

CRACKING THE DOOR TO STATE RECOVERY FROM FEDERAL THRIFTS

DANIEL M. ATTAWAY*

Cite as: Daniel M. Attaway, *Cracking the Door to State Recovery from Federal Thrifts*, 3 SEVENTH CIRCUIT REV. 275 (2007), at <http://www.kentlaw.edu/7cr/v3-1/attaway.pdf>.

INTRODUCTION

From the end of October 1929 to the end of November 1929, the stock market lost over one hundred billion dollars in value.¹ At the time, the loss represented over thirty times the entire federal budget of three billion dollars.² By 1933, the nadir of the Great Depression, nearly 1,700 state chartered savings and loans had failed,³ and almost half of all home loans were in default.⁴ Compounding the crisis, the

* J.D. candidate, May 2008, Chicago-Kent College of Law, Illinois Institute of Technology; B.A. English, B.S.Ch.E., May 2001, Rice University. The author would like to thank his friends and family who have supported him through school, career changes, and even more school. The author also wishes to especially thank those people who provided much helpful criticism for this Note.

¹ CNN.com, *October 29, 1929: "Black Tuesday"*, <http://www.cnn.com/2003/US/03/10/sprj.80.1929.crash/> (last visited Nov. 25, 2007).

² NEW YORK: A DOCUMENTARY FILM (PBS 2007).

³ *WFS Fin. Inc. v. Dean*, 79 F. Supp. 2d 1024, 1026 (W.D. Wis. 1999).

⁴ *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig.*, 491 F.3d 638, 641-42 (7th Cir. 2007) (citing *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S.141, 159 (1982)). The case name changed between the district court opinion and the Seventh Circuit opinion because Ocwen changed its name and charter. In future short citations, the district court case, *In re Ocwen Federal Bank FSB Mortgage Servicing Litig.*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *4 n.2 (March 22, 2006), is referred to as "*In re Ocwen I.*" The Seventh Circuit opinion, *In*

average household owed almost 20% of its income to creditors—an increase of over 10% from 1929.⁵ Forty-five percent of all farm mortgages were in default and home mortgage defaults were above 38% in over half of twenty-two metropolitan areas.⁶ Ten million people were unemployed, and nearly four and a half million people had lost their homes and were living in the streets.⁷

Many modern economists believe that the severity of the Great Depression is partly explained by the collapse of the banking system.⁸ Afraid of runs and the increasing defaults on their balance sheets, bankers further tightened credit—hoarding cash to remain solvent, but depressing macroeconomic output and worsening the economic depression in the process.⁹

During the Great Depression, Congress attempted to save the failing banking industry, expand credit, and prevent millions more people from being forced into the streets by enacting the Home Owners' Loan Act of 1933 (“HOLA”).¹⁰ HOLA restored confidence in the banking industry and to end what President Franklin Delano Roosevelt called the rapid “deflation which was depriving [through

re Ocwen Loan Servicing, LLC Mortgage Servicing Litig., 491 F.3d 638, 641-42 (7th Cir. 2007), is referred to as “*In re Ocwen II*.”

⁵ BENJAMIN BERNANKE, *ESSAYS ON THE GREAT DEPRESSION* 46 (2000).

⁶ *Id.*

⁷ Franklin Delano Roosevelt Memorial, *The Path to Social Justice: Black Tuesday*, <http://www.nps.gov/fdrm/generation/btues.htm> (last visited Nov. 25, 2007).

⁸ BERNANKE, *supra* note 5, at 42-43.

⁹ *Id.* It is a situation that bears many similarities to the financial crisis of 2007. Banks are increasingly taking major writedowns on investments and, if they decide to maintain traditional debt to capital ratios, it could reduce lending by \$2 trillion—representing a severe tightening in credit in the United States. *Bank Capital: Tightening the Safety Belt*, *ECONOMIST*, Nov. 24, 2007, at 77.

¹⁰ Home Owners' Loan Act of 1933 §1, 12 U.S.C. § 1461 (2000). HOLA and the OTS only authorize and regulate federal S&Ls, not federal banks. Federal banks are chartered under the National Bank Act and administered by the Office of the Comptroller of the Currency (“OCC”). Practically, there is little difference between S&Ls and banks, but the OTS mandate is much broader than the OCC's. See Andrew T. Reardon, *An Examination of Recent Preemption Issues in Banking Law*, 90 IOWA L. REV. 347, 363-64 (2004).

default and subsequent foreclosure] many millions of farm and home owners from the title and equity to their property.”¹¹

HOLA created a federally backed and administered system of savings and loans (“S&Ls”), and created what is now the Office of Thrift Supervision (“OTS”).¹² The OTS is the agency charged with developing and administering regulations that provide for the “examination, safe and sound operation, and regulation of [S&Ls].”¹³ Congress gave the OTS “the plenary and full authority . . . to regulate all aspects of the operations of Federal [S&Ls].”¹⁴ The OTS’ “plenary and full” authority means its regulations are “preemptive of any state law purporting to address the subject of the operations of a Federal savings association.”¹⁵ This authority allows the OTS to preempt state laws and regulate “the powers and operations of every Federal [S&L] from its cradle to its corporate grave.”¹⁶ State regulations and common law actions are valid only if they “incidentally affect the lending operations of Federal [S&Ls],” as required by the OTS preemption regulation, 12 C.F.R. § 560.2(c).¹⁷

Courts have generally interpreted HOLA and the OTS’ implementing regulations to pre-empt almost all claims against federal S&Ls.¹⁸ Even when federal law or the regulations do not provide a

¹¹ Signing statement of Franklin D. Roosevelt on HOLA, June 13, 1933, in *THE AMERICAN PRESIDENCY PROJECT* (John Woolley and Gerhard Peters, eds.), <http://www.presidency.ucsb.edu/ws/?pid=14665> (last visited Nov. 25, 2007).

¹² See 12 U.S.C. § 1462(4) (2000). The administrative agency has had several names since its inception. The most recent change was in 1989, when Congress renamed it the OTS. *In re Ocwen Federal Bank FSB Mortgage Servicing Litig.*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *4 n.2 (March 22, 2006). For consistency, OTS is used to refer to the agency or any of its predecessors.

¹³ 12 U.S.C. § 1463(a)(1) (2000).

¹⁴ 12 C.F.R. § 545.2 (2007).

¹⁵ *Id.*

¹⁶ *Fid. Fed. Sav. and Loan Ass’n v. de la Cuesta*, 458 U.S. 141, 145 (1982) (internal quotations and citations omitted).

¹⁷ 12 C.F.R. § 560.2(c) (2007).

¹⁸ See *de la Cuesta*, 458 U.S. at 151, n.9 (providing a survey of relevant federal and state cases where state law was preempted by OTS regulations).

private cause of action, the courts generally do not assert jurisdiction¹⁹ because “[e]ven the States’ salutary effort to redress private wrongs . . . cannot be exerted to regulate activities that are potentially subject to the exclusive federal regulatory scheme.”²⁰ Under much of the federal courts’ jurisprudence, national banks are exempt from state regulation unless Congress or the OTS explicitly authorizes the state regulation.²¹

Recently, the Seventh Circuit decided *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litigation* (“*In re Ocwen II*”).²² In it, the court explicitly rejected the OTS’ analysis of its own preemption regulation (12 C.F.R. §560.2), and expanded what actions only “incidentally affect” S&L operations.²³ The court refused to dismiss the state and common law claims as preempted under HOLA.²⁴ The opening, though limited, allows for some private actions against federal S&Ls and creates a less deferential test for what only incidentally affects a federal S&L.²⁵

Part I of this Note provides an overview of the historical development of the courts’ extremely deferential attitude towards HOLA and the OTS regulations, and the courts’ willingness to find in favor of preemption. Part II traces the procedural history and holding of *In re Ocwen*, and analyzes the court’s reasoning and support for creating a modified analytical framework for judging when state law claims are allowable. Part III discusses the competing interests on both sides of the state law preemption debate, and discusses how allowing

¹⁹ *Silvas v. E*Trade Mortgage Corp.*, 421 F. Supp. 2d 1315, 1320 (S.D. Cal. 2006).

²⁰ *Id.* (quoting *San Diego Bldg. Trades Council v. Garmon*, 359 U.S. 236, 247 (1959)); *see also* *Haehl v. Wash. Mut. Bank, F.A.*, 277 F. Supp. 2d 933, 942 (S.D. Ind. 2003) (State tort law can only be applied to federal S&Ls when it “incidentally affects” lending operations and will not prove to be a regulation on a preempted area.); *but see* *Barnett Bank v. Nelson*, 517 U.S. 25, 33 (1996) (State regulation of federal thrifts is permissible only when it “does not prevent or significantly interfere with the national bank’s exercise of its powers.”).

²¹ Evan B. Berg, *Interstate Banking and Consumer Protection: Curtailing the Comptroller’s Preemption Power*, 15 ANN. REV. BANKING L. 497, 502 (1996).

²² 491 F.3d 638 (7th Cir. 2007).

²³ *See generally id.*

²⁴ *Id.*

²⁵ *Id.*

additional state regulation and private causes of actions could both help and hinder consumer protection. Finally, Part IV concludes that Judge Posner and the Seventh Circuit reached the correct conclusion in the case and that, on balance, some limited state regulation of federal S&Ls will make the system stronger as a whole.

PART I: THE COMPLETE HISTORY OF U.S. FEDERAL BANKS (ABRIDGED)

For most of the history of the United States, the federal government has had a love/hate relationship with the idea of a national banking system; popular fears of large banks and “trusts” resulted in numerous state and federal laws restricting branch banking.²⁶ The law and competition between state and national banking schemes kept the barriers for banking entry low and encouraged the growth of small, independent banks.²⁷ Traditionally, bank failures in the United States occurred more often than failures in countries with centralized banking systems.²⁸ Additionally, the smallness of U.S. banks made financial panics, or “runs,” much more devastating.²⁹ It was not until 1933, after the collapse of the banking system, that Congress began to seriously regulate the industry.³⁰ In the years since the New Deal, federal agencies have increasingly regulated the banking and lending

²⁶ BERNANKE, *supra* note 5, at 44 (2d prtng. 2004).

²⁷ *Id.*

²⁸ *Id.* at 44-45.

²⁹ *Id.* A “run” on a bank occurs when depositors are afraid a bank may be insolvent and move to withdraw their money. A large withdrawal by depositors forces the bank to quickly liquidate assets. If the forced liquidation price is significantly lower than the assets’ value, the bank may suffer financial losses and actually cause the bank to fail. *Id.* at 45.

³⁰ The New Deal saw the rise of the administrative state. Beyond HOLA, these New Deal laws included the Securities Act of 1933, 48 Stat. 74 (codified as amended at 15 U.S.C. § 77(a) (1933) (regulating the sale of securities); the Securities Exchange Act of 1934, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a) (1934) (creating the Securities and Exchange Commission); the Glass-Steagall Act, 12 U.S.C. § 377 (1933) (repealed by the Gramm-Leach-Bliley (Financial Modernization) Act, Pub. L. No. 106-102, 113 Stat. 1341 (1999)) (creating the Federal Deposit Insurance Corporation and dividing banks into commercial and investment enterprises).

industry.³¹ In the case of S&Ls, however, courts have adopted an extremely deferential attitude to regulations from the OTS.³²

A. Historical Development of the National Banking System

Almost since the inception of the United States, the government has fought over whether or not a national bank was necessary. George Washington signed the charter for the First National Bank in 1791, although he had doubts that a national bank was constitutional.³³ As originally conceived, the bank had private shareholders in addition to the U.S. government, and also had greater operating powers than state banks.³⁴ In 1811, James Madison—a Democratic-Republican—allowed the Bank’s twenty year charter to lapse.³⁵ Just five years later,

³¹ See Reardon, *supra* note 11, at 363-64. Based on the economic evidence from the period, the slow financial recovery after the March 1933 “bank holiday” would have been much more difficult without extensive government intervention. The “bank holiday” was the period in March 1933 when President Roosevelt ordered all U.S. banks closed (“on holiday”) until the federal government could determine the bank was solvent. After a bank was reviewed and determined solvent, it was allowed to reopen for business. See BERNANKE, *supra* note 5, at 65.

³² Reardon, *supra* note 11, at 358.

³³ R. Seymour Long, *Andrew Jackson and the National Bank*, 12 THE ENGLISH HISTORICAL REVIEW 45, 85, 88 (Jan. 1897). Hamilton and other Federalists saw the banks as necessary to create their vision of America as a commercial empire. For Hamilton, the bank offered the benefits of a uniform paper currency, better administration of public finances, more efficient tax collection, and a stronger national economy. TREASURY DEP’T (Alexander Hamilton), REPORT ON THE BANK OF THE UNITED STATES (1790), reprinted in LEGISLATIVE AND DOCUMENTARY HISTORY OF THE BANK OF THE UNITED STATES: INCLUDING THE ORIGINAL BANK OF NORTH AMERICA (Matthew St. Clair Clarke & David A. Hall, eds., 1832), at 15. Jefferson and the Democratic-Republicans saw the federal government as having more limited powers. See *Jefferson Versus Hamilton on the Bank of the United States*, in AMERICAN LEGAL HISTORY, at 137 (Kermit L. Hall et al., eds., 2005) [hereinafter *Jefferson v. Hamilton*]. The Democratic-Republicans believed that since the Constitution did not expressly grant the power to establish a national bank, banking was a state issue and a national bank was unconstitutional. Long, *supra* note 33, at 88. See Reardon, *supra* note 11, at 350-51.

³⁴ See *Jefferson v. Hamilton*, *supra* note 33, at 137.

³⁵ Long, *supra* note 33, at 88.

however, Madison chartered the Second National Bank to help underwrite the War of 1812.³⁶ In 1819 the U.S. Supreme Court agreed to hear a constitutional challenge to the bank's right to exist.³⁷ The Court first enumerated the idea of implied federal powers in the Constitution and held that the federal government had the authority to create national banks and to preempt state laws attempting to regulate them.³⁸ It was not until 1832 that the national banking system was again challenged.

Andrew Jackson—the first Democratic president—was a staunch opponent of the national bank.³⁹ Jackson vetoed the legislation that would have renewed the Second National Bank's charter and wrote an impassioned veto statement denouncing the bank as unconstitutional.⁴⁰ When the Second Bank's charter expired in 1836, the area of “free” or “wildcat” banking began.⁴¹ The era was characterized by state regulated banks that created “instability in the nation's currency and frequent bank failures.”⁴² The idea of federally authorized banks would not arise again until the Civil War.⁴³ The Union needed to finance the Civil War, but could not legally obtain funds in state bank credit, forcing it to demand payment from banks in gold and tightening the money supply.⁴⁴ The National Bank Act of 1864 established a system of federally regulated national banks capable of printing

³⁶ *Id.*

³⁷ *McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316 (1819).

³⁸ *Id.*

³⁹ Andrew Jackson's Veto Message July 10, 1832, *reprinted in* AMERICAN LEGAL HISTORY, at 161-62 (Kermit L. Hall et al., eds., 2005).

⁴⁰ *Id.*

⁴¹ Reardon, *supra* note 11, at 351.

⁴² *Id.* at 352.

⁴³ *Id.*

⁴⁴ Jonathan R. Macey et al., BANKING LAW AND REGULATION 2-4, at 10 (3d ed. 2001).

money and encouraged state banks to buy government bonds,⁴⁵ but they were not a national banking system.⁴⁶

By the turn of the century, the general sentiment was that President Jackson's views were correct.⁴⁷ The banking system evolved into that of an "independent treasury" almost exclusively regulated by the States.⁴⁸ A series of panics and runs on banks throughout the late 19th and early 20th centuries, however, finally convinced Congress that a national monetary policy was needed.⁴⁹ In an effort to provide greater monetary control over the U.S. banking system, Congress enacted the Federal Reserve Act of 1913.⁵⁰ The system set up a decentralized national monetary system, but still did not provide for oversight or regulation of individual banks.⁵¹ Importantly, the Federal Reserve was not itself designed to be a consumer bank, but a bank for banks; it was meant to set broad monetary policy and to be a bank's lender of last resort so that the bank could remain solvent.⁵² Although the Federal Reserve could set a broad national monetary policy, it could not ensure that banks operated responsibly.

In 1933, the country had almost reached the nadir of the Great Depression.⁵³ Following the stock market crash, there had been a run on banks and credit had all but disappeared.⁵⁴ Over half of the counties in the United States had seen all their S&Ls close and roughly one-fifth of the nation was without access to an institution capable of

⁴⁵ The National Bank Act, 13 Stat. 100 (June 3, 1864) (codified as amended at 12 U.S.C. §§ 21-216d) (2000). The purpose of the National Bank Act was to "provide a national currency secured by a pledge of United States bonds, and to provide for the circulation and redemption thereof." *See* § 38.

⁴⁶ *Id.*

⁴⁷ Long, *supra* note 33, at 99.

⁴⁸ *Id.* *See also* BERNANKE, *supra* note 5, at 45 (2d prtg. 2004) (noting that until the Great Depression, panics were contained by "loose organizations of urban banks" that provided stability).

⁴⁹ BERNANKE, *supra* note 5, at 45.

⁵⁰ Federal Reserve Act, 38 Stat. 251 (codified as amended at 12 U.S.C. §§ 221-522 (2000)).

⁵¹ *Id.*

⁵² *Id.*

⁵³ BERNANKE, *supra* note 5, at 47-48, 62.

⁵⁴ *See generally* BERNANKE, *supra* note 5, at 41-69.

providing a mortgage.⁵⁵ In the wake of the collapse of the state banking system and the severe contraction of credit to homeowners, Congress enacted HOLA.⁵⁶ HOLA created a system of federally-backed and federally-regulated S&Ls to help ensure they would be “permanent associations to promote the thrift of the people in a cooperative manner, to finance their homes and the homes of their neighbors.”⁵⁷

B. The OTS Regulations

To regulate federally-backed banks, Congress created the OTS under the Department of the Treasury.⁵⁸ HOLA gave the OTS “plenary authority to issue regulations governing federal savings and loans.”⁵⁹ The language creating the OTS “expresses no limits on [its] authority to regulate” and even the Supreme Court has noted that “it would have been difficult for Congress to have given the [OTS] a broader mandate.”⁶⁰

From this grant of authority, the OTS developed regulations, including regulations governing its power to preempt state law.⁶¹ The OTS is “authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal

⁵⁵ *Fid. Fed. Sav. and Loan Ass’n v. de la Cuesta*, 458 U.S. 141, 160 (1982).

⁵⁶ *Id.* In the wake of the financial collapse, many traditional lenders left the market almost entirely. For example, life insurance companies made \$525 million in home mortgage loans in 1929, but only \$16 million in 1934. In 1934, the year after HOLA was enacted, seventy-one percent of all home mortgage loans were made by the Home Owners’ Loan Corporation (created by HOLA). *See* BERNANKE, *supra* note 5, at 64-65.

⁵⁷ S.REP. 73RD CONG.-NO. 91, at 2 (1933).

⁵⁸ *de la Cuesta*, 458 U.S. at 162. The original agency was known as the Federal Home Loan Bank Board. OTS is used for consistency. *See supra* note 12.

⁵⁹ *de la Cuesta*, 458 U.S. at 160.

⁶⁰ *Id.* at 161.

⁶¹ The OTS’ authority to regulate is outlined in sections 4(a) and 5(a) of HOLA. *See* 12 C.F.R. § 560.2(a) (2007).

[S&Ls].”⁶² The OTS regulations—which have been upheld by courts—explicitly give it the power to occupy the “entire field of lending regulation for federal [S&Ls].”⁶³ With only very narrow exceptions, “federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities.”⁶⁴

Because of the broad grant of Congressional power in HOLA, the OTS has, “without limitation,” exempted large swaths of S&L operations from state regulation.⁶⁵ These areas include licensing and registration, credit terms offered to customers, servicing fees, disbursements, escrow accounts, insurance on mortgages, and insurance due on sale clauses.⁶⁶ The narrow exception for state laws

⁶² See HOLA §§ 4(a), 5(a) (codified as amended at 12 U.S.C. §§ 1463(a), 1464(a) (2000)).

⁶³ 12 C.F.R. § 560.2(a).

⁶⁴ *Id.* According to the OTS regulations, “‘state law’ includes any state statute, regulation, ruling, order or judicial decision.” *Id.*

⁶⁵ 12 C.F.R. § 560.2(b) (2007).

⁶⁶ See 12 C.F.R. § 560.2(b). (“Except as provided by the exemption section of the regulation, the following types of state laws are preempted without limitation: (1) Licensing, registration, filings, or reports by creditors; (2) The ability of a creditor to require or obtain private mortgage insurance, insurance for other collateral, or other credit enhancements; (3) Loan-to-value ratios; (4) The terms of credit, including amortization of loans and the deferral and capitalization of interest and adjustments to the interest rate, balance, payments due, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan; (5) Loan-related fees, including without limitation, initial charges, late charges, prepayment penalties, servicing fees, and overlimit fees; (6) Escrow accounts, impound accounts, and similar accounts; (7) Security property, including leaseholds; (8) Access to and use of credit reports; (9) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents and laws requiring creditors to supply copies of credit reports to borrowers or applicants; (10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages; (11) Disbursements and repayments; (12) Usury and interest rate ceilings to the extent provided in 12 U.S.C. 1735f-7a and part 590 of this chapter and 12 U.S.C. 1463(g) and § 560.110 of this part; and (13)

arises when a state law “only incidentally affect[s] the lending operations of Federal [S&Ls] or [is] otherwise consistent with the purposes of [this regulation].”⁶⁷ The regulation also provides one additional area that is not preempted and gives the OTS the ability to allow state or common law claims to proceed.⁶⁸ The OTS may declare a state law not preempted if, upon review, it finds that the law: (i) Furthers a vital state interest; and (ii) Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of [the preemption regulation].⁶⁹ In interpreting the statute and the resulting regulations, however, the courts had to determine the level of deference appropriate to both HOLA and the OTS regulations.

C. Judicial Deference to the OTS Regulations

All regulatory agencies are not created equal however, and their regulations are subject to varying degrees of deference—both from the states and from the courts.⁷⁰ With the rise of the administrative state after the New Deal, the tension between conflicting state and federal laws increased.⁷¹ To deal with the conflicts, courts looked to the

Due-on-sale clauses to the extent provided in 12 U.S.C. 1701j-3 and part 591 of this chapter.”).

⁶⁷ 12 C.F.R. § 560.2(c) (2007).

⁶⁸ *Id.*

⁶⁹ *Id.* (“State laws of the following types are not preempted to the extent that they only incidentally affect the lending operations of Federal savings associations or are otherwise consistent with the purposes of paragraph (a) of this section: (1) Contract and commercial law; (2) Real property law; (3) Homestead laws specified in 12 U.S.C. 1462a(f); (4) Tort law; (5) Criminal law; and (6) Any other law that OTS, upon review, finds: (i) Furthers a vital state interest; and (ii) Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of this section.”).

⁷⁰ For example, the OCC, which regulates national banks, has traditionally had much less authority to preempt state law than the OTS, which regulates national S&Ls. See Reardon, *supra* note 11, at 358.

⁷¹ See Reardon, *supra* note 11, at 356.

Supremacy Clause of the Constitution.⁷² Based on the Supremacy Clause, courts developed a body of precedent that determined when, and to what degree, federal regulations would preempt (i.e. supersede) state laws and regulations.⁷³

1. Preemption Doctrine

To determine whether a state law or regulation is preempted, courts first look to Congressional intent.⁷⁴ Depending on Congressional intent, courts may find either express or implied federal preemption.⁷⁵ In express preemption, Congress explicitly states its intent for the federal law to preempt state law.⁷⁶ Even without explicit Congressional language, Courts may still find implied Congressional intent when the language of the statute requires preemption.⁷⁷ There are two types of implied preemption: field preemption and conflict preemption.⁷⁸ In field preemption⁷⁹, the body of federal law is so encompassing that it makes clear Congress implicitly meant to

⁷² *Id.*; see U.S. CONST. art. VI, cl. 2 (“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof, and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”).

⁷³ Reardon, *supra* note 11, at 356.

⁷⁴ Cal. Fed. Sav. & Loan Ass’n v. Guerra, 479 U.S. 272, 280 (1987).

⁷⁵ Gade v. Nat’l Solid Wastes Mgmt. Ass’n, 505 U.S. 88, 98 (1992) (providing an overview of preemption doctrine).

⁷⁶ Berg, *supra* note 21, at 500. See also Bank of Am. v. City and County of San Francisco, 309 F.3d 551, 558 (9th Cir. 2002) (citing *Guerra*, 479 U.S. at 280).

⁷⁷ *Gade*, 505 U.S. at 98.

⁷⁸ Berg, *supra* note 21, at 500.

⁷⁹ An example of this type of preemption would be immigration; federal law, and not state law, is responsible for determining whether an immigrant may legally enter the country, become a naturalized citizen, or be deported. Monica Guizar, *Facts About Federal Preemption: How to analyze whether state and local initiatives are an unlawful attempt to enforce federal immigration law or regulate immigration* (Nat’l Immigration Law Center, Los Angeles, Cal.), June 2007, at 4, available at http://www.nilc.org/immlawpolicy/LocalLaw/federalpreemptionfacts_2007-06-28.pdf.

preempt state regulation.⁸⁰ Conflict preemption occurs when the state and federal schemes are irreconcilable.⁸¹

Determining the scope of preemption—often even express preemption—requires a detailed analysis to determine what, exactly, Congress meant to preempt.⁸² The problem arises because statutory language is open to interpretation by the courts.⁸³ Courts do not generally presume preemption, especially when the federal law or regulations would preempt the traditional police powers of the states.⁸⁴ If, however, there is a significant history of federal regulation in a particular area, the presumption against preemption does not apply.⁸⁵ Traditionally, courts have held that the OTS' regulation of federal S&Ls are so pervasive that they trigger field preemption.⁸⁶ In fact, some courts have created a reverse presumption in dealing with OTS regulations—that state law is always preempted in the face of OTS regulation.⁸⁷

⁸⁰ *Bank of Am.*, 309 F.3d at 558 (9th Cir. 2002) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). This type of field preemption occurs in two situations: (1) the federal law and regulations are so pervasive that they leave no room for state supplementation or (2) the federal law and regulations are so dominant they preclude additional laws. Reardon, *supra* note 11, at 357.

⁸¹ *Gade*, 505 U.S. at 98. *See also* Berg, *supra* note 21, at 500. Conflict preemption occurs when: (1) it is physically impossible to comply with both the federal and state schemes; (2) the state law or regulation thwarts the intent of Congress; or (3) state law preempts the implementation of the federal law or regulation. Reardon, *supra* note 11, at 358-59.

⁸² Reardon, *supra* note 11, at 356-57.

⁸³ *Id.*

⁸⁴ *Id.* at 358-59.

⁸⁵ *United States v. Locke*, 529 U.S. 89, 108 (2000).

⁸⁶ Reardon, *supra* note 11, at 357 n. 80. The Note catalogues several of the important historical Supreme Court cases where the Court has simply deferred to the OTS regulations. This presumption is important because it often shifts the burden of proof. The OTS' regulations are presumed to preempt state law. Thus, the party challenging the regulation has the burden to show that the state law is not preempted, rather than the OTS having the burden to show that it is.

⁸⁷ *Id.* at 363-64. The article discusses the Ninth Circuit's decision in *Bank of Am. v. City and County of San Francisco*, 309 F.3d 551 (9th Cir. 2002). The opinion concerned banking and S&L regulation (administered by the Office of the Comptroller of the Currency ("OCC") and the OTS, respectively). The court noted

2. Applying Preemption Doctrine to the OTS Regulations

The OTS regulations clearly evince a belief by the agency that Congress granted it the authority to preempt virtually all state regulation.⁸⁸ But a regulatory agency's determination of its power is valid only if the courts uphold both the grant of power and the agency's exercise of it.⁸⁹ If the courts decide that the Congressional grant is unconstitutional, they can limit the ability of the agency to make regulations.⁹⁰ Even if the court holds the grant to be valid, however, they can hold that the regulation is outside the scope of the grant of power.⁹¹

By the time HOLA was passed in 1933, Congress had already evinced a willingness to at least dabble in the banking industry for nearly one hundred fifty years. *McCulloch v. Maryland* first established the Constitutional basis for the federal government to create and regulate a federal banking system.⁹² Since the National Bank Act of 1864 and the Federal Reserve Act of 1913, the Court has recognized that interpreting Congressional banking regulations was an

that federal banking was a traditionally preempted area and stated that it would give deference to the agencies' regulations as long as they were reasonable. Interestingly, however, the court did not analyze the reasonableness of the regulations, but simply stated the regulations were reasonable. *Id.*

⁸⁸ See generally 12 C.F.R. § 560.2 (2007).

⁸⁹ See generally *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837 (1984).

⁹⁰ *Id.* (discussing the standard for deference to administrative regulations and decisions).

⁹¹ *Id.* *Chevron* established a two step test to determine how much deference a court should give to an administrative agency's regulations. First, the court must decide whether Congress explicitly delegated the authority to the agency, and, if so, the reviewing court must defer to the agency's decision unless the delegation of authority was clearly unconstitutional. If Congressional delegation in the statute is ambiguous, the court will defer to the agency if the agency's interpretation is reasonable and the regulation is not clearly arbitrary or capricious. *Id.* at 842-43.

⁹² 17 U.S. (4 Wheat) 316 (1819) (holding Congress had the implied power to create a national banking system and that a state may not impede the exercise of that constitutionally granted power).

exercise in “interpreting grants of both enumerated and incidental ‘powers’ to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law.”⁹³

By the end of the 20th century, both the various circuit courts and the Supreme Court supported the idea that federal regulation of federal banks is so “pervasive as to leave no room for state regulatory control.”⁹⁴ The courts have also held that the OTS’ regulatory power—while leaving the states some room over traditional common law areas and incidental regulations—effectively preempted the field.⁹⁵ The regulations receive a presumption of field preemption because “there has been a ‘history of significant federal presence’ in national banking [and] the presumption against preemption of state law is inapplicable.”⁹⁶ Thus, judicial deference and the history of federal regulation grant the OTS wide latitude in preempting state law affecting S&Ls.⁹⁷

The OTS had promulgated its own interpretation of how its preemption regulations should be interpreted.⁹⁸ The OTS guidelines use a two step analysis to determine whether a state statutory or common law action is preempted.⁹⁹ Under this analysis, the court must first ask whether the state law attempts to regulate any area explicitly preempted by 12 C.F.R. § 560.2(b)—even if the regulation would be indirect.¹⁰⁰ If the answer is yes, then the state law claim is automatically preempted by HOLA and 12 C.F.R. § 560.2(c) cannot

⁹³ *Barnett Bank of Fla. v. Nelson*, 517 U.S. 25, 32 (1996) (tracing the history of preemption from *McCulloch* to the present day).

⁹⁴ *Conference of Fed. Sav. & Loan Ass’ns v. Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff’d*, 445 U.S. 921 (1980).

⁹⁵ *Bank of Am. v. City and County of San Francisco*, 309 F.3d 551, 558-59 (9th Cir. 2002).

⁹⁶ *Bank of Am.*, 309 F.3d at 558-59 (9th Cir. 2002) (citing *United States v. Locke*, 529 U.S. 89, 108 (2000); *Barnett Bank*, 517 U.S. at 33 (1996); *Franklin Nat’l Bank v. New York*, 347 U.S. 373, 375-76 (1954)).

⁹⁷ *Bank of Am.*, 309 F.3d at 558-59 (9th Cir. 2002) (citing *Locke*, 529 U.S. 89, 108 (2000); *Barnett Bank*, 517 U.S. at 33 (1996); *Franklin Nat’l Bank*, 347 U.S. at 375-76 (1954)).

⁹⁸ 61 Fed. Reg. 50,951, 50, 966-67 (Sept. 30, 1996).

⁹⁹ *Id.*

¹⁰⁰ *Id.*

“save” the action.¹⁰¹ Only if the answer is no may the court determine whether the law is not preempted by § 560.2(c) because it would only have an incidental affect on S&L operations.

Finally, the OTS has taken the Supreme Court’s invitation to “not feel bound by existing state law.”¹⁰² For example, federal and state banks were generally not allowed to expand beyond state lines until 1994, when Congress expressly permitted interstate bank acquisitions regardless of state law.¹⁰³ Under OTS regulations, however, federal S&Ls were allowed to take over failing S&Ls in other states without regard to state law, and by 1992, the OTS had abolished all geographic limitations on S&L expansion.¹⁰⁴ The OTS has continued to aggressively assert its regulatory preemption powers, especially in the areas of establishing branch offices, lending activities, and deposit-taking activities.¹⁰⁵ Recently, in 2003, the OTS issued opinions exempting federal S&Ls from state predatory lending laws in Georgia, New York, New Jersey, and New Mexico.¹⁰⁶

Because the Supreme Court expressly left open the question of whether all state regulation of federal S&Ls was preempted by HOLA, lower courts have been forced to determine the level of preemption.¹⁰⁷ For many courts, including the Seventh Circuit, the question has been answered with almost complete deference to the OTS regulations.¹⁰⁸ Only in a minority of courts and jurisdictions have any state regulations been allowed, even when there are only incidental effects

¹⁰¹ *Id.*

¹⁰² *Fid. Fed. Sav. and Loan Ass’n v. de la Cuesta*, 458 U.S. 141, 162 (1982).

¹⁰³ Riegle-Neal Interstate Banking and Branching Efficiency Act, Pub. L. No. 103-328, 108 Stat. 2338 (1994) (codified as amended at 12 U.S.C. § 1 (2000)).

¹⁰⁴ Arthur E. Wilmarth, Jr., *The OCC’s Preemption Rules Exceed the Agency’s Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225, 282-83 (2004).

¹⁰⁵ *Id.* at 285-86.

¹⁰⁶ *Id.* at 286.

¹⁰⁷ *de la Cuesta*, 458 U.S. at 159; *see also* Wilmarth, *supra* note 104, at 285.

¹⁰⁸ *See, e.g.*, *Haehl v. Washington Mut. Bank, F.A.*, 277 F. Supp. 2d 933, 942 (S.D. Ind. 2003), *Wis. League of Fin. Inst., Ltd. v. Galecki*, 707 F. Supp. 401, 404 (D. Wis. 1989), *Moskowitz v. Wash. Mut. Bank*, 768 N.E.2d 262, 264-66 (Ill. App. Ct. 2002); *Bank of Am. v. City and County of San Francisco*, 309 F.3d 551, 558-60 (9th Cir. 2002).

to the banking system.¹⁰⁹ Generally, courts, including both the Illinois state courts and the Seventh Circuit, have been content to preempt all state regulation of federal S&Ls. As justification, these courts cite the long history of significant federal regulation, judicial deference, and the OTS' interpretation of its preemption power.

PART II: IN RE OCWEN

In re Ocwen resulted from the consolidation of a number of complaints brought against Ocwen Loan Servicing, LLC (“Ocwen”)¹¹⁰ into a multi-district litigation (“MDL”) class action.¹¹¹ By 2006, fifty-one plaintiffs had joined the litigation and the Consolidated Complaint listed twenty-three different counts.¹¹² In addition to federal claims under the Fair Debt Collection Practices Act¹¹³ and the Real Estate Settlement Procedures Act,¹¹⁴ the plaintiffs alleged violations of various state consumer protection statutes and common law counts for, among other things, fraud, unjust enrichment, and breach of contract.¹¹⁵

¹⁰⁹ See, e.g., *Gibson v. World Sav. & Loan*, 128 Cal. Rptr. 2d 19, 27-31 (Cal. Ct. App. 2002); *Wells v. Chevy Chase Bank*, 832 A.2d 812, 824-33 (Md. 2003).

¹¹⁰ Ocwen Loan Servicing, LLC was, at the time relevant for the litigation, a federally chartered S&L. Although Ocwen did not actually originate home mortgages, it bought mortgages from other lenders and then administered collecting payments, premiums, and, if necessary, instituted foreclosure proceedings. *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig.*, 491 F.3d 638, 641 (7th Cir. 2007).

¹¹¹ Transfer Order from the MDL Panel Establishing MDL 1604, *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig.*, No. 04-C-02714 (Apr. 16, 2004).

¹¹² *In re Ocwen Fed. Bank FSB Mortgage Servicing Litig.*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *1 (March 22, 2006).

¹¹³ 15 U.S.C. §§ 1692a – 1692p. (2000).

¹¹⁴ 12 U.S.C. §§ 2601 – 17 (2000).

¹¹⁵ See generally Consolidated Class Action Complaint, *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2004 WL 3688469 (Aug. 23, 2004). The claims encompassed state laws in California, Connecticut, Illinois, New Mexico, and Pennsylvania. *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig.*, 491 F.3d 638, 641 (7th Cir. 2007).

The plaintiffs alleged that Ocwen breached their loan agreements by “ignoring grace periods, misapplying and failing to apply loan payments, improperly charging late fees, and force-placing insurance on properties already insured.”¹¹⁶ According to the plaintiffs, this often caused the plaintiffs to be unable to meet their payments, and resulted in Ocwen foreclosing on their mortgages.¹¹⁷ In their complaint, the plaintiffs sought statutory, compensatory, and punitive damages, restitution and an injunction against Ocwen from engaging in similar misconduct.¹¹⁸

A. Procedural History

On April 25, 2005, the district court for the Northern District of Illinois granted Ocwen’s motion for a partial summary judgment, dismissing a single contract claim, but specifically reserving judgment on the rest of the plaintiffs’ state and federal law claims.¹¹⁹

In July 2005, Ocwen filed a motion to enjoin what was, in effect, parallel litigation in the Texas state courts by three Texas law firms that also represented members of the plaintiffs’ class.¹²⁰ The district court enjoined the Texas proceeding, but was reversed on appeal.¹²¹ In reversing the district court, the Seventh Circuit held that “[a]lthough an injunction prohibiting discovery could be appropriate in some circumstances, the broad injunction prohibiting all litigation [in the state of Texas] by the Texas law firms is not supported by the record in this case.”¹²²

¹¹⁶ *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *1 (N.D. Ill. Mar. 22, 2006).

¹¹⁷ Consolidated Class Action Complaint, *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2004 WL 3688469 (Aug. 23, 2004).

¹¹⁸ *Id.*

¹¹⁹ *In re Ocwen I*, No. MDL 1604, 04-C-2714, at *1 (N.D. Ill. Apr. 25, 2005).

¹²⁰ Prelim. Inj. Motion, *In re Ocwen I*, No. MDL 1604, 04-C-2714 (N.D. Ill. July 29, 2005).

¹²¹ *Id.*, see Brief For Appellants, *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *8-12 (N.D. Ill. Mar. 22, 2006); *In re Ocwen I*, No. 05-4268, slip op. at 4 (7th Cir. Dec. 13, 2005).

¹²² *In re Ocwen I*, No. 05-4268, slip op. at 4 (7th Cir. Dec. 13, 2005).

During this time, both parties continued to file motions.¹²³ Ocwen filed motions to dismiss the complaint based on preemption of state law claims, failure to state a claim, and for lack of personal jurisdiction.¹²⁴ The plaintiffs continued to add new named plaintiffs and filed numerous motions to remand various issues to state courts.¹²⁵

In January of 2006, the parties and the district court agreed on an order for determining the numerous outstanding motions.¹²⁶ All parties and the court agreed that most, if not all, of the state causes of action would be dismissed if the court found them preempted by the OTS regulations.¹²⁷ Thus, the agreement stipulated that Ocwen's motion for dismissal of the state law claims would be the first motion decided.¹²⁸ The district court ordered additional briefing in light of the Seventh Circuit's order vacating the injunction against the Texas law firms and ruled on March 22, 2006.¹²⁹

In its ruling, the district court noted that "[s]tate regulation of banking is permissible when it 'does not prevent or significantly interfere with the national bank's exercise of its powers'."¹³⁰ The district court used this concept and the exceptions to federal preemption listed in 12 C.F.R. § 560.2(c) to allow the state law claims to proceed.¹³¹ According to exception six under § 560.2(c), a state law

¹²³ See Docket, *In re Ocwen I*, No. MDL 1604, 04-C-2714 (N.D. Ill.).

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *2 (N.D. Ill. Mar. 22, 2006).

¹²⁷ *Id.*

¹²⁸ *Id.* The district court ordered additional briefing on the issue because it felt that they related to whether to joined state law claims in the consolidated litigation could go forward.

¹²⁹ See generally *id.*

¹³⁰ *Id.* at *4, (citing *Bank of Am. v. City and County of San Francisco*, 309 F.3d 551, 558-59 (9th Cir. 2002) (quoting *Barnett Bank of Fla. v. Nelson*, 517 U.S. 25, 33 (1996))).

¹³¹ *Id.* at *4-5 (March 22, 2006). "State laws governing federal S&Ls are accepted for the following categories when they only 'incidentally affect' lending operations: (1) Contract and commercial law; (2) Real property law; (3) Homestead laws specified in 12 U.S.C. 1462a(f); (4) Tort law; (5) Criminal law; and (6) Any other law that OTS, upon review, finds: (i) Furthers a vital state interest; and (ii)

may regulate a federal S&L when there is a vital state interest and it would further the aims of HOLA.¹³² The court reasoned that consumer protection was a vital state interest, satisfying the first part of the test.¹³³ The district court then reasoned that Congress intended for HOLA to protect consumers, and that allowing the state law claims to proceed would further Congressional intent.¹³⁴ The court allowed Ocwen to file an interlocutory appeal to decide “whether . . . HOLA and its implementing regulations . . . preempt plaintiffs’ state-law claims challenging the mortgage-servicing activities of, and loan-related fees allegedly assessed by, a federal [S&L].”¹³⁵

B. The Seventh Circuit’s Opinion

A Seventh Circuit panel consisting of Judges Posner, Rovner, and Sykes heard the appeal on March 28, 2007 and Judge Posner issued the opinion of the panel on June 22, 2007.¹³⁶ Judge Posner, writing for the court, noted that HOLA does not create private rights of action and gives the OTS only limited remedial authority to enforce its regulations.¹³⁷ In doing so, Judge Posner adopted the reasoning of the district court, and placed consumer protection above a general

Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of this section.” 12 C.F.R. § 560.2(c) (2007).

¹³² 12 C.F.R. § 560.2(c)(6). This is the language that the district court seizes on to deny Ocwen’s motion to dismiss. It is interesting to note, however, that the actual wording of the regulation gives the OTS, not the courts, the final authority to determine whether or not a particular state law meets the criteria. (“Any other law that OTS, upon review, finds . . .”). *Id.*

¹³³ *In re Ocwen I*, at *4 (N.D. Ill. March 22, 2006).

¹³⁴ *Id.* The court also took notice of the Seventh Circuit’s decision to allow the state law claims in Texas to proceed. According to the court’s reasoning, had the Seventh Circuit felt the state law claims had been preempted, it would not have allowed the Texas state law actions to proceed. *Id.*

¹³⁵ Appellants’ Opening Brief, *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2006 WL 2788080 (Sept. 13, 2006).

¹³⁶ *See In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig.*, 491 F.3d 638, 643 (7th Cir. 2007).

¹³⁷ *Id.*

preemption of the field.¹³⁸ The court affirmed the district court's refusal to dismiss the complaint, but also provided an analysis of the state law claims—giving insight into which claims it thought were preempted and which it did not.¹³⁹

1. The Court's Analysis

It is useful to view the court's opinion as having three parts: in the first, the court discusses the background facts and provides an overview of the law; in the second, the court formulates its own rule; and in the third, the court applies its rule to each of the claims.¹⁴⁰ Judge Posner first noted that the complaint "is a hideous sprawling mess" and that "the defendants [could] hardly be blamed for wanting to strangle the monster in its crib" with the motion to preempt most of the litigation.¹⁴¹ The court noted that "of course" Ocwen was correct that the OTS guidelines should be used to interpret the regulations, and even referred to the line between preempted and non-preempted actions as "both intuitive and reasonably clear."¹⁴² Here, however, is where the party ends for Ocwen.

The court stated that HOLA gave the OTS broad plenary power to issue regulations for federal S&Ls, and gave it some power to enforce its regulations, but it did not give the OTS power to adjudicate disputes between the S&Ls and their customers.¹⁴³ The OTS could not provide a remedy to customers who were harmed by S&Ls who violated OTS regulations.¹⁴⁴ The court also noted that consumer

¹³⁸ *Id.* ("It would be surprising for a federal regulation to forbid the homeowner's state to give the homeowner a defense based on . . . breach of contract."); compare *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *4 (N.D. Ill. Mar. 22, 2006) ("[C]ourts should be cautious in finding preemption in areas of consumer protection.").

¹³⁹ *In re Ocwen II*, 491 F.3d at 644-50.

¹⁴⁰ See generally *id.*

¹⁴¹ *Id.* at 643.

¹⁴² *Id.*

¹⁴³ *Id.* (citing OTS, "How to Resolve a Consumer Complaint 1-2," www.ots.treas.gov/docs/4/480924.pdf. (last visited June 5, 2007)).

¹⁴⁴ *Id.*

protection was part of the reason the OTS was created and given the power to regulate in the first place.¹⁴⁵

By emphasizing the purpose of HOLA, the court restricted the language of preempted areas to the actual language of the statute.¹⁴⁶ This restriction effectively expanded the definition of what it means to “incidentally affect” lending operations.¹⁴⁷ The court recognized that certain common law remedies were enforceable—these remedies may affect S&L operations, but they do so no more than they would affect *any* business.¹⁴⁸ For the court, requiring that S&Ls meet minimum standards of ethical business practice was only an incidental effect on an S&L’s operations, even if it forced the S&L to do something not required—or even allowed—by the OTS regulations.

Interestingly, the first part of the opinion is scant on the law of preemption. The court only mentioned preemption in reference to HOLA, the OTS preemption regulation, and the OTS guidelines for interpreting the OTS’ exemption power.¹⁴⁹ The court did not discuss how other courts, or even past Seventh Circuit panels, have interpreted the preemption authority Congress gave the OTS under HOLA or even how preemption of state law normally arises.¹⁵⁰ On reading the first part of the court’s discussion it appears that the court will hold the OTS’ preemption regulation reasonable without discussion and summarily dismiss the state law claims.

This approach would not be without precedent. The Ninth Circuit, in *Bank of America v. City and County of San Francisco*, noted that regulations must be reasonable, but accepted—without discussion—that the OCC and OTS regulations were reasonable.¹⁵¹ Here, the court seems to accept—without discussion—that the OTS regulations preempt the field. Similarly, it appears here that the Seventh Circuit

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *See generally Id.*

¹⁵¹ *See generally* *Bank of Am. v. City and County of San Francisco*, 309 F.3d 551 (9th Cir. 2002).

accepts as obvious that any state law or regulation that attempts to directly regulate the expressly preempted areas is preempted.¹⁵² It also states that “[i]t would not do to let the broad standards characteristic of [contracts, commercial law, and torts] morph into a scheme of state regulation.”¹⁵³ Reading the outline of the law the court provided makes it initially appear that the court will side with precedent and the Ninth Circuit, and adopt an extremely deferential attitude to the OTS regulations.¹⁵⁴ Yet precisely the opposite happens—after acknowledging the regulations and interpretations, the court proceeds to ignore them.¹⁵⁵

According to the court, subsection (c) of the OTS preemption regulation was not meant to “deprive persons harmed by the wrongful acts of savings and loan associations of their basic state common-law-type remedies.”¹⁵⁶ Judge Posner reasoned that Congress has the power to preempt any remedy other than those it prescribes, or to even bar recovery completely, but it does not do so often.¹⁵⁷ When Congress bars recovery to an injured plaintiff, it is the exception, not the rule.¹⁵⁸ For the court, barring recovery is similar to federal preemption—in order for it to exist, Congress must clearly state its intent that the bar should exist and the reasons for the bar.¹⁵⁹

For the court, the OTS meant for state law to complement federal regulations and subsection (c) of the preemption regulation does so by upholding the basic laws and “norms that undergird commercial transactions.”¹⁶⁰ The court reasoned that the norms will only incidentally affect federal S&L operations because the state’s objective—consumer protection—is not in conflict with the OTS’ objective of providing for the safe and sound operation of federal

¹⁵² *In re Ocwen II*, 491 F.3d at 643.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* at 643-44.

¹⁵⁶ *Id.* at 643 (interpreting 12 C.F.R. § 560.2(c) (2007)).

¹⁵⁷ *In re Ocwen II*, 491 F.3d at 644.

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* (noting that ERISA is an example of a federal law that does bar common law suits).

¹⁶⁰ *Id.*

S&Ls.¹⁶¹ Thus, the court held that despite precedent to the contrary, the general state commercial laws are not preempted precisely because they serve the same purpose as the federal regulations.¹⁶²

This interpretation tends to disregard the OTS guidelines for preemption that, just a few paragraphs before, the court had accepted as obvious. Additionally, the court—like the district court before it—failed to follow the strict letter of the OTS’ preemption exemption subsection. Both the Seventh Circuit and the district court based their opinion on a state’s compelling interest in protecting its resident consumers.¹⁶³ Both courts coupled this compelling consumer protection interest with the idea that state consumer protection laws are complementary to the purpose of HOLA and the OTS in general.¹⁶⁴ And both ignored the part of the regulation that states that only the OTS can decide whether a law serves a compelling state interest and is complementary to the OTS regulations such that it should not be exempted.¹⁶⁵ The court appears to give great deference to the regulations, but bases its fundamental argument on a power the OTS clearly meant to keep out of judicial hands.

The court takes the same approach justifying its interpretation with OTS board decisions. It chooses only those decisions that suit its needs. For example, the court cites to an OTS opinion that states that “[s]tate laws prohibiting deceptive acts and practices in the course of commerce are not included in the illustrative list of preempted laws in section 560.2(b).”¹⁶⁶ The court ignores, however, the OTS opinions from 2003 that expressly preempted federal S&Ls from state predatory lending laws in Georgia, New York, New Jersey, and New Mexico.¹⁶⁷

¹⁶¹ *Id.*

¹⁶² *Id.* at 644-45.

¹⁶³ *See id.*; compare *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *4-5 (March 22, 2006).

¹⁶⁴ *In re Ocwen II*, 491 F.3d 638; compare *In re Ocwen I*, No. MDL 1604, 04-C-2714, 2006 WL 794739, at *4-5 (March 22, 2006).

¹⁶⁵ 12 C.F.R. § 560.2(c) (2007).

¹⁶⁶ *In re Ocwen II*, 491 F.3d at 644 (quoting Preemption of State Law Applicable to Credit Card Transactions ¶IIC (Opinion of OTS Chief Counsel, Dec 24, 1996, 1996 WL 767462).

¹⁶⁷ Wilmarth, *supra* note 104, at 286.

The court gives lip service to judicial deference without actually deferring to the OTS.

In coming to this decision Judge Posner and the court had to at least partially break with the long line of cases where the courts refused to enforce any state law or remedy that might possibly affect some aspect of a federal S&L's operations.¹⁶⁸ By determining that common law actions that complement the intent of the federal regulations are acceptable, the court implicitly broadened the definition of what is incidental.¹⁶⁹ And the court does so while giving the appearance of deference.¹⁷⁰ The standard the court seeks to enforce is a far cry from accepting the OTS regulations as so “pervasive as to leave no room for state regulatory control.”¹⁷¹ “[N]o room for state regulatory control” is a clear statement for the states, and the courts, to practice extreme deference when interpreting the regulations and to almost always err on the side of finding preemption.¹⁷²

By holding that general business law¹⁷³ can apply to federal S&Ls, Judge Posner and the court broaden incidental effects to cover consumer protection.¹⁷⁴ This allows plaintiffs to recover when they may otherwise be barred by either prior precedent or the OTS regulations and guidelines.¹⁷⁵ Rather than applying the idea of a pervasive field preemption, the court seems instead to rely on a conflicts analysis of preemption—only those laws that would directly interfere with the federal regulations are preempted, anything else will

¹⁶⁸ See *supra* Part I.

¹⁶⁹ *In re Ocwen II*, 491 F.3d at 643-44.

¹⁷⁰ *Id.* at 643 (In the opening of the opinion, Judge Posner noted that “of course” the OTS regulations were controlling and that the OTS guidelines should be used to interpret the regulations.).

¹⁷¹ *Conference of Fed. Sav. & Loan Ass'ns v. Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff'd*, 445 U.S. 921, 100 (1980).

¹⁷² *Id.*

¹⁷³ The court talks about general business laws as “state laws prohibiting deceptive acts and practices in the course of commerce.” *In re Ocwen II*, 491 F.3d at 644.

¹⁷⁴ See *id.* at 643-45

¹⁷⁵ See *id.*

be saved.¹⁷⁶ Taken in this light, it becomes clear why the court chose not to set forth the varying standards of preemption. If the court had more clearly articulated the standard, it would have largely constrained itself to applying broad field preemption.¹⁷⁷ By explicitly accepting the OTS regulations as binding, however, the court allows itself greater discretion to interpret the regulation as it sees fit.

This approach allowed the court to interpret the regulation for itself—rather than locking it into deference to the OTS. In doing so, the court seems to implicitly accept that even though business standards may differ dramatically from state to state, applying them to federal S&Ls is an acceptable intrusion into the federal regulatory scheme, even though it may force an S&L to conform to a myriad of rules for different jurisdictions. The court's *coup d'état*, then, is not so much which of the state causes of action are not preempted, but rather that the court's new rule allows the courts—and not the OTS—to decide when state law would apply.

2. Applying a New Standard

The court then used its newfound authority and rule to state, in dicta, “which claims fall on the regulatory side of the ledger and which . . . fall on the common law side.”¹⁷⁸ The court took each state law claim in turn, and determined whether it was: (a) clearly preempted, (b) clearly not preempted, or (c) possibly preempted but more information was needed to decide. This Note does not attempt a claim by claim analysis—a process that the court undertook and that it called

¹⁷⁶ See *supra* Part I. (discussing the different methods, relative strength, and presumptions of the various ways of finding preemption).

¹⁷⁷ The majority of circuit courts have accepted the OTS guidelines as controlling. See generally Wilmarth, *supra* note 104; Reardon, *supra* note 11, at 363-64. Had the Seventh Circuit more clearly articulated precedent, it is likely that it would have been forced to follow the OTS guidelines. See, e.g. Bank of Am. v. City and County of San Francisco, 309 F.3d 551 (9th Cir. 2002). The guidelines forbid reaching any exceptions to preemption if there is any effect on a preempted area listed in subsection (b). See *In re Ocwen II*, 491 F.3d at 643.

¹⁷⁸ *In re Ocwen II*, 491 F.3d at 644.

a “tedious recital.”¹⁷⁹ Reviewing the court’s analysis, a pattern emerges.¹⁸⁰

From the court’s discussion of which causes of action are preempted and which are not, it is clear that the court intends that only those actions which would squarely fall into the regulation of a prohibited area should be preempted and bar recovery. The court seems willing to allow more regulatory control by the states in an effort to do what it feels the federal regulations have failed to do—protect consumers.

First, the court held that only one of the seventeen state law claims was clearly fully preempted.¹⁸¹ Claim thirteen charged fraud and a “gross disparity between the value received by the class and the price paid”¹⁸² under the New Mexico Unfair Practices Act.¹⁸³

The court also stated that many of the claims were allowable because they alleged common law actions. For the court, the key to preemption was whether or not the claim had to be classified as a state law (which would be preempted), or whether it could be a common law action (which would generally not be preempted.)

These claims included additional breach of contract claims (claim five), violations of good faith and fair dealing (claim six), fraud (claims three, seven, and twenty), and slander/defamation (claims seventeen, twenty-one);¹⁸⁴ the slander and defamation claims are of particular interest. Both allege that Ocwen committed a wrongful act by either: (1) instituting an *lis pendens* action against the plaintiffs without a valid basis, or (2) representing to third persons that the plaintiffs were in default.¹⁸⁵ Recovery of some value of a bank’s assets through foreclosure seems to be intimately bound to the regular

¹⁷⁹ *Id.* at 648.

¹⁸⁰ *Id.* at 644-48.

¹⁸¹ *See id.*

¹⁸² *Id.* at 647.

¹⁸³ N.M. STAT. ANN. § 57-12-1 (West 2007).

¹⁸⁴ *See id.* at 644-48.

¹⁸⁵ *Id.* at 648.

operation of any bank or S&L.¹⁸⁶ Here, however, the court holds up both actions as “good example[s] of claim[s] that the regulation does not preempt.”¹⁸⁷

The court could not classify nine of the claims. Of those, four included fraud or negligence allegations.¹⁸⁸ Although these claims were brought under various state and common laws, they suffered from the same fatal flaw—a failure to provide enough information for the court to understand what was being alleged.¹⁸⁹ Three of the claims alleged fraud among other clearly preempted actions.¹⁹⁰ The court stated that the three claims were impossible to classify because they did not provide enough information, were not pled with particularity,¹⁹¹ and were impossible to understand.¹⁹² Similarly, the court stated that another claim was a bare assertion of common law negligence that could not stand without more information.¹⁹³ The court also stated that it was unclear whether five additional claims would be preempted because it was unclear whether the plaintiffs allegations covered preempted areas or not.¹⁹⁴

It is the five unclear claims that provide the greatest insight into the court’s path forward, however. For several of the claims, the court gave the plaintiffs a roadmap to avoid preemption—at least as far as the Seventh Circuit is concerned. For example, one of the claims largely dealt with the fees charged by banks and deceptive advertising

¹⁸⁶ As with any business, banks and S&Ls try to minimize their losses on bad investments. For banks, this means minimizing losses on bad loans through foreclosure and resale.

¹⁸⁷ *In re Ocwen II*, 491 F.3d at 648.

¹⁸⁸ *Id.* at 647-48.

¹⁸⁹ *Id.*

¹⁹⁰ The fifteenth claim alleged fraud under the Pennsylvania Uniform Trade Practices and Consumer Protection Law. *Id.* at 647. The sixteenth claim, brought under the Pennsylvania Fair Credit Extension Uniformity Act, basically alleged “deceptive practices in collection,” but also included numerous references to fraud. *Id.* at 647-48. The twenty-second claim alleged common law fraud. *Id.* at 648.

¹⁹¹ See FED R. CIV. P. 9(b) (requiring that fraud be pled with particularity).

¹⁹² *Id.* at 647.

¹⁹³ *Id.* at 648;

¹⁹⁴ See *id.* at 644-48.

practices.¹⁹⁵ The court held most of the claims preempted, but provided two exceptions.¹⁹⁶ In the first exception, the court noted claims of excess fees are generally preempted under the OTS regulations, but would not be preempted if the claim was based on the terms of the loan contract.¹⁹⁷ Similarly, the court stated that claims of deceptive advertising are preempted if they are based in state laws that require truthful marketing, but are not preempted if they are based on common law fraud.¹⁹⁸ In both cases, the court shows the plaintiffs how to make the claims allowable.

The courts determination on when foreclosure fees are due also shows that the court is, to some degree, failing to faithfully defer to the OTS regulations and guidelines. Under Ocwen's mortgage agreements, the plaintiffs must pay all of the fees to foreclose on their house at the beginning of a foreclosure.¹⁹⁹ The claim alleges that this arrangement violated Illinois state law.²⁰⁰ The court stated that the claim would not be preempted as long as it is based in a breach of contract action.²⁰¹ Here the court clearly expands the definition of "incidentally affects."

Inherent in the court's reasoning is a radical concept—an area that would be traditionally preempted under the OTS regulations (when a plaintiff must pay foreclosure fees) is not preempted if it is based on a common law action.²⁰² Fees are an area clearly preempted by § 560.2(b), but, as long as the issue is contractual and not regulatory, it only incidentally affects Ocwen's operations.²⁰³ This holding clearly furthers the court's purpose of allowing plaintiffs to recover under the common law, even though the claims, pled differently, would be preempted. It is an example of just how powerful the Seventh Circuit's new rule can be.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.* at 647.

²⁰¹ *Id.*

²⁰² *Id.* See also 12 C.F.R. § 560.2(b) (2007).

²⁰³ *In re Ocwen II*, 491 F.3d at 647.

In dicta, the court makes clear that its earlier decision to allow the alternative Texas litigation to proceed was not a fluke and that it did not fail to address the preemption issue.²⁰⁴ In *In re Ocwen*, the Seventh Circuit made a policy judgment. From the opinion, it appears the court believes that some state law claims should go forward, even in areas that would traditionally trigger federal preemption. The careful crafting of the opinion and roadmap to avoid preemption make it clear the court feels that states should—at least to some degree—be involved in the regulation of federal S&Ls that operate within their territory.

To reach this outcome, however, the court must make an end-run around the pervasive OTS regulations and the OTS guidelines for interpreting preemption. The court attempts to strike a balance between protecting consumers through state law and ensuring that the common law actions do not preempt the federal regulations. The court first recognizes that the OTS has preemptive power, but then interprets the OTS regulations and guidelines in a way that gives ultimate control of what is preempted and what is not to the courts—not the OTS.

PART III: TOO HOT, TOO COLD, OR JUST RIGHT?

The question then becomes, how much state regulation is too much? Generally, courts have barely cracked the door to state regulation.²⁰⁵ Opening the door to even slightly more of state regulation of federal banks runs the risk of undermining the OTS' authority to preempt state law.²⁰⁶ Undermining that authority could potentially undercut the power of the OTS to enforce its regulations. However, Judge Posner correctly pointed out that barring any state cause of action in blind deference to the OTS seriously undercuts the

²⁰⁴ *Id.* at 644-48.

²⁰⁵ *See, e.g.,* *Gibson v. World Sav. & Loan*, 128 Cal. Rptr. 2d 19, 27-31 (Cal. Ct. App. 2002); *Wells v. Chevy Chase Bank*, 832 A.2d 812, 824-33 (Md. 2003).

²⁰⁶ 12 C.F.R. § 560.2(a) (2007). Note as well that the OTS has aggressively campaigned to expand its exemption power since the 1970's, and has been largely successful in its expansion. *See generally* Wilmarth, *supra* note 104.

ability of consumers to recover because of a federal S&L's bad or negligent acts.²⁰⁷ There is also the additional worry that too much of a good thing is a bad thing. An extremely deferential court that never challenges the OTS' regulations runs the risk of concentrating unchecked power in the hands of the agency—which means that there is nothing to stop it from serving interests other than those in its mandate.²⁰⁸

It is perhaps easiest to start with where the two sides agree. No one doubts that regulation on banks is necessary; banks are “an unusual mix of hazardous might and fragility.”²⁰⁹ Leading economists, including Ben Bernanke, the Chairman of the Federal Reserve, blame much of the length and severity of the Great Depression on the collapse of the banking system.²¹⁰ Even today, banks' balance sheets are composed of liquid debt (deposits that can be called immediately) and illiquid assets (mortgages and other loans).²¹¹

Without a safety net, a failure of investor confidence creates financial panics where people seek to withdraw money from the system.²¹² This forces banks into a liquidity crisis where they must liquidate their illiquid assets, often below market value.²¹³ It also forces them to keep more money in reserve because of higher risk, thus lowering capital available for lending.²¹⁴ Although the Federal Reserve and the federal regulatory agencies have helped to stabilize the system since the Great Depression, the system is still vulnerable to

²⁰⁷ *In re Ocwen*, 491 F.3d at 642-43.

²⁰⁸ Several commentators already feel the OTS and the OCC have exceeded their Congressional mandates and are in the midst of a power grab from the states. See, e.g. Keith R. Fisher, *Toward a Basal Tenth Amendment: A Riposte to National Bank Preemption of State Consumer Protection Laws*, 29 HARV. J. L. & PUB. POL'Y 981 (Summer 2006); Reardon, *supra* note 11, at 363-64; Donald C. Lampe, *Federal Preemption and the Future of Mortgage Loan Regulation*, 59 BUS. LAW. 1297 (May 2004); Berg, *supra* note 21, at 502.

²⁰⁹ *Economics Focus: When to Bail Out*, ECONOMIST, Oct. 6, 2007, at 90.

²¹⁰ See generally BENJAMIN BERNANKE, *ESSAYS ON THE GREAT DEPRESSION* (2d prtg. 2004).

²¹¹ *Economics Focus: When to Bail Out*, *supra* note 209, at 90.

²¹² BERNANKE, *supra* note 5, at 44-45.

²¹³ *Id.*

²¹⁴ *Id.*

shocks—largely from new financial instruments that are largely unregulated.²¹⁵ Today, those instruments, worth nearly \$1 trillion, are losing hundreds of billions of dollars per month in value, and are increasingly forcing banks to hoard money—similar to banking behavior during the Great Depression.²¹⁶

It is also important to remember that banks and S&Ls are businesses—driven by their shareholders to create new capital. Without regulation, banks—the pillars of capitalism—would act like any other business and seek to maximize profit by minimizing daily operating costs. In other words, banks have an incentive to reduce deposits held in reserve to only the amount necessary to meet daily operating costs and lend the remainder to generate more profit. While this may be fine for normal operations, in the event of a run on the bank, the bank would not be able to meet its obligations and could collapse.²¹⁷ Part of the original mandate in HOLA is to ensure the “safe and sound operation, and regulation of savings associations.”²¹⁸ This can only be done when regulations require banks to hold enough cash in reserve to meet at least mild “rainy day” obligations.

Of course, agreeing that there needs to be regulation is not agreeing to how much regulation is proper. On the one hand are those, including the OTS, who favor only allowing federal regulation. They argue that if the regulation is “too hot” (i.e. states get in the business of requiring additional regulations of federally-backed S&Ls), it would hinder both the OTS’ mandate to provide a stable and uniform system of national regulation and could deter growth in the industry by forcing S&Ls to contend with a plethora of national and state

²¹⁵ Bill Gross, *Beware our Shadow Banking System*, FORTUNE, http://money.cnn.com/2007/11/27/newsmakers/gross_banking.fortune/index.htm?postversion=2007112807 (last modified Nov. 28, 2007). An example would be collateralized debt obligations—the method by which prime and sub-prime loans were “repackaged” and sold.

²¹⁶ *Id.*; compare BERNANKE, *supra* note 5, at 62-64.

²¹⁷ See generally BENJAMIN BERNANKE, *ESSAYS ON THE GREAT DEPRESSION* (2d prtng. 2004); see also *Economics Focus: When to Bail Out*, *supra* note 209, at 90.

²¹⁸ 12 U.S.C. § 1463(a)(1) (2000).

regulations.²¹⁹ Those in favor of greater state regulation argue that if the states are preempted from asserting any power over federal S&Ls and the OTS has only limited enforcement authority, then consumers have no recourse or recovery when S&Ls do commit civil torts.²²⁰ The lack of private causes of action provides incentive for S&Ls to maximize profits with little or no concern for the consumer.²²¹

The days of little or no regulation are well behind the United States. Banks and the federal government have entered into a “regulatory pact”—the federal government agrees to guarantee a bank’s deposits and in return, the bank submits to regulation.²²² Similarly, the central banks in the United States and other countries have successfully fought inflation for much of the past thirty years—leading to complacency and a belief that inflation will stay low and the central banks will step in whenever there is trouble.²²³ But the United States is still a vast territory with widely diverse economies—at best, federal regulations are a compromise and are not what will work best in all situations.

Perhaps most interestingly, according to many modern macroeconomists, the current financial climate looks eerily similar to the climate that supposedly triggered the Great Depression.²²⁴ In the 1920’s, consumers increasingly tapped home equity and credit because the money was easily available.²²⁵ When the stock market crashed and prices began to destabilize, those same consumers were spooked and also began to devote proportionately more money to their debt

²¹⁹ Wilmarth, *supra* note 104, at 285-86, *see also* 12 U.S.C. §§ 1463(a), 1464(a) (2000).

²²⁰ *See generally* Fisher, *supra* note 208; *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig.*, 491 F.3d 638 (7th Cir. 2007).

²²¹ *Economics Focus: When to Bail Out*, *supra* note 209, at 90; *CSI: Credit Crunch*, *ECONOMIST*, Oct. 20, 2007, A Special Report on the World Economy 3, at 6-7 (noting that regulations that do not ensure financial consequences “encourages excessive risk-taking”).

²²² *Economics Focus: When to Bail Out*, *supra* note 209, at 90.

²²³ *See generally Heroes of the Zeroes*, *ECONOMIST*, Oct. 20, 2007, Special Report on the World Economy 8, at 8-16.

²²⁴ *See generally* BERNANKE, *supra* note 199.

²²⁵ BERNANKE, *supra* note 5, at 46.

repayments.²²⁶ With less money to spend on discretionary purchases, demand declined and credit tightened, which caused further deflation.²²⁷ Similarly, banks were afraid of runs and insolvency, and thus held more money in reserve and lent money to only the most credit-worthy customers.²²⁸

Part of Congress' intent in enacting HOLA was to standardize lending practices to specifically avoid speculative lending and to restore the banking industry to solid footing.²²⁹ Arguably, HOLA and the OTS managed to do just that, and, with the help of the Federal Reserve, managed the U.S. economy fairly well. However, by the end of the century, lending credit standards were once again irrationally loose.²³⁰ Headlines for much of 2007 have been concerned with the fact that the average United States consumer had—for the first time in history—a negative savings rate and the effect that exotic loans and easy credit will have now that housing prices are deflating and credit is “crunched.”²³¹ In England, for the first time in approximately 150 years, there was a run on a bank.²³² All these factors contribute to a feeling that the world economy is fragile, although it is unlikely that America or the world would see another Great Depression. The fact that Congress is once again talking about a bailout of consumers for defaulting mortgages shows that, at some level, HOLA and the OTS failed to adequately regulate the system.

There are other interests as well, however, and the consumer is only one side of the coin. Banks and federal S&Ls are, at the end of the day, businesses and as such need an incentive to actually operate—primarily profits. Forcing federal S&Ls to comply with a myriad of state regulations as well as federal regulations runs the risk of creating an overregulated industry and could create excessive litigation that

²²⁶ *Id.*

²²⁷ *Id.*

²²⁸ *See id.* at 62-65. During this period, even people with good credit who were a low credit risk found it increasingly difficult to get loans and mortgages. *Id.*

²²⁹ 12 U.S.C. §§ 1463(a), 1464(a) (2000).

²³⁰ *CSI: Credit Crunch*, *supra* note 221, at 6-7.

²³¹ *Id.* at 6.

²³² *Id.* at 8.

would discourage S&Ls from operating, lessen competition, and generally harm the economy as a whole.

This still leaves us with whether the Seventh Circuit managed to strike an appropriate balance that will maximize both judicial and economic efficiency across the spectrum of players and what implications the court's new approach to banking regulation is likely to have on regulatory enforcement within the court's jurisdiction. It seems likely that, on the whole, the court managed to find a workable balance between state and federal regulation. The court's analysis of the claims makes clear that it is willing to allow states at least some regulatory authority.²³³ It appears that the court feels that the states, and not the federal government, is best able to determine how to protect the interests of its citizens and that, at any rate, federal protection is inadequate.²³⁴ The state law claims that the court allows (i.e. fraud, breach of contract, etc.) are claims that are typically associated with "bad actors" in business.²³⁵ Banks are the engines of capitalism, but they are still businesses—and, like any business, should be answerable to their customers.

Banks are central to the economy, but they occupy a unique position—the federal government insures their deposits to provide the general population with the security of knowing their money will always be available, but this insurance also means that banks are free to take greater risks with those deposits.²³⁶ The federal government will bail them out if their loans go bad and they fail to meet their

²³³ See generally *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litig.*, 491 F.3d 638 (7th Cir. 2007).

²³⁴ See generally *In re Ocwen II*, 491 F.3d 638; see also *On Credit Watch*, ECONOMIST, Oct. 20, 2007, Special Report on the World Economy 3, at 26-34 (arguing that lending regulation is to blame for much of the credit crunch in 2007 and that updates to the regulatory scheme are needed to avoid future economic crises); Bill Gross, *Beware our Shadow Banking System*, FORTUNE, http://money.cnn.com/2007/11/27/newsmakers/gross_banking.fortune/index.htm?postversion=2007112807 (last modified Nov. 28, 2007) (arguing that much of the threat to the banking system results from no regulation of risky investments, such as collateralized debt obligations).

²³⁵ See generally *In re Ocwen II*, 491 F.3d 638.

²³⁶ *Economics Focus: When to Bail Out*, *supra* note 209, at 90.

obligations.²³⁷ Thus, even though there is federal regulation, the system encourages banks to take ever larger risks, often at the expense of their consumers and sometimes without being honest about their true motives. By allowing state law claims that implicate good business practices, the Seventh Circuit attempts to correct for the above market distortion. Forcing banks to be more accountable to their consumers makes them less likely to engage in questionable business practices out of fear of litigation. Here, the Seventh Circuit seems to have struck an appropriate balance between ensuring that American thrifts can compete with foreign banks and ensuring that they are not given free reign to run amok.

PART IV: CONCLUSION

For good or ill, Judge Posner is a paragon of the Chicago School of legal reasoning and is widely recognized as a staunch proponent of using the law to create economic efficiency. Here, Judge Posner seems at his best. He holds as clearly preempted those statutes and common law actions that could lead to conflicting state and federal regulations or that may encroach on the efficacy of the federal regulations.²³⁸ At the same time, his fluid application of what it means to incidentally affect lending operations provides consumers with the one thing HOLA and the OTS lack, private causes of action against bad acting S&Ls. The courts have indicated which types of claims it feels should be allowed, and that, unlike many other courts, it will allow some measure of consumer protection. Ultimately, this will strengthen the banking system by making S&Ls more accountable to their customers and less likely to zealously advocate exotic or risky loans without full disclosure. In short, the Seventh Circuit's compromise sacrifices short term gain for long term growth.

The test articulated by the court redraws the lines of when, and how, the OTS can preempt state law actions. Judge Posner and the court have made it easier for plaintiffs to bring actions against S&Ls

²³⁷ See generally *Lessons from the Credit Crunch*, ECONOMIST, Oct. 20, 2007, Special Report on the World Economy.

²³⁸ *In re Ocwen II*, 491 F.3d at 645-48.

by allowing them to recover for claims based on state laws that come from a vital state interest.²³⁹ Although not all claims may go forward, even under this rubric, it is significantly less deferential than past precedent. It does not dismiss the state law claims out of hand. It also provides—through the courts—an important check on the power of a single regulatory agency to set policy with impunity.

The degree to which those state law claims are allowed to move forward will depend on how courts choose to interpret the OTS' assertion that it can preempt almost all state law. If more courts follow the less deferential position of the Seventh Circuit, the overall benefit may be that banks are less reliant on the government and are ultimately healthier institutions. Allowing at least some state law claims to go forward will force banks to become more accountable to their ultimate consumer, the American people. The Seventh Circuit has started down the path to ensuring that, like other businesses, banks must answer to those whom they serve.

²³⁹ *Id.* at 643-45.