

2002

# Mountain America Financial Services, Inc., v. G. Edward Leary, as the Commissioner of the Utah Department of Financial Institutions : Amicus Brief

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

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MOUNTAIN AMERICA FINANCIAL  
SERVICES, INC.,

Plaintiff and Appellee

v.

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

Defendant and Appellant

**UTAH BANKERS ASSOCIATION  
AMICUS BRIEF**

Case No. 20020438-CA

Priority No. 15

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**APPEAL FROM THE THIRD DISTRICT COURT  
IN AND FOR SALT LAKE COUNTY  
JUDGE GLENN K. IWASAKI**

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**LIST OF PARTIES**

PLAINTIFF AND APPELLEE:	MOUNTAIN AMERICA FINANCIAL SERVICES, INC.
DEFENDANT AND APPELLANT:	G. EDWARD LEARY, as the Commissioner of the Utah Department of Financial Institutions
AMICUS CURIAE:	UTAH BANKERS ASSOCIATION

## **TABLE OF CONTENTS**

STATEMENT OF JURISDICTION.....	6
DETERMINATIVE CONSTITUTIONAL PROVISIONS, STATUTES, ORDINANCES, AND RULES.....	6
STATEMENT OF THE CASE.....	8
STATEMENT OF THE FACTS.....	8
SUMMARY OF THE ARGUMENT .....	9
ARGUMENT .....	10
I.    Credit Union Limits on Business Lending Apply to a Credit Union’s Subsidiary.....	10
A.    A Credit Union’s Fundamental Mandate is to Provide Consumer Services .....	10
B.    Business Lending is Ancillary to Service to Individual Credit Union Members .....	11
C.    The Business Loan Limits Apply to a Subsidiary .....	12
II.    Utah Banks Are Entitled To Operate in the Competitive Balance Sought by the Legislature .....	15
CONCLUSION .....	174

## **TABLE OF AUTHORITIES**

### **Cases**

<u>America First Credit Union v. Department of Financial Institutions</u> , 33 P.3d 390 (Utah Ct. App. 2001) .....	12
<u>Front Royal Savings &amp; Loan Ass'n v. First Virginia Bank</u> , 222 Va. 194, 278 S.E.2d 853 (1981) .....	13
<u>Morton International Inc. v. Auditing Division of the Utah State Tax Commission</u> , 814 P.2d 581 (Utah 1991) .....	12
<u>Utah Bankers Association v. America First Credit Union, et al</u> ; 912 P.2d 988 (Utah 1996) .....	13

### **Statutes**

Internal Revenue Code § 501(c)(14) .....	8
Utah Code § 59-7-102(1) .....	8
Utah Code § 78-2a-3(2)(b)(i) .....	4
Utah Code § 7-9-2 .....	4, 8, 9
Utah Code § 7-9-20 .....	4, 9
Utah Code §§ 7-9-34 .....	8

### **Other Authorities**

1915 Utah Laws § 1 .....	8
--------------------------	---

### **Rules**

Utah Administrative Rule R337-4 .....	5, 11
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## **STATEMENT OF JURISDICTION**

The Court of Appeals has jurisdiction over this appeal pursuant to Utah Code § 78-2a-3(2)(b)(i).

## **STATEMENT OF THE ISSUES**

The primary issue before this Court is whether Mountain America Credit Union (“Mountain America”), a Utah chartered credit union, can circumvent statutory prohibitions on business lending by making prohibited business loans through a wholly owned subsidiary.

## **DETERMINATIVE CONSTITUTIONAL PROVISIONS, STATUTES, ORDINANCES, AND RULES**

### **Utah Code § 7-9-2. Description of credit unions.**

A credit union is a cooperative, non-profit association, incorporated under this chapter to encourage thrift among its members, to create sources of credit at fair and reasonable rates of interest, and to provide an opportunity for its members to use and control their resources on a democratic basis in order to improve their economic and social condition.

### **Utah Code § 7-9-20. Board of directors—Powers and duties—Loan limitations.**

. . .

(7)(a) The credit that may be outstanding or available by a credit union at any one time is subject to the limitations described in Subsections (7)(b) and (c):

. . .

(b)(i) A credit union may not extend credit that is not a member-business loan to a member if as a result of that extension of credit the total credit that is not a member-business loan that the credit union has issued to that member exceeds at any one time:

(A) for a credit union with less than \$2,000,000 in capital and surplus, the greater of:

(I) \$1,000; or

(II) 15% of capital and surplus up to a total of \$25,000; or

(B) for a credit union with \$2,000,000 or more in capital and surplus, the greater of:



- (I) \$25,000;
- (II) 1% of capital and surplus; or
- (III) 25% of the regular reserve.

(ii) Beginning March 24, 1999, a credit union may not extend a member-business loan to a person:

(A)(I) if the person is a business entity, unless at least one individual having a controlling interest in that business entity has been a member of the credit union for at least six months prior to the date of the extension of the member-business loan; or

(II) if the person is an individual, unless the individual is a member of the credit union for at least six months prior to the date of the extension of the member-business loan; or

(B) if as a result of the extension of the member-business loan, the total amount outstanding for all member-business loans that the credit union has extended to that person at any one time exceeds the lesser of:

- (I) 10% of the credit union's capital and surplus; or
- (II) \$250,000.

(c)(i) Beginning March 24, 1999, a credit union may not extend a member-business loan if as a result of that member-business loan the credit union's aggregate member-business loan amount calculated under Subsection (7)(c)(ii) at any one time exceeds 1.25 times the sum of:

- (A) the actual undivided earnings; and
- (B) the actual reserves other than the regular reserves.

#### **Utah Administrative Rule R337-4. Establishment of "Credit Union Service Organizations."**

##### **R337-4-1. Authority, Scope, and Purpose.**

- (1) This rule is issued pursuant to Section 7-1-301(3)(a) and construes and applies to Section 7-9-5(34).
- (2) This rule applies to all state-chartered credit unions.
- (3) The purpose of this rule is to define "credit union service organizations" and outline the procedures and requirements for establishing these organizations.

##### **R337-4-2. Definitions.**

- (1) "Capital and surplus" means shares, deposits, reserves, and undivided earnings.
- (2) "Commissioner" means the Commissioner of Financial Institutions.

(3) "Credit union service organization" means an organization which provides any of the following services to its stockholder credit unions:

- (a) Data processing services;
- (b) Promotion marketing and general management support services;
- (c) Access to sophisticated accounting systems;
- (d) Non-profit debt counseling services;
- (e) Management training and education to credit union personnel;
- (f) Services related to processing, selling, or servicing mortgage loans;
- (g) Credit card services;
- (h) Automated teller machine services;
- (i) Insurance agency services;
- (j) Discount brokerage services;
- (k) Shared branch facilities; and

Other services that are commonly associated with the routine operations of the credit unions.

### **STATEMENT OF THE CASE**

#### **Nature of the Case and Course of Proceedings.**

This appeal is from an order and judgment entered by the Honorable Glenn K. Iwasaki of the Third Judicial District Court for Salt Lake County on May 6, 2002, granting summary judgment to plaintiff Mountain America Financial Services, Inc., a subsidiary of Mountain America. R. 140-147.

### **STATEMENT OF THE FACTS**

1. The Appellant, G. Edward Leary, the Utah Commissioner of Financial Institutions (the "Commissioner"), ruled that business loans made by Mountain America through a wholly owned subsidiary of Mountain American violated specific business lending limitations on credit unions. R. 12-14.

2. The Commissioner noted correctly that the amounts of the two business loans at issue exceeded a statutory cap of \$250,000 per loan. The loan amounts were \$768,750 and \$525,000. R. 12-14.

2. Mountain America appealed the Commissioner's decision by filing a lawsuit in Third District Court. R. 1-16.

3. The District Court ruled in favor of Mountain America by concluding that Mountain America's wholly owned subsidiary could make business loans that Mountain America was prohibited from making. R. 140-145.

### **SUMMARY OF THE ARGUMENT**

By statute, the ability of a Utah credit union to make business loans is very limited. This limit on business loans is consistent with a credit union's mandate to provide services to individual consumers. Mountain America cannot circumvent these statutory limits by making prohibited business loans through a wholly owned subsidiary.

Utah banks, as competitors within a highly regulated industry, are entitled to fair competition from credit unions within the competitive framework established by the legislature. Credit unions cannot engage in unlawful competition within that framework by using a subsidiary to make prohibited business loans.

## **ARGUMENT**

### **I. Credit Union Limits on Business Lending Apply to a Credit Union's Subsidiary.**

#### **A. A Credit Union's Fundamental Mandate is to Provide Consumer Services.**

Credit unions serve an important niche for individual consumers and have been provided significant competitive advantages to accomplish that objective. Those advantages include wholesale exemptions from state and federal income taxes.<sup>1</sup> The introductory section of the Utah credit union statute captures this historical mandate regarding services to the individual consumer:

A credit union is a cooperative, non-profit association, incorporated under this chapter to encourage thrift among its members, to create sources of credit at fair and reasonable rates of interest, and to provide an opportunity for its members to use and control their resources on a democratic basis in order to improve their economic and social condition.

Utah Code § 7-9-2.

As the Court would suspect, the credit union statute has evolved throughout the past century to keep pace with changes in financial services. Despite those changes, the mandate for a credit union to serve its member consumers has not. The initial Utah credit union statute, 1915 Utah Laws § 1, which called such institutions “co-operative banks”, defined the institution as

a cooperative association formed for the purpose of promoting thrift among its members, by affording means for saving money in small or large amounts, by

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<sup>1</sup> The exemption from federal income tax is found at Internal Revenue Code § 501(c)(14). The exemption from state income tax is found at Utah Code §§ 7-9-34 and 59-7-102(1).

security deposits or loans of funds upon the associated liability of its members, by furnishing advances or loans for productive purposes, by making loans of a remedial character, by promoting in a co-operative spirit the ideals of help for self-help, and by transacting a general banking business in the interest of its members primarily.

Id. The current description of a credit union found in Section 7-9-2 is not materially different than the description given in 1915. The fundamental purpose of a credit union to provide services to its individual members has not changed in nearly ninety years.

**B. Business Lending is Ancillary to Service to Individual Credit Union Members.**

In 1999, credit unions were given a narrow right to make business loans, an endeavor that is outside their historical mandate. The legislature provided that a credit union can make business loans only to certain business, in certain limited amounts and in certain limited volume. Utah Code § 7-9-(20)7. The following is a rough summary of key limits on credit union business lending:

- a. The member business loan must be to a member who has enjoyed membership in the credit union for at least six (6) months.
- b. The amount of a member business loan cannot exceed \$250,000 with some narrow exceptions.
- c. In the aggregate, the total of a credit union's business loans cannot exceed 1.25 times the sum of its undivided earnings and actual reserves other than regular reserves.

Id. The \$250,000 cap in item b. is one of the limitations that Mountain America wanted to circumvent through the use of a subsidiary.

These limitations on business loans reflect the credit union's mandate to serve its consumer members. These lending limits are not intended to ensure a financial institution's health or to avoid a risky concentration with one borrower. The legislative intent inferred from the foregoing limits is straightforward. In giving service to a particular member, a credit union is now permitted to reach outside its mandate of consumer lending, but only in a very limited way, to make modest business loans for the benefit of that member. These modest business lending opportunities are *ancillary* to the fundamental services to be provided to members on a consumer level.

As an example of this legislative intent, the legislature requires that the borrower be a member of the credit union for six (6) months before a business loan can be made. This requirement ensures that the initial membership is *consumer* oriented and that membership is intended for purposes unrelated to the limited business loan opportunity that eventually would be available to that member.

**C. The Business Loan Limits Apply to a Credit Union Subsidiary.**

The Commissioner understood that the business loan opportunities for Mountain America were intended to be limited. The Commissioner properly determined that the business loan limits should apply to a wholly owned subsidiary of a Mountain America. In addition, the administrative rule promulgated by the Commissioner regarding the establishment of credit union subsidiaries list subsidiary activities that are "service"

oriented. Utah Administrative Rule 337-4-2.<sup>2</sup> Nothing in the Rule 337-4-2 begins to suggest that the subsidiary can make business loans that the credit union itself cannot make. The rule provides that a credit union subsidiary is to assist the credit union in credit union operations. Id. The creation of the subsidiary does not permit unlawful credit union activities.

Mountain America is mistaken in its belief that the restraints on business lending outlined by the legislature have no application if the business loan document simply names a subsidiary of the credit union as the lender rather than the credit union itself. Nothing in the credit union statute begins to suggest that a credit union can disregard the business loan limits by naming a wholly owned subsidiary as the lender on the business loan documents. Mountain America may argue the alternative, that nothing in the credit union statute expressly prohibits a credit union's wholly owned subsidiary from making

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<sup>2</sup> The list of activities in Utah Administrative Rule 337-4-2 for a credit union subsidiary consists of the following:

- (a) Data processing services;
  - (b) Promotion marketing and general management support services;
  - (c) Access to sophisticated accounting systems;
  - (d) Non-profit debt counseling services;
  - (e) Management training and education to credit union personnel;
  - (f) Services related to processing, selling, or servicing mortgage loans;
  - (g) Credit card services;
  - (h) Automated teller machine services;
  - (i) Insurance agency services;
  - (j) Discount brokerage services;
  - (k) Shared branch facilities; and
- Other services that are commonly associated with the routine operations of the credit unions.

business loans that its parent credit union cannot make and that the business loan limits has no application in that instance. That argument is hollow. There is no reasoned explanation that suggests lending limitations on a credit union should have no application to its wholly owned subsidiary. Silence does not warrant circumvention of the limits. Silence favors pursuit of legislative objectives. Silence does not favor an avoidance of those objectives.

More importantly, this Court has noted that when legislative intent cannot be ascertained, deference is given to the agency's reasoned interpretation. See Morton International Inc. v. Auditing Division of the Utah State Tax Commission, 814 P.2d 581, 589 (Utah 1991) ("it is appropriate to conclude that the legislature has delegated authority to the agency to decide the issue"). Given the statutory scheme that limits credit union business loans, the Commissioner concluded with good reason that such limits apply to a wholly owned subsidiary of the credit union. Deference should be given to that conclusion.

Finally, it is helpful to note that this Court has already addressed and rejected another attempt by a credit union to circumvent the business lending prohibitions. In the case of America First Credit Union v. Department of Financial Institutions, 33 P.3d 390 (Utah Ct. App. 2001), a credit union claimed the right to circumvent business lending limits by entering into "loan participations" with another financial institution. This Court had little trouble in concluding that such a transaction was nothing more than a member-



business loan and that the statutory limits applied. *Id.* at 391 (“According to the plain language of the statute, credit union participation in a member-business loan is restricted by membership and loan limitation requirements.”).

## **II. Utah Banks Are Entitled To Operate Within the Competitive Balance Established by the Legislature.**

The Utah Supreme Court has recognized specifically the standing of the UBA (on behalf of its member banks) to enforce the terms of the Utah credit union statute. Utah Bankers Association v. America First Credit Union, et al., 912 P.2d 988, 993 (Utah 1996). The Utah Supreme Court recognized the important right of the banks to enforce the competitive balance sought by the credit union statutes. In holding that the UBA had standing to enforce the Utah credit union statute, the Utah Supreme Court noted the substantial public interest in not permitting unfair competition between financial institutions:

[T]he [Utah] legislature intended to promote competitive equality among state financial institutions as well as between federal and state institutions. As the Virginia Supreme Court stated in interpreting part of Virginia's financial regulatory scheme, ‘Competition in the financial market is constructive and productive; it can sometimes be destructive and unfair, and the public has a substantial interest in protecting all certified financial institutions against ruinous competition.’

*Id.* at 991-92. (quoting Front Royal Savings & Loan Ass'n v. First Virginia Bank, 222 Va. 194, 278 S.E.2d 853, 856 (1981)).

The Utah Supreme Court also noted that “[t]he [Utah] Commissioner [of Financial Institutions] has the power to profoundly affect competition between various institutions

through his authority to supervise the operation and management of institutions, authorize the expansion of the rights, privileges, and benefits of institutions, and establish criteria for the approval of new institutions.” Id. at 991.

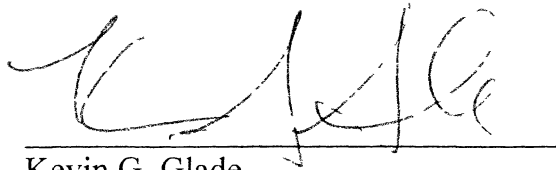
The issue in this appeal regarding the right of a credit union to make business loans puts a spotlight on the competitive balance to be preserved between banks and credit unions. Business lending is a key component of a commercial bank’s profitability, whereas, as discussed previously, the mandate for credit unions is to serve consumers. Mountain America’s effort to circumvent the business lending limitations on a credit union through use of a subsidiary frustrates, if not eliminates, the competitive balance sought by the legislature. Mountain America’s claimed right to make business loans outside the statutory limits puts a serious strain on the competitive balance sought among all financial institutions and would create unfair competition for banks in particular. The ruling of the District Court condoning that unfair competition for UBA member banks should be reversed.

### **CONCLUSION**

The UBA asks respectfully that summary judgment in favor of Mountain America Financial Services, Inc. be reversed and that the District Court be ordered to enter judgment in favor of the Commissioner affirming the Commissioner’s initial ruling against Mountain America.

Respectfully submitted the 27<sup>th</sup> day of August 2002.

RAY, QUINNEY & NEBEKER

A handwritten signature in black ink, appearing to read 'K. Glade', written over a horizontal line.

Kevin G. Glade  
Attorneys for Utah Bankers Association

**[NO ADDENDUM WAS NECESSARY]**

CERTIFICATE OF SERVICE

I hereby certify that I caused to be mailed, postage prepaid, two (2) true and correct copies of the foregoing UTAH BANKERS ASSOCIATION AMICUS BRIEF this 27<sup>th</sup> day of August 2002 to the following:

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