

RECENT CASES

FEDERAL PREEMPTION — *CHEVRON* DEFERENCE — SECOND CIRCUIT FINDS NATIONAL BANK OPERATING SUBSIDIARY EXEMPTED FROM STATE LAW. — *Wachovia Bank v. Burke*, 414 F.3d 305 (2d Cir. 2005).

“Shouldn’t it be the Congress of the United States that would preempt something by statute . . . rather than a regulatory body . . . such as the OCC?”¹ This question — the first posed to the Comptroller of the Currency at his recent appearance before the Senate Subcommittee on Banking — articulates the most troubling frontier of *Chevron* deference. *Chevron U.S.A. Inc. v. Natural Resources Defense Council*² held that on grounds of institutional competence and electoral accountability, courts should accord deference to agency interpretations of their enabling statutes.³ But recent developments have repeatedly raised the question whether such deference is still appropriate to agency interpretations of the scope of state law preemption. Recently, in *Wachovia Bank v. Burke*,⁴ the Second Circuit held that regulations promulgated by the Office of the Comptroller of the Currency (OCC) regarding national bank operating subsidiaries deserve *Chevron* deference.⁵ The court, however, ignored the prior and crucial question whether *Chevron* deference is even justified in this special case when an agency interprets the preemptive scope of its own authority.

Congress has sought to create a genuinely national banking system.⁶ It broadly granted to national banks “all such incidental powers as shall be necessary to carry on the business of banking”⁷ and acted to prevent state interference with or obstruction of those powers by sheltering the banks from “any visitorial powers except as authorized by Federal law.”⁸ In 1996, the OCC — the agency entrusted with oversight of the national banking system — promulgated a regulation defining the “incidental powers” of banks to include the establishment of state-incorporated operating subsidiaries empowered to conduct the same activities as their parent national banks.⁹ Whether those sub-

¹ *Review of the National Bank Preemption Rules: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 108th Cong. 15 (2004) (statement of Sen. Richard Shelby, Chairman, S. Comm. on Banking, Housing, and Urban Affairs) [hereinafter *Senate Hearing*].

² 467 U.S. 837 (1984).

³ *See id.* at 843.

⁴ 414 F.3d 305 (2d Cir. 2005).

⁵ *Id.* at 309.

⁶ *See Marquette Nat’l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314–15 (1978).

⁷ 12 U.S.C. § 24 (2000).

⁸ *Id.* § 484(a).

⁹ 12 C.F.R. § 5.34(e)(3) (2005).

sidiaries were also shielded from state regulation remained unclear until 2001, when the OCC promulgated another regulation, 12 C.F.R. § 7.4006, according the same exemption to operating subsidiaries as to parent banks.¹⁰

Wachovia Mortgage was a state-incorporated bank licensed to make mortgage loans in Connecticut.¹¹ In 2003, it became a wholly owned subsidiary of Wachovia, a national bank, and thereupon surrendered its mortgage licenses to the Connecticut Banking Commissioner, John Burke.¹² In response, the Commissioner issued a Notice of Intent to Issue a Cease and Desist Order to Wachovia Mortgage.¹³ Wachovia Bank and Wachovia Mortgage filed suit in U.S. District Court, seeking declaratory and injunctive relief on the grounds that the Commissioner's visitorial authority was preempted by national banking law, as evidenced by the OCC's new regulation.¹⁴

The trial court granted summary judgment to Wachovia Bank and Wachovia Mortgage.¹⁵ In order to determine whether the regulation was a permissible construction of the statute, the court applied the *Chevron* analysis.¹⁶ At the first step, the court found that Congress had not "addressed the manner in which state law should apply to a national bank operating subsidiary";¹⁷ thus, the court proceeded to the second step of considering whether "the agency's answer is based on a permissible construction of the statute."¹⁸ The court answered affirmatively, finding reasonable the assumption that state regulation of operating subsidiaries would be just as obstructive as state regulation of their parent banks.¹⁹ Section 7.4006 thus preempted state law.²⁰

The Second Circuit affirmed. Writing for the panel, Judge Straub held that the OCC's regulations preempted the Connecticut statutes and shielded Wachovia Mortgage from any exercise of visitorial powers by the Commissioner.²¹ Before beginning its *Chevron* analysis, the court observed that valid federal regulations preempt state law to the

¹⁰ See *id.* § 7.4006 (2005). This does not include exemption from non-visitorial laws such as contract, tort, public safety, and general criminal laws. See *Senate Hearing, supra* note 1, at 5 (statement of John Hawke, Comptroller, OCC).

¹¹ See *Wachovia*, 414 F.3d at 310.

¹² See *id.*

¹³ See *id.*

¹⁴ See *id.*

¹⁵ *Wachovia Bank, N.A. v. Burke*, 319 F. Supp. 2d 275, 290 (D. Conn. 2004).

¹⁶ See *id.* at 282.

¹⁷ *Id.* at 285.

¹⁸ *Id.* (quoting *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984)) (internal quotation marks omitted).

¹⁹ *Id.* at 286.

²⁰ *Id.* at 288.

²¹ *Wachovia*, 414 F.3d at 324. Judges McLaughlin and Hall joined the opinion.

same extent as federal statutes²² and that the usual “presumption against preemption” is not operative in matters of national banking, as it is a field in which the federal government has long been dominant.²³ The relevant question was thus whether the promulgation of section 7.4006 constituted a reasonable exercise of the OCC’s authority under *Chevron*.²⁴

The court resolved the first step in the OCC’s favor.²⁵ Under 12 U.S.C. § 484, the OCC clearly possesses the exclusive power to regulate the national banks, and 12 U.S.C. § 24 grants national banks all “incidental powers” necessary to the “business of banking.” It was also beyond dispute that the discretion to interpret the scope of those “incidental powers”²⁶ lies within the OCC’s authority. Since the matter thus lay within the OCC’s rulemaking authority²⁷ and Congress had not manifested any “clear intent” with respect to the issue,²⁸ the court concluded that the first prong of the *Chevron* analysis was fulfilled.

Moving on to the second prong, the court held that the OCC’s regulation was supported by a “reasonable” rationale and therefore entitled to deference.²⁹ The OCC had justified its finding of state preemption by noting that “operating subsidiaries are, in essence, incorporated departments or divisions of the bank and, accordingly, should not be treated differently than their parent banks.”³⁰ Although the Commissioner objected that this reasoning failed to acknowledge the benefits of corporate separateness enjoyed by the national bank,³¹ the court noted that a distinct policy rationale offered by the OCC sufficed to make the regulation “reasonable”: namely, the subsidiary’s status as a separate entity allowed the parent bank to more safely and soundly monitor and manage the subsidiary’s business.³² The court thus granted deference to the OCC’s regulation.

Though *Chevron* was applied duly and correctly in *Wachovia*, it was invoked without adequately addressing the more fundamental is-

²² See *id.* at 314.

²³ See *id.*

²⁴ See *id.* at 315 (citing *Fid. Fed. Sav. & Loan Ass’n v. de la Cuesta*, 458 U.S. 141, 153–54 (1982)).

²⁵ See *id.* at 319.

²⁶ See *id.* at 316. Operating subsidiaries have been used by the national banks since 1966. See *id.* at 319. However, the freedom of those operating subsidiaries from state law only dated from the Comptroller’s promulgation of section 7.4006 in 2001. See *id.* at 312.

²⁷ *Id.* at 316.

²⁸ *Id.* at 318.

²⁹ *Id.* at 319.

³⁰ *Id.* at 318 (quoting Investment Securities; Bank Activities and Operations; Leasing, 66 Fed. Reg. 34,784, 34,788 (July 2, 2001) (to be codified at 12 C.F.R. pts. 1, 7, 23)).

³¹ *Id.* at 318–19.

³² *Id.* at 319 (citing Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,342, 60,354 (Nov. 27, 1996) (to be codified at 12 C.F.R. pts. 3, 5, 7, 16, 28)).

sue whether the *Chevron* framework was even appropriate. Neither party challenged *Chevron*'s applicability on appeal, a telling fact given that *Chevron*'s high degree of deference more or less predetermined the outcome in the agency's favor. *Wachovia* thus shows that *Chevron* has become the established framework for judicial review of agency regulations³³ while at the same time making clear that *Chevron*'s limits have yet to be satisfactorily determined. The court first failed to address whether *Chevron* deference is even appropriate in preemption analyses, since its animating rationales are far less persuasive — and perhaps entirely unpersuasive — in such contexts; and second, the court failed to adequately consider how *Chevron* is to interact with substantive canons of interpretation, such as the presumption against preemption. The *Wachovia* court is far from alone in uncritically applying *Chevron*, as several other circuit courts have engaged in near identical analyses of the issue.³⁴ But for exactly that reason, the decision underlines the need to reconsider *Chevron*'s appropriate scope, as well as to accommodate that transformative doctrine to the fundamental concerns of our legal system.

A modestly sized but compelling scholarly literature has called into question whether *Chevron*'s rationales retain much persuasive force in preemption contexts.³⁵ Upon inspection, both justifications for *Chevron* deference — the technical expertise of federal agencies and their superior political accountability vis-à-vis the federal judiciary³⁶ — prove ambiguous when the balance between federal power and states' rights is implicated. Thus, though *Chevron* reflects an admirable humility on the part of the federal judiciary and preserves the proportions of the federal division of powers,³⁷ the courts must realize that when federalism concerns are at stake, they are at least as well — if not better — positioned than agencies to decide the issue in question.

First, when preemption issues arise, agencies lose much of their expertise advantage relative to courts. Of course, there is still a substantial technical dimension in which agencies excel: agencies can expertly determine the extent to which diverse state regulatory regimes will

³³ See Cass R. Sunstein, *Law and Administration After Chevron*, 90 COLUM. L. REV. 2071, 2074–75 (1990) (calling attention to more than 1000 citations of *Chevron*'s in its first six years).

³⁴ See, e.g., *Wachovia Bank v. Watters*, 431 F.3d 556 (6th Cir. 2005); *Wells Fargo Bank v. Boutris*, 419 F.3d 949 (9th Cir. 2005).

³⁵ See, e.g., Jack W. Campbell IV, *Regulatory Preemption in the Garcia/Chevron Era*, 59 U. PITT. L. REV. 805, 832 (1998); Nina A. Mendelson, *Chevron and Preemption*, 102 MICH. L. REV. 737, 741–42 (2004); Cass R. Sunstein, *Nondelegation Canons*, 67 U. CHI. L. REV. 315, 331 (2000); Howard P. Walthall, Jr., *Chevron v. Federalism*, 28 CUMB. L. REV. 715, 717–18 (1998).

³⁶ See *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 863–65 (1984) (justifying deference to agency determinations on these grounds).

³⁷ See Campbell, *supra* note 35, at 830 (noting that *Chevron* was not a “federalism case,” but rather a separation-of-powers one).

frustrate an overarching federal purpose.³⁸ Yet that is only half of the equation. The benefits of preemption must be weighed against the value of preserving state autonomy and core regulatory functions, either out of respect for states *qua* sovereigns³⁹ or in order to preserve state “laboratories” of policy innovation.⁴⁰ Such concerns are both abstract and political, extending beyond the particularized expertise possessed by any agency.⁴¹ Federal courts, by contrast, are generalist institutions, the members of which have deep backgrounds in constitutional law and the political history of the United States.⁴²

Agencies’ allegedly superior political accountability must also be reconsidered in the context of preemption. Agencies are inarguably accountable to the electorate through the executive branch, and some scholars argue that agencies possess both substantial opportunities and incentives to pay heed to states’ interests.⁴³ But in the preemption context, the general consensus is that agencies are not designed to represent the interests of states.⁴⁴ The Supreme Court itself has chosen not to defer to agency interpretations when those interpretations alter the “federal-state framework” by encroaching upon traditional state prerogatives,⁴⁵ presumably from the inference that agencies do not sufficiently represent states’ interests; and federal courts have taken notice of other ways in which agencies fail to represent states’ interests, such as being subject to interest capture.⁴⁶ With regard to *Wachovia*, congressional hearings prior to the OCC promulgation revealed strong signs of just such weak agency accountability. Even if one can discount the Senate’s protestations as a power struggle amongst the po-

³⁸ See *id.* at 832; Nicholas Bagley, Note, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y.U. L. REV. 2274, 2287 (2004).

³⁹ See Mendelson, *supra* note 35, at 755 (“[T]he canon represents a reluctance to risk incidental statutory interference with federalism values and with state sovereignty.”).

⁴⁰ See, e.g., 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, 1287–88 (1991).

⁴¹ See Mendelson, *supra* note 35, at 781; see also *id.* at 779–91. Agencies might also exhibit self-aggrandizing biases that favor preemption. See *id.* at 794–97.

⁴² See *id.* at 787–88.

⁴³ See *id.* at 769–78 (arguing that agencies respond to states’ interests through the President and that states have opportunities to intervene either in agency adjudication or notice-and-comment rulemaking).

⁴⁴ See, e.g., *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 908 (2000) (Stevens, J., dissenting) (“[A]dministrative agencies are clearly not designed to represent the interests of States.”); see also Campbell, *supra* note 35, at 832.

⁴⁵ See *Solid Waste Agency v. U.S. Army Corps of Eng’rs*, 531 U.S. 159, 173 (2001).

⁴⁶ See, e.g., *Wells Fargo Bank of Tex. v. James*, 321 F.3d 488, 494 (5th Cir. 2003) (noting the contrast between a “concentrated, organized and well-funded” national banking industry and a “diffuse, unorganized, and definitionally ill-funded” population of bank customers).

litical branches,⁴⁷ the unified and hostile response by state attorneys general leaves little doubt that the OCC was significantly insulated from the states' interests.⁴⁸

The need to reduce the degree of *Chevron* deference becomes more pressing when, as in *Wachovia*, it interferes with the application of preexisting substantive canons of interpretation. In *Wachovia*, *Chevron* conflicted with the presumption against preemption,⁴⁹ which requires clear congressional intent for the preemption of state law.⁵⁰ The tension between these two doctrines is clear:⁵¹ in the face of an ambiguous statement by Congress as to whether a statute is preemptive, the presumption against preemption requires that the court find *no* preemption, while *Chevron* requires that the court *defer* to the agency's (reasonable) decision on the matter. Since the regulation itself finds state law preempted, accommodating both principles is not possible as in other cases.⁵² One must yield, at least partially, and in light of *Chevron*'s already strained justification in preemption contexts, *Chevron* is the better candidate.

The Supreme Court in *Solid Waste Agency v. U.S. Army Corps of Engineers*⁵³ set the precedent for refusing to defer to an agency in such situations. There, the Court opted out of *Chevron* because the agency interpretation pushed the bounds of congressional authority and thus ran counter to another canon, that of constitutional avoidance.⁵⁴ The Court thereby demonstrated that in the face of established canons, *Chevron* can and should be bypassed. Thus, in cases such as *Wachovia*, the court is justified in opting out of *Chevron* in order to preserve the presumption against preemption and the values it embodies. Such an opt-out is further justified by the fact that the *Solid Waste Agency* Court found additional support for its *Chevron*-bypass in the presence

⁴⁷ See, e.g., *Senate Hearing*, *supra* note 1, at 2 (statement of Sen. Paul Sarbanes) ("Let me state at the outset that I am opposed to the actions of the OCC.")

⁴⁸ See, e.g., *Congressional Review of OCC Preemption: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services*, 108th Cong. 86 (2004) (statement of Thomas Miller, Att'y Gen. of Iowa) (criticizing the OCC's effort over the past decade to "push the envelope as far as possible").

⁴⁹ Though the *Wachovia* court ruled that the presumption against preemption does not apply in the field of federal banking, see 414 F.3d at 314, this conclusion is almost certainly erroneous as discussed *infra*.

⁵⁰ See *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

⁵¹ See *Walthall*, *supra* note 35, at 716.

⁵² See, e.g., *Wells Fargo Bank of Tex. v. James*, 321 F.3d 488 (5th Cir. 2003) (engaging in preemption and *Chevron* analyses separately, since — unlike in *Wachovia* — the regulation itself did not claim to preempt).

⁵³ 531 U.S. 159 (2001).

⁵⁴ See *id.* at 172–73.

of federalism issues.⁵⁵ *Solid Waste Agency* thus provides not only the general pattern for compromising *Chevron* in the face of contradictory interpretive principles; it also provides a strong, independent reason for compromising *Chevron* in preemption cases such as *Wachovia*, in which agency interpretations encroach upon traditional state regulatory powers. The means to avoid the excesses of *Chevron* already lie within the reporters; the courts must only take them up.

Two objections might be made as to why the above schema should not apply to *Wachovia*, though both ultimately fail. The first objection would claim that the presumption against preemption does not apply in *Wachovia*: the entire field is preempted since the regulation of national banks has been “substantially occupied by federal authority for an extended period of time.”⁵⁶ However, the *Wachovia* court here merely added one more layer to a series of questionable, accretive interpretations of the Supreme Court case, *Barnett Bank v. Nelson*.⁵⁷ In *Barnett*, the Supreme Court never mentioned the presumption against preemption,⁵⁸ and its language was far from unconditional: the Court observed that the history of “national bank legislation” is “one of interpreting grants of both enumerated and incidental ‘powers’ to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law.”⁵⁹ More fundamentally, the *Wachovia* court ignored the underlying justification for *Barnett*’s proposition: namely, “Congress would not want States . . . to impair significantly . . . the exercise of a power that Congress explicitly granted.”⁶⁰ Yet in *Wachovia*, the extent of this grant was one of the very issues in question.

The second objection would claim that the statute at issue in *Wachovia* was explicitly preemptive, and thus the presumption against preemption does not apply. This was the approach taken by the Supreme Court in *Smiley v. Citibank*,⁶¹ in which the Court articulated a distinction between the “question of the substantive (as opposed to pre-

⁵⁵ See *id.* at 173 (“This concern [to assume that Congress did not delegate the required authority to the agency] is heightened where the administrative interpretation alters the federal-state framework by permitting federal encroachment upon a traditional state power.”).

⁵⁶ *Wachovia*, 414 F.3d at 314 (quoting *Flagg v. Yonkers Sav. & Loan Ass’n*, 396 F.3d 178, 183 (2d Cir. 2005)) (internal quotation marks omitted).

⁵⁷ 517 U.S. 25 (1996).

⁵⁸ See Bagley, *supra* note 38, at 2300 n.121 (noting the Ninth Circuit’s similarly expansive reading of *Barnett* in *Bank of America v. City & County of San Francisco*, 309 F.3d 551, 559 (9th Cir. 2002)).

⁵⁹ *Barnett*, 517 U.S. at 32 (emphases added). Compare this quote with the categorical language of one of the cases cited in *Wachovia*: “[B]ecause there has been a ‘history of significant federal presence’ in national banking, the presumption against preemption of state law is inapplicable.” *Bank of Am.*, 309 F.3d at 559.

⁶⁰ *Barnett*, 517 U.S. at 33 (emphasis added).

⁶¹ 517 U.S. 735 (1996).

emptive) *meaning* of a statute” and “the question of *whether* a statute is pre-emptive.”⁶² Though the presumption could be taken into account in the second case, it was inapplicable in the first and therefore *Chevron* governed.⁶³ Such reasoning unwisely ignores probable congressional intent, besides creating an interpretive discontinuity. According to *Smiley*, states’ rights are assiduously guarded by the presumption against preemption so long as Congress’s purposes are not expressed in explicitly preemptive language; but once Congress makes express its desire to preempt state law, the scope of that preemption suddenly widens to encompass any agency interpretation that can satisfy the requirement of “reasonableness.” Ultimately, unrestrained interpretation of a preemptive statute is equivalent to unrestrained preemption; and thus *Smiley*’s distinction, coupled with *Chevron* deference, opens the door to sweeping preemption of state law. Given broader or more ambiguous statutory language,⁶⁴ *Chevron* and *Smiley* could allow an agency to range far and wide from congressional intent, the supposed lodestar of all preemption inquiries.⁶⁵

Seen from within the confines of the banking industry, *Wachovia* is perhaps unproblematic. It is unclear whether the court’s decision will not ultimately benefit consumers,⁶⁶ and from a legal perspective, it is probable that the OCC would have won even without deference.⁶⁷ But special state prerogatives and traditional federalism concerns have clearly been swept away in *Chevron*’s broad wake.⁶⁸

⁶² *Id.* at 744.

⁶³ *See id.* at 744–45. The petitioner in *Smiley* had argued that owing to the presumption against preemption, the Court should not defer to an OCC interpretation of an explicitly preemptive statute.

⁶⁴ In *Smiley*, the ambiguous statutory term was “interest,” *id.* at 740, which presents a substantially narrower range of interpretive possibilities and implications.

⁶⁵ *See, e.g., Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) (“[T]he purpose of Congress is the ultimate touchstone’ in every pre-emption case.” (quoting *Retail Clerks v. Schermerhorn*, 375 U.S. 96, 103 (1963))).

⁶⁶ *See Senate Hearing, supra* note 1, at 7 (statement of John Hawke, Comptroller, OCC). *But see Bagley, supra* note 38, at 2282–86.

⁶⁷ The OCC convincingly argued that the distinction at issue was merely a formal one and that “operating subsidiaries are, in essence, incorporated departments or divisions of the bank.” *Wachovia*, 414 F.3d at 318 (quoting 66 Fed. Reg. 34,784, 34,788 (July 2, 2001)) (internal quotation marks omitted).

⁶⁸ *See, e.g., The Clearing House Ass’n v. Spitzer*, 394 F. Supp. 2d 620 (S.D.N.Y. 2005) (finding national bank immune from state investigation into racially discriminatory lending practices); *see also* 150 CONG. REC. S3945 (daily ed. Apr. 7, 2004) (statement of Sen. Edwards) (“[P]redatory lenders target African-Americans and other minority communities.”). Though the Supreme Court recently revisited the issue of *Chevron*’s proper application in *Gonzales v. Oregon*, No. 04-623, (U.S. Jan. 17, 2006), *available at* <http://www.supremecourtus.gov/opinions/05pdf/04-623.pdf>, it avoided deciding whether federalism concerns justify bypassing *Chevron*. The Court instead addressed a prior question in the analysis, holding that *Chevron* did not apply because the executive agency had acted in excess of its delegated authority. *See id.*, slip op. at 21.