VIRGINIA JO DUNLAP (CA BAR NO. 142221)
Acting Assistant Commissioner
ALAN S. WEINGER (CA BAR NO. 86717)
Supervising Counsel
JUDY L. HARTLEY (CA BAR NO. 110628)
Senior Corporations Counsel
Department of Corporations
320 West 4th Street, Suite 750
Los Angeles, California 90013-2344
Telephone: (213) 576-7604
Facsimile: (213) 576-7181

Attorneys for Defendant

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF CALIFORNIA

WELLS FARGO BANK, N.A., and WELLS FARGO HOME MORTGAGE, INC., Plaintiffs, vs. DEMETRIOS A. BOUTRIS, in his official capacity as Commissioner of the California Department of Corporations, Defendant.	Civil Action No. S-03-0157 GEB JFM MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION Hearing Date: March 10, 2003 Time: 9:00 a.m. Location: Courtroom 10 **Hearing Requested**

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Defendant, Demetrios A. Boutris, in his official capacity as California Corporations Commissioner ("Commissioner") hereby submits his Opposition to plaintiffs request for the issuance of a Preliminary Injunction.

INTRODUCTION

The issuance of a preliminary injunction will allow WFHMI to continue to mislead California consumers under the pretense that it is licensed under the California Residential Mortgage Lending Act (CRMLA) and the California Finance Lenders Law (CFLL), while simultaneously disregarding the provisions of those statutes designed by the California legislature to afford consumers protection from lenders overcharging them or understating finance charges.

Wells Fargo Bank and WFHMI ask this Court to stay any action of the California Corporations Commissioner pursuant to the CRMLA and CFLL, including his statutory authority to administratively revoke WFHMI's license for violating the law, effectively allowing WFHMI to continue claiming it is licensed by the State of California. At the same time, Wells Fargo Bank and WFHMI ask this Court to reach a conclusion that the CRMLA and CFLL are preempted by overreaching federal regulations promulgated by the Office of the Comptroller of the Currency (OCC).

Wells Fargo Bank and WFHMI cannot demonstrate a likelihood of success that would warrant the issuance of a preliminary injunction on any basis. On its face, California Financial Code section 50204(o) does not expressly limit the rate or amount of interest so as to bring it under the preemptory provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA). Rather, the California statute regulates the number of days a lender may charge consumers interest prior to the recording of their mortgage or deed of trust.

Further, there is no statutory authorization by Congress allowing the OCC to expand its jurisdiction over state-chartered corporations by designating them as operating subsidiaries of a national bank and then preempting all state laws, including consumer protection statutes such as the CRMLA and CFLL. Finally, WFHMI has failed to even demonstrate that it is an operating subsidiary and when it allegedly became so. As such, there is insufficient evidence and authority to support the issuance of a preliminary injunction.

Wells Fargo Bank and WFHMI have failed to prove that they will suffer irreparable harm if required to comply with the CRMLA and CFLL. WFHMI has represented to this Court that it would cost $18 million to complete the audit, required to determine the full amount of refunds necessary to make California consumers whole. However, just weeks before filing the lawsuit WFHMI represented to the Commissioner the cost of the audit would be $2 million. Irrespective of the amount, WFHMI conveniently failed to explain to the court that the cost also would include the amount to cover an audit for Truth In Lending Act ("TILA") understatement of finance charges that the federal authority will undoubtedly require be corrected. Further, WFHMI will not lose significant income during the pendency of this matter without the injunction; it will, however, lose the unfair business advantage it now enjoys over licensees who are required to comply with the California consumer protection laws.

Because Wells Fargo Bank and WFHMI have not met their burden demonstrating that they will suffer irreparable harm and that they are likely to succeed at the time of trial, the preliminary injunction should not be issued.

STATEMENT OF FACTS

Following several regulatory examinations, to which WFHMI submitted as a licensee pursuant to California law, the California Corporations Commissioner demanded on December 4, 2002, that WFHMI conduct an audit of its residential mortgage loans made in California during 2001 and 2002. The audit was demanded in order to identify all loans where per diem interest was charged by WFHMI in excess of that allowed under California Financial Code section 50204(o)[1], to identify those consumers entitled to a refund, and also to identify possible instances of understating finance charges in violation of TILA and California Financial Code section 50204, subdivisions (i), (j) and (k).

[1] California Financial Code section 50204(o) prohibits lenders licensed under the CRMLA from charging interest for more than one day prior to the recording of the mortgage or deed of trust. Typically, in California, the deed of trust is recorded the same day as the loan proceeds are disbursed for the borrowers' use ("loan close"), with loan proceeds being sent by the lender to title and/or the settlement agent the day before closing. The settlement agents and/or title company cause the deed of trust to be recorded and take instructions directly from the lender as to the recording. Burns Decl., paragraph 11. Financial Code section 50204(o) does contain an exception when the borrower affirmatively requests, and the lender agrees to, funding on a Friday or a day prior to a holiday, and specific disclosures are given. In those instances, a lender may charge interest from the business day prior to recording.

Despite being voluntarily licensed under the CRMLA and the CFLL since 1996, and previously complying with all licensing, regulatory, supervisory, examination and enforcement provisions of these statutes, plaintiffs refused to correct the identified deficiencies and to conduct the self audit demanded by the Commissioner. Thereafter, the Commissioner instituted proceedings to revoke the CRMLA and CFLL licenses of WFHMI. The revocation is based on WFHMI's stated intent to not abide by requirements of the CRMLA and the CFLL. Compliance with these consumer protection laws is a necessary predicate to maintaining CRMLA and CFLL licenses. Burns Dec. ¶ 22 and Nagashima Decl¶ 12.

Alternatively, WFHMI could have applied to the Commissioner for a ruling that it is exempt from the CRMLA under California Financial Code section 50003.[2] WFHMI has never made such an application and has never attempted to surrender its licenses based upon alleged status as an operating subsidiary of a national bank. Moreover, from December 1, 1999 through January 2003, WFHMI complied with all requirements of the CRMLA, except those provisions complained of in the revocation action. Burns Decl. ¶¶ 8-10.

During its tenure as a licensee under the CRMLA, WFHMI has consistently filed all reports and paid all assessments required by the CRMLA. Burns Decl.¶ 8. WFHMI has also submitted to all regulatory examinations scheduled by the Commissioner, and responded to all correspondence from the Commissioner concerning these regulatory examinations without question. Since the promulgation of 12 C.F.R. section 7.4006[3], without any objection whatsoever from WFHMI, the Commissioner has conducted at least one further examination. As recently as February 18, 2002, WFHMI agreed with the Commissioner that per diem interest had been overcharged and the finance charge understated, in various loans reviewed by the Commissioner during the April 2001 regulatory examination. WFHMI also made refunds to those specific borrowers as demanded by the Commissioner. Speight Decl.¶¶ 4-6. While WFHMI has consistently resisted a global review

[2] Examples of exemptions include national banks; federal savings associations; wholly owned service corporations of national banks and federal savings associations.

[3] Effective August 1, 2001.

of its loans, at least with respect to the issue of per diem interest, WFHMI did not contest the Commissioner's authority until January 2003 when he continued to demand compliance with the law. Speight Decl.¶ 6; Burns Decl.¶ 10.

Similarly, WFHMI has never applied to the Commissioner for a ruling that it is exempt from the CFLL or otherwise attempted to surrender its license based upon California Financial Code sections 22050-22054.[4] Moreover, it was not until January 2003, after the Commissioner made absolute demand upon WFHMI to conduct an audit and make refunds regarding per diem overcharges and TILA understatements under its CRMLA license, that WFHMI first claimed it was exempt from the CFLL by virtue of being an operating subsidiary of Wells Fargo Bank. Nagashima Decl. ¶¶ 10-11. During its tenure as a licensee under the CFLL, WFHMI has consistently filed all reports and paid all assessments required by the CFLL. Nagashima Decl.¶ 9. WFHMI has also submitted to all regulatory examinations scheduled by the Commissioner, and responded to all correspondence of the Commissioner concerning these regulatory examinations without question until January 2003. After the promulgation of 12 C.F.R. section 7.4006, the Commissioner conducted or commenced four examinations without any objection from WFHMI. Agbonkpolar Decl. ¶¶ 7-10. WFHMI did not contest the Commissioner's authority until it became clear that the Commissioner would not relent in his demand that WFHMI perform the audit on both issues and make consumers whole under the CRMLA. Nagashima Decl. ¶ 11.

By virtue of its recent claims of preemption in correspondence of January 2003 and through the lawsuit, WFHMI has expressly stated its intention not to abide by requirements of the CRMLA and the CFLL. Compliance with these consumer protection laws is a necessary predicate to maintaining CRMLA and CFLL licenses. Burns Decl.¶ 22 and Nagashima Decl.¶ 12. See also California Financial Code section 22714 and 50327. The California Constitution mandates that the laws of this state be enforced until they are stayed by an appellate court decision. (*See* Cal. Const. art. III, § 3.5).

[4] Examples of exemptions include any person doing business under any law of this state or of the United States relating to banks, trust companies, and savings and loan associations.

In addition to submitting to the Commissioner's jurisdiction under both the CRMLA and the CFLL, WFHMI has continued to advertise its licensure to potential and existing California consumers. WFHMI advertises through mailings and a website, claiming that it is licensed under the CRMLA, thereby misleading California consumers into believing that the protections afforded under the CRMLA, including California Financial Code section 50204(o), would apply to their loans if they seek their residential mortgage loan through WFHMI. Burns Decl.¶ 18. WFHMI has even solicited a Department Assistant Commissioner for a loan via priority overnight mail since the filing of this lawsuit wherein WFHMI once again continued to represent that it was licensed by the Commissioner under the CRMLA. Broudy Decl. ¶ 3.

The amount at issue and the exact number of California consumers affected by WFHMI's violation of the CRMLA is unknown because WFHMI has refused to complete the self audit that would identify the more precise numbers. However, during the 2002 follow-up examination, examiners found approximately a 13% rate of per diem interest overcharges for loans made during the year 2001. Until recently, WFHMI had agreed to conduct a global audit of its loan files regarding finance charge understatements, and make appropriate refunds without any concern to costs. A review of loan files for per diem interest overcharges could easily have been included in that review. Speight Decl. ¶ 12.

Further, the number of loans WFHMI has made in California since January 1, 2001 is unsubstantiated. Pursuant to a report filed by WFHMI with the Commissioner in January 2002, WFHMI made 74,775 loans in California in 2001. WFHMI has not filed the report for the calendar year 2002, which is not due until March 2003. While 2002 was a good year for most lenders, the Report of Principal Amount of Loans Originated and Aggregate Amount of Loans Serviced filed to date by CRMLA licensees discloses that loan origination activities were up by approximately 41% in 2002 from 2001. Applying this figure to the loan activity of WFHMI for 2001, the loan activity for WFHMI for 2002 would be approximately 105,433 loans. This would make the loan totals for WFHMI for 2001 and 2002 approximately 180,188. Burns Decl. ¶ 20.

Finally, the audit demanded by the Commissioner should not require a manual review of each file, assuming WFHMI maintained sufficient loan data information in its computer records.

Speight Decl. ¶ 12. Moreover, recent correspondence received by the Commissioner from WFHMI put the audit costs at approximately $2,000,000, which is much less than the $18,000,000 cost WFHMI has represented to the court. Burns Decl. ¶ 20.

ARGUMENT

I. HEIGHTENED STANDARDS FOR PRELIMINARY INJUNCTIVE RELIEF MUST BE APPLIED

A. Moving Parties Must Satisfy A Heightened Burden When Seeking A Preliminary Injunction Against Government Activity

Courts have applied a heightened standard on the moving party when the injunctive relief is sought "to stay governmental action taken in the public interest pursuant to a statutory or regulatory scheme." *Able v. United States*, 44 F.3d 128, 130-31 (2d Cir. 1995) citing *Plaza Health Labs, Inc. v. Perales, 878 F.2d 577, 580 (2d Cir. 1989).* In this line of cases, the moving party must show more than "sufficiently serious questions going to the merits" (also known as the "fair-ground-for litigation" test). *Able*, 44 F.3d at 130. Where the governmental action is based on a statutory scheme to protect the public, such as the CRMLA and CFLL at issue here, plaintiffs must demonstrate (1) irreparable harm should the injunction not be granted and (2) a likelihood of success on the merits. *Id.*

In *Able*, the Second Circuit Court of Appeals reversed and remanded the case to the District Court when it found the lower court abused its discretion by issuing a preliminary injunction based upon the less stringent standard of "sufficiently serious questions going to the merits" rather than the measure of a "likelihood of success on the mertis". *Id.* at 131-132. The court expressly found that it would be inappropriate for the court to substitute its own determination of public interest and apply the lesser standard where the government had engaged the democratic process to produce policy in the name of public interest that was embodied in a statute and implementing regulations. *Id.* The statutory and regulatory scheme in *Able* was the much debated "don't ask, don't tell" policy of the military as related to sexual orientation of its personnel. *Id. at 130.*

Likewise, in *Plaza Health Lab, Inc., supra,* the appellate court affirmed the district court's refusal to issue a preliminary injunction to prohibit the New York Department of Social Services from suspending Plaza Health Lab, Inc.'s ability to participate in the Medicaid program, finding that the lower court properly applied the likelihood of success standard in combination with the irreparable harm element where the government entity was threatened with being prohibited with carrying out its statutory duties. *Plaza Health Labs, Inc,* 878 F.2d at 580.

Plaintiffs assert that the Ninth Circuit Court of Appeals has adopted a more lenient "alternative standard" similar to the standards rejected in *Able, supra,* and *Plaza Health Labs, Inc, supra.* All three authorities cited in the moving papers are distinguishable. Two of the cases involve preliminary injunctions against private corporations, not governmental entities, and should be disregarded as irrelevant. *See International Jensen, Inc. v. Merrasound U.S.A., Inc.,* 4 F.3d 819, 822 (9th Cir. 1993), *Sun Microsystems, Inc. v. Microsoft, Corp.*, 188 F.3d 1115, 1119 (9th Cir. 1999).

Although plaintiffs' third case cited in support for this alternative standard involved the Immigration and Naturalization Service, a federal agency, it was decided prior to the *Able* line of cases. *See National Center for Immigrants Rights, Inc. v. INS,* 743 F.2d 1365, 1369 (9th Cir. 1984). The issue of the appropriate standard for a preliminary injunction to be issued against a governmental entity was not raised, and thus never addressed in the case. *Id.* Further, unlike the situation presented at bar, a newly promulgated regulation, not a statute or statutory scheme designed to protect the public, was under attack. *Id.* at 1367. The CRMLA and CFLL challenged by plaintiffs are statutory schemes developed to provide consumer protection in lending transactions and, therefore, under the rationale as set forth in *Able* and subsequent cases, require the application of more stringent burdens before a preliminary injunction will issue.

It is instructive to note that a District Court in the Northern District of California recently followed the heightened standard established by the Second Circuit. *Ft. Funsten Dog Walkers v. Babbitt*, 96F. Supp. 2d 1021 (N.D. Cal. 2000). There the court acknowledged the "alternative standard" as the standard for the Ninth Circuit, but nevertheless held that "[a] strong showing or entitlement to a preliminary injunction is required where the moving party seeks to enjoin governmental action taken in the public interest pursuant to a statutory or regulatory scheme. In

such cases, the moving party must establish both irreparable injury and a probability of success on the merits." *Id.* at 1032 (cite omitted).

Plaintiffs must therefore establish, to the satisfaction of this court, both irreparable injury and a likelihood of success on the merits, because they are seeking to stay governmental action taken in the public interest pursuant to a statutory or regulatory scheme. As set forth more fully below, plaintiffs cannot meet this burden.

B. The Plaintiffs Burden Is Greater Where The Preliminary Injunction Sought May Be The Equivalent Of Disposing of An Entire Action.

A heavier burden is also placed upon plaintiffs because their request for preliminary relief seeks to essentially dispose of the entire action. *Sanborn Mfg. Co, Inc. v. Campbell Hausfeld/Scott Fetzer Co.*, 997 F.2d 484, 486 (8th Cir. 1993). Plaintiffs seek to enjoin the Commissioner's licensing, regulatory, examination and enforcement powers under both the CRMLA and the CFLL, and to prevent the Commissioner from revoking the CRMLA and CFLL licenses of WFHMI, or otherwise dispossessing WFHMI of those licenses. Plaintiffs are not limiting their action merely to the per diem or TILA statutes. Thus, plaintiffs are seeking to prevail on all issues in the case at this preliminary stage.

When the granting of a preliminary injunction may provide full relief, the standard for granting the injunction is higher than normal. *Sanborn Mfg. Co, Inc*, 997 F.2d at 486. "The burden on the movant 'is a heavy one where, as here, granting the preliminary injunction will give [the movant] substantially the relief it would obtain after a trial on the merits.'" (citation omitted) *Id.* "When the district court's order, albeit in the form of a TRO or preliminary injunction, will finally dispose of the matter in dispute, it is not sufficient for the order to be based on a likelihood of success or balance of hardships. . . the district court's decision must be correct (insofar as possible on what may be an incomplete record.). . . ." (citations omitted) *Romer v. Green Point Sav. Bank*, 27 F.3d 12, 16 (2nd Cir. 1994) (emphasis added). *See also Rivera-Vega, Inc. v Conagra , Inc.* 70 F.3d 153 (1st Cir. 1995) "When, as in this case, the interim relief sought by the NLRB 'is essentially the final relief sought, the likelihood of success should be strong.'" (citation omitted). *Id.* at 164.

Romer v. Green Point Sav. Bank involved bank depositors who sought a temporary restraining order to stop a stock conversion plan of the bank from going forward. The court found

that the granting of the restraining order would make it impossible for the bank to meet the 45-day-sale-date required for such a conversion, and thus the temporary restraining order had the effect of a final injunction. Accordingly, the court held that because the temporary restraining order would have "the effect of a permanent injunction, we review it in the same manner as we would review such a final injunctive order." 27 F.3d 12, 16. The court in *Romer* then went on to find that the bank depositors had not demonstrated "a violation of their rights, no irreparable harm, no likelihood of success, perhaps not even a fair question for litigation, certainly no balance of hardships tipping in their direction, and no entitlement to relief." *Id.at 16.*

Accordingly, because plaintiffs are seeking to obtain the same relief by their preliminary injunction motion that they seek to obtain after a trial on the merits, plaintiffs must demonstrate "(1) a likelihood of success on the merits; (2) the potential for irreparable injury in the absence of relief; (3) that such injury outweighs any harm preliminary injunctive relief would inflict [on interested parties] . . .; and (4) that preliminary relief is in the public interest." *Rivera-Vega, Inc.*, 70 F.3d at 164; *accord Sanborn Mfg. Co.*, 997 F.2d at 485-486.

As more fully discussed below, plaintiffs have failed to meet this heightened burden to dispose of the entire matter on Preliminary Injunction.

C. Injunctive Relief Is Inappropriate When The Rights of Nonparties Will Be Affected.

The preliminary injunctive relief sought by plaintiffs would adversely affect the borrowers who were overcharged as well as all other California consumers, who rely upon the CRMLA and CFLL for protection. None of the consumers or borrowers are parties to this matter. If granted it also could adversely impact other persons or officials acting in the name of the People of the State of California, such as the California Attorney General, none of whom is a party to this action or have been given any notice of the action by plaintiffs. Further, other licensees under the CRMLA and the CFLL will be unfairly disadvantaged in business by being required to abide by the laws of the State of California while their competitor, WFHMI, is allowed to keep its license but not comply with the same laws. The Court must consider the effect of the injunction upon nonparties in determining whether to grant the far-reaching preliminary injunction as requested by plaintiffs. *Publications Int'l, Ltd. v. Meredith Corporation*, 88 F.3d 473, 478 (7th Cir. 1996).

By way of example, the United States District Court for the District of Nevada refused to grant a single shareholder a preliminary injunction to prevent corporate officers from taking actions in furtherance of stock rights they had declared as a dividend to common stockholders of the company because it would seriously affect the investing public who were not parties to the litigation. *Horwitz v. Southwest Forest Industries, Inc.,* 604 F.Supp. 1130, 1136 (D.NV 1985). To allow one shareholder to disrupt the operations of the corporation by way of a preliminary injunction gave too much power to the allegedly aggrieved party. *Id.*

Here, this court should refuse to allow plaintiffs to disrupt the statutory schemes set forth in the CRMLA and CFLL to the detriment of California consumers, businesses and other government agencies without full argument of the issues.

Plaintiffs misstate the law and the function of the OCC when they claim that California and the public will suffer no harm if the preliminary injunction were granted. Plaintiffs fail to acknowledge that California consumers who obtain loans through WFHMI will continue to be overcharged, as WFHMI deems appropriate during the pendency of this lawsuit if a preliminary injunction were issued. Plaintiffs also disregard the misrepresentation inherent in a court order allowing WFHMI to retain its California licenses, but excusing WFHMI from complying with the underlying statutory scheme designed to protect consumers.

Congress did not expressly preempt any law with respect to operating subsidiaries as further discussed below. *See* Section II, B.3 below. While the OCC may continue to regulate plaintiffs during the pendency of this action, even the OCC makes clear that its regulation is not based on consumer protection but rather on protecting the safety and soundness of the financial institutions. *See* OCC letter attached as Exhibit A to plaintiffs First Amended Complaint. Plaintiffs' offer regarding how they plan to make the public whole at a later date if the CRMLA and CFLL are upheld fails to include interest with the refunds for overcharged customers, and it ignores various other provisions of the CRMLA and CFLL that exist for the public protection.[5] Plaintiffs' offer further ignores the issue of understating finance charges, which currently stands as an obstacle to

[5] The CRMLA also requires that licensees maintain adequate staff; maintain records for 3 years; and fund in a timely fashion. It also prohibits unfair or deceptive practices; commingling of trust funds; and untimely closings.

borrowers' ability to properly shop for and compare loans.[6] Finally, plaintiffs improperly seek to enjoin others, including other state officials, from applying the CRMLA, the CFLL and Civil Code section 2948.5, without notice, thus undermining the concepts of due process.

Plaintiffs must meet the higher burden of both irreparable injury and likelihood of success on the merits because they are (1) seeking to stay governmental action taken in the public interest pursuant to a statutory scheme; (2) seeking to dispose of the entire action by preliminary relief, and (3) seeking to adjudicate a matter involving the interests of third parties. Plaintiffs have failed to meet this burden.

II. PLAINTIFFS FAIL TO ESTABLISH THAT THEY ARE LIKELY TO SUCCEED ON THE MERITS.

A. California Financial Code section 50204(o) Is Not Preempted By DIDMCA.

Section 501 (a)(1) of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) does not preempt the Commissioner from applying California Financial Code section 50204 (o) to WFHMI. Section 50204(o) does not fall within the type of activities preempted by DIDMCA because it does not *expressly limit* interest rates or amounts.

Rather, section 50204(o) prohibits a licensee from requiring "a borrower to pay interest on the mortgage loan for a period in excess of one day prior to the recording of the mortgage or deed of trust." Exceptions are provided for weekends or holidays, so long as the information is disclosed to and agreed to by the borrower. California Financial Code section 50204(o). Section 50204(o) does not expressly limit the rate or amount of interest.

Section 501 (a) of DIDMCA preempts state laws "*expressly limiting* the rate or amount of interest, discount points, finance charges, or other charges taken on a first lien on residential real property." 12 U.S.C. section 1735f-7a(a)(1); 12 U.S.C. section 1735f-7a(a)(1)(A) (emphasis added). Congress enacted DIDMCA in 1980 in response to an economy in which interest rates exceeded the levels lenders could legally charge under state usury laws. *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907, 911-12 (3d Cir. 1990). DIDMCA eliminated interest rates set by usury

[6] Understating finance charges results in a lower annual percentage rate being disclosed to the borrower, thus it is not a correct annual percentage rate with which to compare with those of other potential lenders.

laws to allow financial institutions to change market interest on mortgage loans, thus promoting home ownership by increasing the flow of available mortgage money. *Id.*

An analogy may be drawn between California Financial Code section 50204(o) and the simple interest statute (SIS) which is not preempted by DIDMCA according to the appellate court in *Grunbeck v. Dime Savings Bank of New York, FSB*, 74 F.3d 331 (1st Cir. 1996).

Using the traditional rules of statutory construction, the court focused on the term "*expressly limiting"* in DIDMCA to determine its preemptive scope. *Id.* at 338. "The SIS itself, as distinguished from market forces, does not '*serve to . . . restrain'* either the rate or amount of simple interest which may be obtained, since the lender remains free to compensate by increasing the simple interest rate. . . . Nor, in the alternative, does the SIS – as distinguished from market forces – 'limit' the rate or amount of interest if 'limit' means a final, utmost or furthest boundary on the rate or amount of interest, since SIS imposes no ceiling whatsoever on either the rate or amount of simple interest that may be exacted." *Id.* at 338. To the extent that this requirement may affect the total amount of interest potentially realizable under the loans in question, such effect is *incidental* to the requirement and cannot be viewed as an "express" usury ceiling. *Id.* The court failed to find any congressional intent that would allow DIDMCA to preempt the SIS, and therefore determined that no such express limitations existed in the SIS. *Id.*

Like the SIS, California Financial Code section 50204(o) does not set any limitations on the interest rate (i.e. ceilings) as alleged by plaintiffs, but instead sets only a time period for charging per diem interest prior to recordation of the mortgage or deed of trust. Thus, any other effect the statute may have on the total amount of interest potentially realizable to WFHMI is merely incidental and insufficient to result in preemption. *See Grunbeck,* 74 F.3d at 343-44. Further, California Financial Code section 50204(o) imposes no restriction on either the rate or amount of interest charged. The fact that WFHMI can charge per diem interest for only one day prior to recording of the mortgage, does not, in and of itself, set a ceiling or a fixed quantity, as WFHMI still has the ability to charge any rate or amount of interest it determines appropriate.

"The legislative aim in enacting Section 501(a)(1) [12 U.S.C.S. § 1735f-7a] focused on state usury ceilings, with particular emphasis on state usury laws which restrict interest rates to below

market levels and result in artificial disruptions in the supply of home loan mortgage funds." *Grunbeck,* at 339. By contrast California Financial Code section 50204(o) protects borrowers by establishing a date upon which interest may start accruing that is reasonable in light of industry practice allowing for lender funding one day prior to close of escrow. Burns Decl. ¶ 11.

Plaintiffs erroneously rely upon *Shelton v. Mutual Savings & Loan Association,* 738 F.Supp. 1050 (E.D.Mich. 1990) to support their position that California Financial Code section 50204(o) is preempted by DIDMCA. The *Shelton* court, however, found the challenged Michigan statute to be ambiguous and never reached the issue of preemption. *Id.* at 1058.

Plaintiffs inappropriately rely on *Brown v. Investors Mortgage Co.,* 121 F.2d 472 (9th Cir. 1997) to support their allegations. Like *Shelton*, the *Brown* case is distinguishable as it involved the Washington usury law. While DIDMCA was enacted to free financial institutions from state usury laws, California Financial Code section 50204(o) is not a usury statute.[7] Instead it provides a time period for when interest on certain mortgage loans may be applied prior to close of escrow. Section 50204(o) is designed to prevent borrowers from paying interest on funds before such funds are made available for use by the borrower. Therefore, plaintiffs' discussion regarding the *Brown* case is misplaced and without merit.

As discussed above, DIDMCA was intended to preempt usury statutes, not consumer protection statutes like Section 50204(o) that do not expressly limit the rate of interest, but only affect when interest may commence.

B. The OCC Does Not Have Exclusive Visitorial And Licensing Power Over WFHMI.

The OCC does not have exclusive visitorial and licensing powers over WFHMI because WFHMI is not a national bank; it is a separate corporation that claims it is an operating subsidiary of a national bank. Title 12 U.S.C. section 484(a) only grants the OCC exclusive visitorial powers over national banks. Although the OCC has attempted to expand its jurisdiction to include operating subsidiaries of national banks, by promulgating 12 C.F.R. section 7.4006, there is no express

[7] The California Usury statute can be found in Section 1, Article XV of the California Constitution. There are also rate ceilings provided for in the CFLL, however, they do not apply to any loan of $2,500.00 or more. California Financial Code sections 22303, 22304 and 22251.

Congressional authorization for such an action by this regulatory agency, and the OCC exceeded its authority. Therefore, this court should refuse to allow plaintiffs to disrupt the statutory schemes set forth in the CRMLA and CFLL to the detriment of California consumers, businesses and other government agencies by not granting the preliminary injunction.

1. The OCC Exceeded Its Authority By Promulgating A Regulation That Extends Its Jurisdiction To Operating Subsidiaries.

Regulatory agencies specifically derive their authority, including the ability to promulgate regulations, from the statutory scheme they are charged with administering. *United States v. Mead*, 533 U.S. 218, 226 (2001). In the case of the OCC, it is the National Bank Act ("NBA"), and subsequent banking laws enacted by Congress. Thus, a regulatory agency must look to the language of the statutory scheme, or absence thereof, to ascertain its powers for promulgating regulations. *Id.* at 226.

Pursuant to 12 U.S.C. section 24 (seventh), only national banks are granted the authority to engage in lending. No provision in the National Bank Act ("NBA") grants national banks the authority to own or establish operating subsidiaries or to conduct their lending activities through such operating subsidiaries. *See* 12 U.S.C. § 21 et seq. A regulation created by the OCC is the only alleged authority permitting national banks to own or establish operating subsidiaries. *See* 12 C.F.R. section 5.34. And, as acknowledged by plaintiffs, it was pursuant to this regulation that the OCC has now attempted to extrapolate and inappropriately extend its jurisdiction over operating subsidiaries by promulgating 12 C.F.R. section 7.4006. As plaintiffs admit, these two regulations are the only "authority" supporting their claim that WFHMI is subject only to the visitorial powers of the OCC.

The cases relied upon by plaintiffs acknowledge the OCC 's exclusive visitorial powers with respect to national corporations only, not state-chartered entities. *Guthrie v. Harkness*, 199 U.S. 148, 159 (1905). Plaintiffs cite no authority to this court to support the extension of OCC authority beyond national corporations to state-authorized corporations. Indeed, *State of Oregon v. First Nat. Bank of Portland, 123 P.2d 712 (Or. 1912)* also cited by plaintiffs recognizes that "the visitorial power over any civil corporation resides in the authority creating it". *Id.* at 715.

It is undisputed that WFHMI is a corporation created under the California state laws, and is not a national corporation.

WFHMI, as a legal entity separate from Wells Fargo Bank, could engage in the same lending activity it currently engages in without benefit of ownership by the national bank, provided, that it sought and obtained appropriate state license for making such loans. That a national bank owns a portion of a state-chartered corporation does not authorize the OCC to regulate the state-chartered corporations to the exclusion of State authority, absent Congressional authorization.

A District Court in Minnesota agreed with this analysis when it found that the mortgage company operating subsidiary of Fleet National Bank was not a "bank" under Section 133 of the Gramm-Leach-Bliley Act (codified at 12 U.S.C. § 1816), and thus, was subject to shared enforcement of jurisdiction by the state of Minnesota and Federal Trade Commission regarding telemarketing activities. *Minnesota v. Fleet Mortgage*, 181 F.Supp.2d 995, 1000 (U.S. Dist. Minn. 2001). The court found the mortgage company operating subsidiary not to be a bank despite Fleet National Bank's argument that it was "effectively an incorporated department" of a national bank, and the filing of an amicus brief in support thereof by the OCC. *Id.* at 1000. The court further held that "[a]llowing the State to enforce the TSR [Telemarketing Sales Rule] against FMC [Fleet Mortgage Company] will in no way 'restrict' the authority of the OCC to regulate national bank operating subsidiaries just as it has done in the past. The OCC's insistence that it must have exclusive jurisdiction over subsidiaries in order to avoid having its authority 'restricted' is not persuasive." *Id*. at 1001.

Fleet Mortgage is instructive because the court (1) recognized the chartering and regulatory differences between a national bank and its operating subsidiary, (2) rejected the OCC's claim of exclusive regulatory power over operating subsidiaries of national banks, and (3) refused to defer to the OCC's interpretation of the GLBA and the FDIA [Federal Deposit Insurance Act].

In the absence of Congressional authorization, the only basis that plaintiffs and the OCC cite for the OCC's promulgation of 12 C.F.R. section 7.4006 is another OCC created regulation: 12 C.F.R. section 5.34. No cases have addressed the issue of the OCC overstepping its authority in promulgating either of these regulations, however, scholars have questioned the legality

of operating subsidiaries under Section 16 of the Glass-Steagal Act, codified at 12 U.S.C. section 24 (seventh), which prohibits national banks from purchasing any shares of stock of any corporation for its own account.[8]

Further, plaintiffs provide this court with no reason why the Commissioner should not be allowed to continue to jointly regulate WFHMI, a state-chartered subsidiary, even if the OCC were deemed to have some jurisdiction over WFHMI. *See Minnesota v. Fleet Mortgage*, 181 F.Supp.2d at 1000. As discussed above, the Commissioner has a justified interest in regulating the lending activities of WFHMI for the protection of California consumers. The continued joint regulation of WFHMI by the Commissioner and the OCC will neither interfere with, nor restrict, the OCC's authority to regulate national bank subsidiaries.

The OCC has exceeded its grant of authority by promulgating 12 C.F.R. section 7.4006 to unilaterally declare itself the exclusive regulatory body over state-chartered operating subsidiaries of national banks.

2. WFHMI Is Not A National Bank And There Is No Credible Evidence That It Is An Operating Subsidiary.

Even assuming for the sake of argument that this court finds the that the OCC has the authority to expand its jurisdiction to include operating subsidiaries of national banks, there has been no reliable evidence presented to establish WFHMI is an operating subsidiary or the date on which such status was approved by the OCC.[9]

Pursuant to 12 C.F.R. section 5.34, in order to qualify as an operating subsidiary, a subsidiary must (i) conduct only those activities that are permissible for the national bank, and (ii) be owned 50% or more by the national bank or the national bank otherwise controls the subsidiary and no one else owns more than 50% of the voting interest in the subsidiary. Although plaintiffs' allege that WFHMI is an operating subsidiary of Wells Fargo Bank, they have submitted no evidence in

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[8] The New Universal Bank, 110 Harvard L. Rev. 1310, 1316 (April 1997).

[9] In any event, the Commissioner should be allowed to regulate the activity of WFHMI at least through the date it was found to be an operating subsidiary of Wells Fargo Bank by the OCC, or the effective date of 12 C.F.R. section 7.4006, whichever is later.

support of this claim except their own self-serving statements and objectionable legal conclusions. Wissinger Decl. dated February 10, 2003 and Stumpf Decl. dated January 29, 2003 ¶¶ 2-3.

If, as plaintiffs allege in their First Amended Complaint federal law requires that "all operating subsidiaries must file an application and receive prior approval of the OCC", then the failure of Plaintiffs to produce such evidence to this court casts doubt upon the status of WFHMI, sufficient to defeat plaintiffs' request for preliminary injunction.

3. No Deference Should Be Granted Regarding The OCC's Promulgation Of 12 C.F.R. § 7.4006, Or The OCC Opinion Letters Submitted By Plaintiffs.

The case of *Chevron U.S.A. v. National Resources Defense Council, Inc*, 467 U.S. 837 (1984) established a two-part test that, when applied to the case at bar, demonstrates that no deference should be given to the OCC's regulations or opinions. Because Congress has not "directly spoken to the precise question at issue" and the statute is silent but not ambiguous with respect to the specific issue, the agency's interpretation is not to be given deference. *Id* . at 842-843.

Nowhere in the NBA has Congress either granted the authority to own or establish operating subsidiaries, or indicated that any activity conducted through such operating subsidiaries would be preempted from state laws. Thus the first prong of *Chevron* is not met.

The second prong also has not been met because while the statue is silent, it is not ambiguous about the issue. If Congress wanted to invest operating subsidiaries with the same rights as national banks, it would have done so by amending the statute to include operating subsidiaries.

Notwithstanding the foregoing, the OCC's interpretation is not reasonable.

In adopting 12 C.F.R. section 7.4006, the OCC cited 12 U.S.C. section 24a as its authority for promulgating the rule. *See* 66 Fed.Reg. 34784, 34788, n. 15. However, 12 U.S.C. section 24a only authorizes a national bank to control or hold an interest in a financial subsidiary, which by definition under 12 U.S.C. section 24a, subdivision (g)(3) *cannot* be an operating subsidiary. It is based solely upon this reference by Congress in 12 U.S.C. section 24a(g)(3) as to what a financial subsidiary is not, that the OCC asserts that "[s]tate laws, such as licensing requirements, are applicable to a national bank subsidiary only to the extent that they are applicable to national banks." 66 Fed.Reg. at 34788.

The OCC, in adopting 12 C.F.R. section 7.4006, also stated that it relied upon a similar rule promulgated by the Office of Thrift Supervision ("OTS") with respect to operating subsidiaries of federal savings associations. Without conceding the legality of the OTS rule, the OCC's reliance upon the OTS rule is misplaced because federal savings associations have always enjoyed a broader exemption from state laws under the Home Owners Loan Act ("HOLA") than national banks have under the NBA. *See North Arlington Nat. Bank v. Kearney Federal Savings & Loan Ass'n,* 187 F.2d 564, 566 (3rd Cir. 1951); *People v. Coast Federal Sav. & Loan Ass'n,* 98 F.Supp. 311, 319 (S.D. Cal. 1951).

The authority of the OCC is further questioned when even the Comptroller of the Currency John D. Hawke, Jr. admitted during a speech last year to Women in Housing and Finance that the "OCC has no self-executing power to preempt state law." OCC NR 2002-10, at 7. See Appendix, Exhibit 1.

Plaintiffs offer interpretative letters from the OCC in support of its position regarding the promulgation of 12 C.F.R. section 7.4006, and argue that these letters should be given *Chevron* deference. However, plaintiffs' case law does not support such deference to interpretive letters. Notwithstanding the deference the Supreme Court afforded the OCC in an opinion not involving formal rulemaking procedures (*Nationsbank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.,* 513 U.S. 251 (1995)), this District[10] looked to the standard set forth in the Supreme Court case of *Christensen v. Harris County*, 529 U.S. 576 (2000) to determine the deference with which to treat a federal agency's issuance of a take permit: "[i]nterpretations such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron* style deference. . . . Instead, interpretations contained in formats such as opinion letters are 'entitled to respect' under our decision in *Skidmore v. Swift & Co.,* 323 U.S. 140 (1944)." *Id.* at 587. Further, the Ninth Circuit Court of Appeals cited *Christensen* as recently as October 25, 2002 in determining the

[10] *National Wildlife Federation v. Babbitt, 128 F.Supp.2d 1274,1292 (E.D.Cal. 2000).*

standard of deference to give opinion letters by the OCC and its amicus brief. *Bank of America v. City & County of San Francisco*, 309 F.3d 551, 563 (2002).

While *United States v. Mead Corporation*, 533 U.S. 218 (2001), a case cited by plaintiffs in support of *Chevron* deference for the OCC letters, did note that *Chevron* deference had been given to non-formal rulemaking action by the OCC in *Nationsbank*, the Supreme Court in *Mead* specifically stated that "[i]t 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. (cite omitted) Thus, the overwhelming number of our cases applying Chevron deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication." *Id.* at 230.

Accordingly, the OCC opinion letters are entitled only to respect, and nothing more by this court.

C. The CRMLA and The CFLL Are Not Preempted By Federal Law.

The CRMLA and the CFLL do not conflict with federal law, notwithstanding the issue that the OCC exceeded its authority in promulgating 12 C.F.R. section 7.4006. Plaintiffs' brief is filled only with cases supporting the preemption of state laws with respect to national banks. Nonetheless, this case involves two consumer protection laws, which do not, by their own terms, apply to national banks. California Financial Code sections 22050(a) and 50003(g)(l). Further, the Commissioner's application of the CRMLA and the CFLL has been only to WFHMI, a non-national, state-chartered entity, which has voluntarily maintained licenses from the Commissioner under those laws as a means of doing residential mortgage lending business in the State of California. Accordingly, the cases cited by plaintiffs are not on point with this matter.

"Federal law may preempt state law in three different ways. First, Congress may preempt state law by so stating in express terms. (cite omitted) Second, preemption may be inferred when federal regulation in a particular field is 'so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.' (cite omitted) . . . Third, preemption may be implied when state law actually conflicts with federal law." (cite omitted). *Bank of America v. City*

& County of San Francisco, 309 F.3d 551, 558 (9th Cir. 2002); *Accord American Bankers Association v. Lockyer,* 2002 U.S. Dist. LEXIS 2452 (E.D. Cal. Dec. 2002) (slip op. at 21).

There is an assumption of non-preemption afforded to state laws. *See New York State Conf. of Blue Cross & Blue Shield v. Travelers Ins. Co.,* 514 U.S. 645 (1995) "[W]e have never assumed lightly that Congress has derogated state regulation, but instead have addressed claims of preemption with the starting presumption that Congress does not intend to supplant state law." *Id.* at 654. Plaintiffs rely upon the factually dissimilar *United States v. Locke,* 529 U.S. 89 (2000) case in support of their argument that there is no presumption against preemption. In *Locke*, the Supreme Court refused to apply "an 'assumption' of non-preemption" in determining the validity of Washington laws that imposed restrictions on oil tankers using the state's navigable waterways. *Id.* at 108. *Locke* involved Washington State's attempts to regulate "national and international maritime commerce, an area the Supreme Court noted that Congress had created an extensive 'federal statutory structure', which has as one of its objectives a uniformity of regulation for maritime commerce" *Id.* at 108.

In a case similar to this matter, *Video Trax v. Nationsbank, N.A.,* 33 F.Supp.2d 1041 (S.D. Fla. 1998), the court in discussing state laws limitations on service charges and whether they are preempted by the National Bank Act held that"[t]here is no comprehensive federal statutory scheme governing the taking of deposits. Only one section of the Bank Act even relates to this function, and merely authorizes banks to accept deposits. This section may, by implication, also authorize banks to charge for deposit-related services as an incidental power necessary to carry on the business of receiving deposits. But such implied authority does not constitute a regulatory scheme so comprehensive as to displace state law." *Id.* at 1049.

The situation discussed in *Video Trax* is the same as with lending. Only one section of the National Bank Act ("NBA") relates to lending, and it merely authorizes banks to loan on personal

security. *See* 12. U.S.C. section 24 (seventh). As declared by the court in *Video Trax*, this hardly constitutes a comprehensive regulatory scheme.[11]

Further, as stated in *National State Bank v. Long*, 630 F.2d 981 (3d Cir. 1980) "[w]hatever may be the history of federal-state relations in other fields, regulation of banking has been one of dual control since the passage of the National Bank Act in 1863. . . .[U]nquestionably, as in other businesses, federal presence in the banking fields has grown in recent times. But congressional support remains for dual regulation. In only a few instances has Congress expressly preempted state regulation of national banks." *Id.* at 985.

Congress, in adopting the Riegle-Neal Interstate Banking and Efficiency Act of 1994 ("Riegle-Neal Act"), noted the judicial presumption against preemption. The report of the House-Senate conference committee on the Riegle-Neal Act declared: "[s]tates have a strong interest in the activities of and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses, and communities." The House-Senate conference committee went on to state in regards to determining whether state laws are preempted by federal law that "[c]ourts generally use a rule of construction that avoids finding a conflict between Federal and State law where possible." H.R. Rep. No. 103-651 (Conf. Rep.), at 53, reprinted in 1994 U.S. Code Cong. & Ad. News 2068, 2074. See Appendix, Exhibit 2.

Congressional support for dual control, particularly in the area of lending, continues as it was recently the topic of conversation between Comptroller Hawke and former chairman of the State Senate Banking Committee as reported by the American Banker on February 10, 2003. See Appendix, Exhibit 3.

Accordingly, the court must begin reviewing this case with a presumption against preemption.

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[11] *See also Purdue v. Crocker National Bank*, 38 Cal.3d 913, 937 (1985) finding application of state law to banking charges not preempted by a comprehensive federal statuary scheme that occupied the field, and *Booth v. Old National Bank*, 900 F.Supp. 836, 841 (1995) finding that "Congress has not completely preempted the entire banking field."

1. Express Preemption Is Not Present.

The cases cited above regarding the assumption of non-preemption, and Congress' comments regarding the passage of the Riegle-Neal Act further support the conclusion that there is no express preemption of the CRMLA and the CFLL by the NBA. In *Video Trax*, *supra,* the United States District Court of the Southern District of Florida specifically held that "[t]he Bank Act does not contain an express statement that Congress intended to preempt state law in its entirety . . . ." 33 F.Supp.2d at 1048.

Furthermore, as discussed above, the issue of preemption in this matter does not deal with a national bank, but with an alleged operating subsidiary of a national bank. A reading of the NBA discloses no mention of national bank operating subsidiaries. The CRMLA and the CFLL by their own terms do not apply to national banks. California Financial Code sections 22050(a) and 50003(g)(1). Thus, there can be no preemption of the CRMLA and CFLL by express provision.

2. Field Preemption Does Not Apply.

The *Long, Videotrax, Purdue* and *Booth* cases cited above, and Congress' comments regarding the passage of the Riegle-Neal Act also support the conclusion there is no field preemption of the CRMLA and the CFLL by the NBA either. As succinctly stated in the *Video Trax* case "[b]anking is not an area in which Congress has evidenced an intent to occupy the entire field to the exclusion of the states." *Video Trax,* 33 F. Supp. 2d at 1048.

3. The CRMLA And The CFLL Do Not Conflict With The NBA And The OCC Regulations To Such A Degree That Preemption Is Warranted.

Plaintiffs' claim that as an operating subsidiary of Wells Fargo Bank, the CRMLA and CFLL are preempted as to WFHMI because they conflict with the powers granted to Wells Fargo Bank as a national bank, even though WFHMI has voluntarily maintained licenses under the CRMLA and CFLL.

A review of the NBA discloses that it expressly grants national banks the power to lend. 12 U.S.C. section 24(seventh). However, the NBA does not by its express terms, grant national banks the power to own operating subsidiaries or to carry on their lending activities through such operating subsidiaries. This has been a total creation of the OCC, and Plaintiffs' claim is predicated solely upon 12 C.F.R. section 7.4006, promulgated by the OCC, effective August 1, 2001.

There are numerous cases that have set forth the parameters for establishing conflict preemption under the NBA, though none have dealt with an operating subsidiary of a national bank. Most recently, in *Bank of America* the Ninth Circuit found that actual "conflict arises when 'compliance with both federal and state regulations is a physical impossibility,' (cite omitted) or when state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" *Bank of America*, 309 F.3d at 558; a*ccord, American Bankers Association*, 2002 U.S. Dist. LEXIS 24521 (E.D. Cal. Dec. 2002) (Slip Op. at 21). The court in *American Bankers Association* found that conflict preemption can also occur when state law 'frustrates the purpose of the [ ]national legislation, or impairs the efficiencies of [ ] agencies of the federal government to discharge their duties.'" *American Bankers Association,* 2002 U.S. Dist. LEXIS 24521 (E.D. Cal. Dec. 2002) (Slip Op. at 21) citing *McClellan v. Chipman*, 164 U.S. 347, 357 (1896)). The court noted that "state regulation of banking is permissible (not preempted) when 'it does not prevent or significantly interfere with the national bank's exercise of its powers."' (citing *Bank of America*, 309 F.3d 558-559 quoting *Barnett Bank of Marion County v. Nelson*, 517 U.S. 25, 31 (1996)).

In *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353 (1870), the Supreme Court, rejected a national bank's preemption claim with respect to state tax laws, noting the states' ability to regulate national banks.[12] *Id.* at 361-362. The court held that "[i]t is only when State law *incapacitates* the banks from discharging their duties to the [federal] government that it becomes unconstitutional." *Id.* at 361-362 (emphasis added).

A later Supreme Court case, *McClellan v. Chipman*, 164 U.S. 347 (1896), in upholding a Massachusetts statute which invalidated preferences made by insolvent debtors and assignments and transfers made in contemplation of insolvency, including preferential transfers of real property made by an insolvent debtor to a national bank, focused on whether the state law "impairs the efficiency of national banks or frustrates the purpose for which they were created." *Id.*

[12] In making it's ruling, the Court in *National Bank v. Commonwealth* stated "[i]t certainly cannot be maintained that banks or other corporations or instrumentalities of the [federal] government are to be wholly withdrawn from the operation of state legislation. . . .[National banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. 76 U.S. (9 Wall.) 353, 361-362.

at 358. In determining whether state law impaired the efficiency or frustrated the purpose for which national banks were created, the Supreme Court looked to whether a function of the national bank had been *destroyed* if it were required to comply with the state law to the same extent all other citizens of the state were subjected. *Id.*

WFHMI, according to its papers, has been an operating subsidiary of Wells Fargo Bank, under the licensing, regulatory, supervisory, examination, and enforcement jurisdiction of the OCC for several years. During this same time, WFHMI has also voluntarily submitted itself to the licensing, regulation, supervision, examination, and enforcement jurisdiction of the Commissioner under the CRMLA and the CFLL. That this alleged dual regulation has been ongoing for several years, evidences that there is no "physical impossibility" to WFHMI's "simultaneous compliance with both state and federal law". Further, the fact that WFHMI can only charge one day of interest prior to the recordation of the deed under the CRMLA, does not cause a "physical impossibility" for "simultaneous compliance" as there are no per diem interest requirements under the NBA. Thus, it is only the desire of WFHMI to retain these interest overcharges that now has brought the plaintiffs forward to challenge the CRMLA and the CFLL.

WFHMI's ability to comply with both the federal law and the CRMLA and the CFLL for several years evidences that the CRMLA and the CFLL also do not "stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" or "frustrate the purpose of the NBA or impair the efficiencies of the OCC." Or as stated another way by the court in *American Bankers Association,* "does not prevent or significantly interfere with the national bank's exercise of its powers." 2002 U.S. Dist. LEXIS 24521 (Slip Op. at 21).

The CRMLA and the CFLL do not prevent or significantly interfere with the lending activities of Wells Fargo Bank, even if Wells Fargo Bank desires to conduct certain of those lending activities through WFHMI. Again, this is evidenced by plaintiffs' ability to dominate the lending field in California for the last several years through WFHMI (300,000 loans during 2001and 2002 as claimed by plaintiffs), while voluntarily submitting to dual jurisdiction.

The tests established by the Supreme Court in *McClellan* and *Commonwealth*, for determining whether a state law impairs the efficiency or frustrates the purpose for which national

banks were created is whether the state law "destroys a function" of the national bank or "incapacitates" the bank from discharging its duties.

The CRMLA and the CFLL do not "destroy" or "incapacitate" Wells Fargo Bank from lending. The CRMLA and the CFLL by their own terms do not apply to Wells Fargo Bank. Accordingly, Wells Fargo Bank is free to lend through its California branches without any oversight whatsoever from the Commissioner. That Wells Fargo Bank has chosen to conduct certain of its lending activity through WFHMI (the legality of which remains questionable as discussed above), is of no consequence because the lending activities of WFHMI, as attested by plaintiffs, reveals no destruction or incapacitation with respect to its ability to lend.

"As with express preemption, conflict preemption will not be found unless it is the clear intent of Congress. . . . Courts must not lightly infer preemption, and it is the burden of the party claiming Congress intended to preempt state law to prove it." *Video Trax*, 33 F.Supp. 2d at 1048.

D. The Claim of Retaliation Is Specious.

Administrative officials are under a Constitutional and statutory obligation to enforce the laws of the State of California. Calif. Const. art. III, § 3.5.

"An administrative agency . . . has no power: (a) to declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such a statute is unconstitutional." *Id.* at art. III, § 3.5(a).

Following WFHMI's refusal to abide with the demands of the Commissioner to comply with the CRMLA, under which it had voluntarily sought licensure, by conducting an audit and refunding customers who had been overcharged, the Commissioner fulfilled his obligation under the California Constitution and California Financial Code section 50327. That code section provides for suspension or revocation of the license if the Commissioner finds that "the licensee has violated any provision of this division or any rule or order of the commissioner thereunder." Calif. Fin. Code § 50327(a). The Commissioner was, therefore, well within his constitutional and statutory authority when he pursued revocation actions.

Additionally, WFHMI expressly stated its intention not to comply with the provisions of the CRMLA and CFLL when it filed this suit. Compliance with both laws is necessary to maintaining licenses under those consumer protection laws. Burns Decl. ¶ 22. *See also* the Accusations attached as Exhibit A to the Wissinger Decl. dated 2-10-03.

The cases cited by plaintiffs are factually not on point.[13] Further, the *Illinois Association of Mortgage Brokers* dicta cited by plaintiffs was directed not at the state agency official charged with upholding the laws of the state, but rather, at the comments made by a nonparty who filed an *amicus* brief.

Moreover, if as plaintiffs claim, a CRMLA and/or CFLL license is not necessary to conduct residential mortgage lending and servicing business in California, the revocation of the current licenses should have no effect on plaintiffs alleged federal rights not to be licensed to conduct such business.

III. THE BALANCE OF EQUITIES TIPS AGAINST ISSUANCE OF A PRELIMINARY INJUNCTION.

A. Plaintiffs Will Not Be Irreparably Harmed If The Commissioner Is Not Enjoined.

Plaintiffs will not be irreparably harmed if the Commissioner is not enjoined because (1) the revocation actions involving WFHMI will not prevent Wells Fargo Bank from carrying on a residential mortgage lending and servicing business in California; assuming for the sake of argument the CRMLA and the CFLL are preempted as claimed by plaintiffs, then such licenses are not necessary to WFHMI carrying on that business; (2) there will be no disruption to transferring the business from WFHMI to Wells Fargo Bank as the CRMLA provides a transition period; (3) the audit demanded by the Commissioner would not cost more than $2,000,000, if that, and (4)

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[13] Unlike the action of plaintiffs here to preempt entire bodies of state law, both cases involved declaratory relief actions by mortgage broker associations claiming express preemption of state laws under the Alternative Mortgage Transaction Parity Act of 1982. *Illinois Association of Mortgage Brokers v. Office of Banks and Real Estate*,308 F.3d 762 (7th Cir. 2001); *National Home Equity Mortgage Ass'n v. Face*, 239 F.3d 633 (4th Cir. 2001) cert. denied, 534 U.S. 823 (2001). Interestingly, the 7th Circuit Court remanded the case to the district court to determine which state regulations were incompatible with the federal law. *Illinois*, at 768. The implication, of course, is that the entire Illinois regulatory scheme would not be preempted.

Plaintiffs will not lose significant revenue by having to charge per diem interest as required by the CRMLA.

Plaintiffs' first concern regarding irreparable harm is disingenuous. Plaintiffs argue that WFHMI is not required under federal law to be licensed by the Commissioner under the CRMLA and the CFLL in order to conduct residential mortgage lending and servicing in California, and then argue that if WFHMI loses its licenses under the CRMLA and the CFLL, it will be precluded from doing such business in the State of California. If in fact, WFHMI is not required to have a license to lend or service loans in the State of California, either from the Commissioner or another regulator, then the revocation of the CRMLA and the CFLL licenses does not affect WFHMI's ability to continue to lend and service in California.

With respect to plaintiffs' second concern, the CRMLA allows time for any loans in progress to be completed and all servicing to be transferred in order to avoid such disruption. California Financial Code sections 50310 and 50311. Further, the majority of WFHMI's CRMLA locations are within branches of Wells Fargo Bank and it is anticipated the loan origination and servicing could easily be transferred to the national bank. Burns Decl. ¶¶ 23-24. Moreover, little disruption would occur since, as argued by plaintiffs, WFHMI is but a department or division of Wells Fargo Bank. Wissinger Decl. dated February 10, 2003 ¶ 3.

The Commissioner also contests plaintiffs' claim that the audit demanded by the Commissioner would cost $18,000,000. Previous regulatory submissions to the Commissioner by WFHMI indicate that the audit could be performed via computer without the necessity of a manual review of each file. Speight Decl. ¶ 12. Plaintiffs represented to the Department that the cost of the audit would only be $2,000.000. Burns Decl. ¶ 21.

Finally, WFHMI would not lose significant revenue by having to comply with California Financial Code section 50204(o). The regulatory examinations performed by the Commissioner under the CRMLA prior to April 2001 found that WFHMI was charging no more than one day of per diem interest prior to the date of recording of the deed of trust or none at all. Speight Decl. ¶ 11. Moreover, while the April 2001 regulatory examination and the 2002 follow-up found approximately a 13% rate of per diem interest overcharges for loans made during the year 2001, a

significant number when dealing with consumer protection, it is not a number that supports plaintiffs' claim of substantial losses if it is not allowed to charge interest as it deems fit during the pendency of this matter. Contrary to plaintiffs' allegations in the moving papers, the per diem overcharges were not imposed after closing (proceeds disbursed for borrowers benefit), but prior to the recording of the deed of trust. Therefore, borrowers were paying interest on loans before they received use of the funds through title to the property. The per diem overcharges occurring in 14 of 15 loans found were prior to the loan close, and were caused by early funding of the loan. Cherry Decl. ¶¶ 4-5.

Accordingly, since any overcharges that have occurred will more than likely be limited to less than fifteen percent of its 2001 to 2002 loan portfolio, plaintiffs losses, if any, will be minimal.

B. The Public Will Be Harmed During the Pendency Of This Matter By Granting The Preliminary Injunction.

The public will suffer harm if the preliminary injunction is granted because the CRMLA and the CFLL offer the only effective protection for consumers with respect to the lending and servicing of WFHMI.

Plaintiffs argue that no harm will be suffered, because as a matter of law, if the area has been expressly preempted, there can be no harm. Plaintiffs cite to *Trans World Airlines, Inc. v. Mattox,* 897 F.2d 773 (5th Cir. 1990) in support of this proposition. However, Congress did not expressly preempt any law with respect to operating subsidiaries. As such, plaintiffs cite to *Trans World Airlines* is inapposite to this case.

While the OCC may regulate plaintiffs during the pendency of this action, it is clear that such regulation does not tip in favor of consumer protection as demonstrated by the OCC letter attached as Exhibit A to plaintiffs First Amended Complaint. The January 16, 2003 OCC letter indicates that the OCC concentrates its efforts on safety and soundness issues, not consumer protection.

Also, plaintiffs' offer regarding how they would make the public whole at a later date when the CRMLA and CFLL are upheld (refunds for overcharged per diem that do not even include interest) ignores the various other provisions of the CRMLA and CFLL that exist for the publics' protection. *See* footnote 5 above. Further, plaintiffs' offer ignores the issue of understating finance

charges, which currently stands as an obstacle to borrowers' ability to properly shop loans. Thus, consumers will not be protected during the pendency of this matter.

III. PREEMPTION, IF FOUND, COULD ONLY BE APPLIED TO LENDING ACTIVITY ENGAGED IN BY WFHMI AFTER AUGUST 1, 2001.

Assuming for purposes of this argument only that preemption were found, it is presumed that preemption may not retroactively applied. *See Scott v. Boos*, 215 F.3d 940, 943 (9th Cir. 2000) citing *Landgraf v. USI Film*, 511 U.S. 244 (1994). "[C]ongressional enactments and administrative rules will not be construed to have retroactive effect unless their language requires this result." *Landgraf*, 511 U.S. at 272 (cite omitted).

The operating subsidiary preemption rule, 12 C.F.R. section 7.4006, was not promulgated by the OCC until July 2, 2001, and had an express effective date of August 1, 2001. Thus, under the rules of statutory construction set forth in *Landgraf*, federal preemption of the CRMLA and the CFLL, if found by this court, would only apply from August 1, 2001 forward because 12 C.F.R. section 7.4006 has no retroactive application.[14]

The *Landgraf* case states that "when a case implicates a federal statute enacted after the events in suit, the court's first task is to determine whether Congress has expressly prescribed the statute's proper reach. If Congress has done so, there is no need to resort to judicial default rules. If the statute has no express command, the court must determine whether the new statute would have retroactive effect, i.e., whether it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed. If the statute would operate retroactively, our traditional presumption teaches that it does not govern absent clear congressional intent favoring such result." *Id.* at 280.

Because the OCC specifically prescribed the preemption rule to become effective August 1, 2001 there is no need to look at the second prong in *Landgraf* to determine that the rule is not to be applied retroactively.

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[14] The rule of statutory construction set forth in *Landgraf* to determine whether a statute should be applied retroactively was followed by the Eastern District in *Mannat v. United States*, 951 F. Supp. 172 (E.D. CA 1996).

Accordingly, were the court to consider issuing a preliminary injunction based upon federal preemption of the CRMLA and the CFLL, it should have no effect on the conduct of WFHMI prior to August 1, 2002. Accordingly, the Commissioner must be allowed to assert his jurisdiction under the CRMLA and the CFLL, including revocation of licenses, for conduct that occurred prior to that date.

CONCLUSION

For the foregoing reasons, plaintiffs have not shown a likelihood of success sufficient to warrant the issuance of a preliminary injunction and they have failed to prove they will suffer irreparable harm if required to comply with the CRMLA and CFLL. Accordingly, the Court should deny plaintiffs' request for preliminary injunction.

Should the Court believe that preemption applies pursuant to 12 C.F.R. section 7.4006, there is no question but that the OCC regulation was not effective until August 2001. Therefore, preemption could have no bearing on the actions taken by the Commissioner prior to the effective date. As a result, any injunction issued should only restrict acts occurring after August 2001, and no preliminary injunction should apply to any revocation proceeding instituted by the Commissioner pursuant to his statutory and/or regulatory authority regarding conduct by plaintiffs prior to the effective date of the OCC regulation.

Defendant respectfully requests this Court deny Plaintiffs' Motion for a Preliminary Injunction in its entirety, or, in the alternative, grant the limited relief requested above.

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VIRGINIA JO DUNLAP (CA BAR NO. 142221)
Acting Assistant Commissioner
ALAN S. WEINGER
Supervising Counsel

JUDY L. HARTLEY (CA BAR NO. 110628)
320 West 4th Street, Ste. 750
Los Angeles, California 90013-2344
Telephone: (213) 576-7604
Fax: (213) 576-7181

ATTORNEYS FOR DEFENDANT