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Two Recent Court Cases Regarding Preemption*

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This article will discuss two recent cases regarding national bank preemption: Madden v. Midland Credit Management, Inc.[1] and New York Bankers Association, Inc. v. City of New York.[2] Neither case is based on, nor even mentions, the Dodd-Frank Act amendments to the preemption provisions in the National Bank Act.

I. Madden v. Midland Credit Management, Inc.

In this case, the Second Circuit Court of Appeals held that National Bank Act preemption does not apply when a non-bank entity purchases consumer credit card accounts from a national bank, and then charges interest rates on those accounts in excess of state usury limits. In so doing, the court overturned a district court opinion that preemption was applicable because the credit card accounts were originated by a national bank.

The factual background in this case is very important to fully understand the Second Circuit's opinion. The credit card account was originated in 2005 with a national bank. It was sold to a second national bank (FIA Card Services, N.A.) in 2006. In 2008, FIA charged-off the account as uncollectable, and sold the account to Midland, a non-bank debt purchaser. In November 2010, Midland sent a letter to the account debtor seeking payment of the credit card debt and stating that a rate of 27 percent per year applied. This rate was in excess of the state usury limit in the debtor's home state.[3] Thus, based on this chronology, it appears that the usurious rate was imposed by a non-bank entity after the account was sold to that entity, although pursuant to a penalty rate allowed under the loan agreement with the bank.

In its decision, the Court of Appeals affirmed that the NBA preempts state usury laws outside of the state in which the national bank is located. Thus, the court does not question the right of national banks to charge a rate that exceeds the usury limit in the consumer's state, if the rate is not usurious in the home

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[1] U.S. Court of Appeals for the Second Circuit, No. 14-2131 (May 22, 2015) motion for rehearing denied (DATE).

[2] U.S. Dist. Court for the Southern District of New York, No. 15 Civ. 4001 (Aug. 7, 2015).

[3] An issue not resolved in the Second Circuit's decision is whether the usury limit of the debtor's state applies, or the usury limit of the state specified in the credit card agreement applies. The Court of Appeals remanded the case to the District Court for this and related issues.

state of the national bank. The court, citing the Barnett Bank case, stated that preemption applies to non-bank entities if state law significantly interferes with a national bank's ability to exercise its powers. The court noted that preemption applies to companies acting as agents of national banks and other entities that are acting on behalf of a national bank. However, Midland was not acting on behalf of any national bank. It was acting solely in its own interest as the owners of the credit card account.

The Court of Appeals did recognize that applying state usury laws to a non-bank purchaser of bank debt could reduce the price a national bank receives when it sells an account to a non-banking entity. However, the court concluded that such an effect would not significantly interfere with the exercise of a national bank power under the facts in this case.

In reaching this decision, the Court of Appeals distinguished two prior Eighth Circuit cases. In Krispin v. May Department Stores, a non-bank issued credit cards to consumers, and then transferred the accounts to an affiliate, May National Bank. The receivables were sold back to the department store. The bank notified consumers that it was imposing a delinquency fee that exceeded state law. The Eighth Circuit held that preemption was applicable because the delinquency fee was imposed by the bank, notwithstanding the fact that the receivables were immediately sold to a non-bank. The Second Circuit distinguished Krispin on the basis that the accounts were owned by the national bank, whereas in this case, the accounts are owned by a non-bank company.

In Phillips v. FDIC, the Eighth Circuit held that when determining the legality of loan fees, the court must look to the originating entity and not the assignee. The Second Circuit distinguished Phillips because in the present case, the fees were being charged after the loan was sold to Midland, not by the originating national bank.

In summary, the Midland case appears to be limited to a situation in which a national bank sells a loan account to a non-bank entity, and that after the transfer, the non-bank entity imposes an interest charge that would have been permissible for the national bank, but is not permissible for a non-bank. The ruling does not apply when a non-bank entity is acting as an agent for the bank, or where the effect of the state law would be to impermissibly interfere with the powers of a national bank.

II. New York Bankers Ass'n. v. City of New York

In this case, the District Court held that a New York City ordinance called the Responsible Banking Act was preempted by both federal and state law. The ordinance applies to banks that are eligible to hold city funds (Deposit Banks). The city law establishes an eight member commission that is to provide a written assessment of the banking needs of the city with a particular emphasis on low- and moderate-income persons and communities. Public hearings are to be held in each borough, and the commission is to obtain census tract level data relating to each Deposit Bank's efforts to meet the needs of each area, including the bank's efforts to develop and offer credit and financial services most needed by low- and moderate-income individuals and communities, as well as physical branches. Data will also be collected on funding for affordable housing and economic development, the record of these banks in meeting the health and safety deficiencies in foreclosed and bank owned properties, and various other measures. Once this information is compiled, it will be published on the website along with the identification of any Deposit Bank that fails to provide required information. The commission will also establish benchmarks, best practices and recommendations for meeting these needs. Finally, the commission is to evaluate how each Deposit Bank performed relative to these benchmarks and best practices, i.e., rank such banks. The commission may designate or de-designate an institution as a Deposit Bank.

After reviewing the legislative history of the ordinance, the District Court concluded that the purpose of the law was to regulate bank activities, and was not designed or intended to make the city more efficient in the procurement of needed services. In other words, the ordinance seeks to advance general societal goals rather than a "proprietary purpose," i.e., to make the city's procurement of services more efficient or less expensive. In short, the city was using the ordinance as a means to coerce changes in the business practices of subject banks.

Once the District Court determined that the ordinance was regulatory, it proceeded to consider if it was preempted. The court noted that the NBA grants exclusive visitorial power over national banks to the OCC, and that the visitorial authority includes the examination of the bank, inspection of books and records, and the regulation and supervision of a bank's activities. The District Court confirmed that visitorial authority is not limited to on-site inspection, and include requests for the production of information. A request for information by the commission under the ordinance is backed by the implicit threat of public shaming and termination of the bank's status as eligible to accept New York City funds. The court also found that the ordinance is preempted under the NBA because it is attempting to regulate the activities of a national bank that are explicitly governed by OCC regulations. The court also found that the ordinance was in conflict with the federal Community Reinvestment Act (CRA) since it is more burdensome than the CRA. The District Court concluded that the ordinance "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (citing Barnett) and is therefore preempted by federal law.

The court also considered the ordinance under New York State law, which provides that state-chartered banks are to be supervised and regulated through the state's Department of Financial Services. The court determined that this New York State statute preempted the attempt by New York City to regulate state chartered banks through the ordinance.

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