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Chapman Client Alert

September 28, 2020 Current Issues Relevant to Our Clients

Madden-Based Cases in New York Against Securitization Trusts Dismissed

In 2015, the Second Circuit Court of Appeals issued an opinion finding that, under the doctrine of federal preemption, a non-bank assignee of a bank loan could not charge and collect the rates and fees that the bank could charge and was therefore subject to state law usury limits.[1] This decision has been referred to as the *Madden* decision. This finding was in opposition to decades of precedent establishing that the terms of a loan that is “valid when made” does not change when the loan is subsequently sold or transferred to another party. This widely criticized decision created uncertainty for marketplace lending and securitization programs that utilize loan purchases from banks, and as a result, some programs were either curtailed or suspended in the Second Circuit states of Connecticut, New York and Vermont.

Few cases were filed on *Madden* type theories until June 2019 when two cases were filed against securitization trusts in two federal courts in New York.[2] In both cases, class action status was sought against defendants affiliated with two national banks that have acted as special purpose entities in credit card receivables securitization transactions sponsored by the two banks. The actions sought to expand on the *Madden* decision by alleging that the defendants’ acquisition, collection and enforcement of the banks’ credit card receivables violate New York usury laws and that the securitization vehicles as non-bank entities are not entitled to the benefits of federal preemption and must be limited to collecting interest under state usury limits. The defendants filed motions to dismiss each action. In one of the cases, a federal magistrate judge recommended that the action be dismissed because it would interfere with banks’ ability to exercise their federally granted powers. On September 21, 2020, the judge in this case (the *Petersen* case referred to in the footnote) granted the defendants’ motion to dismiss. On September 28, 2020, the judge in the *Cohen* case (referred to in the footnote below) granted the defendants’ motion to dismiss with prejudice. This means that the case cannot be re-filed with the court.

These dismissals are an important development. While not overruling *Madden*, both courts found that different facts required a different result. Both courts distinguished the facts from the *Madden* decision, finding that unlike the *Madden* case where the bank had no continuing interest in the loan because the bank had sold the loan, that in these cases, the two national banks held a continuing interest in the loans including retention of the account and having the continuing right to change interest rates. Both courts noted that the securitization situation was more like a case cited approvingly by the *Madden* court.[3] The courts found that the federal preemption applicable to the two national banks preempted New York usury laws. As a result, the securitization vehicles were entitled to collect interest at the rates the banks could charge and would not be limited to state usury limits. One court did not rely on the newly minted OCC rules on this topic,[4] but approvingly alluded to the OCC’s rationale in enacting the rule in its decision. The other court stated that it did not need to discuss that issue, as it was moot under its already enumerated preemption analysis in the opinion. The decisions also found that application of New York usury laws would significantly interfere with each national bank’s right to sell and securitize loans.

If these decisions are appealed, the Second Circuit will have the unique opportunity to reconsider and clarify its *Madden* decision. In the interim, this is good news for the secondary market, securitizations and investors.

For More Information

If you would like further information concerning the matters discussed in this article, please contact Marc Franson or the Chapman attorney with whom you regularly work:

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1 *Madden v. Midland Funding, LLC,* 786 F.3d 246, cert. denied, 136 S.Ct. 2505 (2016). The doctrine of federal preemption allows federally insured depository institutions to charge the rates and fees allowed in the state where they are located and export those rates and fees to other states and preempt conflicting state laws. That doctrine and this case and its full history are discussed later in this paper.

2 *Petersen, et al. v. Chase Card Funding, LLC et* al., Case 1:19-cv-00741-LJV (W.D.N.Y. filed June 6, 2019) and Cohen et al. v. Capital One Funding, LLC et al., No. 19-03479 (E.D.N.Y. filed June 12, 2019). See, Petersen order at 2020 WL 5628935 (Sept. 21, 2020).

3 *Krispin v May Dep't Stores*, 218 F.3d 919 (8th Cir. 2000) (finding federal preemption applicable to a bank's sale of 100% of its receivables on a daily basis to its department store affiliate).

4 On May 29, 2020, the OCC issued its final rule codifying as a regulation that the interest charged on loans that is permissible before the loan is transferred remains in effect after the loan is transferred. The one sentence regulation: "Interest on a loan that is permissible under 12 USC 85 shall not be affected by the sale, assignment or other transfer of the loan" will be codified for national banks at 12 CFR 7.4001(e) and a similar regulation for federal savings associations will be codified at 12 CFR 160.10(a). These regulations became effective August 3, 2020. *See,* 85 Fed. Reg. 33530 (June 2, 2020). The FDIC also promulgated a final rule to the same effect applicable to state chartered insured banks that became effective on August 21, 2020. *See,* 85 Fed. Reg. 44146 (July 22, 2020), to be codified as 12 C.F.R. 33.4(e).

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