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June 30, 2000

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Dear Mr. XXXXXX:

I am writing in reply to your letter of May 12, 2000 regarding the applicability of Michigan's licensing laws to the business activities of XXXXXX.

In your letter, you asked this agency "to provide [XXXXXX] with its written acknowledgement that (i) [XXXXXX] is not subject to any State law that could not be applied to a federal savings bank operating in Michigan, and (ii) the State will not take any adverse action against any dealer for doing business with [XXXXXX] based on the fact that [XXXXXX] does not maintain any license or registration under Michigan law." In support of your request, you pointed out that the Federal District Court for the Western District of Wisconsin in 1999 upheld the validity of the Office of Thrift Supervision (OTS) regulations that extend the benefits of the federal preemption doctrine to an operating subsidiary of a federal savings bank in *WFS Financial Inc. v. Richard L. Dean, et al.*, 70 F. Supp. 2d (W.D. Wis, 1999). Your letter indicated that XXXXXX "is not subject to state licensing and registration requirements, state law restrictions on loan related fees, or other state laws that purport to regulate the business or operations of [XXXXXX]."

For reasons that are explained in the following pages, I disagree with your conclusion that XXXXXX is entitled to the same federal preemption of state law as its federal thrift affiliate and can not concur with the aforementioned statements.

Even if I agreed with your conclusion that "[XXXXXX] is not subject to any State law that could not be applied to a federal savings bank operating in Michigan," XXXXXX -- just like its federal savings bank affiliate -- would not be able to acquire installment contracts from Michigan licensed installment sellers without the sales finance license required by the Motor Vehicle Sales Finance Act (Act). The Act prohibits licensed motor vehicle installment sellers from selling installment contracts to any person not licensed under the Act. In the attached declaratory ruling issued by the former Financial Institutions Bureau in January of this

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year, the agency enunciated this position to a national bank which had claimed a federal “field” preemption.

In your letter you imply that Michigan law is federally preempted and that because of this preemption XXXXX is allowed to do business in the State of Michigan and conduct licensable business activity without subjecting itself to the licensure and regulatory requirements of state law. Your letter placed considerable emphasis upon the *WFS Financial Inc. v. Richard L. Dean, et al* case.¹ The Court in *WFS Financial Inc.* relied heavily on regulations promulgated by the Office of Thrift Supervision (“OTS”) (12 CFR 560.2(b)(1), 12 CFR 559.3(n)(1)).

Federal regulation 12 CFR 560.2(b) states, in pertinent part, that:

“... the types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding:

(1) Licensing, registration, filings, or reports by creditors;”²

Federal regulation 12 CFR 559.3(n)(1) states:

(n) Does state law apply?

(1) State law applies to operating subsidiaries only to the extent it applies to you [(federal savings associations)].

It is important to recognize that 12 CFR 560.2 was promulgated under the authority vested in the OTS by Congress through sections 4(a)³ and 5(a)⁴ of the Home Owners Loan Act (HOLA). These two sections of HOLA expressly grant the OTS authority to promulgate regulations regarding “the responsibilities” of the OTS.⁵ The responsibilities with which Congress charged the OTS are: (1) to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as federal savings associations (including Federal savings banks); and (2) to charter federal savings associations.⁶ Thus, the plain meaning of HOLA clearly indicates that Congress did not intend to convey any authority upon the OTS to charter or license any business entity other than the federal savings association.

¹ Case no. 99-C-0345-C (WD Wisc 1999).

² It should be noted that “paragraph (a)” refers to the preemption of state law as applied to federal savings associations – “paragraph (a)” does not expressly state or imply that the preemption is applicable to other business entities created and regulated by state law (*i.e.* general business corporations).

³ 12 USC 1463(a).

⁴ 12 USC 1464(a).

⁵ See, 12 USC 1464(a) and 12 CFR 1463(a)(2).

⁶ 12 USC 1464(a).

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The United States Supreme Court has consistently held since *McCullough v Maryland*⁷ that federal preemption of state law requires clear congressional intent. The Supreme Court has stated that “[t]he question in each case is what the purpose of Congress was.”⁸ The purpose of Congress is the ultimate touchstone in determining whether state law is preempted.

None of the statutory authorities upon which the OTS based 12 CFR 559.3(n)(1) indicates any intention of Congress to broadly preempt state licensure and registration law with regard to state-chartered corporations. The section⁹ of HOLA regarding investments made by federal savings associations does not authorize the OTS to organize or license general business corporations or limited liability companies. Thus, the organic law applicable to federal savings associations does not preempt state regulation of general business corporations and limited liability companies (short-term loan companies).

Although state licensure law is not applicable to savings associations chartered by the OTS, such non-applicability or preemption is not transferable to a state-chartered company simply because a federal savings association owns some part of the company. Applying this preemption to such companies leads to some absurd results. To illustrate, if the statement in 12 CFR 559.3(n)(1) providing that state law only applies to operating subsidiaries of federal savings associations if it could be applied likewise to federal savings associations were accepted as true, operating subsidiaries could never come into corporate existence. State corporation and limited liability company laws regarding the creation of such businesses do not apply to federal savings associations. Therefore, under 12 CFR 559.3(n)(1) state corporation and limited liability company laws could not be used to form or create operating subsidiaries. Such a result is absurd. Operating subsidiaries owe their entire existence to state corporation and limited liability company laws. Such state law empowers state officials to charter companies and to recognize and regulate the existence of foreign companies within their state.

A similarly absurd result occurs with the demise of a general business corporation or limited liability company. If the preemption were as broad as stated, no orderly method at law would exist for the ending and wind-up of an operating subsidiary's affairs. Because state assignment for the benefit of creditors, state receivership and conservatorship, corporate and limited liability company wind-up, and shareholder equity statutes do not apply to federal savings associations, under the preemption espoused by your letter such statutes would have no applicability to operating subsidiaries. This is absurd. The only provisions for the dissolution, receivership, conservatorship, or wind-up of state-chartered corporations and limited liability companies are state law, or alternatively, the United

⁷ 17 US 316 (4 Wheat 316), 4 L Ed 579 (1819).

⁸ *Rice v Santa Fe Elevator Corp*, 331 US 218, 230; 67 S Ct 1146; 94 L Ed 1447 (1946).

⁹ 12 USC 1464.

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States Bankruptcy Code, neither of which applies to federal savings associations. This absurdity is compounded by the fact that the OTS has absolutely no authority to take over and rehabilitate or liquidate a failing operating subsidiary.

Finally, 12 CFR 559.3(n)(1) contradicts other OTS regulations that describe the permissible relationships between federal savings associations and their subsidiaries. The OTS regulations¹⁰ applicable to subordinate organization investments of federal savings associations mandate that in order for associations to invest in subordinate organizations the subsidiaries must appear to the public as completely separate corporate entities.

Subsidiaries must ensure that: (1) their business transactions are completely separate from those of the association¹¹; (2) all the formalities of a separate corporate existence are observed¹²; (3) the subsidiary is adequately financed, apart from the assets of the association¹³; (4) it is held out to the public as a separate enterprise¹⁴; and, (5) unless the association has guaranteed a loan made to the subsidiary, any loan made to the subsidiary must indicate that the association is not liable on the debt¹⁵. The assertion that state licensure law does not apply to subordinate organizations of federal savings associations defeats the purported purpose of 12 CFR Part 559. State licensure is an important indicator of separate corporate existence. It is a sign that is held out to the public that a separate, unique, and identifiable enterprise exists.

On August 19, 1997 Carolyn J. Buck, Chief Counsel of the OTS issued a letter regarding federal thrift operating subsidiaries. Ms. Buck's letter states that "[o]ne of the reasons the OTS authorizes federal savings associations to establish operating subsidiaries was to allow institutions to maintain control over an activity but better isolate and contain their liabilities than would be possible if it were conducted in the federal savings association itself."¹⁶

Although the Bureau agrees with Ms. Buck's assertion that it is prudent from a safety and soundness standpoint to allow and perhaps require the use of an operating subsidiary in certain circumstances, her argument that state law can only be applied to the subsidiary if that same law would apply to the association destroys this reason for forming an operating subsidiary (limitations of liability, risk reduction). Shareholders of operating subsidiaries enjoy limitations on liability because of state corporation law, not HOLA.

¹⁰ See, 12 CFR Part 559.

¹¹ 12 CFR 559.10(a)(1).

¹² 12 CFR 559.10(a)(2).

¹³ 12 CFR 559.10(a)(3).

¹⁴ 12 CFR 559.10(a)(4).

¹⁵ 12 CFR 559.10(a)(5).

¹⁶ Letter from Carolyn J. Buck, Chief Counsel of the Office of Thrift Supervision, to an anonymous entity (Aug. 19, 1997) (emphasis added).

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The OTS' General Counsel has issued letters regarding the issue addressed by the Court in *WFS Financial Inc.* The Buck letter¹⁷ makes reference to another OTS letter. This letter, drafted by Ms. Carolyn B. Lieberman, Acting Chief Counsel to the OTS, stated that because "... the OTS lending regulations applicable to federal savings associations (and thus to operating subsidiaries) occupy the entire field of lending regulation, leaving no room for supplemental state requirements. ... [S]tate licensing and registration laws ... have no application to federal savings associations. For the reasons set forth above, this conclusion applies with equal force to operating subsidiaries."¹⁸ In a footnote to this statement Ms. Lieberman indicated that her position was supported by opinions of the United States Supreme Court in *Hillsborough County, Florida v Automated Medical Laboratories, Inc*¹⁹, *Capital Cities Cable, Inc v Crisp*²⁰, and *Rice v Santa Fe Elevator Corp*²¹.

In the *Hillsborough* case, the Supreme Court held that the federal regulations at issue did not preempt state law (county ordinances and regulation of the subject entity) on the basis of field preemption or conflict preemption, where there was no showing of a conflict between state law and the federal regulatory scheme. The *Hillsborough* case involved a state-chartered corporation that sought to avoid licensure and regulation by a political subdivision of the state (Hillsborough County, Florida). The corporation was subject to the regulation and licensure of an agency of the federal government (Food and Drug Administration).

The Court stated that, "[t]o infer pre-emption whenever an agency deals with a problem comprehensively is virtually tantamount to saying that whenever a federal agency decides to step into a field, its regulations will be exclusive. Such a rule, of course, would be inconsistent with the federal-state balance embodied in our Supremacy Clause jurisprudence."²² The Court stated further that, "[u]ndoubtedly, every subject that merits congressional legislation is, by definition, a subject of national concern. That cannot mean, however, that every federal statute ousts all related state law. Neither does the Supremacy Clause require us to rank congressional enactments in order of 'importance' and hold that, for those at the top of the scale, federal regulation must be exclusive."²³

¹⁷ *Id.*

¹⁸ Letter from Carolyn B. Lieberman, Acting Chief Counsel of the Office of Thrift Supervision, to an anonymous entity, 9 (footnotes omitted) (Oct. 17, 1994).

¹⁹ 471 US 707, 105 S Ct 2371, 85 L Ed 2d 714 (1985).

²⁰ 467 US 691, 698-700; 104 S Ct 2694; 81 L Ed 2d 580 (1984).

²¹ 331 US 218, 67 S Ct 1146; 91 L Ed 1447 (1947).

²² *Hillsborough County*, 471 US at 717.

²³ *Id.* at 719.

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In *Capital Cities*, the United States Supreme Court was concerned with the state regulation of federally licensed signals²⁴ carried by local cable television systems.²⁵ The Supreme Court held that if a federal agency preempts an area of state concern “and if this determination ‘represents a reasonable accommodation of conflicting policies’ that are within the agency’s domain, we must conclude that all conflicting state regulations have been precluded.”²⁶

In *Rice*, the Supreme Court was presented with yet another dispute concerning the state regulation of federally licensed activity.²⁷ The Supreme Court found that Congress expressly terminated concurrent state-federal regulation of warehousing. The statute at issue (United States Warehouse Act²⁸), was found to expressly preempt state law regarding state licensure of federally licensed warehousing activity of state-chartered corporations.²⁹ This preemption was found because under the Act a federal license was all that was required to engage in the warehousing activity at issue. The Court, however, did find that the Act did not foreclose some state regulation of licensed warehousemen. The Court found that state law applies in those areas not expressly preempted if Congress fails to cover the field of regulation completely or makes express exceptions to preemption in favor of state regulation.³⁰

Thus, it is clear that Ms. Lieberman’s reliance on the above authorities for the assertion that HOLA preempts state licensure of a state corporation, where some portion of its stock is owned by an OTS-chartered entity, is misplaced. The authorities cited all involve federal agencies expressly empowered by Congress to license certain business activities of state-chartered corporations.

In the issue presented by your letter, no federally licensed business activity is involved. It is likewise clear that no conflict exists between state and federal law with regard to licensure. HOLA does not provide any authority or mechanism for any agency of the federal government to charter or license short-term loan companies organized as state-chartered limited liability companies. The OTS is not vested with any authority to charter or regulate companies other than federal savings associations.³¹ The chartering of limited liability companies (*i.e.* short-term loan companies) and the licensure of their business

²⁴ The license involved here is the federal compulsory copyright license. This license permits local cable operators to retransmit broadcast signals, but prohibits such operators from deleting commercial advertising from such signals. *See*, 17 USC 111.

²⁵ *Capital Cities*, 467 US at 698-700.

²⁶ *Id* at 700 (notes and citations omitted).

²⁷ 331 US at 220-222.

²⁸ 7 USC 241, *et seq* (1944).

²⁹ *Rice*, 331 US at 234.

³⁰ *Id* at 234-237.

³¹ 12 USC 1464(a).

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activity is not within the domain of the OTS. Such companies come into existence by virtue of state law, not HOLA or any regulation of the OTS. Finally, it cannot be argued with any authority that Congress has acted to cause the OTS to occupy the entire field of limited liability companies and short-term consumer lending law. Such a claim is clearly without merit. “[T]he authority of the [OTS] to pre-empt state law is not limitless ... HOLA does not permit the [OTS] to pre-empt the application of all state and local laws.”³² “[A] statement that Congress has totally preempted [state] regulation of all operational activities of federal savings and loan associations is simply too broad.”³³

XXXXX is a state-chartered general business corporation formed in the state of Wisconsin under the Wisconsin Business Corporation Law³⁴, and admitted into the State of Michigan as a foreign general business corporation under Michigan’s Business Corporation Act³⁵. XXXXX has been granted a privilege of doing business in Michigan by participating in the installment sales finance business as a general business corporation, not as a federal savings association. The privilege was conveyed in the form of a contract – a foreign corporation charter. “The charter of a corporation, whether it is created by a special act or formed under a general corporation law, is a contract between the corporation, or the corporators or members, and the State. It is a contract between the State and the corporation, between the corporation and the stockholders, and between the stockholders and the State.”³⁶ The contract XXXXX entered into with the State of Michigan implies that in exchange for all the powers³⁷ and limitations on shareholder liability³⁸, and other benefits of the corporate form, it covenants that it will conduct its business and business dealings with Michigan residents subject to the laws of Michigan.

Corporations are distinct from their shareholders and members. This distinction is recognized even if a single individual or corporation owns all of the corporation’s stock.³⁹ XXXXX is a distinct and separate legal entity from YYYYYY. “[A state] in authorizing its own corporations or those of other States to carry on business ... within its borders may

³² Fidelity Federal Savings & Loan Association v De La Cuesta, 458 U.S. 141, 171-172; 102 S Ct 3014; 73 L Ed 2d 664 (concurring op of O’Connor) (1982).

³³ Dep’t of Banking & Finance (ex rel) Lewis v Standard Federal Savings & Loan Ass’n, 463 So. 2d 297, 301 (citing De La Cuesta, 458 US at 171-172) (Fla Dist Ct App. 1st Dist 1984); *approved*, Dep’t of Banking & Finance v. Standard Federal Savings & Loan Ass’n, 488 So. 2d 50 (Fla 1986). *See*, Gruenbeck v Dime Savings bank 74 F3d 331, 341-342 (1996) (OTS interpretations that do not tender a valid rationale or consider significant issues of state law are “unpersuasive and entitled to no deference”).

³⁴ Wis. Stat. § 180.0101, *et seq.*

³⁵ MCL 450.1101, *et seq.*; MSA 21.200(101), *et seq.*

³⁶ Bruun v Cook, 280 Mich 484, 491; 273 NW 774 (1937) (cited with approval in BCBSM v Governor, 422 Mich 1, 19; 367 NW2d 1 (1985)).

³⁷ *E.g.*, MCL 450.4210; MSA 21.198(4210), and MCL 450.5003; MSA 21.198(5003).

³⁸ MCL 450.4501(2); MSA 21.198(4501)(2).

³⁹ Bourne v Muskegon Circuit Judge, 327 Mich 175, 191-192; 41 NW2d 515 (1950); *cited with approval in* Bitar v Wakim, 456 Mich 428, 431; 572 NW2d 191 (1998).

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qualify the privilege by imposing such conditions and duties as reasonably may be deemed expedient in order that the corporation's activities may not operate to the detriment of the rights of others with whom it may come in contact."⁴⁰ "The granting of a corporate right or privilege rests entirely within the discretion of the state, and when granted may be accompanied by such conditions as the Legislature may judge most befitting to its interests and policy."⁴¹ "[U]nder federal decisions, the sovereignty which determines the existence or non-existence of power in a state corporation is the state."⁴²

Unless an exception applies, the Michigan Legislature has determined all those who purchase motor vehicle installment contracts must be licensed under the Act.⁴³ Further the Michigan Legislature has determined that motor vehicle installment contracts covered by the Act may be sold only to entities licensed under the Act.⁴⁴ This requirement applies whether the business is a domestic or foreign corporation and whether the corporation has as its sole shareholder a state- or federally-chartered depository financial institution. If XXXXX cancels its licenses and continues to purchase motor vehicle installment contracts in the State of Michigan, it will be in violation of Michigan law – it will have violated the covenant of its corporate privilege.

You have implied that such violation is without penalty on the basis of the federal government's power and authority over XXXXX' operations. As explained earlier, the OTS is only authorized to charter federal savings associations, not general business corporations licensed by the states as consumer lenders. XXXXX is organized as a state-chartered general business corporation, admitted into Michigan as a foreign general business corporation to provide the Michigan citizenry automobile financing. To interpret federal law to circumvent the laws of the state regarding its corporations and business entities would "put an end to corporations created [and controlled] by the state and turn them into different corporations" not subject to state law.⁴⁵ Such an interpretation would lead to an unconstitutional encroachment upon the powers retained by the State of Michigan pursuant to the 10th amendment of the United States Constitution.

It should be noted that no provision of Michigan law prevents a state-chartered general business corporation from sharing information with its majority shareholder (federal savings association) or a federal regulatory agency (OTS) that regulates the majority

⁴⁰ Prudential Insurance Co v Cheek, 259 US 530, 536; 42 S Ct 516; 66 L Ed 1044 (1922).

⁴¹ Rudolph Wurlitzer Co v Commissioner, 81 F2d 971, 974 (1936) (*citing* Prudential Insurance Co, 259 US 530); *cert den*, 298 US 676, 56 S Ct 940, 80 L Ed 1397 (1936).

⁴² 81 F2d at 973 (citations omitted).

⁴³ MCL 492.103; MSA 23.628(3).

⁴⁴ MCL 492.115(a); MSA 23.628(15)(a).

⁴⁵ Hopkins Federal Savings & Loan Association v Cleary, 296 US 315, 336; 56 S Ct 235; 80 L Ed 251 (1935). *See*, US Const, amend X.

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shareholder. Therefore, no provision of the Act or other Michigan law impairs the ability of the OTS to ensure that the investment made by a federal savings association in an operating subsidiary is safe, sound, and within the limitations of HOLA.

Because XXXXX will violate its covenant with the State of Michigan if it operates as an unlicensed sales finance company in the state of Michigan, it would not be entitled to any benefit of the corporate form with regard to any business activity conducted within the State of Michigan or with citizens of the State of Michigan. If during any period of non-licensure, XXXXX engages in any business activity licensable under the Act, such activity is unlawful and possibly usurious.

If XXXXX is to operate in the State of Michigan and finance the sale of motor vehicles, it must subject itself to licensure under Michigan law. Otherwise, XXXXX must cease operations in the State of Michigan.⁴⁶

If you have any questions in this regard, please contact Barbara J. Strefling at (517) 373-3470.

Very truly yours,

/ss/

Frank M. Fitzgerald
Commissioner

cc: G. Mielock
B. J. Strefling

⁴⁶ See, 36 Am Jur 2d *Foreign Corporations* § 215-218.