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ALERT

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AFTER A SUMMER FILLED WITH DEVELOPMENTS, A N.Y. FEDERAL COURT FINDS NBA PREEMPTION FOR SECURITIZATION TRUSTS AND DISTINGUISHES *MADDEN*

A federal court in New York has dismissed a class action filed against two credit card securitization trusts and a nonbank limited liability company finding that the National Bank Act ("NBA") preempts New York usury claims. *Peterson v. Chase Card Funding LLC,* No. 19-00741 (W.D.N.Y. Sept. 21, 2020). In rendering its decision, the federal court distinguished *Madden v. Midland Funding* and deferred to the Office of the Comptroller of the Currency's ("OCC") new rule regarding the permissible interest rate on transferred loans (*i.e.*, the "*Madden* fix" valid-when-made ("VWM") rule; *see* our ALERT of July 29, 2020).

The plaintiff in *Peterson* had an unsecured credit card originated by a national bank located outside of New York. The national bank sold credit card receivables to a nonbank limited liability company, which then sold the receivables to two trusts. The trusts issued asset-based securities to finance the purchases of receivables and contracted with the originating national bank to service the credit card accounts. The national bank remained the owner of the credit card accounts. The plaintiff did not name the national bank as a defendant.

The federal court found that the plaintiff's state usury claims are expressly and implicitly preempted by the NBA. With respect to express preemption, the court observed that, as the account owner, the national bank retained a substantial interest in credit card accounts, including the right to increase or decrease the interest rates on accounts. Application of the New York usury limit would conflict with the national bank's powers under the NBA to charge the interest rate permitted under the laws of the national bank's "home state." Thus, the state usury claims were preempted.

Sitting in the U.S. Court of Appeals for the Second Circuit's jurisdiction and bound by the Second Circuit's decisions, the federal court handled *Madden* in its analysis. The federal court determined that *Madden* involved "materially different facts" from the facts in *Peterson.* In *Madden*, the national bank forfeited all interests and rights in the loan accounts by selling whole loans to third-party debt buyers that acted solely on their own. The court in *Peterson* recognized that the national bank, as the credit card account owner, retained a number of rights in the accounts. The federal court recounted that the Second Circuit distinguished the facts of *Madden* from the Eighth Circuit's decision in *Krispin v. May Department Stores* on the basis that *Krispin* involved receivable sales where a bank retained "substantial rights." The federal court said the national bank in *Peterson* is akin to the bank in *Krispin*. Therefore, the *Madden* ruling does not apply.

The federal court also found that the NBA implicitly preempts the plaintiff's state usury claims because application of state usury laws against the credit card receivables purchasers (*i.e.*, the defendants) would significantly interfere with the national bank's exercise of its powers under the NBA. To support its conclusion, the federal court discussed the OCC's recently finalized "*Madden*-fix" (VWM) rule and deferred to the OCC's reasoned judgment in the rule that making transferred loans susceptible to state usury laws would prevent or significantly interfere with the exercise by the national bank of its NBA powers.

A similar ruling is expected in *Cohen v. Capital One Funding, LLC*, No. 1:19-cv-03479 (E.D.N.Y. filed June 12, 2019), which had substantially similar facts and allegations. The National Consumer Law Center ("NCLC") was allowed to file *amicus* briefs in support of plaintiffs in both *Peterson* and *Cohen*. NCLC asked the courts not to make broad rulings and presented Professor Levitan's arguments against VWM arguments.

The *Peterson* case is notable for a few reasons. First, the case should further insulate receivable sales and nonbanks involved in such sales from adverse *Madden* rulings especially given that *Madden* was potentially binding precedent in the *Peterson* case. Second, the federal court gave deference to the OCC's "*Madden*-fix" (VWM) rule in the court's implicit preemption analysis. The rule became effective on August 3, 2020. Few courts have had the opportunity to analyze the OCC's rule and determine whether to defer to the OCC's position regarding the permissible interest rates on transferred loans. Over the summer, the Federal Deposit Insurance Corporation ("FDIC") finalized a similar rule for the permissible interest rates on transferred loans originated by insured state banks.

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State Attorneys General Challenge OCC/FDIC VWM Rules

The Attorneys General ("AGs") of California, Illinois and New York have joined to sue the OCC, and the AGs of California, Illinois, New York, North Carolina, Massachusetts, Minnesota, New Jersey, and the District of Columbia have sued the FDIC, over the federal banking agencies' recently finalized VWM rules. *See California v. OCC*, No. 4:20-cv-05200 (N.D. Cal. filed July 29, 2020), and *California v. FDIC*, No. 4:20-cv-05860 (N.D. Cal. filed Aug. 20, 2020). The AGs ask the courts to declare the rules unlawful and to set them aside, arguing that the agencies have exceeded their authority in violation of the Administrative Procedure Act. The AGs assert that the new OCC and FDIC VWM rules would enable predatory lenders to circumvent the state caps through "rent-a-bank" schemes, in which banks act as lenders in name only, enabling non-bank payday lenders to evade state usury regulations. In the OCC's case, the AGs assert that Congress has "clearly" rejected legislation to expand National Bank Act preemption to non-banks, further undermining the OCC's attempt to rewrite federal law to suit its "extreme" policy preferences.

***Peterson* Follows Other Notable Summer Developments**

The *Peterson* decision is a welcome result for many industry participants and comes after the decision of another federal court in *Rent-Rite Superkegs West LTD v. World Business Lenders, LLC,* 1:19-cv-01552 (D. Colo., filed Aug. 12, 2020); see our ALERT of Aug. 18, 2020. There, the court cited the OCC's new "*Madden*-fix" (VWM) rule when it determined that a promissory note with an interest rate that was valid when made by a federally insured state bank under Section 523 of the Depository Institutions Deregulation and Monetary Control Act of 1980, codified at 12 U.S.C. § 1831d ("Section 1831d"), remains valid upon assignment to a non-bank. The district court noted that the OCC's VWM rule does not address which entity, in the case of assignment, is the "true lender", a material factual dispute that was touched upon briefly in argument during the lower court proceedings but not specifically addressed by the bankruptcy court. The district court noted that Section 1831d could not apply to the promissory note when a non-bank is the "true lender" and returned the case to the bankruptcy court for further consideration of the "true lender" issue.

On August 18, 2020, Colorado Attorney General Phil Weiser announced the settlement of two pieces of related litigation through Assurance of Discontinuance ("AOD") in the matters of Avant of Colorado, LLC and Marlette Funding, LLC (dated as of Aug. 7, 2020). *See Fulford v. Avant of Colorado, LLC*, No. 17CV30377, and *Fulford v. Marlette Funding, LLC*, No. 17CV30376 (both filed in Colo. Dist. Ct. Denver County); see our ALERT of Aug. 20, 2020. The comprehensive settlement addressed not only the specific programs at issue, but established a "safe harbor" for all future loans made through any programs operated by the banks involved in the AOD (the "banks"), provided that such a program complies with the terms of the safe harbor. The AOD followed a recent decision in the *Marlette* litigation in which the court ruled that even if the bank was the "true lender", a nonbank assignee of the loan could not take advantage of the federal usury preemption enjoyed by the bank, nor could an assignee fully stand in the shoes of the bank with respect to the loan's other terms. See Order Regarding Plaintiff's Motion for Determination of Law, *Marlette, supra* (filed June 9, 20202).

Peterson involved a national bank, the OCC's rule and the NBA. The case did not discuss the FDIC's "*Madden*-fix" VWM rule, and was decided under different facts than those in *Rent-Rite*, *Marlette* and *Avant*. We are happy to discuss the affects of the *Peterson* decision (and others) on insured state banks and various fact patterns. ❑

✧ *Mike Tomkies and Susan Seaman*

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