

Protecting Consumers From Consumer Protection: *Watters v. Wachovia Bank*

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I. Introduction

*Watters v. Wachovia Bank*¹ posed a perplexing dilemma for anyone interested in limited government, particularly libertarians and conservatives. On the one hand, the Court's slow but steady crawl back toward federalism holds the future promise of checking the otherwise unchecked growth of the federal government. On the other hand, the very real and present threat to liberty, prosperity, and advancement posed by the recent explosion of state consumer protection legislation might itself go unchecked without the shelter afforded by federal regulation and preemption. Put simply, the choice was one between form and function, federalism and freedom. Should the Commerce Clause and federal banking regulation be read so broadly as to preempt state regulation of banking activity, thereby weakening federalism and the concept of dual regulation? Or should the states maintain significant power to regulate state chartered subsidiaries of national banks, even if that meant the occasional enforcement of misguided and debilitating state consumer protection laws? This difficult choice divides not just the Court but libertarians from conservatives.

As difficult as this choice might be, it is equally difficult to see that this choice is being posed within the record of *Watters v. Wachovia Bank*. While the case nominally pitted the State of Michigan's Office of Insurance and Financial Services ("the OIFS") against the

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¹127 S. Ct. 1559 (2007).

Wachovia National Bank, it was really a duel between the state regulator and the United States Office of the Comptroller of the Currency (“the OCC”). The central issue was whether federalism demanded that a state be permitted to continue to impose regulations on a state mortgage lender, including visitation, when a national bank acquires the state mortgage lender, or whether such state regulation was now preempted by federal law.

Although the Court long ago held in *McCulloch v. Maryland* that federal law trumps state law in the regulation of national banks, both federal and state regulators have shared the regulation of the banking industry. Federal regulation of national banks is vested in the OCC by virtue of the National Bank Act of 1864 (“the NBA”).² States have maintained a parallel regulatory authority over state banks. This system of dual regulation, referred to by the Court as “equalization,” preserves the federalist balance between the states and the federal government with respect to banks operating within their respective spheres.³ As long as state chartered banks operate wholly within a state, their operations are entirely subject to state regulation.⁴ Even when a national bank operates within a state, it is not exempt from the application of state laws of general application.⁵ State law of property, contract, and tort apply to nationally chartered banks as much as they apply to any other individual or entity within the state. State regulation is preempted by federal law, however, if it encroaches on a national bank’s exercise of a function essential or incidental to banking.⁶ The central question in *Watters v. Wachovia Bank*, then, was whether the state’s enforcement of its inspection prerogative touched banking operations of a national bank’s state subsidiary in a way preempted by federal law. In this setting, as in many others, this seemingly straightforward doctrinal question is not entirely straightforward.

²12 U.S.C. § 371.

³*Lewis v. Fidelity & Deposit Co. of Md.*, 292 U.S. 559, 564 (1934) (recognizing “[t]he policy of equalization was adopted in the National Bank Act of 1964”).

⁴See Kenneth Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 *Stan. L. Rev.* 1, 8–13 (1978) (describing the benefits of the dual banking system).

⁵*Id.*

⁶*Id.*

This article will attempt to show that the issue in *Watters v. Wachovia Bank* is actually a policy choice disguised as a doctrinal one. The real issue is whether, given our national credit markets, states should have extensive authority to impose cumbersome, expensive, and, indeed, irrational regulation on operating subsidiaries of national banks. While the decision to extend preemption will affect many forms of state banking regulation, some of its most important consequences will be to limit the reach of state consumer protection legislation. Such state measures, while rhetorically pleasing and politically popular, are increasingly shown by economists and determined by judges to be irrational since they often actually harm the very people they purport to help.

This article proceeds in five parts. After this Introduction, Part II provides a summary of the background of *Watters v. Wachovia Bank*. Part III discusses the conflicting policy choices confronting the Court, as well as libertarians and conservatives interested in limited government and economic prosperity. Part IV explains why, given this dilemma, the interests of freedom and prosperity are advanced with federal control of banking regulation and its concomitant limitations on state consumer protection laws. The pernicious effects of consumer protection laws, particularly in mortgage lending, may be ameliorated in the long run with federal preemption. The recent wave of short-sighted and misguided state consumer protection laws in other areas of consumer credit and commercial finance, unfortunately, will remain unaddressed by the application of preemption in *Watters v. Wachovia Bank*. Part V concludes with a brief look at the forecast for mortgage lending and consumer protection.

II. Background

Wachovia Mortgage, like many other mortgage lenders in the State of Michigan, operated in Michigan and elsewhere as a state-chartered financial institution lending to first-time and repeat homebuyers.⁷ Like other state mortgage lenders in the state of Michigan, Wachovia Mortgage's operations were subject to regulation by the Michigan Office of Insurance and Financial Services.⁸ Among its supervisory functions, the OIFS requires mortgage brokers, lenders,

⁷Wachovia Mortgage was and is actually chartered in North Carolina.

⁸*Watters v. Wachovia Bank*, 127 S. Ct. 1559, 1565 (2007).

and service entities to register with it. Registrants are required, among other things, to pay an annual operating fee, file annual reports, and open their books and records for inspection by OIFS examiners.⁹

Linda Watters, commissioner of the OIFS, exercises “general supervision and control” over registrants and administers the state of Michigan’s lending laws. As commissioner, she has authority to exercise the agency’s visitorial powers, including the power to conduct bank investigations, audits, and examinations.¹⁰ The commissioner also bears the responsibility of enforcing the state’s requirements against registered lenders.¹¹ In addition to these duties, the commissioner was charged with investigating consumer complaints and to take appropriate enforcement action should she find that a particular complaint was not “being adequately pursued by the appropriate federal regulatory authority.”¹²

From 1997 to 2003, Wachovia Mortgage was registered with the OIFS to engage in mortgage lending. Then, on January 1, 2003, Wachovia Mortgage became a wholly owned subsidiary of Wachovia Bank, a national bank federally chartered under the National Bank Act.¹³ Under the NBA, national banks like Wachovia are authorized “[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking.”¹⁴ Among these powers, the NBA specifically authorizes national banks to engage in real estate lending.¹⁵ The statute also expressly permits banks to conduct its banking activities through “operating subsidiaries.”¹⁶ An operating subsidiary may engage solely in activities the bank itself could undertake, subject to the same limitations, terms, and conditions as the bank.¹⁷

⁹ *Id.* at 1566.

¹⁰ *Id.* See Mich. Comp. Laws Ann. §§ 445.1656(1), 445.1679(1)(a) (West 2002).

¹¹ Watters, 127 S. Ct. at 1565.

¹² Mich. Comp. Laws Ann. §§ 445.1663(2) (West 2002).

¹³ 12 U.S.C. § 1 et seq.

¹⁴ 12 U.S.C. § 24.

¹⁵ 12 U.S.C. § 371.

¹⁶ 12 U.S.C. § 24a(g)(3)(A).

¹⁷ 12 C.F.R. § 5.34(e) (2006).

As a wholly owned subsidiary of a national bank, Wachovia Mortgage's management believed it was no longer subject to Michigan banking regulations, including the registration requirement. In March 2003, Wachovia Mortgage informed the state of Michigan that it was surrendering its registration to engage in mortgage lending.¹⁸ Wachovia Mortgage management was of the opinion that Michigan law with respect to mortgage lending registration and oversight, as applied to a wholly owned subsidiary of a national bank like itself, was preempted by federal law.¹⁹

Commissioner Watters responded to the surrender of Wachovia Mortgage's registration by informing Wachovia Mortgage that it would no longer be permitted to engage in mortgage lending activity in the State of Michigan.²⁰ The commissioner's position was that all state chartered mortgage lenders had to comply with Michigan's registration requirements. While Michigan law exempts subsidiaries of national banks that maintain main or branch offices in Michigan, the company had no such offices in Michigan, and therefore did not fall within the law's exemption.²¹ From the commissioner's perspective, she had no choice but to deny Wachovia Mortgage access to Michigan mortgage markets.

Wachovia Bank and Wachovia Mortgage ("the Banks") filed suit against Watters in her official capacity as commissioner of the OIFS, seeking declaratory and injunctive relief to prevent her from enforcing Michigan's registration requirements against Wachovia Mortgage.²² The Banks asserted that two state statutes, the Michigan Mortgage Brokers, Lenders, and Services Licensing Act, and the Michigan Secondary Mortgage Loan Act, were preempted by the NBA and the supervisory authority it vests in the OCC.²³

In response, the commissioner acknowledged that if the real estate lending activity were conducted by the parent company, Wachovia Bank, rather than the subsidiary, Wachovia Mortgage, the parent

¹⁸Watters v. Wachovia Bank, 127 S. Ct. 1559, 1565 (2007).

¹⁹*Id.* at 1565–66.

²⁰*Id.* at 1566.

²¹Mich. Comp. Law. Ann. §§ 445.1652(1)(b) (West Supp. 2006), 445.1675(m) (West 2002), 493.53a(d) (West 1998).

²²Watters, 127 S. Ct. at 1565.

²³*Id.* at 1565–66.

Wachovia Bank and the activity would not be subject to Michigan banking laws and its registration requirements.²⁴ But because the subsidiary, Wachovia Mortgage, was not itself a national bank, it could not evade applicable Michigan controls by becoming a wholly owned subsidiary of a national bank.²⁵ Watters further asserted that her position was supported by the Tenth Amendment to the Constitution of the United States, which she claimed prohibits the OCC from exercising exclusive regulatory authority over lending activities conducted through operating subsidiaries of national banks.²⁶

The United States District Court for the Western District of Michigan granted the Banks' motion for summary judgment on the preemption claim, and rejected the commissioner's Tenth Amendment argument.²⁷ The United States Court of Appeals for the Sixth Circuit affirmed, making it the fourth such circuit court to hold that state bank regulations are preempted, where applied to wholly owned operating subsidiaries of national banks, by federal law and the superintendence vested in the OCC.²⁸

By a narrow five to three decision, the Supreme Court of the United States held that the National Bank Act of 1864, as amended, vests the power to regulate national banks and their wholly owned operating subsidiaries in the Office of the Comptroller of the Currency and therefore preempts state regulation of these entities.²⁹ Writing for the Court, Justice Ginsburg pointed to the Graham-Leach-Bliley Act of 1999,³⁰ amending the National Bank Act, as extending federal regulatory authority to "subsidiaries . . . which may engage only in activities national banks may engage in directly, 'subject to the same terms and conditions that govern the conduct of such activities by national banks.'"³¹ Justice Ginsburg was joined by Justices Kennedy, Souter, Breyer, and Alito.

²⁴ *Id.* at 1566.

²⁵ *Id.*

²⁶ *Id.*

²⁷ 334 F. Supp. 2d 957, 965–66 (W.D. Mich. 2004).

²⁸ 431 F.3d 556 (6th Cir. 2005).

²⁹ Watters, 127 S. Ct at 1568. Justice Thomas took no part in the consideration or decision of the case.

³⁰ 12 U.S.C. § 24a(g)(3)(A).

³¹ Watters v. Wachovia Bank, 127 S. Ct. 1559, 1570 (2007) (Ginsburg, J.) (quoting Graham-Leach-Bliley Act, 12 U.S.C. §24a(g)(3)(A)).

In dissent, Justice John Paul Stevens, joined by the chief justice and Justice Antonin Scalia, argued that the National Bank Act does not itself expressly extend OCC authority to subsidiaries of national banks, and in the absence of such statutory authority the Court should not substantially undermine the delicate balance between state and federal authority and the benefits made possible through the dual banking system.³² According to Justice Stevens, the Court's decision in this case ignores the fact that Congress never expressly mentioned "operating subsidiaries" in Graham-Leach-Bliley, and indeed used that Act to curtail the OCC's definition of such entities by placing restrictions on "financial subsidiaries," thereby distinguishing them, by negative implication, from what the OCC had termed "operating subsidiaries."³³ But the OCC had determined that "operating subsidiaries" could engage in activities that national banks could not engage in directly, a position expressly rejected by Graham-Leach-Bliley.³⁴ Reading the NBA and Graham-Leach-Bliley together to effect preemption where subsidiaries of national banks are concerned, Stevens argued, undermines an important federalist structure in our economy and our traditional understanding of federalism.

Nevertheless, the Court affirmed the lower court determinations that state banking regulation was preempted when applied to state chartered operating subsidiaries of nationally chartered banks.

III. Federalism Versus Freedom? The Policy Choice of

Watters v. Wachovia Bank

At first glance, *Watters v. Wachovia Bank* appears to have realigned the Court into chambers comprised of strange bedfellows. This first impression gives way to a more nuanced perception of the justices, however, once the underlying and unmentioned (except by *amici*) implications of the case are laid bare. This case posed an important dilemma for those interested in limited government and expanded economic freedom. Should a strict notion of federalism, which was conceived by the Framers as an essential check on the aggregation of power by the central government, be relaxed in order to permit

³²*Id.* at 1578 (Stevens, J. dissenting).

³³*Id.* at 1577.

³⁴*Id.*

commercial entities to seek refuge from irrational local laws under the shelter of a potentially unchecked federal regulator? Libertarians might pose the general question more broadly as one of form versus function. “What’s more important, federalism, or the liberty that federalism was designed to protect?” Conservatives, on the other hand, might view the choice differently. “Can structures like federalism, so essential to the preservation of freedom, be abandoned any time we dislike state decision-making?”

It would have been nice if the choice were one of doctrine and not of policy. Had the Court been confronted with a simple matter of statutory interpretation, the policy issue would have been moot, and the decision likely unanimous. The doctrinal dilemma was no simpler than the policy one, however. Under the National Bank Act, “[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law.”³⁵ The NBA specifically confers exclusive authority to exercise these powers in the Office of the Comptroller of the Currency.³⁶ “Visitation” has long been recognized by the Court to mean “the act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting business, and enforce an observance of its laws and regulations.”³⁷ The difficult question, however, was whether the NBA and the powers it conferred on the OCC extended to state-chartered but wholly owned subsidiaries of national banks.

The reason why this question is important is because of the implications with regard to a decision either way. As the American Association for Retired Persons (“the AARP”) noted in its *amicus* brief, a decision holding that wholly owned subsidiaries are exempt from state banking regulation because of preemption would mean that these lenders are also exempt from state consumer protection laws.³⁸

³⁵ 12 U.S.C. § 484(a).

³⁶ *Id.*

³⁷ *Guthrie v. Harkness*, 199 U.S. 148, 158 (1905).

³⁸ See AARP Brief at 3, *Watters v. Wachovia Bank*, 127 S. Ct. 1559 (2007) (“At issue in this case is whether the states will be able to protect their citizens from abuses by national banks operating subsidiaries under the states own charters”). See also Brief of Amicus The Center for State Enforcement of Antitrust and Consumer Protection Laws at 1, *Watters v. Wachovia Bank*, 127 S. Ct. 1559 (2007) (“preemption of state banking laws by the Office of the Comptroller of the Currency will result in inadequate protection of consumers against predatory lending practices and other abuses. . . .”).

Such a holding could also provide an avenue for lenders seeking to escape the application of state consumer protection statutes, like predatory lending laws. Lenders could immunize themselves from these regimes by becoming wholly owned subsidiaries of national banks. Indeed, this is not a new fear; it was originally expressed when the NBA was passed nearly 140 years ago.³⁹

From the perspective of lenders, a holding that subjected wholly owned subsidiaries of national banks to state banking regulation would deprive national banks of the ability to partition their assets and reduce overall risk exposure. By requiring national banks to either submit to state banking regulation, on top of federal regulation, or expand their activity by engaging in operations through divisions rather than separate corporate subsidiaries, such a holding would expose national bank assets to variant and disparate risks associated with disparate regulatory and economic conditions in each state. Add to this the exposure to irrational economic regulation at the state level, often under the banner of consumer protection, and the risks associated with state law become a major cost, perhaps a prohibitive cost in some circumstances, of national banking.

Yet, if those were the policy considerations confronted by Congress, why not let Congress choose? The circumstances of *Watters v. Wachovia Bank* and cases like it required courts to determine, given the statutory framework Congress had established and the regulatory regime flowing from it, which choice Congress actually made. In short, it was the business of the Court to make sense of the framework Congress imposed on these and similarly situated parties.

The majority's approach was to consider the implications of the statutory framework established by the NBA and subsequent amendments. It started with *McCulloch v. Maryland*, to establish the uncontested point that "federal law [is] supreme over state law with respect to national banking."⁴⁰ Supreme federal banking law is rooted, then, in the NBA. This statute, enacted in 1864, created a national banking system, which "shields national banking from

³⁹See B. Hammond, *Banks and Politics in America: From the Revolution to the Civil War* 728 (1957) (it was feared that "existing banks would surrender their state charters and re-incorporate under the terms of the new law with national charters").

⁴⁰*Watters v. Wachovia Bank*, 127 S. Ct. 1559, 1566 (2007).

unduly burdensome and duplicative state regulation.”⁴¹ Federally chartered banks are not, however, shielded from state laws of general application to the extent that such laws do not conflict with the letter and purpose of the NBA.⁴² The Court cited “state usury laws” that “govern the maximum rate of interest national banks can charge on loans,” as well as contracts, which are governed by state contract law, as examples of laws of general application.⁴³

“States are permitted,” according to the Court, “to regulate the activities of national banks where doing so does not prevent or significantly interfere with the national bank’s or the national bank regulator’s exercise of its powers.”⁴⁴ Those “powers” include not just those enumerated by the NBA and other federal statutes but also those “incidental” to a national bank’s powers under those federal laws.⁴⁵

The NBA also specifically enumerates mortgage lending among the powers conferred upon national banks:

Any national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to 1828(o) of this title, and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.⁴⁶

What the NBA does not make clear expressly is that a national bank may engage in this activity through a subsidiary. In fact, Depression Era legislation expressly prohibited national banks from investing in other corporations.⁴⁷ The Glass-Steagall Act was crafted in 1933 to prevent banks from exposing their depositors to speculative activities, such as stock speculation in other companies, which was believed to have led to widespread bank failures.⁴⁸ Two years

⁴¹ *Id.* at 1567.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ 12 U.S.C. § 371(a).

⁴⁷ See Jonathan R. Macey, Geoffrey P. Miller, and Richard Scott Carnell, *Banking Law and Regulation* 21 (3d ed. 2001).

⁴⁸ *Id.*

later, in 1935, Congress prohibited national banks from owning shares of any company.⁴⁹ That prohibition persists to this very day.⁵⁰

Despite the prohibition on bank ownership of shares in other companies, the OCC in 1966 determined “that a national bank may acquire and hold the controlling stock interest in a subsidiary operations corporation” as long as that subsidiary engaged in “functions or activities that a national bank is authorized to carry on.”⁵¹ It was the position of the Comptroller that the categorical prohibition on national bank ownership of corporate stock did not prevent ownership of “operating subsidiaries,” authority for which it found in the “incidental powers” provision of the National Bank Act.⁵²

In 1996, the OCC attempted to expand the ownership powers of national banks, issuing a regulation permitting national bank operating subsidiaries to undertake activities that even the national bank itself was not permitted to engage in directly.⁵³ The passage of the Gramm-Leach-Bliley Act in 1999 directly overruled this particular OCC regulation.⁵⁴ Gramm-Leach-Bliley effectively repealed the Glass-Steagall Act’s ban on affiliations between commercial banks and investment banks.⁵⁵ It also acknowledged the power of national banks to own subsidiary corporations. The Act provided, however, that any national bank subsidiary engaging in activities forbidden to the parent bank would be considered a “financial subsidiary” and would be subject to heightened regulatory obligations.⁵⁶ By implication, then, Gramm-Leach-Bliley, while never mentioning “operating subsidiaries” directly, acknowledges them only to the extent that they engage in activities falling within the enumerated or incidental powers granted to national banks under the National Bank Act.

The next question confronted by the Court, was whether a state-chartered operating subsidiary, which is never mentioned by any

⁴⁹Banking Act of 1935 § 308(b), 49 Stat. 709; see also 31 Fed. Reg. 11459 (1966).

⁵⁰See 12 U.S.C. § 24 (Seventh).

⁵¹31 Fed. Reg. 11459 (1966).

⁵²12 U.S.C. § 24 (Seventh).

⁵³12 C.F.R. §§ 5.34(d)(f) (1997).

⁵⁴12 U.S.C. § 371c-1(a)(1).

⁵⁵12 U.S.C. § 101.

⁵⁶See 12 U.S.C. § 371c-1(a)(1).

federal statute (except Glass-Steagall's blanket prohibition of them), could nevertheless invoke the sanctuary of federal preemption when a state attempts to enforce state banking regulations on it. That is the very question that served as the point of disagreement between the majority and the dissent. The dissent, finding no express statutory authority for operating subsidiaries, could not countenance the extension of federal preemption to such unmentioned entities. The majority found the statutory recognition of a national bank's power to own subsidiaries, coupled with the Comptroller's prescriptions regarding operating subsidiaries, as necessarily implying both the authority for their existence and the concomitant protection of federal law.

But why is this implication necessary? According to the majority, it follows naturally from the policy considerations of the alternative outcomes. Should the Court deny preemption in cases involving operating subsidiaries of national banks, the result would be, according to the Court, "significant interference by state regulators,"⁵⁷ with the imposition of "the burdens and undue duplication state controls could produce."⁵⁸

Justice Stevens, in dissent, rejects this policy justification and advances his own as the basis for rejecting the extension of preemption to operating subsidiaries of national banks. He argues that the regulatory competition between state and federal bank regulation, referred to as "competitive equality," is severely undermined with the extension of preemption to such subsidiaries. According to the dissent, "the policy of competitive equality is . . . firmly embedded in the statutes governing the national banking system . . . [s]o firmly embedded, in fact, that 'the congressional policy of competitive equality with its deference to state standards' is not 'open to modification by the Comptroller of the Currency.'"⁵⁹

Those two dueling policy concerns—confusion and burdensome duplication so worrisome to the majority, and the loss of competitive regulatory federalism mourned by the dissent—served as the explicit basis for resolution of the doctrinal dilemma. Beneath the surface,

⁵⁷ *Watters v. Wachovia Bank*, 127 S. Ct. 1559, 1571 (2007).

⁵⁸ *Id.* at 1568.

⁵⁹ *Id.* at 1575 (Stevens, J., dissenting) (quoting *First Nat. Bank in Plant City v. Dickinson*, 396 U.S. 122, 138 (1969)).

however, a different policy debate was brewing. The dissent accurately identifies the risks to federalism posed by the Court's holding.

The Court, however, fails even to mention a policy concern raised by Commissioner Watters and several of the *amici*, namely, that of consumer protection. The commissioner cites her responsibility "to protect consumers from unfair, unsound, and abusive lending practices" as compelling a decision favoring state regulation of state chartered operating subsidiaries like Wachovia Mortgage.⁶⁰ According to Watters, "[s]tates have a substantial interest in protecting their citizens from abusive mortgage practices."⁶¹ Similarly, the Center for State Enforcement of Antitrust and Consumer Protection Laws argues in its amicus brief that "preemption of state banking laws by the Office of the Comptroller of the Currency will result in inadequate protection of consumers against predatory lending practices and other abuses. . . ."⁶² A joint amicus brief by the American Association of Retired Persons, eleven other consumer groups, and seventeen law professors (collectively "AARP") argues that consumer protection was *the* issue before the Court: "At issue in this case is whether the states will be able to protect their citizens from abuses by national bank operating subsidiaries established under the states' own charters."⁶³ AARP contends that states and localities "are much more likely than the federal government to appreciate the impact of abusive lending practices" and that "empirical studies have demonstrated" that state mortgage lending laws "are effective in reducing predatory lending without reducing consumers' access to legitimate credit."⁶⁴

The dissent acknowledges this policy issue in a footnote when it notes that "Michigan laws focus on consumer protection, whereas the OCC regulations quoted by the Court focus on protection of depositors."⁶⁵ Justice Stevens expresses alarm at the fact that federal

⁶⁰Petitioner's Brief at 5, *Watters v. Wachovia Bank*, 127 S. Ct. 1559 (2007).

⁶¹*Id.* at 11.

⁶²Brief of Amicus Center for State Enforcement of Antitrust and Consumer Protection Laws at 1, *Watters v. Wachovia Bank*, 127 S. Ct. 1559 (2007).

⁶³Brief of Amici AARP et al. at 3, *Watters v. Wachovia Bank*, 127 S. Ct. 1559 (2007).

⁶⁴*Id.* at 8, 10.

⁶⁵*Watters*, 127 S. Ct. at 1580 n.18 (Stevens, J., dissenting).

preemption is now being extended to “nonbank companies incorporated under state law.”⁶⁶ This concern arises because, in Justice Stevens’s view, such companies are not even “engaged in the core banking business of accepting deposits.”⁶⁷ It is unclear why he defines “the core banking business” in this way; he does not, for example, explain the business model under which a bank engaged only in accepting deposits can sustain profitability. But with this particular vision of banking in mind, he makes clear his view that consumer protection is being sacrificed to an agency designed to protect banks and their depositors, not consumers.

If consumer protection is such an important state interest, did the Court make the right choice? Can the economy and society withstand both the impairment to federalism and the loss of state enforcement of consumer protection laws in mortgage lending? Had the court addressed this particular question directly, it should have found even more support for extension of preemption to state chartered mortgage lenders like Wachovia Mortgage.

IV. Protecting Consumers from Consumer Protection

A choice between federalism and consumer protection on the one hand, and duplicative state laws on the other, appears to be no real choice at all. Protection of federalism and consumers would seem to justify substantial additional burdens on large national banks and their corporate subsidiaries. But is this the real choice? Do the interests of states in the enforcement of consumer protection laws tip the balance in favor of federalism and state banking controls?

Both the majority and the dissent in *Watters v. Wachovia Bank* wisely avoided this policy issue, albeit for different reasons. While the rhetoric of consumer protection enflames passions in favor of more and expansive regulation, the economics of consumer protection law counsels precisely the opposite. As a result of the rhetoric, consumer protection laws are politically popular, and such measures are increasing in number and scope. Both economists and courts, however, have reached a consensus that consumer protection laws actually hurt those they purport to help.

⁶⁶ *Id.* at 1580.

⁶⁷ *Id.*

A. The Economics of Consumer Protection Laws

Economists have long understood the counterproductive, and indeed counterintuitive, effects of consumer protection laws. Decades of economic studies have demonstrated that consumers suffer as a result of consumer credit regulations. There is a consensus that, in “the longer run, the costs of [consumer credit] regulation are passed on to consumers in one way or another.”⁶⁸ When consumer protection laws make the extension of credit more costly or unprofitable for providers of credit, credit dries up for those who need it most.

A recent “predatory lending” law in Illinois provides a ready example of the inverse relationship between the passage of consumer protection statutes and the welfare of their intended beneficiaries. In July, 2005, Illinois Governor Rod Blagojevich signed into law Illinois House Bill 4050, the “Illinois Fairness in Lending Act.”⁶⁹ The law authorizes the Illinois Department of Financial and Professional Regulation to assemble a database of mortgage applications for nine zip-codes in Cook County, Illinois.⁷⁰ Most of the nine zip-codes are associated with poor to modest income households on the South and Southwest sides of the City of Chicago.⁷¹ Under the new law, the Department of Financial and Professional Services reviews all new mortgage applications in these nine zip-codes, and determines from the terms of the loan agreement whether the applicant needs credit counseling. If so, then the lender must pay the costs of the counseling, which, according to some sources can add as much as \$500 to \$700 to the cost of a loan, and can add as much as 27 days

⁶⁸Richard L. Peterson, *The Costs of Consumer Credit Regulation* at 3 (Credit Research Center Reprint #13, 1979), available at www.business.gwu.edu/research/centers/fsrp/pdf/Reprint13.pdf. See, e.g., Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. Econ. & Bus. 143 (1981) (concluding that borrower protection laws place upward pressure on the interest rates charged by lenders).

⁶⁹765 ILCS 77/70 new §70(c) (West 2007), available at <http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=094-0280>.

⁷⁰Illinois Office of the Governor Press Release, July 21, 2005, available at: <http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=3&RecNum=4166>.

⁷¹Steve Daniels, *New Lending Law Outlines Zip Codes for Credit Counseling*, *Crains Chicago Business*, (January 30, 2006), available at <http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=3&RecNum=4166>

to the loan approval process.⁷² The law also expressly provides that the borrower “may not waive credit counseling.”⁷³ The purpose of the law was “to protect homebuyers from predatory lending in Cook County’s at-risk communities and reduce the incidence of foreclosures.”⁷⁴

As any economist (or economics student) might predict, the Illinois Fairness in Lending Act became the victim of another law, namely, the law of unintended consequences. Instead of protecting hardworking would-be homeowners from predatory lending, the new law protected them from credit. Within just a few months more than 30 mortgage lenders refused to lend on homes purchased in the targeted zip-codes.⁷⁵ Those lenders determined to service these communities saw a rise in their costs, which translated into higher interest rates on their loans.⁷⁶ The poor and moderate income homeowners were not left out of the suffering either: home sales in the designated zip-codes dropped an average of 45 percent in just one month after the bill took effect.⁷⁷ Home prices plummeted, draining relatively poor but hardworking people of what little equity they had in their homes.⁷⁸

It is true that the program that inspired this new law, the Illinois High Risk Home Loan Act of 2003, saw foreclosures drop by 10 percent from 2003 to 2004.⁷⁹ Unfortunately, this statistic reflects the fact that fewer home loans were extended, and those denied happened to be in the lowest income, riskiest categories, for which sub-prime mortgages are the difference between home ownership and renting. The more important statistic, which the State of Illinois had not measured, was the number of *successful* sub-prime loans

⁷²See Letter to Illinois Assembly at: http://www.themortgagereports.com/illinois_house_bill_4050/.

⁷³765 ILCS 77/70 new §70(c) (West 2007) (“The borrower may not waive credit counseling.”).

⁷⁴Illinois Office of the Governor Press Release, July 21, 2005, available at: <http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=3&RecNum=4166>.

⁷⁵See http://www.themortgagereports.com/illinois_house_bill_4050/.

⁷⁶*Id.*

⁷⁷Some neighborhoods (zip code 60629) saw sales drop by as much as 70 percent. *Id.*

⁷⁸*Id.*

⁷⁹Illinois Office of the Governor Press Release, July 21, 2005, available at: <http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=3&RecNum=4166>.

(ones resulting in a home purchase that did not end in foreclosure) forgone because of the new law. In one fell swoop, hardworking, responsible homeowners were made instantly poorer, and hardworking, responsible homebuyers were instantly denied the American dream of homeownership, all because of where they lived and their elected representatives desire to “protect” them.⁸⁰

Illinois politicians are not alone in employing misguided “predatory lending” laws. Other states have increased both the costs and risks to lenders and borrowers in the sub-prime mortgage market, resulting in many of the same unfortunate side-effects as Illinois currently experiences.⁸¹ Georgia’s predatory lending law, for example, “caused secondary market participants to cease purchasing certain Georgia mortgages and many mortgage lenders to stop making mortgage loans in Georgia,” dramatically reducing the availability of credit.⁸²

⁸⁰See *id.* at 144–45; Office of the Comptroller of the Currency, Preemption Determination & Order, 68 Fed. Reg. 46264, 46271 n.26 (Aug. 5, 2003) (“a growing body of evidence indicates that state anti-predatory lending laws are likely to restrict the availability of credit to subprime borrowers”); OCC Working Paper, Economic Issues in Predatory Lending at 2 (July 30, 2003), available at www.occc.treas.gov/workingpaper.pdf (“there is substantial empirical evidence that anti-predatory statutes can impede the flow of mortgage credit, especially to low-income and higher-risk borrowers, and that any reduction in predatory abuses resulting from these measures is probably achieved at the expense of many legitimate loans”). See also Gregory Elliehausen & Michael Staten, Regulation of Subprime Mortgage Products: An Analysis of North Carolina’s Predatory Lending Law (CRC Working Paper #66) (2002), available at www.business.gwu.edu/research/centers/fsrp/pdf/RevisedWP66.pdf; Robert E. Litan, Unintended Consequences: The Risks of Premature State Regulation of Predatory Lending at 15 (American Bankers Association, 2002), available at www.aba.com/NR/rdonlyres/D881716A-1C75-11D5-AB7B-00508B95258D/28871/PredReport200991.pdf (“State and local laws [on predatory lending] threaten to dry up credit for the very same population about which critics of predatory lending are most concerned,” and risk “discouraging the supply of credit to higher risk borrowers” and “to reduce overall lending to subprime borrowers.”); OCC Working Paper, Economic Issues in Predatory Lending *supra* note 81, at 20 (“There is a good deal of empirical evidence to suggest that anti-predatory statutes impede the flow of mortgage credit, especially to low-income and higher-risk borrowers, and any reductions in predatory abuses resulting from these measures are probably achieved at the expense of many legitimate loans.”).

⁸¹See Donald Lampe, Wrong from the Start? North Carolina’s “Predatory Lending” Law and the Practice vs. Product Debate, 7 Chap. L. Rev. 135, 145 (2004) (studies show that “the North Carolina [predatory lending] law’s ‘triggers’ form usury ceilings on residential mortgage loans made after the effective date of the law”).

Other states, like North Carolina, have opted for what was thought to be less draconian predatory lending protection. But consumers have not fared better under these laws, which dry up the availability of credit for those least likely to afford it. Studies of sub-prime mortgage lending in North Carolina before and after enactment of that state's anti-predatory lending law have shown a 15 percent post-enactment decline in sub-prime mortgage placements.⁸³ As a result of its passage, "creditors appear to have sharply restricted lending to higher-risk customers in North Carolina—but not to customers in neighboring states or to lower risk customers in North Carolina—after passage of the law."⁸⁴ After enactment of the law, "significant declines [in mortgage loans] occurred only in North Carolina and only among the lower-income borrowers. Neither the higher-income borrowers in North Carolina nor borrowers in other states experienced significant declines."⁸⁵ In the end, "the North Carolina statute did impede the flow of mortgage credit to higher-risk borrowers . . . at the expense of many legitimate loans."⁸⁶ In the words of one analyst, studies suggest "that the North Carolina

⁸²Office of the Comptroller of the Currency, Bank Activities and Operations: Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1908 (Jan. 13, 2004); OCC Working Paper, Economic Issues in Predatory Lending, *supra* note 81, at 3, 20 (Fannie Mae and Freddie Mac stopped buying "high cost home loans" after the Georgia Fair Lending Act passed, and the law caused "the nation's seventh largest subprime originator to stop making all subprime loans in Georgia").

⁸³Office of the Comptroller of the Currency, Preemption Determination & Order, 68 Fed. Reg. at 46271 n.26 (citing Keith Harvey & Peter Nigro, Do Predatory Lending Laws Influence Mortgage Lending? An Analysis of the North Carolina Predatory Lending Law, Paper Presented at the Credit Research Conference on Subprime Lending (September 2002)); Elliehausen & Staten, Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Predatory Lending Law, Credit Research Center Working Paper #66 (November 2002); see also OCC Working Paper, Economic Issues in Predatory Lending, *supra* note 81, at 22 (Philadelphia predatory lending ordinance also found to have likely resulted in reduction in legitimate loans).

⁸⁴Elliehausen & Staten, *supra* note 84, at 1.

⁸⁵*Id.* at 15; see also OCC Working Paper, Economic Issues in Predatory Lending *supra* note 81, at 25 (declines were significant and "were found only in the higher-risk segment of the market").

⁸⁶Elliehausen & Staten, *supra* note 84, at 15; see also OCC Working Paper, Economic Issues in Predatory Lending *supra* note 81, at 2, 20 (any putative benefits of the law likely came "at the expense of many legitimate loans"); Keith D. Harvey & Peter J. Nigro, Do Predatory Lending Laws Influence Mortgage Lending?, An Analysis of the North Carolina Predatory Lending Law, 29 J. Real Est. Fin. & Econ. 435 (2004).

'predatory lending' law has led to a reduction in the availability of higher cost or 'subprime' mortgage loan credit in the State."⁸⁷

"Due-on-sale" clauses provide yet another handy example. A due-on-sale clause is a term in a mortgage agreement requiring the balance of the loan to be due and paid upon sale of the underlying real estate.⁸⁸ The sale of the property securing the loan acts to accelerate the loan. In the words of one real estate investment professional, many people . . .

. . . who are not too bright tend to believe lenders want due-on-sale clauses because they are greedy. They then use that notion to rationalize illegal or immoral behavior toward the lender. In fact, the main reasons for due-on-sale clauses is lenders want and need to know to whom they are loaning money and they need to be able to predict roughly when a mortgage will be paid off. If you loaned your car to a friend, who agreed in writing not to let anyone else use it, then you saw it going down the street with some stranger at the wheel, you'd be upset, and rightly so. By the same token, lenders do not like to loan one guy \$100,000 to buy a house then find that someone else now has the house, especially when the new guy has lousy credit and/or inadequate equity or income.⁸⁹

The contractual due-on-sale clauses upheld against state regulation by the Supreme Court in *Fidelity Federal Savings and Loan Association v. de la Cuesta et al.*,⁹⁰ in the words of one commentator, "contribute economic benefit to borrower and lender alike" by keeping interest rates down, fostering the "flow of funds" into state mortgage markets, and helping "to ensure the continued availability of the fixed-rate mortgage, a popular instrument from the borrower's perspective." Fortunately, federal preemption of state "restrictions on

⁸⁷Lampe, *supra* note 82, at 144.

⁸⁸Investorwords.com provides the following definition of "due-on-sale" clause: "A provision in a mortgage enabling the lender to demand full repayment if the borrower sells the mortgaged property." See http://www.investorwords.com/1597/due_on_sale_clause.html.

⁸⁹<http://www.johntreed.com/dueonsale.html>

⁹⁰458 U.S. 156 (1982).

the enforcement of due-on-sale clauses benefits both lenders and borrowers.⁹¹

The same effects can be seen in the area of state usury laws with their interest rate ceilings. In the words of former Federal Reserve Governor Thomas Durkin, “[t]he unanimous or near unanimous view of the profession” of economists is that “ceilings or controls of interest rates have been a bad idea for a long time and will continue to be a bad idea in the future.”⁹² “Nobel Laureate Milton Friedman spoke well for the entire profession in 1970 when he reported, ‘I know of no economist of any standing . . . who has favored a legal limit on the rate of interest that borrowers could pay or lenders receive.’”⁹³

Interest rate ceilings are offered to the voting public as a way to keep the cost of credit under control. Although interest rate ceilings

⁹¹Eric J. Murdock, *The Due-on-Sale Controversy: Beneficial Effects of the Garn-St. Germain Depository Institution Act of 1982*, 1984 Duke L.J. 121, 137, 140 (1984); see also Richard T. Pratt & Tim S. Campbell, *An Economic Analysis of the ‘Due on Sale’ Clause in California Mortgage Markets* 5 (Credit Research Center (CRC) Working Paper #14, Jan. 1979), available at www.business.gwu.edu/research/centers/fsrp/pdf/Mono14.pdf (“economic analysis of the ‘due on sale’ clause . . . demonstrates why unrestricted use of the clause is in the interest of both borrowers and lenders”). See also Grant S. Nelson & Dale A. Whitman, *Congressional Preemption of Mortgage Due-on-Sale Law: An Analysis of the Garn-St. Germain Act*, 35 Hastings L.J. 241, 310 (1983) (arguments for restricting due-on-sale clauses are “not logical”); Thomas Kinzler, *Due on Sale Clauses: The Economic and Legal Issues*, 43 U. Pitt. L. Rev. 441, 460 (1982) (“mortgagors as a whole will benefit through enforcement of [the due on sale clause] because lenders will continue to offer a fixed rate mortgage” and “will be able to charge lower interest rates,” and because enforcing them “insures a supply of mortgage funds for tomorrow’s mortgages”); Alan J. Blocher, *Due-on-Sale in the Secondary Mortgage Market*, 31 Cath. U.L. Rev. 49, 95, 99 (1981) (barring enforcement of due-on-sale clause will drive up interest rates for future borrowers, and “the costs will be borne most heavily by those on relatively fixed incomes, such as the elderly or low-income groups,” and the patchwork of state laws in this area restricting such clauses reduces “the supply of conventional mortgage funding”); Bartke & Tagaropoulos, *Michigan’s Looking Glass World of Due-on-Sale Clauses*, 24 Wayne L. Rev. 971, 1002 (1978) (“A question legitimately may be asked whether a consumer, who is protected to the point that he or she can no longer get home financing because the sources of funds have dried out, is that much better off than before.”).

⁹²Thomas Durkin, *An Economic Perspective on Interest Rate Regulation*, 9 Ga. St. U.L. Rev. 821, 837 (1993), available at www.business.gwu.edu/research/centers/fsrp/pdf/Reprint22.pdf.

⁹³*Id.* at 821 (quoting Milton Friedman, *Defense of Usury*, Newsweek, Apr. 6, 1970, at 79).

are intended to help borrowers, they actually harm them. Interest rate “controls create credit shortages, they impede competition, they waste resources, and probably most tellingly, they do not work anyway.”⁹⁴ Interest rate ceilings actually shut off the flow of credit to the very low-income and high-risk borrowers they seek to help, since these borrowers are precisely the ones for whom the higher risk premium at higher interest rates covers the cost of lending to higher risk consumers. These laws actually promote and fund criminal activity, since rate ceilings make credit unavailable from legitimate lenders, and force high-risk borrowers to turn to loan-sharks. They also victimize the poor by forcing them to purchase goods and services through installment sales, which are merely loan transactions camouflaged as sales transactions, but at inflated prices that reflect the risk associated with the loan.⁹⁵

Consumers have actually benefited when the Supreme Court protected them from consumer protection.⁹⁶ The Court’s decision in *Marquette National Bank v. First Omaha Serv. Corp.*, provides an apt example. In *Marquette National Bank*, the Court held that the National Bank Act preempted state credit card interest rate ceilings except for those imposed by the national bank’s home state.⁹⁷ Likewise,

⁹⁴*Id.* at 837. See also Crafton, An Empirical Test of the Effect of Usury Laws, 23 J.L. & Econ. 135, 140 (1980) (Usury laws lead to a decrease in mortgage loan origination.); Nathan, Economic Analysis of Usury Laws, 10 J. Bank Res. 200, 204 (1980) (“[R]esearch indicates that usury restrictions have limited the flow of credit to mortgage markets.”); Ostas, Effects of Usury Ceilings in the Mortgage Market, 21 J. Fin. 821, 831 (1976) (usury laws reduced mortgage loan volume.).

⁹⁵See, e.g., Christopher DeMuth, The Case Against Credit Card Interest Rate Regulation, 3 Yale J. of Reg. 201, 221 (1986) (“By effectively segmenting the supply of credit and reducing the competition faced by the firms who are superior repricers, usury controls raise net costs of credit. This was the conclusion of one recent study which found that usury controls significantly reduced price competition between finance companies and banks.”) (citing A. Sullivan, Effects of Consumer Loan Rate Ceilings on Competition Between Banks and Finance Companies 20–22 (1981) (CRC Working Paper No. 38)); see also Michael E. Staten & Robert W. Johnson, The Case for Deregulating Interest Rates in Consumer Credit 7, 38, 48, 50 (CRC Monograph #31, 1995), available at www.business.gwu.edu/research/centers/fsrp/pdf/Mono31.pdf.

⁹⁶439 U.S. 299 (1978).

⁹⁷*Id.* See, e.g., Todd Zywicki, The Economics of Credit Cards, 3 Chap. L. Rev. 79, 147 (2000) (“by eliminating archaic and largely ineffective usury restrictions, *Marquette* increased efficiency and competition in the credit card industry, made the market more responsive to consumer demand, and provided large benefits to consumers”).

state laws limiting creditor remedies against debtors, such as garnishment, increase interest rates, drive up the cost of credit, and reduce its availability to the very consumers “protected” by those limits.⁹⁸

B. Judicial Recognition of the Economics of Consumer Protection Laws

Economists are not alone in their understanding of the counterintuitive, inverse relationship between consumer protection laws and the well-being of consumers. Judges have long since come to the same conclusion. Many courts have recognized that protecting a

⁹⁸See, e.g., Richard L. Peterson & James R. Frew, *Creditor Remedy Restrictions and Interstate Differences in Personal Loan Rates and Availability: A Supplementary Analysis 1, 8* (CRC Working Paper #14, 1977), available at www.business.gwu.edu/research/centers/fsrp/pdf/WP14.pdf (“many restrictions on creditors’ remedies are likely to reduce personal loan availability (per capita) and, to a lesser extent, increase personal loan finance rates”; for example, “restrictions on garnishment significantly affected the price and availability of consumer credit,” leading to “significantly elevated finance company personal loan rates,” while “prohibitions against confession of judgment clauses” were linked to “significant increases in loan rates” and “significant reductions in bank personal loan credit availability”); Richard L. Peterson, *The Impact of Creditors’ Remedies on Consumer Loan Charges 4, 7* (CRC Working Paper #15, 1977), available at www.business.gwu.edu/research/centers/fsrp/pdf/WP15.pdf (“bank auto loan rates [were] significantly higher in states with the most restrictive creditor remedies,” and “in every case a lack of restriction on (or prohibition against) a particular creditors’ remedy was associated with lower loan rates”; for example, “State restrictions on attorney fee clauses are associated with 90 basis point increase in bank consumer loan rates,” and restrictions on garnishment increase “consumer finance charges”; moreover, “restrictions on creditors’ remedies also induce lenders to reduce their supplies of consumer credit—both in the aggregate . . . and to the most risky borrower groups”). See also Norman Geis, *Escape from the 15th Century: The Uniform Land Security Act*, 30 *Real Prop. Prob. & Tr. J.* 289, 300 (1995) (“Economists have predicted . . . that the increased cost of lending in the judicial foreclosure states will be reflected in an increased cost of mortgage borrowing”); accord Durham, *In Defense of Strict Foreclosure: A Legal and Economic Analysis*, 36 *S.C. L. Rev.* 461, 495–506 (1985) (increasing obstacles to foreclosure hurts rather than helps consumers); Anne Bradner, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 *Emory L.J.* 971, 997 (1987) (“costs are largely a function of delays built into the system, and the delays [in foreclosure] harm both mortgagor and mortgagee”) (citing Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa’s Traditional Preference for Protection Over Credit*, 71 *Iowa L. Rev.* 1, 9–10, 11–12 (1985)); Note, *Foreclosures, Redemptions, and Homeowners*, 1975 *U. Ill. L.F.* 335, 358–61; Pedowitz, *Mortgage Foreclosure Under the Uniform Land Transactions Act (As Amended)*, 6 *Real. Est. L.J.* 179, 195 (1978); Madway & Pearlman, *Mortgage Forms and Foreclosure Practices: Time for Reform*, 9 *Real Prop. Prob. & Tr. J.* 560, 565 (1974).

particular individual consumer from loan provisions designed to protect the interests of a creditor may actually harm similarly situated consumers in the long run. In *Fidelity Federal Savings & Loan Ass'n v. De la Cuesta*, the Supreme Court upheld a Federal Home Loan Bank Board ("the FHLBB") regulation preempting state laws restricting the enforcement of "due-on-sale" clauses.⁹⁹ In doing so, the Court noted that the FHLBB had reasonably concluded, after economic analysis, that state laws restricting enforcement of due-on-sale clauses "will reduce the amount of home-financing funds available to potential home buyers, and generally cause a rise in home loan interest rates" at borrowers' expense.¹⁰⁰ Although the Court did not exercise its own independent judgment about whether enforcement of due-on-sale clauses was good for consumers, in deferring to the FHLBB it noted that there was nothing "arbitrary or capricious" about the FHLBB's conclusion, which was supported by both analysis and rulings from a number of courts.¹⁰¹

In fact, many other courts agreed with the FHLBB that imposing restrictions on the enforcement of due-on-sale clauses would hurt the very consumers such restrictions purport to help, mortgage borrowers. The United States Court of Appeals for the Fourth Circuit, for example, in *Williams v. First Federal Savings & Loan Ass'n of Arlington*, rejected challenges to the enforceability of a mortgage's due-on-sale clause without proof of impairment of security under Virginia's antitrust and common law.¹⁰² The Court noted that such challenges might immediately benefit "a relative few" homeowners, but that they would cause far more harm to similarly situated prospective homeowners in the future. According to the court, invalidation of the due-on-sale clause in that case would "inexorably lead

⁹⁹*Fidelity Federal Savings and Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982).

¹⁰⁰*Id.* at 168 (quoting the FHLBB's Schott Advisory Opinion); accord *id.* at 169 (citing risk that "flow of home loan funds . . . will be reduced" and savings and loans' very solvency will be endangered). Similarly, analysts have found that this Court's decision in *Marquette National Bank v. First Omaha Serv. Corp.*, 439 U.S. 299 (1978), which held that the National Bank Act preempted state credit card interest rate ceilings except for those imposed by a national bank's home state, had clearly positive results for consumers and resulted in the democratization of credit markets in the United States. See *infra* at 14; Todd Zywicki, *The Economics of Credit Cards*, 3 Chap. L. Rev. 79, 147 (2000).

¹⁰¹*Id.* at 169.

¹⁰²651 F.2d 910, 930 n.47 (4th Cir. 1981).

to an increase in interest rates” and “all future purchasers of homes in the end would suffer.” The Court noted that the purported “beneficence” of protecting borrowers from the clause is “short-sighted,” since this would “necessarily restrict, if not dry up, mortgage funds available to the next generation of borrowers.”¹⁰³

The Massachusetts Supreme Judicial Court, in a similar case, observed that enforcement of a due-on-sale clause was good for consumers, since it “lowers the interest rate at which the bank is willing to loan money” by reducing the lenders risks associated with interest rate fluctuations.¹⁰⁴ The court concluded that “[e]limination of the [due-on-sale] clause ‘will cause widespread hardship to the general home-buying public.’”¹⁰⁵ Other state courts reached similar conclusions.¹⁰⁶ A majority of jurisdictions routinely enforce due-on-sale clauses, while only a minority bars their enforcement under state common law.¹⁰⁷

¹⁰³*Id.* (quoting *Wellenkamp v. Bank of America*, 21 Cal.3d 943, 954, 148 Cal. Rptr. 379, 386 (Cal. 1978) (Clark, J., dissenting)).

¹⁰⁴*Dunware v. Ware Savings Bank*, 423 N.E.2d 998, 1001–02 (Mass. 1981).

¹⁰⁵*Id.* at 1004 (quoting Federal Home Loan Bank Board Advisory Opinion No. 75-647, at 37 (July 30, 1975)).

¹⁰⁶*United Savings Bank Mut. v. Barnette*, 695 P.2d 73, 76 (Or. App. 1981) (noting “the substantial benefits that due-on-sale clauses have on interest rates and loan availability”); *Income Realty & Mortgage Inc. v. Columbia Savings & Loan Ass’n*, 661 P.2d 257, 261–63 (Colo. 1983) (restricting enforcement of due-on-sale clauses will “necessitate an increase in the interest rate of new loans”; “The due-on-sale clause was of benefit to both” lender and borrower, since “the borrowers received a lower interest rate than they would have, if there had been no such clause.”); *Martin v. Peoples Mutual Savings & Loan Ass’n*, 319 N.W.2d 220, 226–28 (Iowa 1982) (“economic and social consequences of nullifying the due-on-sale provisions” include “charging new borrowers a higher rate of interest than they would otherwise be required to pay”; *Occidental Savings & Loan Ass’n v. Venco Partnership*, 293 N.W.2d 843, 847, 849 (Neb. 1980) (if such clauses are not enforced, “ultimately, no one will be able secure satisfactory financing”; accordingly, “a ‘due on sale’ clause is not repugnant to public policy but, to the contrary . . . the clauses may favor the public interest”); *Lake v. Equitable Sav. & Loan Ass’n*, 674 P.2d 419, 422 (Idaho 1983) (“less money available to potential borrowers” if borrowers shielded from enforcement of such clauses); *Weiman v. McHaffie*, 470 So.2d 682, 684 (Fla. 1985) (restricting enforcement of the clause causes “shortage of mortgage money” for buyers); *Malouff v. Midland Federal Savings & Loan Ass’n*, 509 P.2d 1240, 1244–45 (Colo. 1973) (barring such clauses would “increase monthly payments and make the obtaining of such [mortgage] loans prohibitive to many people”) (citation omitted).

¹⁰⁷*Lake*, 674 P.2d at 423.

In short, it is well-recognized by both economists and jurists that credit regulations aimed at protecting consumers often actually hurt them. But just because consumer protection laws are at best ill-advised, and at worst irrational, should courts impose preemption to protect consumers from consumer protection?

While the public choice analysis of the costs and benefits of state versus federal regulation of banking and preemption of consumer protection laws is a question for another article, the immediate policy question for the Court demands an immediate answer. The proliferation of state consumer protection measures, with an absence of the very same measures at the federal level, seems to suggest that federal legislation is less likely than its state counterpart to take the form of irrational, inefficient, and harmful consumer protection laws. Given this likelihood, federal regulation of banking appears to be superior to state regulation. But employment of federal preemption as a check on runaway state consumer protection legislation is a blunt instrument. The purpose of the present discussion is to lay bare the unsubstantiated claim that deference to federalism and state regulation of banks brings with it advantages for consumers through state consumer protection laws. A long line of economic analysis has demonstrated that this claim is far from the truth.

V. Conclusion: The End of the Dual Banking System?

If preemption removes a number of lenders and their customers from the reach of state predatory lending laws, the harmful effects of such state statutes might be mitigated. But the demise of federalism can be exaggerated. First, only wholly owned subsidiaries of national banks are sheltered from state regulation by NBA preemption. Many state chartered institutions will continue to be regulated by state banking and consumer protection laws, and many will have very little choice about it.

Second, the opportunity for state chartered lending institutions to “flee the jurisdiction” by becoming acquired by a nationally chartered bank is not “forum shopping” in the pernicious meaning of the phrase. Forum shopping is bad when it occurs *ex post*, when parties to a transaction seek a favorable outcome by seeking a biased arbiter. On the contrary, *ex ante* forum shopping is what federalism is all about. Parties should exercise their constitutional right to interstate travel, for example, and “vote with their feet” when encountering an inhospitable legal or regulatory climate. Debtors do this all

the time.¹⁰⁸ Why should creditors be different? In other words, pre-emption of state banking law in the narrow case of wholly owned operating subsidiaries of national banks may actually *promote and enhance* federalism, by providing lenders with an *ex ante* choice of legal regime, one that forces regulators to compete for their “business.” In the end, federalism, the system of dual banking, and consumer welfare may all actually be enhanced, not threatened, by the Court’s decision in *Watters v. Wachovia Bank*.

¹⁰⁸See, for example, G. Marcus Cole, *The Federalist Cost of Bankruptcy Exemption Reform*, 74 *Am. Bankr. L.J.* 227, 229 (2000) (discussing “the market for deadbeats” by considering how variations in laws can facilitate exit strategies for certain kinds of debtors); see also Frank H. Buckley and Margaret F. Brinig, *The Market for Deadbeats*, 25 *J. Legal Stud.* 201 (1996) (analyzing the factors that cause debtors to migrate to more favorable jurisdictions).