

AMERICAN BANKER

THE FINANCIAL SERVICES DAILY

Friday, October 20, 2006

VIEWPOINTS

Wachovia Case Should Empower States

The Supreme Court preemption case *Watters v. Wachovia* is of far greater consequence than anyone has imagined.

If the court rules for *Watters* — in effect, for Michigan and against the OCC — the power of states on numerous banking issues will grow substantially.

I believe the court will rule in favor of Michigan.

The recent appointments of Chief Justice John G. Roberts Jr. and Justice Samuel A. Alito Jr. to the court, as well as a very questionable OCC regulation, have given the states their best shot in decades to trump federal preemption.

In 2003, Wachovia converted a mortgage company through which it conducted business in Michigan into an operating subsidiary of its national bank in North Carolina. It then notified the state of Michigan that the subsidiary would “no longer be subject to the requirements” of its Licensing Act.

This might have been OK had Wachovia closed its office and terminated its employees in Michigan, but it didn't. It stayed there and defiantly told the state it was authorized to snub

Michigan law because of an OCC regulation.



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Michigan offered a swift response: If the subsidiary doesn't register and comply with our laws, we'll shut it down. Confident it would prevail on the issue, Wachovia sued Michigan to validate the OCC regulation and won, even on appeal.

The regulation, as I understand it, works something like this. A national bank can create an operating subsidiary to carry out its activities, but the subsidiary needs to comply only with the laws of the state where the bank is headquartered, even if it has offices and workers in other states.

The rationale seems to be that the bank and the subsidiary have to be treated as one and the same thing.

Consequently, because Wachovia's bank was headquartered in North Carolina, its operating subsidiary in effect had to be treated as though it were not in Michigan, at least for the purpose of having to comply with the state's corporation laws.

The OCC arrived at this strange position through an interpretation of the National Bank Act, which says only the OCC can audit the operations of a national bank, including its compliance with applicable federal and state laws.

Although the act gives no similar exclusivity power to the OCC over subsidiaries of national banks, the agency nevertheless granted that power to itself in the regulation. That way it could argue that only one state — the parent's — matters to the subsidiary.

Put another way, if Michigan were irrelevant to Wachovia's bank, because it had no branch there, the state likewise would be irrelevant to its subsidiary.

Carried to its logical conclusion, the OCC regulation seemingly would allow

the subsidiary to disregard Michigan's building, zoning, environmental codes; property taxes and license fees; consumer protection statutes; wage, discrimination, health, and safety standards; etc. Presumably, all of these things would be the worry of North Carolina.

If this scenario strikes you as odd, and perhaps illegal, the Supreme Court will decide early next year if you are right. It will answer several key questions about the OCC's regulation: Is Michigan right that the regulation is unconstitutional as it concerns Wachovia's operating subsidiary? Do Michigan's rights under the 10th Amendment preempt the regulation? Did Congress authorize the OCC to adopt the regulation? Didn't Congress have to do so?

Having read the briefs of Michigan and its allies, and being fairly well acquainted with the Constitution and federal banking law, I am convinced that Michigan has the stronger case.

One reason is the audacity of the regulation for insisting that North Carolina law must apply to Wachovia activities that are unique to Michigan and ultimately of no interest to North Carolina. In fact, North Carolina on its own has

no constitutional authority to erase Michigan law.

The drafters of the Constitution anticipated problems like this in Article IV, which requires states to honor "the public Acts ... of every other state." This rule, the so-called full faith and credit clause, means North Carolina would have to apply Michigan law to Wachovia's operating subsidiary.

The full faith and credit clause and the unquestioned power of states to regulate corporations pursuant to the 10th Amendment explain why the attorneys general of all 50 states, the National Governors Association, and just about every other representative body of the states have filed briefs on Michigan's side.

Even the leading state beneficiaries of bank preemption — Utah, Delaware, and South Dakota — have joined their ranks.

That North Carolina is among them is another rebuke to the OCC. It says, "Don't you dare try to exploit our laws to undermine our constitutional powers."

If the states win, they will challenge more federal regulations and pressure their representatives in Congress to scale back preemption legislation. They might even be able to use a victory to force pricing and service changes for some

retail banking products and services.

Their activism in turn likely will cause a massive increase in PAC spending by banks to influence state legislation. But even tons of it might not be enough to erase the stigma of a decision that tags the OCC, a law enforcement agency, as a law violator.

To regain its reputation and keep the states at bay, the OCC could reduce its preemption assertions and develop aggressive consumer protection measures.

Unpleasant stuff, but probably no worse than if Wachovia and the OCC win. Down the road the agencies could use a ruling in Wachovia's favor to abrogate state (and perhaps federal) laws that are important to our economy, as well as to banks and their customers.

Surely, there are lots of lawyers out there who'd love to pull the agencies' strings to undermine the corporation laws of states like Delaware. They are advocates of a planned economy, and they would delight in having an unrestrained OCC to achieve their ends.

The bottom line: Wachovia is a Pandora's box.

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