Legal Backgrounder

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PARTING THE *WATTERS*: TORT LAW PREEMPTION SIGNALS FROM HIGH COURT'S BANKING OPINION

by

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Over the past dozen years, the United States Supreme Court repeatedly has been drawn into disputes in tort litigation regarding the proper balance between federal regulatory authority over the safety of consumer products and an individual plaintiff's ability to challenge the adequacy of federal safety standards in state tort litigation. In some cases, the Court held that state tort claims impermissibly conflicted with federal standards and were preempted.[1] In others, the Court held that state tort claims did not conflict with federal standards and could proceed.[2] And in still other cases, the Court has reached a middle ground, holding that the viability of the state tort claims at issue turned on the degree to which they conflicted with the federal regulatory regime.[3] In its October 2006 term, the Court signaled that it is prepared to tackle state tort law preemption yet again, twice asking the United States Solicitor General to weigh in on petitions for certiorari seeking review of preemption decisions involving FDA-approved products,[4] and accepting certiorari at least insofar as preemption claims involving medical devices (with the petition on prescription drug preemption still pending).

With the stakes of state tort litigation ever increasing and with the makeup of the Court having recently changed with the addition of Chief Justice Roberts and Justice Alito, industry and plaintiffs groups alike have a

[1]*Buckman Co. v. Plaintiffs' Legal Committee*, 531 U.S. 341 (2001) (tort claim based on fraud on the FDA preempted); *Geier v. American Honda Motor Co.*, 529 U.S. 861 (2000) (tort claim based on failure to install airbags in automobile preempted).

[2]*Sprietsma v. Mercury Marine*, 537 U.S. 51 (2002) (tort claim based on failure to install propeller guard in boat not preempted).

[3]*Bates v. Dow Agrosciences, LLC*, 544 U.S. 431 (2005) (defective design and manufacturing, negligent testing and breach of warranty claims involving pesticide efficacy not preempted, but failure to warn and fraud claims remanded for further consideration of conflict with federal regulation of labeling); *Medtronic, Inc. v. Lohr*, 518 U.S. 470 (1996) (tort claims involving §510k "substantially equivalent" medical devices not preempted, but indicating that preemption would bar claims involving medical devices subject to more rigorous FDA safety review).

[4]*See* Greg Stohr, *Supreme Court may hear Wyeth case*, Bloomberg News, May 21, 2007, http://www.dailyrecord.com/apps/pbcs.dll/article?AID=/20070521/BUSINESS/705210377/1003 (requesting U.S. views on whether to accept certiorari review of Vermont Supreme Court opinion rejecting preemption in prescription drug case); *Amicus* Brief for the United States, *Riegel v. Medtronic, Inc.*, No. 06-179 (U.S. May 2007) (responding to Court request in another case, United States advised against accepting certiorari review of Second Circuit opinion holding that preempted tort claims involving Class III medical device were preempted).

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significant interest in any signals from the Court on where it may be heading on such preemption issues in the future. Recently, the Court has provided one possible clue from an unexpected source – the dispute over state efforts to regulated subsidiaries of national banks. *Watters v. Wachovia Bank, N.A*., 550 U.S. ___ , 127 S. Ct. 1559 (2007). In this LEGAL BACKGROUNDER, we review the Court's recent holding preempting state banking laws and read the tea leaves to foretell what tidings the opinion holds for future preemption rulings in tort litigation.

***The Supreme Court's Preemption Decision in* Watters v. Wachovia Bank**. In *Watters,* decided on April 17, 2007, the Supreme Court held that Michigan statutes requiring mortgage lending corporations to register with the state and become subject to state regulation, were preempted by the National Bank Act ("NBA") for mortgage lenders that are operating subsidiaries of national banks. The decision found that such operating subsidiaries are entitled to the same deference as their national bank parents under the NBA and the regulations of the national banks' primary federal regulator, the Office of the Comptroller of the Currency ("OCC").

The Supreme Court's agreement to hear this case last year generated great interest in the banking world. A number of state bank regulators, like Michigan's Commissioner of Financial Services Linda Watters, and state attorneys general around the country had been asserting their claimed legal authority over most corporations conducting lending operations in their states in order to enforce state consumer protection laws. While these state officials acknowledged that federal law preempted national banks from such state regulation and enforcement, they argued that subsidiaries of national banks like Wachovia Mortgage Corporation were *not* entitled to avoid state law requirements. The disagreement had become very pointed when the OCC repeatedly reiterated its right to be the exclusive regulator of both national banks and all of their operating subsidiaries. Opposing groups angrily responded that the OCC had exceeded its authority to preempt state laws without clear congressional authority to do so. They also contended that OCC was not aggressively enforcing consumer protection laws and that the states would do a better job protecting consumers. The majority decision of the Supreme Court did not comment on the subjective issue of whether OCC is the best regulator for consumer protection issues, but it clearly settled the dispute about whether national bank subsidiaries are subject to such state laws. They are not.

The Supreme Court's decision was delivered by Justice Ginsburg with Justices Kennedy, Souter, Breyer and Alito joining her opinion. Justice Stevens wrote a dissenting opinion (longer than the majority opinion) in which Chief Justice Roberts and Justice Scalia joined. Justice Thomas recused himself.

The Court's decision outlined the nearly two hundred year history of national bank regulation by the federal government with numerous Supreme Court decisions confirming the OCC's regulatory authority over nearly all aspects of national bank operations. The NBA gave national banks both enumerated powers and "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 Seventh. The NBA also gave "visitorial powers" over such banks (*i.e.*, to examine, audit and supervise them) to the OCC to the exclusion of state regulators. 12 U.S.C. § 484(a). The Court then pointed out that real estate lending is one of the specifically enumerated powers of national banks under the NBA, while one of the national banks' recognized "incidental powers" is to conduct certain of their activities through operating subsidiaries.

Citing a long line of prior decisions by the Supreme Court clarifying that national banks may not be subjected to unduly burdensome or duplicative state regulation, the Court pointed out that even Commissioner Watters recognized the federal preemption of her state's laws for national banks, with Watters arguing only that operating subsidiaries were not so entitled because subsidiaries were not expressly identified for preemption rights in the NBA. The majority decision countered that it was not possible to ascribe a motive to the 1864 Congress that enacted the pertinent provisions of the NBA because operating subsidiaries of national banks were not even authorized until 1966. But the NBA's reference to "incidental powers" was nonetheless broad enough to allow subsidiaries that carried out the same authorized powers as their national bank parents to also be entitled to the same preemptive authority over state laws.

The Supreme Court also noted that as recently as 1999 in the Gramm-Leach-Bliley Act, Congress had specifically clarified that "operating subsidiaries" of national banks were subsidiaries that could engage only in activities in which national banks could engage and were subject to the same kind of regulation as national banks. The OCC's regulations and other publications similarly confirm OCC's pervasive authority to examine, supervise and regulate such operating subsidiaries in the same manner as their parent national banks. As a result, these

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subsidiaries should likewise be free from significant interference by state regulators, reasoned the Court, particularly for mortgage lending activities of subsidiaries like Wachovia Mortgage Corporation, which are carrying on "the business of banking" governed by the NBA.[5]

Finally, the Court summarily rejected Commissioner Watters' Tenth Amendment argument because the power to regulate banking was delegated to Congress under the Constitution under both the Commerce Clause and the Necessary and Proper Clause making the Tenth Amendment inapplicable. (The Tenth Amendment reserves to the States only powers *not* delegated to the federal government in the Constitution.)

The dissenting opinion (J. Stevens with C.J. Roberts and J. Scalia) argued that the majority had improperly deferred to the OCC's self-proclaimed authority to supervise subsidiaries to the exclusion of the states in which they conduct business. No act of Congress has immunized those subsidiaries from state law and the "incidental powers" provision of the NBA did not do it either, reasoned the dissent, which warned against giving too much preemptive authority to agencies like the OCC. The majority decision responded directly to this conclusion at footnote 13 of the Court's opinion, by pointing out that "the [dissent's] lengthy discourse on the dangers of vesting preemptive authority in administrative agencies" is beside the point because the majority held that the NBA itself – independent of OCC's regulations – preempted the Michigan laws from applying to national bank's operating subsidiaries. 127 S. Ct. at 1572 n. 13.

But the dissent also addressed the consumer protection issue that made this case so keenly watched in the banking industry. It argued that federal regulation should not preempt state requirements unless the latter actually conflict with federal laws or interfere with federal regulation. The dissent doubted that the Michigan consumer protection laws do either, stating that there is "no evidence, and no reason to believe, that compliance with the Michigan statutes imposed any special burdens on Wachovia Mortgage's activities," and finding it "especially troubling that the Court so blithely preempts Michigan laws designed to protect consumers," when consumer protection is a "field which the states have traditionally occupied." 127 S. Ct. at 1580-81 (Stevens, J. dissenting) (citations omitted)

What Signals Does* Watters *Send Regarding Preemption in Tort Litigation? In addition to the banking community, the Supreme Court's opinion in *Watters* was eagerly anticipated by a variety of regulated entities as to which federal agencies have expressed concerns over inconsistent or conflicting state law. In the area of state tort law in particular, federal agencies such as FDA, NHTSA, and CPSC have recently voiced concerns about the risks to public health that arise where state law imposes requirements that depart from the agencies' expert safety standards.[6] In response, those agencies have announced through regulations and regulatory preambles their views that federally-imposed safety standards preempt conflicting state tort law.[7] As with the OCC's efforts to clarify and maintain its plenary authority over the regulation of subsidiaries of national banks, these federal pronouncements have resulted in a predictable drawing of legal battle lines between industry and plaintiff advocacy groups. And as with state efforts to impose their own

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[5]Both banks and their subsidiaries are subject to state laws that do not conflict with federal banking statutes or regulations, but the majority decision did not believe this was an issue in this case because making mortgage loans is unquestionably a core banking function regulated by the OCC.

[6]*See* Requirements on Content and Format of Labeling for Human Prescription Drug and Biological Products, 71 Fed. Reg. 3922, 3935 (Jan. 24, 2006) ("FDA Preamble") (state tort law requirements on labeling of prescription drugs can, *inter alia*, "discourag[e] safe and effective use of approved products or encourage[e] inappropriate use"); Federal Motor Vehicle Safety Standards; Roof Crash Resistance, 70 Fed. Reg. 49,233, 49,245-46 (proposed Aug. 23, 2005) (to be codified at 49 C.F.R. pt. 571) ("NHTSA Proposed Rule") (fears of state tort liability would encourage carmakers to strengthen car roofs to the point that vehicles would become top heavy and more likely to roll over); Final Rule: Standard for the Flammability (Open Flame) of Mattress Sets, 71 Fed. Reg. 13,472, 13,496 (Mar. 15, 2006) (to be codified at 16 C.F.R. pt. 1633) ("CPSC Final Rule") ("State requirements intended to reduce the risk of mattress fire, no matter how well intentioned, have the potential to undercut the [CPSC's] uniform national flammability standard").

[7]FDA Preamble, 71 Fed. Reg. at 3934 ("FDA believes that under existing preemption principles, FDA approval of labeling under the act, whether it be in the old or new format, preempts conflicting or contrary State law."); NHTSA Proposed Rule, 70 Fed. Reg. at 49,246 +mn ("if the proposal were adopted as a final rule, it would preempt all conflicting State common law requirements, including rules of tort law."); CPSC Final Rule, 71 Fed. Reg. at 13496 ("The Commission intends and expects that the new mattress flammability standard will preempt inconsistent state standards and requirements, whether in the form of positive enactments or court created requirements.").

disparate state law requirements on national bank subsidiaries, the ability of states to impose through tort law their own disparate safety standards on federally-regulated activities will likely turn on the degree to which the courts defer to these federal agency pronouncements.

What then does *Watters* portend for the future of preemption of state tort claims? While one must be careful in reading *Watters* beyond its banking realm, the Court's reasoning evidences a broad view of federal preemption that suggests that federal agency concerns about state tort law may get a receptive hearing. Although the majority went to some pains to avoid the question of what deference to give regulatory pronouncements that exclaim the right of the agency's regulations to preempt state law, in numerous parts of its opinion, the Court appears to rely on OCC's views as to the scope of its federal regulatory authority. (OCC attorneys took an active part in the *amicus* briefing in the *Watters* case.) Thus the federal agency's position helped build the necessary foundation for the Court's holding that state regulation of national bank subsidiaries would impermissibly interfere with federal authority. The Court also rejected the dissent's reliance on the "presumption against preemption" and the argument that preemption required some express statement by Congress of a preemptive intent. In addition, rather than requiring a direct conflict, as the dissent urged, the Court properly recognized that even "duplicative" state examination, supervision, and regulation of national bank subsidiaries would impermissibly interfere with OCC's regulatory authority. Finally, the majority was not swayed by the State's argument that its regulation of national bank subsidiaries was designed to protect consumers obtaining loans.

Watters thus reaffirms the reasoning set forth in the Court's state tort preemption opinions in *Geier v. American Honda Motor Co.*, 529 U.S. 861 (2000) and *Buckman Co. v. Plaintiff's Legal Committee*, 531 U.S. 341 (2001). In *Geier*, the Supreme Court held that a plaintiff's state tort claims for failure to include automobile safety air bags were impliedly preempted despite holding that the claims did not fall within the scope of an express preemption provision in the National Traffic and Motor Vehicle Act. The Court was guided by the NHTSA's judgment – set forth in an *amicus* brief – "that safety would best be promoted if manufacturers installed alternative protection systems in their fleets rather than one particular system in every car." 529 U.S. at 881. The Court deferred not so much to the NHTSA's position that state law claims should be preempted, but to the NHTSA's view of its federal authority and the degree to which the proposed state tort rule intruded upon the agency's regulatory choice. In *Buckman*, the Court likewise focused on the impact that the proposed state tort law claims of fraud-on-the-FDA would have on the ability of FDA to pursue its somewhat delicate balance of regulatory objectives. The Court rejected plaintiffs' argument that its proposed state tort claims were consistent with the federal objective of preventing fraud, agreeing instead with the position expressed by the United States as *amicus* that "State-law fraud-on-the-FDA claims inevitably conflict with the FDA's responsibility to police fraud consistently with the Administration's judgment and objectives." 531 U.S. at 350.

Watters provides a mixed signal on any potential shift in the Court from the addition of Justice Alito (who joined the majority holding that state banking laws were preempted) and Chief Justice Roberts (who joined the dissent). This split among the new Justices could signal a more difficult road for preemption advocates, because Chief Justice Rehnquist and Justice O'Connor had both joined the pro-preemption opinions in the most sharply divided tort preemption cases, *Geier* and *Lohr*. However, reading the Justices is particularly tricky in preemption jurisprudence – where judicial leanings often cross predictable conservative-liberal lines – and the differences between banking regulation and state tort claims may alter an individual Justice's perspective. Justice Scalia, for example, joined the pro-preemption opinions in *Geier* and *Lohr*, but drafted the anti-preemption dissent in *Watters*.

Conclusion. *Watters* provides a clear victory for the OCC and federal control over the regulation of subsidiaries of national banks. It also provides some favorable signals for preemption advocates more broadly, including in state tort litigation where the conflict between state law and federal regulatory objectives is coming increasingly to the fore.

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