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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,

versus

DEMETRIOS A. BOUTRIS, in his official capacity as Commissioner of the California Department of Corporations,

Defendant.

Civil Action No. S-03-0655 GEB JFM

REPLY MEMORANDUM IN SUPPORT OF PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION

Submission scheduled for:
May 5, 2003

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MISCELLANEOUS

INTRODUCTION

Plaintiffs National City Bank of Indiana ("National City Bank") and National City Mortgage Company ("NCMC") have filed a motion for a preliminary injunction that is essentially identical to the motion for a preliminary injunction in *Wells Fargo Bank, N.A. v. Boutris*, Civ. No. S-03-157 GEB JFM. Accordingly, the Court should grant the motion for a preliminary injunction in this case for the same reasons that it granted the motion for a preliminary injunction in *Wells Fargo*. The Commissioner does not contend that there is any material difference between this case and *Wells Fargo*. The arguments in the Commissioner's memorandum in opposition to the motion for a preliminary injunction are copied, largely verbatim, from the Commissioner's arguments in *Wells Fargo*. This Court has already rejected those arguments in *Wells Fargo*, and it should reach the same result in this case.[1]

I. PLAINTIFFS SATISFY THE NINTH CIRCUIT'S STANDARDS FOR GRANTING A PRELIMINARY INJUNCTION

The Commissioner's argument (Opp. 4-9) that Plaintiffs must satisfy a "heightened standard" in this case to obtain a preliminary injunction is both incorrect and irrelevant. The argument is irrelevant because Plaintiffs satisfy *any* reasonable standard for obtaining a preliminary injunction in this case.

While Plaintiffs can satisfy a "heightened" standard, in fact no such standard applies here. The Commissioner cites Second Circuit cases for the proposition that "[c]ourts have applied a heightened standard on the moving party when the injunctive relief is sought 'to

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[1] As the Commissioner's memorandum notes (Opp. 1), on April 21, 2003, the Commissioner commenced administrative proceedings to revoke NCMC's state-issued licenses to make and service mortgage loans in California. Plaintiffs, like the plaintiffs in *Wells Fargo*, are seeking a preliminary injunction to prevent the Commissioner from exercising visitorial authority over NCMC, or otherwise preventing NCMC from continuing to conduct its banking activities pursuant to its federal license issued by the Office of the Comptroller of the Currency ("OCC"). Plaintiffs recognize that a preliminary injunction, like the preliminary injunction in *Wells Fargo*, will not prohibit the Commissioner from revoking the state licenses. Plaintiffs note, however, that if it should later be determined that state licenses *are* required for NCMC to make and service mortgage loans in California, then revocation of those licenses in retaliation for the filing of this federal lawsuit would constitute an independent violation of federal law. *See, e.g., Coszalter v. City of Salem*, 320 F.3d 968, 976-78 (9th Cir. 2003).

stay governmental action taken in the public interest pursuant to a statutory or regulatory scheme.'" Opp. 4 (quoting *Able v. United States*, 44 F.3d 128, 130-31 (2d Cir. 1995)). In fact, neither the Ninth Circuit nor this Court has ever imposed such a standard. *See Bank of America, N.A. v. City & County of San Francisco*, No. C. 99-4817 VRW, 1999 WL 33429989 (N.D. Cal. Nov. 15, 1999) (granting preliminary injunction against ATM fee bans), *aff'd*, 215 F.3d 1332 (9th Cir. 2000); *American Bankers Ass'n v. Lockyer*, 239 F.Supp. 2d 1000, 1021-22 (E.D. Cal. 2002). *Accord Wells Fargo Bank of Texas, N.A. v. James*, 184 F. Supp.2d 586 (W.D. Tex. 2001) (granting preliminary injunction against Texas law banning check-cashing fees in conflict with OCC regulations). Moreover, this case involves a clash between two "statutory and regulatory scheme[s]," one federal and the other state, and thus the Second Circuit cases are not applicable even on their own terms. *Compare* Opp. 5.

As for the Commissioner's argument (Opp. 7-9) that a higher standard should apply because "the rights of nonparties will be affected," this is a non sequitur. If Plaintiffs and the OCC are correct that the state laws at issue in this case are preempted, then no rights arise under those laws.[2]

II. THE COMMISSIONER EFFECTIVELY CONCEDES THAT PLAINTIFFS WILL SUFFER SUBSTANTIAL IRREPARABLE HARM IF THEY DO NOT OBTAIN AN INJUNCTION, AND THE PUBLIC INTEREST ALSO FAVORS AN INJUNCTION

The Commissioner effectively concedes that Plaintiffs will suffer millions of dollars in irreparable harm if the motion for a preliminary injunction is denied. While the Commissioner challenges the number of loans that would need to be audited, he acknowledges that as many as 97,848 loan files would require review. If an audit of 150,000 to 180,000 loans would cost NCMC in excess of $4 million, Knight Decl. ¶ 10, then an audit of nearly 100,000

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[2] Furthermore, if the Court grants a preliminary injunction, nothing will prevent the Commissioner from continuing to litigate this action to a final judgment. Thus, this case differs from cases such as *Romer v. Green Point Sav. Bank*, 27 F.3d 12, 16 (2d Cir. 1994) (cited Opp. 6-7), where an order granting a preliminary injunction would effectively prevent further litigation.

loans would certainly cost millions as well – millions of dollars that could never be recovered by Plaintiffs if they are ultimately successful on the merits of their claims.

The Commissioner also concedes the irreparable harm to Plaintiffs by arguing that "Plaintiffs will not lose significant revenue by having to charge per diem interest as required by the CRMLA," while also arguing that his own investigation revealed "approximately a 26% rate of per diem interest overcharges for loans made during the examination period." Opp. 39. It is undeniable that requiring NCMC to make interest-free loans on 26% of its lending portfolio imposes substantial irreparable harm (over and above the multi-million dollar cost of the audit), because those interest revenues can never be recovered by Plaintiffs if they are ultimately successful on the merits of this action. *See* Knight Decl. ¶ 12.

The Commissioner's arguments regarding the public interest are similarly misguided. *First*, Plaintiffs will refund any interest overcharges if the California per diem interest limitation is ultimately upheld on the merits. *See id.* ¶ 13. *Second*, the OCC will continue to regulate NCMC and will protect the public interest, including the interests of consumers. The Commissioner's argument overlooks the OCC's regulations and the OCC's brief to this Court explaining that its exclusive "visitorial powers" over national banks and their operating subsidiaries include "enforcing compliance with *any applicable* federal *or state* laws concerning banking-related activities." OCC Br. 10 (emphasis added) (quoting 12 C.F.R. § 7.4000(a)(2)).[3] Thus, if a state consumer protection law is not preempted by federal law, the OCC is charged with enforcing that law against national banks and their operating subsidiaries. *Third*, "it is undeniable," and the Commissioner does not dispute, "that the public interest weighs in favor of enjoining the government from violating federal law." *Berne Corp. v.*

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[3] On April 10, 2003, this Court granted the OCC's motion to file its briefs from the *Wells Fargo* litigation in this case.

Government of Virgin Islands, 120 F. Supp. 2d 528, 537 (D.V.I. 2000). *See also* PI Mem. 19 & n.9.[4]

III. THE OCC EXERCISES EXCLUSIVE VISITORIAL AUTHORITY OVER NATIONAL BANK OPERATING SUBSIDIARIES

A. The Commissioner's Assertion Of Visitorial Authority Over NCMC Conflicts With The National Bank Act And The OCC's Regulations

The Commissioner does not dispute that he has no authority to license, regulate, supervise, examine, and exercise enforcement authority over National City Bank, as a national bank. *See* Opp. 9; 12 U.S.C. § 484. The Commissioner also does not dispute that the OCC, after notice and comment, promulgated a regulation that states: "Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries [like NCMC] to the same extent that those laws apply to the parent national bank," 12 C.F.R. § 7.4006, and that "[f]ederal regulations have no less pre-emptive effect than federal statutes," *Fidelity Federal Savings & Loan v. de la Cuesta*, 458 U.S. 141, 153 (1982). Accordingly, under § 7.4006, the Commissioner's state law authority to license, regulate, supervise, examine, and exercise enforcement authority over NCMC is preempted. *See also* PI Mem. 8-12.

Rather than challenging these basic propositions, the Commissioner repeats his failed attack from the *Wells Fargo* injunction on the OCC's authority to allow national banks to establish operating subsidiaries, and to provide that state laws apply to national bank operating subsidiaries to the same extent that they apply to the parent national bank. The Commissioner's arguments lack merit. As the Supreme Court and the Ninth Circuit have repeatedly held, national banks possess broad "incidental powers" under 12 U.S.C. § 24(Seventh), and the OCC

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[4] The public interest is served, and a state suffers no injury, if a state official is enjoined from violating federal law, whether the federal law expressly or impliedly preempts the state law at issue. Thus, there is no basis for the Commissioner's suggestion (Opp. 40) that *Trans World Airlines, Inc. v. Mattox*, 897 F.2d 773, 784 (5th Cir. 1990), *aff'd in part, rev'd in part on other grounds*, 504 U.S. 374 (1992), is limited to cases of express preemption. *See* 897 F.3d at 784 ("Since Congress expressly preempted this area of regulation, the state[] [will] not [be] injured by the [preliminary] injunction."); *see also* PI Mem. 19 (discussing *TWA* case). In any event, the California per diem restriction is expressly preempted by DIDMCA. *See* PI Mem. 15-17.

has wide latitude to interpret and define the scope of these powers. *See NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 256-57 (1995); *Bank of America v. City & County of San Francisco*, 309 F.3d 551, 563 (9th Cir. 2002), *pet. for cert. filed*, No. 02-1404 (Mar. 20, 2003); *M&M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977). As a general matter, any activity that is "convenient or useful" in the performance of one of the enumerated powers under § 24(Seventh), such as lending or deposit-taking, is an authorized "incidental" activity under § 24(Seventh). *See, e.g., Bank of America*, 309 F.3d at 562 (ATM services and fees for those services were valid "incidental powers" of national banks). There can be no doubt that it is "convenient or useful" for a national bank to own an operating subsidiary to specialize in mortgage lending and to conduct mortgage lending on the same terms as the parent national bank. Indeed, this Court recognized in its *Wells Fargo* preliminary injunction order that

> [T]he authority of a national bank to purchase or otherwise acquire and hold stock of a subsidiary operations corporation may properly be found among "such incidental powers" of the bank "as shall be necessary to carry on the business of banking," within the meaning of 12 U.S.C 24(7) . . . . The visitorial powers vested in [the OCC] are adequate to ascertain compliance by bank subsidiaries with the limitations and restrictions applicable to them and their parent national banks.

Wells Fargo PI Order 9 (quoting Acquisition of Controlling Stock Interest in Subsidiary Operations Corporation, 31 Fed. Reg. 11,459, 11,459-60 (Aug. 31, 1966)). Similarly, in promulgating 12 C.F.R. § 7.4006, the OCC observed that

> Operating subsidiaries have been authorized for national banks for decades, recognizing that, under various circumstances, it may be convenient or useful for the bank to conduct activities that the bank could conduct directly, through the alternate form of a controlled subsidiary company. Thus, operating subsidiaries and the activities they conduct are an embodiment of the incidental powers of their parent bank, and often have been described as the equivalent of a department or division of their parent bank – organized for convenience in a different corporate form.
>
> Consistent with the concept underlying this authority for operating subsidiaries, and recent legislation [GLBA] recognizing the status of national bank operating subsidiaries, the proposal provides that

> state law applies to the activities of an operating subsidiary to the same extent it would apply if those activities were conducted by its parent bank. . . . Fundamental to the description of the characteristics of operating subsidiaries in GLBA and the OCC's rule is that, unless otherwise provided by Federal law or OCC regulation, State laws apply to operating subsidiaries to the same extent as they apply to the parent national bank.

Notice of Proposed Rulemaking, 66 Fed. Reg. 8,178, 8,181 n.11 (Jan. 30, 2001). Accordingly, in order for national banks to conduct their authorized activities through a separately incorporated department or division of the bank, the OCC found that it was useful that the same regulatory regime apply to operating subsidiaries as to their parent national banks. This Court should defer to the OCC's interpretation of 12 U.S.C. § 24(Seventh) in its operating subsidiary regulations, 12 C.F.R. §§ 5.34 & 7.4006, under *NationsBank* and *Bank of America*. *See, e.g.*, *NationsBank*, 513 U.S. at 256-57 ("[T]he Comptroller bears primary responsibility for surveillance of 'the business of banking' authorized by § 24 Seventh. We have reiterated: 'It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws.'") (quoting *Clarke v. Secs. Indus. Ass'n*, 479 U.S. 388, 403-04 (1987), and *Investment Co. Inst. v. Camp*, 401 U.S. 617, 626-27 (1971)).

The Commissioner nevertheless argues that Congress has never statutorily provided for operating subsidiaries, and has not given the OCC regulatory authority over them, even though Congress has specifically addressed other types of subsidiaries that may be owned by national banks, such as financial subsidiaries, and has expressly delegated rulemaking authority over these entities to the OCC. In other words, the Commissioner relies on the maxim "*expressio unius est exclusio alterius*" to overcome the OCC's otherwise valid operating subsidiary rules. Opp. 21. In support of this argument, the Commissioner cites the Bank Service Company Act, 12 U.S.C. § 1861 *et seq.*, the Riegle-Neal interstate branching laws, 12 U.S.C. § 36(f), as well as the enactment of GLBA, 12 U.S.C. § 24a, as examples of instances in

which Congress has expressly provided for national banks to create a subsidiary, or specifically protected national banks' interstate branches from state enforcement authority. Opp. 18-22.

There are two fatal defects in the Commissioner's argument. *First*, "the *expressio unius* maxim" upon which the Commissioner relies, "'has little force in the administrative setting,' where [courts] defer to an agency's interpretation of a statute unless Congress has 'directly spoken to the precise question at issue.'" *Mobile Communications Corp. of Am. v. FCC*, 77 F.3d 1399, 1404-05 (D.C. Cir. 1996) (quoting *Texas Rural Legal Aid, Inc. v. Legal Serv. Corp.*, 940 F.2d 685, 694 (D.C. Cir. 1991)). "*Expressio unius* 'is simply too thin a reed to support the conclusion that Congress has clearly resolved [an] issue.'" *See id.* at 1405.[5]

Second, 12 U.S.C. § 24a undermines the Commissioner's argument. As this Court noted in its *Wells Fargo* preliminary injunction order: "The GLBA defines a financial subsidiary as something 'other than a subsidiary that . . . 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 . . . .'" *Wells Fargo* PI Order 9 (quoting 12 U.S.C. § 24a(g)(3)). "A court must . . . interpret the statute 'as a symmetrical and coherent regulatory scheme,' and 'fit, if possible, all parts into an harmonious whole.' Similarly, the meaning of one statute may be affected by other Acts, particularly where Congress has spoken subsequently and more specifically to the topic at hand." *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (citations omitted). The Commissioner's suggestion that the National Bank Act prohibits national banks from owning any subsidiaries not only renders the financial subsidiary provisions of § 24a a nullity, but also contradicts Congress's subsequent reliance on the existing operating subsidiary structure in enacting § 24a(g)(3) in 1999. In other words, Congress's definition of "financial subsidiary" would

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[5] The Commissioner's reliance on *Motion Picture Association of America v. FCC*, 309 F.3d 796 (D.C. Cir. 2002) (cited Opp. 15), is misplaced. In *MPAA*, as the Commissioner acknowledges, the Court narrowly construed the FCC's broad grant of general rulemaking authority to avoid an issue of freedom of speech under the First Amendment. In this case, there is no issue of freedom of speech that would warrant such a narrowing construction.

make no sense if Congress had not approved the OCC's longstanding regulation allowing national banks to establish operating subsidiaries that do no more than a national bank itself can do.[6]

The Court also noted in its *Wells Fargo* preliminary injunction order that the GLBA Conference Report supports the OCC's regulation allowing national banks to establish operating subsidiaries. The Court quoted the Report, which states that operating subsidiaries have long been used for the very purpose for which NCMC was established – *i.e.*, to make mortgage loans on behalf of the parent national bank:

> For at least 30 years, national banks have been authorized to invest in operating subsidiaries that are engaged only in activities that national banks may engage in directly. For example, national banks are authorized directly to make mortgage loans and engage in related mortgage banking activities. Many banks choose to conduct these activities through subsidiary corporations. Nothing in this legislation is intended to affect the authority of national banks to engage in bank permissible activities through subsidiary corporations, or to invest in joint ventures to engage in bank permissible activities with other banks or nonbank companies.

Wells Fargo PI Order 10 (quoting S. Rep. No. 106-44, at 6 (1999)).

The Commissioner's case citations are similarly misplaced. For example, he cites (Opp. 18) *American Insurance Association v. Clarke*, 865 F.2d 278 (D.C. Cir. 1988), apparently not realizing that the D.C. Circuit in that case *approved* of the OCC's authorization of a national bank operating subsidiary to conduct municipal bond activities. Likewise, in *Independent Insurance Agents of America, Inc. v. Hawke*, 211 F.3d 638 (D.C. Cir. 2000) (cited Opp. 16 n.7, 20), the court concluded that 12 U.S.C. § 92, which allows national banks to sell

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[6] The Commissioner also argues that the express preemption provision of § 104(d) of GLBA, 15 U.S.C. § 6701(d), argues against finding "implicit" preemption for operating subsidiaries. Opp. 19-20. The Commissioner's argument concedes that § 104(d) is not applicable here. Further, § 104(d) in no respect diminishes the preemptive force of the OCC's rulemaking, 12 CFR § 7.4006, pursuant to its delegated authority from Congress, which expressly puts operating subsidiaries on the same footing as their parent national banks for purposes of applying state law.

insurance from towns of less than 5,000 persons, would be rendered redundant if the court generally allowed national banks to sell insurance under § 24(Seventh). 211 F.3d at 643-44. By contrast, here it is the Commissioner's interpretation that would nullify Congress's most recent definition of "financial subsidiary" in 12 U.S.C. § 24a(g)(3), which relies on and approves of the OCC's prior regulation allowing such subsidiaries.[7]

Even weaker is the Commissioner's challenge to the OCC's construction of § 484(a) and 12 C.F.R. § 7.4000, which provide the OCC with exclusive visitorial powers over national banks' operating subsidiaries. *Minnesota v. Fleet Mortgage Corp.*, 181 F. Supp. 2d 995 (D. Minn. 2001), on which the Commissioner relies, actually supports Plaintiffs' case. *Fleet Mortgage* holds that states can regulate national banks' operating subsidiaries *when doing so is expressly authorized by federal law.* 181 F. Supp. 2d at 997-98, 1002 (pointing to two federal statutes, one allowing states to enforce the telephone sales rule under the FTC Act and another providing that operating subsidiaries are not to be treated like national banks for purposes of the FTC Act). In this regard, *Fleet Mortgage* dovetails with 12 C.F.R. § 7.4006, which provides that "*Unless otherwise provided by Federal law or OCC regulation*, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank" (emphasis added).[8] The OCC's Brief also echoes the holding of *Fleet*

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[7] The Court also should reject the Commissioner's confused reliance on *National Bank v. Commonwealth*, 76 U.S. 353 (1869), and *McClellan v. Chipman*, 164 U.S. 347 (1896) (both cited Opp. 23-24, 29). Both cases stand for the proposition that background state laws of contract, tort, and property apply to national banks. Thus *National Bank v. Commonwealth* held that national bank "contracts are governed and construed by State laws" as is "[t]heir acquisition and transfer of property" and their "right to collect . . . and . . . to be sued for debts." 76 U.S. at 362. Likewise, in *McClellan*, the Court found that a national bank must comply with a state fraudulent conveyance law absent some showing that "the state law incapacitates the banks from discharging their duties" under the National Bank Act. 164 U.S. at 362. *McClellan* and *Commonwealth* did not address state laws, such as the ones at issue here, that give state regulators authority to exercise visitorial authority over a national bank or its operating subsidiary, or ones that do, in fact, "incapacitate" national banks' powers to establish and operate operating subsidiaries in the manner provided for by the OCC.

[8] The Commissioner argues that NCMC has an "unfair business advantage" over other lenders by virtue, presumably of its status as a national bank operating subsidiary. Opp. 11. But the Supreme Court has rejected any notion of "competitive equality" in the National Bank Act preemption context unless Congress has specifically required it. *Cf. Barnett Bank of Marion* (continued...)

Mortgage: "Because federal law prohibits the Department from exercising visitorial powers over a national bank engaged in real estate lending pursuant to federal law, the Department may not exercise visitorial power over the national bank conducting that activity through an operating subsidiary licensed by the OCC, *absent federal law dictating a contrary result*." OCC Br. 14 (emphasis added). Here, unlike in *Fleet Mortgage*, there is no *federal* law that authorizes the Commissioner to undertake the ongoing licensing, regulation, supervision, examination, and enforcement authority over national banks' operating subsidiaries.[9]

Finally, the Tenth Amendment is of no help to the Commissioner. Opp. 12. As the Supreme Court has explained, the Tenth Amendment is not an independent limitation on federal power, but a confirmation that the federal government may not exercise authority that is not conferred by Article I of the Constitution: "The Tenth Amendment . . . restrains the power of Congress, but this limit is not derived from the text of the Tenth Amendment itself, which . . . is essentially a tautology. Instead, the Tenth Amendment confirms that the power of the Federal Government is subject to limits that may, in a given instance, reserve power to the States. The Tenth Amendment thus directs us to determine, as in this case, whether an incident of state sovereignty is protected by a limitation on an Article I power." *New York v. United States*, 505 U.S. 144, 156-57 (1992).

Here, the Commissioner concedes that Congress has the power to establish national banks, and to vest the OCC with authority to regulate them. Opp. 12. The Commissioner nevertheless contends that "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." *Id.* But Congress clearly

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County, N.A. v. Nelson, 517 U.S. 25, 34 (1996) ("[W]here Congress has not expressly conditioned the grant of 'power' upon a grant of state permission, the Court has ordinarily found that no such condition applies.").

[9] This case does not involve any issues of regulation under the telemarketing sales rules and the FTC Act that were at issue in *Fleet Mortgage*.

has the power to regulate interstate commerce under Article I of the Constitution, and to make all laws "which shall be necessary and proper for carrying into Execution the foregoing Powers." U.S. Const. art. I, § 8, cl. 18. Congress validly established a national banking system according to these powers, and vested the OCC with delegated authority to exercise these powers in implementing the national banking system. There can be no doubt that operating subsidiaries, like national banks, operate in interstate commerce and accordingly are within the scope of Congress's Article I powers. As such, they are also within the scope of the OCC's delegated powers, and the Tenth Amendment presents no obstacle to the OCC's operating subsidiary regulations, including 12 C.F.R. § 7.4006.

B. Section 7.4006 Prevents The Commissioner From Exercising Visitorial Powers Today Over Any NCMC Conduct

The Commissioner argues that "federal preemption of the CRMLA, if found by this court, [sh]ould only apply from August 1, 2001 forward . . . ." Opp. 40-41. The Commissioner reasons that doing so would avoid giving "retroactive" effect to 12 C.F.R. § 7.4006. *See id.* But there is no retroactive effect in applying 12 C.F.R. § 7.4006 to prevent the *present* actions *of the Commissioner*. As the Ninth Circuit has held in rejecting a similar falsely styled retroactivity claim: "a retroactive rule is one that alters the past legal consequences of past actions." *American Mining Congress v. United States Envtl. Prot. Agency*, 965 F.2d 759, 769 (9th Cir. 1992) (emphasis omitted). In that case, the Ninth Circuit rejected a retroactivity challenge to an EPA rule that "require[d] only that owners or operators apply for permits for future discharges from inactive mines." *Id.* The court of appeals concluded that "[a]lthough the rule may reduce the financial attractiveness of mine ownership" because the mines already contained contaminated waste water, "it does not impose liability for past conduct." *Id.*

Here, the "conduct" prohibited by § 7.4006 is *the Commissioner's present* attempts to exercise visitorial powers over NCMC, not NCMC's conduct that the Commissioner seeks to regulate. Thus, like the regulation to which the mine operators in *American Mining Congress* objected, here a distinction must be made between the present attempts at regulatory

action and the actions that give rise to that attempted regulatory action. Section 7.4006 properly operates to prevent *the Commissioner* from exercising visitorial powers presently. In doing so, the Commissioner is prevented from making any findings *today* for the past conduct of NCMC, as such actions are within the exclusive visitorial authority of the OCC.

This Court properly rejected the Commissioner's identical arguments in its *Wells Fargo* preliminary injunction order, *Wells Fargo* PI Order 11-12, in which the Court found that the OCC's interpretation of the National Bank Act and its regulations is not time-limited, and that the OCC's position is not "'unworthy of deference.'" *Id.* at 12 (quoting *Bank of America*, 309 F.3d at 563 n.7). The Court also correctly concluded that "allowing the Commissioner to exercise visitorial powers over WFHMI would appear to 'result in unnecessary and wasteful duplication of effort on the part of the bank and the state agency. From that standpoint enforcement exclusivity in the [OCC] is reasonable and practical.'" *Wells Fargo* PI Order 12-13 (quoting *National State Bank v. Long*, 630 F.2d 981, 988 (3d Cir. 1980)). The Court should again reject the Commissioner's falsely styled retroactivity argument on summary judgment.

IV. NATIONAL CITY BANK HAS STANDING TO PURSUE ITS OWN NATIONAL BANK ACT PREEMPTION CLAIM

The Commissioner's claim that "National City Bank cannot demonstrate that it has suffered an 'injury-in-fact' to a legally protected interest," Opp. 42, lacks merit. In Count II of the Complaint, National City Bank has asserted its own preemption rights under the National Bank Act. *See also* PI Mem. 14-15. National City Bank has a legal right under 12 U.S.C. § 24(Seventh), and 12 C.F.R. §§ 5.34 and 7.4006, to establish and operate an operating subsidiary to carry out the Bank's authorized mortgage lending activities. *See* PI Mem. 14-15. National City Bank has exercised this right by conducting its mortgage lending activities through its wholly owned operating subsidiary, NCMC. *See id.* When the Commissioner threatened to shut down NCMC – and it is undisputed that he now has, *see supra* note 1 – National City Bank suffered a legally cognizable "injury-in-fact" for purposes of Article III standing because, by doing so, the Commissioner interfered with *National City Bank's* legal authority under 12 U.S.C. § 24(Seventh) and 12 C.F.R. §§ 5.34 and 7.4006 to own and operate

an operating subsidiary, and to do so on the same terms and conditions as if it were a separately incorporated department or division of the bank itself.[10]

V. DIDMCA PREEMPTS THE CALIFORNIA PER DIEM INTEREST LIMITATION

A. The Plain Language Of DIDMCA Preempts The California Per Diem Interest Limitation

DIDMCA's express preemption clause provides: "The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance . . . ." 12 U.S.C. § 1735f-7a(a)(1). Where, as here, a statute "contains an express pre-emption 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' pre-emptive intent." *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 664 (1993). "It is elementary that the meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain, . . . the sole function of the courts is to enforce it according to its terms." *Carson Harbor Village, Ltd. v. Unocal Corp.*, 270 F.3d 863, 878 (9th Cir. 2001) (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)), *cert. denied*, 535 U.S. 971 (2002).

By its plain terms, DIDMCA preempts any state law "expressly limiting the rate or amount of interest" that a lender may charge or receive on a residential first mortgage.[11] The

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[10] The Commissioner asserts that there is no reliable evidence that NCMC is an operating subsidiary of a national bank. Opp. 1. This assertion is frivolous. Plaintiffs have submitted sworn declarations attesting to NCMC's status as an operating subsidiary. *See* Knight Decl. ¶ 2; Stitle Decl. ¶ 2. This Court rejected a similar unfounded assertion by the Commissioner in *Wells Fargo*. To put this matter to rest, Plaintiffs are submitting with this memorandum the Declaration of Stephen Smith, attaching a true and correct copy of a letter from the OCC confirming NCMC's status as an operating subsidiary.

[11] It is undisputed that the loans issued by NCMC are subject to DIDMCA's preemption provision because they are: (1) secured by a first lien on residential property; (2) made after March 31, 1980; and (3) "federally-related mortgage loans." 12 U.S.C. § 1735f-7a(a)(1)(A)-(C). It is also undisputed that California has not opted out of the DIDMCA preemption framework. *See id.* § 1735f-7a(b)(2).

California per diem interest limitation falls within the plain terms of DIDMCA's preemption clause because it expressly limits the amount of interest that a lender may charge and receive. Section 50204(o) of the California Financial Code expressly prohibits lenders from charging and receiving "interest on the mortgage loan for a period in excess of one day prior to [the] recording of the mortgage or deed of trust." Similarly, section 2948.5(a) of the California Civil Code expressly provides that "[a] borrower shall not be required to pay interest . . . for a period in excess of one day prior to [the] recording of the mortgage or deed of trust." These state law provisions expressly limit the amount of interest that a lender may charge and receive on a residential first mortgage, and therefore DIDMCA's "statutory language plainly encompasses the loans at issue here." *Brown v. Investors Mortgage Co.*, 121 F.3d 472, 475 (9th Cir. 1997).

B. Relevant Judicial Precedent Confirms That DIDMCA Preempts The California Per Diem Interest Limitation

In *Shelton v. Mutual Savings & Loan Ass'n, F.A.*, 738 F. Supp. 1050, 1058 (E.D. Mich. 1990), the court held that a Michigan statute prohibiting residential mortgage lenders from charging interest on first mortgage loans before disbursement is preempted by DIDMCA. The Commissioner is mistaken in asserting that the *Shelton* court's decision turned on the reference to "*rate* of interest" in the Michigan law, and therefore that it is an "open question" how the Michigan court would regard the California per diem interest limitation. Opp. 35. If a state law that prohibits the charging of interest *before* mortgage funds are disbursed is preempted, as in *Shelton*, then it follows *a fortiori* that a statute prohibiting the charging of interest *after* funds have been disbursed, as here, is also preempted. *See also* PI Mem. 16.[12]

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[12] The unpublished decision in *Larsen v. Countrywide Home Loans, Inc.*, No. 01-C2233, 2001 WL 803689 (N.D. Ill. July 17, 2001), does not support the Commissioner's position. The state law at issue in *Larsen* prohibited lenders from charging interest after the borrower had paid off the principal. *See id.* at *1. The *Larsen* court held that charges incurred after the principal has been repaid are not "interest," because the borrower is "no longer indebted." *Id.* at *2. *Larsen* is easily distinguished from this case. The California per diem interest limitation *does* apply during the period of indebtedness, and thus there is no basis for recharacterizing interest due under the terms of the loan.

The Commissioner relies heavily on the First Circuit's decision in *Grunbeck v. Dime Savings Bank of New York FSB*, 74 F.3d 331 (1st Cir. 1996), but that case cannot be stretched to support the Commissioner's position in this case. The state law at issue in *Grunbeck* prohibited lenders from charging compound interest on first mortgage home loans. *See id.* at 335 n.1. The First Circuit reasoned that such a law does not "expressly limit" either the amount or rate of interest that the lender can charge or receive because the state law does not "prevent[] a lender from contracting for whatever *simple* interest rate will exact an interest return equal to or greater than whatever rate and amount of interest would be recoverable through compounding." *Id.* at 337. The *Grunbeck* court reasoned that the lender could charge or receive any rate or amount of interest by adjusting the interest rate to compensate for the state's prohibition on compound interest.

In the case of California's per diem interest limitation, however, the situation is different. Here, the interest rate on mortgage loans is necessarily set *before* the real estate transaction closes, and cannot be altered after closing. The mortgage is not recorded until *after* closing; and, contrary to the Commissioner's assertion (Opp. 2 n.1), the lender does not have control over the time of recordation. In order for the mortgage to be recorded it must be (1) delivered to the County Recorder's office and (2) officially recorded in the county's records. PI Mem. 17. The lender does not control the timing of either step in the process. The settlement agent is responsible for seeing that the mortgage is delivered to the County Recorder's office. And only the County Recorder is capable of recording the mortgage. *See Citizens for Covenant Compliance v. Anderson*, 906 P.2d 1314, 1320 (Cal. 1996). Thus, this case differs from *Grunbeck* in that the lender cannot control the exact amount and rate of interest it receives on the loan. Depending on the time it takes to record the mortgage, both the amount of interest and the effective rate of interest will vary.[13]

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[13] The Commissioner attempts to obscure the clear difference between this case and *Grunbeck* by asserting that lenders can "bargain[] with the borrowers for additional fees or charges" to recover "lost per diem interest income." Opp. 37. If that were true, it would render California's per diem interest limitation totally ineffective, because lenders could simply (continued...)

The Commissioner is similarly mistaken in his unsupported assertion that the California per diem interest limitation is "designed to protect borrowers." Opp. 35. In fact, the purpose of recording the deed of trust is to protect the lender, not the borrower. By recording the deed of trust and placing the world on notice that the property is encumbered, the lender is entitled to priority over subsequent lenders that obtain a mortgage on the property. *See Cady v. Purser*, 63 P. 844, 845-46 (Cal. 1901); *Hochstein v. Romero*, 268 Cal. Rptr. 202, 205-06 (Cal. Ct. App. 1990). Thus, a delay in recording the deed of trust does not have any detrimental impact on the borrower, although it can have negative consequences for the lender.

As the OCC has noted, the California per diem interest limitation operates like an interest "lottery." OCC Reply Br. 9-10. As a result of the express limitation imposed by California law, the amount of interest the lender receives is made to depend on events that are outside the lender's control. The lender *may* receive the amount of interest provided for in the loan documents – or it may receive less, depending on when the mortgage is recorded.[14]

C. The Commissioner's Arguments That DIDMCA Does Not Preempt The California Per Diem Interest Laws Are Unpersuasive

Where the language of the statute is plain, the court's task is to apply the statute as Congress wrote it. *Carson Harbor Village*, 270 F.3d at 878. The Commissioner nevertheless

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recharacterize lost interest as "fees" or "charges." In addition, it would render DIDMCA's express preemption clause a dead letter because a state could always argue that any express limitation on the amount or rate of interest is not preempted because it could be recovered from the borrower in the form of additional fees or charges. The short answer to the Commissioner's argument is that DIDMCA, by its plain terms, preempts any state law that limits the rate or amount of interest on residential mortgages – without regard to whether the lender could adjust by charging higher fees. Moreover, charging of higher fees to compensate for an amount of loan interest that is unknowable until after closing is unworkable because the federal Truth In Lending Act prohibits lenders from adjusting fees once the transaction closes.

[14] If DIDMCA does not preempt California's per diem interest provisions, then it follows that DIDMCA does not preempt a variety of other possible state laws that expressly limit the amount of interest that a lender can receive. For example, a state might enact a law providing that borrowers are not required to pay interest for each day of the month, depending on some event outside the lender's control – such as a lottery to select "lucky" borrowers, or a state determination that adverse economic conditions or some other reason justifies a reduction in interest payments.

advances various arguments in an effort to avoid the plain language of DIDMCA. These arguments cannot overcome plain statutory language, and are unpersuasive on their own terms.

First, the Commissioner asserts that California's per diem interest laws do not limit the amount or rate of interest that a lender can receive, but instead regulate only the *time period* during which the lender can charge interest. Opp. 34. It is undeniable, however, that the California statutes expressly limit – to zero – the amount of interest that a lender can charge prior to the recording of the mortgage (plus one day). It strains credulity to argue that this is anything other than an express limitation on the amount of interest that lenders can charge or receive.

This conclusion is confirmed by a brief analysis of the factors that determine the "amount of interest" that a lender receives from a borrower. The amount of interest is determined by three factors: the principal amount of the loan, the interest rate, and the time period of the loan. The relationship is expressed by the simple equation $i = P \times r \times t$, where i = the amount of interest, P = the principal, r = the rate, and t = the time period of the loan. By expressly limiting the time period of the loan, the California per diem interest laws expressly limit the amount of interest the lender can receive. Accordingly, those provisions are preempted by DIDMCA.

Second, the Commissioner resorts to legislative history to argue that DIDMCA preempts only state "usury" statutes. Opp. 34. As an initial matter, the Commissioner's argument that the per diem interest laws are "not usury statue[s]," *id.*, is essentially a tautology, since usury laws are defined as "collectively, the laws of a jurisdiction regulating the charging of interest." *Black's Law Dictionary* 1545 (6th ed. 1990); *see also Hall v. Beneficial Fin. Co.*, 173 Cal. Rptr. 450, 451 (Cal. Ct. App. 1981) ("'Usury' has been defined as 'taking more than the law allows upon a loan or for forbearance of a debt.'"). Thus, the question whether the per diem interest laws are "usury" laws can be viewed as a restatement of the question whether the per diem interest laws expressly limit the rate or amount of interest a lender can charge or receive. Moreover, if Congress had intended DIDMCA's preemption provision to apply only to a subset of state laws limiting the rate or amount of interest, Congress would have said so.

Instead, it chose broad statutory language that encompasses *any* state law that expressly limits the rate or amount of interest, whether labeled as a usury law or not. As the Ninth Circuit observed in *Brown*, "[t]he words are unqualified." 121 F.3d at 475. "'Where Congress has, as here, intentionally and unambiguously drafted a particularly broad definition, it is not [the Court's] function to undermine that effort.'" *Middle Mtn. Land & Produce Inc. v. Sound Commodities, Inc.*, 307 F.3d 1220, 1223 (9th Cir. 2002) (quoting *CFTC v. Frankwell Bullion Ltd.*, 99 F.3d 299, 303 (9th Cir. 1996)).[15]

Third, the Commissioner argues that California's per diem interest laws should be deemed to limit "other charges" rather than interest. Opp. 38. This argument is easily answered. By their express terms, the California laws limit the amount of *interest* that a lender can collect before the mortgage is recorded. *See* Cal. Fin. Code § 50204(o) (a lender is prohibited from charging and receiving "*interest* on the mortgage loan for a period in excess of one day prior to recording of the mortgage or deed of trust") (emphasis added); Cal. Civ. Code § 2948.5(a) ("borrower shall not be required to pay *interest* . . . for a period in excess of one day prior to [the] recording of the mortgage or deed of trust . . .") (emphasis added). Indeed, elsewhere in his brief the Commissioner argues that lenders could impose additional "fees" or "charges" to recover "lost per diem *interest* income." Opp. 37 (emphasis added); *see also supra* note 13. The Commissioner thus effectively admits the obvious: the per diem interest limitation restricts *interest*, not fees or charges.

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[15] The legislative history of DIDMCA indicates that Congress intended to exempt from state regulation "those limitations that are included in the annual percentage rate." S. Rep. No. 96-368, at 19 (1979). The time when interest starts to accrue is one component of the APR. *See* 12 C.F.R. § 226.22(a)(1) ("The annual percentage rate is a measure of the cost of credit, expressed as a yearly rate, that relates the amount *and timing* of value received by the consumer to the amount and *timing* of the payments made.") (emphasis added); *id.* pt. 226, app. J (noting that for purposes of calculating the APR, "[t]he term of the transaction begins on the date of its consummation").

CONCLUSION

For the foregoing reasons as well as those discussed in Plaintiffs' opening memorandum, Plaintiffs respectfully request that this Court grant their Motion For Preliminary Injunction.

Respectfully submitted,

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