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IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF CALIFORNIA

NATIONAL CITY BANK OF INDIANA, and NATIONAL CITY MORTGAGE CO., Plaintiffs, vs. DEMETRIOS A. BOUTRIS, in his official capacity as Commissioner of the California Department of Corporations, Defendant.	Civil Action No. S-03-0655 GEB JFM (Related to Case Nos. S-03-0157 GEB JFM and S-03-0256 GEB JFM) MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION Hearing Date: May 5, 2003 Hearing Time: 9:00 a.m. Hearing Location: Courtroom 10 **Hearing Requested** [15 minutes each side]

Defendant, Demetrios A. Boutris, in his official capacity as California Corporations Commissioner ("Commissioner") hereby submits his Opposition to plaintiffs' request for the issuance of a Preliminary Injunction.

INTRODUCTION

National City Mortgage Co. ("NCMC"), while openly in violation of California law, asks this Court to enjoin the California Corporations Commissioner from enforcing or taking any action to enforce the CRMLA. The plaintiffs' motion seeks to prohibit the Commissioner's statutory authority, presumably including his ability to administratively revoke NCMC's license for violating the law, effectively allowing NCMC to continue claiming it is licensed by the State of California. At the same time, National City Bank of Indiana ("National City Bank") and NCMC ask this Court to reach a conclusion that the CRMLA is preempted by overreaching federal regulations promulgated by the Office of the Comptroller of the Currency ("OCC").

National City Bank and NCMC cannot demonstrate a likelihood of success that would warrant the issuance of a preliminary injunction on any basis. There is no statutory authorization by Congress allowing the OCC to expand its jurisdiction over state-chartered corporations by designating them as operating subsidiaries of a national bank and then preempting all state laws, including consumer protection statutes such as the CRMLA. Further, NCMC has even failed to demonstrate that it is an operating subsidiary and when it allegedly became so.

Finally, on its face, California Financial Code section 50204(o) does not expressly limit the rate or amount of interest so as to bring it under the preemptory provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"). Rather, the California statute regulates the number of days a lender may charge consumers interest prior to the recording of their mortgage or deed of trust. As such, there is insufficient evidence and authority to support the issuance of a preliminary injunction.

National City Bank and NCMC have failed to prove that they will suffer irreparable harm if required to comply with the CRMLA. NCMC will not lose significant income during the pendency of this matter without the injunction; it will, however, lose the unfair business advantage it now enjoys over licensees who are required to comply with the California consumer protection laws.

Further, National City Bank cannot demonstrate that it has suffered a violation of its statutory or constitutional rights sufficient to give it standing to bring this action.

Because National City Bank and NCMC have not met their burden demonstrating that they will suffer irreparable harm and that they are likely to succeed at the time of trial and because National City Bank lacks standing to bring this suit, the preliminary injunction should not be issued.

STATEMENT OF FACTS

Following a regulatory examination, to which NCMC submitted as a licensee pursuant to California law, the California Corporations Commissioner demanded on February 27, 2003, that NCMC conduct an audit of its residential mortgage loans made in California from August 2000 to the present. The audit was demanded in order to identify all loans where per diem interest was charged by NCMC in excess of that allowed under California Financial Code section 50204(o)[1] and to identify those consumers entitled to a refund.

Despite being voluntarily licensed under the CRMLA since 1997 and previously complying with all licensing, regulatory, supervisory, examination and enforcement provisions of these statutes, plaintiffs refused to correct the identified deficiencies and to conduct the self audit demanded by the Commissioner. Accordingly, the Commissioner has instituted proceedings to revoke the CRMLA license of NCMC. The revocation is based on NCMC's stated intent to not abide by requirements of the CRMLA. Compliance with these consumer protection laws is a necessary predicate to maintaining a CRMLA license. Declaration of Yolanda Cherry ("Cherry Decl.") ¶ 8.

Alternatively, NCMC could have applied to the Commissioner for a ruling that it is exempt from the CRMLA under California Financial Code section 50003.[2] NCMC has never made such an application and has never attempted to surrender its license based upon its alleged status as an

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[1] California Financial Code section 50204(o) prohibits lenders licensed under the CRMLA from charging interest for more than one day prior to the recording of the mortgage or deed of trust. Typically, in California, the deed of trust is recorded the same day as the loan proceeds are disbursed for the borrowers' use ("loan close"), with loan proceeds being sent by the lender to title and/or the settlement agent the day before closing. The settlement agents and/or title company cause the deed of trust to be recorded and take instructions directly from the lender as to the recording. Burns Decl., paragraph 11. Financial Code section 50204(o) does contain an exception when the borrower affirmatively requests, and the lender agrees to, funding on a Friday or a day prior to a holiday, and specific disclosures are given. In those instances, a lender may charge interest from the business day prior to recording.

[2] Examples of exemptions include national banks; federal savings associations; wholly owned service corporations of national banks and federal savings associations.

operating subsidiary of a national bank. Moreover, from July 1997 through March 2003, NCMC complied with all requirements of the CRMLA, except those provisions complained of in the revocation action. Declaration DiAun M. Burns ("Burns Decl.") ¶¶ 6, 8.

During its tenure as a licensee under the CRMLA, NCMC has consistently filed all reports and paid all assessments required by the CRMLA. Burns Decl.¶ 6. NCMC has also submitted to all regulatory examinations scheduled by the Commissioner, and responded to all correspondence from the Commissioner concerning these regulatory examinations without question. In fact, NCMC did not contest the Commissioner's authority until March 2003 when he continued to demand compliance with the law. Burns Decl.¶¶ 6, 8.

By virtue of its recent claims of preemption in correspondence of March 2003 and through the lawsuit, NCMC has expressly stated its intention not to abide by requirements of the CRMLA. Compliance with these consumer protection laws is a necessary predicate to maintaining a CRMLA license. Cherry Decl.¶ 8. *See also* California Financial Code section 50327. The California Constitution mandates that the laws of this state be enforced until they are stayed by an appellate court decision. (*See* Cal. Const. art. III, § 3.5).

In addition to submitting to the Commissioner's jurisdiction under the CRMLA, NCMC has continued to advertise its licensure to potential and existing California consumers. NCMC advertises through mailings and a website, claiming that it is licensed under the CRMLA, thereby misleading California consumers into believing that the protections afforded under the CRMLA, including California Financial Code section 50204(o), would apply to their loans if they seek their residential mortgage loan through NCMC. Cherry Decl.¶ 7.

The amount at issue and the exact number of California consumers affected by NCMC's violation of the CRMLA is unknown because NCMC has refused to complete the self audit that would identify the more precise numbers. Further, the number of loans NCMC has made in California since August 2000 is unsubstantiated. A review of the Loan Reports filed by NCMC for calendar years 2000, 2001, and 2002 reveal that from August 2000 to December 2000, NCMC originated 719 loans; from January 2001 to December 2001, NCMC originated 6,846 loans; and from January 2002 to December 2002, NCMC originated 54,807 loans. This would make NCMC's

loan totals for 2000, 2001 and 2002 equal to 62,372. In addition, from August 2000 to December 2002, NCMC brokered 35,476 loans. Even assuming that NCMC is including brokered loans in its total, NCMC's loan totals for August 2000 through December 2002 equal 97,848, not the 150,000 to 180,000 loans NCMC claims. Burns Decl. ¶ 9.

The Commissioner hereby requests the Court deny plaintiffs' motion for preliminary injunction as these facts establish that plaintiffs have failed to meet their burden of demonstrating that they will suffer irreparable harm and that they are likely to succeed at the time of trial.

ARGUMENT

I. HEIGHTENED STANDARDS FOR PRELIMINARY INJUNCTIVE RELIEF MUST BE APPLIED

A. Moving Parties Must Satisfy A Heightened Burden When Seeking A Preliminary Injunction Against Government Activity

Courts have applied a heightened standard on the moving party when the injunctive relief is sought "to stay governmental action taken in the public interest pursuant to a statutory or regulatory scheme." *Able v. United States*, 44 F.3d 128, 130-31 (2d Cir. 1995) citing *Plaza Health Labs, Inc. v. Perales*, 878 F.2d 577, 580 (2d Cir. 1989). In this line of cases, the moving party must show more than "sufficiently serious questions going to the merits" (also known as the "fair-ground-for litigation" test). *Able*, 44 F.3d at 130. Where the governmental action is based on a statutory scheme to protect the public, such as the CRMLA at issue here, plaintiffs must demonstrate (1) irreparable harm should the injunction not be granted and (2) a likelihood of success on the merits. *Id.*

In *Able*, the Second Circuit Court of Appeals reversed and remanded the case to the District Court when it found the lower court abused its discretion by issuing a preliminary injunction based upon the less stringent standard of "sufficiently serious questions going to the merits" rather than the measure of a "likelihood of success on the merits". *Id.* at 131-132. The court expressly found that it would be inappropriate for the court to substitute its own determination of public interest and apply the lesser standard where the government had engaged the democratic process to produce policy in the name of public interest that was embodied in a statute and implementing

regulations. *Id.* The statutory and regulatory scheme in *Able* was the much debated "don't ask, don't tell" policy of the military as related to sexual orientation of its personnel. *Id.* at 130.

Likewise, in *Plaza Health Lab, Inc., supra,* the appellate court affirmed the district court's refusal to issue a preliminary injunction to prohibit the New York Department of Social Services from suspending Plaza Health Lab, Inc.'s ability to participate in the Medicaid program, finding that the lower court properly applied the likelihood of success standard in combination with the irreparable harm element where the government entity was threatened with being prohibited with carrying out its statutory duties. *Plaza Health Labs, Inc,* 878 F.2d at 580.

Plaintiffs assert that the Ninth Circuit Court of Appeals has adopted a more lenient "alternative standard" similar to the standards rejected in *Able, supra,* and *Plaza Health Labs, Inc, supra.* All three authorities cited in the moving papers are distinguishable. Two of the cases involve preliminary injunctions against private corporations, not governmental entities, and should be disregarded as irrelevant. *See International Jensen, Inc. v. Merrasound U.S.A., Inc.,* 4 F.3d 819, 822 (9th Cir. 1993), *Sun Microsystems, Inc. v. Microsoft, Corp.*, 188 F.3d 1115, 1119 (9th Cir. 1999).

Although plaintiffs' third case cited in support for this alternative standard involved the Immigration and Naturalization Service, a federal agency, it was decided prior to the *Able* line of cases. *See National Center for Immigrants Rights, Inc. v. INS*, 743 F.2d 1365, 1369 (9th Cir. 1984). The issue of the appropriate standard for a preliminary injunction to be issued against a governmental entity was not raised, and thus never addressed in the case. *Id.* Further, unlike the situation presented at bar, a newly promulgated regulation, not a statute or statutory scheme designed to protect the public, was under attack. *Id.* at 1367. The CRMLA challenged by plaintiffs is a statutory scheme developed to provide consumer protection in lending transactions and, therefore, under the rationale as set forth in *Able* and subsequent cases, requires the application of more stringent burdens before a preliminary injunction will issue.

It is instructive to note that a District Court in the Northern District of California recently followed the heightened standard established by the Second Circuit. *Ft. Funsten Dog Walkers v. Babbitt*, 96 F. Supp. 2d 1021 (N.D. Cal. 2000). There the court acknowledged the

"alternative standard" as the standard for the Ninth Circuit, but nevertheless held that "[a] strong showing or entitlement to a preliminary injunction is required where the moving party seeks to enjoin governmental action taken in the public interest pursuant to a statutory or regulatory scheme. In such cases, the moving party must establish both irreparable injury and a probability of success on the merits." *Id.* at 1032 (cite omitted).

Plaintiffs must therefore establish, to the satisfaction of this court, both irreparable injury and a likelihood of success on the merits, because they are seeking to stay governmental action taken in the public interest pursuant to a statutory or regulatory scheme. As set forth more fully below, plaintiffs cannot meet this burden.

B. The Plaintiffs Burden Is Greater Where The Preliminary Injunction Sought May Be The Equivalent Of Disposing Of An Entire Action

A heavier burden is also placed upon plaintiffs because their request for preliminary relief seeks to essentially dispose of the entire action. *Sanborn Mfg. Co, Inc. v. Campbell Hausfeld/Scott Fetzer Co.*, 997 F.2d 484, 486 (8th Cir. 1993). Plaintiffs seek to enjoin the Commissioner's licensing, regulatory, examination and enforcement powers under the CRMLA, and to prevent the Commissioner from revoking the CRMLA license of NCMC, or otherwise dispossessing NCMC of that license. Plaintiffs are not limiting their action merely to the per diem statute. Thus, plaintiffs are seeking to prevail on all issues in the case at this preliminary stage.

When the granting of a preliminary injunction may provide full relief, the standard for granting the injunction is higher than normal. *Sanborn Mfg. Co, Inc*, 997 F.2d at 486. "The burden on the movant 'is a heavy one where, as here, granting the preliminary injunction will give [the movant] substantially the relief it would obtain after a trial on the merits.'" (citation omitted) *Id.* "When the district court's order, albeit in the form of a TRO or preliminary injunction, will finally dispose of the matter in dispute, it is not sufficient for the order to be based on a likelihood of success or balance of hardships. . . the district court's decision must be correct (insofar as possible on what may be an incomplete record.). . . ." (citations omitted) *Romer v. Green Point Sav. Bank*, 27 F.3d 12, 16 (2nd Cir. 1994) (emphasis added). *See also Rivera-Vega, Inc. v Conagra , Inc.* 70 F.3d

153 (1st Cir. 1995). "When, as in this case, the interim relief sought by the NLRB 'is essentially the final relief sought, the likelihood of success should be strong.'" (citation omitted). *Id.* at 164.

Romer v. Green Point Sav. Bank involved bank depositors who sought a temporary restraining order to stop a stock conversion plan of the bank from going forward. The court found that the granting of the restraining order would make it impossible for the bank to meet the 45-day-sale-date required for such a conversion, and thus the temporary restraining order had the effect of a final injunction. Accordingly, the court held that because the temporary restraining order would have "the effect of a permanent injunction, we review it in the same manner as we would review such a final injunctive order." 27 F.3d 12, 16. The court in *Romer* then went on to find that the bank depositors had not demonstrated "a violation of their rights, no irreparable harm, no likelihood of success, perhaps not even a fair question for litigation, certainly no balance of hardships tipping in their direction, and no entitlement to relief." *Id* .at 16.

Accordingly, because plaintiffs are seeking to obtain the same relief by their preliminary injunction motion that they seek to obtain after a trial on the merits, plaintiffs must demonstrate "(1) a likelihood of success on the merits; (2) the potential for irreparable injury in the absence of relief; (3) that such injury outweighs any harm preliminary injunctive relief would inflict [on interested parties] . . .; and (4) that preliminary relief is in the public interest." *Rivera-Vega, Inc.*, 70 F.3d at 164; *accord Sanborn Mfg. Co.*, 997 F.2d at 485-486.

As more fully discussed below, plaintiffs have failed to meet this heightened burden to dispose of the entire matter on Preliminary Injunction.

C. Injunctive Relief Is Inappropriate When The Rights of Nonparties Will Be Affected

The preliminary injunctive relief sought by plaintiffs would adversely affect the borrowers who were overcharged as well as all other California consumers, who rely upon the CRMLA for protection. None of the consumers or borrowers are parties to this matter. If granted it also could adversely impact other persons or officials acting in the name of the People of the State of California, such as the California Attorney General, none of whom is a party to this action or have been given any notice of the action by plaintiffs. Further, other licensees under the CRMLA will be

unfairly disadvantaged in business by being required to abide by the laws of the State of California while their competitor, NCMC, is allowed to keep its license but not comply with the same laws. The Court must consider the effect of the injunction upon nonparties in determining whether to grant the far-reaching preliminary injunction as requested by plaintiffs. *Publications Int'l, Ltd. v. Meredith Corporation,* 88 F.3d 473, 478 (7th Cir. 1996).

By way of example, the United States District Court for the District of Nevada refused to grant a single shareholder a preliminary injunction to prevent corporate officers from taking actions in furtherance of stock rights they had declared as a dividend to common stockholders of the company because it would seriously affect the investing public who were not parties to the litigation. *Horwitz v. Southwest Forest Industries, Inc.,* 604 F.Supp. 1130, 1136 (D.NV 1985). To allow one shareholder to disrupt the operations of the corporation by way of a preliminary injunction gave too much power to the allegedly aggrieved party. *Id.*

Here, this court should refuse to allow plaintiffs to disrupt the statutory schemes set forth in the CRMLA to the detriment of California consumers, businesses and other government agencies without full argument of the issues.

Plaintiffs misstate the law and the function of the OCC when they claim that California and the public will suffer no harm if the preliminary injunction were granted. Plaintiffs fail to acknowledge that California consumers who obtain loans through NCMC will continue to be overcharged, as NCMC deems appropriate during the pendency of this lawsuit if a preliminary injunction were issued. Plaintiffs also disregard the misrepresentation inherent in a court order allowing NCMC to retain its California licenses, but excusing NCMC from complying with the underlying statutory scheme designed to protect consumers.

Congress did not expressly preempt <u>any law</u> with respect to operating subsidiaries as further discussed below. *See* Section II, A and B below. While the OCC may continue to regulate plaintiffs during the pendency of this action, even the OCC makes clear that its regulation is not based on consumer protection but rather on protecting the safety and soundness of the financial

institutions.[3] Plaintiffs' offer regarding how they plan to make the public whole at a later date if the CRMLA is upheld fails to include interest with the refunds for overcharged customers, and it ignores various other provisions of the CRMLA that exist for the public protection.[4] Finally, plaintiffs improperly seek to enjoin others, including other state officials, from applying the CRMLA and Civil Code section 2948.5, without notice, thus undermining the concepts of due process.

Plaintiffs must meet the higher burden of both irreparable injury and likelihood of success on the merits because they are (1) seeking to stay governmental action taken in the public interest pursuant to a statutory scheme; (2) seeking to dispose of the entire action by preliminary relief, and (3) seeking to adjudicate a matter involving the interests of third parties. Plaintiffs have failed to meet this burden.

II. PLAINTIFFS FAIL TO ESTABLISH THEY ARE LIKELY TO SUCCEED ON THE MERITS

A. An Operating Subsidiary Is *Not* A National Bank

An operating subsidiary is *not* a national bank and should not be granted all the rights and privileges of a national bank. National banks are federally created entities that must enter into articles of association designating themselves as national banks and certifying that they intend to avail themselves of the advantages of the NBA. 12 U.S.C. §§ 21 and 22. In contrast, operating subsidiaries are state-chartered entities. *Cf.* 12 U.S.C. § 21; *but see* 12 C.F.R. § 5.34. No law grants the exclusive regulatory authority over state created entities such as NCMC to the OCC, the agency responsible for overseeing national banks. *See* 12 U.S.C. §§ 1, et seq.

If Congress had intended operating subsidiaries to be the equivalent of national banks, it would have declared its intention and included an operating subsidiary in the very definition of a bank or national bank. Title 12 U.S.C. Section 1813 defines "bank" as "any national bank, State bank, and District Bank, and any Federal branch and insured branch." But, this definition of "bank" formulated by Congress does not include "operating subsidiaries" of national

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[3] The Commissioner respectfully requests the Court take judicial notice of the letter from the OCC dated January 16, 2003, attached as Exhibit A to the Plaintiffs' Complaint in the related case of *Wells Fargo Bank, N.A. v. Boutris* (Civil Action No. S-03-0157).

banks. A court must give meaning to all statutory provisions and interpret the statute consistently with the structure, legislative history and motivating policies, so as to not make ineffective other provisions of the statute. *See*; *United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992); *Bifulco v. United States,* 447 U.S. 381, 387 (1980); *United States v. Fisher,* 58 F.3d 96, 99 (4th Cir. 1995).

NCMC is a state-chartered corporation and has held such corporate status in California since 1993. As a separate corporate entity, NCMC has its own identity, assets, liabilities, and regulatory responsibilities, separate and distinct from those of its parent corporation. Therefore, National City Bank and NCMC are insulated from each other's liabilities and responsibilities because "[e]xcept in unusual circumstances, courts will not disregard the separate identity of a parent and its subsidiary, even a wholly-owned subsidiary." *Securities Industry Ass'n v. Fed. Home Loan Bank Board,* 588 F.Supp. 749 (D.C. Dist. 1984) *citing Labadie Coal Co. v. Black,* 672 F.2d 92, 96 (D.C. Cir. 1982) ("the greatest judicial deference normally is accorded to the separate corporate entity.") It is undisputed that NCMC is not a bank; it is not a state or federally authorized bank. It is a state-authorized corporate citizen that engages in residential lending transactions.

Nowhere has Congress expressed in the federal banking laws that such a state-created legal entity is the equivalent of a nationally organized bank. *See* 12 U.S.C. §§ 1, et seq.; 12 U.S.C. § 21, 12 U.S.C. § 24 (Seventh). Yet plaintiffs are asking this court to rule NCMC is entitled to the same benefits, protections and exclusive oversight as the bank. This interpretation is not supported by any Congressional mandate authorizing an "operating subsidiary", as a separate legal entity distinct from a national bank, to be treated identically as a national bank for purposes of regulation.

In fact, at least one other District Court concluded that a mortgage company operating subsidiary of Fleet National Bank was not a "bank" under Section 133 of the Gramm-Leach-Bliley Act (codified at 12 U.S.C. § 1816), and thus, was subject to shared enforcement of jurisdiction by the state of Minnesota and Federal Trade Commission regarding telemarketing activities. *Minnesota v. Fleet Mortgage,* 181 F.Supp.2d 995, 1000 (U.S. Dist. Minn. 2001). The court found that although the mortgage company was an "operating subsidiary" of a national bank it was not "a bank." *Id.* at

[4] The CRMLA also requires that licensees maintain adequate staff; maintain records for 3 years; and fund in a timely fashion. It also prohibits unfair or deceptive practices; commingling of trust funds; and untimely closings.

999. The court rejected the arguments by both Fleet National Bank and the OCC that the subsidiary was "effectively an incorporated department" of a national bank. *Id.* at 1000. The court further held that "[a]llowing the State to enforce the [Telemarketing Sales Rule] against [Fleet Mortgage Company] will in no way 'restrict' the authority of the OCC to regulate national bank operating subsidiaries just as it has done in the past. The OCC's insistence that it must have exclusive jurisdiction over subsidiaries in order to avoid having its authority 'restricted' is not persuasive." *Id.* at 1001.

Fleet Mortgage analyzed the issues now before this Court, and (1) recognized the chartering and regulatory differences between a national bank and a state-chartered corporation acting as an operating subsidiary of the bank, (2) rejected the OCC's claim of exclusive regulatory power over operating subsidiaries of national banks, and (3) refused to defer to the OCC's interpretation of the GLBA and the FDIA [Federal Deposit Insurance Act]. *Id.* at 999-1002.

NCMC is not chartered or organized as a national bank. *See* 12 U.S.C. §§ 21 et seq. NCMC is a wholly owned subsidiary of National City Bank. Declaration of Stephen A. Stitle in Support of Plaintiffs' Motion for Preliminary Injunction, ¶ 2. Accordingly, where there is no express Congressional authorization to do so, these two separate and distinct entities should not be treated as identical under the NBA.

Finally, as a state chartered corporation conducting business in California, NCMC is availing itself of the rights and privileges of a California corporation, yet claiming not to be subject to California's laws by way of the OCC's exclusive regulatory authority over operating subsidiaries. To treat NCMC the same as a national bank would be to place NCMC in a unique position, giving it an unfair advantage in the marketplace against other mortgage lenders in California not affiliated with national banks and, therefore, subject to California's laws. As a general policy, this result would be inherently unfair to California businesses and affect a result not contemplated or sanctioned by Congress.

As has been succinctly stated by the district court for the Eastern District of Pennsylvania, "The National Bank Act, 12 U.S.C. §§ 21 et seq. regulates national banks and only national banks, which can be identified by the word "national" in their name as required by 12

U.S.C. § 22." *Weiner v. Bank of King of Prussia*, 358 F.Supp. 684, 687 (E.D. Penn. 1973). NCMC is not such a national bank.

B. The OCC Lacks Authority To Adopt Regulations Giving It Exclusive Regulatory Powers Over Operating Subsidiaries

By promulgating regulations seeking to regulate operating subsidiaries of national banks to the exclusion of the states, the OCC is interfering with California's constitutional sovereignty under the Tenth Amendment and taking away the state's powers to regulate and enforce its laws against state-chartered corporations such as NCMC.

"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const. amend. X. Article I, Section 8 of the Constitution authorizes Congress to establish national banks and "to enact legislation for the protection, preservation and regulation of such institutions." *Clark v. United States*, 184 F.2d 952, 953 (10th Cir. 1950). Therefore, a federal statutory scheme over federally created national banks does not violate the Tenth Amendment. *First Union National Bank v. Burke*, 48 F.Supp.2d 132 (D.C. Conn. 1999).

In *First Union*, the Connecticut District Court was presented with the question of the OCC's exclusive visitorial powers over national banks and the potential violation of the Tenth Amendment such exclusivity presented. *Id.* at 148-149. The court found that the NBA and the OCC's regulations *properly* promulgated thereunder did not violate the Tenth Amendment because the NBA "has carved out from state control supervisory authority over these *federal instrumentalities*. *Id.* at 148 (emphasis added). However, as set forth above, NCMC is not a national bank, but rather a corporate citizen of the state of California. Accordingly, neither Congress nor the OCC as the regulatory agency responsible for application of the NBA, have the power to establish and regulate operating subsidiaries of national banks to the exclusion of the states. *See Minnesota v. Fleet Mortgage*, 181 F.Supp.2d 995, 1002 (U.S. Dist. Minn. 2001) (noting that there is no direct authority establishing the OCC's exclusive jurisdiction over operating subsidiaries).

Further, the OCC has exceeded its constitutional and statutory authority in promulgating 12 C.F.R. § 7.4006 which, in essence, seeks to preempt state laws as they apply to operating subsidiaries of national banks.

The first question that must be answered in any preemption analysis is whether Congress intended that federal law or regulation would supersede state law. *Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986). As to preemption of state law, the OCC regulations may only preempt state law " . . . when and if it is acting within the scope of its congressionally delegated authority . . . . An agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless . . . Congress confers power upon it." *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986). The OCC can point to no express delegation of authority.

Congress has not defined an "operating subsidiary" in the NBA or the Gramm-Leach-Bliley Act ("GLBA"). *See generally*, 12 U.S.C. §§ 21 et seq. and 24(a). Congress has not expressly granted national banks the authority to own or establish operating subsidiaries in the NBA or the GLBA. The OCC has interpreted Title 12 U.S.C. Section 24 (Seventh) as giving the OCC the authority to promulgate regulations authorizing national banks to establish operating subsidiaries. Title 12 U.S.C. Section 24 (Seventh), however, authorizes incidental powers to national banks, not the OCC. Thus Section 24 (Seventh) does not constitute an express Congressional delegation to the OCC to preempt state regulation of operating subsidiaries of national banks.

There is a long-standing rule designed to aid courts in statutory construction: ". . . courts must presume that the legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-254 (1992). The failure of Congress to define the term "operating subsidiary" or include operating subsidiaries in the statutory scheme covering national banks must be presumed to be intentional in the absence of language to the contrary.

In fact, the latest comprehensive congressional pronouncement on national banking, the GLBA, makes no explicit reference to operating subsidiaries or the OCC's authority to regulate such entities. *See generally* 12 U.S.C. § 24a; 12 U.S.C. § 24a(g)(3)(A). However, the OCC, which

first promulgated its regulation giving national banks the right to establish operating subsidiaries in 1966, waited until after passage of the GLBA to attempt to expand its exclusive visitorial authority. 12 C.F.R. § 5.34; 31 Fed.Reg. 11,459 (Aug. 31, 1966).

Absent express Congressional authorization for its actions, the OCC has exceeded its authority in promulgating regulations governing "operating subsidiaries" and purporting to preempt the licensing and visitorial provisions of state law such as the CRMLA. *See generally Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

1. The OCC's General Rulemaking Authority Does Not Support Its Promulgation Of Regulations Exclusively Governing Operating Subsidiaries

The OCC's general rulemaking authority under 12 U.S.C. Section 93a is insufficient to support its promulgation of regulations that seek to give the OCC exclusive regulatory authority over operating subsidiaries, especially where as here, the entity is a state-chartered corporation. Title 12 U.S.C. Section 1 establishes the OCC as the federal agency responsible for overseeing national banks established pursuant to the NBA.[5] The general rulemaking authority of the OCC is further defined by 12 U.S.C. § 93a, which provides in part:

> Except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to another regulatory agency, *the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office*, . . ."

12 U.S.C. § 93a (emphasis added).

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[5] 12 U.S.C. § 1 provides:

> There shall be in the Department of the Treasury a bureau charged with the execution of all laws passed by Congress relating to the issue and regulation of national currency secured by United States bonds . . . , of all Federal Reserve notes, except for the cancellation and destruction, and accounting with respect to such cancellation and destruction, of Federal Reserve notes unfit for circulation, the chief officer of which bureau shall be called the Comptroller of the Currency and shall perform his duties under the general directions of the Secretary of the Treasury. The Comptroller of the Currency shall have the same authority over matters within the jurisdiction of the Comptroller as the Director of the Office of Thrift Supervision has over matters within the Director's jurisdiction under section 3(b)(3) of the Home Owners' Loan Act [12 U.S.C. § 1462a(b)(3)(b)(3)] . . .

It is undisputed that the OCC's responsibilities include the oversight and regulation of national banks. While 12 U.S.C. § 93a recognizes and codifies the OCC's authority to regulate in the area of national banking, it does not recognize or codify the OCC's authority to regulate operating subsidiaries of national banks. To regulate operating subsidiaries the OCC must have express Congressional authorization. *See Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)

In *Motion Picture Association of America, Inc. v. Federal Communications Commission,* 309 F.3d 796, 801 (D.C. Cir. 2002), the Court of Appeals specifically addressed the issue of an agency's general grant of authority and found such authority insufficient to support the FCC's promulgation of regulations regarding video description rules that impacted television program content.[6] *Id.* at 805. In *Motion Picture Association of America,* the court rejected the FCC's attempt to rely on a general grant of authority, even though that authority was more broad than that on which the OCC basis its preemption claim in this case.

The FCC was expressly authorized to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." *Id.* at 802-803 (quoting § 1 of the Communications Act, *codified at* 47 U.S.C. § 154(i)). The general grant of authority further directed the agency to "ensure that all people of the United States, without discrimination, have access to wire and radio communication transmissions." *Id.* at 804 (summarizing § 1 of the Communications Act); *cf.* 12 U.S.C. § 93a (granting the OCC the authority to prescribe rules and regulations to carry out the responsibilities of the office).

In adopting regulations requiring video description to provide better access to the blind , the FCC exceeded its authority as the regulations had the effect of governing programming content, which in turn had constitutional implications. *Motion Picture Association of*

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[6] The Motion Picture Association of America, Inc., also put before the court arguments intending to show that another section of the statute (47 U.S.C. § 613) by its express terms denied the FCC the authority to promulgate the regulations at issue. However, the court principally rested its decision that the promulgation of the regulation was improper on the agency's claim of general rulemaking authority. *Motion Picture Association of America, Inc. v. Federal Communications Commission,* 309 F.3d 796, 801, (D.C. Cir. 2002).

America, 309 F.3d 796, 804-805. The court found that important issues such as the implication of constitutional rights required a more express grant of authority than the FCC possessed in its general rulemaking authority and than was implied by the statutory scheme. *Id.* at 805.

Like the constitutional implications raised in *Motion Picture Association of America*, the plaintiffs are asking this Court to condone the OCC's promulgation of regulations that have Tenth Amendment implications. Consistent with the District of Columbia appellate court, this Court should reject the OCC's promulgation of such regulations in the absence of express congressional authorization. The NBA does not expressly address operating subsidiaries. *See* 12 U.S.C. §§ 1, et seq. Further, nothing in the NBA indicates an intent by Congress for the OCC to issue regulations giving it exclusive regulatory authority over operating subsidiaries.

While finding that the FCC's authority under the statute was broad, the court held it was "not without limits." *Motion Picture Association of America,* at 804. Here, while the OCC's general rulemaking authority is broad as it applies to national banks, it must be restrained where it seeks to expand its limited delegated Congressional authority.[7] Congress has never expressly extended the rulemaking authority of the OCC to operating subsidiaries. *Cf.* 12 U.S.C. §24a(a)(5) (directing the OCC to promulgate regulations regarding financial subsidiaries).

To find that the OCC's general rulemaking authority vests in the agency the power to regulate operating subsidiaries of national banks, to the exclusion of the states, would be to grant the OCC unlimited authority not contemplated and not yet authorized by Congress. Administrative agencies, such as the OCC, are not granted unlimited power. Rather, they are given limited and delegated authority only "to adopt regulations to carry into effect the will of Congress as expressed by . . . statute." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 214 (1976). Congress has not seen fit to express its will with regard to operating subsidiaries and has not enacted legislation recognizing or governing operating subsidiaries of national banks. Therefore, the OCC's promulgation of regulations governing operating subsidiaries is a manifestation of the OCC's will,

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[7] *See Independent Insurance Agents of America, Inc. v. Hawke,* 211 F.3d 638, 645-646 (D.C. Dist. 2000) (finding that the Comptroller of the Currency exceeded his congressionally delegated authority when he promulgated regulations pursuant to 12 U.S.C. 24 (Seventh) allowing national banks to sell crop insurance).

not the will of Congress. Such regulations are not proper and exceed the OCC's limited delegated authority.

2. The OCC's Interpretation Of 12 U.S.C. § 24 (Seventh) Does Not Support Its Promulgation Of Regulations Exclusively Governing Operating Subsidiaries

Title 12 U.S.C. § 24 (Seventh) authorizes *national banks* to exercise ". . . all such incidental powers as shall be necessary to carry on the business of banking; . . ." Conceding for purposes of argument that § 24 (Seventh) gives *national banks* the ancillary authority to establish operating subsidiaries, this section in no way acts as express Congressional authority for the *OCC* to regulate such operating subsidiaries to the exclusion of the states. Section 24 (Seventh) makes no mention of operating subsidiaries. Rather it is a broad grant of authority directly to *national banks,* not the regulatory body.

Further, nothing within § 24 (Seventh) expressly grants to the OCC the authority to regulate all "such incidental powers" in which the national banks are permitted to exercise or engage. At best, 12 U.S.C. § 24 (Seventh) gives the OCC the authority to determine what powers are, in fact, incidental to the business of banking. *See NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.,* 513 U.S. 251 (1996).

While several cases have impliedly recognized a national bank's ability to conduct banking activities through operating subsidiaries, no case has directly dealt with the issue of the OCC's exclusive regulatory authority over operating subsidiaries. In *M & M Leasing Corp. v. Seattle First Nat'l Bank,* 563 F.2d 1377 (9th Cir. 1977), the issue before the court was whether the "business of banking" authorized by 12 U.S.C. § 24 (Seventh) included the leasing of personal property. *Id.* at 1380. Contrary to the case at bar, the court was never asked to reach the issue that an operating subsidiary was the equivalent of a national bank or subject to the OCC's exclusive regulatory authority. *See also NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.,* 513 U.S. 251 (1995) (whether national banks may serve as agents in the sale of annuities); *Clarke v. Securities Industry Association,* 479 U.S. 388 (1987) (whether the Comptroller of the Currency exceeded his authority when he approved the application of national banks for the

establishment of discount brokerage subsidiaries); *Marquette National Bank of Minneapolis v. First Omaha Service Corp.*, 439 U.S. 299 (1978) (whether the NBA authorized a national bank located in one state to charge an interest rate allowed by its home state, when that interest rate is greater than the rate permitted by the bank's nonresident customers); *American Insurance Association v. Clarke*, 865 F.2d 278 (D.C. Cir 1988) (whether the formation of a national bank subsidiary to offer municipal bond insurance was permissible under the NBA).

Moreover, Congress has been clear when it intends to delegate authority to the OCC to address areas significantly implicating or preempting state laws. *See generally* 12 U.S.C. § 36; 12 U.S.C. §§ 1861-1867; 12 U.S.C. § 24a. That Congress has not seen fit to delegate such authority to the OCC in the case of operating subsidiaries is tantamount to a declaration from Congress that it has withheld such power. *See Tennessee Valley Authority v. Hill*, 437 U.S. 153 (1978).

In 1994, Congress enacted the Riegle-Neal Interstate Banking Act, which established interstate branches of national banks and codified the conditions upon which a national bank may retain or establish and operate a branch or branches of a national bank. Pub. L. 103-328, 108 Stat. 2338 (Sept. 29, 1994) *codified at* 12 U.S.C. § 36.[8] Pursuant to this statute, branches of national banks are generally subject to the laws of the host State where the branch is located regarding consumer protection, fair lending, community reinvestment and establishment of interstate branches. 12 U.S.C. § 36(f)(1)(A). This is true, except when federal law expressly preempts the application of the state law to a national bank or if the OCC has made a determination that the application of the state law would have a discriminatory impact on the branch. *Id.* The statute further provides that the OCC is responsible for enforcing all applicable state laws to which the branch of a national bank is subject. 12 U.S.C. § 36(f)(1)(B).

There has been no similar declaration from Congress addressing the

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[8] 12 U.S.C. §36(l) defines "branch" as follows:

> The term "branch" as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent. The tern "branch" as used in this section, does not include an automated teller machine or a remote service unit.

application of state law, or authorizing preemption of state law applicable to operating subsidiaries of national banks, or authorizing the OCC's exclusive authority over them.

In the Bank Service Company Act, 12 U.S.C. §§ 1861-1867, Congress has expressly given the OCC the same examination and enforcement authority over a bank service company[9] owned by a national bank that the OCC exercises over the parent national bank. *See* 12 U.S.C. § 1818.[10] The Bank Service Company Act specifically provides that the performance of those acts permissible by the bank service company shall be governed and "subject to regulation and examination by such agency to the same extent as if such services were being performed by the bank itself." 12 U.S.C. § 1867(c)(1). In the case of a bank service company owned or operated by a national bank, the OCC is the appropriate federal agency responsible for such supervision and enforcement. 12 U.S.C. § 1818; 12 U.S.C. §§ 1861-1867.

However, Congress has never enacted similar legislation granting the OCC authority to preempt state laws applicable to such state-chartered entities such as NCMC.

Congress also spoke to the issue of the application of state law to national banks and the preemption of state law when it enacted the Gramm-Leach-Bliley Act (GLBA). *See generally* 12 U.S.C. §§ 24a et seq; *see also* 15 U.S.C. § 6701. The GLBA grants national banks the authority to engage in certain activities, such as insurance activities and securities transactions, through "financial subsidiaries," subject to certain conditions. 12 U.S.C. § 24a(a)(1) and (a)(2).

Title 15 U.S.C. section 6701 of the GLBA expressly limits the preemption of state laws as they apply to financial subsidiaries of national banks. Preemption of a state law is specifically prohibited if: (A) the state law does not relate to or regulate insurance sales, solicitations, or cross marketing activities; (B) the state law does not relate to or regulate the

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[9] A "bank service company" is defined as:

> . . . (2) any corporation-- (i) which is organized to perform services authorized by this Act [12 USCS §§ 1861 et seq.] (ii) all of the capital stock of which is owned by 1 or more insured banks; and (B) any limited liability company-- (i) which is organized to perform services authorized by this Act [12 USCS §§ 1861 et seq]; and (ii) all of the members of which are 1 or more insured banks.

[10] 12 U.S.C. § 1818 sets forth the OCC's general enforcement authority over national banks.

business of insurance activities; (C) the state law does not relate to certain securities investigations or enforcement actions; and (D) the state law does not treat depository institutions and their affiliates differently than other persons engaged in the same activities, does not prevent a depository institution or affiliate from engaging in activities authorized by the GLBA and does not conflict with the intent of the GLBA. 15 U.S.C. § 6701(d)(4)(i) to (iv).

There has been no similar declaration from Congress regarding the application of state law, or preemption of same, as it applies to operating subsidiaries of national banks, or the OCC's exclusive authority over them. In short, where Congress has intended to preempt state laws and vest all authority in the OCC, it has done so explicitly, not implicitly.

The assertions by plaintiffs and the OCC in the preliminary injunction briefing that the OCC has plenary authority to adopt regulations governing operating subsidiaries of national banks to the exclusion of the states is, therefore, flawed and to find otherwise would be to usurp the power of Congress. As the court stated in *Independent Insurance Agents of America, Inc. v. Hawke,* 211 F.3d 638 (D.C. Cir. 2000), such expansive authority would allow national banks and their federal regulatory agency "to constantly expand their field of operations on an incremental basis without congressional action." *Id.* at 645. In this case, an impermissible expansion of the OCC's authority to the exclusive regulation of operating subsidiaries would result in just such an unprecedented and unauthorized expansion of the OCC's power.

3. The GLBA Does Not Delegate To The OCC Authority To Promulgate Regulations Exclusively Governing Operating Subsidiaries

In promulgating 12 C.F.R. § 7.4006, the OCC cited only the GLBA as its statutory authority to expand its exclusive regulatory authority to operating subsidiaries. *See* 66 Fed.Reg. 34784, 34788, n.15. However, Congress did not recognize operating subsidiaries in the GLBA or expressly authorize the OCC to promulgate regulations governing such entities to the exclusion of the states. *See generally* 12 U.S.C. § 24a.

The GLBA grants national banks the authority to engage in certain activities through "*financial subsidiaries,*" subject to certain conditions. 12 U.S.C. § 24a(a)(1) and (a)(2) (emphasis added). Title 12 U.S.C. section 24a, subsection (g)(3)(A), to which the OCC cites as its

authorizing power, is a definition of a "financial subsidiary," not an "operating subsidiary". The term "financial subsidiary" means "any company that is controlled by 1 or more insured depository institutions *other than a subsidiary that*—(A) engages solely in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks. . . ." 12 U.S.C. § 24a(g)(3)(A) (emphasis added).

Under the maxim *expressio unius est exclusio alterius,* where a statute provides authority for one action, and is silent as to a similar, related action, the law must be interpreted as authorizing only the former and not the latter. *See Tennessee Valley Auth. v. Hill,* 437 U.S. 153, 188 (1978); *Nextwave Personal Communications, Inc. v. FCC,* 254 F.3d 130, 152-153 (D.C. Cir. 2001), *petition for cert granted,* 122 S.Ct. 1202 (U.S. Mar. 4, 2002) (No. 01-657). That is, "[a] statute listing the things it does cover exempts, by omission, the things it does not list. As to the items omitted, it is a mistake to say that Congress has been silent. Congress has spoken – these matters are outside the scope of the statute." *Original Honey Baked Ham Co. v. Glickman,* 172 F.3d 885, 887 (D.C. Cir. 1999). Congress did not expressly recognize operating subsidiaries or grant to the OCC the authority to promulgate regulations governing operating subsidiaries in the GLBA. Accordingly, operating subsidiaries and their regulation are outside the scope of the GLBA.

Further, subsection (a)(5) of 12 U.S.C. § 24a explicitly directs the Comptroller of the Currency to enact regulations prescribing the procedures to implement the purposes and provisions of the Act, namely national banks' ability to conduct certain operations through "financial subsidiaries." Despite making the most recent pronouncement on banking law in the GLBA in 1999, Congress gave no similar direction or grant of authority to the Comptroller to promulgate regulations regarding "operating subsidiaries."

Thus, the GLBA is not the express, and cannot be the implied, Congressional authority required to support the OCC's promulgation of 12 C.F.R. § 7.4006, whereby the OCC purports to restrict the application of state laws to operating subsidiaries of national banks. *See United States v. Mead Corporation,* 533 U.S. 218 (2001); *Chevron U.S.A. Inc. v. Natural Resources*

Defense Council, Inc., 467 U.S. 837 (1984). Neither plaintiffs nor the OCC provide this Court with any other Congressional authority for the OCC's action.

4. Absent A Delegation Of Authority From Congress, The OCC's Regulations Are Not Entitled To Deference

Absent direct Congressional authority to regulate operating subsidiaries of national banks, the OCC's regulations regarding operating subsidiaries are not entitled to deference. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

The Supreme Court in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) set forth the analysis in two steps. In the first step, the Court must determine if "Congress has directly spoken to the precise question at issue." *Id.* at 842-843. If Congress has spoken to the issue, that is the end of the Court's inquiry because the Court, as well as the agency, "must give effect to the unambiguously expressed intent of Congress." *Id.* If Congress has not spoken to the exact question and the agency is acting pursuant to an express or implied grant of authority, the Court must employ the second step of the *Chevron* analysis. Under this second step, the Court must determine if the agency's interpretation of the statute is "reasonable" and not otherwise "arbitrary, capricious, or manifestly contrary to the statute." *Id.*

Deference to an agency's action is warranted "only when Congress has left a gap for the agency to fill pursuant to an express or implied 'delegation of authority to the agency.'" *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-844 (1984); *see also United States v. Mead Corporation*, 533 U.S. 218, 226-227 (2001). Where the agency lacks such delegated authority, such as here, there is no need for the Court to engage in the second step of the *Chevron* analysis and inquire whether the regulations are reasonable, as "an agency may not promulgate even reasonable regulations that claim the force of law without delegated authority from Congress." *Motion Picture Association of America, Inc. v. Federal Communications Commission*, 309 F.3d 796, 801 (2002); *see also Christensen v. Harris County*, 529 U.S. 576, 596-597 (2000) (BREYER. J., dissenting) (where it is in doubt that Congress actually intended to delegate particular interpretive authority to an agency, *Chevron* is "inapplicable").

In this case, the OCC lacks the necessary delegated authority from Congress to enact regulations governing operating subsidiaries to the exclusion of the states. Accordingly, the Court need not engage in the second step of the *Chevron* analysis. However, even if the Court were to do so, the OCC's regulations are not reasonable.

5. The OCC's Assertion Of Exclusive Authority Over Operating Subsidiaries Is Unreasonable

The OCC's promulgation of regulations giving it exclusive regulatory authority over operating subsidiaries cannot be a reasonable interpretation of the statute when there is no express congressional delegation of authority to the OCC to regulate operating subsidiaries. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-844 (1984); *see also United States v. Mead Corporation*, 533 U.S. 218, 226-227 (2001); *Motion Picture Association of America, Inc. v. Federal Communications Commission*, 309 F.3d 796, 801 (2002). Not only is the OCC's statutory authority lacking, but the OCC's interpretation of this alleged statutory authority is unreasonable and conflicts with the purposes of the National Bank Act.

The purpose of the National Bank Act of 1864 was to establish a "national banking system." *Marquette National Bank v. First Omaha Service Corp.*, 439 U.S. 299, 314-315 (1978). National banks were established to perform various functions, including providing a currency for the whole country, financing commerce and acting as private depositories. *Franklin National Bank of Franklin Square v. New York*, 347 U.S. 373, 375 (1954).

Since the creation of national banks**,** courts have recognized the applicability of state laws to national banks. *See National Bank v. Commonwealth*, 76 U.S. (9 Wall) 353 (1870) (first case recognizing applicability of state laws to national banks). In *National Bank*, the Supreme Court upheld a Kentucky statute regarding the collection of state taxes directly from national banks, finding that since the NBA was silent on the issue, the bank was subject to the state law. *Id.* at 361-362.

The Supreme Court in *McClellan v. Chipman*, 164 U.S. 347 (1896) held a state statute to be applicable to a national bank even when federal law expressly addressed the subject matter of the state law. *McClellan*, 164 U.S. 347, 358. The federal law permitted national

banks to take real estate for given purposes, including security for debt or in satisfaction of debts, while Massachusetts law forbade certain real estate transfers by insolvent transferees. *Id.* at 357-358.

The Supreme Court upheld the Massachusetts statute in the face of a challenge from the national bank that the law improperly interfered with the functions granted to it by federal law. The Court found no express conflict between the federal law and the Massachusetts law, despite the limitations imposed by the Massachusetts law. *McClellan*, 164 U.S. 347, 358. The Court further noted that no function of national banks is destroyed or hampered by allowing the banks to exercise power to take real estate, subject to the same conditions and restrictions to which all *other citizens* of the state were subjected. *Id.* (emphasis added).

The Court rejected the proposition that any limitation by a state on the making of contracts is a restraint upon the power of a national bank, and indicated that the proper issue was whether the state law violated the act of Congress, noting:

> "As long since settled in the cases already referred to, the purpose and object of Congress in enacting the national bank law was to leave such banks as to their contracts in general under the operation of the state law, and thereby invest them as Federal agencies with local strength, whilst, at the same time, preserving them from undue state interference wherever Congress within the limits of its constitutional authority has expressly so directed, or wherever such state interference frustrates the lawful purpose of Congress or impairs the efficiency of the banks to discharge the duties imposed upon them by the law of the United States."

McClellan, 164 U.S. 347, at 359.

Similarly, recent cases affirm the principle that a national bank is subject to state law unless that law "interferes with the purposes of its creation, or destroys its efficiency, or is in conflict with some paramount federal law." *American Bankers Association v. Lockyer*, 2002 U.S. Dist. LEXIS 24521 (E.D. Cal. Dec. 2002) (*quoting Lewis v. Fidelity & Deposit Co. of Maryland*, 292 U.S. 559, 566 (1934)).

Further, as stated in *National State Bank v. Long*, 630 F.2d 981 (3d Cir. 1980) "[w]hatever may be the history of federal-state relations in other fields, regulation of banking has

been one of dual control since the passage of the National Bank Act in 1863. . . .[U]nquestionably, as in other businesses, federal presence in the banking fields has grown in recent times. But congressional support remains for dual regulation. In only a few instances has Congress expressly preempted state regulation of national banks." *Id.* at 985.

The California statutes at issue in this case in no way interfere with the purposes of the NBA or the operation of national banks. Accordingly, the OCC's interpretation of the National Bank Act as giving it exclusive regulatory authority over operating subsidiaries, which are not national banks, is not reasonable.

C. The CRMLA Is Not Preempted By Federal Law

The CRMLA does not conflict with federal law, notwithstanding the issue that the OCC exceeded its authority in promulgating 12 C.F.R. section 7.4006. Plaintiffs' brief is filled only with cases supporting the preemption of state laws with respect to national banks. Nonetheless, this case involves a consumer protection law, which does not, by its own terms, apply to national banks. California Financial Code section 50003(g)(l). Further, the Commissioner's application of the CRMLA has been only to NCMC, a non-national, state-chartered entity, which has voluntarily maintained its license from the Commissioner under that law as a means of doing residential mortgage lending business in the State of California. Accordingly, the cases cited by plaintiffs are not on point with this matter.

"Federal law may preempt state law in three different ways. First, Congress may preempt state law by so stating in express terms. (cite omitted). Second, preemption may be inferred when federal regulation in a particular field is 'so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.' (cite omitted) . . . Third, preemption may be implied when state law actually conflicts with federal law." (cite omitted). *Bank of America v. City & County of San Francisco,* 309 F.3d 551, 558 (9th Cir. 2002); *Accord American Bankers Association v. Lockyer*, 2002 U.S. Dist. LEXIS 2452 (E.D. Cal. Dec. 2002) (slip op. at 21).

There is an assumption of non-preemption afforded to state laws. *See New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995) "[W]e have never assumed lightly that Congress has derogated state regulation, but instead have addressed

claims of preemption with the starting presumption that Congress does not intend to supplant state law." *Id.* at 654. Plaintiffs rely upon the factually dissimilar *United States v. Locke,* 529 U.S. 89 (2000) case in support of their argument that there is no presumption against preemption. In *Locke*, the Supreme Court refused to apply "an 'assumption' of non-preemption" in determining the validity of Washington laws that imposed restrictions on oil tankers using the state's navigable waterways. *Id.* at 108. *Locke* involved Washington State's attempts to regulate "national and international maritime commerce, an area the Supreme Court noted that Congress had created an extensive 'federal statutory structure', which has as one of its objectives a uniformity of regulation for maritime commerce" *Id.* at 108.

In a case similar to this matter, *Video Trax v. Nationsbank, N.A.,* 33 F.Supp.2d 1041 (S.D. Fla. 1998), the court in discussing state laws limitations on service charges and whether they are preempted by the National Bank Act held that "[t]here is no comprehensive federal statutory scheme governing the taking of deposits. Only one section of the Bank Act even relates to this function, and merely authorizes banks to accept deposits. This section may, by implication, also authorize banks to charge for deposit-related services as an incidental power necessary to carry on the business of receiving deposits. But such implied authority does not constitute a regulatory scheme so comprehensive as to displace state law." *Id.* at 1049.

The situation discussed in *Video Trax* is the same as with lending. Only one section of the National Bank Act ("NBA") relates to lending, and it merely authorizes banks to loan on personal security. *See* 12. U.S.C. section 24 (Seventh). As declared by the court in *Video Trax,* this hardly constitutes a comprehensive regulatory scheme.[11]

Further, as stated in *National State Bank v. Long,* 630 F.2d 981 (3d Cir. 1980) "[w]hatever may be the history of federal-state relations in other fields, regulation of banking has been one of dual control since the passage of the National Bank Act in 1863. . . .[U]nquestionably, as in other businesses, federal presence in the banking fields has grown in recent times. But

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[11] *See also Purdue v. Crocker National Bank,* 38 Cal.3d 913, 937 (1985) finding application of state law to banking charges not preempted by a comprehensive federal statuary scheme that occupied the field, and *Booth v. Old National Bank,* 900 F.Supp. 836, 841 (1995) finding that "Congress has not completely preempted the entire banking field."

congressional support remains for dual regulation. In only a few instances has Congress expressly preempted state regulation of national banks." *Id.* at 985.

Congress, in adopting the Riegle-Neal Interstate Banking and Efficiency Act of 1994 ("Riegle-Neal Act"), noted the judicial presumption against preemption. The report of the House-Senate conference committee on the Riegle-Neal Act declared: "[s]tates have a strong interest in the activities of and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses, and communities." The House-Senate conference committee went on to state in regards to determining whether state laws are preempted by federal law that "[c]ourts generally use a rule of construction that avoids finding a conflict between Federal and State law where possible." H.R. Rep. No. 103-651 (Conf. Rep.), at 53, reprinted in 1994 U.S. Code Cong. & Ad. News 2068, 2074.[12]

Congressional support for dual control, particularly in the area of lending, continues as it was recently the topic of conversation between Comptroller Hawke and former chairman of the State Senate Banking Committee as reported by the American Banker on February 10, 2003.[13]

Accordingly, the court must begin reviewing this case with a presumption against preemption.

1. Express Preemption Is Not Present

The cases cited above regarding the assumption of non-preemption, and Congress' comments regarding the passage of the Riegle-Neal Act further support the conclusion that there is no express preemption of the CRMLA by the NBA. In *Video Trax, supra,* the United States District Court of the Southern District of Florida specifically held that "[t]he Bank Act does

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[12] The Commissioner respectfully requests the Court take judicial notice of the Appendix, at Exhibit 1, attached to the Commissioner's Opposition to Plaintiffs' Motion for Preliminary Injunction in the related case of *Wells Fargo Bank, N.A. v. Boutris* (Civil Action No. S-03-0157).

[13] The Commissioner respectfully requests the Court take judicial notice of the Appendix, at Exhibit 2, attached to the Commissioner's Opposition to Plaintiffs' Motion for Preliminary Injunction in the related case of *Wells Fargo Bank, N.A. v. Boutris* (Civil Action No. S-03-0157).

not contain an express statement that Congress intended to preempt state law in its entirety . . . ." 33 F.Supp.2d at 1048.

Furthermore, as discussed above, the issue of preemption in this matter does not deal with a national bank, but with an alleged operating subsidiary of a national bank. A reading of the NBA discloses no mention of national bank operating subsidiaries. The CRMLA by its own terms does not apply to national banks. California Financial Code section 50003(g)(1). Thus, there can be no preemption of the CRMLA by express provision.

2. Field Preemption Does Not Apply

The *Long, Video Trax, Purdue* and *Booth* cases cited above, and Congress' comments regarding the passage of the Riegle-Neal Act also support the conclusion there is no field preemption of the CRMLA by the NBA either. As succinctly stated in the *Video Trax* case "[b]anking is not an area in which Congress has evidenced an intent to occupy the entire field to the exclusion of the states." *Video Trax,* 33 F. Supp. 2d at 1048.

3. The CRMLA Does Not Conflict With The NBA And The OCC Regulations To Such A Degree That Preemption Is Warranted

Plaintiffs' claim that as an operating subsidiary of National City Bank, the CRMLA is preempted as to NCMC because they conflict with the powers granted to National City Bank as a national bank, even though NCMC has voluntarily maintained its license under the CRMLA.

A review of the NBA discloses that it expressly grants national banks the power to lend. 12 U.S.C. section 24(Seventh). However, the NBA does not by its express terms, grant national banks the power to own operating subsidiaries or to carry on their lending activities through such operating subsidiaries. This has been a total creation of the OCC, and Plaintiffs' claim is predicated solely upon 12 C.F.R. section 7.4006, promulgated by the OCC, effective August 1, 2001.

There are numerous cases that have set forth the parameters for establishing conflict preemption under the NBA, though none have dealt with an operating subsidiary of a national bank. Most recently, in *Bank of America* the Ninth Circuit found that actual "conflict arises

when 'compliance with both federal and state regulations is a physical impossibility,' (cite omitted) or when state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" *Bank of America*, 309 F.3d at 558; a*ccord, American Bankers Association,* 2002 U.S. Dist. LEXIS 24521 (E.D. Cal. Dec. 2002) (Slip Op. at 21). The court in *American Bankers Association* found that conflict preemption can also occur when state law 'frustrates the purpose of the [ ]national legislation, or impairs the efficiencies of [ ] agencies of the federal government to discharge their duties.'" *American Bankers Association,* 2002 U.S. Dist. LEXIS 24521 (E.D. Cal. Dec. 2002) (Slip Op. at 21) citing *McClellan v. Chipman,* 164 U.S. 347, 357 (1896)). The court noted that "state regulation of banking is permissible (not preempted) when 'it does not prevent or significantly interfere with the national bank's exercise of its powers."' (citing *Bank of America,* 309 F.3d 558-559 quoting *Barnett Bank of Marion County v. Nelson,* 517 U.S. 25, 31 (1996)).

In *National Bank v. Commonwealth,* 76 U.S. (9 Wall.) 353 (1870), the Supreme Court, rejected a national bank's preemption claim with respect to state tax laws, noting the states' ability to regulate national banks.[14] *Id.* at 361-362. The court held that "[i]t is only when State law *incapacitates* the banks from discharging their duties to the [federal] government that it becomes unconstitutional." *Id.* at 361-362 (emphasis added).

A later Supreme Court case, *McClellan v. Chipman,* 164 U.S. 347 (1896), in upholding a Massachusetts statute which invalidated preferences made by insolvent debtors and assignments and transfers made in contemplation of insolvency, including preferential transfers of real property made by an insolvent debtor to a national bank, focused on whether the state law "impairs the efficiency of national banks or frustrates the purpose for which they were created." *Id.* at 358. In determining whether state law impaired the efficiency or frustrated the purpose for which national banks were created, the Supreme Court looked to whether a function of the national bank

[14] In making it's ruling, the Court in *National Bank v. Commonwealth* stated "[i]t certainly cannot be maintained that banks or other corporations or instrumentalities of the [federal] government are to be wholly withdrawn from the operation of state legislation. . . .[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. 76 U.S. (9 Wall.) 353, 361-362.

had been *destroyed* if it were required to comply with the state law to the same extent all other citizens of the state were subjected. *Id.*

NCMC, according to its papers, has been an operating subsidiary of National City Bank, under the licensing, regulatory, supervisory, examination, and enforcement jurisdiction of the OCC for several years. During this same time, NCMC has also voluntarily submitted itself to the licensing, regulation, supervision, examination, and enforcement jurisdiction of the Commissioner under the CRMLA. That this alleged dual regulation has been ongoing for several years, evidences that there is no "physical impossibility" to NCMC's "simultaneous compliance with both state and federal law". Further, the fact that NCMC can only charge one day of interest prior to the recordation of the deed under the CRMLA, does not cause a "physical impossibility" for "simultaneous compliance" as there are no per diem interest requirements under the NBA. Thus, it is only the desire of NCMC to retain these interest overcharges that now has brought the plaintiffs forward to challenge the CRMLA.

NCMC's ability to comply with both the federal law and the CRMLA for several years evidences that the CRMLA also does not "stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" or "frustrate the purpose of the NBA or impair the efficiencies of the OCC." Or as stated another way by the court in *American Bankers Association*, "does not prevent or significantly interfere with the national bank's exercise of its powers." 2002 U.S. Dist. LEXIS 24521 (Slip Op. at 21).

The CRMLA *does not prevent or significantly interfere* with the lending activities of National City Bank, even if National City Bank desires to conduct certain of those lending activities through NCMC. Again, this is evidenced by plaintiffs' ability to be a leader in the lending field in California for the last several years through NCMC (150,000 to 180,000 loans from 2000 to present as claimed by plaintiffs), while voluntarily submitting to dual jurisdiction.

The tests established by the Supreme Court in *McClellan* and *National Bank*, for determining whether a state law impairs the efficiency or frustrates the purpose for which national banks were created is whether the state law "destroys a function" of the national bank or "incapacitates" the bank from discharging its duties.

The CRMLA does not "destroy" or "incapacitate" National City Bank from lending. The CRMLA by its own terms does not apply to National City Bank. Accordingly, National City Bank is free to lend through its California branches without any oversight whatsoever from the Commissioner. That National City Bank has chosen to conduct certain of its lending activity through NCMC (the legality of which remains questionable as discussed above), is of no consequence because the lending activities of NCMC, as attested by plaintiffs, reveals no destruction or incapacitation with respect to its ability to lend.

"As with express preemption, conflict preemption will not be found unless it is the clear intent of Congress. . . . Courts must not lightly infer preemption, and it is the burden of the party claiming Congress intended to preempt state law to prove it." *Video Trax*, 33 F.Supp. 2d at 1048.

D. The DIDMCA Does Not Preempt California Law

Plaintiffs cannot demonstrate that preemption exists such that the California per diem interest statutes, which regulate when a lender may begin charging interest, should be invalidated in whole or part. The DIDMCA does not compel preemption of the per diem interest provisions, insofar as the state statutes do not expressly limit the rate or amount of interest plaintiff may charge and they do not frustrate or impair the goals and intent of the federal act.

1. The California Per Diem Statutes Are Not Preempted By DIDMCA.

Under the Supremacy Clause, U.S. Const., Art. VI, cl. 2, and as set forth above, federal law may preempt state law "either by express provision, by implication, or by a conflict between federal and state law. (Citations omitted)." *Shin v. Encore Mortgage Servs.*, 96 F. Supp. 2d 419, 423 (D. N.J. 2000) *citing New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 654 (1995). In addition, in areas traditionally regulated by the states, such as consumer protection, there is a presumption against finding preemption of state law. *California v. Arc America Corp.*, 490 U.S. 93, 101 (1989). "When Congress legislates in a field traditionally occupied by the States, '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.' (Citations omitted)." *Id*. at 101. In *Smiley v. Citibank (S.D.), N.A.*, 11 Cal.

4th 138 (1995), the California Supreme Court found that "historic police powers of the States" extend to banking. *Id*. at 148.

If a statute contains an express preemption clause, the task of statutory construction must in the first instance focus on the plain wording of the clause, which necessarily contains the best evidence of Congress' preemptive intent. *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658 (1993).

If the statutory language is ambiguous, *Burlington N. R.R. Co. v. Oklahoma Tax Comm'n*, 481 U.S. 454, 461 (1987), or would work an unreasonable result, the courts may consult relevant legislative history, *Cabral v. INS*, 15 F.3d 193, 194 (1st Cir. 1994), to confirm an interpretation indicated by the plain language. *Strickland v. Commissioner, Maine Dep't of Human Servs*., 48 F.3d 12, 17 (1st Cir. 1996), *cert. denied*, 116 S. Ct. 145 (1995).

There is no clear and manifest intent of Congress to preempt California statutes concerning when the lender may begin to charge interest. Furthermore, to the extent potential conflict preemption is alleged, compliance with both state and federal law is possible, thus obviating the need for federal preemption of the state statute. *See Arc America Corp.*, 490 U.S. at 94.

The first issue regarding DIDMCA before this court is whether the California Corporations Commissioner may enforce the per diem limitation provision of subdivision (o) of California Financial Code section 50204. This section provides that a lender may not "require a borrower to pay interest on the mortgage loan for a period in excess of one day prior to recording of the mortgage or deed of trust. . . ." Cal. Fin. Code § 50204(o).

Also at issue is whether the Commissioner may enforce an earlier version of California Civil Code § 2948.5[15] (subsequently amended) that read in pertinent part as follows:

> "interest on the principal obligation of a promissory note secured by a mortgage or deed of trust on real property improved with one-to-four residential dwelling units shall

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[15] It should be noted that the Commissioner's authority to enforce the per diem statute is now codified in California Financial Code section 50204(o), and the California Attorney General, who is not a party to this action, retains jurisdiction to enforce the amended Civil Code section 2948.5.

> not commence to accrue prior to close of escrow if the loan proceeds are paid into escrow or, if there was no escrow, the date upon which the loan proceeds have been made available for withdrawal as a matter of right, as specified in subdivision (d) of Section 12413.1 of the Insurance Code."

For purposes of this motion, the Commissioner's arguments apply equally to the former Civil Code section, which will not be discussed separately. Plaintiffs' contention that these statutes are preempted fails to take into account the express language of DIDMCA or the etiology of the Act.

Section 501 (a) of DIDMCA only preempts state laws "*expressly limiting* the rate or amount of interest, discount points, finance charges, or other charges . . . secured by a first lien on residential real property. . . ." 12 U.S.C. § 1735f-7a(a)(1) (emphasis added). Subdivision (o) of California Financial Code section 50204 does not fall within the type of activities preempted by DIDMCA because it does not *expressly limit* interest rates or amounts. Rather, the state statute establishes the date upon which the per diem interest may be assessed upon a borrower.

The DIDMCA statutory scheme was born at the end of the 1970s, in a period of extreme highs in home mortgage interest rates. As the court may find helpful, *Smith v. Fidelity Consumer Discount Co.,* 898 F.2d 907 (3d Cir. 1989) offers an analysis of historical context and legislative intent:

> "DIDMCA was passed at a time when inflation and interest rates were soaring; in this context, *state usury laws* decreased the availability of home mortgage loans and hindered the ability of financial institutions to pay market rates of interest to depositors since usury laws limited them to lending at rates well below those that the market would have dictated. Thus, the Senate Report that accompanied the bill containing what became § 501 of DIDMCA found:
>
> that where *state usury laws* require mortgage rates below market levels of interest, mortgage funds in those states will not be readily available and those funds will flow to other states where market yields are readily available. This artificial disruption of funds availability not only is harmful to potential homebuyers in states with such usury laws, it also frustrates national housing policies and programs. . . .
>
> The committee believes *that this limited modification in state*

> *usury laws* will enhance the stability and viability of our Nation's financial system and is needed to facilitate a national housing policy and the functioning of a national secondary market in mortgage lending. . . ."

Smith at 12 (emphasis added).

While this goal of promoting the American dream of home ownership is certainly laudable, the California statutory provisions challenged by NCMC are unrelated to the very type of laws DIDMCA was enacted to preempt: state usury statutes. Yet, NCMC seeks to don the cloak of federal preemption to avoid a California provision that does not impair that statutory scheme in any way.

Subdivision (o) is not a usury statute.[16] The per diem interest provisions do nothing more than compel a close relationship between the date interest charges begin and the date of recordation of the deed of trust. Subdivision (o) does absolutely nothing to frustrate the broad goals of DIDMCA. It does not limit the rate of interest NCMC can charge. It does not limit the total amount of interest NCMC can collect, as the rate of interest charged remains within the control of the NCMC and may be bargained with the consumer. The state law merely encourages lenders to be assiduous in providing borrowers with recorded title and trust deeds by preventing them from charging interest in excess of an allowable one day time period until the documents are recorded.

2. Unlike State Usury Laws, The "Per Diem" Statute Does Not Impose Any Limitations Or Barriers Upon The Loan Market

Plaintiff's reliance on *Shelton v. Mutual Savings and Loan,* 738 F.Supp. 1050 (E.D. Mich. 1990) for the proposition that if a state law that prohibits charging of interest before loan funds are disbursed is preempted then California's per diem statutes must also be preempted is misplaced. Memorandum of Points and Authorities in Support of Plaintiffs' Motion for Preliminary Injunction, p. 16. Although *Shelton* did find preemption, it dealt in pertinent part with a Michigan statute that read as follows:

> "A mortgage loan or a land contract made under this Act shall not provide for *a rate of interest* added or deducted in advance, and

[16] California's usury law is found in the California Constitution, Article XV, sec. 1.

> interest on the mortgage loan or land contract shall be computed from time to time only on the basis of unpaid balances." (Emphasis added.)

While the court struggled with the meaning of the state statutory language, and found at least three possible interpretations, including those urged by both parties to the suit, the *Shelton* court unlike this Court was faced with a statute that did expressly refer to "a rate of interest." The district court ultimately found it too ambiguous to interpret, and held that it is "not within the province of a federal court to attempt to read the minds of state legislators. . . ." *Shelton* at 1058.

Therefore, it is simply not accurate to say the *Shelton* case holds that a per diem statute like the one at issue here is preempted by DIDMCA. Indeed, that federal court said, ". . . if the state legislature had intended to prohibit lenders from charging interest on undisbursed funds, it could have done so clearly and unambiguously." *Id.* at 1058. Therefore, it remains an open question as to how the *Shelton* court would have ruled on a statute, such as California Financial Code section 50204(o), that does not expressly affect the rate of interest. While the *Shelton* court could not interpret the Michigan statute, it apparently concluded the Michigan law was a usury statute. *See Shelton* at 1057. However, the per diem statutes are unrelated to the California Usury Law. *Compare* Cal. Const. Art. XV, § 1 *with* Cal. Fin. Code § 50204(o).

The Commissioner invites the Court to review the express language and the underlying intent of DIDMCA expressed by Congress, to address the limitations imposed by the usury laws when they impede the loan market. The per diem interest statutes do not seek to impose such limitations. However, the statutes most certainly are "designed to protect borrowers," a goal which the DIDMCA drafting committee thought could peacefully coexist with the goals of the federal statute, and which the Office of Thrift Supervision ("OTS")[17] recognizes as permissible pursuant to its own regulations. *See* 12 C.F.R. 590.3 (c) ("Nothing in this section preempts limitations in state laws on prepayment charges, attorneys fees, late charges or other provisions *designed to protect borrowers*." (emphasis added.)).

[17] The Federal Home Loan Bank Board and its successor, the OTS, are authorized to issue rules and regulations governing the implementation of DIDMCA pursuant to 12 U.S.C. § 1735f-7a(f).

3. DIDMCA Does Not Preempt State Laws, Such As The Per Diem Statute, That Are Designed To Protect Consumers

Grunbeck v. Dime Savings Bank of New York, FSB, 74 F.3d 331 (1st Cir. 1996) considered whether DIDMCA preempted New Hampshire's simple interest statute (SIS). The court failed to find any congressional intent that would allow DIDMCA to preempt the SIS and determined that no express interest rate limitations existed in the SIS.

The *Grunbeck* court emphasized the interpretive importance of the language from Section 501 of DIDMCA "expressly limiting the rate or amount of interest," the same issue under consideration in this case. The court contrasted this language with that contained in companion Section 521 where Congress, as relates to credit cards, preempted all state legislation "with respect to interest rates." *Grunbeck* at 338. The court recognized that Congress was acutely aware that its choice of the distinctive terminology -- "expressly limiting" - would be a primary interpretive tool. *Id*. In other words, this is evidence that if Congress had intended to preempt all state laws relating to interest rates, it could have done so as it did in Section 521. By preempting only those state statutes that "expressly limit" the amount or rate of interest, Congress contemplated state statutes, like the California per diem interest statutes or the New Hampshire simple interest statutes, would not be preempted.

Plaintiffs contend that "there is no basis for the Commissioner's contention in the related cases of *Wells Fargo* and *Quicken Loans, Inc. v. Boutris*, No. 03-0256 GEB JFM, that '[a]n analogy may be drawn between [the] California [per diem restriction] and the simple interest statute (SIS) which is not preempted by DIDMCA according to the appellate court in *Grunbeck.*'" Memorandum of Points and Authorities in Support of Plaintiffs' Motion for Preliminary Injunction, at page 16. Plaintiffs' argument seeks to avoid the clear and simple holding of *Grunbeck* because the SIS, like per diem, does not *expressly limit* the amount of interest. As the *Grunbeck* court found, "The SIS itself, as distinguished from market forces, 'does not serve to. . .restrain' either the rate or amount of simple interest which may be obtained, since the lender remains free to compensate by increasing the simple interest rate. Thus, the SIS does not 'expressly' limit 'the rate or amount of interest.'" *Grunbeck,* 74 F.3d at 338, n. 6.

In analyzing the preemption issue, the *Grunbeck* court looked to the legislative history and to the reason Section 501 of DIDMCA was enacted:

> "The legislative aim in enacting section 501 focused on "state usury ceilings," [Citations] with particular emphasis on state usury laws which restrict interest rates to below-market levels and result in artificial disruptions in the supply of home-loan mortgage funds."

Grunbeck, supra, at 339.

It is undisputed by plaintiffs that the per diem statutes of California do not have any perceptible impact on the supply of home-loan mortgages. Therefore, the purpose for which DIDMCA was enacted is not at issue here.

Like the simple interest statutes in *Grunbeck,* the per diem statutes are consumer protection statutes. By placing the responsibility for any delays between funding and recording the deed on the lender, the California statutes protect the consumer from an "unseen" cost, in much the same way as did the simple interest statute in *Grunbeck*. Despite plaintiffs' contention that " the parties cannot contract around the per diem interest restriction as they could with the simple interest statute in *Grunbeck*" (Memorandum of Points and Authorities in Support of Plaintiffs' Motion for Preliminary Injunction, at page 17), nothing in the per diem interest statutes would prevent a lender from disclosing to and bargaining with borrowers for additional fees or charges that it might use to cover any alleged lost per diem interest income and which would be fully disclosed to the borrower.

Additional guidance may be found in *Larsen v. Countrywide Home Loans, Inc.*, 2001 U.S. Dist. LEXIS 10023 (Ill. 2001). There, the plaintiffs were homeowners who paid off their mortgage early, on August 18, 2000. The lender, however, charged them interest for the entire month of August. The Larsens sued, alleging violation of an Illinois statute prohibiting lenders from charging interest for any period after payment of the principal. The court found that Congress did not mean for DIDMCA to preempt all interest charges since interest charges that constitute prepayment penalties fall outside the scope of the Act. The *Larsen* court noted that other courts have found that state statutes regulating the computation of interest on federally insured loans are not

preempted by federal law, citing *Grunbeck.* The court in *Larsen* specifically declined to interpret the term "rate or amount of interest" so liberally as to preempt to *any* state law that has an effect on how much interest a borrower must pay. *Larsen* at 3. Yet, that is precisely the gist of plaintiff's argument. *See* Plaintiff's Memorandum in Support of Plaintiff's Motion for Preliminary Injunction at 15. As in *Grunbeck* and as followed in *Larsen,* such an argument must be rejected.

4. DIDMCA Also Provides An Exception For "Other Charges"

Alternatively, the very statute so relied on by NCMC does in fact contain an exception under which this court may conclude that California's per diem statute could qualify. Subsection (b)(4) of 12 U.S.C. § 1735f-7a (of DIDMCA) provides as follows:

> "At any time after the date of enactment of this Act (enacted March 31, 1980), any state may adopt a provision of law placing limitations on discount points or *such other charges* on any loan, mortgage, credit sale, or advance described in subsection (a)(1)." (emphasis added)

Whether the per diem charges governed by subdivision (o) of section 50204 of the California statute may be considered "other charges" under DIDMCA, such that California may limit them, is a question of first impression for this Court. Because the moneys charged to the borrower are before he has yet to receive the benefit of his bargain, they may be classified as charges rather than interest.

Plaintiff's claim that the California per diem statute is preempted by DIDMCA must, therefore, fail. The plaintiff provides scant case authority in the face of the well-reasoned *Grunbeck* appellate case. The plain reading of the California statute shows no language *expressly limiting* the amount or rate of interest being charged. And, the legislative aim of DIDMCA (to prevent disruption in the supply of home mortgage loans) is not frustrated by California's application of the per diem statute.

Although plaintiffs will seek to convince the court that DIDMCA preempts California per diem interest statutes, in reality there is no case law anywhere in the nation that so holds. The statutes at issue do not encroach on the narrow field that DIDMCA preempts, and there is no legitimate policy need for this court to erase from California books a statute that the state legislature

considered appropriate for the protection of consumer/borrowers.

III. THE BALANCE OF EQUITIES TIPS AGAINST ISSUANCE OF A PRELIMINARY INJUNCTION

A. Plaintiffs Will Not Be Irreparably Harmed If The Commissioner Is Not Enjoined

Plaintiffs will not be irreparably harmed if the Commissioner is not enjoined because (1) Plaintiffs' alleged audit costs are unsupported and based on inflated loan numbers; and (2) Plaintiffs will not lose significant revenue by having to charge per diem interest as required by the CRMLA.

The Commissioner also contests plaintiffs' claim that the audit demanded by the Commissioner would cost $4,000,000. The number of loans NCMC has made in California since August 2000 is unsubstantiated. A review of the Loan Reports filed by NCMC for calendar years 2000, 2001, and 2002 reveal that from August 2000 to December 2000, NCMC originated 719 loans; from January 2001 to December 2001, NCMC originated 6,846 loans; and from January 2002 to December 2002, NCMC originated 54,807 loans. This would make NCMC's loan totals for 2000, 2001 and 2002 equal to 62,372. In addition, from August 2000 to December 2002, NCMC brokered 35,476 loans. Even assuming that NCMC is including brokered loans in its total, this would make NCMC's loan totals for August 2000 through December 2002 equal to 97,848, not the 150,000 to 180,000 loans NCMC claims. Burns Decl. ¶ 9.

Finally, NCMC would not lose significant revenue by having to comply with California Financial Code section 50204(o). As early as July 2001, NCMC stated in correspondence to the Department in response to a prior regulatory examination, that it understood the requirement that it not charge interest more than one day prior to the date of recording of the deed of trust. Moreover, while the August 2002 regulatory examination found approximately a 26% rate of per diem interest overcharges for loans made during the examination period, a significant number when dealing with consumer protection, it is not a number that supports plaintiffs' claim of substantial losses if it is not allowed to charge interest as it deems fit during the pendency of this action. Cherry Decl., ¶ 4 and Exhibit 1 thereto.

B. The Public Will Be Harmed During the Pendency Of This Matter By Granting The Preliminary Injunction

The public will suffer harm if the preliminary injunction is granted because the CRMLA offers the only effective protection for consumers with respect to the lending and servicing of NCMC.

Plaintiffs argue that no harm will be suffered, because as a matter of law, if the area has been expressly preempted, there can be no harm. Plaintiffs cite to *Trans World Airlines, Inc. v. Mattox,* 897 F.2d 773 (5th Cir. 1990) in support of this proposition. However, Congress did not expressly preempt *any law* with respect to operating subsidiaries. As such, plaintiffs cite to *Trans World Airlines* is inapposite to this case.

While the OCC may regulate plaintiffs during the pendency of this action, it is clear that such regulation does not tip in favor of consumer protection. Also, plaintiffs' offer regarding how they would make the public whole at a later date when the CRMLA is upheld (refunds for overcharged per diem that do not even include interest) ignores the various other provisions of the CRMLA that exist for the publics' protection. *See* footnote 3 above. Thus, consumers will not be protected during the pendency of this matter.

IV. PREEMPTION, IF FOUND, COULD ONLY BE APPLIED TO LENDING ACTIVITY ENGAGED IN BY NCMC AFTER AUGUST 1, 2001

Assuming for purposes of this argument only that preemption were found, it is presumed that preemption may not retroactively applied. *See Scott v. Boos,* 215 F.3d 940, 943 (9th Cir. 2000) citing *Landgraf v. USI Film*, 511 U.S. 244 (1994). "[C]ongressional enactments and administrative rules will not be construed to have retroactive effect unless their language requires this result." *Landgraf,* 511 U.S. at 272 (cite omitted).

The operating subsidiary preemption rule, 12 C.F.R. section 7.4006, was not promulgated by the OCC until July 2, 2001, and had an express effective date of August 1, 2001. Thus, under the rules of statutory construction set forth in *Landgraf,* federal preemption of the CRMLA, if found by

this court, would only apply from August 1, 2001 forward because 12 C.F.R. section 7.4006 has no retroactive application.[18]

The *Landgraf* case states that "when a case implicates a federal statute enacted after the events in suit, the court's first task is to determine whether Congress has expressly prescribed the statute's proper reach. If Congress has done so, there is no need to resort to judicial default rules. If the statute has no express command, the court must determine whether the new statute would have retroactive effect, i.e., whether it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed. If the statute would operate retroactively, our traditional presumption teaches that it does not govern absent clear congressional intent favoring such result." *Id.* at 280.

Because the OCC specifically prescribed the preemption rule to become effective August 1, 2001 there is no need to look at the second prong in *Landgraf* to determine that the rule is not to be applied retroactively.

Accordingly, were the court to consider issuing a preliminary injunction based upon federal preemption of the CRMLA, it should have no effect on the conduct of NCMC prior to August 1, 2002. Accordingly, the Commissioner must be allowed to assert his jurisdiction under the CRMLA, including revocation of licenses, for conduct that occurred prior to that date.

V. NATIONAL CITY BANK HAS FAILED TO SHOW ANY VIOLATION OF ITS RIGHTS

In addition to the other arguments set forth herein, plaintiff National City Bank has failed to show that any of its constitutional or statutory rights have been violated. National City Bank bases its attack on the statutes in question -- the CRMLA, and Civil Code Section 2948.5 -- on the premise that they are unconstitutional *as applied to* it. The Commissioner has never attempted to enforce any California laws relating to National City Bank. The only administrative actions in question being brought by the Commissioner are solely against NCMC, not against National City Bank.

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[18] The rule of statutory construction set forth in *Landgraf* to determine whether a statute should be applied retroactively was followed by the Eastern District in *Mannat v. United States*, 951 F. Supp. 172 (E.D. CA 1996).

Plaintiff's failure to show any attempt by the Commissioner to enforce the laws as to National City Bank demonstrates that National City Bank lacks standing to bring this action. In *San Diego Gun Rights Committee v. Reno*, 98 F.3d 1121, 1126 (9th Cir. 1996), the court affirmed the dismissal of an action where plaintiffs had not been charged with any violations of the 1994 amendment to the federal Gun Control Act, yet alleged that they wished and intended to engage in conduct prohibited by the Act. *Id.* at 1124.

Drawing heavily on the Supreme Court's decision in *Lujan v. Defenders of Wildlife,* 504 U.S. 555 (1992), the court noted the following requirements for standing to sue in federal actions:

> "[P]laintiffs bear the burden of establishing their standing to sue. . . . To do so, they must demonstrate three elements which constitute the "irreducible constitutional minimum" of Article III standing. . . . First, plaintiffs must have suffered an "injury-in-fact" to a legally protected interest that is both "concrete and particularized" and "actual and imminent," as opposed to "'conjectural' or "hypothetical.'" Second, there must be a causal connection between their injury and conduct complained of. Third, it must be "likely"—not merely "speculative"—that their injury will be "redressed by a favorable decision. (quotations as in original, citations omitted.) *San Diego Gun Rights Committee* at 1126.

National City Bank cannot demonstrate that it has suffered an "injury-in-fact" to a legally protected interest. The only action taken by the Commissioner has been against NCMC, a separate and distinct legal entity that sought licensure with him and is failing to comply with the California law. Although National City Bank is the parent corporation, as set forth more fully in Section II above, it is isolated from any regulatory liabilities incurred by NCMC by settled principals of corporate law relating to parents and their subsidiaries. Second, there is no injury to National City Bank other than the alleged injury claimed by NCMC. Finally, because there is no injury to National City Bank, there is no redress that this Court could provide even in a favorable decision to NCMC. Because standing issues may be properly raised at any time, the Commissioner's respectfully requests that the motion for preliminary injunction, at least as to plaintiff National City Bank, be denied on the basis that National City Bank lacks the necessary standing to bring such an action. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992).

CONCLUSION

For the foregoing reasons, plaintiffs have not shown a likelihood of success sufficient to warrant the issuance of a preliminary injunction and they have failed to prove they will suffer irreparable harm if required to comply with the CRMLA. Further, plaintiff National City Bank lacks standing to bring this action. Accordingly, the Court should deny plaintiffs' request for preliminary injunction.

Should the Court believe that preemption applies pursuant to 12 C.F.R. section 7.4006, there is no question but that the OCC regulation was not effective until August 2001. Therefore, preemption could have no bearing on the actions taken by the Commissioner prior to the effective date. As a result, any injunction issued should only restrict acts occurring after August 2001, and no preliminary injunction should apply to any revocation proceeding instituted by the Commissioner pursuant to his statutory and/or regulatory authority regarding conduct by plaintiffs prior to the effective date of the OCC regulation.

Defendant respectfully requests this Court deny Plaintiffs' Motion for a Preliminary Injunction in its entirety, or, in the alternative, grant the limited relief requested above.

Dated: April 21, 2003

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