DREHER TOMKIES LLP ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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OCC'S "*MADDEN*-FIX" RULE UPHELD

The District Court for the Northern District of California has ruled in favor of the Office of the Comptroller of the Currency's ("OCC") cross-motion for summary judgment, upholding the OCC's "Madden-fix" rule and the so-called "valid-when-made" principle. See Order Resolving Cross-Motions for Summary Judgment, *California v. Office of the Comptroller of the Currency*, No. 20-cv-05200-JSW (N.D. Cal. filed 02/08/22). In 2020, California, Illinois and New York ("Plaintiffs") sued the OCC challenging the validity of the OCC's final rule titled *Permissible Interest on Loans That Are Sold, Assigned or Otherwise Transferred* ("Final Rule"), which was promulgated in response to uncertainty surrounding the valid-when-made doctrine in the wake of the ruling of the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016). See our Alerts of Sep. 26, 2019 and June 26, 2020. The Final Rule provides that interest on a loan that is permissible under 12 U.S.C § 85 ("Section 85") shall not be affected by the sale, assignment or other transfer of the loan. 12 C.F.R. § 7.4001(e).

Case Summary

Plaintiffs argued, among other things, that the OCC failed to follow 12 U.S.C. § 25b ("Section 25b") of the Dodd-Frank Act when promulgating the Final Rule, characterizing the effect of the rule as a preemption determination by the OCC. Section 25b sets forth procedures the OCC must follow to preempt a state consumer financial law, allowing such a law to be preempted only if the OCC determines that the state consumer financial law prevents or significantly interferes with the exercise of a national bank's powers. The court disagreed noting that the OCC did not evaluate a particular consumer finance law when creating the Final Rule or make a "preemption determination." Ultimately, the court found that the OCC simply interpreted the National Bank Act ("NBA") itself rather than a state consumer financial law, noting that the Dodd-Frank Act did not upend the authority of national banks to export interest rates under the NBA and that the preemption of state usury law has always been inherent in Section 85, citing *Marquette Nat' l Bank of Minn. v. First Omaha Service Corp.*, 439 U.S. 299 (1978) and *Cohen v. Capital One Funding, LLC*, 489 F. Supp. 3d 33, 47 (E.D.N.Y. 2020).

Plaintiffs also argued that the OCC lacked authority to issue the Final Rule because the Second Circuit implicitly construed the unambiguous terms of 12 U.S.C. § 85 in *Madden*. *See our* ALERT of Mar. 22, 2019. The court concluded that *Madden* did not clearly hold that terms of Section 85 were unambiguous; therefore, the OCC was not precluded from interpreting Section 85.

Finding that *Chevron* deference applied, the court acknowledged that the Final Rule may allow non-banks to charge a rate of interest in excess of state-law usury caps in effect at the time a loan is transferred; however, the Final Rule does not purport to regulate changes to the interest rate or to regulate the transferee's conduct once that transaction is consummated. The relevant portion of Section 85 states that "any association may take, receive, reserve and charge on any loan or discount made . . . interest at the rate allowed by the laws of the State . . . where the bank is located." The OCC argued that Section 85 was silent on the issue in question and that it was acting to fill that statutory gap. The court agreed, stating that Section 85 did not address what happens to the interest rate set by a national bank once it has been incorporated into a contract, let alone a contract that is subsequently transferred. The court recognized the contract principle that "an assignee steps into the shoes of the assignor," noting that the court was persuaded by Professor Levitin's argument that the "valid-when-made" principle *per se* was of more recent vintage but also noting that the OCC's interpretation did not turn on that principle alone.

The court stated that the OCC's interpretation of Section 85, which comports with the valid-when-made principle, was not arbitrary or capricious or manifestly contrary to law and that, commensurate with a national bank's power to transfer or assign loans, the Final Rule provides a national bank the power to do so without altering the interest rate upon which it and the borrower initially agreed.

Comptroller's Statement

Following the announcement of the court' s decision, Michael Hsu, acting Comptroller of the Currency, issued a statement acknowledging the court's ruling while issuing a warning to lenders not to abuse the new legal certainty regarding interest rates. Comptroller Hsu reiterated that "predatory lending has no place in the federal banking system" and that his office "is committed to strong supervision that expands financial inclusion and ensures banks are not used as a vehicle for 'rent-a-charter' arrangements." OCC News Release 2022-13.

FDIC Litigation

Concurrently with the OCC's issuance of its *Madden*-fix rule, the Federal Deposit Insurance Corporation ("FDIC") issued a similar rule.

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See 12 C.F.R. § 331. Several states likewise challenged the FDIC rule. *See California v. FDIC*, No. 20-cv-5860 (filed Aug. 20, 2020). The court in the OCC case specifically referenced the FDIC case in a footnote and indicated that the parties' cross-motions for summary judgment in that case will be addressed in a separate order. We will continue to monitor the FDIC case for updates.

Conclusion

This decision is a major win for the financial services industry, hopefully bringing to a close a tumultuous era created by *Madden*, at least for national banks. State banks still need to await a decision in the FDIC case but a similar result is to be expected, since the FDIC similarly relied upon the contractual principle of assignees stepping into the shoes of their assignors. Nonbank lenders and creditors can hope that judicial recognition of this contractual principle, if not "valid-when-made" *per se*, may help counter future *Madden*-like challenges as well, although states are not prohibited from imposing restrictions on assignees, such as so-called "holder" licensing. We will provide an update when a decision in the FDIC case becomes available. ❑

✧ *Mike Tomkies, Nathan Copeland and Mercedes Ramsey*