

2002

Mountain America Financial Services, Inc. v. G. EDWARD LEARY, as the Commissioner of the Utah Department of Financial Institutions : Reply Brief

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

MOUNTAIN AMERICA FINANCIAL)
SERVICES, INC.,)

Petitioner/Appellee,)

vs.)

G. EDWARD LEARY, as the)
Commissioner of the Utah Department)
of Financial Institutions,)

Respondent/Appellant.)

Case No. 20020438-CA

Priority No. 15

REPLY BRIEF OF APPELLANT

G. EDWARD LEARY, COMMISSIONER OF UTAH DEPARTMENT
OF FINANCIAL INSTITUTIONS

ON APPEAL FROM AN ORDER OF THE THIRD DISTRICT COURT
STATE OF UTAH, JUDGE GLENN IWASAKI

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RCV 10 2002
Pamela Slagg
Clerk of the Court

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TABLE OF CONTENTS

ARGUMENT	1
I. The Plain Language of Utah Code Ann. § 7-9-20(7)(Supp. 2002) Which Establishes Limits on Commercial Lending Apply to the Funds of the Credit Union.	1
II. MAFS’s Reliance on Utah Code Ann. § 7-1-301(8)(Supp. 2002) For Standards For Proper Limitations on CUSO Lending Is Misplaced.	2
A. Other Possible Avenues for CUSO Regulation Do Not Excuse the Commissioner from Enforcing the Provisions of Section 7-9-20(7).	3
B. Under Section 7-1-301(8), the Commissioner is Not Granted Authority to Create Separate Rules for Credit Unions and CUSOs.	3
C. Any Rulemaking Power Granted by Section 7-1-301(8) With Respect to CUSOs and Credit Unions Is Superseded by Section 7-9-20(7).	4
D. Rulemaking Power Under Section 7-1-301(8) Would Allow the Commissioner to Impose the Same Limitations as Contained in Section 7-9-20(7).	5
III. The Commissioner Properly Raised the Issue of Whether the Business Loan Limitations of Section 7-9-20(7) Apply to CUSO to Which the Argument Regarding Utah Code Ann. § 7-9-26(Supp. 2002) Relates.	5
IV. Examining the Actions of a Parent Does Not Constitute a Piercing of the Corporate Veil.	6
CONCLUSION	7

TABLE OF AUTHORITIES

STATE CASES

<u>Olson v. Park-Craig-Olson, Inc.</u> , 815 P.2d 1356 (Utah App. 1991)	2
<u>Salt Lake City Corp. v. James Constructors, Inc.</u> , 761 P.2d 42 (Utah App. 1988)	7

STATE STATUTES

Utah Code Ann. § 7-1-301(8)(Supp.2002)	2, 3, 4, 5
Utah Code Ann. § 7-1-301(8)(a)(Supp.2002)	3
Utah Code Ann. § 7-9-20(7)(Supp.2002)	1, 2, 3, 4, 5, 6
Utah Code Ann. § 7-9-26 (Supp.2002)	5
Utah Code Ann. § 7-9-26(3)(e)(Supp.2002)	5, 6

ARGUMENT

Appellant, G. Edward Leary as the Commissioner of Utah Department of Financial Institutions (“Commissioner”), responds to Appellee’s Brief as follows:

I. The Plain Language of Utah Code Ann. § 7-9-20(7) Which Establishes Limits on Commercial Lending Apply to the Funds of the Credit Union.

Mountain America Financial Services (“MAFS”) has suggested that the Commissioner has improperly interpreted Utah Code Ann. § 7-9-20(7) (Supp. 2001) by reading the word “CUSO” into the statute, and thus the Commissioner’s decision to not approve two business loans made by MAFS was in violation of Utah law. See MAFS Brief at 7-11. This argument misses the point that § 7-9-20(7) applies to the funds of the credit union, rather than merely to the credit union itself.

MAFS argues that because § 7-9-20(7) does not specifically mention the term “CUSO” that the limitations on business lending in § 7-9-20(7) cannot apply to a CUSO. See MAFS Brief at 9-10. However, this interpretation misconstrues the point of the Commissioner’s argument. The Commissioner’s focus is not on the CUSO itself, but instead on the funds of the parent credit union. Section 7-9-20(7) speaks to the way that credit union funds may be utilized with respect to lending. The Commissioner’s position is that when a credit union creates and funds a CUSO, the funds in the CUSO are still properly considered credit union funds. Therefore, when a CUSO makes an extension of credit, it is the same as if the extension of credit was made by the parent credit union. To do otherwise would allow credit unions to avoid the legislatively imposed limitations to

their lending practices through a “strawman” transaction. These “strawman” transactions effectively allow credit unions to launder loans through the CUSO that the credit union is prohibited from making by statute.

MAFS would like to limit the question before the Court to whether or not the word “CUSO” appears in the statute. To limit the issue in such a fashion ignores the fact that § 7-9-20(7) is much more involved than MAFS would like. While it is true that § 7-9-20(7) does not contain the phrase “CUSO lending”, § 7-9-20(7) does speak indirectly to CUSO lending by limiting the way that credit union funds may appropriately be used. Failing to require a CUSO or other subsidiary to use the credit union funds in accordance with § 7-9-20(7) allows credit unions to evade legitimate legislative limitations.

II. MAFS’s Reliance on Utah Code Ann. § 7-1-301(8)(Supp. 2002) For Standards For Proper Limitations on CUSO Lending Is Misplaced.

MAFS suggests that the proper avenue for the Commissioner to impose lending limitations on CUSOs is under the authority granted to the Commissioner under § 7-1-301(8). See MAFS Brief at 12-14. The issue of whether or not the Commissioner has authority under § 7-1-301(8) to make rules with respect to CUSO lending was never raised before the trial court or at the administrative level, accordingly, the issue is not properly before the Court in this matter. Olson v. Park-Craig-Olson, Inc., 815 P. 2d 1356, 1358-59 (Utah App. 1991). However, if the Court decides to consider the matter, the argument fails for several reasons. First, the issue is irrelevant to the matter before the Court. Second, § 7-1-301(8) does not allow the Commissioner to create a separate class

for CUSOs, therefore, § 7-1-301(8) does not provide authority for creating loan limitations for CUSOs by rule. Third, § 7-9-20(7) is a more specific statute that supersedes § 7-1-301(8) with respect to lending limitations. And fourth, if § 7-1-301(8) does provide rulemaking power to the Commissioner with respect to CUSO lending, nothing in § 7-1-301(8) would prevent the Commissioner from adopting the same standards as those contained in § 7-9-20(7).

A. Other Possible Avenues for CUSO Regulation Do Not Excuse the Commissioner from Enforcing the Provisions of Utah Code Ann. § 7-9-20(7)(Supp. 2002).

MAFS attempts to argue that the possibility of the Commissioner having other means to address CUSO lending somehow precludes the Commissioner from enforcing the requirements of § 7-9-20(7). See MAFS Brief at 11. This argument misses the point that the Commissioner has the authority to require CUSOs making loans to comply with the requirements of § 7-9-20(7) because the CUSOs are making loans with the funds of the credit union. To argue that the Commissioner has other authority under which to act does not change the fact that the Commissioner has the authority and responsibility to enforce § 7-9-20(7) with respect to CUSO lending.

B. Under Utah Code Ann. § 7-1-301(8)(Supp. 2002), the Commissioner is Not Granted Authority to Create Separate Rules for Credit Unions and CUSOs.

Under § 7-1-301(8)(a), the Commissioner is granted discretionary authority to “create reasonable classes of depository and other financial institutions including separate classes for savings and loan associations and related institutions, banks and related

institutions, credit unions, and industrial loan corporations.” It is curious that the rule does not speak to related institutions of credit unions. Given that the Legislature specifically authorized the Commissioner to create classes for related institutions of banks and savings and loans, it would appear that the Legislature did not intend to grant the Commissioner the authority to create separate classes for CUSOs as related institutions of credit unions. Therefore, if § 7-1-301(8) were to grant rulemaking authority to the Commissioner with respect to CUSOs, it would appear that CUSOs would have to be subject to the same rules as credit unions.

C. Any Rulemaking Power Granted by Utah Code Ann. § 7-1-301(8)(Supp. 2002) With Respect to CUSOs and Credit Unions Is Superseded by Utah Code Ann. § 7-9-20(7)(Supp. 2002).

The situation is further confused by the fact that § 7-1-301(8) is a general statute that is superseded by the more specific § 7-9-20(7). Under § 7-1-301(8)(b)(vi), the Commissioner could impose limitations on credit union lending as long as the limitations were based on an institution’s capital. However, in light of the specific limitations regarding lending by credit unions contained in § 7-9-20(7), the Commissioner has been preempted from drafting rules with respect to credit union lending. As it is the Commissioner’s position that the requirements of § 7-9-20(7) apply to credit union funds, even in the hands of the CUSO, the limitations of § 7-9-20(7) would also supersede any rulemaking authority that might possibly exist under § 7-1-301(8), with respect to CUSOs.

D. Rulemaking Power Under Utah Code Ann. § 7-1-301(8)(Supp. 2002) Would Allow the Commissioner to Impose the Same Limitations as Contained in Utah Code Ann. § 7-9-20(7)(Supp. 2002).

Finally, even if the Commissioner has rulemaking power with respect to CUSO lending under § 7-1-301(8), there is nothing that would prevent the Commissioner from implementing the same standards with respect to CUSOs as those contained in § 7-9-20(7). The lending limits contained in § 7-9-20(7) are based on capital with certain maximum loan limitations. There is nothing in § 7-1-301(8) that would suggest that the Commissioner could not impose maximum limits on CUSOs as well.

III. The Commissioner Properly Raised the Issue of Whether the Business Loan Limitations of Utah Code Ann. § 7-9-20(7)(Supp. 2002) Apply to CUSO to Which the Argument Regarding Utah Code Ann. § 7-9-26(Supp. 2002) Relates.

MAFS misstates the position of the Commissioner with respect to the application of Utah Code Ann. § 7-9-26. The Commissioner's position is not a new issue that a credit union cannot invest in a CUSO that makes loans. Instead, the Commissioner's position is that a CUSO making loans in excess of the loan limitations in § 7-9-20(7) could put the credit union at risk of being in violation of § 7-9-26, as having made improper investments. This argument is directly tied to the Commissioner's position argued below in opposition to MAFS' Motion for Summary Judgement, specifically that CUSOs must comply with the requirements of § 7-9-20(7).

MAFS suggests that the plain language of § 7-9-26(3)(e) authorizes credit unions to invest in loans made by the CUSO. See MAFS Brief at 14-15. Such an interpretation

is a misreading of the statute. Section 7-9-26(3) outlines the permissible investment activities of a credit union. Under § 7-9-26(3)(e), a credit union is authorized to invest its funds “in shares, stocks, loans, or other obligations of any organization, corporation, or association” if the organization, corporation or association meets the corporate purpose requirements of § 7-9-26(3)(e). [Emphasis added.] MAFS contends that the use of the term “loans” means that a credit union can invest in loans made by the CUSO. However, a careful reading of § 7-9-26(3)(e) shows that a credit union is authorized to invest in a CUSO or other similar entity by purchasing shares of the entity, purchasing stock in the entity, making loans to the entity, or acquiring other obligations of the entity.

The use of the term “other obligations” shows that the terms “shares”, “stocks”, and “loans” are meant to refer to obligations of the entity, in this case the CUSO. A loan made by a CUSO to a consumer would not be an “obligation” of the entity. Only a loan made to the entity (CUSO) by the credit union would be considered an “obligation” of the CUSO. Therefore, § 7-9-26(3)(e) authorizes a credit union to loan funds to a CUSO or similar entity, but does not allow the credit union to invest in loans made by a CUSO to a third party.

IV. Examining the Actions of a Parent Does Not Constitute a Piercing of the Corporate Veil.

MAFS alleges that in order for the Commissioner to apply the member-business lending limitations of § 7-9-20(7) to MAFS, the Commissioner must “pierce the corporate veil” and “imput[e] the actions of MAFS to its sole shareholder, Mountain

America.” MAFS Brief at 16. However, this argument misinterprets the purpose of the “corporate veil” theory. The “corporate veil” is designed to protect a stockholder from economic liability for the actions of the entity in which the stockholder has invested. The Utah Court of Appeals recognized this principle when it stated that the “purpose of such separation is to insulate the stockholders from the liabilities of the corporation, thus limiting their liability to only the amount that the stockholders voluntarily put at risk.” Salt Lake City Corp. v. James Constructors, Inc., 761 P.2d 42, 46 (Utah Ct. App. 1988).

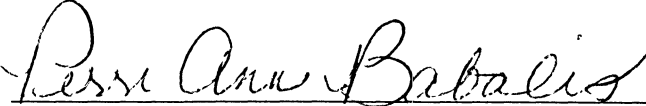
The “corporate veil” theory does not serve to prevent a regulator from ensuring that an entity within its regulatory jurisdiction is complying with the statutory and regulatory requirements to which the entity is subject. The tracing of credit union funds to ensure compliance with relevant statutory and regulatory provisions does not expose the credit union to economic liability for the actions of the CUSO. Accordingly, the corporate veil theory does not act to prevent the tracing of credit union funds. Allowing a subsidiary to claim that the “corporate veil” prevents the Commissioner from examining how a regulated entity utilizes regulated funds would allow the regulated entity to evade legitimate regulation by placing funds in a subsidiary. The “corporate veil” theory was not designed to allow entities to evade legitimate regulation by the formation of subsidiaries.

CONCLUSION

Based on the foregoing and Appellant’s initial brief, G. Edward Leary, Commissioner of the Utah Department of Financial Institutions, respectfully requests that

this Court overturn the District Court's Order granting MAFS's Motion for Summary Judgment, which vacated the Commissioner's Order subjecting CUSOs to the Utah Credit Union Act, and uphold the Order of the Commissioner.

DATED this 25th day of November, 2002.



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CERTIFICATE OF SERVICE

I hereby certify that I caused to be mailed, postage prepaid, two (2) true and correct copies of the Reply Brief of Appellant, this 25th day of November, 2002, to the following:

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