NOTES

THE UNWARRANTED REGULATORY PREEMPTION OF PREDATORY LENDING LAWS

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In response to a perceived increase in the incidence of predatory lending, several states have recently enacted laws designed to protect vulnerable borrowers from abusive lenders. Earlier this year, however, the Office of the Comptroller of the Currency (OCC) determined that the new laws conflicted with the National Bank Act and issued a regulation preempting them. This Note argues that the OCC overstepped its congressionally delegated authority when it promulgated the regulation, and that courts should consequently invalidate it in order to allow states to continue to develop novel legislative responses to the growing problem of abusive lending. The Note proceeds in two stages. First, after canvassing the unsettled case law on the issue, it argues that courts should not categorically defer to agency decisions to preempt state laws. Because of the relative ease with which administrative agencies can preempt state laws and the real threat that preemption orders pose to state legislative independence, the judiciary should scrutinize agency preemption decisions to ensure that they are at the very least reasonable. Second, the Note turns to the substance of the OCC order, contending that it reflects an unwarranted, unnecessary, and unwise effort to meddle in states' purely internal affairs. Because the predatory lending laws only minimally affect national bank lending powers, do not impose costs on the national banking system, and do not generate spillover effects, they do not interfere with national banks in a way that can justify the OCC's wholesale preemption.

INTRODUCTION

In January 2004, the Office of the Comptroller of the Currency (OCC)[1] determined that the National Bank Act[2] preempted a

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1 The Office of the Comptroller of the Currency is a federal agency in the Treasury Department that "charters, regulates, and supervises national banks to ensure a safe, sound, and competitive banking system." OCC Website, *at* http://www.occ.treas.gov (last revised Oct. 8, 2004).

2 12 U.S.C. §§ 21-216d (2000).

recently enacted raft of state consumer-protection laws that state legislatures had hoped would curb what they perceived as an epidemic of predatory lending.[3] The OCC's comprehensive regulation effectively guts states' ability to legislate against predatory lending practices and sets federal law as a de facto ceiling for borrower protection from abusive lending.[4]

This Note argues that the OCC overstepped its congressionally delegated authority in enacting this regulation, and that courts should strike it down in order to leave space for state legislatures and Congress to develop and test novel responses to the growing problem of abusive lending. By preventing states from crafting their own responses to a serious and growing problem—one that defies a straightforward legislative approach—the OCC has virtually ensured that vulnerable borrowers will remain underprotected by underinclusive and underenforced federal law.[5] The preemption regulation thus exemplifies the threat to states' legislative independence posed by allowing weakly accountable federal agencies the unfettered authority to preempt allegedly conflicting state laws. The desirability of judicial policing of agencies' preemptive authority is plain when, as here, agency preemption threatens to hamstring states in their efforts to address what their legislatures have deemed a serious consumer-protection issue.[6] As Iowa's Attorney General put it when testifying before Congress about the OCC preemption, "What we are discussing here today [are] not just . . . arcane, obscure banking regulations. These are fundamental issues of democracy, accountability, federalism, and the boundary between legislative prerogative and bureaucratic fiat."[7]

[3] Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1917 (Jan. 13, 2004) (to be codified at 12 C.F.R. § 34.4(a) (2004)) [hereinafter Preemption Regulation] ("[S]tate laws that obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized real estate lending powers do not apply to national banks.").

[4] *See infra* Part I.E.

[5] *See* Dennis Hevesi, *Looser U.S. Lending Rules Are Protested*, N.Y. TIMES, Apr. 2, 2004, at B8 ("'To think . . . [that the OCC] is trying, in the context of predatory lending, to take away the few voices protecting the most vulnerable individuals, it's an abomination.'" (quoting New York Attorney General Eliot Spitzer)).

[6] *See Congressional Review of OCC Preemption: Hearing Before the Subcomm. on Oversight and Investigations of the Comm. on Financial Services*, 108th Cong. 86 (2004) (statement of Thomas J. Miller, Att'y Gen. of Iowa) (arguing on behalf of all fifty state attorneys general that "the proper balances of federal and state standards and authority to enforce those standards are legislative decisions, not bureaucratic ones").

[7] *Id.*

Part I provides background on the new predatory lending legislation and the secondary mortgage market to give the necessary context for a discussion of the OCC's preemption orders.

Part II shifts to an overview of the role that courts play in reviewing agency preemption decisions, and focuses specifically on the amount of deference that is appropriate when agencies flex their preemption powers. While agency preemption decisions certainly merit some consideration, a categorical deference is in tension with the judiciary's baseline presumption that Congress does not intend to preempt state laws in the absence of a plain statement to the contrary. This tension has muddled Supreme Court jurisprudence on regulatory preemption, leaving it unclear how much deference lower courts ought to give to agency preemption orders. Because of the weak institutional constraints on federal agencies' exercise of their preemption authority, I argue that meaningful judicial scrutiny of regulatory preemption is necessary to ensure that agencies do not exceed their congressionally delegated authority and threaten the lawmaking integrity of state legislatures.

Part III turns to the specific preemption regulation and the OCC's contention that state predatory lending laws interfere with national bank powers. It begins by showing that the concerns prompting the call for enhanced judicial scrutiny of regulatory preemption are acute in this case, particularly given Congress's explicit statement that state consumer protection and fair lending laws should not be preempted.[8] The Note then challenges the OCC's position that national banks are entitled to special deference, and demonstrates that the case law marking out the scope of national bank power vis-à-vis arguably conflicting state laws requires a case-by-case assessment of the degree to which state laws interfere with national banks' delegated powers. I conclude by arguing that because the predatory lending laws only minimally affect national banks' lending powers, do not impose costs on the national banking system or impede the proper functioning of the secondary mortgage market, and do not generate spillover effects, they do not interfere with national banks in a way that can justify the OCC's wholesale preemption of these state laws.

[8] Congress has previously chastised the OCC for its aggressive preemption measures. *See* H.R. CONF. REP. NO. 103-651, at 53–54 (1994).

I.
AN OVERVIEW OF THE PREEMPTION BATTLEGROUND

A. A Primer on Predatory Lending

In 1994, lenders floated mortgage loans worth $34 billion to borrowers with less than pristine credit. By 2002, that number increased more than six fold to $213 billion.[9] This explosion in subprime lending,[10] fueled by the financial market's "[g]rowing recognition of the capacity to lend profitably to borrowers . . . in areas once thought too risky,"[11] has provided a much-needed source of credit to individuals who cannot borrow in the prime market.[12]

The rise of subprime lending, however, has brought with it an attendant increase in the sharp and sometimes fraudulent lending practices that commentators have termed "predatory."[13] While it is difficult (if not impossible) to craft a bright-line definition,[14] a preda-

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[9] ROBERTO G. QUERCIA ET AL., CTR. FOR CMTY. CAPITALISM, THE IMPACT OF NORTH CAROLINA'S PREDATORY LENDING LAW: A DESCRIPTIVE ASSESSMENT 2 (June 2003) (citing Mortgage Market Statistical Manual 2003), *available at* http://www.kenan-flagler.unc.edu/assets/documents/CC_NC_Anti_Predatory_Law_Impact.pdf. As a share of all mortgage originations, subprime originations rose from less than five percent to almost thirteen percent between 1994 and 1999. U.S. DEP'T OF HOUS. & URBAN DEV. & U.S. DEP'T OF TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT 2 (2002) [hereinafter HUD-TREASURY REPORT], http://www.huduser.org/publications/hsgfin/curbing.html. To appreciate the magnitude of this market, consider that the total dollar amount of subprime loans originated in 2002 was just shy of the entire gross domestic product of Sweden ($229.8 billion). World Bank Group, Data-Query, *at* http://www.worldbank.org/data/dataquery.html.

[10] "Subprime mortgages generally are made to individuals and households with impaired or limited credit histories, or high debt relative to their income. Subprime mortgages also are made to creditworthy borrowers with variable or hard-to-document income." HUD-TREASURY REPORT, *supra* note 9, at 26. Because subprime borrowers are more likely than prime borrowers to default, they typically pay a higher interest rate on their mortgage loans. *Id.* at 28.

[11] NICOLAS P. RESTINAS & ERIC S. BELSKY, LOW-INCOME HOMEOWNERSHIP: EXAMINING THE UNEXAMINED GOAL 4 (2002). By the 1990s, the advent of powerful new risk assessment tools and technologies converged with stepped-up regulation and enforcement of community lending laws, as well as sometimes withering media attention on fair lending, to drive low-income mortgage lending to new heights. Aided by a strong economy and automated underwriting tools, mortgage lenders were emboldened to reach out to low-income, minority, and immigrant markets in new ways. *Id.* at 7.

[12] *See* HUD-TREASURY REPORT, *supra* note 9, at 2–3 ("By providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending provides an important service, enabling such borrowers to buy new homes, improve their homes, or access the equity in their homes.").

[13] *See id.* at 17–18. For a discussion of the increased risks of clustered foreclosures in low-income areas, see JOINT CTR. FOR HOUS. STUDIES, HARVARD UNIV., THE STATE OF THE NATION'S HOUSING (2003), *available at* http://www.jchs.harvard.edu/publications/markets/son2003.pdf.

[14] Perhaps the clearest way of conceptualizing the difficulty with crafting an operational definition is to recognize that "[t]here are two extremes of subprime lending—

tory loan can usefully be thought of as a mortgage loan or a series of mortgage loans made by unethical lenders to exploit financially unsophisticated or unwary borrowers.[15] Predatory loans often—although not always—share certain characteristics. Those characteristics may include exorbitantly high interest rates, excessive and hidden fees, large prepayment penalties, negatively amortized payment plans, or required balloon payments.[16] Most predatory lenders refinance existing loans; some offer to consolidate existing mortgages; still others are contractors who offer to refinance a mortgage loan in order to make unnecessary or wasteful repairs.[17] A particularly pernicious hallmark of predatory lending is "loan flipping," which occurs when a mortgage broker convinces an unsuspecting borrower to needlessly and repeatedly refinance her mortgage. Every time the loan is "flipped," the lender extracts value from the borrower in the form of refinancing fees or prepayment penalties.[18]

Predatory lending is correlated with a high rate of mortgage foreclosures and is concentrated in low-income neighborhoods, where its effects can be devastating to individuals and communities.[19] Its harms fall disproportionately on those groups that are overrepresented in the subprime mortgage market: minorities, single women, the poorly educated, and the elderly.[20] These borrowers typically enter into predatory lending agreements under pressure from unscrupulous and aggressive lenders who promise to lighten borrowers' debt burdens.[21] The result for the borrowers is (sometimes grotesque) overpayment, foreclosure, or both.

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lending that is clearly beneficial and justifiable and lending that is clearly fraudulent. Between these two poles there exists a range of practices and combinations of practices that may be labeled predatory based on the circumstances in which they are used." Deborah Goldstein, Note, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 HARV. C.R.-C.L. L. REV. 225, 228–29 (2000).

[15] Siddhartha Venkatesan, Note, *Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending*, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 177, 177 (2004).

[16] HUD-TREASURY REPORT, *supra* note 9, at 17–24. A loan is negatively amortized when the required payments are insufficient to cover even the accrued interest on the loan. The remaining interest is added to the principal amount, increasing the borrower's overall debt burden over time. *Id.* at 91. A balloon payment occurs when a borrower's regular monthly payments do not repay the loan principal and the borrower is left with a lump-sum balance due at the end of the loan term. *Id* at 96.

[17] *Id.* at 1.

[18] *Id.* at 5.

[19] *Id.* at 47–51.

[20] *Id.* at 35–37.

[21] *Id.* at 39.

Lenders stand to gain from predatory lending in one of three ways: They might (1) receive higher interest payments than they would otherwise receive in a competitive market; (2) foreclose on the value of the collateral; or (3) immediately sell the mortgage loan on the secondary mortgage market in exchange for cash.[22] Most unscrupulous mortgage originators are thinly capitalized brokers[23] that choose the third option.[24]

B. *The Secondary Mortgage Market*

Reduced to its essentials,[25] the secondary mortgage market works as follows: A lender will issue (or "originate") a loan to a borrower, taking a repayment note (as consideration) and a mortgage on the borrower's property (as collateral). If a lender decides that it would prefer a lump-sum cash payment to an income stream, it can offer to sell the mortgage loan to Fannie Mae, Freddie Mac,[26] or another securitizing institution (e.g., a commercial bank). The price paid for the loan will reflect the present value of the future income stream discounted by the risk that the borrower will default. Upon receipt of a large enough number of similar mortgage loans, the purchasing institution will pool the loans together and sell shares in that pool. The loan payments made on the pooled mortgages then "pass through" to the pool's shareholders on a pro rata basis.[27] Risk to the ultimate

[22] *Id.* at 39–40, 76–77.

[23] *Id.* at 39 n.42 ("While some brokers utilize warehouse lines of credit to fund loans, most brokers' loans are 'table funded.' In table funding, a loan is processed and closed in the name of the broker. At or about the time of settlement, there is an advance of monies and a transfer of the loan to an investor, ordinarily a finance company, mortgage banker or depository institution.").

[24] *Id.* at 107–08 ("About 35 percent of subprime lending by dollar volume in 1999 was securitized. The volume of subprime loans purchased outright in the whole loan market is not known, though it likely represents a substantial remainder of the non-securitized portion of the market.").

[25] For a more thorough description of the secondary mortgage market, see Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL. L. REV. 1261, 1263–73 (1991).

[26] Fannie Mae was originally a government agency charged with spurring the development of a secondary mortgage market during the Depression. In 1968, the government privatized Fannie Mae and in 1970 created a competing private company, Freddie Mac, both of which maintained ties to the federal government. *Id.* at 1267. Because both Fannie Mae and Freddie Mac are treated by investors as if backed by the full faith and credit of the United States, the institutions are able to borrow money at an extremely low rate. They are behemothic as a result: "With $1 trillion in assets, Fannie Mae is the third-largest United States financial company, behind Citigroup and Bank of America. Freddie Mac, with $700 billion in assets, is fifth." Alex Berenson, *2 Big Mortgage Agencies Pressed to Buy More Low-Income Loans*, N.Y. TIMES, May 12, 2004, at C1.

[27] The secondary mortgage market has dozens of other arrangements that make this distribution differently and appeal to different types of investors. *See, e.g.*, CURTIS J.

purchaser is minimized by holding a portion of a large number of loans; even if a few of the loans in the pool go into default, the total value of the investment will remain stable.[28] These mortgage-backed securities are thus highly liquid, and are bought and sold on financial markets in much the same way as bonds or corporate shares. In addition, placing mortgages on the national capital market allows for an efficient geographical allocation of lending resources and reduces the sensitivity of home mortgage loan rates to changes in local conditions.[29] More importantly, because mortgage-loan originators can sell their loans for cash on the secondary market and relieve themselves of an undiversified asset, they can afford to charge borrowers lower interest rates.

The advantages of an integrated capital market accrue to all lenders, however, including abusive lenders. The secondary mortgage market can encourage predatory lending by allowing thinly capitalized and unregulated mortgage originators to exchange abusive loans for cash. As the secondary market has plunged deep into the subprime market, predatory lenders have used it to magnify their ability to exploit vulnerable groups.

C. Federal Regulation of Predatory Lending

The existing regulatory structure provides some minimal protection to borrowers from predatory practices. Most of this protection comes from the federal Home Ownership and Equity Protection Act of 1994 (HOEPA),[30] which was intended to "provide consumers enhanced protections for certain high-cost home loans."[31] The law seeks to balance protecting at-risk borrowers from abusive lenders against enabling the provision of low-cost credit to consumers. HOEPA's protections are triggered only in two circumstances: when a mortgage loan has a particularly high interest rate, or when the origi-

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BERGER & QUINTIN JOHNSTONE, LAND TRANSFER AND FINANCE: CASES AND MATERIALS 142–50 (4th ed. 1993).

[28] There are other risk-management tools as well, the most important of which is mortgage insurance, provided (for a premium) by Fannie Mae and Freddie Mac.

[29] *See* Schill, *supra* note 25, at 1269.

[30] 15 U.S.C. § 1602(aa) (2000).

[31] HUD-TREASURY REPORT, *supra* note 9, at 53. The scope of the law is narrow:

> [It] does not prohibit loans with high interest rates or fees or cap rates. . . . Instead, it subjects certain loans, the rates or fees for which exceed specified rates or fees (HOEPA loans) to enhanced disclosures, restrictions on certain contract terms, and private and administrative consumer remedies for violations of the act.

Id.

nator's points and fees are atypically large.[32] Variations on these "interest rate" and "points and fees" triggers form the heart of virtually all subsequent predatory lending legislation.[33]

Once a loan triggers HOEPA, the law restricts prepayment penalties and forbids several contract terms that are the hallmarks of predatory lending.[34] Beyond these hard-and-fast rules, a lender may not engage in a pattern or practice of extending HOEPA mortgage loans "without regard to the consumer's ability to repay from other sources . . . other than home equity."[35]

HOEPA also includes an assignee-liability provision that imposes liability on mortgage purchasers up to the value of the high-cost loan (plus fees) if the loan fails to conform with HOEPA.[36] The loans that trigger HOEPA's protections are therefore not bought and sold in securities packages like conventional mortgage loans. For this reason, HOEPA loans are issued only by large financial institutions that can afford to keep them on their books.

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[32] *See id.* at 53–54 (describing HOEPA's triggers). The Federal Reserve recently set the interest trigger rate at eight percent. 12 C.F.R. § 226.32 (2004).

[33] *See, e.g.*, GA. CODE ANN. § 7-6A-2(17) (2004).

[34] According to the HUD-TREASURY REPORT:

> A HOEPA loan may not: have, after default, a rate of interest higher than the rate before default; in most circumstances, require a balloon payment on a loan with a term less than five years; contain terms creating negative amortization; or require prepayment at closing of more than two periodic payments.

HUD-TREASURY REPORT, *supra* note 9, at 53–54.

[35] *Id.*

[36] *Id.* The assignee-liability provision of HOEPA abrogates the holder-in-due-course doctrine for purchasers of high-cost home loan mortgages. The holder-in-due-course doctrine normally protects a good-faith transferee of a negotiable instrument (here, a mortgage loan) from so-called "personal" defenses or claims by the obligor (here, the borrower) on the instrument. U.C.C. § 3-305 (1990). There are exceptions to the rule, however, for "real" defenses, which include, inter alia, illegality, infancy, duress, lack of legal capacity, or fraud. For a discussion of the distinction between "real" and "personal" defenses, see Clayton P. Gillette, *Rules, Standards, and Precautions in Payment Systems*, 82 VA. L. REV. 181, 238–39 (1996). The illegality defense, Gillette points out, does not fit comfortably into the personal/real paradigm. Gillette argues that "[r]eal defenses . . . may best be understood as indicating categories of cases in which there has been a legislative determination that [holders in due course] who share certain attributes . . . are in a better position than the obligor to avoid the losses from a defective transaction." *Id.* at 241. Where the legislature has not spoken on the holder-in-due-course enforceability of a *particular kind* of illegal instrument, however—as is the case with HOEPA—there is a legal muddle. Gillette's suggestion: "If . . . we thought that those who accept instruments that arise out of certain types of illegal transactions were systematically involved in the underlying illegality, we might want to deny [holder-in-due-course] rights, even if we could not prove involvement in the illegality in any particular case." *Id.* at 247. Whether HOEPA or the state laws fall into this category is an open question; it is at least arguable that purchasers of predatory loans are "systematically involved" in the underlying abusive lending. However, most commentators (and financial markets) have simply assumed that assignees will remain protected.

HOEPA has done little to curb predatory lending,[37] primarily because it fails to prevent so-called "junk fees." An unscrupulous lender can avoid HOEPA simply by "packing" a mortgage loan with a litany of unnecessary costs for providing certain named services that are related to, but technically independent of, the mortgage itself.[38]

HOEPA's second major flaw is that it does nothing to curtail loan flipping, and may in fact promote the practice. There is a significant amount of anecdotal evidence suggesting that HOEPA provides an incentive to unscrupulous lenders to make home loans at interest rates and fees that hover just below the HOEPA triggers, and then quickly refinance those mortgage loans ("flipping" them) in order to extract the same fees again.[39] No individual loan will, on its face, trigger HOEPA's protections—but the net effect on a borrower can be devastating.

Given HOEPA's flaws and the absence of other robust federal regulation, states began to devise their own strategies to combat predatory lending.

D. *State Regulation of Predatory Lending*

Following North Carolina's lead in 1999, a growing handful of states over the past few years have enacted predatory lending legislation.[40] The Georgia Fair Lending Act (GFLA)[41] was the first state law to impose assignee liability, and thus the first to attract serious opposition from financial institutions. GFLA is typical of the new type of state legislation and thus instructive as a case study.

At first blush, GFLA appears merely to incorporate HOEPA rather than augment it. It sets its interest rate trigger with direct reference to HOEPA and includes a similar points-and-fees trigger.[42] The law differs, however, in two significant respects. First, GFLA has a broad definition of what constitute "points and fees."[43] The intent of this broader definition is to cure the "junk-fee" gap in HOEPA by making it more difficult for unscrupulous lenders to entice borrowers

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[37] *See, e.g.*, HUD-TREASURY REPORT, *supra* note 9, at 84–85.

[38] As one critic has put it, "Very often, the perceived overcharges [seen in predatory lending] manifest[ ] themselves in numerous, separately-named and itemized fees and charges imposed by mortgage brokers and mortgage lenders, *i.e.*, 'junk fees.'" Donald C. Lampe, *Trigger Happy: Enactments and Aftereffects of North Carolina's "Predatory Lending" Law* 1–2 (2003), *available at* http://www.butera-andrews.com/legislative-updates/directory/new-developments/Lampe%20NC%20Analysis.pdf.

[39] HUD-TREASURY REPORT, *supra* note 9, at 54.

[40] *See infra* notes 44–45 and accompanying text.

[41] GA. CODE ANN. §§ 7-6A-1 to -13 (2004).

[42] GA. CODE ANN. § 7-6A-2(12), (17) (2004).

[43] § 7-6A-2(12).

with a low interest rate mortgage only to saddle them with crippling fees. Second, to prevent lenders from evading HOEPA by rapidly "flipping" mortgages, GFLA lays out a case-by-case standard for evaluating the legality of particular loans.[44] This standard involves the judiciary in assessing the validity of a mortgage loan and inserts an element of uncertainty into the mortgage-loan process. That said, a bright-line definition of "flipping" would likely prove either grossly overinclusive, thereby chilling subprime lending between legitimate lenders and borrowers, or underinclusive, thereby failing to curb loan flipping.

Under GFLA's assignee-liability provision, assignees of high-cost home loans "shall be subject to all affirmative claims and any defenses with respect to the high-cost home loan that the borrower could assert against the [originator] of the high-cost home loan."[45] The hope of legislatures and advocates was that GFLA would fulfill HOEPA's initial promise and make it impossible for thinly capitalized brokers to exchange predatory loans for cash. The only mortgage brokers that could then afford to make high-cost home loans would be those which, like the institutions which make HOEPA loans, have the resources to maintain the loan on their books. Larger and more established financial institutions would, in turn, be more compliance oriented for at least two reasons: (1) They would be subject to greater regulatory control than their fly-by-night counterparts; and (2) they would be much less willing to risk the negative press associated with the exposure of any predatory lending practices.[46]

Other states have followed in Georgia's footsteps. New Jersey, New Mexico, New York, and Massachusetts have all passed laws that broaden the points-and-fees definition of HOEPA, include anti-flipping provisions, and impose assignee liability on purchasers of illegal loans.[47] Other states, including North Carolina, have opted not to impose assignee liability, but have passed otherwise similar laws that

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[44] The Code states:

> Flipping a home loan is the consummating of a high-cost home loan to a borrower that refinances an existing home loan that was consummated within the prior five years when the new loan does not provide reasonable, tangible net benefit to the borrower considering all of the circumstances including, but not limited to, the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances.

§ 7-6A-4.

[45] § 7-6A-6(a).

[46] HUD-TREASURY REPORT, *supra* note 9, at 2.

[47] N.J. STAT. ANN. §§ 46:10B-23 to -24, -25(b), -27(a) (West 2004); N.M. STAT. ANN. §§ 58-21A-3–4, 58-21A-11 (Michie 2003); N.Y. BANKING LAW §§ 6-l.1(g)(1), 2(i), 13 (McKinney 2004); MASS. GEN. LAWS ch. 268 § 1 (2004); *see also* Chris Reidy, *New Law Aims to Halt Predatory Home Loans*, BOSTON GLOBE, Aug. 11, 2004, at C1.

seek to cure some of HOEPA's deficiencies.[48] The laws vary from state to state depending on the legislatures' assessments of how best to address predatory lending, but their basic contours are similar.

E. Preemption Orders

In August 2003, the OCC determined that the National Bank Act preempted the GFLA as applied to national banks and their subsidiaries.[49] At the same time, the OCC proposed another regulation for notice and comment that would preempt *all* state predatory lending laws—with or without assignee-liability provisions—as applied to national banks.[50] That regulation went into effect on January 7, 2004.[51]

The preemption regulation, although technically applying only to federally chartered institutions, effectively guts state predatory lending legislation. On the one hand, if states maintain predatory lending laws in the face of preemption, only state-chartered institutions will bear the costs. Federally chartered institutions that had to comply only with more lenient federal regulations would squeeze state institutions subject to more stringent requirements out of the subprime market.[52] On the other hand, a repeal of those laws would leave state-based lenders free to engage in the very predatory lending practices that the state legislatures had hoped to address. Either way,

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48 N.C. GEN. STAT. §§ 24-1.1E, -10.2 (2003).

49 Preemption Determination and Order, 68 Fed. Reg. 46,264 (Aug. 5, 2003) [hereinafter GFLA Preemption Order].

50 Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 46,119 (proposed Aug. 5, 2003) (to be codified at 12 C.F.R. pts. 7, 34).

51 Preemption Regulation, *supra* note 3. The OCC concurrently enacted a regulation sharply curtailing the ability of state regulators and supervisors to exercise their "visitorial powers" to oversee the activities of national banks. Bank Activities and Operations, 69 Fed. Reg. 1895, 1904 (Jan. 13, 2004) (to be codified at 12 C.F.R. § 7.4000(a)(3) (2004)). A discussion of that rule—which is problematic for many of the same reasons as the Preemption Regulation—is outside the scope of this Note.

52 While national banks are not presently engaged in a significant amount of subprime lending, they would be likely to redouble their efforts in the subprime market if a regulatory shift gave them a competitive advantage over state-based lenders who could no longer compete on interest rates. National banks might argue that the third-party brokers responsible for most predatory lending would remain subject to the state-based law. It would be easy, however, (1) for third-party brokers to be brought in-house as ostensible subsidiaries of the national banks, thereby rendering the state laws inapplicable to them; (2) for national banks to create brokerage wings designed to originate subprime loans; or (3) for state banks to abandon their charters and convert to national banks. *See* Jathon Sapsford, *Critics Cry Foul over New Rules on Bank Review*, WALL ST. J., Jan. 8, 2004, at C1 ("'[The OCC's regulation will] entice state-chartered banks to obtain a national charter and seek the immunity that the OCC is offering. By giving banks a safe harbor, the OCC has a chilling effect on state laws.'" (quoting New York State Attorney General Eliot Spitzer)).

states that prefer a higher level of protection than that offered by federal law would be foreclosed from exercising that preference.

John Hawke, the current Comptroller of the Currency, argues that this is the natural state of affairs in our dual-banking system, which is designed to foster competition between state and national banks in order to create a better and more innovative system overall. According to Hawke, the predatory lending laws undercut this competitive system:

> [W]here has innovation in consumer protection been in Georgia and those other states that have adopted parity preemption provisions scuttling laws applicable to state banks that happen to be preempted for national banks? These laws *could* have been left in place for state banks, and an appeal might have been made to local consumers that customers of state banks had different, arguably *better* protections than those of national banks, thus providing a competitive advantage to state banks. . . . [W]hy are the states not addressing their attention to their *own* institutions?[53]

Hawke's argument is disingenuous at best. Consumers who purchase predatory loans are *not* fully informed about their mortgages, nor are they receptive to complicated "appeals" about differences between the consumer-protection measures available in different banking systems. The predatory lending laws standardize and restrict certain loan terms so that mortgage loans can be more easily understood by less sophisticated consumers on the basis of the two factors to which they are most likely to respond: "interest rates" and "points and fees." Hawke would have us believe that an unsophisticated consumer might choose a state-bank loan with, say, higher fees than a facially comparable national-bank loan because she understands that the national-bank loan is less likely to come laden with hidden fees or loan terms. This is unlikely: If at-risk consumers were savvy enough to know that a national-bank loan is more likely to be predatory than a state-bank loan, they would need no protection from predatory lending legislation in the first place. The current competition between national- and state-chartered banks has not and will not solve this problem.[54] To answer Hawke's question, the reason "states [are] not addressing their attention [solely] to their own institutions"

[53] John D. Hawke, Jr., Comptroller of the Currency, Remarks to Women in Housing and Finance (Sept. 9, 2003), *available at* http://www.occ.treas.gov/ftp/release/2003-69a.pdf.

[54] New Jersey and New Mexico have, in the preambles of their respective legislation, both cited this market failure as a justification for their legislation. *See* N.J. STAT. ANN. § 46:10b-23(c) (West 2004) ("As competition and self-regulation have not eliminated the abusive terms from loans secured by a consumer's home, the consumer protection provisions of this act are necessary to encourage lending at reasonable rates with reasonable terms."); N.M. STAT. ANN. § 58-21A-2(D) (Michie 2003) (making similar finding).

is that they understand that predatory legislation will be meaningless unless it applies equally to national and state banks.

II. STANDARD OF JUDICIAL REVIEW OF REGULATORY PREEMPTION

This Part examines the question of how courts should review decisions by federal agencies to preempt allegedly contrary state law. I begin in Section A by describing the tension between the judiciary's typical deference to expert agencies and its longstanding presumption against preempting state law in the absence of an explicit congressional mandate. Section B discusses why preemption regulations can and should be distinguished from conventional regulations. Section C turns to demonstrating how that tension has muddled Supreme Court precedent, making it difficult to anticipate what level of deference the Court will apply to an agency's preemption regulation when squarely faced with the issue. Section D argues that the judiciary has a role to play in policing the outer boundaries of agency preemptive authority, and that *Chevron* deference should not apply to agency preemption regulations. Ambiguous organic statutes would otherwise license weakly accountable agencies to preempt a wide ambit of contrary state law, even when such preemption would be unnecessary or unwise. When coupled with concerns for regulatory capture and agency aggrandizement, this deference would rob state legislatures of much of their authority and irresponsibly favor federal regulation over state regulation.

A. *The Inherent Tension in Regulatory Preemption*

Asking whether a state statute is preempted by federal law is tantamount to asking whether "Congress, in enacting the Federal Statute, intend[ed] to exercise its constitutionally delegated authority to set aside the laws of a State[.]"[55] That inquiry is complicated, however, when a federal *agency*, citing its ambiguous origination statute, explicitly determines that the statute preempts state laws. In that case, the question becomes whether the judiciary should *infer* that Congress intended to delegate to the relevant agency the authority to preempt the allegedly conflicting state law.

The application of *Chevron* deference would of course call for such an inference. Courts rarely interfere when federal agencies

[55] Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 30 (1996); *see also* Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516 (1992) ("[T]he purpose of Congress is the ultimate touchstone of pre-emption analysis." (internal quotation marks omitted)).

undertake to interpret congressional ambiguities or silences.[56] Moreover, allowing for some measure of regulatory preemption makes good policy sense. Federal agencies, particularly in highly technical fields (like banking) have the expertise and the institutional capacity to make refined judgments about whether state laws will in fact conflict with congressional purposes.[57] By exercising preemptive authority, agencies can in one step remove any lingering uncertainty surrounding preemption questions that would otherwise have been settled through lengthy, costly, and duplicative litigation. Private actors in any jurisdiction can thus structure their behavior to comport with whatever law the agencies hold to be applicable.

In some tension with this, however, is the Supreme Court's longstanding insistence that there is a presumption against a judicial inference of a congressional intent to preempt state law in the face of congressional ambiguity,[58] particularly when the state law is "in a field which the States have traditionally occupied."[59] The Court has identified the source of this authority in principles of federalism that are jealous of the federal government's efforts to wrest "substantial sovereign powers" from states.[60] The Supremacy Clause does, of course, permit Congress to "impose its will" on the states, but the Court has explained that it "must assume Congress does not exercise [this

[56] *See* Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984) ("[L]egislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.").

[57] *See* Geier v. Am. Honda Motor Co., 529 U.S. 861, 883 (2000) ("Congress has delegated to [the agency] authority to implement the statute; the subject matter is technical; and the relevant history and background are complex and extensive. The agency is likely to have a thorough understanding of its own regulation and its objectives and is 'uniquely qualified' to comprehend the likely impact of state requirements.").

[58] *See Cipollone*, 505 U.S. at 533 (Blackmun, J., concurring in part and dissenting in part) ("The principles of federalism and respect for state sovereignty that underlie the Court's reluctance to find preemption where Congress has not spoken directly to the issue apply with equal force where Congress has spoken, though ambiguously.").

[59] Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947) ("[I]n a field which the States have traditionally occupied[,] . . . we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."); *see also* Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) (quoting *Rice*, 331 U.S. at 230).

[60] *Gregory v. Ashcroft*, 501 U.S. 452, 461 (1991), stated:

> This federalist structure of joint sovereigns preserves to the people numerous advantages. It assures a decentralized government that will be more sensitive to the diverse needs of a heterogenous society; it increases opportunity for citizen involvement in democratic processes; it allows for more innovation and experimentation in government; and it makes government more responsive by putting the States in competition for a mobile citizenry. . . . Perhaps the principal benefit of the federalist system is a check on abuses of government power.

Id. at 458.

extraordinary power] lightly."[61] The Court has thus gone so far as to require from Congress an "unmistakably clear" statement of its intention to preempt state law,[62] although, in practice, it normally requires something less.[63]

This gives rise to a conundrum: Does Congress, in speaking ambiguously about the scope of its intent to permit an agency to preempt contrary state law, intend to confer that decisionmaking authority on a federal agency?[64] If that agency furthers Congress's intent by "speaking" on its behalf, we would likely want to craft a background rule that *Chevron* deference ought to apply to preemption regulations. If our goal, however, is ensuring that the power of the federal government is checked by the democratic process, we may want to temper that deference somewhat and scrutinize the preemption efforts of a weakly unaccountable agency. Despite its manifest importance, to date the Supreme Court has not provided lower courts with meaningful guidance on the question.[65]

B. Preemption Regulations v. Conventional Regulations

Treating preemption regulations and conventional regulations differently may at first blush appear to lead to an asymmetrical result: A conventional agency regulation that had the effect of displacing

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[61] *Id.* at 460.

[62] *Id.* at 460–61 ("This plain statement rule is nothing more than an acknowledgment that the States retain substantial sovereign powers under our constitutional scheme, powers with which Congress does not readily interfere."); *see also* 1 LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-29, at 1189 (3d ed. 2000) ("As a corollary of the principle that state action will not lightly be found inconsistent with federal policy . . . federal goals defined at a high level of abstraction or generality [are] given scant preemptive effect.").

[63] 1 TRIBE, *supra* note 62, § 6-28, at 1176 n.21.

[64] This tension has bedeviled both courts and commentators. *See* Teper v. Miller, 82 F.3d 989, 998 (11th Cir. 1996) ("Indeed, there is an inherent tension between *Chevron* deference, which only obtains where a statute is 'silent or ambiguous,' and preemption doctrine, which maintains that state law will not be preempted unless that is 'the clear and manifest purpose of Congress.'"); Jack W. Campbell IV, *Regulatory Preemption in the* Garcia/Chevron *Era*, 59 U. PITT. L. REV. 805, 805–06 (1998) (noting that "[t]wo legal principles . . . increasingly point, with apparently equal persuasive force, to opposite results in regulatory preemption cases"); Paul E. McGreal, *Some* Rice *with Your* Chevron*?: Presumption and Deference in Regulatory Preemption*, 45 CASE W. RES. L. REV. 823, 826 (1995) (examining "underlying tension between presumption and deference"); Howard P. Walthall, Jr., Comment, Chevron *v. Federalism: A Reassessment of Deference to Administrative Preemption*, 28 CUMB. L. REV. 715, 716 (1998) ("The tension between these two principles is clear.").

[65] *Compare Teper*, 82 F.3d at 997–98 (applying *Chevron* while "recogniz[ing] that the law may be unsettled . . . as to the application of *Chevron* to an agency's determination of its own jurisdiction"), *with* Garrelts v. Smithkline Beecham Corp., 943 F. Supp. 1023, 1032–51 (N.D. Iowa 1996) (refusing to apply *Chevron* "because it expands deference to the agency far beyond the express parameters" of Supreme Court case law).

state law but did not speak to preemption would be entitled to *Chevron* deference, whereas a preemption regulation affirmatively displacing precisely the same laws would not.

The difference between "preemption" and "conventional" regulations lies in the role that the judiciary plays in settling the preemption question. Courts normally afford *Chevron* deference to agency regulations without preemption provisions, providing an assurance that the relevant agency did not exceed its authority or exercise that authority arbitrarily. Once those regulations overcome the *Chevron* hurdle, however, courts will apply well-settled preemption principles to determine whether state law must give way to the regulation—and will put a thumb on the scale of allowing both federal and state regulations to stand.[66]

A preemption regulation purports to settle the scope of federal preemption, however, and reflects an agency's effort to transform the preemption question from a judicial inquiry into an administrative *fait accompli.* By policing only for arbitrariness, the application of the deferential *Chevron* doctrine to a preemption regulation would effectively strip the judiciary of most of its responsibility to play a role in determining whether ambiguous congressional enactments should preempt conflicting state laws. Whether this shift of authority away from the judiciary and toward federal agencies is desirable is discussed below in Section D.

C. *Precedent*

The Supreme Court first blessed agency preemption in 1961 in *United States v. Shimer.*[67] At issue in that case was whether the Veteran's Administration (VA) had the authority to issue regulations that preempted contrary Pennsylvania law with respect to mortgage guarantors. The Court, employing the language of deference, held that the VA did have that authority: "If [an administrator's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."[68]

[66] *See, e.g.*, Geier v. Am. Honda Motor Co., 529 U.S. 861, 867 (2000) (holding that "ordinary pre-emption principles" apply to agency regulations); Hillsborough County v. Automated Med. Labs., Inc., 471 U.S. 707, 716 (1985) (applying presumption that state and local regulations can "coexist" with federal regulation).

[67] 367 U.S. 374 (1961).

[68] *Id.* at 383.

The Court returned to the issue in 1982 in *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta*,[69] a pre-*Chevron* case which presents the clearest precedential analog to the recent OCC preemption. Relying on *Shimer*, the Court in *Fidelity* upheld a federal Home Loan Bank Board (Board) regulation permitting federal savings-and-loan institutions (S&Ls) to include enforceable due-on-sale clauses in their contracts, thereby overriding various states' decisions to hold them unenforceable.[70] As the Court noted, its holding in *Shimer* had shifted the judicial inquiry away from a "narrow focus on Congress' intent to supersede state law" to a broader focus on whether the preemption action was within the scope of the agency's delegated authority.[71] It then proceeded to conclude, on an admittedly thin record, that Congress's ambiguous grant of authority to the Board was sufficient to ground preemption.[72]

Notably absent from the majority opinion in *Fidelity*, however, was any discussion of the federalism concerns at stake. Justice O'Connor joined in the opinion to note what otherwise would have seemed obvious: that "the authority of the [Board] to pre-empt state laws is not limitless."[73] And Justices Rehnquist and Stevens dissented to make plain that they did not believe Congress had authorized the preemption in question.[74]

The fractured opinion in *Fidelity* highlights that deciding whether "conflicting policies were committed to the agency's care" is tricky—and is really just another way of asking whether, if it had considered the question, Congress would have authorized the agency to overrule the kind of state law in question. Rendering this kind of judgment is *more* difficult for a court than a typical preemption inquiry because it involves inquiring into the degree to which Congress would have

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69 458 U.S. 141, 153 (1982).

70 A due-on-sale clause is "a contractual provision that permits the lender to declare the entire balance of a loan immediately due and payable if the property securing the loan is sold or otherwise transferred." *Id.* at 145. Due-on-sale clauses allow mortgagees to hedge some of the risk of an interest-rate increase that decreases the value of low-interest loans. When interest rates shot up in the 1970s, courts and legislatures began refusing to enforce due-on-sale clauses as "unconscionable" because they deprived homeowners of the full benefit of the longterm low-interest loans. Lenders argued, however, that preventing them from using due-on-sale clauses as tools to limit their risk would result in increased interest rates for consumers. *Id.*

71 *Id.* at 154 ("A pre-emptive regulation's force does not depend on express congressional authorization to displace state law.").

72 *Id.* at 159–70.

73 *Id.* at 171 (O'Connor, J., concurring).

74 *Id.* at 174 (Rehnquist, J., dissenting) ("Contract and real property law are traditionally the domain of state law. . . . Congress did not intend to create a federal common law of mortgages.").

entrusted technical judgments to agencies in the face of increasingly profound federalism concerns.

After 1984, the Court might have been expected to grapple with the question of whether to apply *Chevron* deference to administrative decisions regarding preemption. In *City of New York v. FCC*,[75] however—the Supreme Court's most recent definitive regulatory preemption case—it declined to do so, preferring instead to rely on *Fidelity* and *Shimer* in holding that it would defer to the FCC's decision to prohibit states and municipalities from imposing more stringent standards governing the quality of cable television signals.[76] The Court did not explain why it did not invoke *Chevron*, however—a peculiar elision given *Chevron*'s centrality in administrative law and the Court's evident willingness in the 1980s to defer to agency preemption decisions.[77] By failing to specify what kind of deference courts ought to show to regulatory preemption, the Court's decision in *City of New York* not to apply *Chevron* has left the state of the law in a muddle.[78] As the D.C. Circuit wrote in its opinion in *City of New York*, "[W]hether *Chevron* deference is required in, or appropriate to, judicial review of an agency's assertion of preemption authority is unsettled."[79]

The Supreme Court's latest, and rather elliptical, discussion of the issue came in 2000's *Geier v. American Honda Motor Co.*,[80] which

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75 486 U.S. 57 (1988).

76 *Id.* at 64.

77 A partial explanation may be that the FCC chose not to argue the point, instead relying on unusually broad legislative history and statutory language to support its claim that it had the authority to preempt. *See* Brief for Federal Respondent at *12–*13, City of New York v. FCC, 814 F.2d 720 (D.C. Cir. 1987) (No. 87-339), 1988 WL 1031794. The D.C. Circuit below also declined to reach the question, although it did discuss the possibility of applying *Chevron* deference to preemption regulations. City of New York v. FCC, 814 F.2d 720, 725–26 (D.C. Cir. 1987), *aff'd*, 486 U.S. 57 (1988). Judge Mikva in dissent argued that the "suggestion is alarming" that *Chevron* might apply. *Id.* at 729 (Mikva, J., concurring in part and dissenting in part); *see also* Medtronic, Inc. v. Lohr, 518 U.S. 470, 512 (1996) (O'Connor, J., dissenting) (noting application of *Chevron* deference to agency preemption decisions is "unwarranted").

78 *Compare Medtronic*, 518 U.S. at 505–06 (Breyer, J., concurring) (stating that "this Court has previously suggested that, in the absence of a clear congressional command as to pre-emption, courts may infer that the relevant administrative agency possesses a degree of leeway to determine which rules, regulations, or other administrative actions will have pre-emptive effect," and citing *Chevron*), *with id.* at 512 (O'Connor, J., concurring) ("It is not certain that an agency regulation determining the pre-emptive effect of *any* federal statute is entitled to deference."). *See also* Cass R. Sunstein, *Law and Administration After* Chevron, 90 COLUM. L. REV. 2071, 2097–101 (1990).

79 *City of New York*, 814 F.2d at 726.

80 529 U.S. 861, 883 (2000) ("We place some weight upon DOT's . . . conclusion . . . that a tort suit such as this one would '"stan[d] as an obstacle to the accomplishment and execution"' of those objectives." (citation omitted) (alteration in original)).

addressed the more conventional statutory question of whether an ambiguous Department of Transportation (DOT) airbag regulation preempted arguably conflicting state tort law. The majority noted in deferring to the DOT that the agency's expert view that its regulation preempted contrary state law (a view the agency did not express in the regulation itself) "should make a difference."[81]

A vigorous dissent joined by four justices argued that the majority's interpretation was out of line with precedent because the Court has "long presumed that state laws—particularly those . . . that are within the scope of the States' historic police powers—are not to be pre-empted by a federal statute unless it is the clear and manifest purpose of *Congress* to do so."[82] The dissent cautioned that, "[u]nlike Congress, administrative agencies are clearly not designed to represent the interests of States, yet with relative ease they can promulgate comprehensive and detailed regulations that have broad preemption ramifications for state law."[83] While the dissent did not reach the question as to whether Congress had in fact authorized the action (deciding instead merely that the regulations themselves did not evince a sufficient preemptive intent),[84] its analysis countered the majority's expertise-driven argument by emphasizing core federalism concerns.[85]

The current debate on the Court as to the level of deference to give to agency decisions to preempt would thus seem to pit its faith in expert agency judgment, particularly in technical fields in which Congress would have been more likely to delegate decisionmaking authority, against its fears that weakly accountable agencies will overstep their authority and trample on state lawmaking autonomy. Although the Rehnquist Court's revitalization of federalism princi-

[81] *Id.* at 883.

[82] *Id.* at 894 (Stevens, J., dissenting) (emphasis added).

[83] *Id.* at 908 (Stevens, J., dissenting).

[84] Tantalizingly, however, Justice Stevens stated in the introduction to the opinion that it is "quite clear to me that Congress neither enacted any such rule itself *nor authorized the Secretary of Transportation to do so.*" *Id.* at 888 (Stevens, J., dissenting) (emphasis added). He did not elaborate, however.

[85] "This is a case about federalism[;] that is, about respect for the constitutional role of the States as sovereign entities." *Id.* at 887 (Stevens, J., dissenting) (internal quotation marks omitted). The dissent noted that formal notice-and-comment rulemaking "respects both the federalism and nondelegation principles that underlie the presumption against pre-emption in the regulatory context." *Id.* at 912. The dissent did not, however, suggest the notice-and-comment rulemaking inoculated a preemption regulation from challenge, nor foreclosed an inquiry into the congressional grant of authority. Given that the notice-and-comment process is a procedural and not a substantive barrier to agency action, and is characteristically dominated by the regulated industries, such a conclusion would be peculiar.

ples[86] has rendered judicial deference to preemption "by administrative fiat" increasingly less likely,[87] the obtuse opinions do not provide a method for resolving or analyzing this tension.[88]

D. The Judiciary Should Not Categorically Defer to Agency Preemption Decisions

This Section argues that the judiciary, in the absence of an explicit indication to the contrary from Congress, should neither categorically defer to agencies' decisions to preempt nor stand as an unwavering obstacle to regulatory preemption.[89] Deference to administrative rulemaking is normally justified by the presumption that when Congress has expressed no particular intent on a subject, it meant to leave its resolution to the agency.[90] The force of that presumption is undercut in the context of agency preemption, however, by the contrary presumption that Congress does not normally intend

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[86] *See, e.g.*, United States v. Morrison, 529 U.S. 598 (2000) (invalidating Violence Against Women Act, 42 U.S.C. § 13981 (2000), because it bore no substantial relationship to interstate commerce).

[87] *See* Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 172 (1982) (Rehnquist, J., dissenting). Note that three justices joined with O'Connor in *Medtronic, Inc. v. Lohr*, 518 U.S. 470 (1996), to criticize the plurality for allegedly deferring to an agency preemption decision *sub silentio*. O'Connor stated: "Apparently recognizing that *Chevron* deference is unwarranted here, the Court does not admit to deferring to these regulations, but merely permits them to [inform] the Court's interpretation. It is not certain that an agency's regulation determining the pre-emptive effect of *any* federal statute is entitled to deference." *Id.* at 512 (O'Connor, J., dissenting) (citations omitted). Although the dissenting justices argued *for* preemption in *Medtronic* on the basis of the text of a congressional preemption clause, it remains to be seen whether they would do so in the face of congressional ambiguity.

[88] *See, e.g.*, Campbell, *supra* note 64, at 807 ("[T]he conflict continues to work mischief."); McGreal, *supra* note 64, at 888 ("[T]he Court has been as unhelpful as the commentary on the issue [of regulatory preemption]."); Walthall, Jr., *supra* note 64, at 718 (concluding with "a call for the Court to clarify its stance in this area").

[89] Other commentators have taken a similar position. *See, e.g.*, Paul Wolfson, *Preemption and Federalism: The Missing Link*, 16 HASTINGS CONST. L.Q. 69, 109 (1988) ("Courts should require administrative agencies to explain why preemption of state laws or uniformity of regulation is necessary to promote a statutory purpose when that determination is made."); *see also* McGreal, *supra* note 64, at 830, 888 (arguing that solution lies in maintaining Court's commitment to deliberation and accountable decisionmaking through "attention to the context of agency action and the best route to deliberation and accountability"); Walthall, Jr., *supra* note 64, at 718 (suggesting "new approach in which the deference given depends on the agency's choice of a narrow or broad interpretation of the preemptive effect of a statute"); James G. Kreissman, Note, *Administrative Preemption in Consumer Banking Law*, 73 VA. L. REV. 911, 913 (1987) (urging that "courts should undertake more rigorous scrutiny of administrative preemption" by giving "heightened attention to the degree of congressional intent manifested and to the nature of the state interest affected").

[90] Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511, 516.

to preempt state law unless it explicitly says so.[91] Eschewing *Chevron* deference in the face of profound federalism concerns, this Note contends that courts should therefore engage in a meaningful review of agency decisions to preempt and satisfy themselves that an agency's preemption decision is at the very least reasonable.[92] As Judge Mikva of the D.C. Circuit put it in 1987:

> An agency's assertion of federal *preemptive* authority is not equivalent to an agency's adoption of a rule to fit its statutory mission and cannot be an occasion for *Chevron*-style deference; rather, in administrative law no less than in other areas, preemption analysis must be guided by respect for the separate spheres of governmental authority in a federalist system. . . . My appraisal . . . would be that the federalism concerns at the heart of preemption doctrine are far more compelling than the separation-of-powers concerns at the heart of *Chevron* jurisprudence.[93]

Careful judicial review of preemption regulations will, inevitably, give rise to the criticism that judges should not be permitted to render discretionary policy decisions. This criticism could come on two fronts: (1) that courts are institutionally ill-equipped to second guess an agency's determination as to whether a state law conflicts with its congressional authority; and (2) that weakly accountable judges should not be rendering policy decisions that ought more appropriately be left to Congress and, by extension, congressionally created agencies.

The first argument is overstated. Although agencies are manifestly better than courts at making substantive policy decisions—providing one unimpeachable rationale for judicial deference—there is less reason to believe that they are better equipped than courts at striking an appropriate federal-state balance.[94] But even in those cases where an agency can bring substantial expertise to bear on the preemption question, the argument ignores the fact that there are few meaningful institutional constraints on a federal agency's willingness

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91 *See* Gregory v. Ashcroft, 501 U.S. 452, 460–61 (1991).

92 *See* Wolfson, *supra* note 89, at 110 ("Upon judicial review of an agency's decision to preempt state law, courts should not be too deferential to the agency's decision . . . . If an agency cannot provide a reasonable explanation for the necessity of preemption, the agency's decision should be vacated."); *see also* Kreissman, *supra* note 89, at 913 ("[T]he current practice of administrative preemption improperly extends agency authority, runs counter to the best interests of banking consumers, and contravenes established doctrines of federalism, preemption, and the separation of powers.").

93 City of New York v. F.C.C., 814 F.2d 720, 729–30 (D.C. Cir. 1987) (Mikva, J., concurring in part and dissenting in part) (emphasis in original) (internal quotation marks omitted).

94 *See* Wolfson, *supra* note 89, at 110 ("The necessity for preemption is not a technical matter in which administrative agencies have particular expertise.").

to issue expansive preemption orders.[95] Courts, in contrast, do have the institutional capacity to investigate the substantive reasonableness of an agency's decision to preempt.[96] Their automatic deference to agency preemption would create an effective presumption that Congress intended to make an unchecked delegation of preemptive authority whenever it passed a broadly worded origination statute—an unlikely and unwise presumption in a healthy federal system.

Agencies may moreover be plagued by either or both of two well-documented institutional pathologies: regulatory capture[97] or self-aggrandizing administrators.[98] These pathologies could manifest themselves in particularly pernicious ways if agencies were given an effective *carte blanche* to override the laws of duly elected state legislatures. Advocates of judicial deference must therefore contend with the uncomfortable fact that the judiciary may be better at patrolling the outer limits of agency preemptive authority than the agencies themselves.

This is not to say that agencies will not sometimes understand far better than courts the complex interactions between state laws and complicated federal regulatory regimes.[99] While courts do have substantial experience in resolving preemption questions, and while fears that agencies will exceed the scope of their authority counsel against a categorical application of *Chevron* deference, in technical fields an agency determination that state law should give way to federal law is entitled to some weight in considering whether a preemption regulation is appropriate. Courts, however, need not abandon the field in order for regulatory preemption to serve a beneficial purpose.

The second argument—that courts should not make these kinds of policy decisions—rests on the assumption that administrative agencies have a democratic pedigree merely because they were established

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95 *See* Geier v. Am. Honda Motor Co., 529 U.S. 861, 908 (2000) (Stevens, J., dissenting); Wolfson, *supra* note 89, at 101 ("[A]dministrative officials, not subject to electoral constraints on their exercise of power, are even less likely to consider the consequences [of preemption] to the states than are members of Congress.").

96 *See, e.g.*, Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (1983) (applying hard-look review to substance of agency rule).

97 *See generally* George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971) (applying public-choice theory to argue that administrative agencies are particularly vulnerable to capture by industries they regulate).

98 For the classic explication of this view, see WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 36–42 (1971), which uses economic theory of utility maximization to explain aggrandizing behavior of bureaucrats. *But see* Daryl J. Levinson, *Empire-Building in Constitutional Law*, 118 HARV. L. REV. (forthcoming Feb. 2005) (questioning plausibility of Niskanen's model) (on file with *New York University Law Review*).

99 *See supra* note 56 and accompanying text.

by a popularly elected Congress. This misses the point. What is at issue is the *relative* accountability, in the context of administrative preemption, of administrative agencies as compared to the judiciary. On this front, neither agencies nor the courts can make a strong claim of democratic responsiveness.

For two reasons, moreover, Congress's relatively greater democratic responsiveness and its undoubted capacity to check overreaching agencies[100] do not imply that the judiciary does not have a role to play in policing agency preemption. First, because of the difficulty and cost of overcoming congressional inertia, Congress's failure to undo agency preemption cannot be equated with congressional approval of that preemption.[101] To rely wholly on Congress would ignore that the judiciary may in fact further congressional intent by *rejecting* agency efforts to preempt contrary state laws where Congress would have intended those laws to stand.[102]

Second, the Congress that originally determined the scope of an agency's preemptive authority will almost certainly not still be sitting when that authority is tested. If that original grant of authority were narrow, judicial deference would transform a later Congress's silence on regulatory preemption—a silence which can be, and often is, enforced by a distinct minority of legislators—into a conferral of authority. This would be a peculiar result given the strong presumption against preemption without an authorization legitimated by a majority in Congress,[103] and it could divert legislators from their law-

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[100] Congress may yet intervene in the case of the OCC preemption. Senator Paul Sarbanes and the nine other Democrats on the Senate Banking Committee sent a letter to John Hawke on November 24, 2003 declaring:

> The OCC now appears to be ignoring both the Supreme Court and Congress by pursuing a preemption agenda that would override any state law that has any impact on a national bank. The OCC's actions and proposals would dramatically alter established preemption standards and would radically affect state-federal relations and consumer protection in the areas of banking.

Letter from Sen. Paul Sarbanes et al. to John Hawke, Comptroller of the Currency, OCC (Nov. 24, 2003) [hereinafter Letter from Sen. Sarbanes], http://sarbanes.senate.gov/pages/press/112403_occ_preempt_letter_bank.html. Hearings have since been held on the appropriateness of the preemption. *See supra* note 6.

[101] *See* Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2347 (2001) ("Because Congress rarely is held accountable for agency decisions, its interest in overseeing much administrative action is uncertain; and because Congress's most potent tools of oversight require collective action (and presidential agreement), its capacity to control agency discretion is restricted.").

[102] *See* Gregory v. Ashcroft, 501 U.S. 452, 460–61 (1991).

[103] Judicial deference could also confer inappropriate lawmaking power on the President, who might push agencies to make aggressive preemption orders with the full knowledge that Congress will be unable to gather a majority to override them. *See generally* Kagan, *supra* note 101 (describing new era of presidential control over agency rulemaking).

making duties to behind-the-scenes efforts to influence agency rulemaking.[104]

Judicial review remains the most viable way to ensure that federal agencies do not overstep their authority and threaten the independence of state legislatures. Whatever the strains on judicial competence, the judiciary should not be chary of intervening when the validity of state legislative enactments and the preservation of the delicate federal balance are at issue.

III.
Scrutinizing the OCC's Orders

The OCC, applying "recognized principles of Federal preemption in considering whether state laws" will apply to national banks,[105] has determined that these predatory lending laws are "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[106] This Part turns away from the abstract questions surrounding the role and scope of judicial review of regulatory preemption to examine whether the OCC's contention is defensible.

Section A demonstrates that the OCC's preemption regulation trenches on traditional state powers, making it a particularly good candidate for judicial scrutiny. Section B argues that the OCC's reliance on Supreme Court precedent about the preemptive scope of national bank law is rooted in a misreading of the relevant case law and ignores congressional guidance on the question of when federal preemption is appropriate.

In Section C, the Note addresses what remains the relevant question: Is the OCC's contention that state predatory lending laws "significantly interfere" with national bank powers justifiable? Because the predatory lending laws (1) will not forbid national banks from exercising their congressionally delegated powers, (2) will not impose costs on the national banking system and thereby threaten its institu-

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104 *See* Peter L. Strauss, *When the Judge Is Not the Primary Official with Responsibility to Read: Agency Interpretation and the Problem of Legislative History*, 66 Chi.-Kent L. Rev. 321, 339–40 (1990) (discussing pernicious separation-of-powers effects of relying on perceived legislative intent of current Congress).

105 12 C.F.R. § 34.4(b) (2004) (codifying procedures OCC will follow in making preemption determinations). The Supreme Court has elaborated:

> Even where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law. Such a conflict arises when compliance with both federal and state regulations is a physical impossibility, or when state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 153 (1982) (citations omitted).

106 GFLA Preemption Order, *supra* note 49, at 46,269.

tional integrity, (3) will not produce invidious spillover effects, and (4) will not infringe on the OCC's alleged authority to protect consumers, I argue that the OCC's preemption regulation stands on a weak foundation and should be struck down.

A. *Courts Should Not Categorically Defer to the OCC's Preemption Regulation*

Consumer protection is undoubtedly an area of traditional state power.[107] It is also beyond question that an essential state interest is at issue when a state asserts its "sovereign interest in the security and stability of title to land."[108] Whatever their effects on the banking industry, the predatory lending laws are designed to protect consumers from the potentially devastating practice of abusive lending by promoting the security and stability of title.[109] The OCC's preemption of the predatory lending laws thus raises profound concerns for state legislative independence, indicating the necessity of heightened judicial scrutiny.

Congress nevertheless intended to delegate much regulatory decision-making in the banking industry to an expert agency. Predatory lending laws will undoubtedly interact with national banks and the hyper-regulated banking industry in ways that will be difficult to anticipate. The OCC, and not courts, will likely be the best institutional actor to decide whether, under conventional preemption principles, a given state law will frustrate congressional intent. Some level of deference may therefore be appropriate, at least to the degree that the OCC is making a "reasonable accommodation of conflicting policies."[110]

A reviewing court will thus, appropriately, confront the tension between acute federalism concerns and a desire to allow the OCC to do its job without judicial interference. In order not to abnegate its role in policing agency preemptive authority, however, the judiciary must make some meaningful inquiry into the substantive justifications for the OCC's order.

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[107] *See, e.g.*, Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 150 (1963) (refusing to intrude upon states' "traditional power to enforce otherwise valid regulations designed for the protection of consumers" without evidence of clear intent of Congress).

[108] BFP v. Resolution Trust Corp., 511 U.S. 531, 544 n.8 (1994).

[109] *See, e.g.*, N.J. STAT. ANN. § 46:10B-23 (West 2004) (stating that "the consumer protection provisions of this act are necessary to encourage [fair] lending" and unwarranted foreclosure).

[110] *See* United States v. Shimer, 367 U.S. 374, 383 (1961).

B. *Conflict Preemption Precedent with Respect to National Banks*

Congress granted to national banks the power to "make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to . . . such restrictions and requirements as the [OCC] may prescribe by regulation or order,"[111] but it did not give them the right to do so wholly unfettered by state law. It rather envisioned that national banks would exercise their authority in a manner consistent with our dual-banking system, complying with nondiscriminatory state laws of general application even as the OCC regulated their banking functions.[112] National banks are thus bound by a wide range of generally applicable state laws, including those that set fair labor practices, prevent false advertising, or impose criminal penalties for fraud—even though these laws can affect (sometimes dramatically) their core banking functions.[113]

Nondiscriminatory laws of general application that vitiate or substantially interfere with powers that Congress intended to confer on federally chartered banks will be preempted, however.[114] A state could not, for example, enforce generally applicable laws against national banks that set mortgage-loan interest rates, or that put a stop to all mortgage lending in the state.

State predatory lending laws are nondiscriminatory, generally applicable laws that *limit* what contractual terms the state will honor in the context of high-cost home mortgage loans, and impose liability on originators (and sometimes purchasers) of illegal loans. The OCC, relying on the Supreme Court's preemption cases with respect to

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111 12 U.S.C. § 371 (2000). An additional list of national bank powers can be found in 12 U.S.C. § 24 (2000). Included among them is the power "to exercise . . . all such incidental powers as shall be necessary to carry on the business of banking." *Id.*

112 For case law espousing this view, see, for example, *McClellan v. Chipman*, 164 U.S. 347 (1896), stating:

> National banks are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law.

Id. at 356–57.

113 *See infra* Part III.B.2.

114 *See* Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 33 (1996) ("In defining the pre-emptive scope of statutes and regulations granting power to national banks, [the Court] . . . take[s] the view that normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted."). Laws that are facially neutral but which disproportionately burden national banks and thereby favor in-state institutions will also be preempted. *See* McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819). The OCC has not claimed, and could not tenably claim, that these predatory lending laws impose a disproportionate burden on national banks vis-à-vis their in-state analogs.

national banks,[115] claims that these laws therefore present "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[116] The following three subsections examine whether the legal arguments relied upon by the OCC support that contention.

1. Barnett Bank*'s Supposed Presumption*

The OCC rests the legitimacy of its preemption orders on the Supreme Court's 1996 decision in *Barnett Bank of Marion County, N.A. v. Nelson*,[117] which concerned a Florida statute that forbade national banks from selling insurance in small towns. A national bank challenged the statute, arguing that an unconditional federal law authorizing national banks to sell insurance preempted the state law.[118] The Supreme Court held that the Florida statute was preempted on the basis of the manifest irreconcilability of Congress's grant of power and the state's outright denial of such power.[119]

The OCC cites *Barnett Bank* for the presumption that "state law conditions on the exercise of national bank powers are preempted if Congress has not expressly directed the application of state law."[120] However, that is neither what the Supreme Court said nor what it meant.[121] It rather recognized that "where Congress has not expressly conditioned the grant of 'power' upon a grant of state permission, the Court has *ordinarily* found that no such condition applies."[122] But the Court clarified that this trend (*not* a presumption) in the case law came about as the *result* of inquiring into congressional intent to displace conflicting state law, which was to be ascertained by assessing the *degree* to which the state law interfered with a congressionally granted power.[123] It is therefore imprecise and overbroad to argue, as

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115 12 C.F.R. § 7.4002(d) (2004) ("The OCC applies preemption principles derived from the United States Constitution, as interpreted through judicial precedent.").

116 GFLA Preemption Order, *supra* note 49, at 46,269 (citation omitted).

117 517 U.S. 25 (1996).

118 *Id.* at 27.

119 *Id.* at 31 ("[T]he Federal Statute authorizes national banks to engage in activities that the State Statute expressly forbids.").

120 GFLA Preemption Order, *supra* note 49, at 46,265.

121 The OCC formulation actually grafts a Ninth Circuit gloss onto the original *Barnett Bank* formulation. GFLA Preemption Order, *supra* note 49, at 46,275 ("[B]ecause there has been a history of significant federal presence in national banking, the presumption against preemption of state laws is inapplicable."(citing Bank of Am., N.A. v. City & County of S.F., 309 F.3d 551, 559 (1996))). Strangely, the Ninth Circuit in *Bank of America* cites *Barnett Bank* to support its gloss, despite the absence of any such language in the decision.

122 Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 34 (1996) (emphasis added).

123 The Court stated:

does the OCC, that "the presumption against preemption of state law is inapplicable when the states attempt to regulate in an area, such as national banking, where there is a history of significant Federal presence."[124] One must still ask whether the state laws in question interfere with congressional intent.

2. *Other Precedent Relating to National Bank Powers*

Contrary to the OCC's claim, Supreme Court precedent is mixed on whether state laws impermissibly interfere with Congress's intent with respect to national banks. It is true that numerous laws have been found to conflict substantially enough with grants of authority to national banks to justify preemption. Thus, the Court has found the National Bank Act to preempt an Iowa statute attempting to promote the "welfare and stability" of banks at the point of insolvency,[125] a New York law governing the distribution of assets of an insolvent bank,[126] and another New York law forbidding national banks to use the word "savings" in advertising.[127]

But it is also true that the judiciary has remained insistent that "states retain some power to regulate national banks in areas such as contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law."[128] To that end, the Supreme Court has refused to preempt some state laws with respect to national banks—for example, a Kentucky statute imposing a tax on bank stock,[129] a Massachusetts fraudulent conveyance law dealing with transfers of real estate,[130] a Kentucky statute governing the escheat of

> Congress would not want states to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted. To say this[, however,] is not to deprive States of the power to regulate national banks, where . . . doing so does not prevent or significantly interfere with the national bank's exercise of its powers.

Id. at 33.

[124] GFLA Preemption Order, *supra* note 49, at 46,270.

[125] Easton v. Iowa, 188 U.S. 220, 231–32 (1903).

[126] Davis v. Elmira Sav. Bank, 161 U.S. 275 (1896).

[127] Franklin Nat'l Bank of Franklin Square v. New York, 347 U.S. 373 (1954). Lower courts have, in recent years, aggressively preempted other state laws of general application, particularly in light of the broad grant of statutory authority to national banks. That aggressiveness has yet to be tested in the Supreme Court. *See, e.g.*, Bank of Am., N.A. v. City & County of S.F., 309 F.3d 551, 551 (1996) (holding that ordinances prohibiting banks from charging ATM fees to non-depositors were preempted by several federal laws).

[128] *Bank of Am.*, 309 F.3d at 559.

[129] Nat'l Bank v. Kentucky, 76 U.S. (9 Wall.) 353, 361 (1869) ("[I]t certainly cannot be maintained that banks or other corporations or instrumentalities of the government are to be wholly withdrawn from the operation of state legislation.").

[130] McClellan v. Chipman, 164 U.S. 347, 358 (1896) ("No function of such banks is destroyed or hampered by allowing the banks to exercise the power to take real estate, provided only they do so under the same conditions and restrictions to which all the other

abandoned bank accounts,[131] a Missouri law preventing the establishment of branch banks,[132] and California state employment discrimination laws.[133]

The OCC argues in its preemption regulation that the types of laws that the Supreme Court has refused to preempt "do not actually regulate the manner and content of the business of banking authorized for national banks under federal law, but rather establish the legal infrastructure that surrounds and supports the conduct of that business."[134] In other words, the OCC would explain the Court's case law by drawing a distinction between laws that set the rules of the game (infrastructural) and those that tell banks how to play the game (regulatory).

This formulation makes some sense as a rough-cut method of ascertaining congressional intent. The OCC, however, without much justification, simply references this distinction to defend its classification of the predatory lending laws as "regulatory."[135] To be sure, the laws are in some ways regulatory,[136] but they could also accurately be characterized as "infrastructural" variations on contract, tort, and property law.[137] They present a difficult problem because they straddle the two categories.

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citizens of the State are subjected, one of which limitations arises from the provisions of the state law which, in case of insolvency, seeks to forbid preferences between creditors.").

131 Anderson Nat'l Bank v. Luckett, 321 U.S. 233 (1944).

132 First Nat'l Bank v. Missouri, 263 U.S. 640 (1924).

133 Cal. Fed. Sav. & Loan Ass'n v. Guerra, 479 U.S. 272 (1987). This case dealt with savings-and-loan institutions (S&Ls) and not banks, but the analysis was identical.

134 GFLA Preemption Order, *supra* note 49, at 46,274.

135 *Id.* at 46,275–76.

136 These state laws might be considered "regulatory" for at least five reasons. First, they "single out a subset of real estate transactions . . . for additional regulation." *Id.* at 46,278. Second, they prescribe certain types of contract provisions with respect to these loans in technically specific and sophisticated ways, a practice more associated with regulation than with what we typically understand as contract, property, or tort law. Third, the remedies associated with the assignee-liability provisions of these laws are not conventional tort or contract remedies, undermining assertions that these are mere infrastructural wrinkles. Fourth, while assignee-liability laws *technically* do not forbid the buying and selling of loans, that is their result. State legislatures are, in effect, telling national banks which loans they are and are not permitted to sell. Fifth, these laws grant to state officials the power to prosecute offenders, a grant which would seem to indicate state regulatory oversight. *See, e.g.*, GA. CODE ANN. § 7-6A-8(a) (2004).

137 The predatory lending laws describe the loan contracts that the states will enforce, and impose penalties both to compensate the victims and deter future violations. In this they resemble statutory overlays on the contract, property, and tort law systems. It is moreover undisputed that state legislatures have the power to impose different remedies for particular classes of contract or tort law violations. Further, while the laws do shape the behavior of financial institutions in discouraging the making of loans the legislature has deemed predatory, this on its own cannot be the *sine qua non* of a regulation: Contract, tort, and property law *also* shape behavior. The contention that the laws "single out" high-

As a formal matter, the OCC's effort to draw a distinction between "infrastructural" and "regulatory" rules is unhelpful. All laws that change the rules of the game invariably tell players how to play the game. As the Supreme Court put it in 1896, "[I]n the broadest sense, any limitation by a State on the making of contracts is a restraint upon the power of a national bank within the State to make such contracts; but the question which we determine is whether it is such a regulation as violates the act of Congress."[138]

Thus the more accurate rule that can be gleaned from the case law is that facially neutral state statutes will generally be permitted to stand until and unless they intrude on bank powers.[139] Case law is, to date, inconclusive as to whether any particular law interferes "too much" with congressional legislation relating to the home mortgage lending practices of national banks.

3. *The Riegle-Neal Act*

If, at bottom, we are attempting to ascertain congressional intent with respect to national bank preemption, surely it is relevant that Congress, in the Riegle-Neal Act of 1994,[140] made an effort to rein in what it saw as the OCC's "inappropriately aggressive" flexing of its preemption authority by making special reference to the very kinds of banking laws that should normally *not* be preempted.[141] The Act, which "is intended to help focus any administrative preemption analysis and to help ensure that an agency only makes a preemption deter-

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cost home loans misses the point. While certain loans are deemed unworthy of enforcement, there is no "singling out" of *national banks* for disparate treatment. These are emphatically laws of general application. The fact that the laws are technical reflects the difficulty of crafting a precise definition for predatory lending. However, if state zoning and criminal law should not be preempted, then the "technicality" of the state laws cannot by themselves be of importance in assessing their character.

138 McClellan v. Chipman, 164 U.S. 347, 358 (1896).

139 *See McClellan*, 164 U.S. at 356–57 (holding for preemption of state laws dealing with national banks only when they conflict with federal laws or "frustrate the purpose" of national banks); *see also* 1 Tribe, *supra* note 62, at §6–30, 1195–96 ("Generally speaking, the Court has come to uphold state regulations that supplement federal efforts so long as compliance with the letter or effectuation of the purpose of the federal enactment is not likely to be significantly impeded by state law.").

140 The full title is the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (1994). Taken as a whole, the Act reflects a congressional effort to "accelerat[e] the movement toward banking and branching across state lines." Mark D. Rollinger, *Interstate Banking and Branching Under the Riegle-Neal Act of 1994*, 33 Harv. J. on Legis. 183, 183 (1996). It is also, however, "as much a states' rights statute as it is a free market statute." *Id.* at 246.

141 *See* H.R. Conf. Rep. No. 103-651, at 53–54 (1994).

mination when the legal basis is compelling and the Federal policy interest is clear"[142] provides in relevant part:

> The laws of the host State regarding community reinvestment, *consumer protection, fair lending,* and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State, *except . . . when Federal law preempts the application of such State laws to a national bank.*[143]

The OCC argues that the exception applies in this case because, as it determined in its order, federal law preempts the predatory lending laws. Classifying the predatory lending statutes as "consumer protection" or "fair lending" statutes is therefore, according to the OCC, irrelevant.

The OCC's argument is weak. Congress used the Riegle-Neal Act deliberately to "carv[e] out a number of zones where the states retain exclusive regulatory authority, or where federal law only applies in the absence of state law on the same subject."[144] How *better* to signal to the OCC—which was expressly criticized for overreaching in the Act's committee report[145]—that it should be chary of treading on state laws intended to protect consumers or ensure fair lending practices? After all, the Act is "pervaded with a sense that states' rights must be respected."[146] Moreover, if the classification of the state laws in question is irrelevant, then all the statute would say is that state law applies to the degree it is not preempted by federal law. But this is true of any legislation, not just "consumer protection" or "fair lending" legislation. Congress meant to do more with the Riegle-Neal Act than state the obvious.

This view is strengthened by a moment's reflection on the dual banking system and the congressional grant of authority to the OCC. The OCC is manifestly not a consumer protection agency; it is rather a regulatory body concerned with ensuring the safety and soundness of the national banking system.[147] The elegance of the dual-banking system is that both the national and state systems have incentives to implement robust and innovative consumer-protection measures in order to attract new customers. In most sectors, then, competition

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[142] *Id.* at 55.

[143] 12 U.S.C. § 36(f)(1)(A) (1994) (emphasis added).

[144] *See* Rollinger, *supra* note 140, at 246.

[145] *See* H.R. CONF. REP. NO. 103-651, at 53–54 (1994) ("[T]he Federal banking agencies have applied traditional preemption principles in a manner the Conferees believe is inappropriately aggressive, resulting in preemption of State law in situations where the federal interest did not warrant that result.").

[146] *See* Rollinger, *supra* note 140, at 246.

[147] *See supra* note 1.

works as a form of self-regulation: Customers go where they know they will be taken care of best. But, as discussed above,[148] the predatory legislation is premised on the well-documented belief that the consumers most prone to predatory lending are *not* knowledgeable consumers, and that healthy competition between banking systems will *not* protect them. The Riegle-Neal Act's singling out of state consumer-protection or fair-lending laws makes sense precisely because federal preemption of these types of laws runs the risk of setting de facto national standards.

In sum, assessing whether these state laws conflict with congressional intent cannot remotely be determined solely by recourse to Supreme Court decisions. It will instead require an evaluation of the degree of interference with national banks' capacity to participate in the mortgage lending business—an inquiry that should be informed by Congress's statement that consumer protection and fair lending laws should not be lightly preempted.

C. Do the Laws "Significantly Interfere" with the Operation of National Banks?

In this Section, I analyze the four ways that these predatory lending laws might arguably interfere with Congress's intent to authorize national banks to engage in home mortgage lending: (1) if they forbid national banks from exercising their congressionally delegated powers, (2) if they impose costs on the national banking system and thereby threaten its institutional integrity, (3) if those costs are not wholly borne by in-state citizens, or (4) if they harm consumers that Congress intended national banks to protect. I contend that in none of these ways do the predatory lending laws interfere sufficiently to justify preemption.

1. National Banks are Not Forbidden From Exercising Delegated Powers

The OCC argues that by limiting the enforceability of certain onerous contractual terms in a distinct category of loans, states have impermissibly infringed on national bank powers to lend on whatever terms they deem appropriate. But the OCC acknowledges that national banks make few loans in the subprime market at all,[149] and that "evidence that national banks are engaged in predatory lending

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148 *See supra* Part II.D.

149 According to a report by the state attorneys general, "Almost all of the leading subprime lenders are mortgage companies and finance companies, not banks or direct bank subsidiaries." GFLA Preemption Order, *supra* note 49, at 46,271.

practices is scant to non-existent."[150] The OCC's claim that the minimal restrictions on the lending patterns of national banks in markets in which they rarely lend constitute a significant impairment of national banks' lending authority is surely overstated.

Moreover, these laws do not forbid national banks from making high-cost home loans. They merely identify a small category of loan terms that are likely to be abusive, the inclusion of any of which can render a high-cost mortgage unenforceable and give rise to certain liabilities. Just as state courts retain the authority to apply their states' (sometimes wildly different) contract law in adjudications, so too do state legislatures retain the authority to specify some small range of contractual terms that the state will not enforce so long as they do not materially affect the business of banking. State contract and property law cannot be vulnerable to displacement simply because they *affect* a federally chartered institution.

2. *High-Cost Borrowers Will Bear the Costs of the Predatory Lending Laws*

Notwithstanding the OCC's efforts to complicate the issue (and thus ground its claim that its expert opinion should be entitled to deference),[151] these laws will not impose any costs on national banks that they will not in turn pass on to high-cost borrowers.

a. Price Mechanism

The predatory lending laws attach a potential liability to certain identifiable high-cost home loans.[152] Would-be purchasers of these

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[150] *Id.*

[151] The OCC sums up its argument as follows:

> These laws introduce new standards for subprime lending that are untested, sometimes vague, often complex, and, in many cases, different from established and well-understood Federal requirements. They also create new potential liabilities and penalties for any lender that missteps in its efforts to comply with those new standards and restrictions. Thus, these laws materially increase a bank's costs and compliance risks in connection with subprime lending. . . . The practical result of these laws, therefore, is to obstruct, or for practical purposes, prevent, national banks from making certain types of real estate loans, causing an overall reduction in credit available to subprime borrowers.

Id. at 46,270–71.

[152] There will be informational costs associated with distinguishing between and parsing varying state laws. However, as I show below, those costs can and will be passed along to consumers. Moreover, the unremarkable fact that there are different legal regimes in different states can hardly justify preemption: National banks consistently comply with a dizzying variety of state laws that dictate their behavior, and Congress certainly did not intend to make state laws uniform across all regulatory dimensions. *See supra* Part III.B. Identifying a high-cost loan is straightforward—the markets identify HOEPA loans without difficulty—but investigating whether that loan then conforms with the relevant law is much

high-cost loans will therefore (a) spend money on compliance measures to ensure that, in their purchases of high-cost home loans, they do not buy any loans forbidden by a state law, or (b) discount the price they pay for the loans for the risk of liability. Either way, the originator of a high-cost home loan can expect to receive a lower price for that loan, regardless of its legality, in the presence of these laws than in their absence. To compensate for either the lower purchase price or the loss in liquidity, which would require the originator to hold the loan on its books, the originator would be forced to charge higher interest rates or fees to high-cost borrowers.[153] The number of high-cost home loans originated will thus drop as a certain percentage of high-cost borrowers are squeezed out of the market.

Critically, however, all a purchaser must do to correct for a new state law is "adjust the price they pay for loans to reflect the expected cost"[154] of the law. While that price adjustment may (or may not) prove quite large, the parties that will bear the costs of these laws *will not be national banks or the secondary mortgage market generally*, which can instead pass those costs along to consumers.

b. Adjustment Costs

The OCC argues that the laws "create new potential liabilities and penalties for any lender that missteps in its efforts to comply with those new standards and restrictions."[155] While this is an accurate statement, the novelty of a state-imposed liability cannot by itself constitute a cognizable interference with national bank power.

Financial institutions can and do compensate for their risky investments by impounding "potential liabilities and penalties" into the price they are willing to pay for given financial instruments. While there might be a period of adjustment where the risk-deflated purchase price for high-cost home loans would reflect uncertainties associated with limited or non-existent actuarial data,[156] financial institutions over time would adjust to the liabilities of these laws as

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more difficult, particularly given the case-specific loan-flipping standards in the predatory lending laws.

153 These borrowers are, of course, those most in need of low-cost credit. One irony of these laws is that *less* well-targeted laws—ones that set very low trigger rates, for example, or greatly expanded the definition of a "high-cost home loan"—would spread the costs over a larger group and minimize the more acute pain felt by high-cost borrowers.

154 Schill, *supra* note 25, at 1293.

155 GFLA Preemption Order, *supra* note 49, at 46,270.

156 These uncertainties could easily be overstated, however, given that all of the predatory lending laws limit assignee liability by providing a "due diligence" defense in the event of a borrower claim, *see, e.g.*, GA. CODE ANN. § 7-6A-6(b) (2004), and by capping the amount of the assignee's liability, *id.* § 7-6A-6(c)(1).

the frequency and magnitude of those liabilities are documented.[157] At all points in the process, however, these institutions would be able to pass along the costs associated with risk adjustments by raising the interest rate at which they lend to high-cost borrowers. The fact that national banks will be forced to adapt to "new potential liabilities" thus could not possibly constitute "interference" with congressional intent: Certainly Congress did not mean for the National Bank Act to freeze the development of any state laws that might incidentally affect the purchase price of a home mortgage loan.[158]

3. *The Laws Do Not Produce Spillover Effects*

The predatory lending laws would be problematic if out-of-state consumers bore some of the costs of other states' predatory lending laws—in other words, if those costs "spilled over" into other states.[159] But because national banks can at little or no cost identify the state where the property securing the loan is located, they will not pass those costs onto out-of-state borrowers. As one commentator has noted, invidious spillover effects are particularly unlikely to flow from state real estate law because "[t]he legal protections are tied to property that, by definition, cannot be moved from one state to another."[160] In-state high-cost borrowers—the same borrowers that have the capacity to vote for their elected officials and engage in the democratic process—will instead bear the full compliance costs and liability risks of the predatory lending laws.

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157 Computer technology has been a significant factor in driving the expansion of the mortgage market into the subprime area. *See* RESTINAS & BELSKY, *supra* note 11, at 4. It would be ironic if financial institutions that used advances in technology to enter a riskier market niche were allowed to claim that their increased technological capacity could not help them to later manage a few new state laws.

158 *See* Letter from Sen. Sarbanes, *supra* note 100 ("The OCC . . . appears to be ignoring both the Supreme Court and Congress by pursuing a preemption agenda that would override any state law that has any impact on a national bank.").

159 "Spillover effects" are also termed "externalities." They would be prevalent if the mortgage market were unable at low cost to determine in which state a home mortgage loan was made. In that case, the market might be forced to spread the costs of complying with some states' predatory lending laws to other states. This would be problematic for the national banking system because one state's aggressive mortgage lending law would increase the price for home mortgage loans in other states and inappropriately curtail the lending powers of the national banking system. Given that one state's borrowers would not bear the full costs of their laws, they might impose improvidently high costs on other states and threaten the integrity of the banking system.

160 Schill, *supra* note 25, at 1293. "Spillovers generated by state mortgage foreclosure laws are likely to be modest and can be eliminated at low cost. Transaction costs and lost scale economies attributable to these laws are also likely to be small in magnitude." *Id.* at 1262.

4. *The OCC Is Not a Consumer Protection Agency*

The OCC justifies its regulatory preemption by contending that it is necessary to protect those in-state high-cost borrowers who would otherwise be harmed by the operation of these laws.[161] This argument necessarily implies that state legislatures—and, by extension, voters—are naïve groups that do not fully understand the consequences of their actions, and that it is therefore the duty of an expert federal agency to intervene.

This justification goes too far on two fronts. First, it is unclear from where the OCC has derived its consumer-protection mission. It points to no congressional authorization for anything beyond the uncontroversial claim that it can make, buy, and sell mortgage loans, and that it is responsible for the safety and soundness of national banks. While the establishment of the national bank system was certainly intended to promote citizen welfare, and while the Comptroller's consumer-protection efforts may be laudable, Congress never granted to the OCC the authority to substitute what *it* believed best protected consumers for what duly elected legislatures believed best protected consumers. Because "[t]he existence and force and function of established institutions of local government are always in the consciousness of lawmakers and, while their weight may vary, they may never be completely overlooked in the task of interpretation,"[162] such a conclusion in the absence of explicit language to the contrary is untenable.

Second, it has not been demonstrated that these laws will prove more costly than beneficial, and the question is currently being hotly debated in the empirical literature.[163] Given the novelty of these laws

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[161] *See, e.g.*, GFLA Preemption Order, *supra* note 49, at 46,270–71; John D. Hawke, Jr., Comptroller of the Currency, Statement of July 24, 2003, (last visited Oct. 9, 2004) ("We know that it's possible to deal effectively with predatory lending *without* putting impediments in the way of those who provide access to legitimate subprime credit."), http://www.occ.treas.gov/consumernews.htm.

[162] BFP v. Resolution Trust Corp., 511 U.S. 531, 539–40 (1994).

[163] The OCC argues that "a growing body of evidence indicates that state anti-predatory lending laws are likely to restrict the availability of credit to subprime borrowers." GFLA Preemption Order, *supra* note 49, at 46,271 n.26. It references two studies that it believes support its claims, and dismisses a third that reaches the opposite conclusions because of its "variables and uncertainties." *Id.* While a rigorous examination of these studies is beyond the scope of this Note, all three studies contain serious methodological limitations. OFFICE OF THE COMPTROLLER OF THE CURRENCY, ECONOMIC ISSUES IN PREDATORY LENDING 22 (2003), *available at* http://mbaa.org/industry/docs/03/occ_workpaper0730.pdf. It is nevertheless surprising that the study that the OCC relies on most heavily examined only "nine finance companies . . . [that] are the largest in the marketplace and therefore probably receive the most scrutiny from the government . . . [and therefore] may not be the worst offenders as far as predatory lending tactics are concerned." The study that the OCC dis-

and the just-emerging empirical analyses, the OCC's conclusion that these laws will impede the beneficial flow of high-cost credit appears to reflect an instrumental effort to support its preemption orders rather than a sound conclusion from the available data.

Moreover, even if the OCC is correct in its assertion that beneficial subprime lending will decline as a result of the predatory lending laws, it does not follow that the laws do not provide a net benefit to high-cost borrowers. It merely demonstrates that the laws are overinclusive. It is not enough to damn the laws on that basis alone, however: Every law is overinclusive.[164] If instances of predatory lending diminish as a result of these laws, and beneficial subprime lending does not halt altogether, it cannot be said that these laws are ineffective. It can merely be said that they are imperfect. Empirical studies can measure the degree of imperfection, and legal scholars can debate methods of perfecting the laws, but ultimately it is up to legislatures to weigh the deficiencies of these laws against their benefits. The judiciary should not permit a politically unaccountable agency to annex to itself these profound judgments in the absence of a colorable justification without more explicit congressional authorization.[165]

Conclusion

Preempting these state predatory lending laws in their infancy is insupportable and unwise.[166] Others have written far more extensively about the importance of state innovation in a healthy federal system,[167] and I only note that their concerns are heightened in the context of the enormous difficulty in crafting appropriate legislative responses to a fast-growing problem—the extent of which is only now becoming apparent.

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misses (for much less grave methodological offenses) drew from a substantially larger statistical sample. *Id.*

164 *See* Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 990–91 (1995) (discussing inevitable overinclusiveness and underinclusiveness of rules).

165 The implication that state legislatures cannot effectively legislate for their citizens appears to be unfounded. While state legislatures came into disregard in the 1950s and 1960s, since that time they have become vastly more responsive and institutionally sound. *See* Schill, *supra* note 25, at 1304–18.

166 One is reminded of George Stigler's famous quip that criticizing an agency for policies that favor its regulated entities "seems to me exactly as appropriate as a criticism of the Great Atlantic and Pacific Tea Company for selling groceries, or as a criticism of a politician for currying popular support." Stigler, *supra* note 97, at 17.

167 *See, e.g.*, New State Ice Co. v. Leibmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("[A] single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."). In the context of real estate law, see, for example, Schill, *supra* note 25, at 1287–88. In the context of environmental regulation, see Richard L. Revesz, *The Race to the Bottom and Federal Environmental Regulation: A Response to Critics*, 82 MINN. L. REV. 535 (1997).

To be clear, this Note does not argue that the new state legislation will prove effective at curbing predatory lending. Undoubtedly, any law that makes it more expensive for those most in need of cheap credit to borrow comes loaded with serious costs. This Note instead makes the institutional argument that, in the absence of reasonable justifications for regulatory preemption, states should be allowed to exercise their historical authority to address their internal affairs without fear of their laws being trumped by overreaching agencies. We are otherwise likely to see the development of a bureaucratized federal law that is not well-tailored to the individual needs or preferences of the states, and which will impede significantly the development of innovative responses to new problems. The banking industry's desire for uniformity in the national securities markets must be justified, in the context of predatory lending at least, by something more than an inchoate cry for deregulation for the sake of deregulation.[168]

[168] As one commentator pointedly put it more than a decade ago, "For real estate finance, as well as other areas of commerce, the development of national markets does not automatically imply that national law is either necessary or desirable." Schill, *supra* note 25, *at* 1263.