jurisdiction and the preemptive reach of the National Bank Act ("NBA"). The NBA sets out a scheme for regulating the operations of national banks. One of the most important changes brought about by the OCC's regulations concerns the applicability of the NBA to entities that are not even banks. Although the NBA exempts national banks from many state laws, it does not exempt their operating subsidiaries – which are not banks and are created under state law. Nonetheless, back in 2001, the OCC announced – on its own authority, supposedly, without really tethering itself to the actual language of the statute – that these operating subsidiaries are just as exempt from state laws as national banks. This led to the present controversy in *Watters*, where a Michigan mortgage lender that was not a bank claimed that the OCC's regulations immunized it from Michigan laws protecting consumers from predatory lenders.

My firm, Trial Lawyers for Public Justice, joined in an *amicus* brief that was principally written by Kathleen Keest of the Center for Responsible Lending (CRL), and which was also joined by 10 other public interest groups, and 17 law professors. Kathleen is widely acknowledged as one of the nation's leading experts on the subject of federal preemption in the banking industry; she probably forgets more about these issues between breakfast and lunch than most lawyers learn in their careers. A copy of the brief is available on TLPJ's website, www.tlpj.org. This brief shows that the stakes involved in *Watters* are enormous. The OCC has brought only a handful of consumer protection or anti-discrimination enforcement cases in several decades, and has a tiny staff to handle such cases. The state agencies, by contrast, have

hundreds of employees and investigators to handle these cases, and have filed hundreds of successful enforcement actions. If the national banks' operating subsidiaries win this case, state laws barring their predatory lending will be gutted – and replaced with absolutely nothing.

The Supreme Court will decide whether judges should give great deference to the OCC's attempt to expand its federal jurisdiction and the preemptive reach of the NBA. While government agencies are often given broad deference to write regulations as they wish, in this case it might make sense for the Supreme Court to view the regulatory agency in a more cautious light. The OCC's neutrality is in question because of its huge financial stake in expanding its jurisdiction. There have been occasions where OCC officials have openly urged banks to declare themselves "national banks" in order to avoid having to follow state law.

The simple truth is that the NBA does not apply to non-bank operating subsidiaries, and it should not be re-written to do so. To hold otherwise would create a shield of liability whereby corporate banks would be immune from liability for the misdeeds of their subsidiaries under state corporate law, and the subsidiaries themselves would be immune from state consumer protection laws, thanks to the OCC's reading of the NBA. Suppose, for example, a non-bank subsidiary committed widespread fraud and ripped off thousands of consumers, incurring enormous financial liabilities. The national bank that owned the subsidiary would say "all those liabilities are limited to the subsidiary, they don't apply to us. Holding us responsible would be like suing Exxon's shareholders if Exxon has another oil spill." Put another way, in *Watters*, the banks are taking a position that would let them have it both ways. They want to say that they aren't responsible for the actions of their non-bank subsidiaries, because the state corporation laws under which those subsidiaries are created provide a layer of protection. At the same time,

however, the national banks want to say that their subsidiaries are different from other state corporations, because they're exempted from all state laws under the NBA.

The *Watters* case is not just important for the impact it may have on the banking industry. It is also important more broadly for what it says about the ability of administrative agencies to expand the scope of federal preemption. Again and again, federal agencies are trying to wipe away state laws, and they are hoping that the courts will defer to them in their efforts to do so. *Watters* arguably tests some of the outer limits of how far federal agencies can go in preempting state laws. Can federal agencies go well beyond the language of the statutes passed by Congress to preempt state laws? Should the Supreme Court give particular deference to agencies who have a strong incentive to wipe away state laws? Consumers should hope that the Supreme Court responds with the answer "no" to these questions when it decides *Watters* this fall.