No. 07-4260

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

STATE FARM BANK, F.S.B., ET AL.,
Plaintiffs-Appellants,
v.

JOHN B. REARDON,
Defendant-Appellee.

On Appeal from the United States District Court
for the Southern District of Ohio, No. 2:05CV268

BRIEF OF *AMICUS CURIAE* CENTER FOR RESPONSIBLE LENDING IN SUPPORT OF DEFENDANT-APPELLEE AND ARGUING FOR AFFIRMANCE

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Dated: February 15, 2008

RULE 26.1 DISCLOSURE STATEMENT

The Center for Responsible Lending ("CRL") is a non-profit supported organization under the Internal Revenue Code. CRL's supporting, or parent, organization is the Center for Community Self-Help, which is tax-exempt under section 501(c)(3) of the Internal Revenue Code. The Center for Community Self-Help's mission is to create ownership and economic opportunities for minorities, women, rural residents, and low-wealth families. Neither CRL nor the Center for Community Self-Help has issued shares or securities.

DATED: February 15, 2008

Respectfully submitted,

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Regulations

Other Authorities

INTEREST OF *AMICUS CURIAE*

This brief is filed with the consent of both parties. Fed. R. App. P. 29(a).

Amicus Curiae the Center for Responsible Lending ("CRL") is a non-profit policy, advocacy, and research organization dedicated to exposing and eliminating abusive lending practices in the mortgage market. CRL is an affiliate of Self-Help, a non-profit lender that has provided more than $5 billion in financing to help over 50,000 low-wealth borrowers buy homes, build businesses, and strengthen community resources. Long before the abuses in subprime mortgage lending became widely apparent and depressed American economic growth, CRL sought to focus the public's attention on these problems and to warn about the many under-regulated actors in the industry, including mortgage brokers.

In its work on behalf of consumers, CRL has witnessed the primary role that states have played in enacting and enforcing laws to protect consumers, particularly with respect to the abusive practices of mortgage brokers. Over the past several years, however, federal banking regulators—including the Office of Thrift Supervision ("OTS")—have grown increasingly bold in opining that state regulations seeking to prevent abuses in the mortgage industry are preempted. Here, the OTS has gone so far so to assert that federal law preempts the states' ability to apply their mortgage broker licensing laws to independent contractors of State Farm Bank, F.S.B. ("State Farm Bank"). The interest of CRL therefore

stems from its desire to prevent further abuses in mortgage lending by ensuring that independent contractors of federal savings associations ("FSAs") continue to be subject to the beneficial oversight of state officials.

SUMMARY OF ARGUMENT

State Farm Bank here seeks to attempt to evade Ohio's mortgage broker licensing laws for its third-party independent contractors. If State Farm Bank's arguments prevail, the resulting "agent" loophole could lead to rampant abuses and immunity from state consumer protection statutes by unscrupulous brokers. As the State of Ohio's brief makes clear, the OTS Chief Counsel's assertion that such independent contractor-brokers are exempt from state licensing laws is not supported by either the Home Owners' Loan Act ("HOLA"), 12 U.S.C. § 1461 *et seq.*, or the preemption provisions in the OTS's regulations. Nor did the OTS Chief Counsel have the ability to create such preemption through his opinion letter. Our brief as *amicus curiae* in support of the State of Ohio supplements the State's arguments and focuses on (i) why Ohio's law protecting its citizens from unscrupulous mortgage lenders is not within the scope of OTS preemption and (ii) why the OTS Chief Counsel's Opinion letter does not expand the scope of OTS preemption.

ARGUMENT

I. PREEMPTING A STATE'S ABILITY TO REGULATE INDEPENDENT CONTRACTOR MORTGAGE BROKERS EXTENDS FAR BEYOND THE SCOPE OF OTS PREEMPTION.

Here, State Farm Bank seeks to evade state mortgage broker registration and licensing requirements for its third-party independent contractors. Ohio's mortgage licensing law, Ohio Rev. Code § 1322.01 *et seq*., protects vulnerable consumers from well-documented abusive mortgage lending practices by mortgage brokers. The Ohio law that State Farm Bank has so vehemently fought to preempt as to its independent contractors (the statute does not apply to a FSA's employees) merely requires that persons who assist consumers in obtaining mortgage loans either (i) limit their activity or forego compensation in assisting consumers with mortgage loans, or (ii) qualify and obtain a mortgage broker's license, or (iii) obtain a loan officer's license and work as an employee of a licensed broker. *See* Ohio Rev. Code §§ 1322.01(E), (G), 1322.02. Moreover, the mortgage broker qualification requirements that State Farm Bank so adamantly opposes are minimal: requiring registration, three years of experience in mortgage lending or other experience approved by the State, and payment of a fee. *Id*. § 1322.03.

Misconduct by mortgage brokers—and the compensation systems and lack of regulation that allowed unscrupulous conduct to occur—have garnered much

Congressional and media attention in light of the current mortgage market crisis.[1] Broker regulation—and the prevention of broker abuses—have emerged as critical components of state laws and federal legislative proposals that seek to prevent abusive and unsound mortgage lending practices. Even the National Association of Mortgage Brokers supports requirements that all mortgage originators be licensed and regulated as necessary prophylactic measures to control and prevent future mortgage crises:

> [M]arket demand for more originators lead to a rapid rise in employment, often at the expense of a knowledgeable and responsible workforce. In a rush to hire, standards were loosened by some to achieve or enhance their growth. Without strong standards, this growth went unregulated and unchecked, resulting in a largely under-educated and unscreened originator workforce. Now, we are experiencing a contraction. To ensure we are not doomed to repeat this cycle again, it is critical to establish strong national standards that apply to all originator entities, regardless or size, corporate organization or structure.

Legislative Proposals on Reforming Mortgage Practices, *supra*, at 3 (written testimony of Marc Savitt, President-elect, National Association of Mortgage

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[1] *See e.g.*, *Subprime and Predatory Mortgage Lending: New Regulatory Guidance, Current Market Conditions and Effects on Regulated Financial Institutions*: *Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services*, 110th Cong. (2007), http://www.house.gov/apps/list/hearing/financialsvcs_dem/ht032707.shtml; *Legislative Proposals on Reforming Mortgage Practices: Hearing Before the H. Comm. on Financial Services*, 110th Cong. (2007), http://www.house.gov/apps/list/hearing/financialsvcs_dem/ht0718073.shtml; Liam Pleven & Susanne Craig, *Deal Fees Under Fire Amid Fire Amid Mortgage Crisis—Guaranteed Rewards of Bankers, Middlemen Are in the Spotlight*, Wall St. J., Jan. 17, 2008, at A1.

Brokers), http://www.house.gov/apps/list/hearing/financialsvcs_dem/ htsavitt102407.pdf.

In fact, unscrupulous conduct by mortgage brokers has been a major cause of the subprime lending crisis now facing some of the nation's largest FSAs. *See, e.g.*, Valerie Bauerlein & Andrew Edwards, *Bargain or Bailout?—WaMu Is Retrenching After Taking Hard Hit From Mortgage Crisis*, Wall St. J., Dec. 11, 2007, at C1 (reporting that Washington Mutual Bank, F.S.B. was reforming how it dealt with mortgage brokers in light of losses); Kate Berry, *Reappraising Third-Party Originators*, Am. Banker, Sept. 4, 2007, at 1 (noting that the subprime credit crisis was causing IndyMac Bank, F.S.B. to become "more selective" in working with mortgage brokers). This crisis has both caused major financial troubles for FSAs and created great hardships for consumers who were brokered inappropriate and unsustainable loans funded by these FSAs. *See, e.g.*, Ruth Simon, *The Mortgage Crisis Fallout: Option ARMs: Next Weakling—Fall in Home Prices, Rise in Loan Values Force Foreclosures*, Wall St. J., Dec. 22, 2007, at A7 (describing the hardship faced by a consumer put into an IndyMac-funded Option ARM by a mortgage broker).

As even the industry recognizes, stricter control over mortgage brokers is essential to combating the subprime lending crisis. *See* Berry, *supra*, at 1 (quoting an IndyMac executive who noted that "there's a lot of money to be made *if you can*

differentiate the strong professional originators from the bad actors" (emphasis added) (quoting Frank Sillman, Chief Executive, IndyMac Bancorp's Mortgage Unit)). Yet holding Ohio's statute is preempted would displace state regulation, even though there is no federal substantive regulation to fill the void. Moreover, the OTS has failed to provide effective regulation of FSAs' own lending practices, let alone regulation of the independent contractors used by the FSAs. *See, e.g.*, Paul Krugman, *Blindly into the Bubble*, N.Y. Times, Dec. 21, 2007, at 39 ("Consider the press conference held on June 3, 2003—just about the time subprime lending was starting to go wild—to announce a new initiative aimed at reducing the regulatory burden on banks. Representatives of four of the five government agencies responsible for financial supervision used tree shears to attack a stack of paper representing bank regulations. The fifth representative, James Gilleran of the Office of Thrift Supervision, wielded a chainsaw."). State law therefore must be allowed to play a role in providing essentially needed mortgage broker regulation.

Regulation is especially important because of the independent agency status enjoyed by mortgage brokers. Recent Congressional testimony has focused on, *inter alia*, how "[b]rokers and lenders are focused on feeding investor demand in exchange for high fees, regardless of how particular products affect individual homeowners. Moreover, because of the way they are compensated, brokers have

incentives to sell excessively expensive loans." *Ending Mortgage Abuse: Safeguarding Homebuyers: Hearing Before the Subcomm. on Housing, Transportation, and Community Development of the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. 8 (2007) (written testimony of Mike Calhoun, President, Center for Responsible Lending), http://banking.senate.gov/_files/calhoun1.pdf. Through the loophole State Farm Bank seeks here, unscrupulous or unqualified mortgage brokers can specifically seek affiliation with FSAs to avoid registration and licensing. Indeed, one FSA has specifically advertised to mortgage brokers that they can avoid state licensing by becoming an affiliate of the bank. *See* Colo. Fed. Sav. Bank, Affiliate Branch Program, http://cofedbank.com/affiliate/ (last visited Feb. 13, 2008).

Further, by eliminating the state licensing requirement for FSA-affiliated independent contractors, this loophole would thwart efforts by the Federal Reserve Board and forty-two state agencies to link up state databases to create a nationwide system to identify brokers and other mortgage originators who run afoul of state regulators and then move to another state and re-open for business. *See Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures: Hearing of the H. Comm. on Financial Services*, 110th Cong. 78 (2007) (written testimony of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System), http://www.house.gov/apps/list/hearing/financialsvcs_dem/

ht092007.shtml. More troubling yet are the implications for other third party agents should preemption extend to independent contractors. For example, telemarketers affiliated with national banks have run afoul of state laws and been subjected to state enforcement. *See, e.g. See People v. Chase Bank USA, N.A.*, No. GIC850483 (Cal. Super. Ct. San Diego County filed July 12, 2005), http://ag.ca.gov/newsalerts/cms05/05-054_0a.pdf.

We now turn from the practical implication of an independent contractor loophole to our arguments focusing on why—as the district court correctly held—the Ohio law does not conflict with State Farm Bank's power to use independent contractors to market its mortgage products and, therefore, is not preempted by HOLA or the OTS preemption regulations.

A. The Modest Nature of the Ohio Statute Does Not Conflict with State Farm Bank's Power To Lend Through Independent Contractors.

To the extent that any preemption arises in this case, it must be from a conflict created with OTS's authorization of lending through independent contractors. *See Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 154-59 (1982) (finding a conflict between California's prohibition of due on sale clauses in mortgage lending and regulations issued by the OTS's predecessor that

authorized such clauses).[2] Ohio's broker registration and licensing laws are minimalist but necessary consumer protection statutes that in no way impair State Farm Bank's ability to offer its mortgage products through third-party independent contractors.

Holding that states cannot apply mortgage broker licensing laws to third parties contracting with a FSA when the OTS has authorized FSAs to lend through those parties could result in all mortgage broker laws being preempted whenever the broker makes a loan funded by a FSA. State Farm Bank does not shy away from such a result when it asks this Court to hold preempted any state law that "restrict[s] its ability to market its products and services to the residents of Ohio in the most efficient and effective way possible." Appellants' Br. 52. This sweeping claim could apply to any state law touching upon a third party acting on behalf of a FSA; the application of *any* state law adds some costs to that third party that in turn could allegedly decrease the FSA's efficiency and efficacy of using a third party. Creating such a limitless scope of federal bank preemption would be unprecedented and contrary to the Supreme Court's holdings under conflict analysis that states may regulate bank activities "where . . . doing so does not prevent or significantly interfere with the national bank's exercise of its powers."

[2] The Supreme Court has explicitly reserved ruling on whether HOLA authorizes field preemption and invoked conflict preemption instead. *See de la Cuesta*, 458 U.S. at 159 n.14. In any case, as explained *infra*, regulation of a FSA's independent contractors is *not* a form of regulating the FSA itself.

Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 33 (1996); *see also id*. at 31-33 (explaining that this limit on the scope of federal preemption under the National Bank Act is consistent with general principles of conflict preemption); *de la Cuesta*, 458 U.S. at 153-59 (examining preemption under HOLA using conflict preemption principles).

Certainly, the OTS has authorized FSAs to lend through third parties. *See* R.1, Compl., Ex.A OTS Op. at 9-10; *see also* OTS, *Examination Handbook* § 750 (2007) (detailing the ability of FSAs to lend through mortgage brokers), http://www.ots.treas.gov/docs/4/422341.pdf. And we do not question the OTS's ability to authorize lending through third parties. *See de la Cuesta*, 458 U.S. at 161 ("The broad language of [HOLA] expresses no limits on the [OTS's] authority to regulate the lending practices of federal savings and loans."). However, the fact that a state law affects the conduct of a third party's conduct does not automatically conflict with the federal bank regulators' authorization to use a third party. *Cf. SPGGC, LLC v. Blumenthal*, 505 F.3d 183, 191 (2d Cir. 2007) (holding that state law that prevents a third party from imposing dormancy fees on gift cards was not preempted by the National Bank Act even though the third party sold the gift cards through an agreement with a national bank).

Ohio's mortgage broker law does nothing to prevent FSAs from lending through third parties. Instead, Ohio has merely set out generally applicable

registration and experience prerequisites that apply evenhandedly to all persons who act as mortgage brokers within the state. *See* Ohio Rev. Code § 1322.01 *et seq*. These registration and licensing requirements are no different than the State of Ohio requiring any other third party with whom State Farm Bank contracts to comply with generally applicable laws that cover such entities, such as business corporation laws or workers' compensation laws. Indeed, the very independent contractors whose conduct is at issue here—State Farm's 17,000 insurance agents—are subject to state insurance law requirements. *See* Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 Am. U. L. Rev 515, 530 (2007).

State Farm Bank does not—and cannot—claim that Ohio's mortgage broker regulations make it impossible for the Bank to use third party agents. In fact, State Farm Bank proffers only one provision of the Ohio mortgage broker law—the requirement under Ohio Rev. Code § 1322.03 that a mortgage broker must have three years of experience in the lending field—that it argues effectively prohibits employing third parties to lend.[3] *See* Appellants' Br. 9. It is troubling that State

[3] Therefore, even if this Court finds the three-year requirement conflicts with FSAs' authority to lend through third parties, it should only declare § 1322.03 preempted, as opposed to the entire Ohio mortgage broker law. *See Garcia v. Wyeth-Ayerst Labs.*, 385 F.3d 961, 966-67 (6th Cir. 2004) (severing a preempted provision from the rest of a state law that was not otherwise preempted).

Farm Bank apparently wants to hire independent agents without any prior experience to broker mortgage loans to its customers. Moreover, State Farm Bank does *not* argue that Ohio's law requiring experience by itself makes it impossible to lend through third parties, but only that the regulation "*within the framework of the State Farm Bank business model*" creates the burden. *Id*. (emphasis added). State Farm Bank's unilateral decision to use a business model relying on inexperienced independent contractors to broker loans—a model that the OTS did not require and a model that is entirely separate from the OTS's authorization of lending through third parties—cannot provide the basis of preemption.

Holding otherwise would create a loophole through which FSA independent contractor-brokers avoid all registration and licensing requirements that the states, Federal Reserve, and even the Mortgage Bankers' Association support. Moreover, FSA independent contractor-brokers can use this loophole for the purpose of avoiding state laws protecting consumers—regulations that consumers and, as we are now seeing, the market as a whole, desperately need.

B. The OTS's Preemption Regulation Is Restricted to Entities over Whom the FSA Has Close Control.

State Farm Bank's reliance on the OTS's general preemption regulations to preempt Ohio's mortgage broker laws also does not withstand scrutiny. State Farm Bank's position ignores the text of the OTS's regulations and attempts to stretch those regulations' preemptive purpose well beyond the outer limits of the text and

interpretive caselaw, which all require close control of entities by FSAs for general preemption to apply. Here, the legal hallmark of the relationship between State Farm Bank and its independent contractor-brokers is the significant freedom from control. Accordingly, as we show, both applicable legal principles and practical implications of independent contractor status prevent independent contractor-brokers from establishing the close relationship required for preemption under the OTS's regulations.

1. Nothing in the OTS's Regulations Extends Preemption to Third-Party Independent Contractors.

The general OTS preemption regulation applying to mortgage lending specifies that "*federal savings associations* may extend credit as authorized under federal law . . . without regard to state laws purporting to regulate or otherwise affect *their* credit activities." 12 C.F.R. § 560.2(a) (emphasis added). Additionally, 12 C.F.R. § 559.3(n)(1) extends this preemption to activities undertaken by operating subsidiaries.[4] As a necessary component of that preemptive authority, to the extent that that state regulation is prohibited against a FSA or its operating subsidiary, it is also preempted against an employee of those entities. *See Weiss v. Wash. Mut. Bank*, 53 Cal. Rptr. 3d 782, 786 (Ct. App. 2007)

[4] The *amicus* brief of the Conference of State Bank Supervisors ("CSBS") exhaustively explains why independent contractors do not qualify as operating subsidiaries. CSBS Br. 19, 29.

("[C]laims preempted as against the employer are necessarily preempted against the employee who acted within the course and scope of his employment.").

Nothing in these preemption regulations, however, extends preemption to other third parties, such as independent contractors, that provide services to FSAs. Not only does the regulations' textual focus on FSAs make this fact clear, but it is a necessary precondition to the OTS's other regulations on preemption.

In 12 C.F.R. § 559.3(n)(2), the OTS has declared that service corporations are *not* cloaked with the preemptive immunity that covers FSAs and their operating subsidiaries, and that "[s]tate law applies. . . except where there is a conflict with federal law." Thus, § 559.3(n)(2) explicitly recognizes that the broad preemption in 12 C.F.R. § 560.2 does not extend to third parties other than operating subsidiaries. Otherwise, § 560.2 would have already have cleared away the state laws that § 559.3(n)(2) dictates still apply to the third party service corporation. In promulgating § 559.3(n), the OTS explained that its reason for limiting preemption to operating subsidiaries and for not giving preemptive immunity to service corporations was that the former "engage only in activities that could be conducted at the parent thrift level" while the latter "engage in activities that are related to and promote, but go beyond, those permitted for federal savings associations themselves" and "need not be controlled by its parent thrift." 61 Fed. Reg. 66,561, 66,563 (Dec. 18, 1996); *see also Fenning v. Glenfed Inc.*, 47 Cal. Rptr. 2d 715, 720

(Ct. App. 1995) ("[P]reemption cannot be implied where, as here, there is scant regulation of service corporations, as opposed to a regulatory scheme is 'so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.'" (quoting *de la Cuesta*, 458 U.S. at 153)); *Spitz v. Goldome Realty Credit Corp.*, 569 N.E.2d 43, 48 (Ill. App. Ct. 1991) ("[N]either Congress nor the [OTS] has attempted to set forth a comprehensive regulatory scheme for service corporations as they did for their federally chartered parent associations. Recognizing the lack of such a comprehensive scheme, it is difficult to conceive that Congress and the [OTS] would only regulate the home mortgage activities of service corporations in selected areas if they did not intend to subject these entities to additional state regulation. An intent to preempt without providing a comprehensive regulatory scheme could lead to the intolerable result of permitting service corporations to perform lending activities, which are traditionally highly regulated, unfettered by *any* regulation."), *aff'd*, 600 N.E.2d 1185 (Ill. 1992).

The Supreme Court's decision last Term in *Watters v. Wachovia Bank, N.A.* does nothing to change this limited scope of the OTS preemption regulation. *Watters* specified that it was *not* interpreting the scope of a similar preemption regulation issued by the Office of the Comptroller of the Currency ("OCC"). 127 S. Ct. 1559, 1572 (2007). Indeed, *Watters*, and its specification that preemption

analysis should "focus[] on the exercise of a national bank's *powers*," dealt solely with the issue of conflict preemption. *Id.* at 1570. The Second Circuit has already noted this limit to *Watters* in rejecting a third party's claim that it was absolutely shielded by the preemption enjoyed by a national bank with which it had a business relationship:

> [I]t does not follow that a state's attempt to regulate the *third party's* conduct is necessarily preempted as it would be if directed toward the bank itself or toward an operating subsidiary. . . . [*W*]*e must ask whether the regulation at issue actually affects the national bank's exercise of any authorized powers* or whether it limits only activities of the third party which are otherwise subject to state control.

Blumenthal, 505 F.3d at 190-91 (emphasis added).[5] As we have already explained, conflict preemption does not prohibit Ohio's mortgage broker law from applying to State Farm agents. *Watters* does not provide any support for extending the preemptive scope of 12 C.F.R. § 560.2.

2. The Significant Freedom of Independent Contractors Prevents Preemption of State Laws Under the OTS's Regulations.

The relationship here between State Farm and its independent contractor-brokers is exactly the type of third-party relationship that courts have repeatedly held does not create the absolute shield of preemption enjoyed by the FSA itself.

[5] The Second Circuit also observed that the analysis in *Watters* largely depended on "the unique role assigned to operating subsidiaries in the context of national banking regulation." *Blumenthal*, 505 F.3d at 190. Therefore, it found significance in the fact that the third party in its case "enjoys no [similar] special status under the statute." *Id.*

This Circuit has recognized significant independence is required between a principal and an agent for the agent to be considered an independent contractor:

> In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.

Weary v. Cochran, 377 F.3d 522, 525 (6th Cir. 2004) (quoting *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323-24 (1992)).

Here, there is no dispute that the State Farm Bank brokers are independent contractors. *See, e.g*, R.1, Compl., Ex.A OTS Op. at 1 ("Agents are independent contractors"; "Agents are not employees"). That is not surprising because "this Court has repeatedly held that insurance agents are independent contractors, rather than employees, in a variety of contexts. Other courts are in accord with this view." *Weary*, 377 F.3d at 524 (citations omitted). Thus, a key component of the brokers' relationship with State Farm Bank is their significant freedom from the bank as independent contractors.

The brokers' freedom—the legal hallmark of the distinction between an independent contractor and employee—makes clear that the application of Ohio's

registration requirements to State Farm Bank's agents does *not* conflict with the OTS's regulations governing FSA operations. Indeed, the independent contractors' freedom—and the FSA's potential lack of liability for misdeeds of the contractor[6]—create an environment where FSA contractors are more likely to engage in predatory lending practices than the FSAs themselves, and therefore state regulation is more appropriate. *See* Peterson, *supra*, at 542-49. Individual independent contractors do not face the same reputational risk or the same financial risks (because they can easily become judgment-proof) as the bank itself. *See id*. at 542-44. These problems are further exacerbated by the FSAs' potential lack of liability for the misdeeds of their independent contractors. The banks, while attempting to claim preemptive immunity for their independent contractors, also seek to insulate themselves legally from their misconduct when tort liability is at issue. *See id*. at 547.

Moreover, because federal bank regulators are most concerned with safety and soundness of deposits, "[i]ndependent contractors of depository institutions will always rank low in priority with respect to threats posed to deposit insurance funds." *Id*. at 544. As a practical matter, the task of overseeing independent

[6] On the liability issue, the district court concluded that "State Farm Bank is not liable for harm caused to another by an act or omission of its independent contractor-agents." R.56, D.Ct. Op. 32. In response, State Farm Bank's brief (at 40 n.7) says only that it *may* be liable for a limited misdeeds relating to marketing by such independent agents.

contractors scattered about in various locations is far more challenging than the responsibility of regulating an FSA. *See id*. at 544-45. Accordingly, despite the OTS's claim of preemption of state laws regulating independent contractors, the OTS has never brought an enforcement action against an agent of a FSA and has only brought a single enforcement case against a FSA affiliate. *See* OTS, Quick Navigation: Enforcement Related, http://www.ots.treas.gov/resultSort.cfm?catNumber=31&catParent=41&doc_cat=90&showDocName=y&sel=8 (last visited Feb. 13, 2008).

Unlike the OTS, the states have the capacity and incentives to regulate mortgage brokers on a state level because of the impact that unscrupulous mortgage lending have on their citizens. Peterson, *supra,* at 548-49. Protecting its citizens from unscrupulous mortgage brokers is exactly what the state of Ohio seeks to do here. *See* Appellee's Br. 26-28.

II. THE OTS CHIEF COUNSEL'S OPINION LETTER COULD NOT EXPAND THE SCOPE OF PREEMPTION AUTHORIZED BY HOLA AND THE OTS'S REGULATIONS.

State Farm also relies on an Opinion Letter of the OTS General Counsel, R.1, Compl., Ex.A OTS Op., that opines that State Farm Bank's independent contractor-brokers are exempt from state mortgage broker laws. We now explain that this Court should not rely on that letter because the letter (i) is inconsistent

with the regulations and (ii) combines numerous hallmarks of administrative action unworthy of deference.

A. The Chief Counsel's Opinion Letter Is Inconsistent with the OTS's Regulations and Thus Not Owed Deference

As an initial matter, State Farm Bank overlooks this Court's previous holding in *Fisher v. Ford Motor Co.* that refused to give binding effect to a letter by a federal agency's general counsel that purported to interpret a regulation. In that case, the General Counsel of the National Highway Transportation Safety Agency had interpreted one of the agency's safety regulations in a letter sent to an interested party. *See* 224 F.3d 570, 575 (6th Cir. 2000). In response to the appellant's attempt to rely on the interpretation contained in that letter, this Court responded that "the General Counsel's opinion is not legally binding on the courts," citing the principle "that when an agency has not cemented its interpretation in the form of binding regulations, its interpretation may not be entitled to *de facto* binding effect through judicial deference." *Id*. (quoting *Chambers v. Ohio Dep't of Human Servs.*, 145 F.3d 793, 803 (6th Cir. 1998)) (internal quotation marks omitted).

Additionally, the OTS Chief Counsel's opinion letter is not entitled to deference because it is inconsistent with the OTS's regulations, which do *not* preempt a state's ability to regulate independent contractors. Blackletter administrative law dictates that agencies' interpretations of their own regulations

cannot be "inconsistent with the regulation." *E.g.*, *Auer v. Robbins*, 519 U.S. 452, 461 (1997). This Court recently held that it will not allow a federal agency to issue a ruling under "the guise of interpreting a regulation" when "reading [a] regulation as expansively as [the agency] urges would impermissibly create *de facto* a new regulation." *City of Cleveland v. Ohio*, 508 F.3d 827, 847 (6th Cir. 2007) (quoting *Christensen v. Harris County*, 529 U.S. 576, 588 (2000) (internal quotation marks omitted)); *see also Caruso v. Blockbuster-Sony Music Entm't Centre at the Waterfront*, 193 F.3d 730, 737 (3d Cir. 1999) (Alito, J.) ("An agency is not allowed to change a legislative rule retroactively through the process of disingenuous interpretation of the rule to mean something other than its original meaning." (internal quotation marks omitted)).

The Supreme Court has explained that "[t]he plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). Moreover, a regulation need not explicitly answer a question in order to be unambiguous. *See City of Cleveland*, 508 F.3d at 847 (refusing to defer to an agency's interpretation that a regulation banned discrimination based on locality when the regulation itself banned other forms of discrimination but was silent about locality). As explained above, the terms of the OTS's preemption regulation both alone and in

combination with other OTS regulations governing subordinate organizations clearly dictate that state regulations generally apply to third-party associates of FSAs like independent contractors.[7] The Chief Counsel's letter purports to be interpreting those regulations. Therefore, the Chief Counsel's attempt to expand the preemptive scope of the OTS's regulations is not entitled to deference because the regulations themselves provide a contrary plain answer.

Moreover, the Chief Counsel's letter cannot be afforded deference because it is inconsistent with the reasoning that the Federal Home Loan Bank Board ("FHLBB"), the OTS's predecessor, adopted in addressing the very question of whether state mortgage broker licensing laws apply to third-party affiliates of FSAs.[8] *See Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 515 (1994) ("[A]n agency's interpretation of a statute or regulation that conflicts with a prior interpretation is entitled to considerably less deference than a consistently held agency view . . . ." (internal quotation marks omitted)). In a 1988 letter from its Deputy General Counsel, the FHLBB opined that a state law requiring the licensing of mortgage brokers and mortgage bankers was not preempted when applied to a wholly-owned service corporation of a FSA that engaged in a

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[7] The briefs of the State and the CSBS also explain why the absence of preemption is clear when the OTS's regulations are read in light of HOLA's statutory context. *See* Appellee's Br. 12-22; CSBS Br. 10-15.

[8] The OTS has explained that its preemption regulations incorporate legal opinions issued by the FHLBB. 61 Fed. Reg. 50,951, 50,952 (Sept. 30, 1996).

mortgage banking and brokerage business. FHLBB Op. by Williams, 1988 WL 1021736 (Nov. 21, 1988). The FHLBB made this determination because "notwithstanding the fact that federal associations' service corporations are heavily regulated in certain respects by the Bank Board," they "are not regulated to the same extent as federal associations. . . . Accordingly, absent a direct conflict [with federal law], the doctrine of federal preemption does not supercede state law." *Id*. at *2-3. The FHLBB then went on to determine that "licensing statutes for mortgage bankers and brokers" as applied to such third-party affiliates "do not directly conflict with federal law" that applies to FSAs. *Id*. at *3. Notably, the FHLBB's analysis gave no weight to the fact that the service corporation was "wholly-owned" by the FSA and therefore would have been subject to the complete control and supervision of the FSA. *See id*. at *1.

B. The Chief Counsel's Letter Is Not Owed Deference Even if the Regulations Are Silent.

As explained above, the OTS preemption regulations clearly do not preempt Ohio's authority to regulate the mortgage brokering activities of State Farm Bank's independent contractors. This Court, however, should not defer to the Chief Counsel's letter even if it believes the regulations are silent on the issue.

Without doubt, HOLA does not explicitly preempt state regulations from applying to an FSA's independent contractors. Likewise, the OTS's regulations do not explicitly preempt state regulations applying to an FSA's independent

contractors. Nevertheless, State Farm Bank argues that by writing a letter, the OTS Chief Counsel created dispositive preemption. In other words, State Farm Bank argues that one official's opinions are enough to foreclose Ohio's ability to exercise its police powers to protect consumers from malfeasance by independent contractors.

Such a claim of deference is breathtaking and unprecedented in this Circuit. To grant such deference, this Court would have to overlook a perfect storm of administrative law caution flags: (i) informality in promulgation, (ii) self-created ambiguity, and (iii) preemption of state laws by declaration. Viewed in combination, these factors foreclose deference to the Chief Counsel's interpretation.

First, the Supreme Court has explained its discomfort with giving dispositive treatment to informally promulgated administrative action. As the Court has explained in the context of agency interpretations of statutes:

> We have recognized a very good indicator of delegation meriting *Chevron* treatment in express congressional authorizations to engage in the process of rulemaking or adjudication that produces regulations or rulings for which deference is claimed. It is fair to assume generally that Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force.

United States v. Mead Corp., 533 U.S. 218, 229-30 (2001) (citations omitted). This Court has just recently noted concerns with deferring to informal

administrative materials in the context of reviewing an agency's interpretation of its own regulations. *See City of Cleveland*, 508 F.3d at 845-46 ("We agree with the district court's interpretation of th[e] regulation. . . . However, the [agency] cannot claim deferential treatment by reference to agency memoranda or letters citing this portion of the regulation as authority for the [contrary] position . . . ."). The OTS Chief Counsel's letter, which was not promulgated by the OTS Director and was not the subject of a notice-and-comment rulemaking, is just such an informal document that has very little basis for deference. Moreover, it is unclear if the Chief Counsel truly applied agency expertise deserving of deference because he neither invited nor responded to expressions of concern by consumer groups about the risks of preempting state laws governing the qualifications of mortgage brokers. Part of an agency's expertise comes through "invok[ing] public comment which the agency can evaluate and assimilate in formulating new regulations;" accordingly, this Court should avoid creating a situation where "an agency may rush to issue ill-conceived proposals in the hope of affecting the decisions of courts or the conduct of regulated persons, evading the risks and responsibilities of submitting its proposals to public comment and other rulemaking procedures."

Anderson Bros. Ford v. Valencia, 452 U.S. 205, 229 (1981) (Stewart, J., dissenting, joined by Burger, C.J., Brennan, Marshall, JJ.).[9]

Second, federal courts have expressed concern about allowing an agency through informal means to "clarify" ambiguities in formal regulations when the agency is responsible for the original ambiguity. As the U.S. Court of Appeals for the District of Columbia Circuit has observed, "[i]t is certainly not open to an agency to promulgate mush and then give it concrete form only through subsequent less formal 'interpretations.'" *Paralyzed Veterans of Am. v. D.C. Arena, L.P.*, 117 F.3d 579, 585 (D.C. Cir. 1997); *see also Thomas Jefferson Univ.*, 512 U.S. at 525 (Thomas, J., dissenting, joined by Stevens, O'Connor, Ginsburg, JJ.) ("By giving substantive effect to such a hopelessly vague regulation, the Court disserves the very purpose behind the delegation of lawmaking power to administrative agencies, which is to 'resol[ve] . . . ambiguity in a statutory text.' Here . . . the Secretary has merely replaced statutory ambiguity with regulatory ambiguity. It is perfectly understandable, of course, for an agency to issue vague regulations, because to do so maximizes agency power and allows the agency greater latitude to make law through adjudication rather than through the more cumbersome rulemaking process. Nonetheless, agency rules should be clear and

[9] For similar reasons, we fully agree with the arguments advanced in the briefs of the State and the CSBS supporting the district court's determination that the informal promulgation letter violated the Administrative Procedure Act. *See* Appellee's Br. 29-33; CSBS Br, 24-31.

definite so that affected parties will have adequate notice concerning the agency's understanding of the law." (citations omitted) (first omission in original)); John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 Colum. L. Rev. 612, 654-80 (1996) (identifying problems with allowing administrative agencies to interpret their own ambiguous regulations). To the extent that the OTS's preemption regulations do not address independent contractors' immunity from state regulation, they are no better than mush on the question. The OTS Chief Counsel should not be allowed to write an informal letter that undoes the OTS's decision to promulgate formal regulations that left the question unresolved.

Finally, federal courts have been hesitant in deferring to agencies' interpretations that baldly declare state laws preempted, like that found in the OTS Chief Counsel's letter. The Supreme Court has never accorded strong deference to an agency's interpretation on preemption. *See Watters*, 127 S. Ct. at 1584 (Stevens, J, dissenting, joined by Roberts, C.J., Scalia, J.); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 512 (1996) (O'Connor, J., concurring in part and dissenting in part, joined by Rehnquist, C.J., Scalia, Thomas, JJ.).[10] Instead, "when an agency

[10] The *Watters* majority did not address the deference owed to an agency's interpretation concerning preemption, as it found the state law in question was preempted by federal statute itself. *See* 127 S. Ct. at 1572 ("[U]nder our interpretation of the statute, the level of deference owed to the [OCC's preemption] regulation is an academic question.").

purports to decided the scope of federal preemption, a healthy respect for state sovereignty calls for something less than *Chevron* deference."[11] *Watters*, 127 S. Ct. at 1584 (Stevens, J., dissenting); *see also Colo. Pub. Utils. Comm'n v. Harmon*, 951 F.2d 1571, 1579 (10th Cir. 1991) ("[A] preemption determination involves matters of law—an area more within the expertise of the courts than within the expertise of the [agency]. Therefore, we defer to [the agency's] determinations that its regulations overlap with Colorado's regulations, but we independently review the legal issue of preemption." (citations omitted)). The OTS Chief Counsel's letter is just such a bald legal assertion that state regulation is preempted. Notably, the letter does not purport to establish a licensing scheme for independent contractors used by FSAs to conduct their lending. Moreover, even if the letter did impose such restrictions, those restrictions would only preempt Ohio's laws to the extent there was a conflict between the two sets of requirements.

Even if any one of the concerns about informality, self-created ambiguity, and bald preemption declarations does not independently deprive the interpretation of deference, the Chief Counsel's letter's combination of these troubling factors renders it unfit for deference. *See Flores v. Rios*, 36 F.3d 507, 514 (6th Cir. 1994) ("Yet even the broadest policy of deference [to agency interpretations] must have

[11] This limit to deference is fully compatible with the principal that administrative interpretations that impose a substantive duty on parties preempt state regulations that create conflicting duties. *See Watters*, 127 S. Ct. at 1583 n.24 (Stevens, J., dissenting).

limits . . . .”). For example, the Second Circuit has held that the bank regulators are already “at or near the outer limits” of receiving deference merely because they have promulgated regulations baldly addressing the scope of preemption. *Clearing House Assoc. v. Cuomo*, 510 F.3d 105, 119 (2d Cir. 2007). The Chief Counsel’s letter, by combining such a declaration with informality and self-created ambiguity, is well beyond the outer limits.

CONCLUSION

For the reasons stated in the State of Ohio’s briefs and supported by our arguments as *amicus curiae*, the decision of the district court should be affirmed.

DATED: February 15, 2008

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CERIFICATE OF COMPLIANCE

I hereby certify that this brief contains 6,782 words and thus complies with the type-volume limitations of Fed. R. App. P. 29(d) because it is no more than one-half the maximum length authorized by Fed. R. App. P. 32(a)(7)(B). In making this certification, the undersigned has relied upon the word count of the word-processing systems used to prepare this brief.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of February 2008, I served two paper copies of the foregoing Brief for *Amicus Curiae* Center for Responsible Lending in Support of Defendant-Appellee and Arguing for Affirmance via First Class Mail, postage prepaid, on all parties herein to the following address:

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